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DHN Food Distributors Ltd v Tower Hamlets London Borough Council, [1976] 1 W.L.R. 852 at 860, 867 (C.A.). – piercing veil by looking at whole economic entity. Group of companies can be treated as single entity when parent company such control that it can control every movement of the subsidiaries 28

Macaura v Norther Assurance Company, [1925] AC 619- frequently cites case for piercing the CV. SH did not have an “insurable interest” in the property of the corporations in which he held shares 29

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# Sole Proprietorship

* One single individual is responsible for controlling the business and liable for all debts/obligations
* No statutory requirements for starting up
  + if earning over $30, 000 a year probably have to get an HST number
  + if you want to run your business under a name other than your own name; in Ontario, you have to register that name under the *Business Names Act* s. 2 (fee of $60 every 5 years)
* easiest and least regulated form of business enterprise in Canada
* sole proprietor is the boss, they can employ others but business contracts are the proprietor’s
* sole proprietor is not an employee of the business and so they are not permitted to make deductible contributions to a registered pension plan or to a deferred profit sharing plan on their own account
* Advantages:
  + Simple to start and to dissolve
  + Modest expenses required to start up
  + Business name does not need to be registered (if using the proprietor’s own name)
  + Losses are flow-through – write off losses against personal income
    - when sole proprietorship loses money, sole proprietor can use business losses to reduce their income and reduce tax bill
    - sole proprietor’s income, including the full amount coming from the business is taxed at the progressive rate applicable to individual (contrasted to income earned by corporations which is taxed at flat rate). If sole proprietor incurs a loss in carrying on business, loss is applied against other income to determine the net income. When you start making gains, switch to corporation
* Disadvantages:
  + personal liability of sole proprietor is unlimited: sole proprietor is liable for all obligations/debts
    - no distinction in law between person and business- all assets of business are owner’s assets
  + Sole proprietor is responsible for both the torts that they personally commit and vicariously for those committed by their employees within the course of their employment
  + assets of sole proprietors business are transferable so when the sole proprietor dies, business ceases to exist unless someone inherits the assets and continues to carry on the business
  + Income is taxed as personal income (higher rate than corporate taxes)
  + When taking loan out, must personally guarantee the loan (personal money involved)

# Partnership

* *Ontario Partnerships Act (OPA)* s.2: “Partnership is the relation that subsists between persons carrying on a business in common with a view of profit”
* a partnership involves relationship between two or more persons which regulates the conduct of these persons and creates right and duties amongst them
* a corporation can also act as a partner
* rule governing the creation and operation of partnerships, the legal rights and responsibilities of partners to one another and the rights and obligations of partnerships, and each partner, to third parties were CL developments
* GP may be created with no formal, legal steps because partnership is a relationship, not legal entity
* Individual partners are exposed to the liabilities of the partnership itself, and to the risk of liabilities incurred by fellow partners acting within the scope of the partnership’s business
* **general partnership:** all partners exposed an unlimited degree to all debts/obligations of partnership

### Essential Elements to Forming a Partnership

* 1. **the carrying on of a business:**S.1(1) business: “every trade, occupation and profession”
  2. **enterprise must be carried on by persons in common:** 2 or more persons with legal capacity to be partners
  3. **the enterprise must be carried on with a view to profit:** joint operation for the sake of gain must exist. Charitable or nonprofit purposes are not partnerships.
* partnerships can arise in one of 2 ways:
  + (1) business people can deliberately form a partnership. Typically enter into a written partnership agreement setting out the terms of the proposed business relationship
  + (2) Court may also find that a partnership exists between two or more people even if they never formally took steps to establish a business partnership

### Characteristics of Partnerships

* + partnership statute in Canada are always provincial- every CL province has their own
  + partnerships in ON are supposed to register under *BNA*
  + minimal formal procedures in comparaison to a corporation
  + evidence consistent with intention to carry on business in common includes: contribution of skill, knowledge or assets to common undertaking, joint property interest, sharing profits and losses, filing income tax returns as partnership, financial statements and joint back accounts and correspondence with third parties (*Continental*)
* where a partnership exists, the partners will be subject to fiduciary duties with respect to each other
* law of partnership does not require a net gain over a determined period to establish a view to profit (*Spire)*

### Advantages of Partnerships

* + Management structure is flexible (unlike the CBCA’s regulations for corporations)
  + Simple to start and to dissolve
  + Loss Flow Through – partners can write off tax losses against income (same as SP)

### Disadvantages of Partnerships

* + individuals are exposed to the liabilities (to an unlimited degree) of the partnership itself, and to the risk of liabilities incurred by acts of their fellow partners acting in the scope of the business
  + Every partner is an agent for the partnership – any principal binds them all

### OPA. ss. 2-5- Establish the Existence of a Partnership

* + s. 2(3) - if you are carrying on business in partnership must be registered
  + s. 2(3)(1) - if your partnership is carrying on business under other name you must register that name
  + s. 3 – situations where partnerships exist: Co-ownership/tenancy of land not enough, best indicator – sharing of profits
  + s. 3(d) – If someone lends money to a partnership but instead of receiving interest, they receive a payment in regard to the partners’ profit/shares of business, lender is not automatically a partner

### OPA. ss. 6-19— Relationships Between Partners and Third Parties (Agency Law)

* + s. 6 – Every partner is an agent of the firm and of each other
  + s. 7 – A contract by one partner is binding on all others (agency)
    - Even if the partners have a written agreement that they need all partners to sign a contract for over $1000, but one partner signs alone, contract will be binding UNLESS the 3rd party who knows about this agreement or UNLESS 3rd party does not know that the partner is a partner
  + s. 8- Where one partner pledges the credit of the firm for a purpose not connected with the firm’s ordinary course of business, firm is not bound, unless they are specially authorized by other partners, but this section does not affect any personal liability incurred by an individual partner.
  + s. 9 - If it is agreed between partners to restrict the power of any of them to bind firm, no act done in contravention of agreement is binding on firm with respect to persons having notice of the agreement.
  + s. 10 – Every partner is jointly liable for all debts/obligations while they are a partner (presumed 50/50)
    - limiting liability: through contract if you give a loan to a company and instead of asking for interest ask for a share in profits. Get the benefit of partnership but limited liability
  + s. 11 – Agency extends to torts committed by any partner in carrying out partnership’s business
  + s. 14- improper employment of trust property for partnership purposes, no other partner liable for it
  + s. 15(2)- if partner dies having his name does not make him or his estate liable
  + s. 18(2) – Retirement does not exonerate partner from debts/obligations incurred before retirement

### OPA. ss. 20-31- Relationships Between Partners (Fiduciary Duties)

* s. 20 – Mutual Rights/Duties of a Partner can be determined by the consent of all partners
  + **Different from corporation** – partners choose management structure otherwise subject to *PA*
* **Equality** – relationships between partners shall be governed by these stipulations, *subject to agreements to the contrary.* 
  + s. 24(1) – equal bearing of both profits and losses
  + s. 24(5) – equal right to manage the business
  + s. 24(9) – equal access to company books
  + **difference between partnerships and corporations:** SH of Corp not guaranteed equal right to manage business
* Consensualism – Unanimity governing admission of new partners + any changes to fundamental characters of the partnership business. The relationships between partners shall be governed by the following stipulations, *subject to any agreements to the contrary*:
  + s. 24(6)- absence of limited liability, partnerships cannot be separate leal person
    - main disadvantage
  + s. 24(7) – the addition of new partners must be agreed upon unanimously
  + s. 24(8) – Changes to ordinary matters can be decided by majority of partners, but changes in the structure of the partnership relationship must be unanimous
  + s. 25 – No partner can be expelled by a majority of the other partners subject to any agreement
  + s. 26(1)- retirement at any point once notice of intention given to other partners if no fixed term
* Fiduciary Character
  + s. 28 – Partners must give true accounts, to a partner or legal rep, of info affecting partnership
  + s. 29 – Partners must account to the firm any benefit derived from the partnership, including to a deceased partner’s surviving family members before the firm is wound up.
  + s. 30 - Partners cannot carry out any business that would compete with the firm
  + If you are in a fiduciary relationship then you have legal duty to put each others interests before your own.
  + two main components:
    - duty of care- duty to do job properly
    - duty of loyalty- duty to work in good faith and best interest of company
* Personal Character – Partnerships can be unstable in comparison to corporations because of s. 33 but instabilities can be compensated for with internal agreements. Partners are guided by their definition of their personal relationship, not by selling shares – personal ties aren’t transferable
  + s. 31 – partner’s assignee is only entitled to the partner’s shares, can’t interfere with business
  + s. 33 – partnership is extinguished upon death/insolvency, unless agreement to the contrary
    - corporation has perpetual succession but here it does not, it dies with them
    - transferability of shares in corp but here, used to pay off shared debt then to partners estate
  + s. 36(1) – after retirement still liable to persons dealing with firm until notice given to person of change

### 5 Types of Relationships Between Partners and Third Parties (Agency):

* Partners will be held liable for various abilities that may be linked to or arise from partnership
* you cannot contract out of being an agent for your partner. If you have a partner sign something in the partnership name, as long as they are competent all partners are liable. But the agreement may include a provisions that states that no partner can sign a contract pursuant to certain stipulations.
* agency fails when the partner acting has no authority to act for the firm in that way, and the person they are dealing either knows the partner has no authority or does not know/believe them to be partner

1. **Pre-Partnership Liabilities** – s. 18(1) – New partners, when admitted, are not liable as agents for debts incurred by the existing partners from before they joined
2. **Liability as Partner** – s. 10 **General principle of agency law** –partners bear liability for each other
3. **Holding Out Liability** – s. 15 – A person is liable as a partner (even if they weren’t) if they knowingly represented (oral or written) themselves or allowed themselves to be represented as a partner
4. **Liability of an apparent partner** – s. 36 – Even after a firm changes its constitution, old members will still be liable until they give notice of change.
   1. liabilities incurred by business after defendant retired as partner but before creditor became aware
   2. retirement does not exonerate partner from debts/obligations incurred by the firm before retirement
5. **Posthumous Liability** – s. 36(3) Deceased partners’ estates not liable for debts occurring after death

# General Partnerships

* multiple owners + more complex than sole
* easy formation, lack of formalities + flexibility in designing internal management
* disadvantages: similar to sole proprietorship
  + all partners are exposed to unlimited degree to all debts and obligations of the partnership
  + partners can limit liability but it involves abstaining from playing part in direction of business
* advantage: tax loss flow through

## ***Continental Bank of Canada v R* (1998)**- view for profit does not have to be predominant intention, it can be ancillary unless there was no contemplation that it would even make them money

**Facts:** Partnership interests transferred from Subsidiary corporation (leasing to main Corporation (Central)) which then transferred/sold to subsidiaries. Continental Bank failed and their subsidiary leasing company was going to sell it. Taxes must be paid on the sale (capital gains). However, if you own property and transfer it to a partner, there is no capital gains tax. So, Continental Bank and Continental Leasing formed a partnership so that they can avoid the taxes. Revenue Canada says this is not legit.

Issue: was “leasing” a member of a valid partnership with the subsidiaries within the meaning of s. 2 of the *PA*?

**Held:** Nothing wrong with this – tax planning. They were in genuine partnership.

**Ratio:** Discloses three essential ingredients for partnership to exist: (1) a business, (2) carried on in common, (3) with a view for profit. A partnership may be formed for a single transaction. To establish carrying on of business, not necessary to show that the parties held meetings, entered into new transactions or made decisions. A recognition of the authority of any partner to bind the partnership is relevant, but the fact that the management rest with a single partner does not mandate the conclusion that the business was not carried on in common. Tax motivation will not derogate from validity of a partnership where essential ingredients of a partnership are present. If a partnership is formed for some other predominant motive, but there is also a real, while ancillary, profit element that is permissible.

**Reasons:** They were doing everything their agreement said (and no one said that a partnership has to last a certain length – ***Spire Freezers***). In determining the existence of a partnership, regard must be paid to the contract and intention of the parties. Courts must look into whether the surrounding facts are consistent with a subjective intention to carry on business in common with a view to profit. The Canadians did not intend to carry on business with a view to profit.

**Held:** Appellant was not a member of a partnership because there was no business being carried on with a view to profit. The partnership agreement and other documentation indicate an intention to form a partnership but that is not sufficient because the fundamental criteria of a valid partnership must still be met.

## ***Cox and Wheatcroft v Hickman* (1860) HL** - New test for intention: sharing profits is an important indication of partnership but it is not determinative. look to the intention of the parties (facts)

**Facts:** Ironworks company gave up business for a while to creditors: take profits until debt is paid off, then return company. The problem: two named defendants: Cox and Wheatcroft: one for short time was one of the trustees running the business. Hickman was a creditor and did not even know these two people were involved, but that C& W had deep pockets. Creditor group wrote bounced cheque & Hickman discovered C & W at some point were part of the creditor group; so sues them. Only entitled to sue them (neither of whom wrote cheque) if he can establish there was a partnership amongst C, W & others & on the basis of rule that each liable for debts and obligations of others.

**Ratio:** Parties intention to create partnership is determinative. Sharing profits is a compelling indicator: but simple sharing profits not enough; have to look at all facts

**Reasoning**: This case is important in developing test for partnership because if we apply the formalistic rule that they did share profits then they are partners. But here the parties only shared profits until the debt was paid, then turned over business to original owner. The HL was really looking for whether the parties intended to create a partnership. Sharing profits is a compelling factor but it is not enough, you must look at all facts. Now it is a test of intention: was it the intention of the parties to create a partnership?

**Note:** made the agency element a requirement of partnership relationship when it held that a business “has to be carried on by or on behalf of one of the partners in order to be a partnership”

## ***Backman v Canada*, [2001] 1 S.C.R. 367-** 3 elements: (1) carrying on a business, (2) in common, (3) with a view to profit (which can be ancillary).

**Facts:** Appellants purported to acquire a partnership interest in an apartment constructer venture from US parties. Immediately after acquiring partnership interest, appellants sold the partnership property back to original owners. Effect of this was to generate accounting losses which the appellants then sought to deduct when calculating their taxable income for the year. If the appellants had been in partnership, the deduction would have been permitted but if the relationship did not constitute a partnership, deduction would not be allowed.

**Issue:** (1) Was the appellant a member of a valid partnership such that he could deduct partnership losses from his income pursuant to s. 96 of the *ITA*? (2) Does the taking of an assignment constitute the appellant as a partner?

**Held:** Appellants did not satisfy the definition of partnership and so deductions were not allowed because there was no business being carried on with a view to profit.

**Reasons:** Partnership agreement and other documents indicate an intention to form a partnership but that is not sufficient because the fundamental criteria of a partnership must still be met. Agreed with the CA that at the time they entered into the transaction, the Canadians did not intend to carry on business with a view to profit in respect of the Dallas Apartment Complex. From *Continental Bank* we know that partnership can be formed for only a brief period of time and that the parties do not need to hold meetings or make decisions and that the passive receipt of rent can constitute a business so it does not matter that the apartment complex was only briefly owned.

**BLL:** Determined what constituted of carrying on business: occupation of time, incurring of liabilities, purpose of livelihood or profit

## ***Shell Canada Ltd v Canada*,** [1999] 3 SCR 622**, *Canada v Antiosko*,** [1994] 2 SCR 312**, *Stubart Investments Ltd v The Queen*,** [1984] 1 SCR 536**-**tax motivation does not derogate from validity of transactions

## ***Hickman Motors Ltd v Canada***, [1997] 2 SCR 336- a business may be established even when the sole business activity if the passive receipts of rent

## ***Spire Freezers Ltd v Canada* [2011] SCC** - duration of carrying on business is not determinative; partnership may be formed for a single transaction, unnecessary for parties to show that they held meetings or made decisions as a partnership. Intention to profit can be ancillary purpose.

**Facts:** Spire Freezers (appellant) bought 75% of an American company (HCP), 50% from one partner of HCP (Peninsula) and 25% from the other partner (BDI). BDI sold its other 25% to other Canadian groups (Spire Group). Revenue Canada disallowed the Canadian groups to claim the losses incurred when HCP was sold because they claimed they were not partners. Tax Court and Fed CA ruled against them.

**Issue:** Were the appellants members of a partnership at the time the losses were incurred?

**Held:** Appeal allowed. There is sufficient evidence to find a common purpose amongst the parties

**Ratio:** The intention to make a profit cannot only be judged subjectively, but also based on objective evidence. The alleged partners’ ancillary purpose must be part of the analysis.

**Reasons:** The common purpose element of a partnership was established by the parties entering valid partnership agreement setting out their respective rights/obligations as partners. Business were running with a view to profit when the Canadians were added and the appellants must have entered with a view to profit because they are told during negotiations about the potential to make profit. Rejected CA’s argument that there was no view to profit because the parties did not contemplate recouping the initial loss. The law of partnership does not require a new gain over a determined period in order to establish view to profit.

**Difference between *Spire* and *Backman*:** (1) there is significant difference between the number of subordinate assets in the cases in terms of the degree of effort required of the appellants and expended by them in management and (2) alleged partnership in *Backman* had no significant management control over that asset, nor did the acquisition of that asset represent a continuation of a pre-existing business. Thus, the partnership here was “an empty hell that does not carry on business”. In this case, the subordinate asset was the entire interest in an apartment building.

### Inferring the Existence of a Partnership

* in the absence of an agreement to the contrary, the rights/obligations of members of a partnership guided by the *PA*
* at common law, the initial and sole test for determining the existence of a partnership was the right to share in the profits but this rule was discarded in *Cox v Hickman* (1860), 11 ER 431 (HL)
* no requirement that one must contribute capital to be partner (*Boudreau v Pierce*, 1986)
* intention of the parties is critical determination of the existence of a partnership
* Three important factors used to indicate this intention are (a) the right to share in the profits, (b) the duty to share the losses and (c) the degree of control to be exercised by the parties
* s. 3 of the *PA* sets out specific situations which do not constitute partnerships
  + s. 3- The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not itself make them a partner in the business, and in particular
    - (a) the receipt by the person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make them a partner in the business or liable as such;
    - (b) a contract for the renumeration of a servant or agent or a person engaged in a business by a share of the profits of the business does not of itself make the servant or agent a partner in the business or liable as such;
    - (c) a person who,
      * (i) was married to a deceased partner immediately before the deceased partner died,
      * (ii) was living with a deceased partner in a conjugal relationship outside marriage immediately before the deceased partner died, or
      * (iii) is a child of a deceased partner
    - and who received by way of annuity a option of the profits made in the business in which the deceased partner was a partner is not by reason only of such receipt a partner in the business or liable as such

### All Aspects of the Business Relationship to be Considered

* to determine whether partnership exists, all aspects of business relationship are considered (*Doran v Duff* (1953)
* must pay attention to the intention of the parties as evidenced by their express agreement or implied by the facts, so the real nature of the relationship is determined (*Robert Porter & Sons Ltd v Armstrong*, 1926)
* person can be a partner even if they have not contributed anything in material way (*Mr W v MNR*, [1952] Ex CR 416)

### Tacit Partnership

* a partnership may be found to exist even if the parties did not direct their minds to forming a business

## ***Beaudoin-Daigneault v Richard*, [1984] 1 SCR 2** - Tacit Partnership- Division of Assets. Partition by Fact

**Facts:** an action was brought after the separation of the parties who lived together on a farm.

**Prior Proceedings:** TJ ordered partition of the farm but CA reversed this decision

**Held:** Partition of the farm ordered because a tacit partnership was found to have existed.

**Reasoning:** In order to satisfy the court that a partnership exists in the absence of a written agreement between two people living together, trial judge must be satisfied that:

1. each partner has made contributions to the common fund either in money or property, or by work.

2. their past conduct must also disclose how losses and gains were distributed.

### Partnership Note a Legal Entity: Aggregate and Unity Theory

* partnership is not a legal entity
* **aggregate theory:** notion that partnership merely represents the separate legal existence of the various partners and their collective rights and duties
  + permits the suing of partners in the firm name
* **unity theory:** recognition of the partnership as a separate and legal unit
  + makes provisions for the division of partnership assets upon dissolution
* each partner is taxed individually on his or her share of the partnership’s income
* it is easier in law to form and dissolve a partnership than a business corporation

### Partnership Agreement

* no formal steps required for the creation of a partnership but customary to define individual interests in a “partnership agreement” and it may override many of the provisions of the *Act*
* partnership agreement should usually set forth the following;
  + partnership name, names of the partners, purposes of the partnership, date of the agreement, location of business, duration of the partnership, investment of each partner (realty, personalty, cash), the sharing of profits between partners, the sharing of losses, any renumeration for service, management and voting powers, arbitration procedure, voluntary or compulsory retirement clauses, the procedure for the purchase or sale of a deceased or retiring partner’s interest, with a method for determining value, respective duties of the partners, accounting periods and arrangements, banking arrangements and the authorization to sign partnership cheques and make loans, powers to hire and discharge employees and fix their salaries

## ***Boudreau v Pierce*** - Written Agreement - Division of Assets. Partnership as of fact- share profits for a day

**Facts:** A sole proprietor who operated a flower shop took on his full time employee as a partner. The sole proprietor had built up some assets and good will in the business. Two years after the partnership was formed, it dissolved as a result of the acrimony that had arisen between the two partners. An application was made to Nova Scotia SC for a determination of the money payable to each partner on dissolution. At trial, the original sole proprietor maintained that he had no intention of sharing the value of the original assets with his partner without some compensation.

**Held:** The value of the assets of the partnership remaining on dissolution was divided equally between the partners after liabilities were paid. The original sole proprietor received no additional compensation for the assets built up before the partnership.

**Note:** The result here could of been avoided by a written partnership agreement.

### Registration of the Partnership

* one formal requirement for the formation of a partnership: registration of the partnership in a public register. This requirement is set out in the *Ontario BNA*, s. 2(3)
* s. 7(1) of the *BNA* says that a person carrying on business in contravention of the registration provisions cannot maintain a proceeding in a court in connection with that business except with leave of the court

### Relations of Partners to One Another

* Partnerships Act s. 20-31 set out the legal implications of the relationship between individual partners. The operation of these sections may be excluded by an agreement between the partners
* s. 21 relates to how “partnership property” is to be defined
* Subsection 21(1) provides that the partnership property shall consist of *all* the property and rights and interests in property which were originally brought into the partnership stock or which were later acquired on account of the firm or for the purposes of the partnership business and in the course of it.
  + parties should provide in partnership agreement what is to be joint or partnership property and what is to be separate property. If they don’t, the courts will infer their intention taking into consideration: the source of the property, the purpose for which it was acquired, and the use which has been made of the property
* 21(2) deals with the devolution of land. Land will devolve according to the ordinary rules of real property but a trust will be imposed on the interest taken sufficient to fulfill the presumptions created by this section
* s. 3(1) - that joint ownership of property does not create a partnership in the thing owned.
* Subsection 21(2) allows such co-owners to purchase other land with profits made from the original co-ownership, and that new land belongs to them also as joint owners (*not* as partners) unless there is agreement to the contrary.
* Section 22 -unless a contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on the account of the firm.
* Section 23 - where land becomes property of a partnership, then unless there is a contrary intention, the land will be treated as personal or movable property and not as real or heritable property. May have significance in the administration of the estate of a deceased partner.
* Section 24 states ten rules to define the relative interests and duties of the members of a partnership. All of these rules are subject to any express or implied partnership agreement.
  + (1) **rule of equality**: specifies that all partners are *prima facie* entitled to share equally in the capital and profits of the business and must contribute equally to the losses sustained by the firm. Rule applies even where one partner does much more work than another, but if one partner receives a salary in respect of an official position, that salary is not to be regarded as profits to be shared.
  + (2) **rule of indemnification:** with respect to certain payments made or liabilities incurred by a partner (a) in the ordinary and proper conduct of the business of the firm; or (b) in or about anything necessarily done for the preservation of the business or property of the firm
  + (2.1) A partner is not required to indemnify the firm or other partners in respect of debts or obligations of the partnership for which a partner is not liable under 10(2)
  + (3) is a rule of interest at 5% per annum for any extra capital that a partner invests in the partnership.
  + (4) states that interest is not a right prior to the ascertainment of profits.
  + (5) every partner may take part in the management of the partnership business.
  + (6) no partner is entitled to remuneration (money paid) for acting in the partnership business. This will apply, in the absence of an agreement to that effect, even to a managing partner (*Whittle* v. *M’Farlane* (1830)).
  + (7) no person may be introduced as partner without consent of all existing partners. Usual practice to include terms of admission of new partners in partnership agreement
  + (8) ordinary business matters are to be decided by a majority of the partners, but no change in the nature of the partnership business may be made without the consent of all existing partners.
  + (9) partnership books are to be kept at the place of business of the partnership or its principal place of business if there are more than one.
* Section 25 - no majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.
* Section 27 deals with the situation where an agreement provides that the partnership shall continue for a fixed term, at the end of which it will expire, and the partners then continue the business after that date. Where there is no express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term so far as is consistent with the incidents of a partnership at will.
* Section 28 partners are bound to render true accounts and full information of all things affecting the partnership to any partner or to his legal representative.
* Section 29 A partner must account for any benefits accruing from partnership that he derives without consent of the other partners from any transaction concerning the partnership or from any use of the partnership property, name or business connection (*Aas v Benham*, [1891] 2 Ch 244 (CA))
* Section 30 a partner must account for and pay over to the firm all profits made in a business of the same nature as and competing with that of the firm. This is occasionally varied by the intent of the partners.
* Section 31 provides for the assignment of a share of partnership receipts. Assignment does not entitle the assignee to interfere in the management or administration of the partnership business. Assignee is entitled only to receive the share of profits to which the assignor-partner would be entitled, and must accept the account of profits which was agreed to by the partners.

### Common Law Fiduciary Duties

* *Powell v Maddock* (1915), 25 Man R 730
  + the requirement of a fiduciary duty for each parter noted in Canada
* fiduciary duty embodies a duty of care/skill (test of reasonableness) and a duty of loyalty (determined by good faith)
* duty of loyalty measured stricter because of the close, personal nature of a partnership
* every partner has a right in law to the information that the others possess and no partner may act at the expense of the others and no secret profit may be made to the exclusion of the others
* breach of fiduciary duty can occur even though partnership has not yet been formed as the use of information gained during negotiations to one’s own advantage constitutes a breach of fiduciary duty (*International Corona Resources Ltd. v. Lac Minerals Ltd*. (1987), 23 O.A.C. 263)
* most fiduciary duties come to an end when one partner refuses to accept its obligations under partnership

### Relations of Partners to Third Persons: Law of Agency

* s. 6-19 of the *PA* set out the principles governing this relationship
* the law of agency is the legal basis for the external relationship between partners and third persons
* Section 6 - every partner is an agent of the partnership and his or her other partners for the purpose of the business of the partnership. The act of every partner who does any act to carry on business binds the firm and the partners unless the partner acting has no authority to act for the firm in that particular matter and the person with whom they are dealing knows that the partner has no authority or does not know or believe that partner to be a partner.
  + This section sets forth the **essential elements of the agency relationship**:
    - **(1)** person acting is a partner,
    - **(2)** acts performed are for carrying on business of the kind carried on by the partnership,
    - **(3)** their specific authority to bind the partnership in that area has not been withdrawn. The active partner will bind the others unless the third party with whom they are dealing either
      * **(a)** knows that he or she lacks a specific authority, or
      * **(b)** is not aware that he or she is a partner.
* Section 7 - acts performed, or instruments executed, in the name of the firm and in a manner indicating an intention to bind the firm, by a person possessing authority from the firm to so execute the document or perform the act (whether or not that person is a partner) have the effect of binding the firm. Express authority to perform an agency act cannot be withdrawn unless the third party has proper notice.
* Section 8 - the firm will not be bound when one partner pledges the credit of the firm for a purpose not connected with the firm’s ordinary course of business, unless that partner has been specifically authorized to do so by other partners. This does not affect the personal liability of the partner pledging the credit.
* Section 9 - if the partners agree to place restrictions on their individual power to bind the firm, then any person who has notice of the agreement is bound by such restrictions.
* Section 15- deals with the concept of “holding out.” It provides:
  + 1)where a person has by words, spoken or written, or by his or her conduct held themselves out to be, or allowed themselves to be represented as, a partner, they will be liable as though they were a partner to any person who has relied on the representation to give credit to the firm. This liability will exist whether or not the representation has been communicated to the creditors by, or with the knowledge of, the person so holding himself or herself out, and
  + (2)Limitation on the “holding out” doctrine: where the name of a deceased person continues to be used in the firm name after the death of that person, no liability shall attach to his or her estate.
* *Tower Cabinet Co v Ingram*, [1949] 2 KB 397
  + issue was whether a former partners, who left the firm, had continued to hold himself out as a partner

### Dormant Partners

* dormant partner: one whose relationship with partnership is hidden from those who do business with firm
* difficulty with dormant partners is seeing if the facts suggest that the agency principle is not applicable

*Court v Berlin*, [1897] 2 QB 396 (CA)

* + held that even dormant partners are liable on contracts entered into on behalf of the firm while they were present with the firm, even if they subsequently terminate their relationship with the firm

### Dissolution of the Partnership

* s. 32 to 44 of the *PA* deals with the dissolution or termination of a partnership
* general rule: on dissolution, partnership assets will be converted into cash of which debts will be paid out of, and the balance distributed amongst the partners

### Key Premises for General Partnerships:

* Legal basis for unlimited liability to 3rd parties for partners in a GP has nothing to do with the fact that each general partner exercises control over the GP. Also not based on 3rd parties’ knowledge that you were a partner.
* It is NOT TRUE that only the state can confer limited liability. It can be created via contract.

