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| Alternatives to Corporations |

# Sole Proprietorship

* Only **one** owner (no co-owners) 🡪 simplest and most widely used form of business
* Few formalities involved in establishing the business
* If a business operates under an assumed name, the proprietor will need to register the name under the *Ontario Business Names Act* so someone knows who to sue
	+ S. 2 🡪 requirement that if you carry on business under name that is not your personal name, you have to register it
* If business carries on specific trade, they may require a license
* Advantages:
	+ Simple
	+ Little involvement with government
	+ Tax advantages 🡪 if business is losing/not generating revenue, can offset losses with other income
* Disadvantages
	+ Unlimited liability 🡪 BIG RISK –if sued the owner could lose everything
	+ Can be tax disadvantages

## Three Types of Partnerships

1. General Partnership
2. Limited Partnership
3. LLP

Why do partnerships exist? 🡪 **So public knows whom to sue**

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| General Partnership |

# General Partnership

* Partnership is a form of business relationship that involves at least two “proprietors”
* Advantages
	+ Simpler than a corporation –Do not need to file forms, set up with government, etc.
	+ May have tax advantages
* Disadvantages
	+ Unlimited Liability 🡪 BIG RISK –if sued all general partners can lose everything; includes wrongs committed by partners in scope of partnership (i.e. if partner is sued, so are you)

## Partnerships Issues/Solutions

* Concerns with partnerships:
	+ 1) Relation to third parties 🡪 need principles that guide way to resolve conflict with non-partners
	+ 2) Relationship between partners 🡪 when partners have friction or conflict with one another
* Addressing these concerns:
	+ 1) Agency law 🡪 deals with concerns for relations to third parties
		- Agent has legal authority to bind principal in contracts 🡪 makes principal liable
		- Once an agency relationship has been established as a matter of law, if the agent commits a tort while carrying out their duties this ALSO binds the principal
		- **S. 6-20 of *Partnership Act***
	+ 2) Fiduciary law 🡪 deals with concerns within partnership
		- Two elements 🡪 includes both elements
			* 1) Integrity/good faith 🡪 will put partners’ interest first, be trustworthy
			* 2) Duty of care 🡪 diligence and care (competence)
		- **s. 29-31 of *Partnership Act***

Partnership Establishment 🡪 Two ways to establish:

1. Directly, consciously decide 🡪 enter into contract, formal agreement to start partnership
2. Acting in partnership 🡪 even if **not formally** established, implications of agency and fiduciary law still apply even if agreement is not formal –nature of business makes it a partnership

## *Beaudoin-Daigneault v. Richard (SCC, 1984)* 🡪 *partnership is matter of fact/nature; can be informal*

* Facts 🡪 couple broke up, only one name on farm –not legally married
* Ratio 🡪 partnership is a matter of FACT –if you are carrying on business as if it were a partnership, it does not matter if it were formally outlined

## Ontario P*artnership Act* 🡪 governs GENERAL partnerships

* *Partnership Act* does not use term “general partnerships” 🡪 just “partnership”
* All Canadian *Partnership Acts* are **PROVINCIAL** 🡪 No federal *Partnership Act*
* **S. 3** 🡪 rules for determining existence of partnership
* Fiduciary duty **s. 20-31**
	+ **CAN BE** **CONTRACTED OUT OF**
	+ **S. 24** 🡪 series of rules that apply between partners – (including equal profit sharing and losses)
	+ **S. 29** 🡪 every partner must account to firm any benefit derived (cannot skim)
	+ **S. 30** 🡪 partner cannot compete without consent of other partners
	+ **S. 45** 🡪 rules of equity continue –partnership does not replace all common law
* Agency Law **s. 6-19**
	+ **CANNOT CONTRACT OUT OF** any agency laws in relation to partnerships
	+ **S. 6** 🡪 every partner is a partnership with firm and all its agents –every partner can sign contracts and bind all the partners
	+ **S. 10** 🡪 ever partner in firm is jointly liable for debts and obligations (unlimited liability)
	+ **S. 11** 🡪 firm is liable to the extent that the wrongdoing partner is
	+ **S. 13** 🡪 every partner is jointly liable for all wrongs

## *Boudreau v Pierce 🡪 Partnership Act can be contracted out of but it must be indicated and does not apply for agency law ONLY fiduciary law*

* Facts 🡪 sole proprietorship running flower shop. Employee wanted in profits –owner agreed but no written agreement. Eventual fallout.
* Held 🡪 employee got half flower shop
* Ratio 🡪 *Partnership Act* can be contracted out of bit it must be indicated

## *Cox v Kickman 🡪 sharing profits does not equal partnership –must be intention of the parties to be partners*

* Sharing profits is NOT alone enough to suggest partnership 🡪 good indicator but not determinative
* Real test 🡪 **intention of the parties** –was it their intention to be in a parternship?

## *Continental Bank, Spire Freezers and Backman (SCC) 🡪 1) partnership can be for single transaction, 2) profit can be secondary purpose, 3) court will look at all factors to see if partnership exists*

* Three leading SCC cases that indicate when partnership exists and lay out certain important rules
* **Key takeaways from these cases:**
	+ Partnership may be formed for single transaction
	+ Profit can be an auxiliary purpose –does NOT need to be primary purpose but can be secondary
	+ Court will try and look at all the factors to determine if partnership exists –pragmatic approach *(Buckman, Spire Freezers)*

## *Backman Canada 🡪 can join partnership for alternate reasons, but must be primary intention to be a part of partnership*

* Facts 🡪 Canadians wanted to buy interest in existing partnership to generate tax loss and write off
* Reasoning 🡪 If you do stuff for tax reasons that’s fine and acceptable but it has to be because you WANT to form the partnership (intention to partnership). Here, intention was just to get tax break so not acceptable
* Held 🡪 no tax break

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| Limited Partnerships |

# Limited Partnerships

* Two or more persons carrying on business BUT there are two kinds of partners:
	+ 1) General Partner
		- Exposed to **unlimited liability**
		- NOTE: must there must be at least 1 general partner
		- General partner can be corporation
		- Makes all management decisions –cannot be employee because they ARE partnership
	+ 2) Limited Partner
		- Those who invest but cannot be sued beyond what they agree to invest –**limited liability**.
		- This partner CANNOT take control of the general running of the business but gets equity in return
		- Can put up cash/property as assets but cannot be services
	+ NOTE –If a partner gets hurt they cannot claim worker’s compensation because they ARE the partnership

## Limited Partnership Creation 🡪 *Limited Partnerships Act*

* Limited partnerships are created entirely by statute, unlike general partnerships
* **PROVINCIAL**
* To have limited partnership, declaration MUST be filed as per s. 3 🡪 last for 5 years
* Historically 🡪 came out of UK Limited Partnership Act, based on French model, income tax was created which allowed limited partnerships without a tax benefit (otherwise people would just incorporate)
* **Regulations** are passed by Governor General –mostly administrative
	+ **S. 2** 🡪 limited partnership can do anything general partnership can in terms of business
	+ **S. 3** 🡪 Limited partnership does not exist until declaration filed
	+ **S. 3.4** 🡪 lasts for 5 years and forgetting to renew does not automatically dissolve partnership
	+ **S. 4** 🡪 record of partners
	+ **S. 5 🡪** a person may be a general partner and a limited partner
	+ **S. 7** 🡪 limited partner contribution –money or other property but not services
	+ **S. 11 🡪** partners share profits
	+ **S. 12.2 (b)🡪** limited partner can be agent, employee or contractor from time to time
	+ **S. 16** 🡪 limited partner liable for money promised to be contributed
	+ **S. 8** 🡪 When limited partner dies, no impact on partnership but when general partner dies it does unless there is another general partner to carry on
	+ **S. 13** 🡪 limited partner control of business –limited partner is not liable as a general partner unless, in addition to exercising rights and powers as a limited partner, the limited partner takes part in the control of the business (loses limited liability at this point)

## *Haughton Graphic Ltd v. Zivot (1986, OJ) 🡪 limited partner who takes control of company becomes liable like a general partner*

* Facts 🡪 Haughton wants to sue someone with money so he went after Zivot, a limited partner. Zivot was a limited partner but he took part in the active control of the company, stated he represented corp, etc.
* Reasoning 🡪 Not just that he happened to be a director but that they actively managed, controlled daily motions, attended meetings, and took such an active role that he is liable as general partner
* Held 🡪 Zivot liable

## *Nordile Holdings v Breckenridge (BCCA, 1992) 🡪 limited partner who does not control is protected by limited liability –can contract out of liability.*

* Facts 🡪 Rental Company went into default and owed Nordile Holdings but couldn’t pay. Nordile went after Breckenridge, a limited partner. Here, P had admission that only D acted in capacity as limited partner and they had a contract that specifically had P promise not to sue.
* Reasoning
	+ Breckenridge only acted in capacity of director and manager as limited partner –admission that this is true
	+ In agreement, Breckenridge indicated they cannot be sued personally

## *Manitoba Limited Partnerships Act*

* Contrasts Ontario entirely\*\*
* If you are dealing with a person and they do not know you are a limited partner, once they find out the liability is gone –since they know you’re limited you are good
* Manitoba Act preferred by businessmen

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| Corporations |

# Corporations

## Corporations Basic Features

**NOTE** 🡪 no minimum share capital required to incorporate

* 1) Separate legal entity 🡪 “artificial person” –in all Ontario and federal statutes, the word “person” includes all corporations unless specified otherwise
	+ Most defining characteristic of corporations in all jurisdictions
* 2) Limited liability 🡪 Corporation does not have limited liability but the limited liability is for the **shareholders** (those who invest in the company). Shareholders cannot be sued only the corporation
	+ **BIG** advantage to eliminate unlimited liability
* 3) Perpetual existence 🡪 corporations do not die –steps taken to dissolve them they do not just expire
* 4) Centralized management allows for specialization under board of directors 🡪 which allows for specialization –gives power to those who specialize in different areas of the company (i.e. investing, managing, etc.)
* 5) Transferability of shares 🡪 in partnerships you cannot sell your interest in the relationship but in corporations shares can be transferred
* Disadvantage 🡪 you lose the tax advantages in corporations –losses cannot be used to offset the shareholders’ income but the corporation can offset its own income itself in future years
* Corporations **cannot be *owned*** –it is its own entity
* Sole proprietors can incorporate –you own 100% of the shares in this case, but STILL you are not the “owner” of the company

## History of Corporations

* UK Company Law is the influence for Canadian corporation law coupled with important American nuances
* First adopted for non-profit organizations, later adopted for for-profits during industrial revolution
* During age of exploration Crown saw corporations as artificial entity or regulated companies that would NOT carry on business but hold the monopoly to a right
* 1862 🡪 UK parliament consolidated corporate statute and passed first real general incorporations statute ***“Companies Act* of 1862”**🡪 Became basis for MANY corporate statutes around the world
* Two ways to incorporate in England historically
	+ 1) Special act of parliament
		- Request parliament to pass special act allowing creation of corporation –not used a lot
		- In Ontario still exists 🡪 i.e. creating universities (UWO was created by UWO Act)
	+ 2) Special grant of sovereign
		- Used more –but had to be connected to get special grant of sovereign
		- Since both were difficult -businessmen lobbied to make corporations easily available

## Three Types of General Incorporation Statute

1. Memorandum/Articles of Association
	* Fundamental underling principles is contract law
	* Registration jurisdiction 🡪 as a citizen you have a **RIGHT** to the corporation –just have to register, pay fee, etc. –rare that anyone is rejected because treated as a RIGHT not a privilege
	* UK Companies Act fits here, in Canada still adopted by BC and Nova Scotia
2. Letter Patents
	* NOT contractual 🡪 grant from government –you apply and they grant you patent for corporation
	* Crown is granting, so in theory government retains discretion (but rarely exercised)
	* Used to be common, now only one jurisdiction uses it in Canada 🡪 Prince Edward Island
3. Statutory Division of Powers Statute
	* Based largely on American system
	* Adopted by six provinces (including Ontario) and federal government

## Dickerson Committee

* “1971 – Tasked with examining the old Federal Incorporation Act, and recommend to Parliament ways to make it ‘state of the art’
* They drafted the ***Canada Business Corporations Act* 1975 (CBCA)**, with commentary on why every provision was included
* The **CBCA** was so well-received that the government of Ontario used it to create its own provincial incorporation statute – the ***Ontario Business Corporations Act* (OBCA)**

## Delaware: United States

* In USA –no federal statute, only by state and Delaware has the best one
* It is considered most incorporation friendly 🡪 majority of fortune 500 companies incorporated here

## Canada: Jurisdictions for Incorporating

* BC and Alberta are commonly chosen for incorporating jurisdiction because of their natural resources
* We do **not** see a “Delaware Phenomenon” in Canada
* But under special circumstances there might be some advantages to certain jurisdictions (i.e. no Canadian residency requirements for directors in BC)
* BUT hard to make the case that any province or jurisdiction is superior to another –all are pretty equal

## Advantages to Incorporating Under Federal Statute (CBCA)

* Name 🡪 can use across Canada (but theoretically easy for provinces to use in other provinces too)
* Location 🡪 flexibility
* Recognition 🡪 perceived “prestige” that comes with federal title (i.e. to overseas entities)
* **NOTE** 🡪 these advantages are not really “advantages” –about half incorporate under CBCA
	+ The provinces are flexible in letting corporations practice anywhere in Canada

## Form 1 🡪 CBCA Incorporation

* Form 1 is the CBCA Articles of Incorporation form on Government of Canada website
* Filling out Form:
	+ Corporate name 🡪 find name on NUANS send in proposed name 90 days before incorporating
	+ Province or territory
	+ Classes and any maximum number of shares 🡪 most choose unlimited to make it simple
	+ Restrictions of any share companies 🡪 **if public no restrictions**, but private corporations most likely want some restrictions (i.e. need consent to transfer shares)
	+ Minimum and maximum number of directors 🡪 private must have 1, public must have 3
	+ Restrictions on business carried on 🡪 do NOT need to specify or restrict –only reason one may restrict it if it were a shareholder stipulation –most have no restrictions

## Numbered Companies

* **S. 11(2) CBCA** 🡪 assigned number to register under if they cannot come up with name
* Can operate under difference name –just registered name is numbered

