



Chartered Secretaries Qualifying Scheme – Level One

Corporate Law

November 2011

Friday morning 25 November 2011

Time allowed: 3 hours and 15 minutes
(including reading time)

Do not open this examination paper until the presiding officer or an invigilator tells you to.

You must not take this paper out of the examination room.

The examination paper contains **six** questions. Each question is worth 25 marks. You must attempt **four questions only**.

Illustrate your answer by reference to decided authority where appropriate.

Note: Where questions refer to the Articles of Incorporation, you should apply the relevant provisions of the Canada Business Corporations Act (CBCA).

Questions

Answer **four** questions from this paper.

1. Harry and Irma have just graduated from university and wish to start up a business designing web sites. They write a business plan indicating the need to buy equipment and software costing \$10,000. Realistically, they also need three months' pay for each of them, to cover the period before the business generates any income. This is estimated at \$10,000. They have sent their business plan with an application for a \$20,000 loan to Needy Bank Inc ('Needy Bank').

Harry and Irma have student debts of approximately \$25,000 each. They each received a graduation gift of \$1,000 and they intend to invest this to help get the business up and running. They are also joint owners of a holiday cottage in Nova Scotia which is worth approximately \$60,000. At the outset, to minimise costs, they intend to run the business from the cottage.

Harry has an aunt, Sally, who is rich and financially shrewd. He knows that any involvement she might be prepared to have with the business would have to be on a sound financial basis.

Required

- (a) Identify the legal business structures, **apart from** a registered corporation, available to Harry and Irma to adopt to run their business. For each type of structure:
- Briefly describe the key legal characteristics.
 - State whether it is an appropriate structure for Harry and Irma from a legal perspective, and why.
- (8 marks)*
- (b) Advise Harry and Irma as to the key characteristics of the types of registered corporations available, the type most appropriate for them, and the legal attractions of this choice.
- (5 marks)*
- (c) Assume that Needy Bank would be unwilling to lend Harry and Irma money, but Sally would be willing to make \$20,000 available. Advise Harry and Irma as to how they might structure the funding of the corporation between equity and debt.
- (8 marks)*
- (d) On a different assumption, assume that Needy Bank agrees to lend \$20,000 but Sally does not want to provide any money. Advise Harry and Irma as to the protections Needy Bank would be likely to seek, over and above a simple loan agreement with the corporation.
- (4 marks)*

(Total: 25 marks)

2. Organa Limited ('Organa') is an organic fruit and vegetable wholesaler. The directors of Organa (none of whom are shareholders of the corporation) are Tabatha, Ursula and Walter. Tabatha is the Procurement Manager and Ursula is the Sales Manager. Organa's Articles of Incorporation are in the form of Articles for Private Corporations Limited by Shares, and they include the following additional Article:

"The activities of the corporation are restricted to the supply of organic fruit and vegetables to retailers and consumers and to the encouragement of the consumption of organic fruit and vegetables.

The directors may not purchase or authorise the purchase of non-organic fruit or vegetables."

The shareholders of Organa have discovered the following:

- (i) The directors have signed an agreement with Freezit & Co ('Freezit'), a business owned by Tabatha's husband, pursuant to which Organa agrees to purchase 100,000 packets of frozen carrots from Freezit at a price of \$1 per packet. The carrots are not organic.
- (ii) Ursula has signed an agreement to supply 300,000 kilograms of non-organic apples to Scrup Inc ('Scrup'), which produces the alcoholic drink cider, for \$150,000.

Required

With reference to relevant legal authority, advise the shareholders:

- (a) Whether or not Organa is bound by the agreement with Freezit. (10 marks)
- (b) Whether or not Organa is bound by the agreement with Scrup. (10 marks)
- (c) In relation to the above matters, what rights Organa has against any of its directors. (5 marks)

(Total: 25 marks)

3. Aiden is a director and the Head of Marketing of Bright Inc ('Bright'). His father, Carl, is an outside director of Dawling Inc ('Dawling'). Both corporations are listed on the Main Market of the Toronto Stock Exchange.

One Friday evening, Aiden and his girlfriend, Emma, had been having dinner at Aiden's parents' house, when dinner had been interrupted by an urgent telephone call to Carl from Dawling's corporate secretary. Emma had overheard Carl say, "Let's make sure we get the timing right because the share price will take a dive once news of this hits the market".

The next day, when having dinner with her own parents, Emma mentioned that Carl had not seemed happy at dinner the night before, and that something very bad must have happened because Carl expected the Dawling share price to dive. She contrasted this with Bright, which, she explained, was about to sign an enormous international contract which would result in lots of overseas travel for Aiden.

On the following Monday morning, Dawling shares were trading at \$2 each. Emma's mother, Geraldine, instructed her broker to sell her shares in Dawling and use the proceeds to buy shares in Bright. With the \$200,000 proceeds from the sale of Geraldine's shares in Dawling, her broker bought 50,000 shares in Bright at \$4 per share.

The following week, Dawling made a public announcement that it had settled an important legal case concerning the validity of a patent protecting one of its best-selling products. The price of Dawling shares promptly fell to \$1.50. The same day, Bright shares gained \$1 to trade at \$5 following an article in the Financial Times reporting that the corporation had secured a lucrative five year marketing contract with a large international corporation. Geraldine was delighted and took her daughter out for lunch to celebrate. Emma is worried.

