Caroline Bradley SPRING SEMESTER 2005

BUSINESS ASSOCIATIONS

THREE HOURS.
THIS IS A CLOSED-BOOK EXAM.

Try to show thought and critical analysis of the materials and issues dealt with in the course.

DO read the question carefully and think about your answers before beginning to write.

DO refer to statutory provisions, cases and other materials where appropriate. If you make general statements, try to back them up with specific references.

DO NOT use abbreviations unless you explain what you are using them to stand for.

DO NOT make assumptions in answering the hypothetical.

DO explain what further information you might need in order to answer the question properly.

DO write legibly and clearly.

You will get credit for following these instructions, and may be penalized for failing to do so.

ANSWER BOTH PARTS OF THE EXAM

PART A (75%)

Uncommon Findings Organization, Inc. (UFO) is a research company based in Arcadia, a state in the US. UFO's shares are traded on the Arcadian Stock Exchange. The Board of Directors of UFO includes four executives: Rick Haney (RH) the Chief Executive Officer (CEO), Tim Deloy (TD), the Chief Financial Officer (CFO); Gary Rush (GR), the Vice President for Investor Relations, and Joe Washcroft (JW), the Vice President and General Counsel. UFO also has four non-management directors: Al Burton (AB), who has known Rick Haney for thirty years and is one of his closest friends; Mort Stanrey (MS), who is married to Rick Haney's sister and is CEO of a large information technology company; Don Molton (DM) a well-known writer who is known for his writings advocating a tough management style and is a close personal friend of Al Burton; and Ron Rumsley (RR) who has only been a board member for a short time and was introduced to Rick Haney by Al Burton. All of the non-management directors except Ron Rumsley sit on a number of other corporate boards. Ron Rumsley enjoys being a member of the UFO board and would like to get involved with other corporations in future. He is very pleased that Rick Haney is well-connected and friendly with many other CEOs and that Rick has been happy with Ron's performance on the UFO board.

UFO was originally a small publishing business founded by Rick Haney, who has always felt that UFO is his baby. He has very strong views about how UFO's business should be run: he dislikes what he sees as unnecessary formalities and likes to consult with board members individually where possible rather than holding formal board meetings (and he does not always bother to consult all board members, even about quite significant matters). Rick Haney thinks that the purpose of the non-management directors is to support management. UFO tends to hold about 4 board meetings per year. The non-management directors receive $200,000 per year each for attending these meetings.

One of the functions the non-management directors do perform is approval of compensation arrangements for UFO's senior executives, acting as UFO's compensation committee. The compensation committee, advised by Tim Deloy's niece, who is a compensation consultant, has established generous compensation arrangements for the senior executives. Two years ago the compensation committee approved a new program proposed by Rick Haney under which it would reimburse senior executives for work-related expenses up to a level of 40% of their base salary. The committee accepted Haney's argument that such a program was normal without any questions. The committee did not set up any compliance system for ensuring that only work-related expenses were in fact reimbursed, but left such matters to the discretion of Tim Deloy. None of the details of the reimbursement plan were disclosed to the public.

Recently Joe Washcroft discovered that Tim Deloy had claimed very large amounts of money as reimbursable expenses that had nothing to do with his work for UFO. At the time Joe Washcroft made this discovery UFO was negotiating a merger with Mergerco, another large information business, and the Board decided to keep things quiet. Rick Haney negotiated a generous severance agreement for Deloy and the entire Board approved this agreement. Soon afterwards UFO reached agreement in principle on the merger terms and made a public announcement of the merger. But Jim Washcroft was nervous, because of his knowledge of Deloy's activities and because he feared that worse news might surface, and sold many of his shares in UFO immediately after the merger announcement. Before the merger was completed Mergerco discovered that UFO's financial condition was worse than it had been led to believe and exercised its contractual right to withdraw. At this point UFO's share price collapsed.

The Arcadian partnership statute is based on RUPA (1997 version) and its corporations statute is the same as the Delaware General Corporation Law.

A number of people are very unhappy. Shareholders in UFO who have retained their shares throughout want to know what they can do. Shareholders who sold their shares immediately before the merger announcement and shareholders who sold at the time when Joe Washcroft sold his shares are also unhappy. What legal rights can these different groups invoke to protect their interests? What difficulties will they encounter?

PART B (25%)

EITHER

1.

“We can discern no reason, in either law or policy, to treat LLCs differently than we treat corporations.” (*Kaycee Land and Livestock* v *Flahive*, Supreme Court of Wyoming 2002).

Explain whether you agree or disagree with the court. Give reasons for your answer. In your answer you may either focus on the issue raised in this case or discuss the statement more generally (with examples to support your argument).

OR

2.

Joanne manages a vegetarian restaurant called Firefly in a large city in Arcadia, which is a state in the US. She manages the restaurant under a contract with the Huge Food Group, Inc. (HFG) which owns the premises. HFG runs its own chain of family restaurants called Foodfest and it also contracts with a number of people like Joanne who run their own restaurants (selling a wide range of different types of food and styles of cuisine) on premises owned by HFG. The contract between HFG and Joanne provides that HFG will lend Joanne a sum of money to help her get her restaurant off the ground, that Joanne will provide all of the kitchen fittings and equipment and that HFG and Joanne will share the profits of the restaurant. In order to make sure that the restaurant is successful HFG sends Anna to Firefly once per month to see what is going on, and to ask Joanne and her staff for information. Joanne also supplies weekly financial reports to HFG.

Joanne hired a new chef, Beth, and she has been very impressed by Beth's work, as have Firefly's customers. Joanne and Beth have jointly begun to offer regular cooking seminars to their customers, and these seminars have been very popular. Joanne and Beth share the work in the restaurant, although Joanne manages most of the paperwork. Joanne offered Beth a profit-sharing arrangement because she was afraid that if she did not do this she would lose Beth.

Unfortunately, a month ago, Beth agreed to buy some very expensive kitchen equipment from Kool Kitchens without consulting Joanne first. Joanne says she should not have to pay for the equipment. She also says that Beth should leave Firefly immediately. Beth argues that if she has to leave she should be able to take her share of the value of Firefly's business with her. Discuss these facts and the legal issues they raise. Who, if anyone, should be liable to pay for the kitchen equipment and on what legal theory or theories ? What other facts would you need to know? On what legal theory could Beth be entitled to a share of the value of Firefly's business? What facts would make a difference?

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