## Fundamental Incorporation Provisions

* **S. 5 CBCA** 🡪 outlines who can incorporate
* **S. 4 OBCA** 🡪 who can incorporate (identical to s. 5 of CBCA)
* Federal database –used to incorporate federally **AND** provincially

## Cautionary Suffix

* **S. 10(1)** of **OBCA** and **CBCA**
* This is the requirement of “Inc. or Ltd.” attached to business corporation –pick through list under s.10
* Called cautionary suffix because it “warns” the public this is a corporation

## Corporate Seal

* **S. 23 of CBCA** and **s. 13 of OBCA** outline the corporate seal
* A corporation may have a corporate seal but **not** necessary –historically was necessary
* Corporate seal in itself **MAY NOT** be enough to execute a contract under sale –need something more ***[Finlop]***

## *Salomon v Salomon & Co 🡪 corporation is a separate legal entity; foundational case that establishes rule*

* Prominent foundational case for establishing the doctrine that a corporation is an independent legal entity not to be identified with its incorporators
* Facts 🡪 Salomon began business as sole proprietorship. Decided to incorporate with family getting a share of the company. Salomon’s debenture was for £10,000, which happened to be the entire value of the company. The company went into liquidation with Salomon’s debentures ahead of unsecured creditors.
	+ **NOTE** 🡪 debenture ranks ahead of all insecurities and get paid first
* Takeaway:
	+ Salomon was not a sympathetic plaintiff –CA says he was trying to defraud creditors
	+ When this important case enters our law, it does not come in as a case where the courts said “we must help this poor person” –rather the HL should have ruled to the contrary
	+ The proposition that the **corporation is a separate entity** came form this case –controversial because this is not a proper example as Salomon was hiding behind his corporation
	+ **Corporate veil cases 🡪 runs against** extremely strong precedent of Salomon BUT Salomon has never been overturned
* Held 🡪 for D

## *Lee v Lee’s Air Farming (1961) 🡪 corporation is separate entity; worker can be considered separate from it*

* Facts 🡪 Lee was the sole employee, president and director of Lee’s Air Farming Ltd. He was killed in a plane crash while performing his duties as a worker of the company. Wife sued for worker’s compensation.
* Held 🡪 if you did all the steps right and set up a corporation properly, it behaves as a separate entity –you can be considered a worker separate from the entity

## Private Corporations vs. Publicly Held Corporations

* Private 🡪 shares not sold to public, often family business
* Publicly traded 🡪 bigger corporations with shares on stock exchange (available to public)
* Terms “public and private” not used in statutes
	+ **CBCA** 🡪 “distributing corporation” = public and “non-distributing” =private
	+ **OBCA** 🡪 “offering corporation” =public and “non-offering” =private

## Control Devices in Closely-Held Corporations

* There are a number of devices that may be used to allocate control and management powers and to protect the interests of both majority and minority shareholders in the close corporation. These devices and techniques include:
	+ (1) Classification of equity securities and allocation of such securities among the shareholders;
	+ (2) Class voting for directors;
	+ (3) Constitutional provisions requiring unanimity or high percentage votes for shareholder and director action;
	+ (4) Voting agreements and other agreements among shareholders; and
	+ (5) Voting trusts.
		- Instructs trustee how to vote the shares

## Review: Steps to Incorporating

1. Search/choose a name 🡪 NUANs search (name search company)
2. File articles of incorporation 🡪 fills out the necessary form and submits, pays the fee, fills out form saying who first director is
3. Receive back the certificate of incorporation 🡪 this becomes corporation constitution
	1. Point at which new artificial person comes into existence
	2. **S. 15** of **OBCA and CBCA**
4. Issue of shares 🡪 Hold organizational meeting (or if only one shareholder, just do written resolution) to decide on allocating shares
5. Pass a bylaw 🡪 documents dealing with organizational details (officers, seal, requirements for meetings)
6. Organizational resolutions 🡪 outlines who holds what title in the corporation –one person can hold multiple offices of the corporation or ALL of them (i.e. one person can be director, officer, treasurer, etc.)

## Why is corporation valuable?

* Allows for specialization 🡪 those with specialties in running business, investing, etc. can join forces and create business
* Capital “lock-in” 🡪 in a partnership people put their money in together, but it is possible for one to get out and dissolve the partnership (very destabilizing) but in corporations the capital is locked in –If you want out you cannot get the capital back (the money is committed)
* Limited liability 🡪 shareholders are not liable for debts of the company
* Asset partitioning/entity shielding 🡪 company is not liable for debts of shareholders either –assets of corporation are protected from shareholder floundering/debts

## Limited Liability

* Encourage risk-taking 🡪 but this is not the complete answer –they are already risk takers
* Justifications why it is valuable outside encouraging risk taking ***[Michelle & Easterbrook]***
	+ 1) Reduces costs to investors for monitoring managers
	+ 2) Reduce costs of monitoring other shareholders 🡪 if the company is sued without limited liability and the shareholders can be sued too, you want to know how many/who is a shareholder
	+ 3) Would make it impossible to have anonymous market where shares are traded 🡪 value of shares would vary depending on who had it and directors may act to benefit themselves at the expense of shareholders with unlimited liability
	+ 4) With limited liability, market value of company’s stock reflects info about how business is being run and not on outside factors –i.e. politics
	+ 5) Allows for diversifying portfolios 🡪 shareholders can invest in more companies without fear of losing everything from one
	+ 6) Allow corporations to make optimal investment decisions 🡪 if there were unlimited liability no matter how good the decision is, you cannot open yourself up to risk

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| Shareholder Agreements |

# Shareholder Agreements

* Allows for shareholders to:
	+ Pooling votes to elect person they wish to,
	+ Agreement in advance on votes
	+ Contractual obligation to ensure what was agreed upon is done (enforceable under statutes)
* **NOTE:** only shareholders can agree in advance **NOT** directors –directors are responsible to use discretion as things change and do what is best for the company so illogical to decide in advance

## Voting Trust Agreements

* At common law, voting trusts were valid and enforceable.
* Under a voting trust agreement, shareholders would place their shares in a trust.
* The trust document would include provisions instructing the trustee how to vote the shares.

## Directors Cannot Fetter Discretion

* Directors must use discretion at time of decision and cannot agree in advance like shareholders because it “fetters” their discretion as directors
* However, the mere fact that a shareholder was also a director did not, for that reason alone, render a voting agreement unenforceable ***[Greenwell]***

## *Greenwell v Porter (1902) 🡪 a shareholder may bind himself by contract not to vote or to vote in a particular way but directors cannot –if the director is a shareholder he is precluded from entering into a voting agreement not for the mere fact that he is a shareholder though*

* Facts 🡪 P brought action to enforce the agreement as it regards to voting
* Reasoning
	+ Directors cannot enter into an agreement with regard to their voting in respect of these shares although an ordinary shareholder can
	+ If shareholder is a director, he cannot enter into such an agreement

## *Ringuet v Bergeron (1960, SCC) 🡪 shareholder may agree by contract how they will vote their shares which is enforceable –if directors’ discretion is “fettered” then agreements are unenforceable but here it was contract on what directors would be voted in so it is acceptable*

* Facts 🡪 P and D and four others each held 50 shares –all shares in company. Had an agreement to get 50 shares from Frank and divide them from parties –would have control of company and agreed to vote in specific directors/management and would penalize if agreement breached. One of parties sued parties to contract for failing to transfer agreed upon shares.
* Held 🡪 For P
* Reasoning
	+ If the directors’ discretion was fettered – unenforceable.
	+ But here, the directors’ discretion was not fettered. Shareholders may always agree by contract in a closely-held company as to how they will vote their shares, and such an agreement is enforceable.

## Unanimous Shareholder Agreements (USA)

* **S. 146 of CBCA** and **s. 108 of OBCA** 🡪 important instrument for shareholders who have chosen to use one
* When a USA is in place it allows for the restriction and determination of management of the corporation
* Used to modify what would otherwise be the effects of statute
* Shares some attributes of a corporations articles and by-laws but rises to level of quasi-constitutional
* Most common for private shareholders but not prohibited for public companies (just not common)
* **NOT** every agreement signed by all shareholders is an USA it must have:
	+ 1) All shareholders signed
	+ 2) Some provision in it that restricts power of directors to manage

## *Duha Printers (Western) Ltd v The Queen (1998, SCC) 🡪 USA carries special weight and rises to a greater level of significance (corporate constitution level) than ordinary shareholder agreement*

* USA ranks with constitution and by-laws –much greater significance than ordinary agreements
* A mere agreement does not signal same weight in control as USA
* Significant in determining de jure control of the corporation

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| Piercing the Corporate Veil  |

# Lifting the Veil/Piercing the Veil

* When the principles of corporations (separate entity, limited liability) are disregarded and the court looks beyond the corporation as a separate legal entity
* Two instances where courts are willing to pierce the veil:
	+ 1) Corporation
		- Where corporation itself asks the courts to disregard the corporate personality ***(DHN Food Distributors Ltd.; Kosmopolous)***
	+ 2) Outside plaintiffs
		- Much more common where outsider is suing the corporation and the corporation has committed tort/breached contract but has no money –plaintiff wants to get at someone who has money such as the shareholder so they ask courts to pierce the veil ***(Transamerica Life Insurance; Chevron Corporation)***

## *DHN Food Distributors Ltd. v Tower Hamlets London Borough Council (1976, CA) 🡪 The corporate veil may be pierced where groups of companies can be treated as partners*

* Facts 🡪 DHN had subsidiaries. One subsidiary was subject to compulsory purchase and courts were asked if subsidiaries were treated as their own or as part of DHN in which DHN could recover.
* Reasoning
	+ Three companies were treated as one –so DHN can claim compensation
	+ These subsidiaries are bound entirely to the parent company and must do just what the parent company says… This group is virtually the same as a partnership in which all the three companies are partners. They should not be treated separately so as to be defeated on a technical point.

## *Adams v Cape 🡪 Salomon rule applies as default –cannot be disregarded to “do justice”*

* Facts 🡪UK Company bought corporation to do business in USA. Some Americans suffered harm. Plaintiffs brought action against Cape in USA. Cape argued USA had no jurisdiction to make judgment
* Reasoning
	+ If the subsidiary is an agent and commits a tort in the scope of its agency, then there may be liability 🡪 but there is NO presumption of agency
	+ For better or worse, the *Solomon* rule recognizes the distinction between subsidiaries and parent companies
* Ratio 🡪 there is no principle in law that to do justice, the court can disregard the *Solomon* rule

## *Kosmopolous v Constitution Insurance Co (1987, SCC) 🡪 Salomon rule is so fundamental courts will do whatever they can to refrain from piercing corporate veil, including changing other areas of law first*

* Big case for “lifting corporate veil”
* Facts 🡪 Mr. Kosmopolous incorporated his leather goods business. But his fire insurance policy still states P as the sole proprietor and not the corporation. Insurance refused to pay. P sued.
* Reasoning: Wilson
	+ Separation of legal entities is statutory so courts must follow as closely as possible (CBCA, OBCA)
	+ Lifting the veil (treating the business’ right to property insurance as if it was the same as the sole shareholder’s) would have allowed this plaintiff to enjoy the benefits of incorporation while avoiding the costs – so, the court chose not to separate the legal entities
* Held 🡪 As a corporate law matter, for D – P was not owed insurance. But as insurance law principal, for P (see note).
* Note 🡪 As an insurance law matter, SCC decided that Mr. Kosmopolous had insurable interest in his assets and could therefore recover (this reversed a longstanding principle, so his lawyer did not even try to argue this, rather argued piercing the corporate veil).
* Takeaways:
	+ We will change a whole other area of law before we pierce the veil –because that principle is not as important as upholding the *Solomon* rule

## *Transamerica Life Insurance v Canadian Life Assurance (1996, Ont) 🡪 courts will pierce corporate veil when evidence of 1) complete parent company control/domination 2) there is conduct akin to fraud*

* Facts 🡪 D’s subsidiary business, CLMS, handled P’s corporate loans. Did so negligently and lost P $60 million. P wanted to sue D as CLMS’s parent company but D claimed corporate wall separating them from subsidiary.
* Reasoning: Sharpe
	+ Courts will disregard separate legal personality of corporate entity only where:
		- 1) Complete control 🡪 subsidiary does not function independently, complete domination
		- 2) Conduct akin to fraud 🡪 evidence suggests subsidiary is shield for dealings
* Held 🡪 NOT piercing veil 🡪 no evidence of complete control or fraud behaviour

## *Yaiguaje v Chevron Corporation (ONCA, 2018)🡪 two part test from Transamerica applies –cannot pierce veil to find “just” outcome*

* Facts 🡪 Chevron caused damage in Ecuador. Ecuador citizens tried to sue Chevron in USA and failed. So they commenced action in Canada against Chevron Canada –a subsidiary of Chevron. Chevron Canada states it is a separate legal entity from Chevron
* Reasoning: majority 🡪 reasoning allows for **certainty**
	+ Plaintiffs cannot bring themselves within the two part test (***Transamerica****)* –suggest veil should be pierced to be “just” –appellants are asking for the law to be changed which is not acceptable
	+ Chevron Canada was set up to carry business in Canada and had nothing to do with this judgment
	+ The subsidiary is far removed from parent company
* Reasoning: concurring 🡪 reasoning allows more for **justice**
	+ Test from *Transamerica* is **NOT** only appropriate approach in deciding when to pierce veil
	+ But it is still not appropriate to pierce the veil here
* Held 🡪 no piercing of veil

## What to note about these cases:

1. Judge always invokes *Salomon* principle first
2. Principle is hard to discern 🡪 judges intuitively make judgment (i.e. when puppets, sham, etc.)
3. Judges are reluctant to pierce the veil

## Statutory Disregard for Separate Corporate Entity

* Some statutes impose liability on directors for certain actions regardless of *Salomon* rule
* Defence of due diligence
* **CBCA:**
	+ **S. 118** 🡪 directors who participate in certain kinds of prohibited corporate activities (i.e. improper payment of dividend) than the director can be held personally liable
	+ **S. 118(2)** 🡪 only directors who voted for/consented to illegal activity are liable
	+ **s. 119** 🡪 directors of a corporation are personally liable for unpaid employee wages up to 6 months under certain circumstances
* **OBCA**
	+ **S. 130** 🡪 same as s. 118 as CBCA
	+ **S. 130(2)** 🡪 same as s. 118(2) of CBCA
	+ **S. 131** 🡪 same as s. 119 of CBCA
* ***Income Tax Act***
	+ **S. 227.1** 🡪 employer has obligation to withhold tax from paycheck and remit it to Canada Revenue Agency –if a company fails to do that then directors are personally liable to pay that tax