### The Basics for Partnerships

1. Partnership is the relationship that subsists between persons carrying on a business in common with a view to profit (*PA* s. 2)
2. Profit sharing does not, by itself, prove a partnership
3. If you do all of the things that the law says denotes a partnership, you are in a partnership whether you understood all the legal ramifications or not
4. A partnership is not a separate entity, it is just a collection/aggregate/ relationship of individuals (*Lee*)
5. Corporations can be in partnership with other corporations because corporations are person
6. A sole proprietorship is run by one person and that person is exposed to unlimited liability
7. GP exposes all partners to unlimited liability and is governed by fiduciary responsibility (*Partnership* Act)
8. LPs can only be sued for the difference between what they have agreed to invest and what they already invested
9. If a LP takes control of the business of a partnership they become a GP and they are exposed to unlimited liability, unless they contract out of it (*Haughton, Nordile*,)
10. A limited partnership is not the same as a limited liability partnership
11. In LLP each partner is liable only for the errors/omissions of themselves and people working directly under the,
12. ULC’s in which shareholder do not have limited liability operation in Nova Scotia, Alberta and BC
13. LLC’s offer limited liability for every member even if they conduct business of the company, operation in USA only

# Limited partnerships

* Can only exist after a filing is made with the government, and when that filing lapses, partnership dies
* differs from GP in two particular ways:
  + **(1)** in a limited partnership, many people have an ownership interest, yet have limited liability
  + **(2)** the limited partnership is a creation of statute. Unlike a general partnership, a limited partnership cannot be inferred from the conduct of the parties. It must be deliberately created in accordance with specific statutory rules. Only available in jurisdiction which have enacted limited partnership legislation
* in order to exist must satisfy the requirements of the *Limited Partnerships Act (LPA)*
* s. 2(1) of *LPA* - a limited partnership may be formed to carry on any business that a GP may conduct
* limited partnership is formed by filing a declaration containing the preformation prescribed in s. 1.1 of the Regulations. There is a fee for such a declaration which is $210.
* major difference between general partnership and a limited partnership: in a limited partnership, each limited partner is only liable for the obligations of the limited partnership to the extent of the amount of property contributed by that limited partner to the capital of the firm (s. 9)
* management of a limited partnership rests in the hands off the general partner and a limited partner can lose the protection of limited liability if they take part in the control of the business (s. 13)

### Advantages of Limited Partnership

* + **Limited Liability** – LP’s are only liable for the specific $ contribution that they invested in the business as a partner (can’t be sued for more than that amount)
  + **Transferability** – LP partnership can be assigned (like a share interest in a corporation)
  + **Tax loss flow through** – like GP, LP’s are incentivized to invest in partnerships by representing losses as less income to be taxed (can write off losses against other income).
    - Can write-off very quickly (i.e., in year 1) which attracts investors
    - Ex: Investor contributes $10,000 to a business. If the business is an LP, the investor can write off the $10,000 against his $80,000 salary so that he is only taxed on $70,000. Assuming that person’s tax bracket is 45%, that means the person really only contributed $4,500. If the business is a corporation, investor cannot write against personal income, but rather the corporation writes it off against other corporate income.
  + **LP’s can be employees of the business** – unlike corporate shareholders, who cannot be employed by their corporations past their shareholder role

### Disadvantages of Limited Partnership

* + **Limited Liability is revoked if LP takes control of the business**
  + **Rooted in Statute** – cannot be recognized by common law, have to adhere to *LPA*
  + **Not a Separate Legal Personality** – Can be assigned, but the partner cannot be separated from the relevant debt/obligations of its $ contribution (i.e., the money you put into an LP as a limited partner will be lost, but that is the extent of money you lose)
  + requires more legal formality than sole proprietorship or general partnership

### Characteristics of Limited Partnership

* creature of statute
  + s. 3- how to set up LP (make filing with gov’t, declaration filed with registrar in accordance with act
    - s. 3(3)- expiry of declaration
  + s. 4(1) - GP has to maintain current record of LPs stating prescribed info
* generally consists of at least 1 general partner and 1 limited partner (s. 2(2))
  + **GP**- manages the business and is liable to an unlimited degree for all debts and obligations. GP is usually a corporation in order to avoid liability
  + LP- Invest capital and receive a typically proportionate return/share of profits. Only liable to the extent of their contribution to the firm (limited liability) but this protection is lost if they take part in the control of the business. They are entitled to have access to certain financial information and entitled to vote on certain major matters. (s. 9)
    - LPA s. 7(1) - an LP may contribute money or property but NOT services
    - invest capital and do not participate in running business
    - LPs job is to put money and get a return, basically a fractional interest to be negotiated
    - s. 13- LP not liable as GP unless they take control of the business
* withdrawal - LP has the right to demand and receive the return of the LP’s contribution (s. 15)
  + 4 typical circumstances
    - dissolution
    - if partnership agreements provides for it
    - if no procedure is specified in agreement, then after they give 6 months notice to other partners
    - if all other partners consent to return/withdraw
  + not entitled to withdraw unless there are sufficient assets to cover all partnership liabilities
* dissolution
  + dissolved upon death, retirement, mental incompetence of GP or dissolution of corporate GP
  + s. 21(a)- other partners can continue partnership
  + s. 15(4)- can dissolve if withdraw of contribution is not forthcoming on his demand
* taxation
  + take partnership income or loss into account when accounting for personal income tax
  + federal government has introduced special tax incentives for certain areas of business to promote investment- allowance for rapid expenses for tax purposes of the cost of items which would otherwise be capitalized and offset against income over a much longer period + allowing any resulting tax losses to offset income of taxpayer from other sources

### How to Create a Limited Partnership

Ontario *Limited Partnerships Act* RSO 1990 –

* s. 2(2) At least one general partner controlling the business and at least one limited partner
  + Partner= legal individuals (corporations can be general or limited partners)
  + General partner in an LP is the same as a regular partner in a GP – unlimited liability
  + most LPs in Canada have corporation as the GP – helps avoid practical harm because corporations have unlimited liability (thus, everyone has limited liability) – shell company ($0)
* s. 3(2) Formed by filing a declaration under s.3 of the *LPA*
  + Give partners’ names, the name and address of the firm, the general nature of the business, and the “prescribed” contributions of each partner
    - “Prescribed” = set out by the relevant regulations
* s .3(4) – Declarations expire every five years, but can be reinstated by paying a fee
  + Differs from corporations, which don’t expire

### What do Limited Partnerships Entail?

Ontario *Limited Partnerships Act* RSO 1990

* s. 5 – A person can be a general partner and a limited partner at the same time
  + Why? Distribution of profits – The profits have to be spread among the GP and LP. So, a GP might need to assume a role of an LP in order to receive the profits that they want
* s.7 – LP’s can contribute money but not services – *Zivot/Nordile* (but, as stated in s. 12(2), they can be employees, but that can’t be their LP contribution).
* s.9 - Limited partners are only liable for the extent of his/her contribution (S.9), unless he/she also takes part in control of the business (s. 13(1))
* s. 10- Limited partner has the same rights as a general partner to true and full information of all things affecting the limited partnership
* s. 11 – Limited Partners get a share of the profits and to have their contributions returned
  + But, debt ranks ahead of equity, so lenders get paid before partners
* s. 12 – Limited Partners can examine the state of the business, and can “advise” without changing LP
* s. 12(2)(b) – they can work as an advisor or an employee to the business
* s. 13 – Limited Partner is not liable as a general partner, unless they take part in control of the business
  + Limited Partners give up their immunity from liability for more than the specific amount that they invested if they ever assume control of the business. (still LP but same liability as GP)
* s. 14(2)- permits LPs to agree that one or more of them have a priority over other LPs in respect of return of contribution or compensation by way of income. Must be set out in partnership agreement.
* a limited partner is entitled to have the limited partnership dissolved and its affairs wound up where they have rightfully but unsuccessful demanded the return of capital contribution or the liabilities of the limited partnership have not been paid in the circumstances contemplated by 15(4)
* s. 16 – Limited partner is liable to the LP for any money they have not yet contributed but that was agreed to be part of the contribution.
* s. 18 - **Transferability** –LPs can assign their partnership, if the other partners agree to transfer
  + s. 18(2) - can substitute and will get all rights and power, like when someone dies
  + limited partners can assign their interest but assignee has only limited rights until becoming a substituted limited partner by meeting the requirements of 18(4)
  + s. 18(3) - assignee who is not a substitute has no right to inspect books; give info; account affairs; entitled to only receive shares of profits/return of contribution
  + s. 18(4)- to become substituted consent in writing by all partners; or if assignor has power and authorizes
  + s. 18(7)- substitution does not release assignor from liability under s. 16 and 30

### Withdrawal

* + if a limited partner does not sell their interest, that person may receive a return of capital contribution in the 4 circumstances in s. 15 (above)
  + s. 15(2)- in addition to those four circumstances, also cannot withdraw unless sufficient partnership assets to cover all partnership liabilities

### Dissolution

* s. 2- Limited partnership is dissolved upon the retirement, death or mental incompetence of a GP (but not an LP), for the dissolution of a general partner when the general partner is a corporation unless the remaining general partner continue to the business in accordance with s. 21
* s. 23(1)(b)- can also dissolve when all LP’s withdraw
* s. 15(4)- LP can dissolve if their return is not forthcoming on their demand
* s. 14(2)(a)- can dissolve if assets insufficient and otherwise be entitled to be repaid contribution
* s. 24- the settlement of account after the dissolution of a limited partnership
* s. 27 – The rules of the province that you incorporated in are the ones that apply to your partnership, even if you move provinces

### Mistakes

* s. 30- Effect of false statement in record of limited partners. Can hold every GP liable if suffered as a result and LP if they become aware and failed to take steps to correct it in a reasonable time
* s.31 – Liability of person mistakenly believing the person is a limited partner
  + Ex. I thought that I was investing in order to become a limited partner on record. Turns out I was wrong. If the business ends up being sued, I am not liable.

**Not a separate legal entity** – just like general partnerships, not separate from the individual

**No double tax on dividends** – better than being a shareholder, earnings are taxed as income, not twice under income and capital gains as with corporations. Corporations may tax on their actual or imputed profit and shareholders pay taxed on dividends achieved by them from the corporation - results in double taxation.

* under *ICA*, individual partners take their share of partnership income or loss into account when computing their personal income. This is a direct flow through of income.
* some lower-level tax incentives – the Government allows LP’s to expense a lot of things rather than capitalize/depreciate them, in order to encourage investments in things like resources and CanCon

### Who Can be a Limited Partner?

* a person can be a GP and an LP at the same time in the same partnership (s. 5(1))
  + almost all profits are allocations to LPs
  + the GP doesn't get any profits
  + you have no limited liability
* an LP may be an employee of a partnership, but this is not true for a general partnership
* it only takes one time to make yourself a GP then you are a GP forever
* LP can assign their interests to third party, but assignment does not have full rights of LP (s. 18)

## ***Haughton Graphic Ltd v Zivot* (1986) ONHC** – Limited Partners dissolve their shield from liability if they exercise control of business interests. Individuals may for a LP as LPs within a corporation as the GP even though they are directors of it, so long as the actions carried out by the individuals do not assumed such control.

**Facts:** D was the controlling operator of the GP corporation of a magazine producing business. During the course of business, he assumed the role of one of the partnership’s limited partners. He did so because the businesses profits were being shifted to limited partners, plus he would get the tax loss flow-through. After a printing contract fell through, P attempted to sue him as more than a limited partner.

**Issue:** What does “control of the business” mean? Was it necessary that the plaintiff think that Zivot was a GP in order for him to be treated as one under the statute?

**D’s Argument:** The plaintiff did not rely on the knowledge of whether or not D was a limited partner or the controlling mind of a GP. So, ‘control of the business’ should not be substituted for estoppel. Also, if D was found liable, the value of LPs would be jeopardized as people would not be able to ensure that they could receive the profits for their controlling decisions

**Held:** D was found liable – he gave up his right to limited partner liability.

**Ratio:** If a limited partner seems to take control of the business they are exposed to the unlimited liability of a general partner. In this case, Zivot is not being held to unlimited liability because of his role as a director of the general partner corporation, but rather because of his role as a limited partner taking control over the business aspects of everything.

**Reasons:** Eberle J – Reliance is not a factor in determining the liability of general or limited partners. It doesn’t matter how much the plaintiff knew. If evidence exists that D exercised control of business interests, they give away their barrier from liability (Zivot had business cards saying he was the owner, and introduced himself as such)

**Note:** Court says that the humans that are officers of the GP and are also an LP are liable to an unlimited degree. If they were not an LP, they would be protected by the corporation, but because they are a limited partner too, they are seen to be taking control.

## ***Nordile Holdings Ltd v Breckenridge* (1992) BCSC** – Express specification of the capacity of LP’s (in contract) can override statute if it explicitly blocks lawsuits against LPs.

**Facts:** D was a limited partner to a rental properties partnership, as well as the director of the partnership’s sole general partner business. The partnership fell into debt to P, P sued D as a general partner to the business (relied upon *Zivot*). P admitted that D was acting solely in the capacity as director of the GP when they participated in the LP.

**Issue:** Can Breckenridge be held personally liable to Nordile?

**Held:** Appeal dismissed. D was not liable as a GP – shielded by his limited partnership rights

**Reasons:** The defendant in this case had signed an agreement to become a limited partner that explicitly stated that the plaintiff could not sue limited partners (*Zivot* did not have this). D admitted that he was acting SOLELY in his role as director of GP – thus, he could not be acting in any other capacity. Breckenridge included in agreement that he participated in Arbutus once in the capacity of a director, which excludes him from liability. This was an agreed fact so it cannot be argued on at trial. If he was acting solely as a director then he was not acting as an LP. LP who was controller of corporate GP did not take control of partnership because not acting solely in his capacity as director/officer of the GP so not personally liable.

### Why be Both a GP and LP?

* As GP you cannot buy LP interest by saying you will work for company. LP is an economic interest.
* LP’s are often set up that all right to receive profits is allocation to limited partners. The only reason they would give GP anything is to say that this is genuinely a partner.

### Takeaway from the two major LP cases:

* While they contrast, they are actually aligned in how the law approaches the limit of control
* *Zivot* Reaction:
  + People were initially nervous that the decision would ensure that any individuals that ran GP businesses could not become LPs (to receive profit) without giving up liability
  + But, the *Zivot* facts were highly specific – the individual in question clearly took a high degree of control as part of his personal capacity – so, limited partners who exercise a far lower degree of control are probably not doomed to liability because of the decision
* Key Distinctions Between *Zivot* and *Nordile*

1. The plaintiff in *Nordile* agreed to a statement of facts at trial, which included the fact that the defendant acted solely in his capacity as general partner’s controller
   1. If the parties agreed that the defendant acted solely as a GP and therefore had no role as a limited partner, the issue of limited liability was moot. The overlap between the roles could not be recognized, therefore the shield to liability was never exempted. D’s specific contract with P ensured that P could not sue D as a LP

### Limited Partnerships Carrying on Business Outside Jurisdiction

* when a LP carried on its business outside jurisdiction of formation, they are governed by statute of where they set up and the limited liability protection of its LPs may be lost sometimes (s. 27(2)).

### No Separate Legal Personality

* Limited Partnership Act does not confer separate legal personality on a limited partnership

### Fiduciary Duties

* fiduciary duties owed by one partner to another, especially GP to LP (*Molchan v Omega Oil & Gas Ltd)*

### Tax Considerations

* limited partnership income is not taxed in the limited partnership itself as a separate tax entity, but rather the income is taxed in the hands of each individual limited partner and the general partner
* although s. 96 of the Income Tax Act requires a partnership to compute its income as if it were a separate person, that income or loss is “flowed through” to the limited partners
* if the limited partnership does suffer early on, the limited partners are protected from risk by virtue of their limited liability but they may benefit from the deductibility of such losses against their other income because this will lower their taxable income and therefore will lower their income taxes
* By way of comparison, the business corporation as a separate legal person and taxpayer first pays tax on its income and the shareholders pay an additional tax when the “after-tax” income of the corporation is distributed to them in the form of taxable dividends. If the corporation suffers losses or has excess deductions, these are “stored” by the corporation for deduction against subsequent profits. Normally, such losses do not flow through to shareholders of limited partnerships carrying on business outside jurisdiction
* a limited partnership with a corporation as a general partner can be reorganized as a corporation once the limited partnership has “flowed through” all available deductions and credits, the GP may arrange to purchase the interest of limited partners in exchange for shares of the GP business corporation
* The principal reason for favouring a corporation over a limited partnership is the added liquidity shares are thought to have over limited partnership interests

# Limited Liability Partnerships (type of General Partnership)

* originally created in Texas, US in 1991 and introduced into Ontario in 1998
* distinguishing feature: permits partners to insulate themselves from any liabilities of their fellow partners. The partnership itself is still liable for such acts (limited liability changed from partial shield to full shield). Partners exclude their liability for the negligent or other described wrongful acts of a partner by registering as a LLP
* outlined in s. 10(2)- Each individual partner in an LLP is liable for their own negligence and the negligence of the people who worked under that individual partner (as long as you took reasonable actions to prevent actions) but not liable for any other debts or obligations incurred of partnership
* s. 44 - preconditions to acquiring LLP status: (1) written agreement to do so between 2 or more people designating their partnership as LLP, (2) permits practice of certain professions for LLP and requires minimum liability insurance, (3) name is registered under BNA and (4) name must include LLP as the last words or letters of firm name
* Personal property of innocent partners not be exposed to claims of 3rd parties wronged by “guilty” partners
* Only certain professions covered by professionally liability insurance can use LLP’s (accounting, law).
* Hybrid between corporation and partnership
* members allowed to participate in management/control of a business without losing limited liability
* Company can be taxed as a partnership or corporation, depending what you prefer
* Can contract out of everything (e.g., in Delaware – the fiduciary obligation of the directors)
* every partner is liable jointly with all other partners except for when loss is caused by another person’s negligent acts or omissions

# Corporations

* single person can incorporate him/herself as well
* a corporation has its own legal personality separate from shareholders directors + officers
* the basics of corporations:
  + 1) a corporation cannot have the same name as another corporation
  + 2) the corporate name must have a cautionary suffix
  + 3) A corporation can do business as a business name- what the public will know them as
  + 4) Private issuers are entitled to an exemption under the securities act so they do not have to have a prospectus, but they must have less than 50 shareholders (not including employees)
  + 5) A corporation will be created with directors- who then could issue shares
  + 6) Not necessary to impose restriction but in certain scenarios they can be beneficial
  + 7) Setting out shares (share conditions) describing what kinds of shares can be issued. They will name a class of shares and identify the number the company can issue
* **SHs:** fundamental role is to elect directors - do not manage the company in capacity as SH (can be director and SH) (*Lee*)
* **directors:** fundamental role is to appoint the officers (like CEO, CFO, President) - periodic job, typically not full time employee but manages the organization and running of the company
* **officers:** run the company
* **employees:** hired by officers

### Federal or Provincial?

* provincial government give capacity but not authority/right to operate anywhere in the world
* if you incorporate under federal statute, you have the right to do business anywhere in Canada
* in the US - states have the authority and most public companies incorporate in Delaware and have headquarters in different state **(Delaware Phenomenon)**
* maybe some reasoning to choosing one statute (BC statute- no residency requirement) but overall no difference
* Constitution authorizes provinces to make laws in relation to companies with provincial objects under s. 92(11)
* incorporation of companies for objects other than provincial falls within the general powers of the federal Parliament under s. 91 (*Parsons v. Citizens Insurance Co. of Canada* (1881), 7 App. Cas. 96 (P.C.))

*Bonanza Creek Gold Mining Company Ltd v R*, [1916] 1 AC 566

* + PC held “with provincial objects” imposed territorial limitation, not functional one. Meant that the province could not endow a provincial corp with the right to carry on business in another jurisdiction, but that did not preclude a province from conferring on a corp the capacity or power to carry on business elsewhere if extra-provincial jurisdiction allowed it.
  + Provinces have readily granted the permission to other provinces. Therefore, a provincially incorporated company enjoys the same amount of mobility as a federally incorporated company
    - Federal Incorporation is seen as prestigious but this is a myth because it is not difficult to obtain so it is not prestigious. It is actually cheaper to incorporation under CBCA than OBCA

### Defining Features of a Corporation

1. **Corporation is separate legal entity from owners/shareholders** (*Salomon*)– imply limited liability
   * can be sued in its own name and enter into contracts even with its own shareholders
2. **Limited Liability** – Shareholders can limit liability from debts/obligations
   * shareholder is not responsible for the debts or obligations issued by a corporation
   * Incentivizes people to engage in business and take risks
3. **Transferability of Shares** – SHs/owners of corporations can transfer their role (ownership/equity interest) in business
4. **Perpetual Existence/ Perpetual Succession** – Corporations outlive their creators
   * continuation of a corporation’s existence despite the death bankruptcy, insanity, change in membership or an exit from the business of any owner or member occurs - not affected by any changes/ deaths of its members
5. **Centralized Management** – Structure of management is regulated by statute
   * management falls upon centralized body (Board of Directors)
   * people with expertise run the business and passive investors stay on the sidelines

### Basic Structure of a Corporation

* Each position can be occupied by the same person (common in smaller companies)
* In a large public company, this structure is very formal
  + SH provide money and vote on large matters (mostly just passive investors)
  + Technically directors manage the corporation, but in large companies they don’t really do any day-to-day but rather supervise the officers (intermittently at board meetings mostly)
  + Officers are really in charge
* In smaller companies, formalities are relaxed because there aren’t enough people

### Origins of Corporations

* The concept of corporations predates its use by profit-seeking enterprises
  1. **Existed historically to protect property rights** – ex. Universities own property. Professors come and go but institution continues. University exists in and of itself – specific individuals are separate from it
  2. **“Regulated Companies”** – corporations that existed to protect a legal monopoly privilege – made sense in historic time where distance made it hard for little selling companies to support an economy
  3. **“Joint Stock Company”** – Members would pool cash together to create a stock. To sue each other, the investors would have to sue the pooled company first – stepping stone to current business corporation
* 1720 – South Sea Company–
  + - Company that had a Crown-given monopoly for selling goods to the south seas in the UK. In exchange, the company had to assume the entire national debt of the UK.
    - The company sold its shares publicly, reaching a peak in 1720
    - It collapsed (bubble popped). Tons of its public shareholders had taken out loans to buy their shares. They couldn’t pay their loans, market collapsed
    - ***The Bubble Act 1720*** –
      * You can’t sell shares unless your company has been chartered by the government
      * Prior to this Act, companies were buying charters from other companies
      * No more charters will be granted
      * Hurt all of South Sea Company’s competitors, allowing them to rise (and pay national debt)
      * bill was not in response to the South Sea Company’s failings, but in response to their lobbying (monopoly business with ties to the government)
      * Repealed in 1825
      * government saved its own debt from failing by ensuring monopoly (and setting out regulations for stock companies)
* 1844 – *Joint Stock Companies Act*
  + - Before this, corporations could be created either by getting a grant from the Crown or by a Parliamentary act – **Issue:** easy to sway both for the wealthy, but the non-wealthy couldn’t gain legal recourse to starting companies
    - England’s first general incorporation statute (outlining forms to file and fees to pay)
    - The act set out the rules for how people can raise capital without special government permission, but didn’t include limited liability rights
    - Suddenly *anyone* could incorporate
* 1855 – *Limited Liability Act*
  + - Any *Joint Stock Companies Act* SHs cannot be sued for the debts/obligations of the company (conferred limited liability upon those SHs)
* 1862 – *Companies Act*
  + - First modern English corporations statute
    - Separate legal entity from SHs
    - No special legislation/crown permission required to incorporate

### The Delaware Phenomenon

Over 50% of American corporations incorporate in Delaware rather than federally or in their home state – Why?

* robber barons used to incorporate in NJ b/c favourable statutory terms which allowed them to make huge trusts. People got scared of massive monopolies, so NJ was forced to amend. Delaware responded by taking on the good terms, companies flocked to Delaware.
* Delaware won’t change laws b/c they receive 30% of funding from out-of-state public incorporation
* (a) flexible corporate statute (b) specialized court (Delaware Chancery Court – appointed judges – can hire experienced corporate lawyers)

**How Canada Compares to the US’ Delaware Incentives**

* Unlike US, our distribution of public incorporation is proportionate
  + Public companies mostly incorporated in BC, b/c they are BC companies that choose home statutes.
  + Alberta has many as well (related to oil and gas)
* **General practice =** (1) to incorporate provincially in the province where the corporation expects to carry on business (2) Incorporate federally if the corporation expects to conduct business in several provinces

# Three Methods of incorporation IN CANADA

### 1) Memorandum Statutes

* Memorandum statute = theory all members of an incorporation are in contract with one another
  + - Shareholders have all the power to make decisions and form a contract and delegate powers to D and O
    - Only in Nova Scotia and BC, so be careful in applying contract precedent
* powers/obligations of a corp determined by contract of the members through the article of association, subject to statute
* Distinguished from letters patent b/c government has no discretion to refuse incorporation (just must comply with statute)
* it is a **registration jurisdiction**. It is a citizens right to incorporate, you just have to register, file the paperwork and pay the fee and the Government has to give it to you. It is not a privilege, it is a right.

### 2) Letters Patent System

* incorporation under this system was not of right
* Grant from the government to incorporate a company. Apply to the State to grant you laters patent creating corporation
  + Directors exercise powers they are authorized from the letters patent (NOT from SH)
* **“Registration”** – Investors fill out paperwork and pay fee, then **might** be granted their license to operate a corporation – not a guarantee (government uses discretion)
* differs from MoA b/c it is not a contract between SHs of the company or between the company and its SHs
* PEI is the only jurisdiction left with letters patent statutes

### 3) Statutory Division of Powers

* CBCA and OBCA are examples
* Statutes that decree what directors, officers and SHs get to do
* powers and obligations of the corporation are defined by statute, it is not a contract and it is not guaranteed
* incorporation is effected by delivering to incorporating officer a document called articles of incorporation (s. 6-9; s. 4-7)
* Statutory Division of Powers – shareholders don’t get to decide roles of directors. Bound by statute
* Every province except BC, Nova Scotia, and PEI
* **registration statutes:** as long as you comply with the act, you cannot be turned down. If documents are in order, then incorporating office is required to issue certificate of incorporation. Can appeal if officer refuses

### Dickerson Committee

* 1971 – Examined old Fed. Incorporation Act, recommended to Parliament ways to make it better/modernize
* They drafted the *CBCA* 1975, 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)

### Unlimited Liability Companies (ULC) - Nova Scotia, Alberta and BC

* corporation that does not give SH limited liability. Exposes SH to the debts/obligations of the company to unlimited degree
* Nova Scotia *Companies Act* – 3 Types of Corporations: companies limited by shares (all modern companies), companies limited by guarantee, **unlimited company**
* Why do unlimited companies exist?
  + In 1862, many people wanted to reject the ‘immoral’ effect of limited liability
  + American companies doing business in Canada can get two tax write-offs for incorporating their Canadian subsidiaries as ULC’s – “double dip”

### Choosing Federal or Provincial Incorporation

* for corporations controlled by foreign SHs, may be advantageous to incorporate in a Canadian jurisdiction where there are no Canadian residency requirements for directors (BC)
  + E.g. Barrick Gold Corporation decided to continue as corporation under BC Act rather than OBCA because the BC statute did not impose any Canadian residency requirements for corporate directors meaning Barrick can attract the most qualified and experienced directors from a global talent tool
* some advantages to incorporating in one of the two MoA jurisdictions (NS and BC)

### Practicalities of Incorporation under OBCA

* must have a director, SH and officer for a business corporation but there is no maximum to the # of directors
* when you incorporate you first elect a director who elects SHs but after that SHs elect directors who appoint officers

# How to Incorporate - CBCA

* **Fill out Form 1 Form**
  + **Step 1:** Pick a corporate name. Name must comply with s. 10 and 12 of the CBCA. Fed Government maintains a database “NUANS” where all the names of companies are entered into. Articles of Incorporation must be accompanied by a NUANS Name Search Report (which will tell you how confusing your proposed name is with other names) dated no more than 90 days prior to the receipt of the Articles by Corporations Canada. Numbered name may be assigned under subsection 11(2) of the CBCA without a Nuans Name Search Report. You cannot have a name that is misleading or confusing with another company. Every corporation has to have a suffix such as Limited, Inc etc.
  + **Step 2:** Set out the name of the province/territory within Canada where the RO is to be situated.
  + **Step 3:** The classes and any max # of shares that the corporation is authorized to issue. Set out the details required by paragraph 6(1)(c) of the CBCA including details of the rights, privileges, restrictions and conditions attached to each class of shares. If a class of shares may be issued in series, the authority given to the directors to fix the # of shares in, and to determine the designation of, and the rights, privileges, restrictions and conditions attaching to shares of each series. All shares must be without nominal or par value and must comply with the provisions of Part Vof the CBCA.Most people say an unlimited number of shares. Might add, “the rights, conditions and privileges set out in Schedule 1”.
  + **Step 4:** Restrictions, if any, on the right to transfer shares of the corporation. You might say, “no share in the capital of the company shall be transferred except with the consent of the directors expressed by a majority of the votes at a meeting or in writing signed by a majority of the directors”
  + **Step 5:** Minimum and maximum number of directors. Act does not specify how many you have to have but you need at least 1. If cumulative voting is permitted, the number of directors must be fixed.
  + **Step 6:** Restrictions, if any, on the business the corporation may carry on. Is there anything that I don’t want the business to do. Do not have to specify, in fact you cannot, why you are setting the company up but you can restrict the business. E.g if a shareholder does not want to be involved if anything the business is doing has to do with tobacco etc. Most businesses just say “none”
  + **Step 7:** Other provisions, if any, permitted by CBCA or its Regs to be set out in the by-laws of the corporation, that are to form part of the articles, including pre-emptive rights or cumulative voting provisions. Common provision: **(1)** if small private company- provision saying you cannot have more than 50 shareholders and **(2)** no invitation to the public to subscribe for securities is permitted
  + **Step 8:** Declaration. Each incorporator must state their name and affix their signature. If incorporator is a corporation, that name shall be the name of the corporation and the articles shall be signed by an individual authorized by the corporation.
  + You submit this form, along with the fee (online is 200, in paper is 250) and an address of the registered office and the names of who the directors are along with a NUANS Name Search Report if applicable
* Articles of Incorporation are filed with the Director, who is obligated to issue a Certificate of Incorporation if it is found that the articles conform to law and the conditions precedent have been met.
* s. 3of the CBCA sets out the application of the CBCA
* **Name:**
  + if a name is available it may be reserved for a period of 90 days
  + s. 12/ 9 sets forth certain prohibitions in terms of corporation names
  + “Limited,” “Incorporated,” “Corporation,” or the abbreviations shall be part other than only in a figurative or descriptive sense of the name of every corporation (s. 10(1)), but when incorporated may use either full or abbreviated form
  + Subject to 10(5) and12(1), corporation may carry on business under name other than corporate name 10(6)
  + 10(5)-the corporation must set out its name in all contracts, invoices, negotiable instruments and orders for goods or services issued or made by or on behalf of the corporation
  + once a name is settled, a corporation may choose to adopt a corporate seal to affix a corporation’s seal on corporate documents. No CBCA requirement that a corporation have a seal but most do

### The Corporate Seal

* corporations are no longer required to have a corporate seal but some do (OBCA s. 13)
* at CL, the seal was the corporations signature so a seal technically adds nothing extra
* $40 fee for adopting a seal

## ***Friedmann Equity Developments Inc v Final Note Ltd* [2000] 1 SCR 842** – Affirmed the sealed contract rule in general with caveats

* + under sealed contract rule, an undisclosed principal cannot be sued by a 3rd party under a contract if that principal’s agent has executed the contract with the 3rd party under the agent’s seal.
  + the rule could apply when corporations (not just individuals) act as agents
  + the seal of a corporation is equivalent to signature of person, so affixing corporate seal may not be evidence of intention to create a sealed instrument. Court must examine the instrument and circumstances surrounding its creation to determine whether the corporation intended to create a sealed instrument by affixing its corporate seal
  + an undisclosed principal may sue or be sued on a simple contract entered into on behalf of an agent. **Exception:** when such a contract is executed under seal, the undisclosed principal can neither sue nor be sued upon it because only parties to a sealed instrument may have obligations and rights under it

### Registered Office:

* + The place within Canada where the RO is situated must be included within the articles

### Capital

* + CBCA permit a corporation to have an unlimited amount of authorized capital
  + s. 6(1)- articles may set out a max # of shares that a corporation can issue. If a max # is set out, this number can only be changed by amending articles in accordance with CBCA Part XV (fundamental changes)
  + CBCA abolished par value charges and the formal terms “common" and “preferred” shares
  + s. 6(1)(c) - articles may provide for **more than 1** class of shares but if they do, the rights, privileges, restrictions and conditions attaching to each class must be set out in articles
  + when a corporation has **only one** class of shares, the rights of the holders are equal in all respects, and include the right to vote at any meeting of SHs, to receive any dividend declared by corporation and to receive the remaining property of corp on dissolution (for OBCA, not dividend right)
  + If the articles provide for **more than one** class of shares, rights referred to above must be attached to at least 1 class of shares; but, all rights are not required to be attached to single class. Can be spread out.
  + once provision is put into articles, any change will trigger SH’s right to dissent s. 190

### Business and Powers

* + corporation has the capacity, rights, powers and privileges of natural person, although articles may restrict powers

### Directors

* + when articles are sent to the Director, a notice in prescribed form must be filed at the same time
  + directors named in notice hold office from the issue of the certificate until 1st SH meeting
  + after issuance of the certificate of incorporation, incorporator or director may call meeting of directors
  + s. 104(1)/ 117(1)- directors may make by-laws and conduct all of the other business required to complete organizational procedures of the corporation
  + s. 105/ 118- qualifications of directors

### Special Clauses

* + incorporators can make provisions a permanent part of the corporation which will be more difficult to change
  + ***Cumulative Voting*** (section 107/ 120): cumulative voting in election of directors
  + ***Pre-emptive rights***(subsection 28(1)/ 26(1)): To preserve a SHs proportionate dividend, liquidation and voting rights, articles may provide that no shares of a class shall be issued unless shares have first been offered to the SHs holding shares of that class, and that those SHs have a preemptive right to acquire the offered shares in proportion to their holdings of the shares of that class, at such price and on such terms as those shares are to be offered to others.
  + ***Purchase of the Corporation’s Issued Shares***(34-36): incorporators may want to restrict power of the corporation to purchase its own shares. E.g the power in 34not restricted to the common shares of the corporation.
  + ***Special Powers*:** questions raised as to whether the borrowing powers in section 189, which do not include the giving of security on the “undertaking” of a corporation, are wide enough
  + securities register must record all securities issued by corporation in registered form, indicating the name and address of each person who is/has been a security holder, # of securities held by each and the date/ particulars of the issue and transfers of each security (s. 50(1))
  + corporation must maintain adequate corporate records, including the articles, bylaws, USA, meeting minutes resolutions of SHs, notices concerning particulars or directors and securities register (s. 20(2), 140(1)). Can be kept at either RO or other place designated by directors (s. 20(4), 140(1)).
  + when accounting records are kept outside Canada, accounting records adequate to enable directors to ascertain financial position of the corp with reasonable accuracy on quarterly basis must also be kept at RO or other office in Canada(20(5)).
  + Each year a corporation must file annual returns with the Director (section 263).

