THIS EXAMINATION CONSISTS OF 4 PAGES

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THE UNIVERSITY OF BRITISH COLUMBIA

PETER A. ALLARD SCHOOL OF LAW

FINAL EXAMINATION – DECEMBER 2022

LAW 463/576

Securities Regulation

SECTION 1

Professor Maziar Peihani

**TOTAL MARKS:** 100

**TIME ALLOWED:** 2 HOURS

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**NOTE:**

1. This is an open book examination. Students may take any materials they wish into the examination room.

THIS EXAMINATION CONSISTS OF THREE QUESTIONS. ANSWER ALL QUESTIONS.

**Question One: 60 Marks**

CanadaBank is a bank regulated by the Office of Superintendent of Financial Institutions (OSFI) and a reporting issuer in British Columbia. In March of year two, CanadaBank sold $480 million of subordinated debt securities (“medium term notes”) on a Prospectus Supplement to a Base Shelf Prospectus. The supplement and the prospectus incorporate by reference the issuer’s latest Annual Information Form as well annual and interim financial statements and the management proxy circular prepared for the annual shareholder meeting. All these documents are prepared by CanadaBank management. The underwriting firm of Bixwell Golden was hired to be lead underwriter in the preparation of the shelf prospectus in January of year one.

At the time, banks in the geographic region where CanadaBank operated were experiencing relatively high bankruptcy rates as a result of a spate of commercial loan failures. Bixwell Golden asked its law firm of Navis Jones & Ito to conduct due diligence. Partner Sarah Jones worked with three associates over a two-week period to distribute questionnaires to management; review prior British Columbia Securities Commission (BCSC) filings; review CanadaBank’s material contracts; and review board minutes. All minutes were provided in a timely fashion except CanadaBank Executive Committee meeting minutes for year one which had not been typed up yet. Jones asked CanadaBank CEO Ralph Smith about the delay and was informed “there were no problems in the minutes, just an overworked staff.”

Shortly after the March offering, OSFI announced it had initiated a formal investigation of CanadaBank’s recordkeeping, citing concerns about whether there had been an appropriate evaluation of the collateral for commercial loans in its home region. Following the announcement, CanadaBank’s subordinated debt, which had been sold at $100 per note, slumped to $86. The announcement comes at a time of economic uncertainty: housing activity has retreated sharply, commodity prices have elevated, and households and businesses are softening spending. A group of investors who bought the securities during the distribution period file a law suit for misrepresentation in prospectus against (1) CanadaBank; (2) the board of directors of CanadaBank; (3) the underwriter Bixwell Golden; and (4) Navis Jones & Ito.

In a parallel development, the missing Executive Committee meeting minutes for year one were typed up. They revealed ongoing discussions between the Executive Committee (which included three inside directors: Ralph Smith; CFO Paula Larsen; and executive vice president Harriet Zahn) and OSFI. OSFI had proposed a consent settlement in February of year two, which the Executive Committee rejected. Three long-time outside directors, attorney Sarah Jones and business executives Peter Quirk and Hazel Choi, did not attend the Executive Committee meetings.

Please discuss how the court should decide the case. Assume that the issuer has followed the appropriate filling procedures for the prospectus as well the aforementioned continuous disclosure documents.

**Question Two: 30 Marks**

1. Samantha Jones, a young associate with the law firm of Osler, Hoskin & Harcourt LLP, is making a substantial income and wants to invest in a ski country condominium. Her problem is she can rarely take weekends off and will probably only use the condo three or four weekends each year. For this reason, she is particularly attracted by the brochures her real estate agent gave her for Ski Lodge Condos (“Ski Lodge”), a development being constructed by a major resort company in Whistler. Ski Lodge stresses the strong economic return and tax shelter advantages associated with acquiring a unit in its development. It also encourages condo owners to place their unit on the market with Ski Lodge for a weekend rental to tourists if the owner notifies management that she will not be occupying the unit that weekend. Tourists pay between $500 and $700 to rent the unit for a weekend, and, over the year, rental income of $15,000 or more is possible. For Samantha, this economic return makes the purchase price ($250,000) acceptable. Assume next that the rental income received with respect to a unit that is rented out for the weekend is allocated according to one of the following three formulas:
   1. all rental income is allocated pro rata among all owners who notify management their unit is available for rent that weekend, regardless of whether the unit is actually rented (management suggests this technique prevents them from “playing favorites” and directing rentals to preferred clients);
   2. rental income is allocated only to the unit that was occupied and in the amount paid by the tenant, minus a $150 service charge that management deducts and keeps; or
   3. rental income, again, is allocated on a unit-by-unit basis that reflects the actual occupancy of the unit, but it is shared on a 2/3:1/3 basis, with management keeping one-third of the rental income for its services in advertising the unit to the ski vacation market and soliciting rentals.

Under which of these options, if any, does the arrangement between Samantha and Ski Lodge amount to a security?

1. Assume Samantha buys a unit in Ski Lodge and makes substantial improvements to it, for example, by installing a hot tub, a mini-bar, a sound system, and a luxurious king-size bed. The total cost of these improvements is $25,000, and, as a result, the unit now rents for more than any other unit in the Ski Lodge development (i.e., $850 per weekend). Does this additional factor change your analysis? Under all, or only some, of the three rental allocation formulas discussed in part (a) above?

**Question Three: 10 Marks**

Coast Financial Services, Inc. (“Coast Financial”), a reporting issuer in BC, has a shareholder-approved qualified stock option plan that authorizes its Compensation Committee to grant options to management to purchase up to 30 million shares over a defined period. The plan requires that all options be granted at the market price of the stock on the date of grant by the Compensation Committee. On July 1, 2015, the Committee granted an option to its CEO, Dudley Doright, to purchase 1 million shares at the then-market price of $30 per share. However, one week before, on June 24, 2015, Coast Financial’s stock price had fallen to $27 per share (its lowest for the year). In granting the stock option, the Committee never discussed what the current price was, and did not date the corporate minutes, leaving this task to Coast Financial’s Assistant Secretary. The Assistant Secretary, however, backdated the option to June 24th (and, hence, to $27 per share). Five years later, in 2020, these details were uncovered as part of an overall review of stock option practices shortly before Doright’s stock option expired. As it turns out, Coast Financial’s stock price fell in 2016 to $25 per share (before Doright’s stock option vested and became exercisable), and the stock price never again reached $27. Doright’s counsel argued that the whole matter is immaterial because there was “not a dollar’s loss or dilution to any shareholder.” But, while no longer CEO, Doright remained as Chairman of the Board. Was the option-backdating material? What if Doright had retired from all corporate offices in 2019?

**END OF EXAM**