Chartered Secretaries Qualifying Scheme – Level Two

Corporate Secretarial Practice

November 2011

Final Marking Scheme

Each question carries 25 marks

Questions 1 to 4 are based on the pre-released case study. Questions 5 and 6 are not based on the pre-released case study.

You must attempt four questions only.

Note: Where questions refer to Canadian statutes, you should assume the relevant Articles apply under the Canadian Business Corporations Act.

Case Study

Constant Flux Ltd.

You are the newly-appointed corporate secretary of Constant Flux Ltd. ('Flux'), a company listed on the Toronto Stock Exchange. Flux's main business is the production of high definition televisions and the business frequently changes its product lines to keep up with evolving technologies and customer preferences. Flux has several subsidiary companies. As a result of changing product lines, there has been much change in Flux over the past few years, with some parts of the business contracting and being closed down, whilst other parts of the business have been expanding.

Just prior to your appointment, Flux had acquired a controlling share in a former competitor, a group comprising a holding company and a number of subsidiaries. Some of these are public limited companies and some private, but none of them are listed on any stock exchange. All of these companies are solvent.

Your company secretarial team is relatively inexperienced and will need your help on how to implement certain proposed changes to the structure of the companies within the group. In particular, your team is unsure when a different treatment may be required for the private limited companies as opposed to the public ones. Mr. White is a director of all of the companies in the newly acquired group (but is not a director of Flux) and, as such, travels extensively on business. Mr. White has asked for certain procedures to be considered for adoption for board meetings, to take account of his extensive travelling, and for a review of certain elements of governance for the business. You have agreed to help your team on these matters.

Flux is reaching the end of its financial year and undertakes extensive year-end planning, covering a range of corporate matters. The year-end planning will cover not only Flux, but it will also incorporate a review of all of its subsidiary companies and all companies in which it has a controlling share. One of the objectives of the year-end review is to ensure that the structure of the group companies is optimized for the most efficient running of the group. The review will also ensure that appropriate arrangements are in place to support the group's short-term objectives, which currently include work to ensure that the group has adequate financial resources. The company plans to introduce a brand new range of large-screen televisions next year and will need to conserve cash where possible in order to fund this. The new range of televisions will be developed with Fancy Screens Limited, a company which is not part of the Flux group. The share capital of Flux consists of common shares, preference shares and cumulative preference shares. The company also has interest-bearing debentures. Mr. Grey, the Finance Director, has some questions for you about the dividends and has some proposals on which he would like your advice.

Year-end planning includes preparation for next year's Annual General Meeting (AGM) for Flux. The chairman of Flux requires a 'Questions & Answers' pack for the next AGM and the chairman has asked you to prepare answers to several questions. The Questions & Answers pack will be particularly helpful as there is a small section of shareholders who have become disgruntled with the company's strategic direction. The disgruntled shareholders believe that the company should start producing computers, as they believe this is a larger and more profitable market. However, the company is adamant that this is not a wise strategy for it to follow. It is clear that this group of shareholders is becoming frustrated that the company refuses to change its strategic direction and the chairman is now concerned at what actions the group may take next.

There have been several changes to the board of Flux and this will require you to provide advice and guidance to the incoming new director(s), particularly in respect of certain constitutional and governance procedures. There are currently six directors of Flux. As a listed company, compliance with applicable regulations is a paramount matter for the corporate secretary and part of your duties will be to ensure that you provide high quality advice on relevant aspects, both to any new director(s) and the rest of the board. In particular, Mrs. Plan was appointed to the board of Flux recently as the Strategy Director and, as this is her first directorship, she has several questions on which she seeks your guidance.

Questions

*Answer **any four** questions from this paper*

Questions 1 – 4, below, are connected to the pre-released case study.

1. Mrs Plan, as the Strategy Director, has a number of questions on which she seeks your advice:

   (a) Mrs Plan wishes to know whether the number of directors serving at Flux is sufficient and whether it would be a problem if the number of directors attending at a board meeting fell below the quorum for the meeting. She would also like to know what happens if the number of directors appointed were to fall below the quorum.

   (6 marks)

   (b) Mrs Plan asks you if it is necessary to have independent directors on the board and if there are any differences or similarities compared to executive directors in respect of their roles or duties.

   (6 marks)

   Mr Grey, as the Finance Director, has a number of questions about dividends and also wants to develop an understanding of other proposals.

   (d) Mr Grey suggests that Flux should not pay any dividends on its shares next year in order to conserve cash ahead of the introduction of the new range of televisions next year. He would like to know if this is possible and whether any issues may arise.

   (6 marks)

   (e) Mr Grey has heard that other companies operate scrip certificates. He asks what these are and where the regulations condone such certificates. He also noted from the accounts that there were a substantial amount of unclaimed dividends and asked if it could be decided that the dividends were no longer owing to shareholders. He would also like your recommendations for reducing the amount of unclaimed dividends.

   (7 marks)

   Required

   Provide the advice requested in (a), (b), (c) and (d) above. Your advice should include any steps which would need to be taken to address any issues raised.