# What do you need when your incorporate a company?

* + over 18, mentally competent, not bankrupt to be an incorporator s. 5(1) of CBCA; OBCA s. 4(2)
  + articles of incorporation and documents required by s. 19 and106 of the Act. - what has to be in them
    - CBCA s. 6, OBCA s. 5
    - name search, CBCA s. 11(1); OBCA s. 18(1) must submit your name proposal
    - numbered companies- It is a company that you cannot come up with a name that they can clear. If you are operating a business where you are not publicly advertising your name, they may just ask to be assigned a number. S. 11(2) CBCAand s. 8 of OBCA
* OBCA s. 9 **-** the name cannot be one that is likely to deceive.

# Articles of Incorporation

s. 6(1) - Articles must set out: (a)The name of the corporation, (b) The province of its registered office, (c) The classes of shares/max number of shares to be offered by directors, (d) Restrictions on share classes/transfers (usually majority of directors must agree), (e) The number of directors and (f) any restrictions on business

s. 10(1); s. 10: – Corporation must have a cautionary suffix (Ltd, Inc, Corp) in order to warn people of the entity’s limited liability

* two elements: Distinctive Element (name) & Legal Element (ltd, inc etc)

The directors issue the shares to the SHs, but SHs appoint directors.

OBCA s. 5(1) and (2): The director must consent to being named (Director = provincial actor who approves the articles of incorporation; director = of the company).

# Defining Features of a Corporation

1. **Separate Legal Entity**
   1. as a legal person, the corporation can own property, have rights and be subject to liabilities
   2. generally, members cannot sue to enforce corporation's rights, nor sued in respect of liabilities
   3. *Salomon v Salomon Co* :corporation is independent legal entity not to be identified with incorporators
2. **Limited Liability**
3. **Transferability of Shares**
4. **Perpetual Existence**
5. **Centralized Management (independent from shareholders)**

### Feature #1- Separate Legal Entity

CBCA S. 15 **/ 15**

* (a) A corporation has the capacity and, the rights, powers and privileges of a natural person.
* (b) A corporation may carry on business throughout Canada
* (c) A corporation has the capacity to carry on its business, conduct its affairs and exercise its powers in any jurisdiction outside Canada to the extent that the laws of such jurisdiction permit.

## ***Salomon v Salomon & Co* (1897) HL** – A corporation is a legal entity separate and distinct from its SH.Where one person incorporates and is the sole SH, there is still a corporation and that person enjoys LL.

**Facts:** Salomon was the sole proprietor of a shop. His sons wanted to become his partners, so he turned his business into limited corporation. This new corporation now exists and Salomon is one of its shareholders. It was worth about £10,000 but he valued it at £40,000 but this does not matter because there were no outside investors (no fraud). Salomon was the company’s principal creditor and SH – he made himself a secured creditor through a debenture which he got by over valuing his company (an IOU on the company’s assets) as well as 20,001 shares and cash. The company had 20 007 shares, so the 6 remaining shares were split amongst his family in order to reach the 7 shareholders requirement for the *Companies Act,* 1862. A year later, the company failed and was forced to sell its assets to pay its debts (some of which were owed to Salomon through the debenture). Salomon was a creditor but also a SH. Creditors get paid before SHs. The company’s other creditors raised a claim in court, arguing that Salomon could not receive debts from a company of which he was also the principal SH.

**P’s claims against Salomon:** 1) Agency – his losses/the company’s were actually the same, 2) Fraud – he incorporated a company that was just a front for himself

**Prior Proceedings:** TJ said that he could not do this and that it was a device to defraud creditors. “Hard cases make bad law”. If you adhere to the letter of a law, a person who is trying to dodge his creditors gets rewarded. This is part of the reason it has been upheld for so many years. Short of fraud, difficult to find exceptions to this.

**Issue:** Can a person secure themselves as creditor (owed debt) to their own assets?

**Held:** For D – he was entitled to recover for the sale of assets. The notion that the corporation is separate from the humans was brought forward in the Corporation Act and the HL has said that the statute holds up.

**Reasons:** Lord MacNaghten –

* No Fraud – the *Companies Act* does not require a balance in shareholder duties, or that they need to have a will of their own. This precedent guided later statutes to allow for single-person corporations
* Agency – Companies are legal individuals, separate from shareholders
* The company is a separate legal person so no problem here
  + Can’t argue that Mr. Salomon is the company’s agent because that would undermine this principle in corporate law

### Key Salomon Takeaways

* Fraud – 7 SHs requirement no longer exists – Salomon forced to make a balance in SH duties because the Act
* Sole SH can secure their interest through a debenture, even though no comparable mechanism exists for sole proprietors
  + Basically insurance mechanism – ensured he was paid before creditors who had no control of business
* It seems like Mr. Salomon should have been liable and there were reasons to find him so
* It has never been overturned – the limited liability principle is too important to uphold

### Shell Companies

* no requirement under CBCA or OBCA for corporations to have any minimum paid-up capital
* corporations can be incorporated as “shell companies” that have no assets beyond the $1 paid to enable each corporation to issue at least one “fully paid” share when first incorporated

## ***Lee v Lee’s Air Farming* (1960) New Zealand** – SH can enter contracts with themselves as employees – separation of legal entities. Person can act in dual roles in a company.

**Facts:** Lee was the sole shareholder of his own incorporated company. He was also its only employee. Lee flew planes that sprayed stuff on crops. He set up a corporation to do that. He was the sole officer, he was the sole director and sole employee. He was signing cheques to himself as director of the company. He died on the job, and his wife wanted to sue the business to recover compensation damages from the company

**Issue:** Was the husband a worker under a contract of service with the corporate employer? If he is a worker she is, if he is an owner she is not. Not employment contract because he was his own boss in every respect.

**Ratio:** The mere fact that someone is a director of a company is no impediment to his entering a contract to serve that company.

**Held:** For the plaintiff – she was awarded compensation damages from the company.

**Reasons:** His corporation is a separate person in law, and there is nothing wrong with Lee being employed by that separate person. The corporation must act through people so the fact that Lee was the only operator of the corporation doesn't change the separation in law.There is no reason why a director of a company can’t sign a contract to serve that company – they would be exercising two roles (corporate legal entity and employee) which are legally separate. The company and the deceased were separate legal individuals – a person wasn’t employing himself, a corporation was employing him

### Feature #2- Limited Liability

* CBCA s. 45; OBCA s.92(1) – Shareholders of corporation not liable for corporation debts/obligations
* Directors immune from corporation liability because they are separate from obligations of corporation
  + Statutory exceptions:
    - Environmental legislation (e.g., dumping toxic waste)
    - *Income Tax Act*, s. 227.1 - every employer required to withhold income tax from employee salary and remit to CRA. If employer fails to do so and employer is a corporation, the directors can be sued by CRA
      * This is used all the time to hold directors liable
      * S. 227.1 not limited to business corporations (even not-for-profits)
  + **Nicholls** – problem with cases that pierced corporate veil is that they defy statute – limited liability is statutory.

### Why does Limited Liability exist?

* Common Answer – To encourage risk taking but no evidence people are incentivized to incorporate
  + Better approach – **Limited Liability offers an optimal level of economic** **risk** (benefits of taking risks doesn’t cost more than the cost of shifting risk to others)

### Six Reasons for Limited Liability

* Decreases monitoring costs for shareholders
  + If you invest in a corporation in a world with unlimited liability, every investment you make would require you to monitor the company constantly because making a $100 investment would put you on the hook for a potentially greater amount of liability.
* Lowers the cost of monitoring other shareholders
  + In a world where all companies expose shareholders to unlimited liability, you don’t want to be the richest shareholder because, if you are, you’ll be the target of a lawsuit.
* Facilitates the free transferability of shares
  + Makes it possible (and easier) for one company to buy up the shares of another because shares in a limited liability company can never be a liability.
  + Free transferability incentivizes managers of public companies
  + “Market for Corporate Control”
    - Large number and great dispersion of shareholders – shareholders typically don’t know each other
    - Senior offices/directors of public companies want to divert corporate resources to themselves (either blatantly or in disguised ways) – this is a problem.
    - The idea is that if a director is worried that diverting corporate assets would cause a share price to fall, that another company observing that my company is terribly managed would swoop in and buy all of the shares/complete a takeover (hostile or friendly) bid.
    - Managers are aware that if they go too far, a hostile bidder would swoop in and fire them. Thus, there is a **disincentive to divert corporate assets for personal use.**
* Optimal portfolio diversification
  + Immunity from liability promotes portfolio diversification because you can invest in a lot of different companies without worrying about being liable (to an unlimited extent) for all of those companies’ debts and obligations.
* Allows corporate managers to make optimal investment decisions
  + If you are a director or officer of a corporation where all of your shareholders are exposed to unlimited liability, you can’t risk investing in anything where there is a significant risk of loss, even if the return is really high.
  + We want companies to be risk-neutral/pursue opportunities where the expected return is higher than the investment. In a world where we only had unlimited liability, risks could never be pursued because of the possibility that shareholders could be sued for negative consequences of taking that risk.
* Pricing shares – only thing that will affect price of shares is performance of asset itself.
  + Perpetual existence
  + Transferability of shares
  + Centralized management (under a Board of Directors)
  + Differences between provincial statutes are minimal but potentially important (e.g. residency requirement)

# Piercing the Corporate Veil

* corporations are considered separate legal entities or persons in law from the SHs - allows SH to enjoy limited liability
* piercing the corporate veil means to suspend the principle that a corporation is a separate legal entity in order to go after the human beings behind the corporation
  + (1) imposition of liability upon shareholders for obligations of corporation
  + (2) non-recognition of the separate personality of a corporation where the correct construction of a statutory or other legal standard so requires
* courts reluctant to depart from this but will pierce CV in equitable circumstances or where it is flagrantly opposed to justice
* Instances where the court chooses to disregard separation of legal entities, and treat the corporation and its SH as the same, court rules that the owners or controllers are personally liable there SHs may become liable for corporation’s actions
* Until recently, Canadian courts did not like to pierce the veil (*Kosmopoulous*)
* Where do judges get the authority to impose exceptions to the statutory provisions declaring limited liability (CBCA s. 45)?
  + The courts never say the provisions are unconstitutional
  + The Acts make exceptions in certain situations, but the judges have gone beyond those
  + Courts have been quite cautious and not cavalier when piercing the corporate veil
* Risk of having veil pierced is higher for small private corporations than large public corporations
  + In private corporations, roles performed by top people are mixed up – directors, SH, etc.
  + In public corporations, more separate – SH have nothing to do with company’s operations
* some provisions place personal liability on directors and deprive them of separate corporate entity protection
  + s. 119/ 131-directors of a corporation personally liable to employees for all the debts not exceeding six months wages due for services perform for the company while they were directors
  + s. 123(4)/ 135(4)- provides defence for innocent director if they exercise care, diligence and skill of a reasonably prudent person including reliance on good faith

## **Kosmopolous v Constitution Insurance Co (1987) SCC** – The CV will not be lifted simply in the name of equity for a sole SH who will otherwise not be deemed to have insurable interests in assets of company. Cannot pick and choose when to benefit from corporation.

**Facts:** After serving as the SP of a store, P incorporated under the OBCA. His insurance on the store was under his personal name, as he had secured it before incorporating, and insurance advisor did not advise him to change insurance to corporate name. A neighbour’s fire damaged the store and he filed a claim on behalf of the business for insurance $.

**Held:** As a corporate law matter, for D – P was not owed insurance. Although the SCC did not think it was appropriate to life the corporate veil they dismissed the appeal.

**Reasons:** Lifting the CV requires circumstances in which allowing a corporation’s rights/obligations to be treated as those of its shareholders would align with justice, convenience and public good

* + The separation of legal entities is entirely statutory, so it is something that the court has to bind its decisions by
* Lifting the veil 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
* Wilson J’s *obiter* statement that courts have the power to pierce the veil when it is just and equitable to do so

**Note:** The court cast doubt on the *Macaura* decision.

**Note:** As an insurance law matter, SCC decided that Mr. Kosmopolous had insurable interest in his assets and could recover

## **DHN Food Distributors Ltd v Tower Hamlets London Borough Council, [1976] 1 W.L.R. 852 at 860, 867 (C.A.).** – piercing veil by looking at whole economic entity. Group of companies can be treated as single entity when parent company such control that it can control every movement of the subsidiaries

**Facts:** D.H.N. was a holding company which controlled two wholly owned subsidiaries, Bronze Investments Ltd and D.H.N. Food Transport Ltd. Bronze was the registered owner of certain land, but did not actually carry on business on the land. D.H.N., however, did carry on business on that land. The land was expropriated, and D.H.N. sought compensation for loss of its use from London Borough Council. Council pleaded that only Bronze, as owner, would be entitled to compensation for disturbance of business, and, since Bronze did not carry on business on the land, it had not suffered any loss of business. D.H.N. had suffered loss, but it was not the registered owner and therefore was not entitled to compensation.

**Held:** Holding company could claim compensation for the compulsory purchase

**Ratio:** A court could pierce the corporate veil and look at the economic entity of the whole group instead of the separate legal entities of various companies within a group

**Reasoning (Denning):** Subsidiaries were bound hand and food to the parent company and must do just what the parent company say. This group was 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.

## ***Macaura v Norther Assurance Company*, [1925] AC 619-** frequently cites case for piercing the CV. SH did not have an “insurable interest” in the property of the corporations in which he held shares

## **Clarkson Co Ltd v Zhelka (1967) ONHC** – CV can be pierced if separation of entities is: a) allowing sham business or b) is opposed to justice. Pierced where conduct is akin to fraud. If a company is formed for the express purpose of doing a wrongful or unlawful act, the individuals as well as the corporation are responsible to whom liability is owed

**Facts:** D’s bro incorporated several companies. He set things up so that he could mortgage land to D without bearing losses.

**Held:** For P – the veil was lifted.

**Ratio:** If a company is formed for the express purpose of doing a wrongful or unlawful act, the individuals responsible, as well as the company, are responsible to those to whom liability is legally owed.

**Reasons: Thompson J** : It would be “flagrantly opposed to justice” if the court allowed the veil of the separation of legal entities to allow a SH to incorporate a company to get away with sham business

## **Adams v Cape Industries [1991] – EWCA -** Group of incorporated companies can structure itself so liability for certain activities falls upon subsidiary. No presumption of agency in corporate subsidiaries.

**Facts:** English parent held shares in two subsidiaries- one in US, one in UK and was being sued for asbestos exposure without warnings. US sub entered into agency agreement with UK sub for purpose of making sales in the US; US Court gave judgement against UK subsidiary but jurisdiction was contested.

**Held:** For S - did not find parent (Cape Industries) liable for subsidiary obligations

**Ratio:** The court is not entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used to as to ensure that the legal liability in respect of particular future activities of the group will fall on another member of the group.

**Reasoning:** The UK sub deemed to be a mere facade, but doesn't matter b/c it was not found to be carrying on business in the US. However, US company was not found to be a facade- shares were not held by Cape, but by it’s former president.

* Where a company is a sham, cloak, or alter ego for an incorporator, the company is considered a mere agent for conduct of personal business
  + Whether an individual has constituted the company his agent is a question of fact in each case. A controlling or total share interest does not in itself establish such agency

## **TransAmerica Life Insurance Co of Canada v Canada Life Assurance Co (1997) ONCA** – Just and equitable is not a test for lifting the CV. Corporations are separate from subsidiaries unless they use them as puppets. CV can be pierced when corporation is completely dominated and used as a shield for fraud/improper conduct

**Facts:** D’s wholly owned subsidiary business, CLMS, handled P’s corporate loans. They did so negligently, the loans defaulted, and P lost $60 million. P wanted to sue D in tort for the damages, but D claimed that the corporate wall separated them from their subsidiary corporation as 2 individuals. P argued that veil should be pierced and D should be liable as CLMS’s sole shareholder.

**Held:** For D – the wall was not pierced

**Reasons:** The courts will disregard the separate legal personality principle only where it is **completely dominated and controlled and being used as a shield for fraudulent or improper conduct**

1. Complete Control – Subsidiary does not function independently, complete domination
   1. Here, CLMS had independent management/wasn’t a puppet of Canada Life
2. Conduct akin to Fraud – Evidence that suggests the subsidiary is a shield for dealings
   1. No evidence D had any nefarious purpose. Even if CLMS acted fraudulently, CL had nothing to do with that

## **Yaiguaje v Chevron Corp (2017) ONSC**

**Facts:** P= residents of Ecuador – hold a judgement in Ecuadorian court for $9.5 billion.Chevron (formerly Texaco at the time) caused extensive environmental pollution. Chevron wholly owns and operates Chevron Canada. In 2013 Chevron and Chevron Canada challenged jurisdiction of ONSC to enforce Ecuadorian judgment. SCC held that ONSC can enforce Ecuadorian judgment. Chevron and Chevron Canada have separate boards – Chevron Canada has never conducted business in Ecuador. Chevron is sole owner of Chevron Canada shares. Chevron Canada states it is a separate legal entity from Chevron – P alleges no wrong against Chevron Canada**.** Chevron’s income solely comes from approximately 1500 subsidiaries

**Held**: For D. No liability for Chevron.

**Reasoning:** Ps unable to rely on Ontario Execution Act because it is procedural and doesn't create right or interest in assets where asset doesn't belong to judgement-debtor. Chevon wasn't party to initial proceeding and NOT judgement-debtor in that action. If P’s submissions were accepted then assets of Ontario subsidiaries would automatically and always be subject to execution orders to satisfy judgement of parents companies (so rejected this). Principle of corporate separateness applies within context of group companies like Chevron and affiliates. P would therefore need to prove that Chevron dominated and controlled Chevron Canada to use as a shield for fraudulent and improper purpose but because it was submitted by P that Chevron Canada did no wrongdoing this was not found. Court found this was a typical parent/subsidiary relationship.

**Issues/Answers:** (a) Are the shares and assets of Chevron Canada eligible and available for execution and seizure pursuant to the *Execution Act* to satisfy the Ecuadorian judgment against Chevron? No, Chevron has no legally recognized interest in Chevron Canada’s assets unless the corporate veil between the two is pierced

* (b) If they are not, should Chevron Canada’s corporate veil be pierced so that its shares and assets are available to satisfy the Ecuadorian judgment against its indirect parent, Chevron? No because:
  + Corporate separateness - *Salomon*
  + Principle of separateness applies equally to groups of companies (subsidiaries) – (Adams)
  + Chevron Canada doesn’t own its shares, therefor P cannot sue to recover them
  + Not a puppet – typical subsidiary-parent relationship

## ***Lynch v Segal* (2007) ONCA-** The test for lifting the CV in the family law context is that the corporations in question are completely controlled by one spouse, for that spouse’s benefit and no 3rd parties involved.

**Facts:** P & D were divorcing. D was extremely wealthy. He hid his assets in corporations so that he wouldn’t lose them if ever found liable. The assets in question were vested in land.

**Held:** For P – corporate wall was pierced so that property can be transferred to wife

**Reasons:** Blair JA : D was the beneficial owner of his corporations’ shares and land

* “A more flexible approach is appropriate in the family law context, particularly where, as here, corporation in question are completely controlled by one spouse, for that spouse’s benefit, and no 3rd parties are involved.”
* Legal entities should not be recognized here because that would go against the modern reasoning for limited liability
  + Limited liability exists to protect shareholders from corporate liability
  + In this case, it would protect a corporation from shareholder liability – not proper corporate law

**Note:** This is bad law. Courts would not approach corporations like this – they would acknowledge the separation of assets

### Examples Where Piercing (from Lecture)

1. Person works for company. They signed a non-compete clause with employer - I wont compete with you for a period of time if I ever leave. Person left employee of company and set up corporation. Said I’m not competing, that’s just the corporation.
2. Person enters into contract to sell a very unique piece of land to another person. For land purchases, there is a period of time between the signing and the closing. Before that date, the seller got cold feet. I am contractually obligated to do it but I don’t want to. I know I’m going to have to pay damages if I do that but I don’t want to make an order of specific performance. Remedy in contract law - most usual way is damages. But courts can also order equitable remedy if common law remedy is inadequate. This seller was worried that court would say equitable remedy. She was ready to pay damages because she was in breach, but she wants them only to be able to get damages, I don’t want them to be able to order specific performance b/c I will no longer own the property.

* Courts held: in both of these cases pierced corporate veil. Number 1, said go away that’s really you. Number 2 said, go away, even though you transferred this property to a corporation we’re going to say you really owned it so specific performance.

# Private Corporations

* public corporations: business corporations that sell shares or other securities to the public
* Private Corporations: corporations which the shares are held by small group of people, usually know each other
  + Closely held shares (very small group of shareholders), not sold publicly
  + Used for 2 purposes:
    - Small business wants corporate benefits like limited liability, estate planning and corporate income taxing
    - Instruments of Private Corporations – Large corporation establishes closely-held private corporation for a specific transaction or to hold specific assets
* *Companies Act* 1907 – “Private Company” means a company which by its articles:
  + Restricts the right to transfer its shares
  + Limits its number of shareholders to 50 (other than employees)
  + Prohibits public offerings of shares/debentures
* Dickerson committee eschewed the separation (private vs public) but distinguished them on functional rather than doctrinal grounds. Public companies are referred to as:
  + CBCA – Distributing Corporation
    - All other corporations are private
  + OBCA – Offering Corporation
    - These kinds of corporations must list their shares on the stock exchanges
    - By default, if you are not one of these, you are a private corporation

### Legislative differences between Private and Public Corporations

|  |  |  |
| --- | --- | --- |
| **Topic** | **CBCA** | **OBCA** |
| **Proxy** | s. 149(2)- all distributing corporations must before annual meeting and any corporations with more than 50 shareholders whether they are distributing or not | s. 112- not required to solicit proxies in connections with meetings unless you are an offering corporation.  s. 110(2.1) - a proxy for a meeting expires 1 year after its date of issue |
| **Auditor** | S.162/163 - Must appoint if distributing and if non-distributing must appoint unless 100% of shareholders agree not to | S.148 - all offering must appoint auditor, if you are not and all shareholders consent IN WRITING then you don’t |
| **Number of Directors** | S.102(2) - non distributing don’t need more than 1; distributing at least 2- in both cases if you have more than 3 at least 2 cannot be officers and employees | S.115(2) - non-offering don’t have to have more than 1; (b) offering must not have fewer than 3; at least 1/3 must be independent |
| **Auditing Committees** | S.171(1) - Distributing corporations must have an audit committee | S.158 - offering corporations must have an audit committee |
| **Notice of Annual Meetings** | 135(1).1 - min notice period for distributing companies; non permitted to enact bylaws that shorten that period | S.96 - offering not less than 21 days, any other corp not less than 10, and for both no more than 50 |
| **Filing Annual Financial Statements** | S.160(1) - Distributing required to file annual FS with director | S.156 - offering have to file with OSC (commission) |
| **Shareholder Lists** |  | S.146(1) - available to more people in the case of a public corporation |
| **Share Transfer Restrictions** | S.174- distributing not allowed to have any restriction the transfer of your share they must be freely transferable   * Limited exception for some Canadian companies in certain industries subject to Canadian ownership | S.42 - private companies (non-offering) always impose restrictions on share transfers |
| **Provisions to Facilitate Easy Operation of Private Corporation** | * Same as OBCA | S.129 - possible for business at both shareholders and director’s meetings to be done by way of unanimous written resolution (some exceptions with auditors s.104) |

### The Closely Held Corporation

* devices used to allocate control and management powers and to protect the interests of majority and minority shareholders in the close corporation are:
  + classification of equity shares and allocation of such securities among the shareholders;
  + class voting for directors;
  + constitutional provisions requiring unanimity or high percentage votes for share-holder and director action;
  + voting agreements and other agreements among shareholders;
  + voting trusts
* operation of a closely held corporation is facilitated by a number of statutory provisions in the CBCA:
  + s. 5- incorporation by a single incorporator
  + s. 102(2) - one directors
  + s. 114(8), 139(4)/ 126(12), 101(4) - single director or shareholder able to hold a valid meetings
  + s. 117, 142/ 129(1), 104(1)- formal meetings of both directors and shareholders can be eliminated by consent resolutions
  + s. 114(6), 136, 126(10), 98 - waiver of notice
  + s. 114(9), 126(13) - telephone meetings of directors
  + s. 6(1)(d) - restrictions on transferability of shares can be included in the articles of incorporation
  + s. 163- auditor can be dispensed with if all shareholders consent
* with careful drafting of the articles of incorporation it is possible to limit the board’s normal authority. The following provisions are:
  + s. 140(1) - voting rights of shares can be weighted differently
  + s. 28 - pre-emptive rights can be given in the articles
  + s. 107 - cumulative voting
  + s. 103, 116- restrictions on the directors’ power to enact, amend or repeal of by-laws
  + s. 121, 125, - restriction on directors’ power to appoint and enumerate officers and to delegate authority
  + s. 114(1), 132(1)- control by shareholders of place of meetings
  + s. 114(2), 139(1), (2) - require higher than normal quorum
  + s. 6(3)- require higher than normal majorities before certain kinds of action may be taken

### Differences between Private/Public Corporations in Statute

**Public (Distributing Corps) Must Have** (CBCA)**: (from chart above)**

S. 102(2)/ 115(2)(3) – At least 3 directors, at least 2 have to be independent

S. 20(1) – Corporate records available to wide class of people

S. 149(2) – Managers do not have to send out proxy solicitation forms if the company is not publicly held

S. 160 – Distributing corporations’ financial statements have to be filed with their Director

S. 162 – must have external auditor (163 – private can vote against it with 100%)

S. 171 – Audit committee

S. 135(1) – Distributing Shareholder meetings must give 21 days’ notice, Private corps can give less

S. 206 – Compulsory Acquisition Rule – If 90% of ] corporation is sold, last 10% can be forced to sell

* Without this, one s/h could take advantage of the buyer by not letting them perform a full takeover unless they paid unfair price

OBCA:

* Only “offering corporations” must solicit proxies before meetings
  + CBCA says that not-public corps can choose not to send solicitation forms
* At least 1/3 of Directors must be independent
* S.96 – Non-offering corps can reduce the 21-day notice required for shareholder meetings
* S.156 – Offering corps have to file their financial statements with their Director

# Shareholder Agreements

### Voting Trust Agreements

* CBCA s. 145.1 and OBCA s. 108(1)permit agreements among 2+ shareholders as to how shares will be voted
  + - Unlawful for SHs to bind directors – an invalid attempt to fetter the exercise of the directors’ discretion
* at CL, voting trusts were enforceable. Under these agreements, shareholders would place their shares in a trust which would include provisions instructing trustees how to vote shares
* the advantage of entering into a voting trust arrangement was that shareholders assured that none of their fellow shareholders might “defect” and vote their shares in favour of some other candidates
* agreements between shareholders as to how each would vote their shares, without the shares being placed in trust were enforceable at CL. But, there was an exception in cases where shareholders were also directors and the voting agreement operation as a way to fetter the discretion of the corporate directors. However, the mere fact that a shareholder was also a director did not, for that reason, render a voting agreement unenforceable (*Greenwell v Porter,* [1902] 1 Ch 530.)

## **Greenwell v Porter, [1902] 1 Ch. 530** - Shareholder can be a director and have a voting agreement

**Facts:** Pbrought this action to enforce the agreement so far as regards the provision as to voting. The defendant stated that since they were directors voting agreements could not be enforced.

**Held:** Injunction granted until the trial restraining the defendants from voting against the resolution for the re-election of Trevor White as a director

**Ratio:** The mere fact that a shareholder was also a director did not render voting agreement unenforceable

## ***Clark v Dodge* (1936) – NYSC**

**Facts:** P and D owned 25% and 75% of stock in two companies, respectively. D took no active part in the business but was a director and controlled the directors of each company. P was a director, treasurer, and GM of one of the companies and also was in charge of a major portion of the other company. The companies manufactured medicinal products with secret formulas which were only known to P. The two entered into a contract expressing D’s desire for P to run one of the companies, outlining the salary he should attain etc., but for P to share the formula with one of D’s sons. P alleges D failed to hold up his end of the bargain.

**Prior Proceedings:** Appeal court dismissed claim.

**Held:** For P, reverse appellate decision.

**Reasons:** The agreement was legal. If there was any invasion of the powers of the directorate under that agreement, it was so slight as to be negligible and there was no damage suffered to anyone. D as a stockholder agreeing to vote for P as director is a perfectly valid contract, and the other components of the agreement could harm nobody. In a closely-held corporation such as this one, agreements between the directors (also sole SHs) should not be interfered with, so long as they do not harm other parties

## **Ringuet v Bergeron (1960)** – SCC SHs can form voting trusts to vote specific directors in

**Facts:** The appellant and respondent and four others each held 50 shares – constituted all the issued capital stock of the company. Had an agreement to get 50 shares from Frank and divide them among the parties – would have then had control of the company and agreed to vote in specific people as directors/management at certain salaries, and provided for penalty if agreement breached. One of the parties to the contract is suing two shareholders for failing to transfer his agreed-upon shares.

**Held:** For P. Such agreement is valid

**Ratio:** Shareholders can, via agreement or voting trust, unite upon a course of action and upon officers whom they elect. Shareholders have the right to combine their interests and voting powers to secure such control of a company and to ensure that the company will be managed by certain persons. The arrangement is not prohibited by law, good morals or public order. The fact that this agreement may involve detriment to the minority does not render it illegal or contrary to public order.

**Reasons:** If the directors’ discretion was fettered – unenforceable. But here, the directors’ discretion was not fettered. This was simple agreement between SHs to unite upon a course of action and officers they will elect. 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. Here, the shareholders agreed to vote directors in at a later time. Totally okay. No harm to the public.

* Further, the parties contracted. Distinguished from a claim brought by minority shareholders against the action of directors and majority SHs. Even if the contract had the effect of disadvantaging minority shareholders, they contracted to it.

### Unanimous Shareholder Agreement (USA)

* Contains information like who will be the director (i.e., contractual agreement to vote shares towards one person being recognized as director) - important if one SH is the dominant one and can simply fire the director whenever they want
* Primarily seen in private companies
* USA can be used to modify the effects of certain statutory provisions and violations of its provisions can be the grounds for obtaining a restraining or compliance order under the corporate statute
* s. 2(1) defines USA as an agreement described in 146(1) or a declaration of a SH described in 146(2)
* Challenges under the CL is the notion that you can’t have an agreement that fetters the directors’ discretion
  + CBCA s. 146(6) now allows this by way of USA
  + Dickerson Committee suggested we need more flexibility for small private companies

s. 146/ 108

* More than a contract - akin to a constitutional document (*Duha Printers*)
* USA must include 100% of the SHs, but not all agreements signed by all shareholders is a unanimous shareholder agreement
* s. 146(1) A USA among shareholders to limit or restrict the managerial powers of directors/managers
  + Very significant for private corporations – not hard to get unanimous vote
  + If it does not restrict directors’ powers and just restricts share transfers, it is not a USA
* s. 146(2) A sole SH can sign a s.146(1) agreement on their own, if it limits or restricts the managerial powers of directors.
  + Directors have to be 25% Canadians at least
* s. 146(3)/108(4) A purchaser/transferee of shares subject to a USA is subject to it even if they don’t sign (constructive party)
* s. 146(4) If notice is not given to a s.146(3) purchaser/transferee that the shares they were dealing with were subject to a USA, they can rescind the transaction within 30 days. (for OBCA within 60 days).
* s. 146(5)/108(5) Parties to a USA have all the rights, powers, duties and liabilities of a director of the corporation, whether they arise under this Act *or otherwise*
  + “*or otherwise”* - to ensure the transfer of directors’ personal liability to shareholders along with their powers. BUT, directors are still judged for taking reasonable steps when making decisions, as this provision cannot negate liability under the *Criminal Code*.
  + Getting directors’ liability is a **disadvantage** of having a Unanimous Shareholder Agreement
* s. 146(6) Nothing prevents SHs from fettering their discretion when exercising powers of directors under USA
  + Ensures that there is no clash of premises for shareholders of private corporations who are also their directors – if a S.146(1) agreement becomes terrible for the shareholder, they can use discretion to avoid it as Directors
  + No statutory duty on SHs’ decisions – can make decisions and promises in advance and will be legally enforceable
  + special majorities run on removal of directors (146(6)(4)) doesn't apply to USA

OBCA s. 108

* s. 108(3) - Where a person is the registered holder of all the issued shares of a corporation makes a written declaration that restricts in whole or in part the powers of the directors to manage or supervise the management of the business and affairs of a corporation, the declaration is a USA

OBCA s. 108(2) – 108(11)

Same as the CBCA, except for if there was no notice given to a purchaser/transferee about the fact that their shares were subject to a unanimous shareholder agreement, they have 60 days to either cancel their purchase or to receive fair market value for their purchase, **but only if** the share certificate did not contain a reference to the USA (s. 108(9))

* Also specifies that a USA can only be amended in compliance with the specifications set out in the agreement (s. 108(6)(a). CBCA fails to specify.
* Since directors cannot resolve disputes amongst themselves in arbitration (would fetter their discretion), OBCA s. 108(6)(b) specifies that shareholder disputes under a USA may be resolved in arbitration.

