

**BUSINESS ORGANIZATIONS 45.228**  
**Prof. Casey M. Chisick**

**SAMPLE EXAMINATION PROBLEMS FOR 1999-2000**

**PLEASE NOTE:** The following problems are extracted from final examinations set over the years by Prof. Art Braid. Although they may well prove useful to you in helping to focus your thinking and studying about corporate law, and although the issues raised by the problems are obviously among those we have considered in class, please be aware that the format of these problems, and the manner in which the issues are canvassed, may not be identical to the problems you will encounter on this year's final examination. Thus, please feel free to use these problems to hone your corporate law problem-solving skills but do not rely too heavily on them for purposes of setting your expectations for this year's exam.

Specifically, you should be aware that, in addition to traditional fact-scenario problems like the ones set out below, this year's exam will require you to deal with at least one straight policy question in the form of an essay. It is also possible that substantive law will be examined by means other than simply long answers. I will, of course, give you advance notice of what the actual format of the examination will be.

Please make sure to have reviewed the following problems and be prepared to discuss them at the optional exam review seminars scheduled for March 28 and March 30. The review seminars will be of very little use if you have not prepared for them in advance. Also, please remember that these seminars will be your only opportunity for exam review; I will not be conducting a formal exam review during class time.

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1. On December 1, 1992, two brothers, Glen Harper and Bud Harper, decided to go into the construction business and, therefore, instructed their solicitor to incorporate a corporation under the *Canada Business Corporations Act* (the "C.B.C.A."), to be called Harper Construction Ltd. The Harpers signed the Articles of Incorporation and the lawyer told them she would have the documents to the Director of Corporations on or before December 4, 1992.

Bud told Glen that he had an option to purchase certain construction equipment at an advantageous price from Ace Trucks, provided that Ace Trucks received a valid purchase order from either Bud personally or from a corporation in which he was interested as shareholder if, and only if, the purchase order was received by Ace Trucks by December 4, 1992.

True to her word, the lawyer delivered the documents on December 4, 1992, to the Director of Corporations under the C.B.C.A. and later that afternoon Bud delivered to Ace Trucks the following purchase order:

"DATE: December 4, 1992.  
TO: Ace Trucks  
FROM: Harper Construction Ltd.

Harper Construction Ltd., a Corporation under the C.B.C.A. does hereby irrevocably exercise the option to purchase the equipment set out in Schedule "A" hereto at the aggregate price of One Hundred and Fifty Thousand Dollars (\$150,000.00) pursuant to the Option Agreement between Bud Harper, as Optionee, and Ace Trucks, as Optionor, and dated November 15, 1992.

Signed: Harper Construction Ltd.  
per "Bud Harper" [signature]

It was not until December 8, 1992, that the Director of Corporations actually signed the Certificate of Incorporation incorporating Harper Construction Ltd. However, it was dated December 4, 1992.

Ace Trucks has discovered the facts and has refused to accept the "order" of Harper Construction Ltd. as a valid exercise of the option within the option period, and has asked for an additional \$50,000 on the purchase price. The Harpers and Ace trucks have agreed to refer this dispute to the Court on a Statement of Agreed Facts. In the meantime, the Harpers now have the equipment and have paid \$200,000 into a trust (escrow) account pending the outcome of the court action.

Render the judgment of the Court.

2. Notwithstanding these potential difficulties, the Harpers then embarked on the construction business with their new corporation. They were very ambitious and agreed that the corporation would involve itself in all aspects of the construction industry, including building supplies, construction equipment as well as property development throughout Western Canada.

By the end of 1994 Harper Construction Ltd. was well on its way towards achieving all the corporate goals. The shareholding on December 31, 1994, was as follows:

Glen Harper	-	40 shares
Bud Harper	-	40 shares
Sam Martin	-	20 shares

Sam Martin, a recent graduate from the University of Manitoba with both Bachelor of Commerce and Bachelor of Laws degrees and a bag full of money, left to him by his Aunt Tillie, had been brought into the company in 1993 both as a shareholder and as an employee. He paid a substantial amount in cash to the corporation for his 20% shareholding and was put in charge of the development of the corporation's building supplies operations. All three were also directors and Glen and Bud were President and the Vice-President of the Corporation respectively.