   (Total: 25 marks)

(a)

Upto six marks for stating the Constant Flux is likely to have a sufficient numbers of directors (six, as explained in the case study) to be quorate and to meet the requirements of the CBCA (Section 111 (2)). Most incorporating legislation in Canada sets out the minimum number of directors a corporation is required to have. Public (offering, distributing) corporations must have a minimum of three directors. The number of directors or, a minimum to a maximum range of the number of directors, of the corporation must be set out in the incorporating documents creating the corporation. Subject to the by-laws of a corporation, a majority of the number of directors or of the minimum number of directors required by the articles constitute the quorum. In addition, it is required to maintain minimum quorum requirements set out in the by-laws, throughout the meeting of the directors. It is important to note that in addition to the requirements respecting the overall size of the quorum, many Canadian Corporate statutes also require that a minimum number of the directors present at a board meeting be resident Canadians. Generally, the statutory requirement is that a majority of those present be resident Canadians, but the CBCA only requires 25% of those present to be resident Canadians. If the requisite number of resident Canadians is not present at a meeting, the action of the board or committee will be effective if subsequently ratified by enough Canadian resident directors. If the total number of directors falls below the quorum, immediate action would need to be taken by the remaining director(s). Section 114 (1) and (2) allows the remaining director (s) to continue for the purpose of filling vacancies or calling a general meeting, notwithstanding that the board meeting would otherwise be inquorate. This will enable further director(s) to be appointed to remedy the quorum

(b)

Upto three marks for explaining the appointment of independent directors is recommended for listed companies by many Canadian corporate statutes. Independent directors are usually appointed to contribute judgment and objectivity to the deliberations of the board by bringing relevant experience from outside the company. They bring independent and an objective view to board decision-making. This is of particular importance to listed companies and Governance Best Practices where it is recommended that at least half of the board, excluding the Chairman, should consist of independent directors.

Upto three marks for dealing with the key differences and similarities between an independent director and an executive director. The key differences between these two types of directors are that an independent director does not have executive responsibilities and is not an employee of the company. The key similarity is that an independent director is a statutory director and as such he or she legally has the same liabilities, responsibilities and duties as an

executive director. Other valid points raised by candidates may be considered in addition to the above.

(c)

Upto six marks for answering that it is up to the directors to declare dividends under their authority in the various Canadian statutes. Dividends are declared by the Board of Directors based on the dividend rights attached to each class of shares. Unless there is a fixed dividend (sometimes found in a type of preferred share created to guarantee a fixed return on investment) the directors have discretion to declare a dividend. Directors also have discretion to determine, where a dividend is declared, how much the dividend should be for each class of share. Factors that influence the exercise of discretion in the directors' declaration of dividends include the availability of requisite funds, the need to maintain working capital and the general position and requirements of the corporation. Directors must balance the desire to provide a return to shareholders with the need to retain profits, both current and accumulated, for the corporation. Similarly, directors are required to meet solvency tests in the context of declaring dividends. To do otherwise, would impose personal liability on directors. The tensions are in place with a view to ensuring that the directors declare a fair dividend based on all the circumstances.

Directors may not declare a dividend if there are reasonable grounds for believing that the corporation would not meet certain statutory solvency tests if the dividend were paid. If dividends are declared contrary to these statutory limitations, the directors can be jointly and severally liable to the corporation for any amounts paid and not otherwise recovered by the corporation.

The directors are under no obligation to declare dividends – even on preferred shares whose terms include a cumulative dividend at a specified rate. Shareholders cannot compel directors to pay a dividend. This is consistent with the principle that the corporation is an entity distinct from the shareholders, with interests and needs which may or may not be consistent with those of its shareholders. When funds are available, it is the board's prerogative and responsibility to decide whether to declare a dividend or to use the money for other corporate purposes.

Certain shares, such as preferred shares, may have a right to receive preferential dividends. This right is not a legal right to receive dividends. It is a right to receive a dividend, if it is declared by the directors, before a dividend is paid on certain other classes of shares. Once again, the directors cannot be compelled to declare these dividends. Similarly, the fact that a corporation has historically paid dividends on a particular class of shares does not create any legal obligation to continue to pay such dividends.

When cash is not available, directors may decide to borrow to finance a dividend. This may be done, for example, in order to keep the capital markets receptive to the corporation's securities. The directors will generally be acting properly in borrowing for these purposes, provided that the borrowing is in the best interests of the corporation and the corporation satisfies the solvency tests notwithstanding the borrowing and payment of a dividend.

Before declaring a dividend, directors should review the corporation's financial statements and receive confirmation from someone on whom they can reasonably rely, such as the corporation's Chief Financial Officer, that there are no reasonable grounds for believing that the solvency tests will not be met.

(d)

Upto 3 marks for noting remarks below:

Directors are entitled to attach conditions to any scrip certificates (certificates representing fractional shares) the corporation issues. The CBCA provision is Section 49 (16). The directors may attach conditions to any scrip certificates issued by a corporation, including conditions that:

(a) The scrip certificates become void if not exchanged for a share certificate representing a full share before a specified date; and
(b) Any shares for which such scrip certificates are exchangeable may, notwithstanding any pre-emptive right, be issued by the corporation to any person and the proceeds thereof distributed rateably to the holders of the scrip certificates.