## **Duha Printers (Western) Ltd v The Queen, [1998] 1 SCR 795** - USA is a constitutional document of similar importance as a corporations articles and by laws

**Facts:** There is required to examine the decision of “control” for the purpose of the Income Tax Act in order to determine whether the appellant corporation was entitled to deduct from its 1985 taxable income certain non-capital losses incurred by a predecessor corporation in an amalgamation. In this regard, it will be necessary to consider which of various factors may properly be considered in assessing the demure control of a corporation, and in particular, whether a USA, is to be considered a constating document for the purposes of the de jure control inquiry. Marr’s was majority SH of Duha 3 and wanted to use Duha 2 as a tax write off but the government was saying that because of the USA associated with Duha 2 he did not have enough control over the company in order to use it as tax write off.

**Held:** USAs are both an agreement and a constating document- fundamentally changes the power structure within a corporation in such a way as to render it a constitutional document that affects control.

**Reasoning:** Constitutional because of the role of USAs in overall context of corporate governance - broad SH power to control corporation. Numerous provisions of the Act that govern fundamental aspects of the running of a corporation that are expressly made subject to the USA. It’s subject is equivalent to articles and copy must be held at RO. Breach of USA entitles complainant or creditor to seek compliance or other remedy. SH assumed all rights, powers, duties and liabilities of directors which re removed by the agreement. This is an option for SH in closely held corporation to organize the enterprise as they see fit. Directors owe a general duty not to individual SH, but to the corporation. SH don't normally have power to play managements role - can make certain fundamental changes, but their primary remedy is to remove directors. It must be an otherwise lawful agreement in writing. Agreement was USA because it restricted director power, specifically the power to issue shares. The agreement did not in fact result in the loss of de jure control by Marr’s. The inability to issue new shares without unanimous SH approval, did restrict the powers of directors to manage business and affairs of Duha No. 2, was not so severe a restriction that Marr’s can be said to have lost the ability to exercise effective control over the affairs and fortunes of the company through its majority SHs.

# Pre-Incorporation Contracts

* Even though the contracts are signed by the human beings in charge of running it, it is understood that it is not those individuals who are bound, but rather the corporation
* designated promoter of corporation can sign contract prior to incorporation on behalf of the company

OBCA s. 15 – corporations have the capacity/rights/privileges of a natural person

* The default provision
* Crucial provision that says human beings are not subject to the *ultra vires* doctrine
* Exception: can write in restrictions into articles of incorporation that say, for example, this corporation is not authorized to carry on business with regard to shoes
  + If you then enter into a contract to buy shoes, is it *ultra vires*?
* **Doctrine of ostensible or apparent authority:** sometimes an agent who has no actual authority will be able to bind the company if it is reasonable for the person dealing with to think that they could make that contract
* **Doctrine of Constructive Notice (s. 17)**: If the articles of incorporation are public then you can see who is an agent of the corporation. This was the law for many years but it was thought that it leads to unfairness. For small contracts, it doesn't make sense for people to go look up the articles of incorporation

### Common Law Standard for Pre-Incorporation Liability

## **Kelner v Baxter (1866)** – Parties that contract on behalf of a pre-incorporated company with intention to carry out contract not saved from liability by separate legal entity principle. Both parties understood that they were contracting with a corporation that did not yet exist but both intended to be bound by contract once incorporated. Overruled by CBCA s. 14(2)

**Facts:** P & D entered into a contract for the sale of P’s wine to D’s hotel business, which was in the process of incorporation, for £900. P delivered the wine, and D incorporated. D adopted the contract and ratified it. The wine was consumed. Soon after, D’s business went bankrupt and couldn’t pay P. P sues the individuals behind failed company.

**Issue:** Is a pre-incorporated company a separate legal entity from its promoting shareholders?

**Held:** For P – was able to sue the shareholders personally.

**Ratio:** A pre-incorporated company is not an entity with the legal power to operate as an individual yet.

**Reasons:** If the Gravesend Royal Alexandra Hotel Company had been an existing company all this time, the persons who signed the agreement would have signed as agents of the company. But, as there was no company in existence at the time, the agreement would be wholly inoperative unless it were held to be binding on the defendants personally.

* + Must assume they intended to be personally bound
* ***Kelner v Baxter Rule*** – Since the parties who signed a contract intended for it to be binding, and an unincorporated company cannot be given obligations because it doesn’t exist as an individual yet, promoters of a pre-incorporated company are liable for contracts that had clear intent to be ratified/carried out.

Note: CBCA s.14(2) has since made it law that **corporations, by words or conduct, may adopt pre-incorporation contracts and assume its responsibilities**

## **Black v Smallwood (1966) Australian High Court** – Limited Kelner – If party signed contract with the mistaken intent that they were doing so for an incorporated company, Kelner doesn’t bind them. Where both parties think that corporation exists and the written contract discloses no intention to be personally bound, contract null

**Facts:** P contracted with D (directors of an unincorporated company) under the mistaken belief that their company had been incorporated fully. K to purchase land, apparent corp. of D’s failed to purchase, P sued for specific performance.

**D’s Argument:** *Kelner* is distinguished because our intent was to make a company liable, not ourselves.

**Held:** For D – contract was nullified/no personal liability.

**Reasons:** *Kelner v Baxter* found personal liability because all of the parties knew that the corporation was not yet formed, therefore the intent when signing the contract was undoubtedly the SHs’ personally – they were both principals. Here, P is trying to infer that the parties were principals where they were not

* Ds here only made the contract/provided their signatures under the mistaken belief that they were not principals
* Relied on *Newborne v Sensolid-* PI signs contract as “Ltd” but never actually sets up corporation
  + the contract is null because it is a non existent corporation + P did not sign on behalf of the company

## ***Newborne v Sensolid* (Great Britain) Ltd [1954] – QB -** contract nullified because P knew the company was non-existent (entered in with directing mind not agency)

**Facts:** Mr. Newborne (P) signs a contract on behalf of his yet to be incorporated company to acquire tin ham. D wanted to repudiate the contract. P sues in his own name based on *Kelner*.

**Held:** For D.

**Reasons:** No contract/ contract nullified. The pre-incorporation contract was made, not with the plaintiffs, whether as agent or principle, but with a limited company which at the date of the contract was non-existent, and that therefore the contract was a nullity. Different than *Kelner* – Newborn never said that he was signing the contract in the name of the corporation, but rather he signed as the corporation. But since the company did not legally exist yet, the contract is void because you cannot make a contract with a non-existent person/legal entity.

* The parties thought there was a corporation, but there was not. It was their intention to enter into a contract only with a corporation. Intention is defeated because company did not exist.

**Ratio:** This case clarified *Kelner* and its application via distinction:

1) if you signed with corporation name then it is VS if you sign solely with personal signature

2) In *Kelner*, they both knew there was no corporation but here the intention is clear of BOTH parties to make contract with corporation

**Note:** Same effect as*Black v Smallwood*.

## ***Wickberg v Shatsky & Shatsky* (1969) BCSC-** Defendants aware of non existent company but made it appear as though they were a company and had P sign a contract. Contract nullified but breach of warranty.

**Facts:** The defendants purchased an interest and became directors of a corporation called Rapid Addressing Systems Ltd in Vancouver. D’s then decided to carry on business under a name “Rapid Data (Western) Ltd”, although no company was ever incorporated under that name. D hired the P to be manager of the corporation, and executed a contract on the letterhead of Rapid Data (Western) Ltd and signed by the defendant, Shatsky, as president. Ds instructed P that the company should drop the “Ltd” suffix and continue as Rapid Data (Western). Business not successful, and P, after refusing to work on commission was fired.

**Grounds for Claim:** P sued on 3 grounds:

1) Shatsky is personally liable as a party to K since it was signed by him as agent for nonexistent principle;

2) Shatsky brothers are each liable for breach of warranty of authority

3) Business by which the P was employed was a partnership and therefore Shatsky bros are both liable as GP

**Issue:** Are the defendants personally liable?

**Held:** For Ds – not personally liable for the unincorporated company. Not liable under contract, but liable under breach of warranty. No causal connection between breach and loss. Nominal damages awarded

**Reasons:** a person signing on behalf of a non-existing company is not automatically liable

* + P argues that *Black v Smallwood*was decided that there was no liability because neither party knew the company was not incorporated, but here D’s knew so *Kelner* should be applied.
  + This may be so, but the promoters’ intentions are what matter. In *Kelner*, both parties intended to be bound by the K, whereas here and in *Black*, the parties did not so intend

### Statutory Reforms of the Pre-Incorporation Liability Standard

* **Ontario Select Committee on Company Law** found that the rule in *Kelner* did not consistently protect the parties to a pre-incorporated contract.
* Committee recommended that the law be amended to allow a corporation, through a unilateral act, to adopt a pre-incorporation contract, thereby relieving the promoter of any liability. Where it is just and equitable to the interests of the contracting party, application could be made to the court for an order that the promoters & the company will be jointly and severally liable under a pre-incorporation contract

s. 14 CBCA & s.21 OBCA

* CBCA s.14(1) s.21(1) – Person who enters into, or purports to enter into, a written contract in their name of or on behalf of a corporation before it comes into legal existence is personally bound by the contract and personally entitled to its benefits
  + Reflects *Kelner v Baxter*
  + Applies to when you used your own name (*Kelner*) AND when you used a company name (*Black v Smallwood*)
  + Dickerson Committee: Only written contracts because we do not want it to be possible for corporations to be exposed to contractual commitments made for them by 3rd parties, since the pre-incorporation company may have other shareholders and not just the person that makes the contract
  + “Purports to enter into” - want to avoid parties saying the common law applies (i.e., *Smallwood*) because this is meant to supplant the common law
* CBCA S.14(2)/s.21(2) – A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt a written contract made before it came into existence in its name or on its behalf, and on such adoption:
  + (a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and
  + (b) a person who purported to act in the name of or behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract
  + Modifies *Kelner v Baxter* – intention to honour a contract can transferred
* CBCA s.14(3) – Allows a plaintiff to still try and sue humans even after their corporation adopted their liabilities – rarely used
  + An exception to the rule
  + Side Note: There’s no such rule for shareholder immunity (piercing the corporate veil) – either s. 14(3) is unnecessary or the legislature should consider making a similar exceptional provision for piercing the corporate veil
* CBCA s.14(4) – If promoters want to avoid liability when making pre-incorporation contracts, they can do so by using express written language in their contracts
  + If in *Kelner*, there had been a provision saying: “we are buying this wine on behalf of the hotel, and in any event Baxter is not personally liable” then Kelner would not have won
    - Even if they do not set up a corporation later, Baxter won’t be liable
  + Argument pro S.14(4) – Allows parties freedom to conduct business in a free market without federal regulation of the specifics of contract
    - Issue – A contract like this has no consideration – all of the legal obligations are on one side if the other party can just assign liability to a non-existing entity and escape liability in the end
  + *Szeckett v Huang* – must be in writing
  + *1394918 ON Ltd v 1310210 ON Ltd* (2002) – Court built on *Szeckett v Huang*
    - The intent of parties is not a relevant consideration – only in common law, but not in statute
    - The Statutory definition of contracts is not defined by the common law definitions of pre-incorporation intent (*Black v Smallwood* is irrelevant)
    - The court looks for specific wording
  + Issue: Companies making *Kelner* contracts (personal names, not corporation name) can use S.14(4) wording to remove personal liability, but parties making *Black v Smallwood* contracts (company name b/c they believed company was a legal entity) will never use these words because they thought that they were only using a company (no need to protect any human)
* OBCA s.21 – written or oral contracts (not only written like the CBCA)
  + s. 21 reflects the inviolability of the corporate form. Corporation is given the option to adopt a pre incorporation contract instead of being bound automatically to pre-incorporation agreements upon incorporation
  + corporation required to take positive steps if it wishes to adopt which requires knowledge of the contract and terms
  + So, a situation can arise where there is no incorporated company and no written contract, but the provincial statute will find personal liability (overriding common law, which would not have found liability)
  + Even if there is evidence that the subjective intention of the parties was never to hold individuals liable (like in *Black v Smallwood*) s. 21 now hold people personally liable
  + s. 21(1) ensures that the promoter is bound by the agreement until it has been adopted by the corporation, unless, under s. 21(4) the parties expressly provide that the promoter is not bound by the contract or entitled to its benefits

### Two Major Issues of CBCA s. 14 and OBCA s. 21

* + 1. **Issue 1** - Since pre-incorporated corporations haven’t been incorporated at all yet, how do we know whether the CBCA or OBCA statutory rules apply? They break down on analysis and it is easy to find situations where this doesn’t work. They are the opposite where the contract is oral, so the difference matters greatly.
    2. **Issue 2** – Contract law is provincial (civil/property rights), but it also has a federal anchor (corporate law – business across borders) – both CBCA and OBCA can be strongly argued to apply to contracts

### Common Law Post Statute

## **Sherwood Designs v 872935 Ont. Ltd. (1998) ONCA-** Effect of indoor management rule: lawyer deemed to be lawful agent of the corporation. S. 18 & 14 of the CBCA set contemporary standard for contract liability - intent can be contracted by held out agents, then transferred to the corporation

**Facts:** Clients (King, McCreary, and Pellizzari) come to law office and want to enter a transaction. Sign a pre-incorporation contract in which they have agreed to buy some land from Sherwood. Law firm pulled shelf company from numbered company book that happened to be incorporated after the contract was entered into. Drafts some draft resolutions to adopt the contract. Sends the drafts to the lawyers of Sherwood without signing it to make sure it is satisfactory with them. Before getting it back, clients come back saying the deal is off and they also don’t want the company anymore. Different person wants a corporation and uses that same numbered corporation, buy a big building. Sherwood never thought there was an agreement not to close so they sued the numbered company that appeared on their drafts (the new company that had nothing to do with the contract). Sherwood also sued King, McCreary and Pellizzari on their promissory note. TJ held for P against the 3 individuals but dismissed the case against the corporation. P appealed.

**Issue:** even though the contract was intended for the first purchase, can the second owners of the corporation be liable for the contract even though the contract took place before they had it?

**Held:** For P (appeal allowed). The numbered company was held liable and had to pay

**Reasons (Abella J):** This was sufficient to constitute adoption. Business people have to be able to rely on letters from lawyers saying that this is the number of the company that is entering the contract.

* Cannot “escape a common-sense interpretation of **OBCA** **s. 21(2)**.The provision allows a corporation, "by *any* action or conduct signifying its intention to be bound thereby", to adopt a contract made before the corporation came into existence. There is nothing to suggest a requirement of formal documentation before any such intention can be extracted.
* If you contract with a company yet to be incorporated, you have no right to be impliedly guaranteed that the company has assets. They could be a shell company with $1.

**Reasons:** The indoor management rule tells us that the P had no reason not to take the letter they received about the purchase at face value even though it was sent by a lawyer in the firm and not someone that actually directed the corporation

**Note:** NOW, numbered companies are NOT re-used by firms to avoid situations similar to this.

**Abella JA-** Combination of pre-incorporation and post-incorporation CBCA principles

1. Corporations are bound/liable for contracts made by agent that they have held out to have authority to make agency decisions - relies on CBCA s. 18(1) (indoor management)
2. s. 14(2) Corporations can take on the intent to complete a binding contract made by its agent before its incorporation

## **Szeckett v Huang (1998) – ONCA**

**Facts:** Both individuals primarily located in Hong Kong, though one had a location in Toronto. Business run in Hong Kong and the intellectual property was being exploited there. In the course of negotiating the pre-incorporation contract, one party said that he wants the other to be personally liable for the obligations. The other party said no, you are dealing with a corporation only – strikes out all of the language to the contrary. There was NO specific provision that said that he would not be personally liable, only the evidence that he struck out to the contrary. The company never incorporated.

**Held:** For P. Personally liable.

**Reasons:** 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.

**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.

### Contemporary Standard for Pre-Incorporation Liability (Statute & CL Takeaways)

1. CBCA - Person who enters into a written contract in their name or on behalf of a corporation before it comes into legal existence is personally bound by the contract
   * 1. If OBCA corporation, this applies to both written and oral contracts
2. *Kelner v Baxter* Rule – The key consideration is principle of intent – the court looks for whether the authorizing parties (or ostensibly authorized parties) intended to make a binding legal contract, and if they did, they are personally liable because a pre-incorporated company cannot be given legal responsibilities yet
3. After incorporation, companies can adopt the liability for pre-incorporated contracts from their promoters – CBCA S.14(2) – *Sherwood Designs* – made it easier for promoters not to be bound by a strict interpretation of *Kelner v Baxter* rule.

# Ultra Vires, Agency Doctrine and Indoor Management Rule

CBCA has articles surrounding liability of corporations for failed contracts made post-incorporation (OBCA s.18 & 19 are same)

### The Ultra Vires Doctrine

* + ultra vires: 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.
* It stopped corporations from doing business in areas not expressly stated in incorporation documents. It used to be that corporations were incorporated for a particular purpose and they could not do anything outside of that purpose
* if the corporation has the legal capacity to do only such acts that are expressly or by reasonably implication authorized by its objects clause, then acts outside that range are null and void for want of legal capacity in the corporation and cannot be set right even with unanimous assent of all shareholders
* **But corporations now do not have objects clauses in Canada**
* a restriction may be included in the articles that a corporation must refrain from engaging in a particular activity
* Dickerson Committee wanted to get rid of it – not really used in Canada much anymore
  + Has been almost entirely eliminated in Canada – CBCA ss. 15, 16
  + ultra vires doctrine appears to be restricted in operation in those jurisdictions which follow letters patent system
* old doctrine of constructive notice had an important relationship to the ultra vires doctrine. Under a registration system the memorandum and articles of association of a corporation are registered in a public office and are open for public inspection. According to doctrine of constructive notice persons dealing with a corporation were presumed not only to have read the registered documents but also to have understood them.
* **the constructive notice doctrine has been abolished by statutory amendment to corporation statutes**
* ways to limit the scope of the ultra vires doctrine:
  + (1) memoranda containing statements of some twenty or thirty objects and ancillary powers, covering every conceivable business and all the incidental powers which might be needed to accomplish them;
  + (2) the blending of objects and powers with which the objects are to be pursued; and
  + (3) the statement that each provision, whether technically an object or a power, should be regarded as an independent object and not ancillary to any other stated object. Such a statement was upheld as valid in *Cotman* v. *Brougham*).
* corporations began to add classes such as “to carry on any other trade or business whatsoever and which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company. This type of clause was upheld in *Bell Houses Ltd v City Wall Propertied Ltd*, [1966] 2 QB 656 (CA) three major problems in relation to ultra vires:
  + (1) limitations on a corporation's legal capacity;
  + (2) the tendency of objects clauses to mislead outsiders as to current activities of the business; and
  + (3) the difficulty of conferring adequate protection upon shareholders against unauthorized transactions, while at the same time safeguarding the interests of the creditors.
* s.15/s. 15 –Corporations have the rights, powers, and privileges of a natural person and conduct business in any jurisdiction in Canada (if the jurisdiction so permits). All companies have the capacity and, subject to the Act, the rights, powers, and privileges of a natural person
  + *Ultra Vires* doctrine is of no legal use - natural persons don’t have any restrictions like those suggested by the doctrine
* s. 16(1)/s. 17(1) – Not necessary to pass by-law to confer additional powers to corp. The right of any such company to carry on particular types of business or to exercise particular powers may be restricted by express provisions in its articles
* s. 16(2) / s. 17(2)– Restrictions – A corporation shall not carry on any business or exercise any power restricted by its articles from carrying on or exercising, nor shall the corporation exercise its powers in a manner contrary to its articles.
* s.16(3)/s. 17(3) – No act of a corporation, including any transfer of property to or by a corporation, is invalid by reason only that the act or transfer is contrary to its articles or this Act. Protects the interests of 3rd parties
  + i.e., contracts will not be invalid just because restrictions are not followed
  + s. 17 - abolishes the doctrine of constructive notice
  + s. 18(1)/ 19 - Authority of Directors, Officers and Agents
    - no corporation and no guarantor of an obligation of a corporation may assert against a person dealing with the corporation or against a person who acquired rights from the corporation that
      * (a) the article, by laws and any USA have not been complied with [cannot say not bound b/c not following articles]
      * (b) the persons named in the most recent notice sent to the Director under s. 106 or 113 are not the directors of the corporation [cannot say that they are not your directors when they are according to papers]
      * (c) the place named in the most recent notice sent to the Director under s.19 is not the RO of corporation;
      * (d) Indoor Management rule: a person held out by a corporation as a director, officer or agent of the corporation has not been duly appointed or has no authority to exercise the powers and perform the duties that are customary in the business of the corporation or usual for a director, officer, agent or mandatory
      * (e) a document issued by any director, officer, agent or mandatory of a corporation with actual authority to issue the document is not valid or genuine
      * (f) a sale, lease or change of property referred to in 189(3) was not authorized
  + s. 18(2)/19 - Subsection 18(1) does not apply in respect of person who has, or ought to have knowledge of a situation described in that subsection by virtue of their relationship the corporation
  + s. 247/ 253- complainant, including a SH or creditor may seek relief against unauthorized transaction by applying to the court for an order restraining a company from carrying out the restricted transaction

### The Agency Doctrine

* While human shareholders are not the same legal entity as their corporations, they have to physically do contract signing/representation on behalf of their businesses
* Issue – are corporations liable for humans’ contracts?
  + Yes, but only for legal agents – humans with “usual, apparent, ostensible or actual” authority to sign/act on their behalf
  + Usual = authority ascribed to the agent by common or trade understanding by virtue of the particular office held by him/her
  + Apparent/Ostensible = authority with which the agent has been clothed as a result of the principal’s express or implied (by conduct or acquiescence, spoken or written words) representations
* Agency complications:
  1. There could be a number of agents and principals – who makes representations on behalf of who?
  2. Courts superimpose special corporate rules over regular agency rules
     + Constructive Notice Rule - outsiders are deemed to be familiar with a public corporations’ documents. Thus, if documents contain restrictions for agent’s authority, outsider cannot claim ignorance to these restrictions if agent acts within usual authority (and not according to the restrictions)
     + Indoor Management Rule (see below; confines Constructive Notice Rule)
* Also referred to as the “Ostensible Authority Doctrine”
  + employee who didn’t actually have contracting authority but had a genuine degree of ostensible authority can make a corporation responsible

### Constructive Notice Rule

* that outsiders are deemed to be familiar with the contents of those of the corporations constitutional and related documents that are filed in a public office
* Where you are contracting with a corporation (as opposed to a partnership), there is a requirement that you are assumed to have knowledge of anything in the corporation’s publicly filed documents.
  + If there’s a provision in the public documents which explicitly states that the CEO doesn’t have authority, even you hadn’t read that provision, you’re deemed to have “constructive notice” of it.
* Corporations differ fundamentally from partnerships in the sense that corporation’s documents are public.
  + Partnership agreements are private.
* Some law reform authors thought this was a **harsh doctrine.**
  + It doesn’t make sense to always expect people to look at articles of incorporation.

### The Indoor Management Rule

* How post-incorporation agency is measured in Canada
* Often referred to as the *“Rule in Turquand’s Case”* which mitigated the effect of the constructive notice doctrine. In this case, even if he had looked at the articles that talk about shareholders having to have a meeting over a debenture, he still wouldn’t have known that the conditions would have been met. The shareholders did not have the meeting but that is not in the articles nor is it his obligation to ensure such conditions are met. So only responsible if the thing in the documents would have given you the information required to know about your contract
* An outsider does not need to satisfy himself that the internal regulations of the corporation are complied with – a balance between the corporation’s interest not to have its assets dissipated by unauthorized acts of its agents with the interests of outsiders to be able to conduct business with the corporation’s agents without undue restrictions
  + Example: Articles of incorporation said that a company can enter into a contract as long as the shareholders voted in favour of it. Employees outside of the shareholders made a contract with a third party, which failed. The third party sued the corporation, but it claimed that since the people who signed it on their behalf weren't legal agents, the contract is void and specific performance cannot be raised. The third party plaintiff won- doctrines of ostensible authority and the indoor management principle bound the company
* **indoor management rule:** holds that an outsider is entitled to assumed that a corporation has properly complied with all required internal procedures when entering into a contract
* indoor management rule was considered during the corporation statute reform process but rather than abolition, the reformers attempted to codify the common law rule (CBCA s. 18, OBCA s. 19)
* sometimes, corporate agents who do not have actual authority have the ability to bind the corporation, but not in cases where any reasonable person would not expect that person to have actual authority

CBCA ss. 17, 18 & OBCA ss. 18, 19

* s. 17/ s. 18 – No person is held to have knowledge of the contents of a document automatically
  + Overrides the common law rule of constructive notice
  + one caveat: by reason only that the document has been filed by the director or available for inspection
* s. 18(1)/ s. 19(1) – see above
* s. 18(2)/ s. 19(2)– see above
* *Sherwood Designs v 872935 Ont. Ltd.* (1998) ONCA
  + CARTHY JA: The solicitor was acting on behalf of the corporation when he sent the letter to Sherwood. But regardless, this fact does not matter due to the “Indoor Management Rule which prevents the corporation from disputing the ostensible authority held out by the letter. The recipients of the letter were entitled to adopt its terms at face value and to approach the closing of the transaction expecting to deal with the corporation.”
  + BORINS JA (dissent): Indoor Management Rule does not apply because at the time of the contract, the purchasers had yet to be incorporated. OBCA s. 19(d) only refers to dealing with a person`held out by the corporation as director, officer, or agent. The solicitor was not any of those and especially because at time of K they had yet to be incorporated.
    - If wrong about this, Sherwood ought to have made inquiries – clear that the corporation had not yet turned its mind to whether they would adopt the pre-incorporation contract

## ***Freeman and Lockyear (A Firm) v Buckhurst Park Properties (Mangal) Ltd*, [1964] 1 All E.R.**

**Facts:** One director of Buckhurst, commissioned Freeman and Lockyer as architects for their Buckhurst Park Estate project. Buckhurst later refused to pay their invoices, saying that the director was not authorized to enter into the transaction which commissioned the architects

**Issue:** Is the company bound to pay?

**Held:** Yes, the company must pay.

**Reasons:** Director had acted as the managing director of Buckhurst. The director did not have actual authority. The articles of association prohibited the director’s action, requiring all 4 directors to agree on such actions being taken. There are four preconditions to apparent authority: a representation many by the principal (company) to the 3rd party (architects); authority of the principal to make that representation; inducement of the third party by the representation into a contract and capacity of the principal to enter into that contract. The representation was made by the appointment of the director into his position, whose office would normally provide powers of authorization; the company had the power to appoint its own directors; the architects were induced into carrying out the work by the representation of the company that the director had authority and the company was not prohibited (by way of its articles of association) from entering into contracts such as that with the architects. The director therefore had the apparent authority and bound the company.

# Tortious Liability of Corporations

### General Concepts

1. Corporations are legally separate and distinct from the shareholders, employees, directors, operators and agents running them (*Companies Act* 1862, *Salomon*)
   1. Even if the only employee is also the director of the corporation (*Lee*)
2. If a person chooses to advertise and hold himself out to the public without identifying the name of the company with which he is associated, he runs the risk of being held personally liable (*Moir*)
3. Employees are not personally liable when acting within the scope of their duties, except under very specific circumstances
4. In all events, officers, directors and employees of a corporation are responsible for their tortious conduct even though that conduct was directed in a bona fide manner to the best interests of the company, always subject to the *Said v Butt* exception
5. The mere fact that the employee is performing the “very essence” of a contract between the plaintiff and his or her employer does not, in itself, necessarily preclude a conclusion that a duty of care was present (*London Drugs*)
6. Outlier?- Directors and officers cannot be sued unless they exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own
7. The corporate veil will be lifted when the corporation was a sham or just an agent(*Clarkson*)

* corporation can be held vicariously liable for certain torts committed by its servants and agents but in some rare cases, it is not possible to hold a corporation vicariously liable for the tortious actions of its ordinary employees or agents, even when those agents were acting within the scope of the authority. Here, it is necessary to determine if the corporation itself committed the tort, directly not merely vicariously
* the wrongful acts of a person found to occupy a sufficiently high place in the corporation’s hierarchy to constitute a “directing mind and will” will be treated as the fault of the company itself
* the cases in which a corporation is liable on the doctrine of respondeat superior for torts committed by a servant or agent involve a consideration different from the cases of a contractual liability
* Sometimes vicarious liability is not available in tort (could be precluded by statute), so corporations can be directly liable (not an employee or agent) – but need distinction b/w torts committed by an agent of a corporation (vicarious liability) and torts committed by the corporation itself (direct liability)
  + Some corporate officials are more than mere agents (directing mind and will – need to be the person/people making the policies)
  + Policy-making function could be geographic or functional
* Can almost always succeed in suing a corporation on the basis of vicarious liability
* if they are personally liable they must be the directing mind

## **Sullivan v Desrosiers (1986)(CA)-** Principal SH can be liable for tortious actions even though company committed them, when it is clear that individuals actions caused the tort. Usually for intentional torts.

**Facts:** Mr. Sullivan, the defendant, had carried on farming operations in New Brunswick. In 1980, he incorporated a corporation, Sullivan Farms Ltd., to continue operating this farm. By that time, most of the farming operations involved raising hogs. The plaintiffs were homeowners who lived near this farm and brought an action against Mr. Sullivan alleging that the smell associated with the hog harming operations constituted a nuisance.

**Held:** Liable

**Ratio:** Employees of the company are held personally responsible for their tortious acts

**Reasons:** Mr. Sullivan was the principal employee of the company and the person responsible for its day to day operations and on that basis he was responsive for both creating and maintaining the nuisance. Once it is determined that a person breaches a duty owed to neighbouring landowners not to interfere with their reasonable enjoyment of their property, liability may be imposed may not escape by saying that as well as being a wrongdoer he is also a company manager or employee.

## **The “Rhone” v The “Peter AB Widener”, [1993] 1 S.C.R. 497** - Must have “governing authority the management and operation” of corporation to be a directing mind. For identification theory, the court must identify the actions which substantiate a labelling of the directing mind,and deterring whether that individual had those actions within the scope of his assignment employment.

**Facts:** While moored in the Montreal Port, the “Rhone” was struck by the “Peter Widener”, a barge that was being towed by several tugboats. The tugboats were owned by the Great Lakes tugboat company. “North Central”, owner of the Rhone, sued Great Lakes and Captain Kelch, the captain of one of the tugboats, for negligence.

**Issue:** Was Kelch a directing mind of “North Central” by virtue of the fact that he exercised some discretion and performed some non-navigational functions as an incident of his employment?

**Held:** No, Kelch was not a directing mind.

**Reasons:** In order to be a directing mind, the discretion given to the employee must amount to a delegation of control authority for the purpose of setting policy rather than out of necessity to accomplish the employees duties. To determine liability, the focus of the inquiry must be whether the impugned individual has been relegated the “governing executive authority” of the company within the scope of their authority and the courts must consider who has the decision making power in a relevant sphere of corporate activity. In this case, Another captain had the final authority and his navigation authority wasn't unusual in this trade.

# Corporate Criminal Liability

* Purposes of criminal law: punishment, stigma, deterrence, rehabilitation, retribution, closure
* Struck the common law as incoherent to hold corporations (mere concepts) as liable for crimes

### 2 Major Questions for How Canadian Criminal Law applies to Corporate Individuals

1. Why should corporations be held criminally responsible?
2. How does *mens rea* apply to a corporate individual?

### Why Should Corporations be held Criminally Responsible?

* 3 Arguments against:
  1. Aims of crim punishment (deterrence, rehabilitation, retribution) do not apply to most corporate bodies
  2. Corporations must be controlled by humans – wouldn’t it be better to single out the individuals within criminal circumstances?
  3. Criminal punishments like fines will likely affect many people who are not to blame – shareholders who are liable criminally for the corporate individual, employees laid off as a financial consequence
* Arguments for:
  1. Corporations that perform acts that cannot be handled by civil/administrative bodies should be treated as criminals – significant enough harm
  2. The stigma of a criminal conviction is necessary for bodies that exert economic/social influence -modern corporations are too influential in society to avoid societal labels

### How does Mens Rea Apply to a Corporate Individual?

* Current Anglo-Canadian approach: only the mental state of those directing the corporation’s affairs will be ascribed to the corporation (identification/organic theory of corporate criminal liability)

## **Canadian Dredge & Dock Co Ltd v The Queen (1985) SCC** – Seminal Canadian case for judging whose fault element should dictate corporate criminal liability. The identification doctrine only operates where the Crown demonstrates that the action taken by the directing mind was within the field of operation assigned to him, was not totally in fraud of the corporation, and was by design or result partly for the benefit of the company. To trigger its operation and through it corporate criminal liability for the actions of the employee, the actor-employee who physically committed the offence must be the ego, the “centre” of the corporate personality, the “vital organ” of the corporate body or its directing mind. [No longer the test – CC amended in 2004]

**Facts:** P was a corporation that was charged with the criminal offence of conspiracy to defraud (ss.380 & 465). Senior officers of the corporation (GM, VP) conspired with their peers at other companies to bid on subcontracts, deciding that P’s company would purposely bid low and then give payments and profitable subcontracts to the “losing” bidders/co-conspirators. Senior officers kept payments that were supposed to go to their companies.

