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Herbstsemester 2017

Gesellschaftsrecht

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Duration: 120 minutes

- Please check both at receipt as well as at submission of the exam the number of question sheets. The examination contains 3 pages and 4 questions.

Notes on marking

- When marking the exam each question is weighted separately. Points are distributed to the individual questions as follows:

Question 1	30 points	30 %
Question 2	20 points	20 %
Question 3	20 points	20 %
Question 4	30 points	30 %
Total	100 points	100 %

We wish you a lot of success!

Question 1 (30%)

HighTec AG („the company") designs and installs computer software. At a recent board meeting, the following resolutions were passed:

(a) To purchase a plot of land from Steven, the husband of Michelle, one of the company's directors, for CHF 500'000. Michelle did not disclose that the land is owned by her husband.

(b) To reject a proposed contract with the University of Limmat to install a new computer system in its library. The board did not feel that there was enough profit in the contract to make it commercially viable. After the meeting, Thomas, a director of the company, approached the University of Limmat and has been offered the contract in his personal capacity which he intends to accept.

(c) To purchase some new computer equipment from another company Digital Solutions AG. This contract was negotiated by Stephanie, one of HighTec AG's directors, who, unknown to HighTec AG, has been paid a CHF 10'000 commission by Digital Solutions AG for recommending that company to HighTec AG.

(d) To award Urs, a newly-appointed executive director, a signing bonus of CHF 500'000 for agreeing to become Head of Finance and Director of HighTec AG.

Advise the company on any potential breaches of corporate law.

Question 2 (20%)

Please discuss the theory and rationale of insider dealing law and whether or not the legal prohibition on insider dealing is justified (in your view).

Question 3 (20%)

'Corporate social responsibility is a radical and unnecessary expansion of corporate law'
Do you agree with this statement? Discuss.

Question 4 (30%)

Digital Assets Ltd is a company based in the United Kingdom. Eden Sharehan owns 21% of its shares. Achille Taloon is the sole member of its board of directors.
Achille Taloon willfully produced financial accounts for the tax year ending on December 31, 2016 that overestimated the value of Digital Assets Ltd. The financial statements were audited by P&L Audit Ltd and published on March 30, 2017. Achille Taloon was reelected at the general meeting that took place on June 15, 2017. A couple of months later, negative information was disclosed to the markets, which made clear that the financial accounts were inaccurate and that the company was not as profitable as it seemed. The price of its shares

dropped significantly. Eden Sharehan would surely not have reelected Achille Taloon if the audited accounts had portrayed a true and fair view of the company.

a) Eden Sharehan is planning on filing a lawsuit against P&L Audit Ltd. Please discuss whether P&L Audit Ltd owes a duty of care to Eden Sharehan.
b) Assume that Digital Assets Ltd files for bankruptcy on November 16, 2017. The liquidator of Digital Assets Ltd (in liquidation) is considering suing P&L Audit Ltd to recover losses for the benefits of the company's shareholders and creditors. Please address whether P&L Audit Ltd will be able to defeat Digital Assets Ltd (in liquidation)'s claim of breach of duty of care by asserting the *ex turpi causa* defense.

	Points
Question 1 (30%)	30
The question is not intended to be jurisdiction specific. Rather, the answer should raise general corporate law issues that might be applicable and then to discuss possible issues by making reference to corporate law rules and governance issues that we have covered in the course. It is not necessary to cite specific provisions or rulings from Swiss, UK, EU and US law. Rather, students are expected to spot the main issue. Students are also expected to explain the rationale of the applicable rules.	
Main issues: Fiduciary duties of the BoD / Principal-Agent Problem	
Fiduciary principle - The rules deriving from the fiduciary principle preserve the gains resulting from the separation of management from risk bearing, while limiting the ability of managers to give priority to their own interests at the expense of the firm. - Fiduciary principles are meant to be rules for completing "incomplete contracts". Overcome high costs of contracting (the overarching fiduciary principle replaces detailed contracts on agency problems) - Distinction between management practices that harm investors' interests, and practices that at the same time benefit managers and investors	5
Duty of care, duty of loyalty and duty of disclosure - Duty of care – to act as a prudent person does in the management of his own affairs of equal gravity. - Duty of loyalty – to maximize the investors' wealth rather than one's own wealth (Swiss & UK) - Duty to Disclose Conflicts and Material Interests	5
- **(a)** Main issue: duty of loyalty / conflict of interests =>breach of duty to disclose conflicts and material interests. Duty to report in advance (UK) or short time thereafter (USA)	5
- **(b)** Main issue: duty of loyalty / conflict of interests => breach of duty to disclose; T knew through his role as a BoD member about the contracting possibility => "corporate information". Consequently he is required to inform the board. Even though the company was not hurt, the duty of loyalty requires T to inform the Board about the deal, since this opportunity was given to him by the use of corporate information.	5
- **(c)** Main issue: conflict of interests, breach of duty of loyalty (as she chooses Digital solutions because she would obtain the commission, not because it is the best partner for High Tec AG. Consequently S is required to disclose the deal to the Board. Under US Law, the Board would scrutinise whether the deal was good or bad for the company. In	5

