

AGN:  
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SPRING SEMESTER 2018

# **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 questions 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.**

Zcorp, Inc. is a corporation incorporated in Arcadia, a state in the US, and the Zcorp common stock is traded on the Arcadian Stock Exchange (ASE). Zcorp has been in the business of developing and selling computer software for a number of years. The Board of Directors of Zcorp comprises Bo (the CEO), Cara (Chief Financial Officer), Devon (Secretary), Eve (the Chief Information Security Officer), together with Faith, who is appointed by the holders of Zcorp's Class A preference shares, and George.

Bo, Cara and Devon were the original founders of Zcorp. Bo was the programmer who developed Zcorp's first commercially successful products, she has always been the driving force in developing innovative ideas in the business, and she is well known as a technology entrepreneur and is often an invited speaker at conferences. Bo owns 25% of the common stock in Zcorp. Cara and Devon each own 5% of the common stock, and to a large extent they have always seen their role as facilitating Bo's work. The other directors have much smaller shareholdings as participants in the Zcorp share option scheme (in which employees also participate).

The Zcorp Board recently decided that Zcorp should get involved in distributed ledger technology and cryptocurrencies. Bo brought a proposal to the Board that Zcorp should acquire Wave LLC, an Arcadian LLC that Bo set up with her sister, Hila, to develop a cryptocurrency called wavelets. Bo told the Board that wavelets would be an essential component of Zcorp's cryptocurrency endeavors for the future. Although Wave LLC had been losing money ever since it was set up, Bo argued for Zcorp to pay a generous price to acquire Wave LLC, based on the argument that Zcorp needed to establish a presence in the cryptocurrency space quickly, that investors would consider Zcorp stock to be more attractive if it was involved in cryptocurrency, and that acquiring Wave LLC would be the quickest way to make this happen. The Board did not spend any time investigating other options, and agreed to the acquisition at the price Bo proposed. The Board made a public announcement about the transaction, emphasizing the significant benefits Zcorp expected from the acquisition.

Isaac, a member of Wave LLC, and one of the main developers of wavelets, thinks that he will not be a good fit at Zcorp, so he has been exploring other opportunities. He thinks that he can use his share of the purchase price of Wave LLC, together with other savings, to invest in a new startup venture with Jeb. During the negotiations with Jeb, Isaac lets slip some information about aspects of the wavelets code that make wavelets vulnerable to hacking. Isaac knows that Jeb owns common

stock in Zcorp and that the information may be interesting to him because of this. Isaac tells Jeb that he has learned a lot from his experience at Wave LLC, and that he hopes to put this knowledge to good use in his future work with Jeb. Isaac and Jeb decide to establish an LLC to carry on business together. Subsequently, Jeb sells his common stock in Zcorp.

Wave LLC is a Member-managed LLC, and its operating agreement states:

“Members are required to maintain the confidentiality of information relating to Wave LLC and its products; apart from this requirement Members shall have no duties or liabilities, including fiduciary duties, to the Company, any Member or any other Person.”

The Arcadian LLC statute provides:

An operating agreement may not eliminate the duty of loyalty or the duty of care or the obligation of good faith and fair dealing, or relieve a person from liability for conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law.... However, if not manifestly unreasonable, the operating agreement may alter or eliminate aspects of the duty of loyalty or the duty of care or identify specific types or categories of activities that do not violate the duty of loyalty.”

George is not an officer of Zcorp, but he has a lot of spare time and is very enthusiastic about the business. He is very well connected in tech circles and very wealthy and Bo and the others have always felt that his contacts are beneficial to Zcorp. George likes to hang out with Zcorp employees and discuss programming with them. Some Zcorp employees find him rather creepy and he has been known to make unwelcome sexual advances to employees. In the past Zcorp entered into a settlement agreement with an employee with respect to this behavior. At the time, Bo told George he must never engage in this behavior in future. Until recently George was able to keep his behavior quiet, but a few months ago a number of employees objected to George's behavior. George went to Eve for help and Eve and Devon together entered into settlement and non-disclosure agreements with the employees on Zcorp's behalf without informing the rest of the Board. Eve and Devon said that it would be in everyone's interests to keep things quiet and George promised to behave better in future. Some of George's activities could involve criminal liability under Arcadian law.

The story about George's activities got out and Zcorp shareholders are unhappy. They are also unhappy because they have learned about the vulnerability of wavelets to hacking. These events, together with some recent market scepticism about cryptocurrencies, have resulted in a decline in the market price of Zcorp common stock.

**Answer the following questions, explaining what further facts you would need to know and giving reasons for your answers:**

1. (25 points) What legal issues does the proposed acquisition by Zcorp of Wave LLC present for Zcorp and its officers, directors and shareholders? In your answer you should consider any issues that arise as of the time of Board approval of the merger, and also after the merger has been carried out, specifying what, if any, procedural steps would make a difference to your analysis.

2. (25 points) What legal issues do these facts raise with respect to Isaac and Jeb?

3. (25 points) What legal issues does George's situation raise with respect to George, Eve, Devon and the Board of Directors as a whole?

4. (25 points) You do not need to link your answer to this question to the hypothetical facts set out above. Answer part a or part b of this question. **Either:**

a. Using examples from the course materials, discuss whether Boards of Directors do and should think of corporate social responsibility as an invitation to pursue socially beneficial activities, or only those which are beneficial to the corporation?

**Or**

b. Control is an important concept in business organization law, leading to risks of liability, but control is not defined in a clear or determinate way. Using examples from the course materials discuss the advantages and disadvantages of an indeterminate or uncertain conception of control in business organization law.