**Issue:** The ‘identification’ theory of judging whose *mens rea* should be assessed to hold a company liable needed to be clarified

**Held:** For the Crown

**Reasons:** 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. If you commit the thing then you are guilty, AR only and no defence of due diligence. Must pay fine even if it was an accident.
   * no constitutional argument because there is no stigma
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.
   * + if you commit the AR, then you are presumed guilty, however there is due diligence defence. This works for corporations as well as with the same process used for humans.
     + must take reasonable steps to not commit the offence
   * Different from absolute liability because of the available due diligence defence
3. Offences Requiring Mens Rea
   * only applies to senior officers within the scope of their employment. Must have sufficient rank within the corporation such that we can say that you were the corporation yourself.
   * *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd* (1915) HoL – Viscount Haldane – the fault element must be judged by the corporation’s “directing mind… the very ego and centre of the personality of the corporation” – could be officer, could be the board of directors
     + Bringing in the principle from tort law that if the directing mind and will committed the criminal act, the *mens rea* can be satisfied to convict a corporation

Estey J – the **doctrine of identification** merges the board of directors, the managing director, the superintendent, the manager/whoever is delegated by the board of directors to have executive control of the corporation – The standard is very elastic, as long as the party can be proved to be the directing mind (*Lennard’s*) and can be considered a primary representative of the corporation’s mind (**Winn’s Theory**)

**Identification Doctrine:** for mens rea offences, the directing mind and will of a human who has policy making authority or manages a significant portion of the business counts as the MR

* The doctrine has value in criminal law – was supplanted by S.22 of the *CC* in order to set an identification standard for how to prosecute corporations whose controlling minds committed criminal offences
* The doctrine ceases to operate when the directing mind of the corporation’s actions are meant to harm (defraud) the corporation itself. So too when the directing mind seeks to attain benefits not for the company but for him/herself.
  + Doctrine of identification operates ONLY where the Crown demonstrates the directing mind (1) was within the field of operation assigned to him; (2) was not totally in fraud of the corporation; and (3) was by design or result partly for the benefit of the company.
* In the present case, the defendant corporations were not defrauded in the narrow sense described, even though some of the benefits of the illicit scheme were diverted to the directing minds
* No defence that corporate officer was acting in violation of direct orders.

### Criminal Code C-45- Supplants Common Law (Stat authority built off of *Canadian Dredge)*

Bill C-45 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 ss. 22.1 and 22 to the *CC*

**S. 1(2) “Organization” (can be criminally liable) means:**

(a) a public body, body corporate, society, company, firm, partnership or

(b) an association of persons that is created for a common purpose, has an operational structure, holds itself out to be an association of persons

### Section 22.1 - Strict Liability

**S. 22.1(a) – Negligence – an “organization” is a party to a criminal negligence offence if acting within the scope of their authority:**

* 1. one of its representatives (anyone who works for the corporation) was party to the offence,
  2. or two or more of its representatives engaged in conduct that if done by one representative would have made them a party to the offence

**S. 22.1(b) –** the senior officer who is responsible for the aspect of the organization’s activities that is relevant to the offence departs — or the senior officers, collectively, depart — markedly from the standard of care that, in the circumstances, could reasonably be expected to prevent a representative of the organization from being a party to the offence.

* Senior officer = member that plays a role in creating policy (similar to directing mind and will, but then continues to intentionally expand the common law) … “or is responsible for managing an important aspect of the organization’s activities and, in the case of a body corporate, includes a director, its chief executive officer and its chief financial officer”

**Representative:** Director, partner, employee, member agent or contractor of organization

**Senior Officer:** Plays an important role in establishment of organizations policies OR exercising management function

### Section 22.2- Full Mens Rea Offence

S. 22.2 – Offences that require the Crown to prove fault (Canadian Dredge’s Type 3), an “organization” is party to an offence if, with the intent to benefit the organization, one of its senior officers (someone who manages an important aspect of the business at the senior level):

* 1. acting within scope of authority, was party to the offence
  2. had the mental state required to be a party, and directed another representative to perform it
  3. knowing that another representative of the organization is or is about to be party to the offence, does not take all reasonable measures to stop them from being a party (duty to prevent)

SECTION 718.21 A court that imposes a sentence on an organization shall also take into consideration the following factors:

1. any advantage realized by the organization as a result of the offence;
2. the degree of planning involved in carrying out the offence and the duration and complexity of the offence;
3. whether the organization has attempted to conceal its assets, or convert them, in order to show that it is not able to pay a fine or make restitution;
4. the impact that the sentence would have on the economic viability of the organization and the continued employment of its employees;
5. the cost to public authorities of the investigation and prosecution of the offence;
6. any regulatory penalty imposed not he organization or one of its representatives in respect of the conduct that formed the basis of the offence;
7. whether the organization was- or any of its representatives who were involved in the commission of the offence were - convicted of a similar offence or sanctioned by a regulatory body for similar conduct;
8. any penalty imposed by the organization on a representative for their role in the commission of the offence;
9. any restitution that the organization is ordered to make or any amount that the organization has paid to a victim of the offence; and
10. any measures that the organization has taken to reduce the likelihood of it committing a subsequent offence

### Section 2 of the CC - Definitions

**organization** means:

* 1. a public body, body corporate, society, company, firm, partnership, trade union or municipality, o
  2. an association of persons that

i) is created for a common purpose

ii) has an operational structure, and

iii) holds itself out to the public as an associations of persons;

**representative,** in resect of an organization, means a director, partner, employee, member, agent or contractor of the organization

**senior officer** means a representative who plays an important role int he establishment of an organization’s policies or is responsible for managing an important aspect of the organization’s activities and, int he case of a body corporate, includes a director, its chief executive officer and its chief financial officer;

### Summary of Criminal Liability

1. Corporations can commit crimes and torts
2. Identification Doctrine: For mens rea offences, the directing mind and will of a human who has policy- making authority or manages a significant portion of the business counts as the mens rea *(Canadian Dredge & Dock Co)*
3. Why should we hold corporations criminally responsible at all? Because they are capable of carrying out actions that deserve the social stigma of a criminal conviction

# Financial Statements

* three basic elements to all business enterprises:
  + (1) the risk of loss,
  + (2) the power of control,
  + (3) the participation in the profits of the business enterprise while it is a going concern and in its assets on the dissolution of the enterprise
* the allocation of these three elements is effect through the “capital structure” of the corporation

1. Balance Sheet
   * Assets = Shareholders’ Equity + Liabilities
   * in limited liability, a negative equity number does not result in shareholders putting in any more money
   * financial statements are management’s responsibility to prepare and then auditors give their substantive opinion on the statement - they made a clear designation on the statement of their notes
   * Ex: if assets are $500K and liabilities are $600K, equity must be -$100K. BUT the shareholders are not responsible for putting in that extra $100K in liabilities because they have limited liability – not responsible for company’s debts
     + Left Side – Assets – Liquid to least liquid
       - Historic cost – not market value
         * Issue in highly inflated economy
       - Goodwill isn’t listed on the BS – Coke has low assets listed because their biggest asset (brand) is not listed
       - What the corporation OWNS
     + Right Side – Liabilities and Equity
       - What the corporation OWES
   * Not a valuation of the company, just a snapshot of the things law requires you to list
     + Goodwill is most companies’ most valuable asset, and it isn’t listed
     + A snapshot of one day in history (end of accounting period) and by the time it is prepared, it is already history (because over a year can pass between annual balance sheets)
   * Prepared by management, not auditors. Auditors review it.
2. Income Statement/ Statement of Operations: A record of what happened in the company over a year (not a snapshot, but a video)
   * Revenue – Expenses = Net Income
     + Profit a better indicator than revenue of how company is doing
     + “Gross margins” = important number
   * Expenses include employee wages
   * Not a perfect measure of a company’s actual yearly earnings – capital expenses have to be spread over their useful life, but the income statement doesn’t reflect this
     + A company that spent $100 on a machine that will last 10 years can’t list it all the year they buy it, even though they spent $100 in cash that year since it is misleading
       - Misleading because that machine is not just a one-year machine, but will last for 10 years so you must write it off over 10 years
   * **Takeaway:** Earnings does not automatically mean cash – can be manipulated by accountants to selectively include/not include amortization/depreciation and deferred tax
3. Cash Flow Statement: attempt to address limitations of balance sheet + income statement
   * Necessary because a company without any cash could have positive-looking balance sheets and income statements
     + In the depression, there were healthy-looking company’s (more assets than liabilities), but the next day they were bankrupt because they could not turn their assets into cash quickly enough
     + Sometimes accounting convention requires entries that have nothing to do with cash
     + Machine issue from ‘income statement’ somewhat rectified
   * Company have to be liquid enough to ensure that their partnering businesses can be paid – can’t allow companies to list revenue if none of it is cash

# Corporate Finance- CBCA Part 5

* Any privilege given to directors is ALWAYS subject to the fiduciary duty and obligation of good faith to the corporation and its shareholders

s.24 (1)/ 22(1) – Shares have to be in registered form, and without nominal or “par value” – public companies must register on the share register

* if you want to be an owner of a share in Canada you name must be inputted in the “books” of the company onto the share register before you are qualified as holding a share
* NOBO- Non- Objective Beneficial Owner- a shareholder of a public corporation who does not object to allowing the corporation’s directors to know who they are
* OBO- Objecting Beneficial Owner- keep their name a secret
* “Bearer instrument” = does not need to be registered to be used, all you have to do is hold the certificate
  + Thought to be too easily used for activities contrary to public policy (e.g., tax evasion)
  + Jurisdictions that allow for these are not sketchy, just have different policy choices – many believe there are advantages in terms of facilitating transfer of shares, the freedom they provide to people, etc.
  + NO CANADIAN CORPORATION HAS BEARER SHARES
* The people who buy shares in a company can do it through holdings like the Canadian Deposit Securities (CDS) – don’t have to give their legal name as a shareholder
  + Does not violate the law – there is a registered owner, but companies cannot find out who their individual shareholders are (unless they consent)
* for public companies in Canada a technique is used where ordinary investors do not have shares registered in their own name
  + instead Depository Companies are set up as simply a holding for all of the shares which will represent different brokerage companies which will be listed + then an investors name will be listed on the brokers register but not actually on the company you are buying shares from
  + most companies do not and cannot find out who their registered shareholders are
  + easier if the shares are not registered in each investors individual name because it makes the trading of shares more efficient + limits the amount of administration required per trade

s.24 (3) – Companies that only register one class of shares must give all shareholders:

(a) a vote at any shareholder meeting

(b) any dividend declared by the corporation

* + But not actually a right of the shareholders – directors have discretion, but usually they will not capriciously withhold dividends

(c) a right to property upon liquidation (only after creditors are paid)

* companies who designate difference classes of shareholders like preferred shareholders with a set dividend rate do not ave to fulfill that dividend rate always
  + but they cannot withhold capriciously
* public companies with preferred shares with set dividend rates will not fail to pay for two reasons

OBCA s. 22(3) - Where a corporation has only one class of shares, the rights of the holders thereof are equal in all respects and include the rights,

1. to vote at all meetings of shareholders; and
2. to receive the remaining property of the corporation upon dissolution

s. 24(4)/ 22(4): classes of shares – A company’s articles can declare multiple classes of shares

(a) Each class’ rights have to be listed officially

(b) one of the classes must be given the three s. 24(3)/ 22(3) shareholder rights but all such rights are not required to be attached to one class

## *United Fuel Investments Ltd v Union Gas Company of Canada Ltd-* share interest doesn't give SH any interest in assets of corporation. Preferred shareholders suffered from a restrictive dividend policy

**Facts:** United Fuel was winding up, owed many Union gas shares. Minority SH wanted court to order pro rated distribution of Union Gas Shares

**Held:** No Entitlement to them, ownership interest only in corporation not in corporations assets

s. 25(1)/ 23(1) issues of shares – Directors control how shares are issued – when, to who, how many, what price

(a) Subject to the article, the by law and USA and to s. 28, shares may be issued at such times and to such person and for such considerations as the directors determine BUT it must be exercised honestly, in good faith and in the best interests of the corporation

* + everything directors do is subject to their fiduciary duty so their ability to decide to issue shares and to determine at what price those shares will be sold is qualified by their fiduciary duty

s. 25(2)/ 23(2): shares non-assessable – Shares issued by a corporation are non-assessable

* Cannot call on shareholders to put more money in (cannot make a financial call on the shares)
* holders are not liable to the corporation or to its creditors in respect thereof
* share can never be a liability it can only be an asset - you cannot buy equity that you would then have to list as a liability when producing a balance sheet

s. 25(3)/ 23(3): consideration – Shares can only be issued by directors in exchange for consideration in the form of present cash back, property, or already have received past services from the shareholder

* The consideration ($, property, or past services) can’t be lesser in value than the equivalent of the money that the corporation would have received if the corporation would have sold the share on the public capital markets; no IOU’s
* a partly paid share is also party IOU so they are illegal. You have to pay fully for a share.

s. 25(4)/ 23(4): consideration other than money consideration other than money - in determining whether property or past services are the fair equivalent of a money consideration, directors can take into account reasonable charges and expenses, reorganization and payments for property and services expected to benefit the corporation

s. 25(5): definition of property – does not include a promissory note or a promise to pay that is made by a person to whom a share is issued, or a person who does not deal at arm’s length, within the meaning of that expression in *ITA*

s. 26/ 24(1) – Corporation shall maintain stated capital account. Cannot arbitrarily change stated capital account

s. 27 - allows for an expedited way to creating shares in response to market conditions

s. 27(1)/ 25(1) – A company can issue series of shares within its declared share classes

* Ex. It can issue an initial series of 1000 common shares with fixed dividend interests, and then declare the rest of its common shares non-dividend interests
* 27(3)/ 25(3) - new series of shares issued cannot take priority over shares already outstanding within the same class

# Corporate Financing- Debt & Equity

### 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”)
* “securities” is used in corporation law to cover a wide variety of corporate instruments that may be subdivided into two classifications:
  + (1) equity securities: create a shareholder relationship; and
  + (2) debt securities: create a creditor- debtor relationship between the holder of the security and the corporation

### Debt

* Duration is outlined
* Has to be paid back
* when a corporation borrows money, this creates a contractual debtor-creditor relationship: the corporation becomes debtor and the person who lends the corporation the money becomes the creditor
* a corporation that wants to borrow money can choose to enter into a loan agreement with a lender (bank) OR it can choose to sell debt securities (such as bonds, debentures, or notes) to investors
* corporate statutes confer upon directors the power to borrow money on the credit of corporation (s. 189; s. 184)

### Debt Securities

* a debt security (such as a bond, debenture, or note) is like a corporate IOU
* the corporation receives money (as a loan) from an investor, and in exchange, the corporation issues the bond, debenture or note to the investor
* the bond, debenture or note issued by the corporation to the investor states (among other things):
  + (a) **WHEN** the corporation must repay the money (the *principal*):
  + (b) **How much** interest the corporation must pay on that money;
  + (c) **WHEN** the corporation must make interest payments (Annually? Semi-annually? Monthly?)
* when corporations issue debt securities to the public, this is done through a trust indenture
* the use of trust indentures raises investor protection issues. CBCA/OBCA include rules that must be followed when a corporation issues debt securities to the public under trust indenture (CBCA Part VIII; OBCA Part V)

### Equity

* there are three basic share attributes:
  + the right to attend shareholder meetings and **VOTE**
  + the right to a **RETURN OF CAPITAL ON A WINDING UP (but only after ALL debts of the corporation have been paid IN FULL)**
  + the “right” to receive **DIVIDENDS** if and when “declared” by the corporation
* a “share” is the interest of a shareholder in a corporation measured by a sum of money and made up of various legal and equitable rights and obligations
* a share is a form of security issued by a corporation that does not result in creditor-debtor relationship
* when a person becomes a shareholder, they cease to have any further proprietary rights or interest in the consideration that they gave for the shares
* if a corporation has only one “class” of share, those shares **MUST** include these basic share rights:
  + the right to vote at any meetings of the shareholders
  + the right to receive any of the corporation’s property that remains when the corporation has been dissolved **(after the corporations creditors have been paid in full)(**CBCA s. 24(3); OBCA s. 22(3))
  + CBCA provides that if there is only one class of share, that class must also include the right to receive any dividend declared by the corporation (CBCA.s 24(3)(b)). However, since declaring dividends is **ALWAYS** a matter of the directors’ discretion, this is not a “right” that corresponds to an obligation on the part of the corporation. That is probably why the OBCA omits references to dividends in s. 22.
* if a corporation has more than one class of shares, no single class is required to have all of these basic rights
* BUT amongst all existing classes of shares, these rights must be conferred
* No duration, money does not have to be repaid
* Shareholders elect the company’s BOD through a vote
* Shareholders do not “own” the company – they invest in a legal individual’s business
* 2 Ways for Shareholders to earn on their investment: capital gains, and/or dividends
* Historic Development – People gave trading voyages $ to spend on their selling trips, and were paid a share of the profit when the voyage returned

### Common & Preferred Shares:

* + Common Shares
    - represent the residual interest of the holders thereof in the assets, earnings and control of corporation
    - no certain dividends ever, but also no ceiling on the rate of a dividend if given
    - voting rights on the appointment of directors
    - if corporation prospers. the increase in value accrues to the common shares
    - if the corporation suffers loss and must be liquidated, the common shareholders will bear the greatest burden of losses since preferred shares usually receive a fixed return of capital before the common shareholders receive anything
    - usually common shares are voting shares
  + Preferred (“compromise securities”) -
    - class of shares that entitles its holders to some rights in preference to the rights of more junior classes of shares, such as common or ordinary shares
    - distinguishing feature of a preferred share is that it is a share which gives the holder some preference or priority over the holders of shares of another class
    - dividends given at a pre-determined cap rate in years the company chooses to pay out dividends
    - normally given a fixed dividend rate, usually expressed as a percentage of the share’s initial issue price or a reference amount related to that price
    - they are an attempt to endow the investor with certain vague and unenforceable rights against the earnings of a corporation without giving a lien on the earnings
    - a corporation cannot issued secured preferred shares in the sense that they have some right of return of capital which is equal or superior to the rights of creditors to payment of their claims
    - preferred shareholders are risk takers who are required to invest capital in the business and who can look only to what is left after creditors are fully provided for
    - preferred shareholders rank behind creditors but before common shareholders on a voluntary or involuntary dissolution of the company
    - preferred shares can usually be redeemed at the company’s option
    - a preferred shareholder does not usually participate in the earning of the corporation. Opportunity for gain is restricted and their chance of loss is greater than bond/debenture holder but less than the common shareholder
    - under the CBCA, classes of shares must be set out in the articles. New classes of shares may be created by special resolution pursuant to CBCA s. 173
    - First shareholders paid w/dividends
  + Neither common or preferred dividends are certain – company’s discretion

## **Muljo v Sunwest Projects Ltd (1991) (CA)** - Equality in regard to capacity as SHs. Common SHs receive rateable distribution upon winding up, regardless of individual differences in paid up capital.

**Facts:** Two shareholders in the same company. First investor pays $1 per share for 200 shares. Second investor pays several hundred thousand dollars for the share. Person who paid more said he deserves more upon the winding up and said they should get what they paid for the shares and then split the assets.

**Held:** No, all shares are treated equally

**Reasons:** Equality in capacity in shareholders.

## **McClurg v Canada, [1990] 3 SCR 10200-** Different classes can have different rights like dividends. A discretionary dividend clause is sufficient to rebut the presumption of SH equality.

**Facts:** McClurg incorporated a truck dealer and the SHs of the company were divided in three classes: A (vote and control the company, McClurg), B (right to dividend, his wife) and C (liquidation and sales right, McClurg). As the business was making money, the directors (McClurg) decided to give the dividend to his wife since, from a tax point of view, it was better to give it to her than to him who was already getting a salary. The director had the discretion to give dividend or not, and then, to whom. The Minister of National Revenue, stated that the business arrangement was going against the equality of the shareholders.

**Issue:** Should this set up be prohibited in corporate law? (i.e. whether the dividends received by his wife in respect of Class B common shares of Northland Trucks should be attributed to the husband, McClurg, and officer and director of Northland Trucks and the holder of the controlling Class A common shares in the capital stock of that company)?

**Held:** No! There is nothing wrong in the use of the discretionary dividend clause in allocation of corporate dividends. There is nothing in the CBCA or at CL that prohibits this dividend allocation technique.

**Ratio:** Two views on the SC’s approach to corporate law: Dickson’s approach sees corporate law as facilitative, while La Forest takes a more interventionist approach.

**Reasoning(Dickson):** There are two conceptual questions: 1) should a dividend be declared? 2. Are you entitled to it (who are you?). The discretionary dividend clause is both a valid means of allocated declared dividends and is sufficient to rebut the presumption of equality amongst shares: “the inclusion in the articles of a discretionary dividend clause expressly establishes that the corporation intends to derogate from the principle of equality among shareholders. The provision included in the articles alters the division of profits which in the absence of such a provision would have to be made in accordance with the principle of equality among shareholders.” The declaration of dividend is limited legally in that it must be exercised in good faith and in the best interests of the company. The purpose of ensuring that shareholders are fully aware of their entitlements and privileges has been met since the dividend entitlements are clearly set out in the description of the share classes.In the end, given that the legislature has not chosen to disallow the discretionary dividend clause, and no shareholder has taken remedial actions against its use, it would be paternalistic for this Court to invalidate the claus. If the legislature determines that the use of the discretionary dividend clause undermines the reasonable expectations of shareholders or is in some way unfair to an interested party, then it is up to the legislature to limit the use of this means of structuring corporate affairs.

### Authorized Versus Share Capital

* **authorized capital:** the total max number of shares that a corporation is authorized, under articles to issue
* under both CBCA and OBCA, although a corporation is PERMITTED to limit the maximum number of shares it is authorized to issue, it is no longer required to do so. (CBCA s. 6(1)(c); OBCA Form 1, item b) (form 1 is ‘prescribed’ from for Articles of Incorporation under s. 5(1): Ontario Regulation 289/00 s. 2(1))
* most CBCA and OBCA corporations choose not to place limits on their authorized capital and so are authorized, by their articles, to issue an unlimited number of shares of one or more classes

### Issued and Outstanding Shares

* issued and outstanding shares refer to those shares that have actually been created and sold by the corporation to investors (“issued”) and have not subsequently been repurchased by the corporation or redeemed etc., and so are still “outstanding” and in the hands of shareholders
* the # of validly issued and outstanding shares can NEVER be greater than # of authorized shares

### Issuance of Shares

* par value shares are no longer permitted under CBCA or OBCA (CBCA s. 24(1); OBCA s. 22(1))
* shares must be FULLY-PAID before they may be issued (CBCA s. 25(3); OBCA s. 23(3))
* shares must be in REGISTERED form (CBCA s. 24(1); OBCA s. 22(1))
* Registered form: cannot be “bearer” shares (whoever holds it holds value and their name must be on books)
  + why prevent bearer shares?- they are too easy to be used for things that are against public policy such as tax evasion and use for things that shouldn't be encouraged
  + shares are publicly traded so to change every time would not make sense. If share has multiple holders the bank will be on the companies book as the holder but the actual holder will be on banks book
* Par value share= a share with some dollar figure on it
  + illegal under OBCA and CBCA because they re misleading

### Classification of Shares

* ***Common shares*** = equity shares to which are attached voting rights exercisable in all circumstances, irrespective of the number or percentage of shares owned, that are not less, on a per share basis, than the voting rights attached to any other shares of an outstanding class of shares of the issuer
* ***Equity shares***= shares that carry a residual right to participate in the earnings of the issuer and, upon liquidation or winding up of the issuer in its assets
* ***Non-voting shares*** = restricted shares that do not carry the right to vote except for a right to vote that is mandated in special circumstances by law
* ***Preference shares*** = shares which are attached a preference or right over the shares of any class of equity shares of the issuer, but does not include equity shares
* ***Restricted Share term***= every non-voting shares, subordinate voting shares restricted voting shares and every other term designated under 4.1(2) - restricted share are equity shares that are not common shares; and equity shares determined to be restricted under subsection 4.1(1)
* ***Restricted voting shares*** = carry a right to vote subject to restriction on the number of % of shares that may be voted by a person, a company or any combination of persons and companies
* ***Subject Securities*** = shares that have effect of changing a class of outstanding equity shares into restricted shares
* ***Subordinate voting shares*** = restricted shares that carry a right to vote if there are shares of another class of shares outstanding that carry a greater right to vote on a per share basis

### Issuance of New Shares

* a purchaser of shares SUBSCRIBES for shares (and tenders the purchase price to the corporation)
* if the corporation accepts the subscription, the directors then **ALLOT** and **ISSUE** the shares (either by resolution passed by a majority of the directors at meeting, or written resolution signed by ALL of the directors)
* the name/address of the SHs is recorded in the SHARE REGISTER (private corporations- MINUTE BOOK)
* corporation may deliver SHARE CERTIFICATE to the SH. Certificate is NOT the share, but is EVIDENCE of it.

### Purchasing Shares on a Stock Exchange

* most Canadians who hold shares did NOT buy new shares directly from the company issuing them, they usually purchase their share on a stock exchange from other SH (buying previously owned shares)
* money used to purchase shares on the stock exchange goes to selling SH, not companying issuing share

### Presumed Equality of Shares

* at common law, shares were all presumed to be equal UNLESS the share conditions/articles specifically said otherwise (Birch v Cooper, 1989)

### Dividends

* a dividend is a distribution of money or property paid by the corporation to shareholders
* only directors can declare dividends
* payment of dividends is ALWAYS within directors discretion and subject to specific statutory rules intended to prevent corporations from paying dividends in circumstances that impair corporation's ability to pay creditors
* unless there is an express provision to the contrary, each share is entitled to participate equally with every other share in the distribution of dividends declared
* common preference involves the right to a preferential dividend, entitling the holder of such shares to payment of a specified dividend per share before any dividend is paid on more junior classes of shares
* preferred shares in Canada are often issued as **“rate reset preferred shares”** on which the rate is periodically reset while the shares are outstanding
* contractual right given to preferred shareholders is a contingent on board’s determination that there is a fund viable for lawful distribution among shareholders
* **“fund available” -** the max amount which may be distributed to SHs as dividends, irrespective of whether there is sufficient cash in hand

### How Dividends Are Declared and Paid

* directors first DECLARE a dividend (by resolution). The declaration will state: (1) The “record date” (date on which a SHs name must appear in the share register to be entitled to receive the dividend) and (2) the payment date (the date on which the dividend will actually be paid). The declaration of the dividend typically occurs well BEFORE the record date and well BEFORE the actual payment date
  + e.g. the directors might pass a resolution at a meeting on March 7, declaring a dividend to be paid on April 15 to those shareholders who are registered shareholders as of March 21.
* once a dividend has been declared, it becomes a debt of the corporation, so if it is not paid, the shareholders may sue to enforce payment (Re Severn and Wye and Severn Bridge Railway Co, [1896] 1 Ch 559)
* when dividend is declared, a date of record is established which follows the date of declaration by 3 or 4 weeks. SH listed as the owner of the shares on the date of record is the person eligible to receive the dividend. List of SHs as of the date of record must be compiled. To provide this record, a corporation will close its share transfer register before date of record.
* from the closing date the share is sold “ex dividend”. A person who buys the share before the ex dividend date is entitled to receive the dividend (cum dividend). A shareholders who sells a share between the date of declaration and the ex dividend date does not receive the dividend.
* Canadian courts have not allowed SHs to force directors to pay dividend. BOD enjoys a broad discretion to determine a corporations dividend policy
* In *De Vall* v. *Wainwright Gas Co.*, [1932] 2 D.L.R. 145 (Alta. S.C., A.D.) established the supremacy of the board in deciding whether to declare dividends in the absence of other express authority.
* s. 241 CBCA - the oppression remedy. Although courts are given a wide jurisdiction to intervene in the business /affairs of corporation, they are cautious about exercising discretion where it involves ordering the payment of a dividend to shareholders.
* Sparling v Javelin International Ltd (1987), 37 BLR 265 (Que Sup Ct)
  + failure of the court to order declaration of a dividend was due to the fact that the directors of J could not legally declare a dividend under 42(b) without first effecting reduction in stated capital to eliminate deficit
* *Fidelity Management & Research Co v Gulf Canada Resources Ltd* (1996), 27 BLR 135 (Ont Gen Div)
  + preferred shareholders cannot force a corporation to pay arrears of dividends simply because the corporation has profits sufficient to pay the arrears
  + “as and when declared by the BOD” gave discretion to BOD with respect to declaration of dividends

### Limits on the Payment of Dividends

* CBCA s. 42; OBCA s. 38
  + 42/38- a corporation shall not declare or pay dividend if there are reasonable grounds for believing that
    - (a) the corporation is, or would after payment be, unable to pay liabilities as they become due; or
    - (b) the realizable value of the corporation’s assets would be less than the aggregate of its liabilities and stated capital of all classes

### Preferred (or Preference) Shares

* the term “preferred” (or “preference”) shares is NOT defined in the OBCA or CBCA
* preferred shares are understood to have some “preference” over more junior shares (common shares)
* usual preference is a right to receive a stated dividend before any dividends are paid on more junior shares, and a right to receive return of capital (what they originally paid for share) on winding up or dissolution

### Cumulative or Non-Cumulative Dividends

* some preference shares have a stated dividend or dividend rate (similar to interest rate on bond or debenture)
* these dividends may be cumulative or non- cumulative (depending on articles of incorporation say)
* preferential dividend is usually **cumulative** meaning that if it is not paid on one year, such dividends accumulate and must be paid, before any dividend can be legally paid on junior shares such as common shares. Dividends must be paid for all years following the issuance of such preferred shares without regard to the earnings of the corporation in any particular year during that period
* If the preferential dividend is **non-cumulative**, then if the dividend is not paid in any year it does not have to be made up in any subsequent year before dividends can be paid on the common shares
* if dividends are cumulative and have NOT been declared/paid when a company is wound up/dissolved, are SH entitled to receive their accumulated, unpaid dividends out of funds available on winding up? (*Re Canada Tea)*
* if the intention is that the preferential dividend is not to be cumulative it must be clearly indicated by language (*Staples v Eastman Photographic Materials Company,* [1896] 2 Ch 303 (CA))
* There may be a provision in the share conditions enabling the preferred shareholders to further participate in the earnings of the corporation after the specified preferential dividend has been paid
* *Will v United Lankat Plantations Company* (1913), [1914] AC 11
  + HL held that unless a right to participate is specifically given, it is presumed that the preferred shareholder is excluded from any right to share in surplus profits
  + confirmed in Canada in *Re Canadian Pacific Ltd* (1990), 72 OR (2d) 545

|  | Canada | UK |
| --- | --- | --- |
| Further Participating in Dividends while Business is a Going Concern? | NONE  (*Re Can Pacific*; Principle referred to in *International Power v McMaster*) | NONE  (*Will v United Lankat*) |
| Right to accumulated Unpaid Dividends on winding up? | NONE  (*Re Canada Tea*) | NONE  (*Re Crichton’s Oil*)  **BUT NOTE:** Gower has argued that courts will go other way where articles give “slightest indication to the contrary” (Walter Symons Ltd; Re F. de Jong) |
| Right to participate in a Residual Distribution on a Winding Up (After receiving preferential return of Capital)? | MAY BE SUCH A RIGHT TO PARTICIPATE  (*International Power v McMaster*)  **BUT NOTE:** Decided before HL decision in Scottish’s Insurance; and it may be few distributions will be characterized as returns of capital (Re Canadian Pacific) | NO RESIDUAL RIGHT TO PARTICIPATE  (*Scottish Insurance v Wilsons*) |

### Rights of Preferred Shareholders on Winding Up

## **Westfair Foods Ltd v Watt (1991) – Alta CA**

**Facts:** Westfair altered a long standing corporate policy and began paying all retained earnings generated in 1 year (less the amount of the prescribed dividend paid to the class A or preferred SHs) to the common SHs are a dividend in the following year. Preferred SHs complained that this policy was oppressive in that it reduced the amount of money that would be available to preferred SHs upon liquidation of the corporation. TJ agreed with the claim. But CA now disagrees.