Upto 4 marks for noting that unclaimed dividends are amounts owing to shareholders unless they have been forfeited in accordance with the various Canadian statutes. Recommendations for reducing the amount of unclaimed dividends in the future might include:

- Investigate any returned mail sent to shareholders and trace the shareholder through the bank where the shareholder previously collected his or her dividend.
- Introduce dividend mandates where the shareholder can issue a standing instruction to the company that payment goes straight to a designated bank account.
- Employ tracing agents to locate missing shareholders.

2. The chairman requires answers to the following questions in the 'Questions & Answers' AGM pack:

(a) (i) What would be the procedure for the disgruntled shareholders to add a new resolution, that the company should start producing computers, to the agenda of the next AGM? Describe shareholders' dissent rights.

(ii) Can the disgruntled shareholders amend any of the existing ordinary or special resolutions during the AGM itself? In particular, the chairman is concerned that a group of shareholders may wish to remove a director at the AGM.

(14 marks)

(b) How should the chairman respond to an ordinary shareholder or joint shareholder attending the AGM who claims the meeting is invalid as they failed to receive notice of the AGM?

(5 marks)

(c) Is a shareholder able to insist that a member chairs the next AGM and what are the constitutional provisions in respect of the appointment of the chairman at a general meeting? In addition, what constitutional provisions are there in case the shareholders' frustrations cause disorder at a general meeting.

(6 marks)

Required

Provide advice to the chairman in respect of (a), (b) and (c) above. Your advice should include relevant statutory steps, timings and procedures which would need to be considered.

(Total: 25 marks)

(a)

Upto three marks for explaining that the disgruntled shareholders may be able to add a resolution to the business of the AGM provided they meet the statutory requirements of CBCA Section 135 (6) which applies to public companies. The first matter to ascertain is the number of "disgruntled" shareholders and the size of the holding they represent. CBCA Section 143 (1) states that the directors must call a meeting of shareholders if one is requisitioned by shareholders holding at least 5% of the shares carrying the right to vote. If the directors fail to call a meeting of shareholders within 21 days of receiving the requisition, any shareholder who signed the resolution may call the meeting.

Upto three marks for noting that there are a number of transactions and corporate changes in which the shareholders have a right to dissent. Where shareholder approval is required for a corporation to effect a fundamental change, such as an amalgamation or continuation of the corporation into another jurisdiction, shareholders are entitled to formally dissent and to be paid the value of their shares.

Upto six marks Shareholders and directors express their will by voting upon and passing resolutions. Ordinary or general resolutions are decisions passed by a simple majority. A tie vote is not sufficient to pass a resolution. In other words, in order for a resolution to pass, there must be at least one more vote for than against the resolution.
For the passing of directors' resolutions, corporate legislation requires that a majority of directors present, as long as there is a continuing quorum, vote in favour of the resolution. For the passing of a shareholders' resolution, a majority of the votes represented in person or by proxy must be in favour for the period of time that the initial quorum existed. The general rule is one common share equals one vote, although different companies can have different rules in this regard.

Ordinary Resolutions

By-laws (CBCA Sections 103 (1) and (2)

103. (1) Unless the articles, by-laws or a unanimous shareholder agreement otherwise provide, the directors may, by resolution, make, amend or repeal any by-laws that regulate the business or affairs of the corporation.

Shareholder approval

(2) The directors shall submit a by-law, or an amendment or a repeal of a by-law, made under subsection (1) to the shareholders at the next meeting of shareholders, and the shareholders may, by ordinary resolution, confirm, reject or amend the by-law, amendment or repeal.

Special Resolutions

Shareholders may also be called to special meetings. The notice for a special meeting must state the time and place of the meeting and provide shareholders with enough information in advance so that they know what they will be asked to consider and vote on at the meeting.

Only shareholders have special resolutions. A special resolution is mandated under corporate legislation in very specific situations, including fundamental changes to the corporation. Basically, a special resolution is required where major changes to the business, finances and structure of the corporation have to be approved by 2/3 or more of the votes of the shareholders. Every special resolution requires a detailed notice of the circumstances around the decision as well as the text of the proposed special resolution. The information must be provided to the shareholders prior to the meeting at which the vote is to be held. This information must be provided to the shareholders with the notice of meeting to enable the shareholders to make a

reasonable decision as to whether or not attend the meeting, or appoint a proxy holder.

Shareholders can propose their own resolutions for an AGM but they have to act in sufficient numbers: there must either be at least enough of them to represent at least five per cent of the shares carrying the right to vote.

When there is a special resolution proposed that must be passed by at least two thirds of the votes of shares represented in person or by proxy, minority shareholders have a remedy available to them. If the vote carries, any shareholder, who did not agree with the special resolution i.e. disgruntled shareholders, and dissented in the vote, has the right to demand the corporation buy back the dissenting shareholder's shares at fair market value. A special resolution cannot be changed at the AGM but a shareholder can vote against a resolution.