In 1989, prior to the incorporation of Harper Construction Ltd., Bud Harper, together with one of his old friends, Doug McIntosh, had pooled their money to purchase 360 acres of land 15 miles outside the City of Winnipeg for \$50,000. This land was and remains registered in the name of Doug McIntosh. They decided that this was a good location for a golf course that the two would try to build sometime in the future. Bud never told his brother or anyone else about his interest in this land.

In January, 1995, it was unanimously agreed at a Board of Directors meeting that the corporation would create a summer/winter resort near the City of Winnipeg and would be in the market to acquire suitable land. Doug McIntosh learned about the desire of the company for land for this purpose from Sam Martin. McIntosh then approached Glen Harper and offered to sell the land to Harper Construction Ltd. for \$1,000,000. After an appraisal by an independent expert had confirmed the market value of the property at between \$800,000 to \$1,000,000, the Board of Directors of Harper Construction Ltd. agreed with McIntosh to acquire the land at the asking price of \$1,000,000. Glen and Sam agreed with each other that the land was perfect for the proposed purpose; indeed, it was probably the only land near Winnipeg that met all the criteria. Bud Harper did not attend the Board of Directors meeting when the matter was considered, as he thought it best to be absent at that time, and therefore, he feigned illness. In February, 1995, after the transaction had been concluded and the money paid, Glen Harper discovered that his brother was a one-half owner of the property and both he and Sam Martin, as directors, have asked Bud to pay to the Company \$475,000, being his share of the profits on the sale of the land. Bud has refused unless the Corporation retransfers the land to Doug McIntosh in return for repayment of the purchase price.

Discuss the rights of Harper Construction Ltd. against Bud Harper with respect to this transaction.

3. While the above matter was pending, Glen and Bud discussed whether or not the corporation should continue to be their sole vehicle for buying land, creating a plan for its development, constructing the proposed development and then continuing to hold the land as owner. From their personal tax position and in respect of their family situations, they agreed that it would be desirable if they could also use, respectively, their own family corporations for the landholding and development business. They agreed that in the future all new opportunities for development that came their way would not necessarily be made available to Harper Construction Ltd. as they had been in the past. They decided that henceforth when land became available for purchase that was suitable for the construction of warehouses, Glen's new family corporation would be given the first opportunity to purchase and develop the land and, when land became available for purchase that was suitable for small strip-mall development, then Bud's new family corporation would be given the first opportunity to purchase and develop the land. Only if the respective corporations were not interested would the opportunity then be given to Harper Construction Ltd. Sam was not told about the incorporation of these family corporations nor of the agreement of Bud and Glen in respect of the decision to give the first opportunity of purchase and development of land suitable for development for warehouse or strip-mall purposes to Glen and Bud. To their credit, Glen and Bud also agreed between themselves that any actual development on the properties purchased by the family corporations would involve Harper Construction Ltd. as the general contractor and the prime supplier of building materials.

Over the past two years, the following has occurred:

- (i) ACE Realty wrote a letter addressed to Harper Construction Ltd., to the attention of Glen Harper as President, asking whether Harper Construction Ltd. was interested in acquiring a piece of property zoned for warehouse and manufacturing purposes and which was ripe for development. Glen received the letter, spoke to Bud and they agreed that because Harper Construction Ltd. had sufficient projects underway at that time to keep it busy, Glen's family corporation should pursue that opportunity. Accordingly, this was done and it is estimated that the family corporation will earn a very handsome profit once the development has been completed.
- (ii) The president of a Winnipeg real estate agency was an old school chum of Bud's. Harper Construction Ltd. had not, in the past, had any business dealings whatever with either the president or his real estate agency. The president of the real estate agency, while on the golf course with Bud, told Bud that a large eastern land developer had recently purchased some land zoned residential near the outskirts of Winnipeg and that the eastern developer intended to construct a large housing development thereon. Bud was aware that this would enhance the value of the surrounding area and that the development of a strip-mall would be most advantageous. He received the green light from his brother Glen to purchase land in the area adjacent to this proposed new development, in the name of his family corporation. Accordingly, the family corporation purchased the land and it has now increased in value tenfold since the announcement of the new housing development was made by the eastern developer.