**Issue:** The principal question was whether this new policy is unfair because of its impact on the class A SHs.

**Held:** No they were not entitled.

**Reasons:** “As between preference shares and common shares, it is fair that the common SHs take all needed earnings as dividends after the preferred dividend is paid”. The advantage of the new policy to the common SHs is obvious, that being an immediate and enlarged return on investment. Disadvantage to Class A SHs is that, if the company were to wind up, fewer retained earning would be available for them to share. Thus, Class A SHs have an interest in earning retention until liquidation, because then and only then they will share in it. This reflects a conflict between the two classes. Tradition view of the right to share assets on liquidation is that it is a shield, not a sword. Even if the SHs have no claim that would mandate a policy of retained annual earnings, what claim deserving of protection to the SHs have in retained earnings and liquidation? The answer is based upon the assertion that the right to share in distribution of assets on liquidation is a security for recovery of investment in the event that the business fails. Expectation of SHs is the business will not fail so the company has a duty of prudent management to forestall that event. Company also has a duty to invest prudently so that the asset base that supports the investment is not lose. This may or may not mean that it can reduce or must maintain retained earnings. That is a business judgement but it is reviewable. The management must take care to keep in mind that this is so although it might be instructed by the controlling SHs to liquidate or strip or otherwise reduce the capital of the company because it serves their interests. To this extent, directors who are in the employ of the controlling SH have a conflict of interests.

## ***Re Canada Tea Co* (1959), 21 DLR (2d) 90 (Ont HC)-** Arrear dividends on preferential shares don't hold priority over common SHs in winding up asst distribution. Preferential Shareholders don’t have a right to dividends in winding up unless expressly provided.

**Facts:** Preference share holders at the liquidation dissolution or winding up of the company or other distribution of capital among shareholders were entitled to repayment of the capital upon such shares in preference to the right of common SHs to repayment of capital paid up on such common shares, but the holders of the said preference shares shall not have a right to any further participation in the assets of the company in any such event. No mention is made of their right to arrears of dividends on winding up.

**Held:** Dividends from part of assets of the estate available to shareholders on winding up

**Reasons:** A dividend means prima facie a payment made to the shareholders while the company is a going concern; after the commencement of a winding-up dividend is no longer payable. Therefore, the right of the preference shareholders was limited to the payment of a preferential dividend while the company was a going concern.

* *Birch v Cropper* (1889), 14 App Cas 525 (HL)
  + all shares rank equally and if there is to be a preference, doctrine of equality must be overcome by specific provision in share conditions. So, where the preferred share conditions are silent with respect to a preference as to dividend or return of capital, then they will have the same rights as ordinary SHs
* *Scottish Insurance Corporation v Wilsons & Clyde Coal Company,* [1949] AC 462
  + preferred shareholders can share in corporation assets on winding up only as provided for by the articles of association or terms of issue of the shares
* *International Power co v McMaster University,* [1946] SCR 178
  + case where the terms of issue were silent as to what would happen on a winding up. Court held that preferred shares were entitled to participate equally in the surplus after all dividend arrears not preference shares, and declared but unpaid dividends on the common shares were paid, and the paid up capital of the par value share was returned
* *Re Canadian Pacific Ltd (*1990), 72 OR 545
  + may have weakened the rights of preferred shareholders to participate in corporate distributions

### Redeemable Preferred Shares

* at CL, corporations NOT permitted to purchase their own shares from their shareholders (*Trevor v Whitworth*)
* the CBCA and OBCA now permit corporations to redeem or purchase their own shares PROVIDED THAT THEY COMPLY WITH SPECIFIC STATUTORY RULES INTENDED TO ENSURE THAT CORPORATIONS DO NOT RETURN MONEY TO THEIR SHs UNDER CIRCUMSTANCES THAT WOULD IMPROPERLY IMPAIR THE CORPORATION’S ABILITY TO SATISFY ITS DEBTS (CBCA s. 34-36; OBCA s. 30-32).

## ***Trevor v Whitworth* (1887), 12 App Cas 409 (HL)-** Companies cannot buy their own shares. No longer law

**Facts:** A company bought back almost a quarter of its own shares. During liquidation of company, one SH applied to the court for thebalance of amounts owned to him after the buyback.

**Prior Proceedings:** CA held that he should be paid.

**Held:** Share buybacks are unlawful. HL held that the buyback was ultra vires the company.

**Reasons:** “If the claim under consideration can be supported, the result would seem to be this, that the whole of the SHs, with the exception of those holding 7 individual shares, might now be claiming payment of the sums paid upon their shares as against the creditors, who had a right to look at the moneys subscribed as the course out of which the company’s liabilities to them were to be met. And the stringent precautions to prevent the reduction of the capital of a limited company, without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale, and so effect the desired result…”

**Note:** This case is often used in support for the Capital Maintenance Rule.

### Convertible Preferred Shares

* corporations often issues preferred shares, or debt instruments that may be CONVERTED, at the option of the holder, into other types of shares, such as common shares
* with convertible preferred shares, holders may, by exercising their option, join with the common SHs in the enjoyment of greater prosperity should the corporation prosper.
* once the conversion is exercised, all preferences disappear
* s. 29(3) and 27(3) require corporations to reserve a sufficient number of shares to meet the exercise of such rights in cases where the articles of incorporation limit the number of authorized shares
* **anti dilution provisions:** provisions that protect preferred SH against having conversion right being reduced in value by the subsequent actions of the corporation

### Shares in Series

* corporation may provide for the issuance of preferred shares from time to time in one or more series
* **advantage:** once the class is created, the designation of a particular block as a series and the conditions to attach may be done by a simple directors’ resolution and articles of amendment filed designating the series without the necessity of calling a special or general meeting of shareholders or obtaining shareholder approval

### Right to Vote

* s. 140 and s. 102 states that unless the articles otherwise provide, each share of a corporation entitles the holder to one vote at a meeting of shareholders
* s. 24(2) and s. 22(4) provide for the issuing of more than one class of shares and stipulate that the rights, privileges, restrictions and conditions attaching to the shares of each class must be set out in the articles
* rights set out in s. 24(3) or s. 22(3) shall be attached to at least one class of shares but all such rights are not required to be attached to the same class
  + if you only have one class of shares, you cannot have differing rights between them
  + if you only have one class of shares, they all must be voting shares

## **Bowater Canadian Limited v RL Crain Ltd (1987) – Ont CA**- step down provisions are not enforceable but you can have separate separate voting rights for classes of shares

**Facts:** Bowater challenged provision in Crain’s articles of incorporation which provided for step-down shares (when shares initially issued, shareholder entitled to 10 votes per share, but if the original holder ever sold them to anyone else, the shares would step down and only give the holder 1 vote per share). This structure was put in place at the time the company was being sold, to entice the people to stay in the company that gave them 10 votes. Original holder sells shares to P, who was aware of the articles. P sues and says that provision is illegal.

**Held**: For P.

**Reasons:** 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. TJ held that there is no express provision in the CBCA that prohibits step-down provision. However, s. 24(5) of the Act should be interpreted in accordance with the principles of corporation law with the result that the rights which are attached to a class off shares must be provided equally to all shares of that class.

**NOTE**: *Bushell v Faith* (famous UK case) says step-down shares ARE permissible.

### Debt vs Equity

|  | Debt | Equity |
| --- | --- | --- |
| Tax Deductibility | Corporation can DEDUCT interest paid on debt i calculating its taxable income (and so pay less tax) | Corporation CANNOT deduct dividends it pays on shoes in calculating its taxable income |
| Potential upside gain for investors | Holders of debt (lenders) CANNOT receive more money back from the corporation than the amount they have loaned (plus interest). Because interest payments are fixed, no dilution of earnings. (Benefits (but also risks) of “leverage)). BUT some debt instruments may be convertible or exchangeable into equity | Shareholders may share in increasing value of the corporation in which they own shares. If the corporation does well, the value of shares will rise.  But some preferential shares are fixed income securities and so do not have such an upside value. |
| Voting rights (at annual meetings and on certain major events) | Holders of debt DO NOT get voting rights. Therefore no dilution of voting control. | Holders of shares get voting rights to elect directors at each annual meeting of the corporation and to approve certain other major corporate changes. |
| Right to sue corporation for non-payment | Holders of deb can due corporation if the corporation fails to repay principal when it is due, or fails to make interest payments when due. The relationship is CONTRACTUAL. | Holders of shares CANNOT sue to force corporation to declare dividends (but CAN sue if dividends have bee “declared” but not paid) |
| “Ranking” on winding-up | If a corporation is wound up or dissolved debt holders get paid IN FULL BEFORE ANY distribution is made to shareholders. DEBT RANKS AHEAD OF EQUITY. | Shareholders will receive NOTHING in a wind up or dissolution UNLESS debt holders have been paid in full. DEBT RANKS AHEAD OF EQUITY. |

### Financial Statements

* Basic Financial Statements
  + Statement of Financial Position (Balance Sheet)
  + Income Statement (Statement of Comprehensive Income is required under IFRS)
  + Statement of Cash Flows
  + Statement of Retained Earnings/ Statement of changes in equity

### Statement of Financial Position (Balance Sheet)

* a “snapshot” of the corporation’s financial position as of one specific date (last date in an accounting period)
* the fundamental balance sheet identity:
  + assets= liabilities + shareholders’ equity
* current vs non current assets
  + current assets are those which are expected to be either consumed or converted into cash within 1 year
* current vs non current liabilities
  + current liabilities are those liabilities reasonable expected to be paid within one year
* assets:
  + whats the corporation owns
  + note: certain valuable assets (“internally generated assets”) NOT reported on balance sheet
* liabilities (and equity):
  + what the corporation owes (liabilities) AND
  + residual interest in the corporation’s assets after deducting all the liabilities (equity)
    - includes: common shares, preferred shares and retained earnings

### Income Statement (or Statement of Operations)

* summarizes financial performance over the accounting period (e.g. for a year, or a quarter year period)
* the “top line” is total sales (before any deduction for expenses)
* the “bottom line” is net income (or accounting earnings)
  + revenue - expenses= net income (loss)

### Attention of Share Capital

* general rule of corporation law that once the authorized share capital of a corporation has become fixed by its basic constitutional document, there is no power in the corporation, SH or directors to alter such share capital
* OBCA and CBCA include the concept of unlimited authorized share capital and, unless its share capital is limited by the articles of incorporation, a corporation will not have to increase its authorized share capital
* OBCA and CBCA provide specific requirements for when a corporation wishes to reduce its capital
* rule in *Trevor v Whitworth* prohibited a corporation’s purchase of its own shares. The rationale for this was to protect creditors of the corporation, who are entitled to rely on its paid-up capital as a source of funds to which they can look for payment. This rule has been relaxed in certain cases (e.g. a corporation was permitted to receive its own fully paid-up shares in a transaction which did not require it to pay out any assets to the shareholder who relinquished their shares). Also does not apply to the provision of financial assistance by the corporation for the purchase by a third party of its own shares
* OBCA and CBCA have abrogated the *Trevor* prohibition and given corporations a general power to purchase their own shares, subject to certain solvency protections

### Debt Financing

* refers to the borrowing of money, usually from a bank or other lender or by issuing debt securities, such as bonds, debentures or notes to investors
* s. 189(1) and (2) and s. 184(1) and (2) provide that the directors of corporations have the power to borrow money on the credit of the corporation, grant security interests in the property of the corporation and give guarantees on behalf of the corporation unless the articles, by-laws or a USA provide otherwise.
* Further, Part VIII of CBCA and Part V of OBCA set out the rules that must be followed when a CBCA corporation or an OBCA corporation issues debt securities to the public under a trust indenture.
* the right to object to an amalgamation (CBCA, s. 185(2); OBCA, s. 178(2))
* the right to seek a compliance order (CBCA, s. 247; OBCA, s. 253)
* the right to examine certain corporate records or shareholder lists (CBCA, s. 21; OBCA, s. 145).

### Pre-Emptive Rights

* require that a corporation must offer existing SHs opportunities to subscribe for a new share offering in the proportion that their shareholdings bear to the total number of shares issued and outstanding
* a pre emptive rights gives every minority shareholder the right to purchase the discounted shares thus protecting them from share dilution
* serves two purposes:
  + 1) Makes it more difficult for managers to alter distribution of control/issue shares to defeat a takeover bid
  + 2) Share issuance at an undervalue will result in the “dilution” of interests of currents SHs, with concomitant diminution value of their interests

s. 28/ s. 26: pre-emptive rights – A corporation cannot hold shares of its own stock, and neither can its subsidiaries

* requires that the corporation must offer existing shareholders the opportunity to subscribe for a new share offering in the proportion that their shareholdings bear to the total number of shares issued and outstanding
  + makes it difficult for managers to increase share numbers to protect against a majority anticipated takeover bid
  + serves also by share issuance at an undervalue resulting in the solution of the interests of current shareholders
    - i.e. Majority shareholder purchases shares at a discounted price- they have diluted the number of shares without paying full value which means that the yearly payout per share will be diminished - pre-emptive right protects against this
* under Canadian Law the issuance of shares does not necessarily give rise to a pre-emptive right
  + under old improver purpose test an issuance of shares designed to alter or influence control could be struck down as a break of fiduciary duty of the directors
  + courts have dropped this test in favour of a test of acting honestly on reasonable grounds
    - the issuance of shares designed expressly to deprive the majority SH of control was approved on the grounds that the evidence established that the directors were acting honestly and in the best interests of the company issuing the shares

s. 26- allows for pre-emptive right if put in article or adopted by USA

s. 30 – A corporation cannot hold shares of its own stock, and neither can its subsidiaries

s. 34(1) – A corporation can buy back its own shares (and cancel them – s.30) if it satisfied certain provisions in act

* Used to be illegal at common law because it looks like (1) corporations wanted to manipulate its own prices and/or (2) they are buying and holding them in order to return share capital to equity holders which is unfair because creditors’ interest supersedes equity

s.34(2) – A corporation cannot buy back its own shares if doing so would make it unable to then pay its liabilities, or would cause the company’s realizable assets to be worth less than its liabilities on the balance sheet

s. 35 – List of scenarios where a corporation is allowed to buy back its own shares (to settle a debt, if it passes one of the two s. 34(2) standards)

s. 36 – corporation can only buy back its own shares (after passing s. 34/35 tests) at price lower than redemption price stated in its articles

s. 42 **– Dividends** (cash payments to shareholders)

* Corporations cannot pay them to shareholders:
  + (a) If it would not be able to pay its liabilities as they become due; OR
  + (b) If its realizable assets would then be lower than the aggregate of liabilities plus stated capital on the balance sheet (balance sheet test from s. 34(2)) (NOT equity + liabilities - if it said your assets could not be less than equity plus liabilities you would always pass that test: remember, assets = shareholder equity + liabilities
* Timing – The day dividends are declared is when they become legal debt, so that’s the day the two tests ((a) and (b)) apply

# Auditors

* **Function**: to assess the financial statements which the corporation proposes to place before the shareholders and to report on the preparation and accuracy of those statements.
* CBCA s. 155(1)(a) & CBCA Regulations 71(1)/OBCA s. 154 – Auditors must prepare statements in accordance with the Canadian Generally Accepted Accounting Practices (GAAP) set by CPA
* CBCA s.158 – corps financial statements are reviewed by auditors, who give reports to directors/officers
* CBCA s.159 - Directors/Officers show them to shareholders - Shareholders do not approve financial statements, they just receive them
* CBCA s. 162/165/ OBCA s. 149 – Corporations’ shareholders have the right to appoint and to remove auditors
  + If corporation fails to allow shareholders to appoint auditor, shareholders can apply to the court to appoint one regardless of the corporation’s financial circumstances, as it is a mandatory provision
  + act requires that auditors make report on financial statements on annual basis
  + auditor is under a duty to attend shareholder’s meeting an answer questions
* CBCA s.161/OBCA s.152 – Auditors must be qualified and independent. This section disqualifies persons from acting as auditors who are not independent (chartered accountants from an external firms)
* s. 161(2)/ s. 152(2) - definition of independent
* CBCA s.163(3)/OBCA s.148 – Private companies do not need auditors (If 100% of their shareholders agree that an auditor isn’t necessary). Public companies do. Non reporting companies or those who's gross revenue do not exceed certain limits do not need auditors (non-distributing and non offering). Non distributing/ offering (private) have to have auditor unless shareholders in a resolution unanimously agree otherwise (s. 163/s. 148).
  + Iacobucci, Pilkington, and Prichard disagree –– only small closely held corporations should be exempt
* CBCA s.165 – Shareholders can remove an auditor by a majority vote
* CBCA s. 168(1)/ 151(1) – Auditors have the right to attend meetings and answer any questions
  + s. 168(2)/ 151(2) – Directors and SHs have the right to require the auditor to attend a SH meeting
  + s. 168(5)-(6) – if corporation is a reporting company, notice of removal of an auditor must be given in the information circular, with the name of management’s new nominee placed on the proxy form
    - done to protect independence of auditor, and so that management doesn’t remove an uncooperative auditor and replace him/her with one more amenable to management interests
* CBCA s. 159/ s. 153- must state whether a statement is in accordance with GAAP/GFRS
* CBCA s.170/ 153(5) – Auditors have the legal right to demand from directors, officers, employees, or agents of the corporation all relevant information needed in order to give their annual reports.
* CBCA s.171/OBCA s.158 – Widely held corporations (SHs) are required by law to appoint audit committees – directors whose express duty is to deal with the auditors that the corporation hires
* CBCA s. 172/ OBCA s. 157(1) – The auditor has the qualified privilege to any written statement or report which the auditor makes pursuant to his duties under the act
* CBCA s. 247/OBCA s. 253 – Auditor’s duties can be enforced by application to the court
  + A present/former security holder, director, officer, creditor and any other person to whom the court grants standing may apply

### Removing Auditors

* s. 161(4)/ s. 152(4)- an interest party may apply the court for an order to disqualify or remove auditor
* s. 165(1)/ 152(4)- SHs may pass an ordinary resolution at a special or general meeting which has been called for the purpose of removing the authority
* ordinary resolution is a simply majority; 50% +1 of voting shares

### Auditor’s Liability

* *Hercules Management Ltd v Ernst & Young:* Auditors liable only to (1) corp itself and (2) those who use audit for purpose for which it is prepared, namely shareholders to exercise duty to oversee management

### The Audit Committee

* CBCA S.171 & OBCA S.158 - require appointment of an audit committee in large or widely held companies
* A corporation described in s. 101(2) (distributing company with outstanding shares) shall have an audit committee composed of no less than 3 directors, a majority of whom are not officers or employees
  + Note: Private companies don’t need to have an audit committee.

# Corporate Governance- Shareholders

* Corporations have no owners
* SHs are not owners, but their role is as close to ownership as a corporation gets
* basic structure of a business corporation is a pyramid:
  + base: shareholders whose vote is required to elect the BOD and to approve major corporate actions
  + second level: Directors who form the policy making body of the corporation
  + top: officers have a certain amount of discretion but generally execute policies formulated by the board
* Most corporations in Canada are closely-held so many believe that the legislation and judicial rules should be altered to reflect this reality
* shareholders play no part in managing a corporation + their opinion is expressed via majority opinion
* under memorandum of association system (i.e. Nova Scotia Companies Act):
  + SHs are free to determine the distribution of management powers and are free to tailor the kind of management structures that are best suited to the needs of the corporation
  + memorandum and articles of association constitute a contract and the articles can designate the powers to be exercised by the board and the manner in which SH can participate in management decisions
* under letters patent system (PEI Companies Act):
  + letter patent and bylaws do not constitute a contract
  + the incorporating Acts vest the powers of management exclusively in the BOD
* Pre-emptive rights
  + Require that a corporation offer existing SHs the opportunity to subscribe for a new share offering in proportion that their shareholdings bear to the total number of shares issued and outstanding
    - Makes it difficult for management to carefully allot shares to defeat a takeover bid
  + Also gives minority SHs the right to purchase underpriced shares, resulting in protection from dilution of the interests of SHs
  + Under Canadian law, issuance of shares does not give rise to a pre-emptive right. However, the directors must be acting honestly, in good faith and in the best interests of the company when issuing shares (*Teck Corp Ltd v Millar* (1972) – BCSC)
* CBCA ss. 19-22, 138 - Shareholder access to corporate records
  + Shareholders have the right to get access to by-laws at the office of the corporation (which are not available publicly)
  + Iacobucci, Pilkington, and Prichard- Access to records is important for two reasons:
    - (1) Shareholders need to be able to make informed decisions about whether to invest or not
    - (2) Shareholders need to be able to evaluate work of managers and directors and exercise their right to hold them accountable for their actions
    - The authors also advocate for access to records to be free of charge, to encourage shareholders to exercise their statutory right
  + Non-voting shareholders have equal access to voting shareholders (*EnCana Corp v Douglas* (2005))
  + Directors who are also shareholders can access the records as well (*Leggat v Jennings* (2013))
  + But shareholders have NO right to see the minutes of directors’ meeting
    - Any shareholder could have access to this, including competitors who buy just one share and then use that information to better their own companies

### Shareholders Right to Corporate Information: Access to Corporate Records

* On request, a corporation's shareholders and creditors can access the following records:
  + articles of amendment, including amended articles of incorporation or restated articles of incorporation
  + by-laws and their amendments
  + any USA
  + minutes of meetings and shareholder resolutions
  + notices that have been filed, meaning:
    - Form 2 – Initial Registered Office Address and First Board of Directors
    - Form 3 – Change of Registered Office Address
    - Form 6 – Changes Regarding Directors  
      Note that, when filed online, the original signed notice must be kept with your corporate records.
  + a share register showing the names and addresses of all SHs, and details of shares held
  + a securities register showing the names and addresses of those who are or have been a security holder; the # of securities held by each security holder; and, the date and particulars of the issue as well as the transfer of each security.
* A corporation's shareholders and creditors cannot, however, access the following records:
  + minutes of meetings of the directors
  + resolutions of the directors and minutes of committees
  + accounting records.
  + Corporate statutes require corporations to maintain specified records and allow access to records by shareholders + other designated persons

|  | CBCA Corproation | Section of CBCA | OBCA Corporation | Section of OBCA |
| --- | --- | --- | --- | --- |
| Number of Directors | * only one director is required unless the corporation is a distributing corporation with outstanding shares held by more than on person * they do require corporations to have at least 3 directors if, in the case of the CBCA the corporation is a distributing corporation with outstanding shares held by more than on person | s. 102(2) | * only one director is required unless the corporation is an offering corporation * they do require corporations to have at least 3 directors if the corporation is an offering corporation | s. 115 (2) |
| Director eligibility requirements | * statute requires that a director be an individual (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 | s. 105 | * statute requires that a director be an individual (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 | s. 118 |
| Number of directors to constitute a quorum at a meeting | * provide that subject to the articles or bylaws, a majority of the number of directors or minimum number of directors required by the articles normally constitute a quorum at any meeting of the directors | s. 114(2) | * provide that subject to the articles or bylaws, a majority of the number of directors or minimum number of directors required by the articles normally constitute a quorum at any meeting of the directors | s. 126(3) |
| How many directors must be “resident Canadians”? | * require that at lest 25% of the directors of a corporation must be resident Canadians, | s. 105(3)(4) | * require that at lest 25% of the directors of a corporation must be resident Canadians, | s. 118(3) |

## ***Automatic Self-Cleansing Filter Syndicate Co v Cuninghame*, [1906] 2 Ch 34 (CA)-** directors not agents of shareholders

**Facts:** Plaintiff got majority of shares to vote in favour of such a resolution while the directors were opposed to it. They declined to comply with the resolution. So he brought this action in the name of the company, against the company directors. The constitution stated that only a three quarter majority could remove the directors. It said the general power of management was vested in the directors “subject to such regulations as might from time to time be made by extraordinary resolution”. In this case the words “regulations” referred to the articles of association. The articles could be changed by a three quarter majority of votes. It did not say anything about issuing directions to the directors.

**Ratio:** Directors are not agents of the shareholders and are therefore not bound to implement shareholder resolutions where special rules already provided for a different procedure

**Reasons:** Simple majority of SHs was not enough to override the requirement in the constitution that the directors may only be given instructions through a three quarter majority. Directors were entitled to reject the offer. They are not agents to the shareholders nor the company. SHs would need to dismiss the directors or change the constitution.

**Note:** In Memorandum association companies, the shareholder retained all the power and delegated the power to directors. This case is a historical turning point. Cannot take back the power except in accordance with articles.

### Under the CBCA and OBCA

* s. 102(1) and s. 115(1) make it clear that the management of the business and affairs of the corporation by the directors can be subject to a USA. By this agreement, the power of the directors may be restricted
* s. 103 and s. 116 - directors are given the power to make, amend or repeal any bylaws that regulate the business or affair of the corporation but this power is subject to any contrary provision in the articles, bylaws or USA. Shareholders must confirm any proposal for change made by directors
* s. 103(5) and s. 116(5) - shareholders are given the express power to make proposal to make, change, or repeal a bylaw.
* s. 175 and s. 169- shareholders are able to alter the articles
* s. 146(2) and s. 108(2) - a USA is valid notwithstanding that fact that it restricts the discretion of the directors.
* s. 108(6)(a)- USA may, without restricting the generality of subsection (2), provide that any amendment of the USA may be effected in a manner specified there in

### The Board of Directors

* the most important right shareholders have is the right to elect directors and to remove them from office
* s. 102(2) and s. 115(2) - only one director is required, unless the corporation is a distributing corporation with outstanding shares held by more than 1 person (CBCA) or offering corporation (OBCA) where they need 3.
  + required because of the adoption of the “one person corporation” (CBCA s. 5(1) and OBCA s. 4(1)
* 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
* The powers conferred upon the board of directors may be exercised by a majority of those present at a meeting, provided there is a quorum. At common law it takes a majority of the board to constitute a quorum (*York Tramways Co.* v. *Willows* (1882), 8 Q.B.D. 685.)
* s. 114(2) and s. 126(3) provide that subject to the articles or by-laws, a majority of the # of directors or minimum # of directors required by the articles normally constitutes a quorum at any meeting of directors.
  + The OBCA further stipulates, however, that in no case may a quorum of directors be less than two-fifths of the number of directors or minimum number of directors and that where a corporation has fewer than three directors, all directors must be present to constitute a quorum (OBCA, s. 114(4)).
* CBCA and OBCA provide that a resolution in writing signed by all directors entitled to vote on that resolution shall be as valid as if passed at a meeting. (See CBCA, s. 117; OBCA, s. 129)
* directors exercise powers either by holding formal meetings to pass resolutions or unanimously in writing
* All directors should be given notice of meetings in accordance with the requirements of the corporation's articles of association or by-laws. It will not be a duly constituted meeting if notice is not given to nor waived by a director (*Anderson Lumber Co.* v. *Canadian Conifer Ltd.* (1977), 4 A.R. 282 (S.C.A.D.))
* statutes require a director to be an individual (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. ( s. 105; s. 118)
* CBCA and the OBCA require that at least 25 % of the directors of a corporation must be resident Canadians,
  + NOTE: the definitions of “resident Canadian” found in the two statutes are not identical. (ss. 105(3)(4), s. 2(1), definition of “resident Canadian”; OBCA, s. 118(3), s. 1(1), definition of “resident Canadian”).
* 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 affiliate corporation. (See, s.102(2); s. 115(3)).
* originally, at CL directors had no right or authority to delegate their powers or duties without special authority in either the governing statute or constitutional documents of the corporation (*delegatus non potest delegare)*
* BUT, the CBCA and the OBCA now do permit the board of directors to delegate some, though not all, of their powers. (See, s. 115, s. 121; s. 127, s. 133)
* Section 106(3) and 119(4) require that the board of directors be elected by the shareholders in a general meeting. Under s. 106(3) and (4) and s. 119(4) and (5), the directors are permitted 3 year terms and staggered terms so that continuity in the board can be assured.
  + these provisions do not apply where a corporation adopts cumulative voting
* at CL SHs have no right to remove directors appointed for a definite term of office before the expiration of that third. CBCA and OBCA permit the shareholders to remove directors at any time by ordinary resolution (simple majority vote), except in cases where the corporation’s articles provide for cumulative voting (s. 109; s. 122).

### Cumulative Voting

* cumulative voting: a system of voting at SH meetings designed to overcome the perceived unfairness that results when shareholders holing just over 50% of a corporations shares are able to elect 100% of the BOD
* Dickerson Committee said that the purpose of a cumulative voting system is to enable minority interests to obtain representation on the board of directors by permitting them to multiply the number of shares they control by the number of directors to be elected, and then to concentrate the total # of votes upon a single candidate or group of candidates, and thereby secure the election of their nominees.

### Access To Corporate Information

* corporation statutes place an emphasis on access by shareholders, creditors and sometimes public to corporate information
* Section 21 and section 145 permit inspection by shareholders and creditors and in some circumstances any person of shareholders' registers and certain other information in the possession of the corporation.
* s. 21 (3) requires the applicant for the shareholders’ list to file an affidavit and s. 146(1) requires the applicant for the shareholders list to file a statutory declaration, in each case stating the applicant’s name and address and that the list will not be used by any person except in accordance with uses permitted by the respective statutes (s. 21(9) or s. 146(8)).

### Management Powers in a Business Corporation

* BOD is given power to manage or supervise the management of the business and affairs of the corporation
* function of the board include the responsibility for :
  + (1) determining corporation policies on matters including products, prices, services, wage rates and general labour relations;
  + (2) selecting, supervising and dismissing senior officers and other executive employees;
  + (3) fixing executive compensation and fringe benefits;
  + (4) delegating authority for administrative functions; and
  + (5) introducing and participating in fundamental changes in the corporation structure.
* most of the management powers supposedly vested in BOD is actually vested in senior officers and executives
* the increasing influence of institutional investors and of activist investors has begun to tip the balance of corporate power back in the direction of shareholders

### The Agency Problem

### Berle & Means – *The Modern Corporation and Private Property* (1932)

* By the 1930’s, corporations’ shares had become so widely held (rather than being controlled by the entrepreneurs that run them) that their shareholders had shrinking incentives/opportunities to assume responsibility for controlling the corporation’s affairs
* “Rational apathy” - one vote among many means shareholders will underestimate the value of their votes
* In response, corporations’ acting managers assumed almost unchecked control of massive corporations
  + Issue – managers have little/no stake in corporations’ capital, but the responsibility of controlling their corporations – no incentive to act towards furthering the corporation’s profit, but rather minimize risk for their own earnings
    - Separation of agency might incentivize managers to take risks without fearing personal harm
    - Legal restraints: shareholder proposals (CBCA s. 137/OBCA s. 99), managerial duties of a fiduciary nature (CBCA s. 122/OBCA s. 134)
* The economists who identified the agency problem did not want the solution to be government, but rather wanted it to be sorted out by the market

How do investors mitigate Berle & Means’ separation of agency issue?