Upto two marks for stating that a director cannot be removed at the AGM itself but if the director is subject to election or re-election, shareholders who do not support the director can of course vote against the resolution. One of the key items to be covered in the annual meeting of shareholders is the election of the directors as of the date of the organizational meeting and thereafter as the term of each director expires or are placement is required. Directors are elected by ordinary resolution. Generally speaking, the vote is by the majority attending the meeting. The *CBCA*, however, allows for cumulative voting of directors so as to give minority shareholders some say in the election of directors.

(b)

Upto five marks for explaining that, the AGM cannot be validly held unless every person entitled to attend has been given a reasonable opportunity to be present. Generally speaking, notice of a meeting must be sent and the contents of the notice must be clear and explicit. Five principal rules regarding the notice to be given of a meeting:

1 The proper person(s) entitled to convene the meeting must authorize the notice of meeting.
2 All persons entitled to receive a notice, and who are able to attend, must be served.
3 The time, place and date should be convenient to the majority of the members to the extent practicable.
4 The business to be transacted must be clearly stated.
5 In addition, notice must be given according to the regulations under the *CBCA* or *OBCA* or any shareholder agreement. If a specific time period is required to be given regarding the notice, clear days must be given. In other words both the day of mailing and the day of the meeting must be excluded in complying with time period requirements. In order to make a meeting legal where insufficient or even no notice was given to everyone entitled to it, a waiver from all persons entitled to receive the notice must be obtained. Waiver of notice provisions can be found in corporate legislation and by-laws. In addition to the general concepts of notice of meetings mentioned above,

under corporate legislation, there exist some issues regarding notice at shareholders' meetings. They are as follows:

Right to Receive Notice

This sets out the various persons entitled to receive notice of a shareholders' meeting and the time-related requirements for the sending of notices. Under corporate legislation, there exist different minimum and maximum times for notices to be sent in the context of notice of meetings for public or private corporations.

Fixing Record Date and When Notice Not Required

In determining what shareholders are to receive notice, the corporation must determine who the shareholders are as at a specific date, referred to as the "record date". Section 134(2) of the *CBCA* requires the fixing of a record date for the purpose of notice of meeting to shareholders. If a shareholder is not shown as a registered shareholder in the records, no notice is required. Failure, however, to receive notice does not deprive a shareholder from voting at the meeting.

Waiver of Notice

Any person entitled to attend a shareholders' meeting can waive notice of a meeting of shareholders. Attendance at the meeting constitutes notice unless the attendance is for the express purpose of objecting to the lawfulness of the meeting.

Contents of Notice

The contents of the notice of a shareholders' meeting must include the nature of the business in sufficient detail to enable the shareholders to form a reasoned judgment, and the text of any special resolution(s) to be submitted to the meeting. Notice of meeting must be complete and no misleading. A management circular should accompany the notice or be part of the notice of meeting.

The directors must call a meeting of shareholders if one is requisitioned by shareholders holding at least 5% of the shares carrying the right to vote. If the directors fail to call a meeting of shareholders within 21 days of receiving the requisition, any shareholder who signed the resolution may call the meeting. The CBCA resolution is 143 (1).

(c)

Upto four marks for stating that it would be difficult and unlikely for a scenario to arise where a shareholder insists that a member chairs a general meeting. Under the CBCA, Sections 135 (3) and Section 137 provides that any member may chair a general meeting if he or she is elected by resolution of the members passed at the meeting but that this is subject to the provisions of the company's by-laws. The Chairman of the Board is generally nominated to be chairman at general meetings. The chairman should be advised that it is highly unusual for a member to chair a general meeting of a listed company and that this scenario would only arise in the very unlikely case that no directors were available or willing to chair the meeting.

Upto two marks for stating that the chairman of the meeting has powers to adjourn a general meeting if it appears to him or her that an adjournment is necessary to protect the safety of any person attending the meeting or to ensure that the business of the meeting is conducted in an orderly manner. Where a meeting is discontinued to convene at another time and place, the applicable term is adjournment. When the business of the meeting has been completed, there is no need per se to make a motion to adjourn the meeting. It is instead within the power of the chair to declare the meeting terminated. A motion for termination is not required. Generally speaking, if a quorum is not present, the meeting is not validly constituted. As a result, a motion to adjourn would be incorrectly made.

3. In respect of the business acquired just prior to your appointment:

(a) Some of the companies are inactive and are not required. You have agreed to prepare a short briefing for your team as to why striking off these companies would be the best course of action. You have also agreed to provide advice on the considerations, authorities and required steps they would need to take to strike off the companies.

(14 marks)

(b) To help provide cover whilst Mr White is on his business travels, it is being considered whether Mr Black should be appointed as an additional director for a specific term to Mr White. However, your team are unsure whether an additional director for a specific term has the same role and capacity as any other director. They would like to know if any authorities need to be obtained or other steps taken for the appointment of Mr Black. They are also unclear whether, during a board meeting, the votes and interests of Mr White would be in addition to Mr Black's votes and interests.

(11 marks)

Required

Provide the advice requested in respect of (a) and (b) above.

