

BUSINESS ASSOCIATIONS

TAKE-HOME EXAM

ANSWER PART A (all 3 questions) AND PART B (1 question)

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 clearly.

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

PART A

Xcorp and Yfund are corporations incorporated in Arcadia, a state in the US. Arcadia's corporations statute is modeled on the Delaware General Corporation Law.

Xcorp was founded as a Fintech (financial technology) company by Adam, Billie, and Chas, who all shared a dorm room at the University of Arcadia, and have been close friends ever since. While they were still students they began working together on a plan to build a business. Adam studied computer science and wanted to create apps that would allow consumers to manage their money more effectively and at a lower cost than would be possible working with mainstream financial institutions. Billie was a business major and focused on finance and accounting, and Chas studied marketing. At Xcorp they are all directors, officers and shareholders. As the ideas person, Adam, the CEO, owns 30% of the common stock, and Billie, the Chief Financial Officer (CFO), and Chas, the Chief Marketing Officer, each own 10% of the common stock. For a long time Xcorp also has had three outside directors, Don, Ella, and Frankie. Don is the Chair of the University of Arcadia Computer Science Department and has known Adam since he was a student, Ella is the President of the Bank of Arcadia and has been a long time friend of Billie's mother, and Frankie is the technology correspondent for the Arcadia Times newspaper.

Xcorp began by working on a payments app, which has been very successful, and more recently moved into the lending business, in particular by facilitating loan transactions between borrowers and individuals interested in making money by lending money for a financial return. Adam led a team that developed a process to assess the risks of making loans to particular borrowers. That line of business has been doing well. The Board of Xcorp has been discussing whether Xcorp should expand into the provision of investment advice. There is evidence that this is an area where there is not much competition and which would fit well with Xcorp's other business. But Adam is rather bored with Fintech by this point and the Board decides not to pursue this idea.

Xcorp has raised some venture capital funding from Yfund which now owns a significant amount of preferred stock which carries the right to appoint one director to the Xcorp Board of Directors. Yfund appointed Gerard, who also acts as a director of a

number of other companies in which Yfund has invested, to the Board.

At the first Board meeting Gerard attended, he raised the issue of compliance with Anti-Moneylaundering (AML) regulation under Arcadia state law and federal law. Because of Xcorp's activities in processing payments, Arcadia is a money services business and subject to these rules. None of the three founders of Xcorp has any knowledge of, or interest in, compliance. Gerard says that Xcorp should hire a Chief Compliance Officer to develop and run a compliance program. The Board decides that there are more urgent matters to address and that they will consider this idea at a future meeting. Gerard informs Yfund of these developments and also that Xcorp believes that the provision of financial advice would be a profitable area. Yfund's management decides to look for opportunities to invest in businesses focusing on financial advice.

A year ago, Adam met Hasan at a technology conference and learned that Hasan was developing a dating app with a sophisticated algorithm to match people. Adam is interested in Hasan's work because of his own work for Xcorp on lending risk assessment, and he quickly decided to join with Hasan in developing the dating app, agreeing to provide a significant amount of funding, and also to provide expertise. They did not formalize the relationship in any way. Some months ago, Adam asked two of Xcorp's employees to help out with work on the dating app. Recently, because Adam and Hasan were about to meet with prospective investors, Adam increased the number of Xcorp employees who were working on the dating app. At an Xcorp Board meeting, Adam introduces Hasan to the Board, and they give a presentation about the dating app. Adam says to the Xcorp Board that he thinks that the dating app would be a useful addition to Xcorp's range of products and would be able to be the basis for expansion beyond Fintech. Gerard is skeptical but the others are used to thinking of Adam as the person at Xcorp with the best ideas and they agree that Xcorp should buy the dating app business for the price Adam and Hasan suggest.

In the course of their collaboration, Adam and Hasan have spent quite a lot of time discussing the various technology-related businesses that have recently been established in Arcadia. They discuss the inconvenience of having to worry about regulation, and Adam tells Hasan about Gerard's concern about Xcorp's lack of AML compliance procedures, and also that Gerard has said that many newer technology

businesses in Arcadia have similar compliance issues, naming some of these companies. Hasan happens to own shares in one of these other companies and decides to sell the shares.

Through her work at the Arcadia Times, Frankie learns that a whistleblower has disclosed Xcorp's lack of AML compliance measures, and also that staff at Xcorp are aware that Xcorp's payments app and loans platform are in fact being used to launder money, and that the Arcadia Division of Finance has begun an investigation into Xcorp. She informs the Xcorp Board of this news before it is published. After the Arcadia Times publishes this information Xcorp's shareholders are concerned.

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

1. [45 points] How have the officers and directors of Xcorp breached their duties to Xcorp, and what risks of liability do they face?
2. [20 points] What difficulties would shareholders of Xcorp face in trying to sue the directors and officers of Xcorp?
3. [15 points] Does Hasan have any liability here? Explain your conclusion.

PART B (20 points)

Answer 1 of the following questions, using examples from the course materials to illustrate your arguments:

1. In what ways is business organization law indeterminate or uncertain? Does this matter?
2. Do the rules of corporate law encourage good business judgment, and/or profit maximization for the benefit of shareholders?
3. What are the arguments for and against a permissive approach to contracting around business organization default rules?