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| Corporate Contracting, Criminal and Tort Liability |

# Corporate Contracting, Criminal, and Tort Liability

## Ultra Vires

* Corporations used to be required to include an “objects or objectives” clause in articles indicating what business the corporation would carry on
* Doctrine of ultra vires 🡪 refers to “the principle that certain incorporated bodies have no power to perform actions (typically involving entering into contracts with third parties) beyond those for which they were originally incorporated”
* Why was doctrine created?
	+ 1) Protect shareholders 🡪 make sure the money they invested is being used for the purpose they thought they were contributing to
	+ 2) Protect corporation 🡪 ensure they do not veer outside their object
* **NOTE:** today Canada does **NOT** use the doctrine
* Canadian revisions that replaced Ultra Vires Doctrine: **CBCA**
	+ **S. 15** 🡪 Corporations can enter into any contract they wish to with capacity of natural person
	+ **S. 16(1)** 🡪 consistent with s. 15 –do not need bylaws to give extra powers
	+ **S. 16(2)** 🡪 corporation can put in restrictions but if they do they have to abide by them (most people do not put restrictions) –**supports idea that ultra vires is not completely abolished**
	+ **S. 16(3)** 🡪 no act of corporation is invalid only by reason that it is contrary to an article
		- **NOTE: contradicts s. 16(2) –indicates ultra vires is gone**
		- **NOTE:** acting contrary AND having knowledge of restriction can be sufficient
	+ **S. 17** 🡪 you are not assumed to know something just because it is a public document
	+ **S. 18** 🡪 no corporation may assert against a person dealing with the corporation that a) the articles, bylaws and USA have not been complied with
		- I.e. cannot say you will not pay someone because it goes against the articles
	+ **S. 18(2)** 🡪 does not apply when they have knowledge by virtue of relationship to corporation
* Note: Unusually Canadian corporations say ultra vires has been abolished under CBCA and instead we have sections 15-18
	+ BUT under each section there is a little qualifier that there are traces of ultra vires
	+ Worry there may be some circumstances where it might make sense to set contract aside

## Indoor Management Rule

* Before the doctrine of constructive notice was abolished by statute, courts often had to address cases where the registered memorandum or articles provided that a corporation could enter into contractual relations upon compliance with certain internal procedures (e.g., approval by resolution of the directors).
* Rule form *Turquand* 🡪 an outsider could simply assume that the corporation had taken all necessary internal steps –thus what has become known as “indoor management rule” holds that an outsider is entitled to assume that a corporation has properly complied with all required internal procedures when entering a contract
* Instead of abolishing this rule, reformers attempted to codify the common law rule (see CBCA and OBCA)

## Corporate Contract Liability *(Freeman v Lockyer)*

* Agents **actual authority**
	+ With actual authority, the agent can sign any contract that binds the corporation
	+ An “actual” authority is a legal relationship between principal and agent created by a consensual agreement to which they alone are parties
	+ No issue because the person has actual authority to do so –legal implications when NO authority
* Agents with **apparent or ostensible authority**
	+ Legal relationship between the principal and the contractor created by a representation, intended to be that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the "apparent" authority
	+ Reasonable to assume apparent authority 🡪Agent can be assumed to have authority to enter into contract if it is reasonable to infer they had the authority to do so in the circumstances/context and it is relevant to their level/position –otherwise corporate business would never be able to carry on
	+ Unreasonable to assume apparent authority 🡪 in contrast a lower employee can be reasonably assumed to NOT have apparent authority to sign major contracts above their position/level
* **CBCA s. 18** 🡪 corporation is not able to say individual does not have actual authority when the role they occupy has apparent authority (i.e. CEO actions)
* Cannot be enough that agent states they have apparent authority 🡪 must be something more in the form of representation by the company

## Corporation Liability in Tort

* Vicarious liability 🡪 if agent commits tort in course of employment, principal is liable for actions (**MOST COMMON** for corporation liability in tort)
* Some statutory exemptions 🡪 i.e. person committing tort must be directing mind
* Direct liability possible (but rare)

## *Sullivan v Desrosiers (1986, CA) 🡪 being principal manager/employee and managing the day to day operations of company means they can be held personally liable*

* Facts 🡪 D had farming operation he incorporated. He had hog farm and smell constituted a nuisance. Claim was brought and at trial Sullivan, as sole shareholder of corporation, found personally liable. On appeal, Mr. Sullivan argued that he should not have been held personally liable because it was the corporation, and not him personally, that had created the nuisance
* Reasoning
	+ D is principal shareholder –also manager and principal employee
	+ D is responsible for day-to-day operations on that basis –he is responsible for creating and maintaining the nuisance
* Held 🡪 dismiss appeal –D held personally liable

## Corporate Liability under Criminal Law

* Amendments in 2004 that made it easier to hold corporations liable for crimes
* Three types of offences 🡪 strict liability, absolute liability and mens rea offence ***(Canadian Dredge***)
* Identification doctrine for mens rea 🡪 Company is liable when a crime is committed by senior employees, namely the "directing mind" of the corporation ***(Canadian Dredge; The “Rhone”)***

## *Canadian Dredge & Dock Company v R (1985, SCC) 🡪 three types of criminal liability for corporations; offences requiring mens rea require identification doctrine (party is the directing mind of company and can be considered primary representative)*

* Facts 🡪 P was a corporation that was charged with the criminal offence of conspiracy to defraud. Senior officers of the corporation (GM, VP) conspired with their peers at other companies to bid on subcontracts. Senior officers kept payments that were supposed to go to their companies.
* Held **🡪** For the Crown
* Reasoning: Estey J 🡪There are 3 classifications of criminal offences:
	+ 1) Absolute Liability Offences – *mens rea* is not relevant – no need for a new rule to dictate how corporations can be charged with absolute liability, they are treated as a natural person.
	+ 2) Strict Liability Offences – *actus reus* is sufficient without proving *mens rea* – liability between a corporation and an unincorporated legal individual is irrelevant – like absolute liability. Different from absolute liability because of the available due diligence defense
	+ **3) Offences Requiring Mens Rea**
		- Requires identification doctrine
	+ **Identification Doctrine** 🡪 allows for parties to be criminally prosecuted for corporation
		- Standard is flexible
		- Party involved must be proved to be a directing mind and can be considered a primary representative of the corporation’s mind

## *The “Rhone” v the “Peter AB Widener” (SCC, 1993) 🡪 to hold company liable, employee must be of “directing mind and will” of the company (i.e. governing authority and policy making authority)*

* Facts 🡪 A ship, the ‘Rhone” was damaged when struck by a barge “the Widener” in the Port of Montreal. Tugboats were pulling the barge when it struck the Rhone –one of the tugboats was the Ohio captained by Mr. Kelch and owned by the Great Lakes Towing Company. The owners of the Rhone sued the Great Lakes Towing Company. The basis of the claim was that the damage to the Rhône was caused by Captain Kelch’s negligence in towing the Widener, and the Great Lakes Towing Company was liable for Captain negligence
* Reasoning:
	+ It is not enough that Kelch was an employee of the corporation –he needed a role of directing mind and will (high position within corporation with discretion and authority in scope of position)
	+ He needs sufficient governing executive authority and policy making authority to be directing mind and will
* Held 🡪 Kelch did not have sufficient authority so he was not the directing mind and will

## Amendment Post-2004

* Bill C-45 🡪 supplements common law –statutory authority built off *Canadian Dredge*
	+ Set out what an organization was and how it can be charged as a party to a criminal offence (negligence or direct fault)
	+ Statutory standard for criminal liability of corporations in Canada
	+ Added s. 22.1 and 22.2 to CC
* **S. 22.1 of Criminal Code** 🡪 negligence
	+ Senior officer must involved at some level for the corporation to be liable but can be representative who must play important role in organization of company’s policy or is responsible for managing important aspect of organization’s operations
* **S. 22.2 of Criminal Code** 🡪 full mens rea offences
	+ Senior officer who is a party to an offence or has the mental state required to be a party, directs the work of other representatives to do the act
* **NOTE:** these provisions do not absolve individuals of personal criminal liability, it just adds on the corporation

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| Pre-Incorporation Contracts |

# Pre-Incorporation Contract

* Pre-incorporation contract law is difficult because if a corporation genuinely is a separate entity a contract cannot be made before it comes into existence –somewhat incoherent /difficult area
* Generally, pre-incorporation contracts are **NOT** effective because corporation does not yet exist –cannot be agent for non-existent corporation (***Kelner v Baxter***) 🡪 here, actors can be found personally liable and bound
* FORM OF SIGNATURE MATTERS 🡪 signing “as corporation” (not liable because no corporation yet) vs. signing “on behalf of corporation” (personally liable)
* Issues solved?
	+ Competing notions 🡪 pre-incorporation contracts want it both ways that corporation is a legal entity and that it is not yet –issues are unsolvable
	+ CBCA and OBCA do not sufficiently address these issues or fix anything

## *Kelner v Baxter 🡪 sets out the rule for pre-incorporated contracts –cannot contract for company that does not “exist” yet and actors can be found to be personally bound when they do so*

* Facts 🡪 contract for the sale of wine. Kelner was selling it to Baxter on behalf of the corporation. They stated they were contracting “on behalf of the company”.
* Held 🡪 personally liable
* Ratio
	+ Pre-incorporation contracts not effective because the corporation is a new being so it cannot have rights or responsibilities when it does not yet exist –cannot be an agent for a non-existent entity (rigid formalistic view)
	+ If there is evidence the actors themselves are being bound than they will be bound

## *Newborne v. Sensolid 🡪 cannot sign as corporation when it does not “exist” –signing in name of corporation that does not exist yet means no contract (turns on arbitrary wording)*

* Actors signed in name of corporation despite not being incorporated yet
* Signed as “someone” who is non-existent so contract does not exist –not personally liable
* Criticism 🡪 turns on arbitrary wording

## *Black v. Smallwood 🡪 reinforces Newborne that cannot be liable when actors did NOT intend to contract on behalf of non-existent company*

* Facts 🡪 parties were promoters and entered into contract –mistakenly thought company was registered
* Held 🡪 not personally liable
* Reasoning
	+ The respondents did not contract, or purport to contract, on behalf of the non-existent company. They simply subscribed the name of the non-existent company and added their own signatures as directors in the belief that the company had been formed and that they were directors.
	+ Decision in ***Newborne*** was correct

## *Wickberg v Shatsky 🡪 person signing for non-existent company is not automatically liable –here P knew the company was not incorporated and D did not intend to be personally liable.*

* Facts 🡪 P signed written employment contract that he was general manager of a non-existent company. D, as president of the company, signed contract. D later fired P and P sued.
* Reasoning
	+ Where the agent is not personally liable on the contract, an action for breach of warranty of authority would only produce nominal damages, because since the company or association has no existence and so no funds, it would hardly be possible to prove a loss arising from the lack of authority. Any effective liability would have to be in deceit, or possibly in negligence.
* Held 🡪 for D –not personally liable only nominal damages

## Statutes Changing Common Law:

**CBCA**

* **S. 14(1)** 🡪 actor entering into contract on behalf of corporation before existence is personally liable
* **S. 14(2)** 🡪 corporation after coming into existence may signify its intention to be bound before it came into existence in its name or on its behalf
	+ **A)** This adoption means corporation is bound by contract and entitled to its benefits
	+ **B)** The person who acted in the name or behalf ceases to be bound
* **S. 14(3)** 🡪 court discretion
* **S. 14(4)** 🡪 exemption clause –actor not personally bound if expressly indicated in contract

**OBCA**

* **S. 21(1)** 🡪 person who enters into both oral and written contracts on behalf of corporation before it exists is personally bound
	+ NOTE: applies to both **written and oral** contracts unlike CBCA
* **S. 21(2.1)** 🡪 Extra provision where a contract can be assigned amended or terminated before corporation comes into existence
* **S. 21(2)** 🡪 corporation after coming into existence may signify its intention to be bound before it came into existence in its name or on its behalf
* **S. 21(4)** 🡪 can contract out of liability

## *Sherwood Designs (ONCA) 🡪 s. 21(2) of OBCA requires common sense approach –an action that signifies intention to be bound means corporation is bound*

* Facts 🡪 Sherwood selling business and entered into contract with King (acting on behalf of company not yet in existence). King went to get number for corporation from lawyer but did not incorporate. Number for corporation was recycled by firm and used by new company who bought a building. Sherwood sued the numbered corporation listed on contract that wasn’t King and happened to be used by new corporation.
* Held 🡪 for Sherwood
* Reasoning: Majority (Abella)
	+ Cannot escape common sense interpretation of s. 21(2) of OBCA –any action or conduct signifying intention to be bound
	+ Indicating the number of corporation from the lawyer (agent for corporation) constitutes adoption
	+ The least a corporation has to do to still accept a contract
* Reasoning: Dissent (Borans)
	+ Abella made a mistake in interpreting s. 21(2)
	+ There was no intention of the NEW numbered company to be bound to Sherwood
* THIS IS STILL THE LAW –HAS NOT BEEN REVERSED
* **Note**: Issue - there is no principle difference between what happened here and some stranger writing a letter “on behalf of Microsoft” to enter into a contract.
* **Note:** NOW, numbered companies are NOT re-used by firms to avoid situations similar to this.