(Total: 25 marks)

(a)

Upto three marks for explaining that the business may retain any company which is inactive or not required, provided it maintains all necessary statutory filings, however, retaining companies which are no longer needed and inactive is a waste of resources. The most appropriate course of action would be for the companies involved to apply to be struck off on the grounds that they are no longer trading and no longer required. As stated in the case study, all of the companies in the recently acquired business are solvent and hence candidates should exclude any voluntary liquidation proceedings as the solution to this problem as this would be unnecessary and a more complicated route which could usually take longer than a strike off. The main reasons for striking off the companies which are not needed include leaving the group with a simpler corporate structure, a reduction in corporate administration and lower running costs, for example a saving in the annual return filing fees.

Upto three marks for three of the five answers identified below for stating that the preliminary consideration in order for the companies involved to qualify for dissolving procedure. In order to qualify under Section 212(1) of the CBCA (Dissolution by Director), the following conditions must be considered:

(i) Dissolve a corporation by issuing a certificate of dissolution under this section of the corporation;

(ii) Has not commenced business within three years after the date shown in its certificate of incorporation;
(iii) Has not carried on its business, for three consecutive years,
(iv) Is in default for a period of one year in sending to the Director, any fee, notice or document required by this Act; or
(v) Does not have any directors or is in the situation described in subsection 109 (4).

The team should therefore be advised that they should review the above and ensure any required actions are completed at least three months ahead of the application to dissolve.

Upto three marks for dealing with the required authorities to dissolve a company. It is not necessary to seek shareholder approval for this process and the decision to apply for dissolution is made by board resolution. Unanimous board consent is advisable in case of subsequent objections. Once board approval is received, Section 211 of the CBCA describes the steps of dissolution.

Upto three marks for responding to the required steps which need to be taken, which are in respect of informing interested parties about the proposed dissolution. All parties must be informed by providing them with notice as per Sections 220 and 221 of the CBCA. Candidates may describe actions stated in these sections.

Upto two marks for stated that in the absence of any valid objections, under Section 221 (b) of the CBCA states that ”without delay publish notice by insertion once a week for two consecutive weeks in a newspaper published or distributed in the place where the corporation has its registered office and take reasonable steps to give notice of the appointment in each province where the corporation carries on business”.

(b)

Upto two marks stating that Section 106 (8) *“Appointment of directors”* states that the directors may, if the articles of the corporation so provide, appoint one or more additional directors, who shall hold office, for a term expiring not later than the next annual meeting of shareholders”…..

Upto four marks for considering the required authorities to appoint Mr. Black. Candidates should noted that some of the companies of which Mr. White is a director are private limited companies and such the Canadian statutes and internal by-laws will need to be referred to and amended. It is also necessary to ascertain whether Mr. Black is already a director of the companies

concerned. All appointments will be subject to approval by the board of directors.

Upto three marks for dealing with the votes of Mr. Black as he is appointed as an additional director for a specific term, he will only have one vote. Both Mr. White and Mr. Black will have one individual vote.

Upto two marks for explaining that Mr. Black is already an appointed director and there is nothing to preclude him from voting on any matter in which he has no interest in.

4. The board is reviewing year-end matters:

(a) Mr Grey wants to conserve cash ahead of the introduction of the new range of televisions next year. He asks you what the potential sources of capital are in order to achieve this.

(6 marks)

(b) In reviewing year end matters, Mr Grey asks you what the rules are on the constraints of shares in a public company, as well as the rules on the sale of constrained shares, in order to determine whether the structure of the group companies is optimized for the most efficient running of the group?

(9 marks)

(c) Mr Grey is considering creating a new class of shares and would like your advice on methods of altering share capital, including the procedure for alteration of share capital.

(10 marks)

Required

Provide the advice requested in (a), (b) and (c) above.

(Total: 25 marks)

(a)

Up to six marks (i) Money and property secured, by way of loans or further issuance of shares, from the initial investors; (ii) Retained earnings or other cash flows such as depreciation or depletion reserves; (iii) Equity capital arising by the issuance of shares to additional Investors and, if a public corporation, the public; and Debt capital i.e. borrowed capital raised from financial institutions or other financiers by way of loans, mortgages or the sale of bonds or debentures.

(b)

Up to three marks for noting that the CBCA permits a public company to add a provision to its articles constraining the transfer of its shares to certain persons or for certain purposes. A special resolution of the shareholders is required to amend the articles to add, change or remove such a condition. ***CBCA Section 174 (1)***

Up to six marks for noting that if a company has constraints on the issue, transfer or ownership of its shares, the directors may, under certain circumstances, sell shares owned contrary to those constraints. The directors must select the shares for sale in good faith and in a manner that is not unfairly prejudicial to and does not unfairly disregard the interests of, the holders of the shares in the constrained class or series taken as a whole. ***(Students will be awarded marks for quoting sections of CBCA Section 46 (1).***

Under the CBCA, a public company may amend its articles in accordance with the regulations to impose certain constraints on the issue, transfer and ownership of its shares. The Regulations to the CBCA set out certain powers and duties of directors of a contrained share corporation. ***(Students will be awarded marks for quoting sections of CBCA Section 76 (1).***

(c)

Up to ten marks for noting that section 173 (1) of the CBCA provides for the shareholders to make the following amendments to the Articles as far as they relate to share structure.

