Empire College School of Law
Professor McCann
Business Organizations – Mid-Term
Fall Semester 2009-2010
December 7, 2009

Midterm Examination

Midterm Essay Questions – 2 Hours

Question 1.

Joy, Mervyn and Greg decided to go into the dry-cleaning business. On January 2, 2009, Joy found a building that had previously been a dry cleaning establishment. Concerned someone else might rent it first, Joy gave her personal check for a deposit and signed a three year lease. She informed the landlord that the tenant would be Joy, Mervyn and Greg and the landlord filled out the lease in all three names. Only Joy signed the lease.

On January 5, 2009, Joy, Mervyn and Greg held a meeting and decided that the three of them would operate the business as equals. They would each put in $1,000 to get started and if the business needed more money, they would contribute equally. They would share the profits equally as well.

When it came time to buy equipment they decided they would take turns buying the needed items such that Joy would buy the solvent tank and Mervyn would buy the conveyor equipment and Greg would buy the pressing equipment, and so forth. The idea was that each of them would have identifiable pieces of property he or she would own (and could take with them) when the business dissolved.

Their business prospered. However, in September of 2009, Mervyn got a call from Dan who ran a competing establishment around the corner. It turned out that due to a strike in Germany it was impossible now to buy conveyor equipment for dry cleaning shops. Dan said he would give Mervyn $20,000 as a “signing bonus” if Mervyn would leave the business he ran with Joy and Greg and, instead, bring his conveyor equipment to Dan’s establishment and become Dan’s employee. Mervyn would make far more money and, with Mervyn’s equipment, Dan would be able to increase his profits while Joy and Greg would lose the capacity to operate profitably until they replaced Mervyn’s equipment. It would likely be a year before they could replace the equipment.

Mervyn has told Joy and Greg that he intends to accept Dan’s offer and will be taking his equipment. Joy and Greg have consulted you. In particular, they want to know if there is any way they can keep Mervyn from joining forces with Dan, taking his equipment, and leaving them unable to operate. Joy also wants to know who is responsible for the lease if the business cannot operate. What would you tell them?

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QUESTION 2

Acme Explosives, Inc. is a corporation organized under the laws of the State of Nelaska. Its articles provide that the corporation is to engage in the manufacture and sale of explosives for entertainment and demolition purposes. Acme has a five person board of directors. The current directors are Abraham Ashford (who is Acme's president, and a 40% shareholder), Beverly Bovary (who is Abraham's sister, a 15% shareholder and Acme's secretary), Carl Castle (who holds 35% of Acme's stock), David Diller (who is an ornithologist); and Francine Fishman (who is engaged to Abraham). The remaining 10% of the shares are owned by a variety of individuals.

Recently it has come to Abraham's attention from the manufacturing foreman that some of the explosives Acme has shipped for fireworks displays are unstable. If the containers are jolted or dropped, the crates could explode. Acme has trucks now shipping the product all over the US for use in New Year's fireworks displays. Some of these celebrations, such as one in Chicago, can attract 50,000 people.

Each year, on December 21st, Abraham, as President, receives a generous bonus based on Acme's overall performance. Sales of the New Year's fireworks make up a large part of Acme's revenue which, in turn, is used to calculate Abraham's bonus. If Acme must recall, or halt use of, the New Year's fireworks, Abraham's bonus will be nearly zero. Over dinner, Abraham tells Francine about the explosion problem and about the consequences for his bonus. She is uninterested, instead turning the conversation to wedding plans.

The following week there is a board meeting. Carl senses Abraham is uneasy about something and asks Abraham if there is anything the directors should know. Abraham says "no," and the directors then unanimously vote to approve the year-end bonuses. Abraham casts his vote in favor of the bonus as well. As they leave the meeting, Abraham tells Beverly not to bother to document Carl's question or his answer in the minutes. She rarely keeps minutes anyway and readily agrees.

On December 21st, Abraham receives his bonus. On December 22nd, a shipment of fireworks blows up without warning on a sidewalk in Tulsa, injuring 60 people. The next day, another shipment explodes in Salt Lake City. As law enforcement agencies announce investigations, the value of Acme stock starts to plummet.

Carl calls an emergency meeting of the Board. The by-laws require a quorum of three directors to take board action. Abraham, sensing Carl will be hostile, decides not to attend the meeting and convinces Francine and Beverly to stay away as well. Not only do the three stay away from the directors meeting, Abraham then convenes an emergency meeting of the shareholders without notice and, voting his shares together with Beverly's, votes to remove Carl from the Board. They then vote to amend the articles to create a new class of super-stock available only to officers of the corporation, each share of which carries ten votes. They then issue themselves 1000 shares each of the stock. When they are done, Carl's shares constitute less than 2% of the voting shares of the corporation.

You have received a call from Carl. What rights does Carl have in this situation? Against whom can he enforce those rights? What exposure does he have for the exploding crates?