## *Szeckett v Huang (1998, ONCA) 🡪 even if intention is to NOT be personally bound, there must be evidence to that effect –contract out of personal liability easiest solution (s. 14(4))*

* Facts 🡪 two individuals signed agreement with D to develop technology. D was to incorporate to manufacture technology. In pre-corporation negotiations one of P said he wanted D to be personally liable, D said no. Project did not go forward because D did not incorporate.
* Held 🡪 for P –D is personally liable
* Reasoning
	+ Even though he could prove that he intended NOT to be personally bound, evidence of this is not an explicit contractual agreement. Intention is not enough
	+ If he did not want to be bound he should have contracted out –s. 14(4) of the CBCA
* Note **🡪** How did they determine that the company that had not yet incorporated would have been a corporation under OBCA rather than the CBCA? The companies were in Hong Kong!
	+ This is contract law, which is provincial jurisdiction. Which means s. 14 of CBCA could even be *ultra vires*. The courts never deal with this issue. You can’t link a corporation that doesn’t exist.
	+ Incoherent area of the law –legislatures did not address the fundamental problem of contradictory premises here

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| Corporate Finance |

# Corporate Finance

## Debt vs. Equity

* Two basic ways for corporations to raise money to carry on business:
	+ 1) **Borrow** money (this is “debt financing”)
	+ 2) **Issue (and sell)** shares (this is “equity financing”)

## Debt 🡪 borrowing money

* When a corporation borrows money, this creates a contractual debtor-creditor relationship: the corporation becomes the **debtor** and the person lending money becomes the **creditor**
* Two options for borrowing money
	+ 1) Loan agreement with lenders (such as bank)
	+ 2) Debt securities 🡪 corporation gets money and issues bonds, debentures, or notes to investors
* **CBCA s. 189 and OBCA s. 184** 🡪 give directors power to borrow money on credit of the corporate
* The debt securities issued by the corporation to investors states:
	+ 1) **WHEN** the corporation must repay the money (the principle)
	+ 2) How much **INTEREST** the corporation must pay on that money
	+ 3) WHEN the corporation must make **interest payments** (monthly, annually, etc.)

## Fundamental Features of Equity 🡪 Shares

* There are three basic share attributes **CBCA s. 24**
	+ 1) Right to attend shareholder meetings and **vote** (on election of directors)
	+ 2) Right to a **return of capital on winding up** (but only after all debts have been paid FULLY)
	+ 3) Right to receive **dividends** if and when “declared” by corporation
* NOTE 🡪 **s. 22** **OBCA does not have a right to receive dividends as right of shareholder**
* If corporation only has one class of shares (i.e. type or kind) those shares MUST include those three rights
* If corporation has more than one class of shares, no one single class is required to have ALL these rights but they **must** be granted/divided among the classes however the corporation likes

## Preferred vs. Common Shares

* Common shares 🡪 Represent the residual interest of holders –if corporation prospers, the increase in value accrues to the common shares but also bear biggest burden if corporation suffers losses
* Preferred share 🡪 normally given a fixed dividend rate, usually expressed as a percentage of the share’s initial issue price –if corporation suffers, receive a fixed return of capital before common shareholders do

## Authorized Capital vs. Issued Share Capital

Authorized Shares

* The “authorized capital” refers to the total (maximum) number of shares that a corporation is authorized, under the articles of incorporation, to issue
* **CBCA s. 6 and OBCA Form 1 Item 6** 🡪 corporation is PERMITTED to limit maximum number of shares it authorizes but it is not required to do so –aka can authorize unlimited shares

Issued and Outstanding Shares

* Shares that have actually been sold by the corporation to investors (issued) and have not subsequently been repurchased by corporation or redeemed (outstanding in hands of shareholders)
* Outstanding shares can NEVER be greater than number of authorized shares

## Issuance of Shares

* Par value shares are **NO** longer permitted under CBCA or OBCA
	+ Shares that had a dollar figure on it indicating the value of the company at the time of issuance
	+ Dickerson committee did not like par value shares –market value after issuance does not match initial value
* Shares must be **fully-paid** before they may be issued 🡪 **CBCA s. 25(3) and OBCA s. 23(3)**
	+ Can be paid in money, property, or past services that are not less in value of what its worth
* Shares must be in **registered** form 🡪 **CBCA s. 24(1) and OBCA s. 22(1)**

## Issuance of New Shares

* A purchaser of shares **subscribes** for shares (and tenders the purchase price)
* If the corporation accepts the subscription, the directors then **allot and issue** the shares (either by a resolution passed by majority of directors at a meeting, or in written resolution singed by ALL directors)
* The name and address of the shareholder is then recorded in the **share register** (which, in the case of private corporations, is kept in the minutes book)
* The corporation may deliver a **share certificate** to the shareholder, the certificate is NOT the share but is **evidence** of the share

## Purchasing Shares on Stock Exchange

* Most Canadians who hold shares did NOT buy new shares directly from corporation
* Instead, most purchase their shares on a stock exchange from other shareholders (“previously owned”)
* Money used to purchase from stock exchange does NOT go to corporation –goes to selling shareholder

## Presumed Equality of Shares

* At common law, shares are presumed to be equal **UNLESS** the share conditions specify (***Birch v Copper)***
* What does the principle of equality mean in practice? Consider the following cases:
	+ *Mujo v Sunwest Projects Ltd.*
	+ *McClurg v Canada*
	+ *Bowater Canadian Ltd v RL Crain Inc*

## *Birch v Cropper🡪 default = all shares rank equally unless specific provision in share condition says otherwise*

* All shares rank equally and if there is to be a preference, this doctrine of equality must be overcome by some specific provision in the share conditions
* Where preferred share conditions are silent with respect to either as a preference as to dividend or return of capital, then in that respect they will have the same rights as ordinary shareholders

## *Muljo v Sunwest Projects Ltd (1991, BCCA) 🡪 presumed equality of shares means each share has the same share interest (equality of shareholders) not of purchase price*

* Facts 🡪 two shareholders –first took 200 shares paid $1. Other goes to buyer who offers 200 shares for hundreds more $. Company winds up. Shareholder who paid more $ wants more $.
* Reasoning 🡪 shares are equal and have exact same rights. Those holding the same number of shares have the same share interests –does not matter how much was paid for them.
* Note 🡪 both P and D argued *Birch v Cropper*
	+ One said equality =equality of money (P)
	+ Other said equality =equal as shareholders (D)
* D’s interpretation of equality of shareholders was correct

## *McClurg v Canada (1990, SCC) 🡪 even a trivial difference in shareholder rights can be enough to constitute separate classes of shares as long as articles of incorporation indicate so*

* Facts 🡪 McClurgs set up family business –each had different shares. At end of year declared dividends based on their salaries –chose whatever had lowest taxes. Had “discretionary dividend clause” in articles of incorporation. Canada National Revenue argued this is the same class of shares –the human being holding the share should not be what distinguishes when the nature of the shares is the same.
* Reasoning: Dickson (majority)
	+ There are separate classes of shares –it is enough that dividend rights differ
	+ A discretionary dividend clause is sufficient to rebut the presumption of shareholder equality
* Reasoning: La Forest (dissent)
	+ This will create dangerous precedent if companies are allowed to look at who holds shares and allows them to arrange their shares accordingly
	+ It contravenes principle that directors are not permitted to favour one class at expense of others

## *Bowater Canadian Ltd v RL Crain Inc (1987, Ont CA) 🡪opposite McClurg –share rights attach to the share itself and do not vary depending on holder of the share*

* Facts 🡪 P challenged D’s articles of incorporation that allowed step-down shares (some shareholders entitled to 10 votes, some 1) Structure put in place at time company was sold to entice shareholders. Original shareholder (with 10 votes) sells to P (who now has 1) –P was aware of clause.
* Reasoning
	+ Agrees with dissent in *McClurg* –company deciding shares based on person holding it
	+ Share rights are rights that attach to the share itself and cannot vary depending on the human being that owns them. If there was not equality of rights within a class of shareholders, there would be great opportunity for fraud. Step-down provision struck out.
* Held 🡪 for P
* **Note**: opposite to *McClurg* holding

## Dividend

* A dividend is a distribution of money or property paid by the corporation to shareholders
* Only the directors can declare dividends
* The payment of dividends is always within the discretion of the directors **AND** subject to specific statutory rules intended to prevent corporations from paying dividends under circumstances that might impair the corporation’s ability to pay its creditors
	+ **DEBT RANKS AHEAD OF EQUITY –**restriction on dividends payments

## How Dividends are Declared and Paid

* Directors first **declare** a dividend (by resolution). The declaration will state:
	+ 1) The “record date” (i.e. date on which a shareholder’s name must appear in the share register to be entitled to receive the dividend)
	+ 2) The payment date (date when dividend will actually be paid)
* Once a dividend has been declared, it becomes a debt of the corporation, so if it is not actually paid, the shareholders may sue to enforce payment

## Limits on Payment of Dividends

* **CBCA s. 42 and OBCA s. 38** 🡪 a corporation cannot declare or pay a dividend is the corporation would be unable to pay its liabilities or its assets are less than its debts
	+ As soon as dividends are declared they become **DEBTS** of company
* This means company cannot pay dividend if there would:
	+ 1) Not be enough money to pay creditors/debts/liabilities and
	+ 2) Assets would be depleted completely by paying dividends 🡪 balance & check test/insolvency test must be passed
* It is illegal to break this law, and if directors do so they are **personally liable** to pay the debts now

## Cumulative vs. Non-Cumulative Dividends

* Some preferred shares have a stated dividend or dividend rate
* These dividends may be:
	+ **1) Cumulative** 🡪 you get a dividend in a year and if directors don’t pay, it accumulates to next year
	+ **2) Non-Cumulative** 🡪 share gets you the same price a year, if company does not pay in a given year it does NOT carry forward to next year (extinguished completely)

**Preferred Shares Premise**

* They rank behind creditors but before common shareholders (if specified) on a voluntary or involuntary dissolution of the company
* Premises decided by UK and Canada Courts:
	+ 1) Shares are to be treated as equal unless articles stated otherwise
	+ 2) Preferred shares look a lot like debt –fixed rate for purchase fixed rate when winding up
	+ 3) Those who buy preferred shares do not expect an upside –they look like bonds
* So why do people buy preferred shares? 🡪 Price (cheaper than common shares)

## *Westfair Foods Ltd v Watt (1991, CA) 🡪 cannot unfairly disregard the interests of one class of shareholders (preferential) in favour of the other (common)*

* Facts 🡪 Appellant is a public corporation with two classes of shares –Class A and common shares. Corporation adopted a new policy that distributed its net annual earnings as dividends. Class A shares had interest in retained earnings, so it was argued by those shareholders as oppressive. TJ found for D.
* Held 🡪 for P –appeal dismissed
* Reasoning
	+ Class A shareholders expected their interest in retained earnings to be maintained – they expected to share in the business success or failure of the corporation. Altering the relationship between the classes of shares in the marketplace unfairly prejudiced class A shares.
	+ The corporation relied narrowly on the rights of the shareholders as outlined in shareholders’ agreement and did not consider their interests
		- Legal rights may derive from the reasonable expectations of shareholders regarding their relationship to other corporate constituents

## *Re Canada Tea Co (1959, Ont HC) 🡪 preference shareholders are not entitled to debts of dividends over common shareholders in the distribution of assets when a company winds up*

* Facts 🡪 Company winding up and needs to determine respective rights of the common and preferred shareholders. Clause in winding up resolution that outlined rights of each shareholder class.
* Held 🡪 there will be an order determining that the preference shareholders of the company are not entitled to debts of dividend in preference to the common shareholders in the distribution of the assets of the company in the winding-up.

## Redeemable Preferred Shares

* At common law, corporations are **NOT** permitted to purchase their own shares from their shareholders **(*Trevor v Whitworth)***
* The CBCA and OBCA now **do permit** corporations to redeem or otherwise purchase their own shares, permitted they comply with specific statutory rules indented to ensure that corporations do not return the money to their shareholders under circumstances that would improperly impair the corporation’s ability to satisfy their debts
	+ **CBCA ss. 34-36** and **OBCA ss. 30-32**

## *Trevor v Whitworth (1887, HL) 🡪 company cannot purchase its own shares –it is an ultra vires activity*

* Facts 🡪 Corporation in UK –Shofield bought shares on behalf of the company from deceased Whitworth. Shares were paid for partly by cash and partly by promissory note. Company wound up and respondents claimed the amount owing on note. It was found purchase of shares was on behalf of company and not on Schofiled’s own account.
* Issue 🡪 Does company have power to purchase its own shares?
* Held 🡪 company cannot purchase own shares –respondents cannot recover purchase price
* Reasoning
	+ A purchase by the company with a view to resale would amount to trafficking in its own shares, an *ultra vires* activity
	+ A purchase with the intention of retaining the shares would amount to an unauthorized reduction of capital

## Convertible Preferred Shares

* Shares or debt instruments may be **converted** at the option of the holder into other types of shares
	+ Built in feature where they can be converted into common shares
	+ Makes them more valuable –common practice to build this in
	+ Some are convertible and some aren’t –market decision on what investors want and what appeals to them

## Debt v Equity Comparison Chart

|  |  |  |
| --- | --- | --- |
|  | **Debt (crediors)** | **Equity (shareholders)** |
| Tax Deductibility  | Corporations can **deduct** interest paid on debt in calculating its taxable income (and so pay less) | Corporations **cannot** deduct dividends it pays on shares in calculating its taxable income |
| Potential | Holders of debt (i.e. lenders) **cannot** receive more | Shareholders **may** share in increasing value of corporation in which they own shares. If corporation does well =increase in value of shares |
| Upside gain for investors | Money back from corporation is greater that what they loaned –**because interest payments are fixed, no dilution of earnings** (benefits but also risk of “leverage”) | Shareholders may share in increasing value of corporation. BUT some preferred shares are fixed-income securities and so do not have such an upside value |
| Voting rights | Do NOT get voting rights –**therefore, no dilution of voting control** | Holders of shares **get voting rights** at each annual meeting and to approve other major corporate changes |
| Right to sue corporation for non-payment | Relationship is **contractual** –they can sue if they fail to pay | Holders of share **CANNOT** sue to force corporation to declare dividends –BUT can sue if they declared them but didn’t pay |
| “Ranking” on winding up | **DEBT RANKS AHEAD OF EQUITY** –debt holders are paid in full before any distribution is made to shareholders | Receive NOTHING in wind up unless debt holders have been paid –**DEBT RANKS AHEAD OF EQUITY** Classes of shares indicate order of pay –if forgot to declare all shares treated equally  |

## Basic Financial Statements:

* Statement of financial position (balance sheet)
* Income statement (statement of comprehensive income as required under IFRS)
* Statement of cash flows
* Statement of retained earnings/statement of changes in equity

## Balance Sheet

* Provides a “snapshot” of the corporation’s financial position as of that specific day
* The fundamental balance sheet identity:
	+ **Assets = Liabilities + Shareholder’s Equity**
	+ **Liabilities = Assets –Shareholder’s Equity**
	+ **Shareholder’s Equity = Assets –Liabilities**
* Assets are reported if they have a future economic benefit –those with no future benefit are taken off
	+ Current vs. non-current assets 🡪 current =those expected to be consumed or converted into cash within one year (i.e. cash, supplies, inventory)
	+ Current vs. non-current liabilities 🡪 current are those liabilities expected to be paid within one year
* Set up of balance sheet (typically)
	+ Left side outlines assets 🡪 what corporation **OWNS**
	+ Right side outlines liabilities (and equity) 🡪 what corporation **OWES**

## Income Statements (or statement of operations)

* Summarized financial performance **over the accounting period** (e.g. for a year or a quarter-year period)
* Formula:
	+ **Revenue – Expenses =Net Income (or loss)**
* Note 🡪 the income statement is not a valuation of the company –typically reflects historic costs NOT market value

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| Director-Shareholder Dichotomy  |

# Director/Shareholder Dichotomy

## Authority

* **CBCA s. 102** and **OBCA s. 115** 🡪 director has authority to direct/supervisor management of corporation
* **CBCA s. 103** and **OBCA s. 116** 🡪 directors have power to make, amend, repeal bylaws in regulating business
* This is **NOT** delegated power –Acts give the mandate
	+ With exception of unanimous shareholder agreements
* Basic structure of business:
	+ Shareholders 🡪 elect Directors 🡪 who appoint Officers
* Issue 🡪 shareholders think they are owners of corporation but they are not –they own a bundle of rights but corporation is not a thing that can be owned as a matter of law. The shareholders relationship to the corporation is the closest it gets to ownership. Creates issues with governance.