(1) Change the maximum number of shares that the corporation is authorized to issue;
(2) Reduce or increase stated capital, if its stated capital is set out in the Articles;
(3) Create a new class of shares;
(4) Change the designation of all or any of its shares, and add, change or remove any rights, privileges, restrictions and conditions including rights to accrued dividends, in respect of all or any of its shares, whether issued or unissued;
(5) Change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series or into the same or a different number of shares of other classes or series;
(6) Divide a class of shares, wither issued or unissued, into series and fix the number of shares in each series and the rights, privileges, restrictions and conditions thereof;
(7) Authorize the directors to divide any class of unissued shares into series and to fix the number of shares in each series and the rights, privileges, restrictions and conditions thereof;
(8) Authorize the directors to change the rights, privileges, restrictions and conditions attached to unissued shares of any series; or
(9) Add, change or remove restrictions on the transfer of shares.

Section 38 of the CBCA permits a corporation by special resolution (i.e. a resolution passed by a majority of not less than two-thirds of the votes cast by shareholders who voted in respect of that resolution, or signed by all the shareholders entitled to vote on that resolution) to reduce its stated capital for any reason including: (1) extinguishing or reducing a liability in respect of an amount unpaid on any share (2) distributing to the holder of a share in any class or series of shares not exceeding the stated capital of the class or series; and (e) deleting an amount not represented by realizable assets.

Questions 5 and 6, below, are not connected to the pre-released case study.

5. You are the Assistant Corporate Secretary of Knowledge First Limited ('Knowledge'). You have just been advised by the General Counsel and Corporate Secretary that the first shareholders' meeting of Knowledge will be held within six months. The President is concerned about the restriction on powers of the shareholders versus directors and also wants to know more about the potential power of shareholders when entering into a unanimous shareholder agreement. The General Counsel and Corporate Secretary has asked you the following questions in order for her to assist the President and CEO with the first meeting.

   (a) Outline five restrictions on the power of shareholders to restrict the power of directors.

   (5 marks)

   (b) What is a unanimous shareholder agreement and what are the effects to the directors of such an agreement?

   (5 marks)

   (c) Describe in detail the contents of an Agenda for an annual shareholders meeting. Differentiate between annual, special and class meetings of shareholders.

   (10 marks)

   (d) Describe five rights given to shareholders under the CBCA.

   (5 marks)

   Required

   Write a memorandum to the General Counsel and Corporate Secretary addressing points (a) to (d).

   (Total: 25 marks)

MEMORANDUM

DATE: Today's date
TO: General Counsel & Corporate Secretary
FROM: Assistant Corporate Secretary
SUBJECT: SHAREHOLDERS' MEETINGS

(a) (i) ***Restrictions on the Corporation's Business***
The CBCA makes it clear that a corporation may not carry on any business or exercise any powers that it is restricted by its articles from carrying on or exercising. The ability of the shareholders to restrict the corporation's business and powers by including a provision in the articles replaces the approach in the predecessor statute to the CBCA of requiring a corporation to include an objects clause in its article of incorporation. ***CBCA provision is Section 16 (2) and (3).***

(ii) ***Restrictions on Issuance of Shares***
Under the common law, it is the director who determines when shares should be issued, to whom and for what consideration. This power is specifically set out in the CBCA, but is made subject to any restrictions in the corporation's articles, by-laws or any unanimous shareholder agreement or to any pre-emptive rights set out in the articles. ***CBCA provision is Section 25 (1) and Section 28 (1).***

(iii)***Restrictions on Purchase and Redemption of Shares***
Provided that the corporation satisfies the financial capacity tests set out in the CBCA, it may purchase, redeem or otherwise acquire its own shares. However the articles may impose restrictions on this authority. ***CBCA provision is Section 34 (1) and Section 35 (1).***

(iv) ***Restrictions on Directors' Power to Manage***
The ability of the directors to manage the business and affairs of the corporation may be restricted in whole or in part by a unanimous shareholder agreement. This permits shareholders to depart from the statutory scheme of the directors managing the corporation, provided that all of the shareholders agree. ***CBCA provision is Section 102 (1).***

(v) ***Restrictions on Authority to Make By-Laws***
The directors have the authority to make new by-laws or to amend or repeal existing by-laws, but this authority is subject to confirmation, rejection or amendment by the shareholders at its next meeting of shareholders. ***CBCA provision is Section 103 (1) and (2).***

(vi) ***Restrictions on Authority to Fill a Vacancy on the Board***
The shareholders my eliminate the authority of directors to fill vacancies on the board under certain circumstances by providing in the articles that a vacancy among the directors shall only be filled by a vote of the shareholders.

