AGN:
Caroline Bradley SPRING SEMESTER 2019

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.

Amy and Beto are member managers of Zed LLC and Cory and Don are members of Zed LLC. Zed LLC carries on business in Arcadia, a state in the US.

Zed LLC is in the business of selling online advertising. Zed's customers pay Zed for traffic to their websites. Zed customers buy account memberships which entitle them to buy different advertising packages from Zed. Amy (who is a wealthy heiress who does not really need to work) is responsible for marketing Zed's services to potential customers, and for managing Zed's finances, and Beto is responsible for managing the technical side of the business. Beto is very focused on his own part of the business and does not monitor Amy. Amy is very disorganized and does not keep good financial records. She sometimes pays her own bills out of Zed's bank account, but sometimes also pays Zed's creditors with a personal check.

Zed's operating agreement provides that the member managers of Zcorp "shall have no duties or liabilities, including fiduciary duties, to Zed LLC, to any Member or to any other Person."

Zed LLC has regular customers and Super customers. Super customers buy Super Zed Packages (SZPs) for a monthly fee of $50 and are encouraged to visit, spend time at, and click on adverts on websites belonging to other Zed customers. SZP customers benefit from financial incentives to encourage them to click: a SZP customer who performs a set number of clicks in one day is entitled to receive a share of Zed's revenues for that day, up to a maximum of $55 per month per SZP. But Super customers can buy multiple packages (some have bought thousands) and can in theory earn multiple revenue shares for one daily set of clicks. Super customers are entitled to receive commissions for introducing new Super customers. Super customers help Zed LLC to present its advertising to regular customers as effective in attracting clicks. The Super customers hope to make money, and Zed LLC has been signing up increasing numbers of Super customers. Some of the Super customers have introduced many other Super customers in order to maximize their commissions.

After a while some customers of Zed LLC who were actually interested in the benefits they expected to get from the advertizing began to realize that there was a problem, and that they were overpaying significantly for useless advertising. They began to demand their money back. Cory and Don are concerned that their capital investment in Zed LLC is at risk. When Cory and Don invested in Zed LLC Amy and Beto made a number of very concrete representations about Zed LLC's business model, and Cory and Don trusted them. Now they think that trust was misplaced.

Xcorp, a corporation incorporated in Arcadia, with shares traded on the Arcadian Stock Exchange, is one of Zed's customers (but is not involved with the SZPs). Elizabeth is Xcorp's CEO, founder and 25% shareholder. Howard is the Chief Financial Officer (CFO), and has been a very close friend of Elizabeth's for 30 years — their families vacation together every summer. Julian has been Xcorp's General Counsel for 25 years and is married to Elizabeth's brother, Pete. Kamala, Marianne, Pete (Elizabeth's brother) and Stacey are Directors of Xcorp.

Elizabeth is very worried that if Zed LLC collapses, Beto, who is her son, will be very discouraged. She knows that Beto has strong technical skills with respect to online advertising and that he has been developing his programming skllls. She decides that Xcorp should set up a new division which will be headed up by Beto to support his projects. Elizabeth calls a Board meeting to approve the setting up of the new division with Beto at its head, and a generous contract of employment for Beto which acknowledges that Beto will be carrying on his own independent business activities while working as Xcorp's new division head, provided that he does so in his spare time. The Board goes along with Elizabeth's plan without asking any questions because she is very persuasive and they tend to let her have her way.

While Beto is working for Xcorp he meets an old friend, William, who comes to Xcorp's offices to discuss a new idea he has which would fit well with Xcorp's new division's plans. But Beto feels that his position at Xcorp is unsatisfying and he persuades William that they should pursue the new idea together and not get Xcorp involved. They manage to raise enough money to get working on the new idea and it has recently begun to be very profitable.

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

1. (30 points). Tom is Super customer of Zed LLC who invested in 1000 SZPs (paying $50,000 per month and expecting to receive $55,000 per month for a profit of $5000 per month). Tom has not received any payments from Zed LLC for the last two months and he wants to know how he can recover the money Zed LLC owes him. What legal theories do you think Tom can rely on to recover his money? Would the same legal theories help Cory and Don or would they need to rely on different legal theories?

2. (30 points) Discuss any possible liability based on the facts described on the part of Elizabeth, Howard, Julian, Kamala, Marianne, Pete, Stacey and Beto.

3. (15 points) If an Xcorp shareholder who is bothered by Xcorp's hiring of Beto and his subsequent activities with William wants to sue Beto, Xcorp and Xcorp's directors, what difficulties will the shareholder face ?

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). Write a critical assessment of Lorenzo v SEC (US Supreme Court, 2019) or Stone v Ritter (Delaware Supreme Court 2006)

OR

(b) Delaware rules regulating business organizations are fuzzy rules, rather than rules with bright lines. Using examples from the course materials, assess whether this statement is true, and whether you think that fuzzy rules are or are not appropriate tools for business organization law.

Appendix: The Arcadian LLC Statute

Under the Arcadian LLC statute, member managers of an Arcadian LLC are subject to default fiduciary duties. The statute also contains the following provision:

The LLC operating agreement may not:

(5) alter or eliminate the duty of loyalty or the duty of care, except as otherwise provided in subsection (d)...

(8) relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or knowing violation of law;...

(17) ... restrict the rights under this [act] of a person other than a member of the LLC;

(d) ... without limiting other terms that may be included in an LLC operating agreement, the following rules apply:

(1) The operating agreement may:

(A) specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts...

(3) If not manifestly unreasonable, the operating agreement may:

(A) alter or eliminate the aspects of the duty of loyalty stated in this statute

(B) identify specific types or categories of activities that do not violate the duty of loyalty;

(C) alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law; and

(D) alter or eliminate any other fiduciary duty.

(e) The court shall decide as a matter of law whether a term of an operating agreement is manifestly unreasonable under subsection(d)(3). The court:

(1) shall make its determination as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time; and

(2) may invalidate the term only if, in light of the purposes and business of the LLC, it is readily apparent that:

(A) the objective of the term is unreasonable; or

(B) the term is an unreasonable means to achieve the term's objective.