## *Automatic Self Cleansing Filter Syndicate v Cuninghame (CA, 1906) 🡪directors have the power to run/manage the company as vested by the shareholders –cannot simply be revoked*

* Facts 🡪 Articles of company vested authority to manage business in directors. M owned 55% of shares. M wanted to sell company –board did not want to. M could not get approval of three-fourths of shareholders, instead simple majority of 55% voted to pass resolution for sale. M took company to court to force the sale.
* Note 🡪 in 1906 the CBCA was not in effect –today this would be a non-issue
* Reasoning
	+ Shareholders had vested power in directors to act via articles of incorporation –cannot simply revoke this power and make substantial decisions by a simple majority of shareholders
* Ratio 🡪 once shareholders have delegated power to the directors in memorandum, directors have power to manage and shareholders cannot simply revoke it except in accordance with the articles

## Shareholder Authority

* Every resolution passed by shareholders are precatory (advisory) –directors not bound to follow
* Institutional shareholders
	+ Not just general commercial enterprises –they’re businesses that exist to invest shares (i.e. insurance companies, hedge funds)
	+ The nature of investment has changed to allow Canadians to hold their savings in mutual funds, investments, etc.
	+ Institutional shareholders are important to placing new issues of stocks and bonds, as they can afford to buy more of an issue than individual investors.
	+ Is this a good or bad system?
		- Institutions need to meet their own goals, reports so they may be incentivized to pressure companies to make more profit in the short term that could hurt them in the long term 🡪 investors become too short termed focused

## Number of Directors

* **CBCA s. 102(2)** 🡪 only one director required unless corporation is a distributing corporation with outstanding shares held by more than one person
* **OBCA s. 115(2)** 🡪 only one director required unless it is an offering corporation
* However, the CBCA and the OBCA, while permitting the “one-person corporation,” do require corporations to have at least three directors if, in the case of the CBCA the corporation is a distributing corporation with outstanding shares held by more than one person or, in the case of the OBCA, is the corporation is an offering corporation.

## Qualification of Director

* At most, the statutes require a director to be an individual (i.e., not a corporation) over the age of majority and not an undischarged bankrupt or of unsound mind or incapable and so found by a court 🡪 **CBCA, s. 105; OBCA, s. 118**

## Outside Directors

* Modern corporation statutes often require at least two directors of public corporations to be outsiders, i.e., they must not be officers or employees of the corporation or any affiliate corporation 🡪 **CBCA, s.102(2);**
* At least 1/3rd of public corporation directors must NOT be officers or employees of the corporation or its affiliates **OBCA, s. 115(3)).**

## Removal, Election and Terms of Directors

* **S. 106 of CBCA** and **s. 119 of OBCA**
	+ **106(3)** Board of directors can be elected by the shareholders in a general meeting
	+ **106 (4)** Directors are permitted 3 year terms and staggers so continuity of board is ensured
* **S. 109 CBCA** and **s. 122 OBCA**
	+ Shareholders may remove directors at any time by ordinary resolution (simple majority vote), except in cases where the corporation’s articles provide for cumulative voting

## Director Power/Delegation

* **S. 115, s. 121 CBCA** and **s. 127, s. 133 OBCA**
	+ Directors CANNOT delegate certain powers to officers
	+ This includes 🡪 declaring dividends, approving proxy circular, approve financial statements, adopt/amend bylaws, issue shares, fill a vacancy among directors, approve shareholders

## Directors Resolutions –Quorum

* Not outlined in the Acts 🡪 has to be unanimous because there is no opportunity to discuss
* If a quorum of members cannot be at the meeting a resolution in writing signed by all directors entitled to vote on that resolution is valid and effectual as if passed at a meeting **🡪 CBCA s. 117** and **OBCA s. 129**

## Appointment of Auditor

* **Ss. 161-172 of CBCA** and ss. **149-145 OBCA** outline the appointment and role of auditors
* Public corporations **MUST** by law have an auditor
* Private corporation
	+ If it is a private corporation, they do NOT need an auditor –it is at discretion of company if they want one
	+ It must be unanimous from shareholders to decide to formally dispense of an auditor for non-offering/non-distributing companies
		- **CBCA s. 163** and **OBCA s. 148**

## Shareholder’s Access to Records

* **S. 21 CBCA** and **s. 145 of OBCA** 🡪 permit the inspection by shareholders and creditors and in some circumstances any person of shareholders' registers and certain other information in the possession of the corporation
* They can access records such are 🡪 registry, land title division, etc.
* They can have minutes from the shareholders meeting but **NOT from the director’s meetings** 🡪 it is not enumerated in **s. 21** for a reason
	+ There is stuff talked about in directors meetings that are confidential and there is no way to share just with shareholders because that would permit the public to know this information
	+ Part of the reason we cannot have shareholders interfering in directors’ authority is because they do not have all the information and are not permitted to
* Exception **CBCA s. 120(6.1)** and **OBCA no equivalent** 🡪 Even though shareholders cannot normally see directors minutes, they are allowed to see portions of the minutes where disclosure was given

## Director Residency Requirements

* **Ss. 105(3)(4), s. 2(1) definition of “resident Canadian” in CBCA** outlines requirements
* **S. 118(3), s. 1(1) definition of ”resident Canadian” in OBCA**
	+ Both the CBCA and OBCA require at least 25% of directors be resident Canadians
	+ BUT definitions differ between the two Acts
		- Under **OBCA** 🡪 as long as permanent resident you are fine
		- Under **CBCA** 🡪 permanent residents who do not obtain their permanent citizenship within a year are excluded as “resident Canadian”
			* Major issue 🡪 pressure to become a citizen with CBCA description and inconsistent with immigration policies in Canada for employment–CBCA BAD DEFINITON

## Relationship between Shareholders-Directors

* Two competing concerns:
	+ 1) Since directors are only responsible to shareholders (i.e. only shareholders can replace them) we expect directors are only worried about shareholder’s interest and trumping all others of company
	+ 2) Although shareholders have right to vote, it is not an important power directors are afraid of –directors effectively control not only corporation but in stealth way the voting process
* Shareholders alone among all the other persons that transact voluntarily with the corporation have **no** contractual rights and have a financial claim against the corporation’s assets BUT it ranks at the bottom (behind debts)
* For this reason scholars argue corporate law should impose a duty on directors to act in a way to maximize the value of the shareholders agreement because they stand at the end of the line, so all ahead of them would have a protected interest too
* What is the correct relationship between shareholders and directors?
	+ We turn to the mechanics of shareholder control
	+ Shareholders now have more of a voice and can try and get their ideas across
		- Investors can launch proxy contests at shareholder meetings (extreme option)
		- Investors can launch a shareholder proposal (less extreme option)

## Voting Powers

* **S. 140(1) CBCA** and **s. 102(1) OBCA** 🡪 general rule: each share entitles holder to one vote
* Shareholders who vote are voting on resolutions
* Voting is usually by show of hands OR by ballot
	+ Both **CBCA s. 141(1)** and **OBCA s. 103(2)** unless a ballot is demanded default is show of hands
	+ Ballot can be demanded before **OR** after show of hands
	+ With show of hands one person =one vote
	+ With ballot one share = one vote –so someone with 10 million shares can have their vote equally weighed to match that
	+ Contentious meetings 🡪 ALWAYS vote by ballot

## Two types of Shareholder Resolutions 🡪 1) Ordinary resolution 2) Special resolution

* **1) Ordinary resolution** **CBCA s. 2(1)** and **OBCA s. 1(1)**
	+ Passed by at least the majority of the votes cast at the meeting (not majority overall, but of all those who *cast* a vote)
	+ Corporations usually set a quorum requirement of 25% (at 100% means all have veto power)
* **2) Special Resolution CBCA s. 2(1), s. 142** and **OBCA s. 1(1), s. 104**
	+ A 2/3 vote cast on that matter at the meeting –again not of the entire group but those who cast vote
	+ **OR** signed written resolution
	+ Act tells you when you need a special resolution vs. ordinary –i.e. voting on amending articles
	+ Typically special resolution is only used in few circumstances
* Shareholders can pass almost any resolution **instead of through a meeting as a written resolution** as long as it is signed by **100%** of the shareholders who are eligible to vote on that matter
	+ **S. 142 CBCA** and **s. 104 OBCA**
	+ Many small private corporations opt for written resolutions instead of meetings
	+ Written resolutions qualify as a special resolution
	+ Some exception apply 🡪 i.e. removing director

## Shareholder Meetings

* All corporations are required to have shareholder meetings approximately every year
* Requirement 🡪 after incorporation first meeting is required within 18 months
* Then after this period each annual meeting must be held within 15 months and meeting cannot be more than 6 months after financial year end 🡪 **CBCA s. 133 and** **OBCA s. 94(1)**
* Business that must be conducted at annual meeting:
	+ 1) Elect or reelect directors
	+ 2) Appoint or reappoint auditors (if applicable for private companies)
	+ 3) Receiving financial statements and considering auditors’ report (if applicable)
* These criteria are the ordinary business at the annual meeting and any other business is considered special business and this is to be done at special meetings –to do special business at the annual meeting, you can add it to the agenda and it becomes an “annual meeting and a special meeting”
	+ A special resolution has **NOTHING** to do with a special meeting –do not mix these up. A special meeting may not need a special resolution
* Shareholders do **NOT** approve financial statements –they simply receive them whereas management approves them by indicating they are accurate –shareholders cannot approve them because they would not know if they are accurate

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| Proxies and Proxy Solicitation |

# Proxies and Proxy Solicitation

## Proxy Role

* Proxy 🡪 person who attends in the place of a shareholder or the document brought as representative
* **CBCA s. 148 and OBCA s. 110** 🡪 shareholders have a right to vote by proxy
* When corporations send out notice of shareholder meeting they must include a form for proxy
	+ Form for proxy 🡪 has all items that will be voted on and space where shareholder can indicate how they want their proxy to vote
	+ Proxy holders are listed on form if shareholder does not know anyone in the area and chosen proxy must vote in accordance with how shareholder indicated BY LAW
	+ Problem 🡪 proxy forms only have option to “vote or withhold vote” –no “against” box
* Shareholders can decide is proxy is to have discretionary power 🡪 for if amendments are made during voting the proxy is trusted to vote in accordance with shareholder’s interest

## Soliciting Proxies

* Those who cannot attend the meeting fill the proxy form out
* In soliciting proxies, there must be an information circular/proxy circular included
* **NOTE:** difference in soliciting proxies between CBCA and OBCA
	+ Not all corporations have to solicit proxies 🡪 under **OBCA s.111** only offering corporations not private corporations
	+ **CBCA s. 149** says all distributing corporations must solicit proxies and all non-distributing corporations with more than 50 shareholders

## *Blair v Consolodated Enfield Corp. (1995, SCC) 🡪 conduct of meetings and test for chair of meeting acting in good faith*

* Facts 🡪 Blair was chair of meeting of shareholders. After seeking legal advice, he decided to void some proxy votes in the context of unexpected contested election for directorship. Controlling shareholders asked court to overrule that decision. They succeeded -Blair appealed and lost. Then asked for corporation to cover his legal costs in accordance to s. 136 of OBCA
* Legal issue 🡪 if he had been acting in good faith of honesty an fairness, he gets compensated for costs and if he was self-interested and acting in bad faith, then no costs covered
* Held 🡪 Blair acted in good faith and costs can be covered
* Reasoning: Iocubucci
	+ Standard for chair of meeting🡪 one of honesty and fairness to all individual interests and directed generally toward the best interests of the company
		- BUT not like a judge –does not need to be wholly uninterested
	+ Blair took the matter seriously –adjourned matter, sought legal advice, etc. although it was wrong to invalidate the proxies he did not do so in bad faith

## *Brown v Duby (1980, Ont HC) 🡪 broad definition of solicitation*

* Facts 🡪 P is corporation and shareholder. D’s are rest of shareholders. P claims D sent two letters to certain shareholders that constituted a solicitation of proxies under s. 150 in breach of Act. They made their proxy contest well know since they thought the managers were doing a bad job.
* Issue 🡪 did the letters constitute solicitation and thus a breach of the CBCA?
* Reasoning: Craig
	+ First letter was not solicitation but second letter although saying “not soliciting proxies at this time” appears to be solicitation as outlined in Act
	+ Object of Act and provisions are for benefit of shareholders and to protect them from possible harm
* Held 🡪 Shareholders will be held to have attempted to solicit proxies if they send out a proxy circular. Telling someone not to sign someone else’s proxy amounts to solicitation of proxies.
* **Note** 🡪 no remedy ordered –court does not want to tip scales between management/shareholders. They want voters to be informed and not give management a “win” –shareholders decide for themselves