Other Restrictions considered when Marking will be:

Restrictions Relating to Directors' Meetings (CBCA Section 114 (1).
Restrictions on Authority to Appoint and Delegate to Officers

(CBCA Section 121)
Restrictions on Borrowing Authority

(b) A USA permits the shareholders to perform some or all of the functions otherwise performed by the directors. CBCA provision is Section 2 (1) and Section 146 (1) and (2). To the extent that the powers of the directors to manage the business and affairs of the corporation are restricted, the directors are relieved of their duties and liabilities under the corporate statute to the same extent. Whether this provision in a corporate statute would relieve directors of duties and liabilities imposed by statutes other than the corporate statutes has not been considered by the Canadian courts. The CBCA provides that the parties who are given the power to manage or supervise the management of the business and affairs of the corporation under a unanimous shareholder agreement have all the rights, powers, duties and liabilities of a director of the corporation.

(c) A typical Agenda for an Annual meeting is as noted below:

AGENDA FOR ANNUAL MEETING OF KNOWLEDGE FIRST LIMITED

AGENDA FOR ANNUAL MEETING OF SHAREHOLDERS HELD ON **date and location details**

1. Chairman	Chairman calls meeting to order. Names secretary. Names scrutineers, if any.
2. Shareholders	Shareholders are to register their names. Proxies are to be deposited.
3. Notice	(If requested) Secretary reads notice calling meeting and affidavit of mailing.
4. Quorum	Secretary (or scrutineers) reports on attendance. Chairman declares meeting duly constituted.
5. Minutes	(If requested) Secretary reads minutes of last meeting. Chairman asks for errors or omissions. Motion to verify. Discussion and vote. Declares result.
6. Financial statement.	Treasurer tables annual report and financial Statement
7. Receiving	Motion to receive financial statement Discussion and vote. Chairman declares result.
8. Election of Directors	Chairman calls for nominations. Motion (or declaration) closing nominations. If exactly the required number is nominated. Chairman declares nominees elected.

	If ballot is required, chairman asks for motion directing secretary to cast a single ballot for election of those nominated. If more than required number is nominated, a poll is taken. Chairman declares result of election.
9. Auditor	Calls for motion to appoint an auditor and to authorize the board to fix remuneration of auditor. Vote is taken. Declares result.
10.Other Business	Asks for further business.
11.Conclusion	Motion to conclude meeting.

Unless the class of shareholders specifically require it, only the common shareholders have the right to receive notice, as of the record date, and to attend the annual general meeting ("AGM") of shareholders. The AGM is commonly called by directors' resolution, under the timelines imposed by the legislation. The AGM gives the shareholders the right to hear about various items including the consideration of the financial statements of the corporation and vote on items, including electing directors and reappointing auditors (or continuing exemption from the auditor requirement, if allowed).

Any other items to be discussed and/or voted upon are called "special business" and can be done as part of the general meeting or in a separately called special meeting of shareholders. A special meeting can be called separately and at a different time and place as the AGM. For a public corporation where the expense and time required to hold any shareholders' meeting can be excessive, a special meeting can be called at the same time as the AGM.

In addition, most corporate legislation allow for the holders of different classes of shares to receive notice, attend shareholders' special meetings and vote where the corporation is proposing either to amend the articles in certain ways or amalgamate; see *CBCA*, sections 176 and 183(4), respectively. The articles may also give classes of shareholders other than common shareholders the right to attend meetings and vote in specific circumstances.

(d) Included in shareholders' rights are the right to elect and remove directors, right to appoint and remove auditors and right to receive notice of and participate in and vote at shareholders meetings. Please note that although many of these rights were traditionally given only to holders of common shares, in recent times variations of some of these rights have also been given to the holders of certain preferred shares. Holders of all shares should consult the articles of incorporation to determine the share rights for the class of shares held.

Securities Registers Including the Shareholders Register

Under the incorporating legislation, corporations are required to maintain

a number of corporate records including a security register in which is recorded securities (including shares) issued in registered form. The register must show specific information about the security and the security holder. In practice the security register for shares consists of three records: the shareholders' register, the shareholders' ledger and the share (or stock) transfer register. Together, all three records provide the required information and allow the corporation to determine the legal owner of all of its issued and outstanding shares at specific points in time as required. This information is needed because of notices to be given and dividends to be sent to the shareholders as required.

Shareholder Ability to Change the Board

Shareholders who are dissatisfied with how the directors are running the corporation may remove the directors or refuse to re-elect them. Although this may be a difficult course to take, particularly where the shares of the corporation are widely held.

Dissent Rights

There are a number of transactions and corporate changes in which the shareholders have a right to dissent. Where shareholder approval is required for a corporation to effect a fundamental change, such as an amalgamation or continuation of the corporation into another jurisdiction, shareholders are entitled to formally dissent and to be paid the fair value of their shares.

Shareholder Approval Under Securities Laws or Stock Exchange Rules

Shareholder approval of certain transactions may be required under securities laws or stock exchange rules, whether or not required under corporate law.

6. In addition to the full range of statutory liabilities, it is possible for directors to be held liable for certain common law breaches arising from the actions of the corporation. However, some incorporating legislation, such as the CBCA, deals with 'insider trading' and the latter is also dealt with under securities legislation to ensure that 'insiders', as defined under the legislation, report about and only trade in securities in a mandated fashion. Directors may only be liable if they act in such a deliberate and reckless way that they make the wrongful acts their own as distinct from the corporation's.

   (a) What are the classes of persons included in the definition of an 'insider' of a distributing corporation?