Sam has now discovered not only the transactions but the agreement between Glen and Bud that led to them. He has told both Glen and Bud that they are each liable to account to Harper Construction Ltd. for the profits which they have made on these transactions. Glen and Bud have disagreed because, as they have said, no real harm has come to Harper Construction Ltd. because it is as busy as ever and it has and will be able to make profits from any construction contracts or supply contracts. The three have agreed to abide by the consensus of opinion of second year law students as expressed by them on a final examination in the subject of Business Organizations Law. You are a member of that class of second year law students.

- (a) Please give a reasoned opinion as to whether Glen should account to the corporation for any profits which he might make arising out of the development of the land that his family corporation purchased from ACE Realty.

- (b) Please give a reasoned opinion as to whether Bud should account to the corporation for the increased value in the land that he purchased adjacent to the new housing development.

4. Footwarmers Ltd. was incorporated in 1981 under the C.B.C.A. with its business restricted in its Articles as follows:

"Carrying on the business of manufacturing and selling electric footwarmers."

The Articles created two classes of shares, common and preferred.

The Articles also provided as follows:

"The holders of the preferred shares shall not be entitled to vote but shall be entitled to a first fixed preferential dividend of 10% of the issue price of the shares. On dissolution the holders shall be entitled to receive any arrears of dividends and to a return of capital before the holders of the common shares."

"The holders of the common shares shall be entitled to vote, to receive dividends, if declared, and to surplus property upon dissolution."

No dividends have been declared or paid on the preferred shares for the last four years.

From the first year of operation the corporation had issued shares as follows:

NAME OF SHAREHOLDER	COMMON SHARES	PREFERRED SHARES
Muriel Foster	10,001	Nil
Lois Harper	3,499	Nil
Violet Yorke	2,200	4,000
Mary Bradley	2,100	2,000
Barbara Gates	1,100	2,000
Lillian McIntosh	1,100	2,000

The directors and officers (all full-time employees of the corporation) were as follows:

Foster - president and director  
Harper - executive vice-president and director  
Yorke - secretary-treasurer and director

The other three shareholders were not employed by the corporation. The by-laws of the corporation provided, inter alia, that:

1. No contract for the sale of any land shall be made unless the proposed contract is first approved by the Board of Directors and ratified by the shareholders.
2. No officer shall enter into any contract respecting any business other than business which promotes the manufacture and sale of footwarmers, without the prior approval of the shareholders.

Three years ago, the corporation created a wholly owned subsidiary Manitoba corporation called R. & D. Ltd. to perform research on and to test market new products related to footwarmers. The entire start-up and working capital for R. & D. Ltd. was provided by a loan from the parent corporation. R. & D. Ltd. had \$1.00 stated capital. All facilities and equipment needed were provided by the parent corporation to R. & D. Ltd. under short term leases. R. & D. Ltd. charged fees to the parent corporation for its services. These fees each fiscal year generally equalled the amount that the corporation had advanced during that year to R. & D. Ltd. in order to enable R. & D. Ltd. to pay its operating costs. Almost the entire operating costs of R. & D. Ltd. were salaries paid to the research and test marketing staff employed by R. & D. Ltd.