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| --- |
| Shareholder Proposals |

# Shareholder Proposals

* Shareholders draft a proposal and management must include it in management’s information circular
* Cheap way for shareholders to get concern heard before annual meeting 🡪 costs them nothing
* Outlined in both act
	+ **CBCA s. 137** 🡪 has restrictions - must have held shares for at least 6 months and represent at least 1% of shares or $2000 market value
		- **Outlined in the regulations –“saying prescribed”**
	+ **OBCA s. 99** 🡪 must be registered or beneficial shareholder –not restrictions like CBCA
* **S. 137** amended after *Varity Corp* –exclusion relied on in this case NO longer the law
* **Note 🡪** proposals almost never pass –if it was something directors wanted they would bring the proposal forward on their own
* Proposals are advisory and never bind the corporation because directors have directing control

## *Varity Corp v Jesuit Fathers of Upper Canada (1987, Ont CA) 🡪 created changes to s. 137 whereas proposals must tie into the business affairs of the corporation or else management may exclude the proposal*

* Facts 🡪 D wanted its moral concerns regarding Varity’s involvement in apartheid South Africa, put to a vote at next shareholder meeting. Varity applies for order to omit the proposal from the management proxy circular pursuant to what is now CBCA s. 137(9)
* Held 🡪 for P –did not have to include the proposal in their circular
* Reasoning
	+ Political/moral concerns and personal claims do not have to be respected as shareholder proposals –CBCA reform took out the language on grounds of “political, economic, etc. causes”
	+ Proposals have to significantly tie in the business affairs of the corporation
* Note **🡪 s. 137(5)(b.1)** was created after this case (must be related to business)

## CBCA and OBCA Proposal Differences

|  |  |  |
| --- | --- | --- |
|  | **CBCA** | **OBCA** |
| Who can make proposal? | **s. 137(1.1) reg. 46** 🡪 must hold at least 1% of all outstanding shares or shares worth at least $2000 market value (at time of proposal) | **s. 99** 🡪 Any registered or beneficial shareholder***Note:*** *most shareholders are not registered so including “beneficial” means shareholders can make proposals more easily* |
| When does it need to be submitted?  | **s. 137(5) reg. 49**🡪 at least 90 days before the anniversary date of the **notice from the meeting from last year** *\*\*Does not explain how proposals work for non-distributing corporations but theoretically applies to both* | **s. 99(5)🡪** for offering corporation at least 60 days of the anniversary day of the last meeting or 60 days before the meeting if a “special meeting”*\*\*Theoretically applies to both private and public corporations*🡪 Non-offering corporations can be decided upon in articles or not less than 21 or more than 60 days  |
| How many words can be written in support of proposal? | **s. 137(3)** 🡪 Cannot exceed 500 words –No limit for management in response | **s. 99(3)(4)** 🡪 Cannot exceed 500 words. No limit for management in response |
| When is management allowed to say the proposal will NOT be included? | **137(5)(d)🡪** If a substantially same proposal has been submitted in the apt 5 years, management can refuse to include it If you submitted it once and it did not get more than 3% of votes, twice and not more than 6% votes and three or more did not get more than 10% of votes  | **s. 99(5)(d)🡪** If a substantially same proposal has been submitted in the apt 5 years, management can refuse to include it If you submitted it once and it did not get more than 3% of votes, twice and not more than 6% votes and three or more did not get more than 10% of votes |
| When can management block a proposal? | **s. 137 (5)(b.1)** 🡪 Management does not have to include it if it clearly appears that the proposal does not relate in a significant way to the business or affairs of the corporation*\*\*Altered after* ***Varity*** *where it used to say to further beliefs or carry out a grievance*  | **s. 99 (5)(b.1)** 🡪 management can block it when it does not relate to the business affairs |

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| Duty of Care Owed by Directors/Managers |

# Directors Two Duties 🡪 1) Duty of care 2) Duty of Loyalty

* 1) **Duty of care, diligence, skill** 🡪 Being competent
	+ At common law, it was a low bar - It was a subjective standard - Based on their skills and abilities
	+ Dickerson committee wanted to upgrade the standard - Remove the lax subjective standard - s. **122(1)(b) CBCA** - “care, diligence, skill that a reasonably prudent person would exercise”
	+ But it is still hard to sue directors because of the business judgment rule
	+ Business Judgment Rule - As long as a decision is made on a reasonably informed basis and on good faith, the courts will take a deferential approach
* 2) **Duty of Loyalty/Fiduciary duty** 🡪 “Best interests of the company”
	+ **CBCA S. 122(1)(a)** - Every director and officer shall “act honestly and in good faith with a view to the best interests of the corporation”
	+ This language was derived from the common law duty of loyalty - At common law, the old cases used the phrase “honestly and in good faith with the best interests of the company”
	+ Dickerson committee changed it to corporation - No discussion in the report about the significance of the language, but there is some suggestion that while “company” is a collective meaning and includes the shareholders, corporation might mean something different

**NOTE: Fiduciary duty is owed to the *corporation* not to creditors (different from duty of care)**

* But ***BCE*** indicates they have a duty to “consider” not owe though

# Duty of Care Owed by Directors/Managers

## Director Accountability/Duty Owed

* Director expectations/accountability used to be all common law 🡪 was not in CBCA or OBCA
	+ Common law duty of care was a low standard
	+ Absolutely lowest threshold 🡪 ***Re Cardiff Savings Bank***
		- 6-month-old boy became president –attended 1 meeting in lifetime. Court said he was not present for any of the meetings where bad stuff happened so not liable (LOW BAR)

## *Re City Equitable Fire Insurance Company Ltd (1924) 🡪 three requirements of director duty: 1) skill must be that which is reasonably expected from a person of his knowledge/experience; 2) Duties are of intermittent nature 3) in respect of all duties some may be left to some other official (delegated)*

* Issue 🡪 can directors be liable for not detecting fraud? Do they owe a duty of care?
* Reasoning
	+ Duty of care = duty of due diligence, care, etc.
	+ Duty of loyalty =duty of integrity, honesty, good faith
	+ Court articulates three basic propositions about director’s duties:
		- 1) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience
		- 2) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed.
			* He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so.
		- 3) In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly

## Dickerson Committee Proposal

* Proposed to change common law standard 🡪 this standard is too weak/low and allows for subjectivity
* Proposed upgrade 🡪 objective standard –requiring directors and officers to meet the standard of a “reasonably prudent person”

## Statutory Reality after Dickerson Proposal

* **CBCA s. 122(1)(b)** 🡪 statutory duty of care
* Emulates but does NOT replicate standard proposed by Dickerson Committee
	+ **Main difference** = the enacted version includes the words **“in comparable circumstances”,** which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account.
* **S. 227 Income Tax Act** is nearly identical to s. 122(1)(b) of CBCA –this outlines duty of care for taxes

## Ontario Statutory Changes for Duty of Care

* **OBCA S. 134(1)(b)** 🡪 statutory duty of care
* Language came from Lawrence Committee (preceded Dickerson Committee) –looked at same issue
* Following ***People v Wise*** OBCA amended its legislation to “in comparable circumstances”

## Business Judgment Rule

* United States rule 🡪 Principle of deference to judgment of business people who are assumed to know more about business than the courts
* 1988 🡪 judge in Ontario adopted the principle and in ***People v Wise*** the SCC correctly observed the rule signaling this judgment rule is not the same as the US one but has similar policy basis (deferring to expert decision makers)
* This rule **seemed highly protective of directors until** ***Smith v Van Gorkom***
	+ This is still the case, *Smith v Van Gorkom* was unusual
	+ Delaware revised its statutes after to ensure this never happened again 🡪 BUT our statutes in Canada/Ontario do not have this provision
* Canadian rule is **NOT** the same as the American rule

## *Smith v Van Gorkom (1985, Del SC) 🡪 Under the business judgment rule, a business judgment is presumed to be an informed judgment, but the judgment will not be shielded under the rule if the decision was unadvised*

* Facts 🡪 D was CEO who sold company. Board approved of sale and got majority of shareholders to approve but minority shareholders said it was not at value. Lawyer advised they could be sued. D sold the company to friend, Pritzker, for value which they could get not what it was worth
* Issue 🡪 whether the business judgement by Board to approve sale was an informed decision?
* Reasoning
	+ Business judgment rule 🡪 Board judgement presumed to be informed judgment BUT judgment will not be shielded under the rule if the decision was unadvised.
	+ Directors are protected if they relied in good faith on reports from officers
	+ Board of directors breached their fiduciary duty to shareholders by:
		- 1) Failure to inform them of all information reasonably available to them and relevant to their decision to recommend the sale
		- 2) By their failure to disclose all material information such as a reasonable shareholder would consider important in deciding whether to approve offer
* Held 🡪 For P –Board breached fiduciary duty

## *Peoples Department Store v Wise (2004, SCC) 🡪 duty of care may be owed to someone other than corporation (possibly shareholders –NOTE OBCA amended so just “to corporation” but CBCA still vague) –Canadian business judgment rule protects directors as long as reasonable, informed decision made*

* Facts 🡪 Peoples wanted to sell company. Wise bought it under leveraged buyout. Owners of Peoples wanted to protect interests –placed strict conditions on management and took security in assets of corporation. As a result Peoples and Wise forced to run separate operations and not consolidate under former owners paid fully. Created problems for both companies. Directors of Wise initiated new arrangement that allocated inventory in a certain way. Peoples was put into bankruptcy proceedings and the trustee petitioned the court to include the director’s personal assets as a result of a breach of their fiduciary duty.
* Issue 🡪 do directors owe fiduciary duty to creditors? Was there a breach of duty of care here?
* Reasoning:
	+ It’s important to differentiate the duty of care and fiduciary duties. Directors owe creditors a duty of care, but not fiduciary duties.
	+ **The fiduciary duty is owed to the *corporation* and not to the creditors.** Directors are protected by Canadian business judgment rule as long as reasonable, informed decision made
	+ Any liability would have to arise by virtue of the director’s breach of the generalized duty of care to the company, and not by virtue of their breach of fiduciary duties.
* Two important notes:
	+ 1) Duty of care of directors is not specified as to who it is owed to 🡪 so Ontario amended its **OBCA s. 134** to include “duty to the corporation” to ensure no mistake going forward **BUT** the **CBCA** **s. 122** was not amended so it is still vague
	+ 2) Made it clear shareholders cannot sue to enforce the duty unless they have some other legal right to sue

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| Duty of Loyalty Owed by Directors/Managers |

# Duty of Loyalty 🡪 “best interests of corporation”

* Avoiding conflict of interest 🡪 directors have a fiduciary duty they are not to put themselves in a situation where there personal interests conflict with their duty
* Specific application of general principle
	+ Corporate opportunities cases 🡪 director taken business opportunity for himself
	+ Interested directors contracts 🡪 contracts where director entered into business with corporation itself (applicable CBCA and OBCA provisions)

## *Peoples Department Store v Wise (2004, SCC) 🡪 availability of oppression remedy means fiduciary duty imposed on directors by CBCA s. 122(1)(a) does not include to creditors*

* Prior proceedings 🡪 TJ held directors acting in interests of shareholders are breaching their duty; CA disagreed saying best interests of corporation mean best interest of creditors if corporation is in vicinity of insolvency
* Issue 🡪 were Wise brothers in breach of their duty of loyalty when entering into procurement policy?
* Reasoning: Duty of Loyalty
	+ “Best interests of the corporation” should not be read to mean solely “best interests of the shareholders”
	+ No fraud or dishonesty on the part of the Wise Brothers
	+ SCC rejects the “vicinity of insolvency” language - “The director’s fiduciary duty does not change when a corporation is in the nebulous vicinity of insolvency”
	+ The **availability of such a broad oppression remedy undermines any perceived need to extend the fiduciary duty imposed on directors by s. 122(1)(a) of the CBCA to include creditors**
		- Since they can recover under this remedy, the fiduciary duty owed by directors to the corporation does not extend to creditors
* Held 🡪 appeal dismissed –brothers not in breach of fiduciary duty

## *BCE v 1976 Debentureholders (SCC, 2008) 🡪 directors owe a fiduciary duty only to corporation but should act as a “good corporate citizen” toward other stakeholders*

* Facts 🡪 BCE was shareholder of Bell Canada. BCE was participating in leveraged buyout –person buying corporation borrows money for purchase. Bell would end up owing more than $30 billion after the deal. Since debt ranks before equity, Bell’s debentureholders were angry because the new $30 billion debt would rank ahead of them. This also would cause debenture value to drop by 20%. Shareholders voted 97% in favour of deal and debentureholders were mad so they sued.
* Issue 🡪 what does “best interests of corporation” mean? Was duty of loyalty breached?
* Prior proceedings 🡪 TJ allowed deal but CA overturned the decision (NO DEAL)
	+ **NOTE:** this was shocking because first time deal of this size was not approved by court
* Reasoning: Duty of Loyalty
	+ When a company is being sold the only job/obligation of directors is to get the highest price possible for return of shareholders 🡪 if they do not, then breaks fiduciary duty
	+ **BUT** it might be appropriate for directors of the company to look to interests like community, shareholders, employees, etc.
	+ Duty court is describing is not mandatory but optional –directors do not NEED to consider these other interests but they may
	+ Only one place where they are obligated to consider these interests 🡪 Directors should maximize shareholder profit but they cannot do it at the expense of the others –directors owe a fiduciary duty to the corporation, and only the corporation as a “good corporate citizen”
	+ They should be acting as “**good corporate citizen”**
		- What is a good corporate citizen? 🡪 Cannot unfairly disregard interests
	+ Directors had a duty to consider the debenture holders’ interests –having considered them they decided to honour their contractual obligations and nothing more –there was nothing in the contract that prohibited Bell from taking on addition debt
* Held 🡪 deal can go through –for BCE

## Arrangements Provision –s. 192 CBCA

* Provision allows company to do a complicated transaction that they cannot do under other provisions
* “Catch all” provision used by corporations quite often
* BUT requires court approval 🡪 must convince court that deal is “fair and reasonable”

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| Corporate Social Responsibility (CSR) |

# Corporate Social Responsibility (CSR)

**NOTE** 🡪 fiduciary duty of directors leads to discussions of CSR –who is a duty owed to? What does the “best interests of the company” mean? To shareholders, to others?