**Via Shareholder Voting (Statutory/Government View)**

* Core of the legal and market control mechanisms used by corporations’ owners to constrain managers’ self-interests
  1. Shareholders vote on the makeup of the board of directors, and can vote to remove a director who acts contrary to ownership’s goals (majority vote)
  2. Shareholders also vote on the occurrence of significant enumerated events (“fundamental changes”), like amalgamation, sale of all or substantially all of the assets of the corporation, continuance in another jurisdiction, and changes to the corporation’s articles of incorporation.
* Can lead to oversight of management in important ways:
  1. Shareholders with large blocks of shares (usually investors) control a high percentage of shares on the market – these investors have much better incentives to use their voting power effectively to ensure that individuals with proven track records are elected as directors
  2. Hostile takeover a voting class of security holders facilitates management replacement by going over existing managements’ heads
  3. Replacement by proxy battle dissident shareholders attempt to replace management by securing the proxies to vote for an alternate slate of directors nominated by those dissidents
* In practice, has little to no positive effect on corporate activity
  1. Few shareholders actually attend shareholders’ meeting, so they send proxies
     + When it comes to nominating directors, management sends a form of proxy to shareholders to endorse management’s slate of candidates by nominating as proxyholder a person designed by management who will vote for management’s choices
     + Further, only shareholders holding 5% of the shares or 5% of the class of shares are entitled to vote at the meeting to make nominations for directors
     + Any nominations shareholders make will likely be doomed since management has solicited proxies for its nominees in advance – management’s candidates will typically run unopposed
  2. “Rational shareholder apathy” modern public corporation share ownership is so fragmented (in US and UK esp.) that the costs of becoming sufficiently informed to vote effectively are quite large
     + Many shareholders simply fail to return the proxy material sent to them by management or endorse candidates without investigation into the nominees
  3. It is costly

**Via the Markets (Economist/Contract View)**

* Once you say that people can contract freely, and government has no control, you realize that some elements of corporate law are not explained by contracts
  + You can contract for limited liability but that would be inefficient
  + Trustees would be in contract with your other business partners (the main reason why we have corporate law)
* Dominant paradigm for 20 years in American corporate law

1. **Managerial Market** – managers who make self-interested decisions will suffer when they hit the open market looking for another job as a manager
   * + Two ways for managers to divert value to themselves – directly transferring money to selves or by not working hard
     + Market for managerial talent will discipline managers
2. **Product Market** – a manager’s failure to sell products will almost always result in them being replaced in their role. The success/failure of a corporation’s products in the common marketplace dictates the behaviour of managers to the corporation’s shareholders
   * + Managers foreseeing (*ex ante*) that if they divert value they will be unsuccessful in product markets, they will not stray from their responsibilities
3. **Capital Markets** – bond and equity markets located in major countries that accurately provide information surrounding the relevant costs inherent in agency conflicts
   * If corporations are known to have managers that shirk their responsibilities, their shares will be lower
   * The shareholders voting won’t stop managerial shirking, but the fear of management losing their jobs will
4. **Market for Corporate Control** – managers who operate their corporations based on self-interest are far more likely to be affected by a hostile takeover when their shares inevitably lose value
   * Hostile takeover = dissident shareholders bid to rejig management
   * The most powerful market of them all

### Three Basic Attributes of Shares

1. Voting Rights (see above section on Berle and Means Agency Issue for more detail)
   1. Not all classes of shares have voting rights, but if you have only one class of shares they must have voting rights. You cannot limit the voting rights of those shares (CBCA s. 24(3))
      1. Dangerous if, voting shareholders resolve to amend articles to remove a preferential dividend attached to a class of non-voting shares – those non-voting shareholders can’t vote on it!
         * Protected by CBCA - (1) mandatory enfranchisement of shares that would not otherwise carry the right to vote; (2) certain fundamental transactions must be approved separately by every class of shareholder, whether or not the class would otherwise have the right to vote
         * Important to have uninterested shareholders approve fundamental transactions
         * Growing trend = shareholder approvals/ratifications must be given by a majority of the minority of shareholders
   2. *Jacobsen v United Canso Oil and Gas Ltd* (1980) – Alta QB
      1. **FACTS**: Company passed a by-law (in legitimate fashion) that said no matter how many shares you own, you can have a maximum of 1000 votes (if you have 1000 or more shares). P said although it was ratified by shareholders, it is not allowed.

**HELD**: This is illegal. If you have only one class of shares (as United Canso had), you cannot limit in any way the voting rights of those shares, since shareholders of the same class are equals. If you want to mess around with voting rights, you can but you must have different classes of shares. S. 59(1)(a) explicitly disallows restrictions on the right to vote when only one class of shares exists.

* 1. Dominant shareholders usually were involved in setting up the company in the first place
     1. Didn’t want to lose voting powers so they hold dual class voting shares
     2. Must be different classes – can’t differentiate voting rights within one class of shares
  2. *Bowater Canadian Limited v RL Crain Ltd* (1987) – Ont CA (step down provisions case analysis above)
  3. Shareholder Meetings:
     1. Meeting - CBCA s. 94(1) OBCA s. 133 says you must have annual meeting but does not have to be every year (first annual meeting 18 months after inception and each subsequent meeting within 15 months of the previous one)
* Private corporations often do not have formal meetings, but decide things by way of written resolution circulated to shareholders
  + If all shareholders sign, it passes and is as valid as if passed at a meeting
* Public companies do have meetings – usually around spring – (1) directors are elected, (2) auditors are appointed, (3) financial statements are considered, etc.
  + 1. Special Meeting CBCA s. 131(5) – called on some basis other than the regular annual meeting (anything other than those three things at the annual meeting is deemed to be special)
       - Shareholders are entitled to call a special meeting (CBCA s. 105(1) OBCA s. 143) – usually when they are angry about what the directors have done
  1. Shareholders’ fundamental right = electing and replacing directors
     1. Not very effective since management controls proxy system
     2. Can replace directors at any time by proxy vote even if director’s term is not up
  2. Shareholders vote on certain fundamental corporate changes too (e.g., amalgamations, amendments to articles, sale of substantial portion of assets, etc.)
     1. Usually, directors make all the important decisions
     2. Theory underlying those votes = certain major transactions represent a fundamental change in the nature of the shareholders’ investment
  3. PROXIES (see section below)

1. Dividends
   1. “The thing to be divided” in mathematics
      1. Used to be the same in corporate law – the pool of profits people made, which would then be distributed to all the people who invested in the venture
      2. Equity came about because corporations got tired of going out for each new venture to attain investors – would rather just have a group of investors involved with the entire corporation and receive a regular sum of money
   2. Dividend income today = amount paid by corporation (the individual amount that shareholders are paid)
   3. Directors cannot issue dividends
   4. s. 32- corporation shall not declare or pay a dividend if there are reasonably grounds for believe that a corporation cannot make payment to shareholders unless its first satisfied that by making payment, it can still pay all other bills. But even if it can satisfy that test, to must also be so that the assets are equal to all sum of liability plus stated capital
   5. A corporation cannot declare or pay its dividends unless (s. 42):
      1. They can still pay its liabilities as they become due
      2. The corporation’s assets will still be worth more than the aggregate of its liabilities and capital
   6. If corporations make dividend payments contrary to this, directors are personally liable (s. 130(2))
      1. Shareholders can sue if the dividends are not paid. This is odd because a corporation is not permitted to issue the payments unless it satisfies those 2 conditions
      2. Corporations would be better off to let shareholders sue rather than pay dividends when they cannot because the courts would probably say that even though the dividend paid a debt on the day of declaration, the corporation was not legally allowed to pay it
   7. Dividends are not a debt of the corporation until they are declared – must decide which shareholders get the dividends
2. Residual Rights on Winding Up or Liquidation
   * + debts are ranked ahead of equity - must protect creditors to an unfair return of capital to SHs
     + if there is not enough money to pay in full, shareholders get nothing
     + share repurchase provision
       - anytime shareholders are getting money + the company has outstanding debts the creditors will be concerned about this
       - can only buy back shares/give back capital to SH when creditors have been satisfied

# Proxies and Proxy Solicitation

* most shareholders do not attend shareholder meetings and send a proxy instead. The managers of the corporation are required to solicit proxies for all of the shareholders (s. 149(2), s. 111). Directors cannot be nominated directly at the meeting because the shareholder who recited their directive in advance would not be able to vote
* proxy holder is someone who comes to meeting to cast vote for someone else
* **mandatory solicitations:** the management of a public corporation when the board has the annual meeting, is required to send out all of its SH a form of proxy that will them to appoint someone else
* 2 elements: each SH gets a form of proxy; management has to give shareholders information
* OBCA- only offering (public) corporations have to solicit proxies in connection with annual meeting
* CBCA- two types of companies must solicit proxies: (1) distributing corporations and (2) any corporation with more than 50 SHs. Management is not required to send a proxy if it is not a distributing corporation or if you have 50 or fewer shareholders. If you have more than 50 SHs, even if you are a private company you have it

CBCA s. 147 – Proxy holders can attend/vote by appearing at the meeting with a proxy form

CBCA s. 147, 109 – definition of “solicitation”

* request to assign or not assign = solicitation

CBCA s. 148(4), 110(4) – Shareholders can revoke proxy by written notice of revocation at any time up to day of meeting

CBCA s. 149(1) s. 111 Subject to subsection (2), the management of a corporation shall, concurrently with giving notice of a meeting of shareholders, send a form of proxy in prescribed form to each SH entitled to receive notice of the meeting.

s. 149(2) Exception: Management is not required to send a form of proxy under subsection (1) if it

(a) is not a distributing corporation; and

(b) has fifty or less shareholders entitled to vote at a meeting, two or more joint holders being counted as 1 SH

CBCA s. 150(1), s. 112 A person cannot solicit shareholder proxies, unless they sent out an official solicitation circular

CBCA s. 150(1)(a)/ s. 112- when management solicits shareholders they have to submit proxy

1(b) provision applied in Brown- soliciting proxies, were dissident, but did not provide info circular

CBCA s.150(1.1) / s. 112(1.1) You don’t need to send a solicitation circular if you are dealing with 15 or fewer shareholders

Under OBCA s. 120, only offering companies (i.e., public companies) are required to solicit proxies

Under CBCA s. 149(2), both public companies AND corporations with more than 50 shareholders must solicit proxies

Proxy voting also applies to dissidents (shareholder who dissents from management)

* Dissident shareholders communicate with their fellow shareholders via proxy

### Proxy Rules

* assures shareholders maintain vote without being present at AGM + that their “voice will be informed”
* apply not only to managers but to dissident sharheodelrs (those shareholders that dissent from management)

### Proxy Solicitation

* mandatory to send out prior to the meeting
* if management is having a meeting, they must solicit proxies + send information about the meeting agenda
* whenever anyone solicits proxies they must also provide information

### Proxy Information Circulars

* + Management must give shareholders the information to make an informed decision – highly regulated
  + Dissidents must also provide proxy circular to the people they are soliciting

### Proxy Contests

* SH advisors and managers’ solicitors battle to gain shareholders’ slate of votes towards a list of new director nominees for the annual s. 133 meeting
* Has made s. 150 solicitation a significant industry and means for which manager agency can be kept in check by shareholders

## **Brown v Duby (1980) Ont HC** – the definitions of “solicit” and “solicitation” are very broad. In this case, the press release expressly referenced an intention to solicit (risk for relatively informal communication between shareholder to be construed as proxy solicitation requiring assembly of a dissidents proxy circular)

**Background**: Our corporate law says that if management is having an annual meeting it MUST solicit proxies (which means that they have to (1) send proxies to vote on shareholder information and (2) send out a proxy information circular). Definition is broad (s. 147 CBCA)

**Facts**: Shareholder Committee of United Canso sent out letter saying they are not soliciting proxies, but told SH not to sign United Canso’s proxy and rather wait for the committee’s proxy form at a later date. P (United Canso) claims that D (dissident shareholders) solicited proxies without the dissident proxy circular required by s. 150(1)(b)

**Issue:** Problem is whether there were proper proxy solicitations that complied with all proxy rules.

**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. Court held that they did not violate SEC, but that doesn't matter because they must comply by its own governing statute (CBCA) and they did not do that

**Reasons:** It is solicitation because they said not to sign any potential proxy solicitations from the company which is fine but they did not comply with rules of proxy solicitation because they did not provide information with solicitation.

**Note**: No remedy ordered. Court doesn’t want to tip scales in dispute between management and SHs.

* Also stands for the rule that the status of a corporation is to be determined by the law of the incorporating jurisdiction

Proxy legislation has been criticized for doing exactly the opposite of what it was designed to do – give SHs a say in key changes to company. As in *Duby*, sometimes informal communication may be construed as soliciting proxies.

* There have been changes to the CBCA to address these concerns
  + CBCA s. 150(1.1)/ s. 112(1.1) - don’t need dissident proxy circular if soliciting to 15 or fewer shareholders
  + CBCA s. 150(1.2)/ s. 112(1.2) - don’t need dissident proxy circular if solicitation is by public broadcast or speech
* A press release during the solicitation process does not automatically become a proxy solicitation (*Smoothwater Capital Partners LP I v Equity Financial Holdings Inc* (2014) Ont SCJ)

### Proxy Expenses

* *Goodwood Inc v Cathay Forest Products Corp* (2013) Ont SC - shareholder entitled to be reimbursed by the company for the cost of preparing the dissident proxy circular: (1) the circular disclosed this intention; (2) the shareholders overwhelmingly supported the dissident proposal; and (3) applicant would have been entitled to reimbursement if it was a meeting called under CBCA s. 143(4).
* s. 143(6) and s. 105(6) deal with costs relating to proxy solicitation and holding shareholder meetings stating that corporation shall reimburse shareholders with some exceptions

### Breach of Proxy Legislation - Remedies

* **Derivative Action** - The corporation is the injured party and shareholders are hurt only indirectly as a consequence of the harm to the corporation
  + Arises from breach of fiduciary duty owed to the corporation
* **Personal Action** - Harm to the shareholder is not merely incidental to the harm to the corporation, but is particular to a shareholder or group of shareholders
  + Arises from breach of duty owed directly to the shareholders
* *Canada v Saskatchewan Wheat Pool* [1983] SCC - there is no independent tort of breach of a statutory provision – such a breach may serve as evidence of breach of duty owed to D
* s. 154 – Breach of proxy allows Director/interested person to get restraining order or injunction against meeting
* s. 247 – General restraining order for breach of any provision of the Act
  + *Polar Star* - company sought restraining order under this section for director’s alleged breach of solicitation violating s. 150(1)(b). **HELD** that s. 247 not available remedy since the director acted in his position as SH and not director. Even if available, court has discretion based on harm to company, SHs.
* s. 253(2) - similar to s. 154, but only allows Ontario Securities Commission to apply to court for an order
* **Injunction** is flexible tool used to prevent a solicitation from occurring, a meeting from being held, or resolutions passed at a meeting from being acted upon
* Claim for **damages** relatively difficult to make because no metric to assess damage in these cases – without misrepresentation by management, for example, maybe director would be elected anyway

### Shareholder Activist

* identifies a public corporation that has a significant agency problem. If there were different officer and directors that corporation would be better managed and would make more profit.
* proxy solicitation included any act that could be reasonably construed as withholding a proxy for someone else

### How to:

1. You can talk to 15 people (who are more likely to vote with you) without passing a circular around
   1. More than that is proxy solicitation, which is illegal (CBCA s. 150)
2. Dissident proxy circular (CBCA s. 150)
3. Show up at a meeting and put a motion forward

# Shareholder Meetings

* majority rule is a fundamental concept of corporation law
* minority shareholders are protected by the common law right of discussion, the rights which they have under the relevant state including the oppression remedy provisions, the articles and bylaws of the corporation
* so long as the majority acts in good faith in connection with the matters dealt with at duly constituted meetings, which are within the jurisdiction of such meetings, the decisions of the majority will be binding on all the shareholders and express the position of the corporation.
* shareholder powers may be broken into two categories:
  + (i) power to annually elect directors and appoint auditors by ordinary resolution of simple majority; and
  + ii) the power to effect fundamental changes (e.g. amalgamation of the corporation with another corporation ) by way of special resolution that requires the support of 2/3 of votes cast.
* Shareholders must also approve the creation or amendment of all by-laws (ss. 103(2), (5); s. 116(2)).
* each share entitles holder to one vote ( s. 140(1); s. 102(1)). Where corporation has more than 1 class of shares, voting rights may differ between classes; however, voting rights within a class must be equal: (*Bowater*)
* s. 189(6))- each share carries the right to vote (whether or not the share otherwise carries the right to vote
* OBCA has a slightly different provision, entitling non-voting shares to vote only in cases where the sale, lease or exchange would affect such shares in a manner different from another class of voting shares. In such a case, not only are the non-voting shares entitled to a vote, but they are entitled to a separate class vote. (OBCA, s. 184(6)). The change in such a case must be approved separately by the holders of each class by a majority of not less than two-thirds of the votes cast in respect thereof, (OBCA, s, 184(7)).
* s. 189(7)- separate class votes where one class of shares is affected differently by sale lease/exchange.
* a meeting convened for another purpose cannot be converted into a shareholders' meeting in the face of protests from some of the shareholders, (*Spicer* v. *Volkswagen Canada Ltd.* v. (1978))
* Matters coming before a shareholders' meeting are ordinarily dealt with by the moving and seconding of a motion which, after reasonable opportunity for discussion, is put to a vote. A motion duly passed becomes a resolution. Subject to any provision in the governing statutes, or in the by-laws of a company, ordinarily resolutions are decided by a simple majority vote (i.e., 50% of the votes cast, plus 1).
* shareholder has the right to refrain from voting and he or she has the right even if he or she has voted but before the result of the vote is declared by the chair to change that vote if it is by show of hands. If the vote is by ballot, the shareholder has the right until the time the ballot is handed to the chair or the scrutineer.
* A shareholder may either attend and vote in person at meetings or may appoint another person to act as proxy
* Voting at shareholders' meetings is usually by show of hands or by ballot. Both the OBCA and the CBCA provide that, unless the corporation’s by-laws say otherwise, votes at a shareholders meeting will be by show of hands unless a ballot is demanded. (CBCA, s. 141(1); OBCA, s. 103(1))
  + If a vote is by show of hands a shareholder has only one vote irrespective of the size of her shareholdings and a shareholder holding proxies has only one vote no matter the number of proxies she holds.
* A shareholder has the right to demand a vote by ballot, either before or after a vote by show of hands. (s. 141(2); s. 103(2)). If there has been a vote by a show of hands the demand must be made as soon as the vote is over and once a vote by ballot is demanded a vote on a motion by a show of hands becomes a nullity. In the absence of the demand for a vote by ballot, the chair's declaration that a vote is carried is final.
* 137(1)(b) and 99(1)(b) gives a shareholder who is entitled to vote at a meeting a right of discussion.
* Annual Meetings (CBCA s. 133.1/ 94(1))
  + must host their first meeting within 18 months of issuing shares
  + host an annual meeting ever 15 month from thereon out
  + small corporations don’t usually host physical meeting, instead they create written resolutions
  + at least 3 items of business must be transacted at annual meeting:
    - election of directors (106(3), 119(4))
    - appointment of auditors (162(1), 149(1)
    - presentation of financial statements and auditor’s report to the shareholders (155(1); 154(1))
* Special Meetings (CBCA s. 133.2/135(5), 96(5)/143)
  + directors may at any time call a special meeting of the shareholders
  + anything outside of the basic stuff that is done is considered special + requires a different meetings
    - if corporation has something that needs SH approval they can tie it to AGM but title meeting Special
  + SH can requisition directors to call meeting if they have equal to/more than 5% of voting shares (143)
  + s.133(2) & s.94(1)(b) - Directors can call special meetings of shareholders
  + S.143 & s.105 - shareholders who have not less than 5% of the issued shares that carry the right to vote at a meeting may ‘requisition’ a shareholder’s meeting to transact business stated in the requisition
  + s.132 & s.93 - the place where meetings may be held
  + s.135 & s.96 - notice of meetings

CBCA s. 139/ s. 101 - Quorum requirements – unless by-laws provide otherwise, quorum is met if the SHs of the majority of the shares entitled to vote at the meeting are present (in person or by proxy)

* public companies set their own quorums because most likely this provisional quorum is too difficult to satisfy
* in any meeting, you must have a rule that says how many people must be there before meeting counts
* usually Canadian quorum requirements is at least 2 people
  + In public companies, usually 25% of the # of shares outstanding (plus 2 people) must be present

CBCA s. 140 - Unless articles otherwise provide, each share of the corporation entitles the holder to 1 vote

CBCA s. 141 - Unless otherwise provided, votes at meetings are by show of hands, or by ballots if required in advance

* S. 141(2) - shareholder or proxyholder may demand a ballot, before OR AFTER any vote by show of hands
  + This protects shareholders or proxyholders who have a significant number of shares against a faulty vote by show of hands (show of hands doesn’t represent the number of votes people have)
  + Especially important to call a vote by ballot if the matter is contentious

CBCA s. 142/ s. 104- Signed resolution by 100% of shareholders entitled to vote at meeting is as good as if a vote was done at a meeting

* 100% required probably to give any minority the chance to state their case and try to persuade others

## **Blair v Consolidated Enfield Corp (1993) – Ont CA; aff’d (1995) – SCC**

**Background:** Mr. Blair was the chair of Consolidated Enfield and acting as chair of meeting. Dissident group (Canadian Express) were in acrimonious discussions with Enfield about upcoming meeting and were threatening to replace some directors. In the course of discussions, Consolidated Enfield had been led to believe that Canadian Express was going to stand down and support management’s slate when it came time for the meeting. At the meeting, Canadian Express proxyholders changed their tune and tried to nominate someone for director that WASN’T on management’s list (Mr. Blair was on the list – thus the Chair’s own position on the board was in jeopardy). Meeting was stopped, they contacted some lawyers, and the lawyers said the proxies CANNOT be used to vote for the other person because the proxy circulars that had been deposited before the meeting did not give the proxyholders any discretion, they merely said “vote for Mr. Blair.” Mr. Blair then ruled accordingly. Shareholders sue him. Court held that the advice from the lawyers was incorrect {*Canadian Express Ltd v Blair* (1989) – OntHC}. Mr. Blair’s decision was an error. He was also found not to be exercising his quasi-judicial function properly. Court found for SHs and Mr. Blair held liable. But, Mr. Blair has indemnity from Consolidated Enfield, which is what this case is about. His right to indemnity (in OBCA s. 136(1)) has exclusions. If what he did was in good faith with a view to the best interests of the corporation, he has right of indemnity. If he was acting in bad faith, would not be entitled to indemnity. TJ found for D.

**Issue:** Must determine if Clair was acting in honest and good faith of the company.

**Held:** Appeal allowed, for P (Mr. Blair).

**Reasons:** He was not rash. He stopped meeting to consult with counsel. Even though the ruling was in his favour to keep him on as chair, he acted in the best interest of the company in ensuring that the board of directors was elected lawfully.Further,Mr. Blair had a duty not just to the shareholders in the room, but also to the other shareholders of the company that had chosen not to attend the meeting based on what they read in the proxy circular. If he is going to tell the dissident shareholders that they can change what was in their proxy circular, he would then have to inform the other shareholders. Essentially like bringing a new issue that the absent shareholders did not know was being voted upon, which would be unfair. Blair took all appropriate steps to make a rational decision. He consulted with legal advisors who verified with further legal advisors back at office. Legal advice does not automatically sanctify conduct as honest and in good faith for the purposes of claiming indemnity but it should not be simply dismissed because it favours the election of the chairperson or comes from a law firm whose own retainer is at sake. It must be considered in the context in which it was given and alongside the duty of the chairperson to act fairly. The Duty of fairness relates to the decision making process and conduct of a proper corporate meeting and he had a duty to all members.

# Shareholder Proposals

* way in which shareholders can have their voice heard without having to go through the cost of proxy fight.
* the range of action that may validly be decided upon at a meeting of shareholders is defined by the operation of two separate principles – the principle of constitutionality and the principle of notice.
  + principle of notice: requires that all items to be acted upon at the shareholders' meeting be properly identified and described in sufficient detail to permit shareholders to form a reasoned judgment concerning such items (*Re Hampshire Land Co.*, [1896] 2 Ch. 743)
* CBCA and OBCA govern the identification of items and quantum of detail requires (s. 135(5)(6), 146, 150 and regs. 54-66; s. 110-112, Not Reg 62 ss. 27-38
* s. 143 and s. 105 gives SH holding at least 5% of the issued shares the right to requisition a special meeting
  + If the board of directors refuses to convene a meeting within the required time following receipt of an appropriate requisition, the meeting may be called by the requisitionists themselves.
* s. 143(6) and s. 105(6)- cost and reimbursement of the above right
* the proportion of shareholders required to requisition a meeting is high enough to act as a significant barrier to the use of such a provision in large corporations with widely dispersed shareholdings.
* at CL, the management of a corporation is under no obligation to make any reference to any non management view of the matters to be discussed (Campbell v Australian Mutual Provident Society (1908)). This places shareholders wishing to have a matter discussed at a meeting at a serious disadvantage because the meeting cannot effectively do anything not fairly comprehended by notice of meeting. Only alternative open to dissident shareholders is to requisition a meeting - procedure which could be costly. Disadvantage addressed by statute.
* CBCA and OBCA seek to provide a suitable alternative by enabling a voting shareholder to submit “proposals” to be included in management’s proxy circular and considered at a shareholders meeting (s. 137 and s. 99)

CBCA s. 137/OBCA s. 99

* permits a shareholder in a corporation to which the proxy provisions apply to have their proposals included in management’s proxy circular
* proposals are circulated at corporations expense with management proxy circular; SH may also request that management circulate supporting statement that in combo with proposal does not exceed 500 words (Reg s. 48; Reg s. 23(4))
* to prevent the provisions from being used as a platform for shareholders to hit personal grievances or political issues, language was included that stipulated that the corporation was not required to include any shareholder proposal in management’s information circular if it ran afoul of certain rules (Varity v Jesuit Fathers)
* s. 137(5)(b.1) and s. 99(5)(b.1) include more general language which says that a proposal may be excluded if “it clearly appears that the proposal does not relate in a significant way to the business or affairs of the corp.”
* 4 categories: (1) that articles be amended (175(1); 169(1); (2) that a by-law be made, amended, or repealed (103(5); 116(5); (3) those holding at least 5% of the shares or 5% of a class of voting shares can make nominations for electing directors (137(4); 99(4)); (4) anything else that doesn’t fall outside of business or affairs of the corporation (137(5); 99(5))
* Very important practical tool for shareholders:
  + - * + Shareholders usually only have annual meetings, where they vote on things
        + Before these annual meetings, managers have to prepare regulated documents with detailed information that they give to all shareholders – information circular
        + Without shareholder proposals, a shareholder could only express his/her concern with their own very expensive, regulated information document

SH proposals are placed on the managers’ info circular that they give to SHs at meeting

* + - * + Using proposals, shareholders raise issues to a SH vote without management’s selective use of the info document, and without incurring the difficulties of producing their own info circular
* Most proposals fail, but may still have value if they do - people talk about it, newspapers might pick it up and give publicity, etc. (*Varity Corp v Jesuit Fathers of UC*)
  + In reality, the majority of publicly- traded Canadian companies are controlled either legally or effectively by an individual or small group, impossible for minority SH to secure enough votes to pass a proposal
  + Most likely avenue for success is to win enough support that management decides to make the changes to avoid alienating investors

### Eligibility to Submit Shareholder Proposal

* To be eligible to submit a proposal, a shareholder must continuously hold a prescribed minimum number of shares for a prescribed amount of time before submitting a proposal.

CBCA: a 6-month hold period on shares worth $2,000 OR comprising 1% of the total number of outstanding voting shares, whichever is less (CBCR s. 46).

* Support from other shareholders can be counted towards meeting eligibility requirements s. 137(1.1)(b)
* The corporation has the right to demand proof that the SH meets the eligibility requirements s. 137(1.4)

OBCA: not same as CBCA anyone can make a proposal

### Shareholder Proposal Functions

1. To get something forward that management will not sponsor
2. Publicity. Varity case- even though SH knew making proposal didn't expect they would vote and adopt it they achieved what they wanted which as publicity

## **Varity Corp v Jesuit Fathers of Upper Canada (1987) – Ont HC; aff’d (1987) Ont CA** - A corporation is justified in refusing a proposal when the primary purpose of it is political

**Facts:** D wanted its moral concerns, regarding Varity’s involvement in apartheid South Africa, put to a vote at Varity’s next shareholder meeting. Varity applies for an order to omit the proposal from the management proxy circular, pursuant to what is now s. 137(9).Application by Varity for an order permitting Varity not to include a proposal that the company end its investments in SA related to objections against doing business in a country that had anything to do with apartheid.

**Issue:** Could Varity refuse to include the proposal in its shareholder circular?

**Held:** For P – did not have to include the proposal in their circular because its primary purpose is political (s.137(5)).

**Ratio:** A corporation is justified in refusing a proposal the primary purpose of which is political, e.g. a proposal primary purpose of which is to “abolish apartheid in South Africa”

**Reasons:** The language of the proposal and supporting statement indicate that the primary purpose of the proposal is the abolition of apartheid in South Africa. The fact that there may be a more specific purpose does not save the proposal and the company cannot be compelled to distribute the proposal.

* Political/moral concerns and personal claims do not have to be respected as shareholder proposals
* Proposals have to 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 s.137(1) Subject to subsections (1.1) and (1.2), a registered holder or beneficial owner of shares that are entitled to be voted at an annual meeting of shareholders may

* + (a) submit to the corp notice of any matter that the person proposes to raise at the meeting (a “proposal”); and
  + (b)discuss at meeting any matter in respect of which the person would have been entitled to submit a proposal

CBCA s.137(1.1) **– Shareholder Proposal Limits –** to be eligible to submit a proposal for inclusion in the information circular, a shareholder must be a shareholder according to **Regulation 46**

* Shareholder for at least 6 months before date of proposal submission
* Share interest must equal at least $2000 OR at least 1% of the corporation’s shares
  + Support from other shareholders can be counted toward meeting this requirement
* Only a person holding 5% of outstanding shares can nominate a director (SH can do this together if their collective shares are more than 5%)
* **Note:** Drafters did not want to encourage “action shares” (often just 1 share in a corporation that someone would buy solely for the purpose of making a proposal against management)

OBCA s. 99 – Any shareholder can raise a proposal (1 share is good enough, unlike CBCA which has reg 46 limits)

* + No time or money constraints

**Note:** The specific statutory language discussed in the Varity case was subsequently amended. Now, CBCA s. 137(5)(b.1) and OBCA s. 99(5)(b.1) include more general language which simply provides that a proposal may be excluded if “it clearly appears that the proposal does not relate in a significant way to the business or affairs of the corporation.”

s. 137(2)/s. 99(2) - corporation that solicits proxies shall set out the proposal in the management proxy circular required by s. 150 or attach the proposal thereto.

s. 137(3)/ s. 99(3)– Person who submits proposal can attach supporting statement which together cannot exceed 500 words

CBCA s. 137(5)/ s. 99(5) – **Exemptions for proxy circular and supporting statement requirements in subsections** (2) **and** (3) **–** Managers do not have to include shareholder proposals in their info documents at the annual meeting if the proposal is a reflection of just one shareholder’s personal grievances

* + The SH isn’t raising it because it goes against company’s best interests; rather, it just goes against their sensibilities
  + “Precatory (advice) Only” – Proposals have to be advice being offered, not directions/commands by SHs
    - Otherwise, managers would lose their CBCA right to control the corporation

# Directors’ Roles

s. 102/ s. 115(1) – Directors have the responsibility to supervise management of the corporation

s. 102(1)/s. 115(2) - Any corporation has to have at least 1 director

s. 102(2)/ s. 115(3) – Distributing Corporation (public company with multiple shareholders) must have at least 3 directors, and at least 2 of them have to not be officers of the corporation or its affiliates

s. 109/ s. 122(1)– Removal of directors – Does not appear in USA’s Delaware Provisions

* Ordinary Resolution = majority vote between shareholders
* Special Resolution = 2/3 shareholder vote

s. 115/s. 127(1) – Directors may appoint managing directors and delegate powers to them

s. 115(3)/ s. 127(3) – Outlines exceptions to s. 115, what directors may not delegate

s. 117 /s. 129(1)– Director Resolutions can be signed written resolutions rather than meetings in person

s. 118(2)/ s. 130(2) Directors personally liable for: purchase/acquisition of shares, paying dividends without satisfying 2 tests

s. 119/s. 131 – Directors are personally liable to the corporation’s employees for unpaid wages within 6 months

s. 121/s. 133 – Directors may designate officers

s. 121(a)/s. 133(a) – Directors CANNOT delegate to officers anything that they cannot delegate to the managing director under s. 115(3) which includes the declaration of dividends

s. 121 (b)/s. 133(b) - a director may be appointed to any office of the corporation

s.121(c)/s. 133(c) - two or more offices of the corporation may be held by the same person

# Duty of Care Owed by Managers and directors

CBCA s. 122/OBCA s. 134

* The statutory response to the agency debate – Dickerson Committee (see below)
* CBCA and OBCA are NOT memorandum corporate statutes, and one implication of that is that the shareholders don’t delegate to the directors the power to run the company, but rather is dictated by statute
  + Sometimes Canadian courts get this wrong b/c they take UK precedent where SHs DO delegate power

### The 2 Major Duties Owed by Directors & Officers to Shareholders

CBCA s. 122(1)/OBCA s. 134 – Every director/officer of a corporation in exercising their powers and discharging their duties shall:

**(a) – Act honestly and in good faith with a view to the best interests of the corporation** [Duty of Loyalty - **Fiduciary Duty**]

* Many cases touch on corporate social responsibility

**(b) – Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances** [Duty of Care]

* At common law, DOC was a very low threshold
* Due to *People’s Department v Wise*, this provision in the CBCA applies to more than just the corporation.