The president and chief executive officer of R. & D. Ltd. was, since incorporation, Lucy Toole, who was at the time of her appointment, and had been for many years, the chief of research for the parent corporation. It was Toole who hired all the staff for R. & D. Ltd. All staff, including Toole, received their salaries from cheques drawn on the account of R. & D. Ltd. Toole would calculate monthly the total salary payment requirement for R. & D. Ltd. and requisition this amount from the comptroller of the parent corporation. A transfer of funds would then be made from the bank account of the parent corporation to the bank account of R. & D. Ltd. Fees generated by R. & D. Ltd. would be billed to the parent corporation and these would be used to offset any liability arising out of the salary advances.

The Board of Directors of R. & D. Ltd. consisted of Muriel Foster, Lois Harper and Violet Yorke and they were also authorized by the parent corporation to cast its vote at any meetings of the shareholders of R. & D. Ltd. Although Toole was the chief executive officer of R. & D. Ltd., she was instructed by the board of R. & D. Ltd. not to enter into any contract on behalf of the subsidiary which would involve it in a non-salary expenditure commitment greater than \$1,000.00 without first getting the consent of Muriel Foster.

At a meeting of the board of the parent corporation Muriel Foster presented a proposal that all research and test marketing should be contracted out to others as soon as possible and that the operations of the subsidiary should be wound down immediately, and the staff (other than Toole) should be dismissed and the corporation dissolved. Her rationale for this was that the work could be done less expensively and more efficiently by independent persons. Toole would be rehired by the parent corporation to act as the liaison between the corporation and the independent contractors. The board of directors passed a motion which agreed with the proposal in principle but referred the matter to counsel for the corporation to determine how this could best be achieved without any liability to the parent corporation. Foster pointed out to the meeting that because all the employees of R. & D. Ltd. would lose their jobs, and there was no time to give proper notice in lieu of dismissal, that the subsidiary would clearly be liable for damages for wrongful dismissal. She stated that these damages would be substantial and that the subsidiary would have no assets whatever with which to pay the damages. She was concerned as to the position of Footwarmers Ltd., the parent corporation, and any potential liability it might have with respect to payment of these substantial damages. She indicated that this is why she thought it best to refer the matter to counsel.

The following events have also occurred respecting Footwarmers Ltd:

1. Barbara Gates, a shareholder of Footwarmers Ltd. since 1981, contacted Muriel Foster with a view to purchasing from the company for \$20,000.00 a vacant piece of land owned by the company. Foster believed that this land had a market value of only \$5,000.00 and quickly agreed, on behalf of the corporation, to sell the land to Gates for \$20,000. The contract was signed by Foster on behalf of the corporation but, before the transfer of land had taken place, the entire area was rezoned by the city thereby making the land worth \$50,000.00.
2. Muriel Foster and Lois Harper signed a contract on behalf of the corporation with Micro Ltd. for Micro Ltd. to supply "electronic components for ear-warmers". Before the contract was signed, the lawyer for Micro Ltd. had asked for and had obtained a copy of the Articles of Footwarmers Ltd.

You, as a brilliant corporate/commercial lawyer, are told about all of the above and further told that the shareholders of Footwarmers Ltd. are contemplating the possible dissolution of the corporation itself. It appears that there will be sufficient assets to pay off all the creditors, to return all capital and still leave quite a bit for the equity shareholders.

In the light of the foregoing, you are asked to render reasoned opinions on:

- (a) The liability of Footwarmers Ltd. to compensate the research and test marketing staff of R. & D. Ltd. for their wrongful dismissal. (NOTE: In s. 119 of the C.B.C.A. the term "wages" does not include damages for wrongful dismissal.)
- (b) The rights of the common and preferred shareholders of Footwarmers Ltd. on the dissolution of the corporation.
- (c) The enforceability against Footwarmers Ltd. of the contract for the sale of land by Footwarmers Ltd. to Barbara Gates. The directors have refused to carry out the transaction.
- (d) The enforceability against Footwarmers Ltd. of the contract with Micro Ltd. Again, the directors have refused to carry out the transaction.