## CSR Background/ Perspectives

* People maximize their own utility –this means in most situations maximizing own selfish interest
* 1950 financial focus 🡪 maximizing shareholder wealth as measured by shareholders
	+ Will project increase share price? –if yes, do it… if no, then do not
* Friedman (1970s) 🡪 cannot take money from shareholders or corporation for good causes
	+ Subversive and undermining system to frame companies as necessarily entities to do good
	+ Socialism is not good but younger people are being fed the idea it is –advocating against socialism and saying we need less of the political left
* Dickerson Committee/ McLachlin CJ –views on corporation
	+ Old view 🡪 only maximize shareholder profit
	+ New view 🡪 modern view is that corporations do good for all and broader public interests
* So which view is it?

## *Dodge Brothers v Ford Motor (1906) 🡪corporations must act to maximize shareholder profit not to help community –encompasses old view*

* Facts 🡪 P were remainder shareholders in Ford. P sent D letter saying they want their dividend paid said D made millions. D ignored it and built new facility so they could lower costs and help community. D wanted to help community and P sued saying they are not to do that but owe duty to shareholders
* Held 🡪 for Dodge Brothers
* Reasoning 🡪 that is not the goal of business corporation –goal is to maximize profit for shareholders not to help the community (encompasses old view)
* **NOTE**: case was in 1906 –has the attitude changed since?

## Berle/Dodd Debate

* Berle
	+ Fiduciary duty to serve principal’s interest
	+ Even though it looks like it, directors do not actually have absolute power and control they hold the power “in trust” so they must act in the interests of shareholders or courts will strike it down
	+ Berle believed that corporations were simply vehicles for advancing and protecting shareholders’ interests and that corporate law should be interpreted to reflect this principle.
	+ He suggested that any other account of corporations’ function and purpose would “defeat the very object and nature of the corporation itself.
* *Park v Daily News UK*
	+ Even if most of the time this is generally true, lawyers oppose this idea because even if there was only a conflict once ever, this is the conflict that requires a legal principle
	+ This is where court says you are allowed to serve other interests as long as the reason for doing it is to serve the shareholders
* Dodd
	+ Normative argument –normatively this is the right thing to do
	+ Attitudes are changing 🡪 growing feeling not only that business has responsibilities to the community but that our corporate managers who control business should voluntarily and without waiting for legal compulsion manage it in such a way as to fulfill those responsibilities.
	+ “Enlightened Self-Interest Stance” 🡪 idea that by serving interests of others, directors are really just serving long-term interests of corporation and thus increasing shareholder returns
	+ Courts should provide great latitude to corporate managers 🡪 allow them a “wide range of secretion as to what policies will best promote the interests of shareholders”
	+ Even when there is a conflict it is okay for directors to give money to good causes at the expense of shareholder value
		- Altruistic with other people’s money
* Berle’s response
	+ Not hostile to Dodd’s argument –sympathetic and thinks although this is good, it is only a theory
	+ While this is a good idea, there would be a gap in accountability
	+ Problem is there is no legal principle on which Dodd’s theory is based –we cannot let corporate directors do whatever they want because they will “do the right thing” –this is a dangerous principle and leads to a gap in accountability
	+ Notion that corporation has become so powerful we need a principle to govern these actions –it is not defined and there is concern that with Dodd’s view there will be bad results
* Owen Young 1920s
	+ Both Berle and Dodds liked Owen Young who stated his job at General Electric was to serve certain people –not just shareholders
	+ Famous for attitude job is to serve beyond shareholder interest
	+ Ida Harbelt –famous writer advocating for Owen Young
* **Moving forward**
	+ We need a governance or principle that guides corporate actions and allows them to be socially responsible while mitigating the positive legal obligations they have to the shareholders

## Darrell West’s Paper

* On the Brooking Institution he states in American schools they are taught directors’ duty is to maximize shareholder profit and this is “troubling”
* Rather, directors owe a duty to others beyond the shareholders
* Surveyed the curriculum of business schools –Results of the survey show him that it is more frequent in law schools that director’s duty is only to shareholders –it is LESS frequent in business schools 🡪 this is troubling because it may be mistaken as a proposition of law (not just in normative sense)
	+ Lynn Stout (famous professor) indicates so –her ideas deserve to be read and listened to
	+ She says it is wrong to say that the duty of director’s is only to maximize shareholder profit
* **BUT** 🡪 is West’s position problematic? Is there a reason all these leading law schools teach this? Why is Stout’s position right?

## Managerialism

* View that directors of large corporations were a profession and not simply the hired help, and like other professionals, they should understand their duty to be inherently one of public service
* Approach 🡪 balance multiple interests; not primarily serving shareholders alone
* Dominant in the 1950s, shifted in the 1970s (though Nicholls isn’t persuaded)
* “Best” way to operate corporation in the interest of society
* Why did we slide “backwards”? Broader political agenda + neo-conservative economy that maps view that corporations should only serve shareholders
	+ Subset of this argument: social license, associated with incorporations who carry on resource-development, where there are allegations that those practices were carried out in America, they would not be legal

## Moral Or Legal Responsibility with CSR?

When we talk about corporate social responsibility, are we talking about legal or moral responsibility?

* Legal 🡪 directors must act honestly and in good faith in the interests of the corporation
	+ Something more than maximizing wealth?
	+ Owen Young, 1920s: “job is serving employees… shareholders at bottom”
	+ Ida Tarbell: highly supportive of Young; model is the future of business
* Corporate social responsibility seems to be new based on Young’s perspective
* Single-minded pursuit of profit in corporations is not seen as suspect like it is seen as in human beings;
	+ We compartmentalize and do things that are not “the most important thing” all the time (i.e. As defence lawyer, obligation even if you know a person is guilty; single-minded movement toward an obligation rather than a social goal)
	+ Ex. Corporate managers should focus on making money, subject to obeying all laws and moral principles; other mechanisms serve social goals

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| Director Conflict 1) Corporate Opportunity 2) Interested Directors |

# Two Classifications for Classifying Director Conflict

* These two are **distinct** and must be treated different why? 🡪 One is monitored heavily by statutory regime (interested directors’ officers’ contracts) the other is all common law (corporate opportunities)
* Common proposition 🡪 director needs to be careful not to let personal interest conflict with company
* Two classifications
	+ **1) Corporate Opportunities**
	+ **2) Interested Director’s officers’ contracts**

# Corporate Opportunities

* Where director is not entering into the contract with the corporation but is entering into a contract INSTEAD of the corporation (director seized opportunity that should have been corporation’s)
* **ALL common law**
* Statutory underpinning is just general director duties –does not actually indicate corporate opportunity 🡪 **CBCA s. 122 and OBCA s. 134**

## *Regal (Hastings) Ltd. v Gulliver (1942, HL) 🡪 when opportunity comes to person because they were a director and performing their duties, then director CANNOT take opportunity –if they do they will have to turn profits over to corporation (breaches fiduciary duty)*

* Facts 🡪 Board of directors of Regal had 5 members (the defendants). Regal wanted to buy two theatres. Seller was uneasy so would only accept deal if he was given £5000 for the shares or received directors’ guarantees. Company put down £2000, 4 directors each put £500 and other director, Gulliver, found friend to contribute £500. Solicitor, Garton, also gave £500 so full £5000 was down. At time of sale, directors made a profit off the shares. New owner of Regal sued directors for breaching fiduciary duty and taking opportunity from corporation
* Issue 🡪 did the directors take a corporate opportunity
* Held 🡪 for P –all directors liable except Gulliver (since he did not purchase himself) and Garton because duty does not extend to solicitors.
* Reasoning
	+ When an opportunity comes to you only because you were a director and in the course or performing your duties, than you cannot take the opportunity –doesn’t matter company lost no money, you CANNOT profit as a director of the company and if you do, you must pay it to the company
* **Note:** Professor Seeley’s concerns with unjust/odd result
	+ Oddity 🡪 directors could have been protected by a resolution or calling shareholders meeting –this is odd because directors were shareholders so they would have been blessing themselves
	+ Unjust 🡪 Appears as though wrong people “won” –directors acted in good faith and Gulliver, who didn’t want to put own assets on the line, walks away free; AND P knew what directors were doing and decided to buy company anyways (sneaky to turn around and sue)

## *Peso Silver Mines Ltd v Cropper (SCC, 1966) 🡪 Contrasts Regal – If investment is risky, directors can reject it on behalf of fiduciary duty but accept it personally*

* Facts 🡪Company that regularly assesses mining business. They look at the claims and decide whether they are valuable or not. Cropper, as president, who is in meeting where company says they don’t want the claim, leaves the meeting and says he will take them personally. The company changed hands and had new directors who sued Cropper for taking an opportunity.
* Held 🡪 for D (Cropper)
* Reasoning
	+ 1) Cropper did not obtain his investment only by reason of being a director of the uninterested corporation –he had a personal interest
	+ 2) There is a difference between corporations’ risk profiles and directors’ individual risk profiles
		- When the board made its decision to reject the offer on behalf of the shareholders, it did so with a genuine view to corporate interests (reject high risks)
		- So, the director didn’t reject it for his own gain, he rejected it as part of his fiduciary duty
	+ 3) The corporation was in the business of assessing claims –no single claim they rejected had an effect on the success/profit of the company.
		- Different from *Regal* where one-off opportunity tangibly affects corporation
* **NOTE** 🡪 commentators think this is wrong –he pursued opportunity after a meeting where he was on the board –only knew of opportunity because he was director

## *Canadian Aero Services Ltd v O’Malley (1973, SCC) 🡪 agents/officers of corporation owe the same fiduciary duty that directors owe to it –this fiduciary duty can persist after they have left the corporation based on 4 factors*

* Facts 🡪 Canadian Aero was a subsidiary of American company. Wanted a Canadian government contract –didn’t think they would get it because US controlled entity. D’s worked as highest officers of P. D’s decided to leave P because they didn’t think they would get the contract and started own company that successfully won the project. P sued them for wrongfully taking corporate opportunity that they obtained as officers.
* Held 🡪 for P
* Reasoning: Laskin
	+ High ranking officers such as O’Malley and Zarzycki are not mere employees of the company but rather are agents
	+ As agents of the corporation, they owed the same fiduciary duty that the directors owe to it. This duty precluded them from obtaining for themselves any property or business advantage either belonging to the company or for which it has been negotiating
	+ Even if the corporation was certain to have no chance at the opportunity, no D/O can use their position as a means to achieve their own profit 🡪 P does not have to suffer loss
	+ Fiduciary duty can persist even after D/O left corporation –how long is a matter of fact
	+ Factors court use to judge if officers were breaching fiduciary duty in pursuing opportunity:
		- 1) Did D hold relevant office? (Officer/director)
		- 2) Nature/ripeness of opportunity (Did D gain opportunity as agent of company?)
		- 3) Whether the rejection was tied closely to officer’s duties (distinguished *Peso* –where good faith rejection of opportunity –not the case here)
		- 4) Amount of knowledge that D/O had
* **NOTE**: again P did not have to prove they would have gotten the contract, but D’s still need to account for the profit

# Interested Director’s Officers’ Contracts

* Where company enters into contract WITH director personally
* Originally common law but corporations were drafting around the rules and so finally government passed specific statutory regime
* Relevant provisions 🡪 **CBCA s. 120** and **OBCA s. 132**

## CBCA s. 120/ OBCA s. 132

* What has to be disclosed? **S. 120(1) and s. 120(1)**
	+ Disclose in writing or by requesting it be entered into minutes –the **nature and extent of any interest** that he or she has in a **material contract** or transaction, **IF** the director of officer is a party to contract, has material interest or some sort of capacity to it
* When must disclosure be made? **S. 120(2) and s. 120(2)**
	+ At meeting of proposed contract, as soon as director becomes interested, etc.
	+ Provision covers variety of circumstances
* Attendance at meeting is mandatory by interested directors **S. 120(5) and s. 120(5)**
	+ Interested director required to disclose cannot vote on any resolution to approve contact unless:
		- A) Contract is about director’s own remuneration (i.e. salary/pay) 🡪 **different in OBCA** –only applies to directors in OBCA but in CBCA includes CEOs, Officers, etc.
		- B) For indemnity or insurance under s. 124
		- C) Is with an affiliate
* General Continuing Disclosure **S. 120(6) and s. 120(6)**
	+ Where corporation deals regularly with another party in which director is interested or also a party
	+ I.e. director on two boards
* Allowing (limited) access to directors minutes to review disclosures **s. 120(6.1) NOT in OBCA**
	+ Even though shareholders cannot normally see directors minutes, they are allowed to see portions of the minutes where disclosure was given
	+ **This is NOT in the OBCA**
* Effect of disclosure 🡪 **s. 120(7) and s. 120(7)**
	+ Contract is voidable at option of corporation if interested director has made a profit and it is accountable to the corporation
	+ It is valid if:
		- 1) Disclosure was made in accordance with s. 120(1)-(6.1)
		- 2) Transaction was approved by directors
		- 3) Contract or transaction was reasonable or fair to the corporation when it was approved
	+ **OBCA different in subtle way** 🡪 a. 132(7) says contract is not voidable **ONLY** by reason that director is interested –must have some other reason also
* Confirmation by shareholders 🡪 **s. 120(7.1) and s. 120(7.1)**
	+ Even if conditions are not met, a director acting in good faith is not accountable to the corporation for any profit realized and the transaction is not invalid by reason only provided there is **shareholder approval**
	+ Can be saved by shareholders in the following steps:
		- A) The contract or transaction is approved or confirmed by special resolution at a meeting of the shareholders;
		- B) Disclosure of the interest was made to the shareholders in a manner sufficient to indicate its nature before the contract or transaction was approved or confirmed; and
		- C) The contract or transaction was reasonable and fair to the corporation when it was approved or confirmed.
* Application to Court 🡪 **s. 120(8) and s. 120(8)**
	+ Court may order corporation to set aside contract if sees fit