the latter case S could possibly be required to give the commission to the company. - **(d)** Potential issue: Any regulation on excess compensation. CH: VegüV is applicable only to companies with listed shares, no to private companies => VegüV would not be applicable, as the company in question is not a listed company. As it is neither a bank nor an investment firm, the relevant EU regulations on remuneration would not apply. (Points given for referring to these regulations in general and arguing why these rules either do apply or don't apply) The students can also discuss these issues as well from the capital protection perspective. But full points will be awarded, only if the mains issue – the duty of loyalty – is spotted.	5
Question 2 (20%)	20
Definition of insider dealing (ID)= trading in organized securities markets on the basis of material, privileged or non-public information in order to make a profit or avoid a loss Insider dealing law is necessary in order to promote the efficient pricing of securities and to enhance the integrity of the capital markets	1 1
Relationship based Rationale: ID= breach of the fiduciary relationship of trust and confidence, where one can be established between typically the insider and the Company concerned. Trading of equity securities from the company concerned on the basis of inside information is a form of theft from the company and indirectly extracts rents from shareholders. **Misappropriation Theory** = expansion of the relationship-based rationale: wrongdoer acts on the basis of information which is acquired through any fiduciary relationship and which is intended to be confidential. This theory is based on breach of duty owed to the person from whom the information was obtained. Tippee= insider if he or she had reason to suspect that the information obtained is from an inside source and as such unlawfully obtained **MAD 2003 =** > expansion of the notion of insider dealing beyond a fiduciary relationship between an insider and a Company. New EU law should also apply to other equities, eg. bonds, hybrid instruments, derivative contracts. Applicable to multiple trading facilities **MAR 2016=>** further expansion of the notion of insider dealing: The new law applies to any derivative contract, even organised trading facilities. Bilateral commodities trades are covered by MAR 2016; high frequency trades fall into MAR 2016= >departure from the original notion, ≠ steeling of information; ≠ extracting corporate property. Discuss whether the extension of the notion of insider dealing has gone too far or not / whether and to what extend it is justified: Contra expansion: Insider dealing enables the information to get faster into the	4 2 5 2 5

market which is beneficial for the market as a whole; Pro expansion: Insider dealing undermines the notion of fairness => less money invested into the market.	
Question 3 (20%)	20
The discussion should cover the following aspects: ➢ Definition of CSR: A form of corporate self-regulation integrated into a business model. ➢ Discuss whether the promotion of other societal values is in the best interest of the company and whether CSR good deeds tie into the fiduciary duty. Discuss what is in the best interest of the company = what is in the best interest of most of the shareholders o Pro: Image making is in the interest of the company (AP Smith Manufacturing Co. v. Barlow); o Contra: The duty is owed to most of the current and future shareholders = middle & long term profitability is in the best interest of the shareholders. The shareholders can decide themselves what do to with the profits earned and whether they want to use it for good deeds. o Include aspects such as the Halo Effect and the principle of separate legal entity ➢ Discuss what is the understanding of a company in corporate law. Does corporate law consider non-shareholder interests? How does CSR comply with the role of corporate law? Build your argument upon the existing company models o property model o Nexus of contracts model o social institution model	1 14 5
Question 4 (30%)	**Points**
a) Duty of care	15
Applicable law: UK law Issue = civil liability of auditors Tort liability = if no contractual relationship between plaintiff and defendant *i.e.* no contractual relationship between Eden Sharehan and P&L Audit Ltd Therefore, the question arises as to whom does P&L Audit Ltd owe a duty of care	4
UK law: Auditors owe a duty of care to the company in the interests of its shareholders	1
Case law: *Caparo Industries PLC v. Dickman* Under the Caparo test, three elements give rise to a duty of care: (i) foreseeability of damage, (ii) proximity and (iii) fair, just and reasonable to impose liability	10
Issue = with respect to the proximity element Is the relationship between the auditors and the shareholder proximate enough? Duty of care owed to shareholders as a class = in order for them to be able to exercise their	

class rights Duty of care owed to shareholders „for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to regard or control or remove those to whom that conduct has been confided" (*Caparo* case) But duty of care not owed to individual investors (in their individual capacity) *i.c.* Eden Sharehan = shareholder of Digital Assets Ltd Shareholders reelected the member of the board of directors Achille Taloon at the general meeting in reliance on audited reports that were published about 2 months before the general meeting. The shareholder Eden Sharehan would not have reelected Achille Taloon if the audited accounts were accurate. As a shareholder of Digital Assets Ltd, Eden Sharehan was owed a duty of care in order to be able to take an informed decision as to how to exercise class rights, i.e. to decide whether to reelect Achille Taloon or not. Therefore, P&L Audit Ltd owed a duty of care to Eden Sharehan in order to exercise his class rights (and not to him in his individual capacity).	
b) *Ex turpi causa* defense	15
Issue = to what extent auditors can assert the *ex turpi causa* defense to defeat the liquidator's claim of breach of duty of care = question of the civil liability of auditors in the case of insolvency of the company	
Case law: *Moore Stephens v. Stone & Rolls Ltd (in liq)* *Ex turpi causa* defense = illegality defense If wrongdoing is attributed to the company itself = like the company itself committed the wrongdoing. It is not possible for the company to rely on its own illegality to sue the auditors = applies in cases where there are no innocent directors or shareholders	5
= Duty of care not owed to creditors even in the case of insolvency proceedings Liquidator will not able to recover money for the creditors if auditors can assert the *ex turpi causa* defense	5
i.c. Achille Taloon committed the wrongdoing: Achille Taloon willfully produced inaccurate financial accounts that overestimated the value of Digital Assets Ltd. Achille Taloon was the sole member of the board of directors. However, there were innocent shareholders who relied on the inaccurate audited reports in order to vote at the general meeting and reelect Achille Taloon. Duty of care owed to the company in the interest of the shareholders = duty of care owed to the innocent shareholders that were not given the opportunity to exercise their class rights properly at the general meeting. Therefore, P&L Audit Ltd will not be able to defeat the liquidator's claim of breach of duty of care by asserting the *ex turpi causa* defense	5