   (5 marks)

   (b) Discuss how directors could be determined 'insiders', and their obligations.

   (10 marks)

   (c) What are the defences available to a director who has been charged with 'insider trading'?

   (5 marks)

   (d) What are the liabilities for a director, for offences under the corporate statutes (CBCA), who knowingly authorizes, permits or acquiesces in the corporation while failing to comply with certain provisions?

   (5 marks)

   (Total: 25 marks)

(a)

Section 126 of the CBCA states the following are definitions of an "insider":

(a) Directors and officers of a distributing corporation;
(b) Directors and officers of a subsidiary of distributing corporation;
(c) Directors and officers of a body corporate that enter into a business combination with a distribution corporation;
(d) A person employed or retained by a distributing corporation; and
(e) A director or an officer of a corporate body that beneficially owns, directly or indirectly, shares of a distribution corporation, or that exercises control or direction over shares of the distributing corporation.

(b)

Regulation of insider trading is intended to promote fairness in the capital markets. Persons who have information about a corporation by virtue of their relationship with that corporation should not be in a position to use that information to trade in securities of the corporation or to assist others to trade in securities of the corporation before that information is publicly disseminated.

(i) Directors as Insiders – Directors are insiders of the corporation on whose board they serve, but they are also deemed to be insiders of any other

corporation of which their corporation owns or controls more than 10% of the voting security. Insider trading rules have two aspects. First, as insiders, directors must report to the securities authorities their ownership of and any trade they make in securities of the corporation in which they are insiders. Second, because they are in a "special relationship" for securities law purposes to any corporation which they are insiders, they may be liable if they trade in securities of that corporation with knowledge of a material fact or material change that has not been generally disclosed.

(ii) Insider Trading Reports – Persons who hold securities in the corporation are required to file an insider report when they become insiders. When directors trade in securities of entities in which they are insiders, they must file a report of that trade within 10 days of the trade or within 10 days of the end of the month in which they make the trade, again depending on the jurisdiction.

(iii) Use of Inside Information – Under both the corporate and securities statutes, directors are liable for using confidential or "inside" information about the corporation to trade in securities of the corporation or for passing such information on to someone else. The provisions and language used to describe these liabilities vary depending on the statute, but significant terms include "material fact", "material change", "material information" and "confidential information".

A director who trades with knowledge of such information or who provides that information to someone else may encounter liability on three levels. First, the director may be subject to a fine of the profit made or the loss-avoided. If a corporation is convicted of insider trading in the securities of another corporation, every director who authorized or acquiesced in the offence is also guilty and is liable for damages resulting from the trade. The director may also be liable to the person who traded with the director or with the person the director advised of an undisclosed material change or material fact. The director will also be liable to the corporation for any gain realized by insider trading or tipping.

(c)

- Proof that a director reasonably believed that the information had been generally disclosed is a defence.
- If the other party to the transaction knew about the undisclosed information or ought reasonably to have known, the director is not liable.
- A director may purchase share in an automatic plan such as a share purchase plan which was in place before the director became aware of the confidential information.
- Trading might take place to fulfill a legally binding obligation entered into by a director prior to the acquisition of the undisclosed information.
- An investment might constitute insider trading, but no director, officer, partner, employee or agent of the firm who was involved in the investment decision had actual knowledge of the inside information.
- If a director informs a third party of an undisclosed material fact or a material change in the necessary course of business, that action does not

constitute tipping.

(d)

The corporate statutes impose a number of obligations on the corporation. To ensure compliance by the corporation, the corporate statutes also impose personal liability on a director who knowingly authorizes, permits or acquiesces in the corporation failing to comply with certain provisions. The offences for which a director may incur such liability under the CBCA include the following:

- Failure of the corporation to send a proxy to shareholders at the same time as they are given notice of a shareholder meeting as required by the CBCA.
- Failure by the corporation to send a management proxy circular to shareholders and to the Director under the CBCA before soliciting proxies; and
- The inclusion by the corporation of an untrue statement of a material fact in certain documents such as a management proxy circular required under the CBCA or the omission by the corporation of a material fact in such a document.

Directors may be liable for fines or prison terms or both whether or not the corporation itself has been prosecuted or convicted for the offences described above. It is important to note that directors **must have** knowingly authorized, permitted or acquiesced in the commission of the offence before they will incur liability.

The Criminal Code now includes indictable offences of “insider trading” and “tipping”. The offence of insider trading differs in several ways from the insider trading prohibitions under Canadian securities legislation, in that the Criminal Code offence takes a much broader approach as it applies throughout Canada, without regard to the jurisdiction in which the trade occurred and whether the securities are listed for trading on a stock exchange or are privately held. The Criminal Code also makes it an offence for persons who possess or obtain insider information and knowingly convey that information with the knowledge that there is a risk that the recipient will use the information to buy or sell a security to which the information relates or may convey the information to someone else who may do so. In contrast to the parallel regulatory offence under provincial securities legislation, the Crown faces a must higher burden of proof when prosecuting the Criminal Code offence. This criminal offence of insider trading carries a penalty of imprisonment up to 10 years and the offence of tipping is punishable by a term of up to five years.