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| Shareholder Remedies |

# Shareholder Remedies

## Why do we need shareholder remedies?

* Corporations rely on majority rule and limited liability 🡪 protects from third parties not themselves
* D/O that engage in opportunity/conflict are hirting coproraiton but they decide when corporation sues and they will not sue themselves so shareholders need a remedy

## Four Major Remedies Available: CBCA and OBCA

1. Derivative Action
2. Oppression Remedy
3. Compliance Order
4. Dissent and appraisal remedy (not on exam)

## Compliance Order CBCA s. 247 and OBCA s. 253

* Directors not acting in accordance with act, regulations, articles of incorporation, USA, etc. than a “complainant or a creditor” can go to the court and get an order that makes them comply
* Simplest remedy but not used very often because there is no money in it

# Derivative Action 🡪 CBCA s. 239 and OBCA s. 246

* Allows shareholders to step into shoes of corporation and make them sue 🡪 because directors usually have power to decide if the corporation sues they obviously do not wish to sue themselves
* Rule in Foss v Harbottle
	+ 1) Individual shareholders have no cause of action to sue for wrong so it must be brought *either by the corporation or by way of derivative action*
	+ 2) Shareholders can cleanse any action done by the director by agreeing to do so in a *shareholder meeting* 🡪 **PROBLEM** –director could be a majority shareholder
		- This rule made it hard for shareholders to succeed
		- Dickerson Committee did not approve any recommended changes

## Who can bring a derivative action? 🡪 CBCA s. 238 and OBCA s. 235

* A **complainant** –who is a complainant?
	+ (a) Registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
	+ (b) A director or an officer or a former director or officer of a corporation or any of its affiliates,
	+ (c) The Director (government official)
	+ (d) Any other person who, in the discretion of a court, is a proper person to make an application under this Part.
* **NOTE:** Definition of complainant applies to both the derivative action and the oppression remedy –the definition however outlined here applies ONLY to derivative action because oppression remedies are personal whereas derivative actions are people who represent interests of corporation, not their own interests

## Double derivative action

* Registered shareholders of the corporation’s “Affiliates” are eligible to bring an action as defined by complainant. So can be an “indirect” party essentially

## *First Edmonton Plac Ltd. v 315888 Alberta Ltd 🡪 to be a complainant for a derivative action the creditor is a person who would be entrusted with advancing the interests of the corporation*

* Facts 🡪 Landlord incentivized numbered company to move in (Rent-free $200k). Company controlled by three lawyers and signed 10 year lease. After rent free period lawyers vacated. Landlord alleged the actions of directors of the numbered company were unfairly prejudicial to or unfairly disregarded the landlord's interests.
* Issue 🡪 is the applicant a “proper person” to bring a derivative action?
* Held 🡪 creditors are within scope of CBCA s. 231 to bring forward complaint
* Reasoning
	+ Criterion to be applied for complainant for derivative action 🡪 would the creditor be a person who could reasonably be entrusted with the responsibility of advancing the interests of the corporation by seeking a remedy to right the wrong allegedly done to the corporation

## Application to Court for Derivative Action

* For derivative action must apply to the court for approval to pursue 🡪 **CBCA s. 239(1) OBCA s. 246(1)**
* This prevents just any shareholder from stepping into shoes of corporation –deters illegitimate claims
* Three criteria to get approved by court 🡪 **CBCA S. 239(2)** and **OBCA s. 246(2)**
	+ 1) They must give the directors notice of the action for 14 days which gives them time to right the wrong essentially
	+ 2) Complainant must be acting in good faith
	+ 3) It is in the best interests of the corporation that the action be brought

## Cost for derivative action

* Since it is the corporation’s action and they will be benefiting , shouldn’t they pay costs?
* Courts will likely grant costs if leave is granted under s. 239(2) ***[Turner]***

## *Turner et al. v Mailhot et al (1985, Ont Ct) 🡪 court will likely grant costs if leave is granted under s. 239(2) –criteria is satisfied*

* Facts 🡪 P and wife owned 30% of shares, D and wife owned 70%. After a disagreement, P and wife were locked out of the company’s premises and had wife’s employment and P’s position as director and officer terminated. P obtained leave seeking return to company and lost income diverted to D. Applied for indemnity under **CBCA s. 242(4)**.
* Issue 🡪 should costs be covered for the action?
* Reasoning
	+ Since P is 1 of 2 shareholders it appears to be more of a struggle for each parties’ own advantage
	+ Test for costs 🡪 if we are prepared to grant leave under s. 239(2) then we are likely prepared to cover costs as well.
	+ These conditions establish a *prima facie*, rebuttable presumption for the right to be indemnified
	+ But since it is only *prima facie,* other factors can weigh in. Here, the benefit sought appears to be more for P than the company
* Held 🡪 P gets half the indemnity he requires since company funders were paid to D for his defence

**Available Orders 🡪 if** the action is won:

* **CBCA s. 240** procedural orders 🡪 former or present security holders who were wronged can be paid directly (not the corporation)
* **CBCA S. 242** 🡪 when you bring a derivative action that action will not be stayed or dismissed by reason only that the shareholders allowed it in a meeting (disregards second prong of Rule in Foss v Harbottle)

## Relationship between Derivative Action and Oppression

* Most oppression remedies have a significant family/friend dynamic that is ripping apart –deeply personal
* So it is hard to separate it out easily what was done to person vs. what was done to company 🡪 many bring claim for derivative action and oppression remedy because they could not sort out which was which
* **Key difference**
	+ Practical difference is do not need leave for oppression remedy whereas derivative action requires leave from the court to pursue
	+ For oppression remedy can be a personal interest but for derivative it must be people who represent interests of corporation, not their own interests

# Oppression Remedy 🡪 CBCA s. 241 and OBCA s. 248

* Most important remedy 🡪 *BCE* leading SCC case
* First line of attack for remedy
* Oppression remedy is a statutory remedy not common law
* Equitable remedy 🡪 no general rules rather what is fair and just; fact specific
* Protects “**reasonable expectations of complainants”**
* Broad, flexible and discretionary 🡪 judges have ability to fix the problem how they wish
* Test is for the effect of an action but NOT the intent or motivation of the director in doing the action 🡪 does not require a finding of wrongfulness

## English Origin of Oppression Remedy

* Grounded in English common law 🡪 used to be for minority shareholders
* Back then –either solve differences or dissolve company –the remedy acts as an “in between”
* Rarely used –Jenkins Committee explained the weaknesses of the UK Act that Dickerson committee responded to:
	+ 1) Remedy only available if circumstances dire enough to justify winding up the corporation
	+ 2) Remedy only available where there was an oppressive **course of conduct**
	+ 3) Remedy only available where conduct “oppressive” (i.e., illegal)
	+ 4) Remedy only available where complainant oppressed in his or her **capacity as a shareholder**
		- Fails to recognize the many roles in small businesses

## CBCA Oppression Remedy 🡪 s. 241

* Addressed the four weakness of UK Oppression Remedy by Jenkins Committee
* Gives broad remedial powers
* Goal 🡪 enable courts to apply a remedy that would offer continuing relief or indemnity to complainant
* Jurisdiction
	+ Most provinces also enacted oppression remedy, not all identical 🡪 except PEI
	+ **OBCA s. 248**
* Remedy for Public or Private?
	+ Applies to both private and public corporations –either can use oppression remedy
	+ BUT Dickerson Committee points out used most frequently/primarily by private corporations

## Who can bring an oppression remedy forward? 🡪s. 238

* **A complainant** 🡪 **s. 238** “complainant definition”
* **SAME** definition as derivative action
* However, in derivative “proper person” means someone who can represent companies best interests, for oppression remedies it is broader and can be a **personal interest**
* 80% of oppression remedies are shareholders
* Other “proper people” according to the Courts:
	+ Creditors (*Royal Trust v Hordo; Peoples v Wise; First Edmonton*)
	+ Employees (*Downtown Eatery* – the only case allowing employees as proper people)
	+ Corporation itself (*Calmont Leasing v Kredt; Gainers Inc v Pocklington*)
	+ Trustee in bankruptcy
	+ Others (e.g., people who believed they were going to be a shareholder but were oppressed and denied shareholder status)

## What constitutes oppression, unfair prejudice, or unfair disregard? 🡪 s. 241

* **s. 241 🡪** Do not have to prove all but just one of those options
* Some are easier to prove –i.e. unfair disregard easier than oppression
* Cases are very fact specific
* Protects “interests” not simply legal rights (not just what is legal, but what if fair –*BCE*)
* Not necessary to show “want of probity” (*Brant Investments*) 🡪 do not have to show that oppression was result of wrongful act, it is the effect that matters

## What is the role of “Reasonable Expectations”?

* Once the courts recognize that the oppression remedy protects more than strictly legal rights it is necessary to articulate what interests are deserving of protection
* Reasonable 🡪 Regulation of voluntary relationships by regard to the expectations raised in the mind of a party by the word or act of the other, and which the first party ordinarily would realize it was encouraging
* Something about the relationship that raised in the mind of one of the parties, a reasonable expectation of what it will entail
* After ***BCE v 1976 Debentureholders*** there was a two step test:
	+ 1) Evidence must establish a complainant’s expectation **AND** that the expectation was objectively reasonable
	+ 2) Reasonable expectation must have been thwarted in a manner that was oppressive, unfairly prejudicial, or unfairly disregarded complainant’s interest
		- MUST anchor this standard with the *Act* to establish oppression/unfair disregard/prejudice
		- Cannot have an oppression remedy turning entirely on reasonable expectations –so it needs to be anchored in the *Act* to stop common law from raising above the statute
* If the fair and reasonable test is met, then the action does NOT move forward

## Broadness of Available Court Order Remedies

* **S. 241(3)** Court can order:
	+ Regulation or change of corporation’s bylaws, articles, USA, etc.
	+ To appoint new directors in place of any or all directors
	+ To vary or set aside a transaction or contract
	+ To compensate an aggrieved person
* Broad discretion for court in ordering remedy 🡪 can interfere greatly with corporation
* Most oppression cases brought by minority shareholders in private corporation 🡪 most common remedy is that majority shareholder buys out the minority shareholder

## Personal Liability of Directors for Oppression

* In ***Wilson v Alharayeri*** the SCC considered when it is “fit” to hold a director of a corporation personally liable for oppressive conduct

## *Wilson v Alhargyeri (SCC, 2017) 🡪 rule for holding directors personally liable under oppression remedy; test for determining what is considered “fit”*

* Facts 🡪 private placement ordered =diluted proportion of common shares held by any shareholder who did not participate in it. Prior to issuing private placement, board refused to covert Class A and Class B common shares held by the respondent even though these shares were convertible and met the test. In contrast, Board accelerated convertible shares held by Class C shareholders including the President and CEO despite doubt expressed by auditors that the test had NOT been met for these classes. As a result, the respondent’s shares and value were significantly reduced.
* Prior proceedings 🡪 TJ found President/CEO personally liable for respondent’s loss as theyw ere the only two people on the audit committee. Used influential position to advocate against converting respondent’s shares
* Held 🡪 appeal dismissed –for respondent
* Reasoning
	+ Order under oppression remedy should go no further than to correct injustice/unfairness
	+ Rule for personal liability of D/O:
		- 1) The director or officer must be implicated in the oppressive conduct. In other words, the oppressive conduct must be attributable to the individual director because of his or her action or inaction
		- 2) Imposition of liability must be fit in all of the circumstances.
	+ What is “fit”**:**
		- Where directors obtain a personal benefit from their conduct;
		- Where directors have increased their control of the corporation by the oppressive conduct;
		- Where directors have breached a personal duty they have as directors;
		- Where directors have misused a corporate power; and
		- Where a remedy against the corporation would prejudice other security holders.
* “4 general principles to consider in determining if it is “fit” to find a director personally liable for oppression
	+ 1) Must be fair (if there is bad faith usually easy to see unfair)
	+ 2) Go no further than necessary to rectify oppression
	+ 3) Any order must only vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders.
	+ 4) Court should consider the general corporate law context in exercising its remedial discretion. Director liability cannot be a surrogate for other forms of statutory or common law relief, particularly where it may be more fitting in the circumstances

## *Ernst & Young v Essar Global Fund Ltd (ONCA, 2017) 🡪 there will be circumstances where a shareholder suffers harm in the shareholder’s capacity as a stakeholder from the same wrongful conduct that causes harm to the corporation*

* Facts 🡪 Appellants submit respondents do not have grounds to bring action in form of oppression remedy, only a derivative action. They say claim asserted is a corporate claim and no one was harmed directly or personally but only derivatively
* Held 🡪 for respondents –can bring oppression remedy AND derivative action
* Reasoning:
	+ There will be circumstances in which a stakeholder suffers harm in the stakeholder’s capacity as stakeholder, from the same wrongful conduct that causes harm to the corporation. In my opinion
	+ There can be “overlap” and an action can be brought forward under both

## Remedies Compared Chart

|  |  |  |  |
| --- | --- | --- | --- |
| **Remedy** | **Statutory Reference** | **Harm Alleged** | **Who may bring it** |
| Derivative Action | CBCA ss. 239-240 | Wrongs done **TO** corporation | A “complainant” (as defined in statute)Leave of court required |
| OBCA ss. 246-247 |
| Oppression Remedy | CBCA s 241 | Act committed **BY** the corporation, affiliates that effects a result, or businessor affairs or powers of directors of corporation or affiliates conducted in a manner, that “is oppressive or unfairly prejudicial or unfairly disregards the interests of any security holder, creditor, director or officer” **[NOTE: OBCA INCLUDES THREATENED HARM]** | A “complainant” (as defined in statute)[Cases developed concept of “reasonable expectations” The Supreme Court of Canada in BCE v. 1976 Debentureholders formulated a two-prong test for oppression claims: “(1) Does the evidence support the reasonable expectation asserted by the claimant? And (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms ‘oppression’, ‘unfair prejudice’ or ‘unfair disregard’ of a relevant interest?” BCE, at para. 68] |
| OBCA s. 248 |
| Compliance Order | CBCA s. 247 | Failure to comply with Act, articles, by-laws, USA, etc. | A “complainant” (as defined) or a creditor |
| OBCA s. 253 (s. 243(2) parallels CBCA s. 154) |