Required

- (a) Who is an insider, what is insider trading and how is the law governing insider trading structured in Canada?
(9 marks)
- (b) Discuss whether Aiden or Carl may have committed any criminal offences.
(8 marks)
- (c) Discuss whether Geraldine may have committed any criminal offences.
(8 marks)

(Total: 25 marks)

4. The share capital of Praktique Ltd ('Praktique'), a mirror manufacturer, is 200,000 x \$1 common shares and 20,000 x \$1 preferred shares. The rights attached to the preferred shares are defined in the corporation's Articles of Incorporation which state that:

- Preferred share dividends are 12% per annum payable on May 1 of each year.
- Preferred share voting rights are restricted to dividend matters.
- In the event of a winding up, preferred shares shall have priority as to return of capital.

The directors of Praktique are Quinten, Roberta and Peter. Quinten and Roberta each own 30% of the common shares. The remainder are owned by Vince, a business investor. The preferred shares are owned by Peter.

Praktique has been very profitable. Provided that it can raise additional capital, its growth prospects and future profitability are not in question but it is unlikely to make any profits this year. Whilst considering how much new capital they need and how best to raise it, Quinten and Roberta were advised that the preferred share dividend rights are significantly higher than interest rates at which Praktique can borrow. They developed a plan to restructure the capital of Praktique by paying off the preferred shares and issuing additional \$1 common shares. They were advised that if 150,000 new \$1 common shares are issued they should be priced at \$3 per share. Quinten and Roberta are interested in purchasing the new shares.

When Peter is informed of the restructuring plan he is not happy. He has no wish to sell his preferred shares and wishes to buy 50,000 common shares.

Required

- (a) Advise Praktique of the steps that need to be taken to issue the proposed new common shares. *(7 marks)*
- (b) Advise Vince what, if any, rights he may have if Quinten and Roberta issue the common shares to themselves. *(5 marks)*
- (c) Advise Peter whether or not his preferred shares may be cancelled without his agreement and, if they can, the steps Praktique must take to achieve this. *(7 marks)*
- (d) Advise Peter whether or not he is entitled to have any of the new common shares issued to him. *(6 marks)*

(Total: 25 marks)

5. Sharpshirt Inc ('Sharpshirt') owns a chain of men's fashion shops. Having borrowed extensively to open new outlets, recent trading has been poor and Sharpshirt is experiencing financial difficulties. The shareholders and directors are convinced these financial difficulties will be short-lived, that sales and profits will improve over the coming year, and that Sharpshirt will, in time, be able to pay its debts in full.

Also, Sharpshirt's financial creditors are nervous, particularly Loan Inc, which has not been paid the last three repayment instalments of the loan it made to Sharpshirt, secured by a general floating charge over all Sharpshirt's assets and business. Also, Tee Ltd, a trade creditor, tired of waiting for payment of the \$25,000 it is owed, has sent Sharpshirt a demand notice for the sum.

Required

- (a) Explain the process of winding up, liquidation and dissolution of corporations in Canada and how, and by whom, these would be commenced in relation to Sharpshirt.

(10 marks)

- (b) Distinguish between the respective roles of liquidators and receivers. Relating your answer to Sharpshirt, outline who may seek to appoint a liquidator, receiver or receiver manager, the processes for appointment, and whether or not a receiver or receiver manager can be appointed if a winding up application is pending.

(15 marks)

(Total: 25 marks)

6. Anita, Betty, Nigel and Mason are each directors and owners of 25% of the shares of Xenon Inc ('Xenon'), a corporation specialising in the sale of expensive metal jewellery. In April 2011, Anita bought a \$105,000 car from the corporation for \$70,000. At a board meeting in May 2011, at which only Nigel and Mason were in attendance, they retrospectively approved the sale. Betty, who is the sales director, spends a lot of her time abroad seeking new customers and was unable to attend this meeting.

In June 2011, Anita took Nigel with her to a meeting with Drago Inc ('Drago') to discuss the renewal of a lucrative jewellery supply contract between Xenon and Drago which was about to expire. At the meeting, Anita proposed a 20% increase in the prices to be paid by Drago. Nigel was surprised but just sat and listened to Anita, thinking that she must have her reasons. After the meeting, Anita visited Drago alone and suggested that it should stop dealing with Xenon and contract with her directly, as she could personally supply the same pieces of jewellery to them at 90% of the prices it had been paying Xenon for the last 12 months. Drago subsequently allowed the supply contract with Xenon to expire and began to buy jewellery from Anita personally.

When Betty read the minutes of the May 2011 board meeting and also learnt that Drago had contracted with Anita personally, she became very concerned. She asked Nigel and Mason what they thought about these developments and was shocked when they seemed unconcerned and expressed complete confidence in Anita.

Required

- (a) Advise Betty as to any and all breaches of duty or other legal shortcomings arising from the facts. (12 marks)
- (b) Advise Betty as to whether a derivative action can be pursued, the steps involved in pursuing such action, and whether or not she could pursue such action without the support of Nigel and Mason. (8 marks)
- (c) Outline briefly any other application Betty may be able to make to obtain a remedy in the circumstances. (5 marks)
- (Total: 25 marks)*

The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.