**Directors also have many statutory liabilities**

* E.g., s. 227.1 of *Income Tax Act* – if corporation employs people and fails to deduct tax from pay cheques and send to CRA, directors are personally liable for that money
  + Defense: due diligence - important because CRA frequently goes after directors personally, no matter how desperate the company is
  + This defense is worded exactly as the duty of care provision in CBCA s. 122(1)(b)

### S. 122(1)(b) Duty of Care

* the CL standard of corporate directors’ duty of care diligence and skill was notoriously low and the likelihood of a plaintiff succeeding in a claim against corporate directors alleging only a breach of the duty of care was low
* the standard at CL was said to be a subjective standard: a director was only required to exercise the degree of skill that could be expected of a person of his or her own particular experience and abilities. There was no objective standard that all competent directors were expected to satisfy
* an article such as that under which the directors in *City Equitable Fire Insurance Company* were relieved of liability is no longer permitted under the s. 122(3) and s. 134(2)
* at CL, it may not be sufficient to merely show that a director has breached the duty of care that they owe the corporation. Some courts have held that plaintiffs must also show that the proper performance of their duties by the director would have avoided the loss (*Barnes v Andrews*, 289 F 614 (SD NY, 1924)).
  + defendant is not subject to burden of proving that loss would have happened whether he had done his duty or not
* **Lawrence Committee** wanted a more stringent professional standard so they suggested putting a higher standard in CBCA and OBCA and the language they proposed was “director of a company must exercise the degree of care, diligence and skill that a reasonably competent person would exercise”
  + Ontario government ultimately changes this to “reasonably prudent person”
* **Dickerson Committee (after Lawrence)** formed a new formulation of duty of care, diligence and skill intended to upgrade CL standard. The language they proposed was “reasonably prudent person would exercise”. Drafters added “in comparable circumstances”
* the directorial duty of care has been codified in s. 122(1)(b) and s. 134(1)(b)
  + upgrading CL duty was the intent of Proposals for a New Business Corporation Law for Canada
    - the formulation of the duty of care, diligence and skill owed by directors represents an attempt to upgrade standard presently required of them. Principal change here is where at present law it seems to be that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him having regard to his knowledge/experience (*City Equitable*), under s. 122(1)(b), he now has to conform to standard of a reasonably prudent man

## **Re City Equitable Fire Insurance Company Ltd (1925)-** old Low CL subjective standard- that of a reasonable person given the individual director’s expertise and is entitled to rely on company’s officers.

**Facts:** Once-profitable company wound up. Managing director was found to be fraudulent in diverging funds to another company. Liquidator brings action against directors and auditors [pursuant to a power equivalent to CBCA s. 215(1)] alleging negligence and breach of duty. Directors were not participants in the fraud but rather were being sued for failing to find the fraud.

**Issue:** Can innocent directors be held liable for the fraud of co-directors? Were the directors in breach of their duty?

**Held:** For Ds.

**Ratio:** Standard is that of a reasonable person given the individual director’s expertise.

**Reasons:** A director is not akin to a trustee. Directors must act in a skillful and diligent manner, but what that precisely means is not obvious from the case law. In order to ascertain the duties that a person appointed to the board undertakes to perform it is necessary to consider: (1) the nature of the company’s business and (2) the manner in which the word of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is reasonable in the circumstances, and is not inconsistent with any express provisions of the articles of association. A few propositions to base negligence assessment on:

* (1) Director need not exhibit a greater skill than may reasonably be expected from a person of his knowledge and experience
  + E.g., if you are illiterate, you are only expected to do what an illiterate person is expected to do
* (2) A director is not liable for mere errors of judgment and a director is not bound to give continuous attention to the affairs of his company – should be of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he is placed (which he is not bound to always attend)
  + [Now, CBCA doesn’t say directors need to attend meetings, but according to s. 123, those who do are deemed to consent to resolutions passed there unless they dissent]
* (3) A director is allowed to trust other officials to perform their duties honestly
  + Businesses cannot continue based on distrust
  + [Now, CBCA s. 123(5)/ 135(4) says that a director meets duties of loyalty and care under 122(1) if they relied in good faith on (a) financial statements of the corporation/written report of the auditor, or (b) a report from a person whose profession lends credibility to a statement made by a professional person
    - CBCA broader: “In good faith” is broader than “reasonably” or “non-negligently” as described by the court
    - CBCA narrower: only allows for reliance on certain officials, not officials broadly

**Note:** Some directors and the auditor were found negligent but protected by Article 150 of the company’s articles of association, which said they had to demonstrate wilful misconduct to be liable. Now, CBCA s. 122(3) would invalidate that Article.

## **Re Brazilian Rubber Plantations and Estates Ltd [1911] – CA**

**Facts:** All the directors of this company were induced to become directors, though each of them had little to no experience. They relied on a report for the acquisition of a rubber plantation that contained an exaggeration of the acreage of the plantation.

**Held:** For Ds.

**Reasons:** Impossible to say the men were dishonest, but rather they fell into the trap of dishonest men. No expertise is required of directors, but a director must take reasonable care in conducting any part of the business he takes part in. Such reasonable care is measured by the level of care an ordinary man is expected to take in the same circumstances, not what the court thinks is reasonable.

* Directors frequently make allowances for exaggerations contained within the propositions of interested parties– exaggeration and fraud are not the same thing
* The directors believed the contract was beneficial for the company and were not negligent in coming to that conclusion

### Dickerson Committee’s Response to the Low Common Law Standard Duty of Care

* The CBCA needs a higher standard for the duties owed by directors/officers to shareholders than what the common law (*Re City Equitable; Re Brazilian Rubber*) has held
* Included **“reasonably prudent person”**
  + It can’t be a professional standard, otherwise there would be anomalous results. People wouldn’t know whether they were qualified to be directors or not (at the time of the Dickerson Committee, there were no director certification programs).
  + Objective standard for directors’/officers’ duties, rather than the historic subjective/low standard
  + People thought it would deter people from taking on director role, but Dickerson Committee firm that it would not have that effect
* Though not recommended by the Dickerson Committee, Parliament also introduced **“In comparable circumstances”**
  + Introduced more subjectivity (*Soper v Canada*)

## **Soper v Canada (1998)** – The Dickerson Committee objective standard is not actually reflected in s.122

* What does “comparable circumstances” in s.122 mean?
* Objective/subjective mix – the Dickerson committee can’t make a totally objective standard for reasonable director/officer behaviour, because Parliament intended some subjective elements in Tax acts
  + Parliament added “In comparable circumstance” AFTER the Dickerson committee recommended to add “reasonably prudent person” – thus they wanted some subjectivity
* The words “comparable circumstances” actually reflect the Lawrence Committee (came before Dickerson committee and was Ontario’s version), who had used a standard that wasn’t as strictly objective as Dickerson
  + Parliament was assumedly just conforming to the language in Ontario

## **People’s Department Store Inc v Wise (2004) – SCC -** BJR and Duty of Care

**Facts:** Wise and Peoples were clothing retail companies competing in a highly competitive market. Marks and Spencer, which owned Peoples, looked to sell the company. Wise bought it under a leveraged buyout. To protect its interests, Marks and Spencer placed strict conditions on the management of Peoples and took security in the assets of that corporation. As a result, Peoples and Wise were forced to run two separate operations and could not consolidate fully until M&S were paid fully. This caused serious problems for both companies. The directors of Wise (who were also the directors of Peoples) initiated a new arrangement for acquiring and partitioning merchandise. As a result of this arrangement, Peoples would buy the bulk of the merchandise and Wise would owe a credit to peoples. 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. Wise owed Peoples $4 million. This inter-corporate debt caused prejudice to the creditors of Peoples, who had to wait to be reimbursed with the creditors of Wise. If Wise did not owe the $4 million to Peoples, solely the creditors of Peoples would be able to get access to that money. Peoples’ trustee in bankruptcy brought an action against the directors of Peoples’ (the Wise brothers), saying they breached both duties of loyalty and care as set out in CBCA s. 122(1) in allowing the VP Finance’s plan to go through.

**Issue:** Do the directors of a corporation have a duty to creditors? Or do they only have a duty to shareholders?

**Held:** SCC upheld court of appeal judgement. The directors did not breach any duty owed to the corporation. Wise made a reasonable business decision and acted in good faith. Further, they had nothing to gain, and indeed only could lose, from Peoples’ demise

**Ratio:** The duty of loyalty does not extend to creditors. So as long as the directors act in the best interests of the corporation, even if creditors take a loss, the directors are not personally liable for their decisions. The best interests of the corporation should be read not simply as the best interests of the shareholder. There is no shareholders primacy in Canada. At all times, D and O owe their fiduciary obligations to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders. Duty: whether someone is acting with a view to the best interests of the corporation it may be legitimate given all the circumstances for the board of directors to consider, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment. If corporation is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a better corp and not to favour the interests of any one group of stakeholders

**Reasons:** The standard for S.122(1)(b) duty of care is **objective** – rejected *Soper*’s objective/subjective mix. Need to define it as objective to explain that the factual circumstances are important surrounding duty of care (s. 122(1)(b)), as compared to the subjective motivation of the director being important for the fiduciary duty (s. 122(1)(a)). S.122(1)(b)’s duties are owed to more than just the corporation:

* + At the point of near-bankruptcy, shareholders are owed no economic interest. Thus, perhaps directors had a duty to their creditors, who have the only remaining economic interest.
  + Therefore, this duty MUST be owed to more than the corporation
  + However, this does not mean that the DOC creates a separate actionable right (i.e., it may be owed to many different people, but that does not give those people the right to sue unless they have some other right)
    - In this case, it happened in Quebec and there was Civil Code language that seemed to give creditors the right to sue
* The Business Judgment Rule states that courts must not import business knowledge they do not have – must look at all the surrounding circumstances and consider that businesses are forced to make decisions in high-pressure situations and sometimes without all the facts they would like
* However, if Wise did act unreasonably, wouldn’t have been able to rely on the defence of good faith (CBCA s. 123(5)) because their VP Finance is not considered a professional under that section (he wasn’t an accountant)

**Note:** The OBCA was amended to correct this decision. It changed the DOC in Ontario to apply ONLY to the corporation. The CBCA was never amended. Thus, we don’t quite know who the duty is owed to under the CBCA.

**Note:** Also applicable to Fiduciary Duty (section below).

### The Delaware “Business Judgement Rule” vs the Canadian “Business Judgement Rule”

**Delaware’s “Business Judgment Rule”**

* + Majority of American corporations incorporate in Delaware, and are bound by the state’s “Business Judgment Rule”
  + Fundamental Principle: Corporations are private enterprises. Thus, directors and officers have business expertise, where the courts/judges do not (court can’t second-guess business decisions)
    - * Judicial deference to valid business decisions, as long as they were honest
      * Courts try to avoid the hindsight bias – not the court’s place to look at decisions made by directors and officers and say that they were not the right decision to make for the corporation
        + Would be inhospitable to effective business decision-making
      * Shifts the onus of proof off directors’ shoulders, who typically have to prove they acted appropriately, to the plaintiff to prove that they did not
  + 3 Standards of Delaware’s BJR:

1. Ordinary Business Judgment Rule
   * Business decision not overturned unless it could not be connected to any rational purpose
     + No rational purpose does not even mean it has to be reasonable
   * Directors are presumed to operate on a reasonable, good judgment basis
     + P must show why this is not true. If P does so, shifts immediately to #3
       - * *Smith v Van Gorkom* – this rule was undermined
         * Even lower standard than Canada’s – If there is any business purpose at all that director/officer had for their decision, they are protected from legal scrutiny entirely

Canada’s version of this looks more like Delaware’s intermediate standard

There does not appear to be a presumption in Canada either, though the cases seem to suggest otherwise

1. Intermediate standard
   * Reasonableness
   * Emerged from hostile takeover bids
2. Entire Fairness
   * + - * Burden shifted to directors to show that they followed a fair process and got a fair price
         * No deference is given if directors made a decision built on a conflict of interests
         * The Canadian BJR does not discuss this

**Canada’s “Business Judgment Rule”**

* + Only arose in the 1990s, long after American states declared theirs
  + Same Fundamental Principle as Delaware (judicial deference)
  + Shareholders get to decide who their directors are, so they should live with their decisions
  + In Canada, onus is always on P so the shifting onus (Delaware) isn’t an issue
  + 3 Standards of Review that judges would use to justify the Fundamental Principle/deference

1. Not patently unreasonable
   * The court will not interfere if directors/officers’ decision was made on a reasonably informed, good-faith basis
     + But no presumption
   * Court can disagree entirely with the decision, but will not quash it if it was not fundamentally unreasonable
   * Unlike Delaware, the courts in Canada judge the reasonableness of the decision before they give deference
2. Reasonableness
   * Was the decision reasonable, even if I disagree with it?
   * The decision-maker as the right to be wrong as long as they are reasonable
3. Correctness (similar to Delaware’s entire fairness rule, but less well-outlined)
   * Would I have made this same decision?
   * The toughest one to assess

### Takeaways from the Comparison of Business Judgement Rules

1. The Delaware Rule gives full deference to directors/officers’ business decisions if there was any business purpose behind them at all – never the court’s place to judge reasonableness. Three standards of review support the rule

* s.102(b)(7) of the Delaware Act – directors can be relieved of duty of care liability in relation to losses
  + No parallel in Canada – s. 122(b) always applies to directors

2. The Canadian Rule is given the same name as the Delaware standard, but it is not nearly as well-defined by statute or common law. Judges in Canada still look at “reasonableness” before giving total deference

## **Smith v Van Gorkom (1985) – Del. SC** – Major Decision that undermined the strong roots of the “not patently unreasonable” justification for Delaware deference – grossly uninformed = breach of s.122(a)

**Facts:** Van Gorkam (Chairman of Trans Union) was advised that he would be able to sell his majority of shares (effectively selling the company) in Trans Union at $55 per share, even though they had never been valued publicly above $37 per share, and he hadn’t gone out and received a real informed price. VG called a senior management meeting and only 2 supported the takeover proposal. Nevertheless, VG called a board meeting to propose it. Trans Union’s lawyer advised the board they could be sued if they rejected the offer and that an investment banker’s “fairness letter” was not required. After 2 hours, board approved Merger Agreement (which arrived too late for them to study it). The suit is between investors (P) and directors/VG (D) of Trans Union. Chancery court finds for D. P appealed.

**Held:** For P – the “not patently unreasonable” reason did not shield the officer’s behaviour from being judged for reasonableness before being given deference. The parties settled right before the court held D liable – paid P $23 million.

**Reasons:**

* Gross negligence is the applicable standard of care to find liability under the business judgment rule. Here, the directors were grossly negligent. Directors had to make an informed decision before submitting proposal to shareholders, and they did not do so:
  + (a) Directors did not inform themselves of VG’s role in forcing the sale
  + (b) The directors were uninformed of the “**Intrinsic value**” of the company
    - Intrinsic Value = The value irrespective of market valuation (calculated based on present value (PV = cash flow/discount rate) – a good investment is a company whose IV is higher than its market price
    - This is historically an extremely difficult if not impossible number to estimate. To think that they could do it so quickly is absurd
  + (c) Only gave this 2 hours’ consideration, without prior notice, and not an emergency
* They acted recklessly and unprofessionally
* one of the reasons why he was found to be negligent was because when selling the company he did not consider the intrinsic value
* VG is approaching mandatory retirement required by Trans Union he may have tried to cash out before his retirement
* Ds’ Arguments: (1) The amount of money they were receiving was significant ($55 per share as compared to its market value of $37); (2) Board members had a lot of collective experience; (3) relied on lawyer’s advice that they might be sued if they reject the proposal.

Court:

* + (1) Basing value on market price alone is faulty – the market had consistently undervalued Trans Union’s stock, acknowledged by Ds. They should have ascribed an intrinsic value and didn’t.
  + (2) Competence is outweighed by gross negligence. The expediency with which the deal was carried out and the lack of exploration is significant.
  + (3) The lawyer’s advice about a fairness opinion is correct but meaningless without adequate information regarding the intrinsic value of the company. No defense. Lawyer’s advice that they could get sued is also irrelevant – corporate life is full of instances where directors must make difficult/sensitive decisions that are subject to suit

**Issues with The Decision:**

* From D’s vantage point:
  + They acted entirely reasonably. Why should the court dictate how much information a corporation has to compile/how it measures intrinsic value when making private business transactions?
  + D didn’t act in bad faith – every director is going to believe that their company’s market value underrepresent its actual value
  + Dissenting judge emphasized the wealth of experience among the 10 board members and that they knew full well what they were doing
* So, why was the “not patently unreasonable” standard ignored by the court? Mistakes happen
  + **Nicholls** – the court appears to care about process. The court won’t try and judge the substance of business transactions for being reasonable, but they will go beyond the deference presumption if directors’ process looks grossly negligent
  + S.102(7)(b) is now recognized in Delaware – corporations can protect directors from liability for certain financial losses (protect them from breaches of the duty of care)
* Why did the majority put so much value on the intrinsic value since it’s so hard to determine?
  + Market value is a better indicator…what people will ACTUALLY pay
  + Unless there is something distorting the market, it should be followed

### Indemnification and Insurance

* CBCA s. 124 and OBCA s. 136 provide for the indemnification and insurance of directors and officers

### Dissenting Directors

* a director who does not agree with a particular decision of the full board may dissent
* procedures for dissent are codified in CBCA s. 123 and the OBCA s. 135.
* Certain sections impose directorial liability only where the director has voted for or consented to a resolution authorizing the prohibited conduct such as when corporations sell shares for other than money (CBCA s. 118(1),(2); OBCA s. 130(1)(2)
* to bring a claim against directors, employees must have first obtained judgement against the corporation or have proved a claim against it
* 118(6); 130(6) allow the director to escape liability by proving that he did not know and could not reasonably have known that the shoe was issued for a consideration less than the fair equivalent for the money that the corporation would have received if the share had been issued for money

## **UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc (2002) ONCA** – Canadian definition of the business judgment rule – S.122(b) is breached by officers’ negligent process (echoes Van Gorkom) **(Repap decision)**

**Facts:** Compensation committee wanted to pass a compensation agreement that had a provision that if the market capitalization increased, CEO would get a big bonus. But it was change in the world price of the company’s commodity that affected the market capitalization the most and is unrelated to the company’s performance. It also contained a provision that would bankrupt Repap. Board of directors resigned in protest. A new board came into effect and approved the compensation agreement that was recommended by an external compensation consultant who had not been told about the contentious nature of the issue. The shareholders sued the directors claiming a breach of s.122(b) duty of care.

**Held:** For P - Business Judgment Rule fails.

**Reasons:** Lax J –

“A board is entitled, indeed encouraged, to retain advisors, but this does not relieve directors of the obligation to exercise reasonable diligence”

* Canadian reflection of *Van Gorkom’s*exception to the Business Judgment Rule
  + The Court has shifted to a procedural focus when approaching directors’ duty of care – court can scrutinize decisions made with a negligent process
  + “Directors are only protected [by the BJR] to the extent that their actions actually evidence their business judgment”
* In Canadian courts, directors aren’t given deference simply because they can prove their actions had some sort of reasoning behind it – has to be within a reasonable range
  + They must make informed and independent decisions on a rational basis with reasonable grounds for believing that their actions will promote and maximize shareholder value
* This decision was not reasonable, prudent, or carefully-considered
  + They acted on an uninformed recommendation

**Note:** Abandoning the BJR is rare in Canada.

* Directors protected to extent that actions evidence a business judgment
* Not knowing what was going on is not a business judgment
* Must exercise judgment in order to be protected
* Principle of deference presupposes that directors are scrupulous
* “Demonstrate diligence in arriving at decisions”
  + Process oriented focus of Canadian BJR
* “Courts are entitled to consider content of decision...”
  + Clear departure from the Delaware BJR
* “Boards not subject to microscopic examination but are subject to examination”
  + Again, a clear departure from Delaware BJR
  + Canadian courts repeat this formulation, but then trot out a detailed examination of what the directors did – i.e., courts tend to conduct microscopic examinations.
  + E.g. *Brant v Keeprite*
* “BJR cannot apply if the board of directors acts on the advice of a director’s committee that makes an uninformed recommendation.”
  + Directors can’t say that setting up a committee to make a decision and then acting on that committee’s recommendation was akin to due diligence if committee didn’t have necessary/adequate information
  + Same with law firms – a company can’t claim they exercised due diligence by relying on law firm’s advice unless they gave the firm all of the necessary information to make the decision.

## **Brant Investments Ltd v KeepRite Inc (1991) ONCA-** judges should not substitute their own BJ for that of managers, directors or a committee but they are to evaluate the fairness and reasonableness of process

**Facts:** Parent company (ICM) wanted to merge KeepRite, one of its publicly-held subsidiary corporations, with two of its other wholly-owned subsidiaries. Developed a committee independent of the board of directors to determine whether it was fair to the public shareholders. [“Independent” = not part of management, not under control of significant shareholders, no bias]. The committee said they would not endorse the merger unless they increased the price paid to those public shareholders. Full board approved, but a group of minority shareholders sued, saying it was oppressive to their interests.

**Held:**

**Reasons:** The onus for proving a breach of S.122(b) duty of care is on the claimant – the court will not scrutinize a business decision that appears to have been reasonable unless the claimant can show evidence of oppressive or unfair conduct (which includes negligent conduct – *UPM*)

* The minority shareholders were considered and rejected by KeepRite management and by the independent committee – directors are not required to consider every alternative transaction
  + Their conduct was not oppressive or negligent; need not consider shifting onus
  + The committee was not called to come up with alternatives, but rather evaluate the proposed transaction before it
  + The committee retained a consulting firm to help, and it was determined that the plan made business sense- no suggestion that any info presented was inaccurate or misleading
* P contends that TJ should have closely examined the business decision made by the committee
  + Business Judgment Rule prevents TJ from examining under a microscope- but TJ did so anyways and still found no issue with the decision
* The Business Judgment Rule will not save directors/officers who made an uninformed decision
  + It isn’t a shield to reasonable due diligence (*UPM*)
  + To protect from this, companies often elect external committees of officers (*Schneider*)
  + Onus won’t be shifted to the directors if their decision was clearly informed by non-conflicted external directors

**Note:** Many believe that there is no such thing as an independent board member. Camaraderie between board members is likely.

* Court says the relationship between BJR and Oppression Remedy (=minority shareholders able to rectify unfairness without destroying the corporation) oppression remedy does not supplant the BJR
  + But this statement is not supported by all

### Takeaway from s. 122(1)(b)

* Onus is on the claimant (corporation/shareholders) to prove that the directors breached their care, diligence or skill, in regards to what a reasonable D/O would have done within the circumstances
* The Business Judgment Rule negates D/O from scrutiny in Canada – only standard of review
* *UPM/Schneider/Brant* – Unless shareholders can prove that D/O did not employ care/judgment within a range of reasonable procedural options, immunity will save D/O
  + Shareholders should try and prove uninformed procedure – *UPM/Brant*, contrast *Schneider*

### S. 122(1)(a)/ s. 134(1)(a)- Fiduciary Duty (Duty of Loyalty)

* note that s. 120 and 122 apply to corporate officers as well as directors
* fiduciary duties are legal norms that a re imposed on directors and managers in relation to their conduct with the corporation and SH
* these duties ensure that the myriad of corporate actors carry out their respective duties with good faith, do no put themselves in a position where their duty may conflict with self interest and do not derive secret profit from their office

### What is the s.122(1)(a) Fiduciary Duty? Whose best interests?

* Corporate Social Responsibility– since only shareholders can ensure that directors keep a corporation responsible to society, directors have to act in view of shareholder interests always
  + More than just profits (though contractarian view would say profits are paramount)
  + “Triple Bottom Line” (1) profit (2) people (society, employees) (3) planet
  + Impact on stakeholders (employees, consumers, environment, community, shareholders)
    - What about tobacco companies? The product is *legal.* Government has warned, but people still consume. There are many products that are illegal to sell, but tobacco is not one of them
      * Those companies would argue that we are making our company as socially responsible as possible, but it has not been determined that our product is wrong to sell
  + Could just be a marketing ploy (“virtue signals” – we have a desire to be perceived as good people)
* What are the best interests of the corporation?
  + Shareholder wealth maximization?
  + Perhaps corporations should aspire to do good things at all times to all people everywhere
* Dickerson Committee
  + Recommended the language used in the provision of s. 122(1)(a) but wanted to leave the definition of “best interests” to the court. Wanted to avoid an “anachronistic” view (avoid the old-school shareholder primacy view)
* Milton Friedman
  + The social responsibility of business is to increase its profits (without deception or fraud)
* Modigliani & Miller – Good Faith Share Value Maximization
  + The problem with profit maximization
    - Given uncertainty, profit-maximization was not, in fact, a meaningful goal, but was merely a “random variable” which “no longer has an operational meaning”
    - “Profit maximization” makes no economic sense – it’s an incoherent goal, meaning directors cannot actually owe it.
  + “Share Value Maximization” is the only correct goal of businesses
    - Everything directors do, they should be asking themselves if the action will raise the market value of the corporation’s shares
    - Share Value Maximization is what s. 122(1)(a) makes directors owe, as long as it is built upon internalizing the corporation’s externalities
      * All costs imposed on society must be captured and included in their price in order for us to be sure that maximizing shareholder wealth is consistent with a happy and healthy society
      * E.g., If maximizing shareholder wealth is built on things like pollution, then the duty is not genuinely adhered to
    - Must be in accordance with legality and morality
  + Critics of share value maximization say this will harm the creditors
* Hansmann & Kraakman – “The End of History for Corporate Law”
  + We think the standard worldwide is moving towards a shareholder primacy standard
  + Convergence on consensus that the best means to the ends of serving society (which corporations must do) is managers being strongly accountable to shareholder interests and, at least in direct terms, only to those interests
  + Protections for non-shareholder stakeholders comes in forms outside corporate law
* **Posner – Economic Analysis of Law**
  + It is not realistic to expect much voluntary effort to subordinate profit maximization to social responsibility. Issues:
    - Suboptimization manager who tries for both likely to do neither well
    - Standard difficult for managers to decide which stance is politically/morally ethical
    - Distributive justice costs of social responsibility to be borne by consumers in the form of higher prices
    - Substitution if corporation dedicates itself to social responsibility, shareholders will be less able to do so; if corporation refrains, shareholders can devote more resources to charity etc.
* **Kent Greenfield – “Reclaiming Corporate Law in a New Gilded Age”**
  + Characterization of the regulation of the corporation falls into 3 categories:
    - (1) Regulation requiring or encouraging certain results
    - (2) Regulation requiring or encouraging certain processes/actions
    - (3) Regulation requiring or encouraging certain internal structures
  + Non-equity investors must rely on #1 and #2
  + Shareholders are the only ones with structural protection (#3)
  + But corporate law might have comparative advantages over other kinds of law in addressing the concerns of stakeholders
    - More efficient to have the corporation distribute wealth than the government doing so after the fact through tax and welfare laws
  + Corporations may have expertise that government does not, so perhaps broadening the scope of corporate responsibilities would allow management to be proactive in addressing issues of social concern
  + Conclusion: foolish to leave corporate law as an untapped resource if non-shareholder stakeholders need more regulatory protection
* Iacobucci J’s opinion: loyalty to the shareholders, not the “corporation” as a person
  + - That would be like a tour bus driver asking: “what route is best for the bus?” rather than choosing a route based upon the people whose interests are tied to it

## **Parke v Daily News**

**Facts:** Daily News’ longtime, faithful employees were now retired and didn’t have enough pension. Took profits from the company and paid to employees to take care of them. Parke, a shareholder, sued.

**Held:** For P.

**Reasons:** No authority for the proposition that the directors’ duty is to help its employees – no contractual obligation. They are good people trying to do the right thing, but a business must conduct itself like a business – cannot give away shareholder money. Need to ensure that spending is reasonably incidental to the carrying on of the company’s business.

## **People’s Department Store Inc v Wise (2004)** – Fiduciary duty is owed at all times to the corporation not necessarily the shareholders or creditors but those interests can be considered. Main point: Duty of Care; Objective standard for directors- to whom do they owe a duty? At least to creditors.

**Facts:** see above.

* + “Best Interests of the corporation” should be read not simply as the best interests of the shareholders
    - Does not support shareholder primacy
  + Any duty owed to the interests of stakeholders is permissive, not a mandatory legal duty (most of the time they are looked after by D/O’s good faith for the corporation overlapping, but they are not guaranteed it alone)
  + Where a corporation is in financial trouble, the D/O must be careful to act in its best interests by creating a better corporation, not to favour the interests of any group of stakeholders

**Issue:** Is the duty of directors owed solely to SHs or does it include creditors?

**Held:** For D, Wise brothers did not breach their fiduciary duty.

**Ratio:** The standard of care is objective. So long as the directors act in a reasonably prudent manner, they will not be held liable. The duty of loyalty does not extend to creditors. So long as the directors act in the best interests of the corporation, even if creditors take a loss, the directors are not personally liable for their decisions.

*Tech v Miller* (BCSC)

* Case always cited by people who want to argue that directors owe a duty to many stakeholders
* Case does not go as far as creating a duty, just says directors are permitted to consider people other shareholders--> case is a tentative step to something like stakeholder constituency duty
* Language is highly protective of directors as it says it may be legitimate to consider shareholder suppliers, consumers, creditors etc.

**Reasoning:** The duty of loyalty requires directors to act in the best interests of the corporation. From an economic perspective this would mean maximizing shareholder wealth. SCC cites the above case and rejects the vicinity of insolvency argument accepted by TJ. Director’s duty does not change when in the vicinity of insolvency. As long as the directors acted in good faith, this case serves as a shield for directors, not a sword for SHs and creditors. SCC mentions that there is a broad oppression remedy which means that we don't need to develop a robust fiduciary law to protect creditors.

## **BCE Inc v 1976 Debentureholders (2008) SCC -** Fiduciary duty is owed only to the corporation, but directors must act as a “good corporate citizen” toward other stakeholders

**Facts:** involved a proposed arrangements under s.192 of the CBCA. More than 90% of friendly transactions are done as arrangements under that section. An arrangement requires a court hearing for fair process checking. This case is the court's approval hearing. The trial division said yes, the court of appeal said no, n. BCE was going to be bought out by a consortium of headed by Ontario Teachers pension Plan Board. BCE was going to have to guarantee $30 billion in debt. This is a leveraged buyout. The Teachers were going to borrow the money to buy it and then load up BCE with debt. The 1976 Debentureholders were creditors of BCE and they were not happy. Their debentures were worth essentially nothing to them because they dropped in value from AAA to BB. But it was a paper loss, so you would think it wouldn't affect them. But al ot of the Debentureholders were pension funds and weren't allowed to hold debentures that were that low of value so they were forced to sell so they went to the court to say that it was not fair and reasonable to approve the arrangement. They also sued under the oppression remedy. They argued that the transaction caused the value of their debts to decr by 20% so the directors failed in their duty to protect their economic interest or at least consider their interests in the decision.

**Issue:** Was the arrangement fair and reasonable?

**Ratio:** The directors of BCE were required to consider the interests of the debenture holders, and then weigh it against everything else and make a good decision. Directors are required to act in the best interests of the corp viewed as a good/responsible corporate citizen (different than Dodge v Ford in the U.S). Fiduciary duty can be long term or short term, requires directors to ensure that corp meets its statutory obligations. Directors owe their duty to the corp, not to the stakeholders. Reasonable expectation of stakeholders is simply that directors act in the best interests of the corp. In oppression cases where the interests of diff stakeholders conflict, directors just have to act in best interests of the corp having regard to all relevant considerations and also the need to treat affected stakeholders in a fair equal manner

**Held:** For BCE – **s.122(1)(a)** fiduciary duty is not owed to stakeholders. The arrangement can go ahead, the directors sufficiently considered the minority stakeholder’s interests and made a decision in the best interests of the corporation.

**Reasons:** Just because **s. 241** Oppression Remedies allow stakeholders to raise a claim against directors’ discretion, and though courts should give deference to directors taking into account the interests of stakeholders (per BJR), the directors do not owe stakeholders a fiduciary duty.

* Oftentimes the interests of stakeholders and the corporation coincide, but directors owe duty to the corporation foremost. Stakeholders need to hold that as a reasonable expectation.
* “Directors owe a fiduciary duty to the corporation, and only to the corporation”
  + - **Required to act as a good corporate citizen**
  + “Must act as a “**responsible corporate citizen**”
  + Here, the directors considered the debuntureholders interests and determined that the most they could do was honour their contractual obligations – no further commitments could be made (this fulfilled the directors’ duty to the debentureholders’ interests)

**Reasoning:** A new standard for directors' fiduciary duties is articulated: directors are "required to act in the best interests of the corporation **viewed as a good corporate citizen"** or perhaps a "responsible corporate citizen". The shareholders had approved the arrangement by a huge majority and it was clear that the shareholders approved of this. The directors clearly considered the interests of minority stakeholders but there’s no obligation for them to take further steps to restructure the purchase in a way that would provide a price increase to shareholders AND preserve high market value for the debentures (minority shareholders). Also there was no evidence to show that it was even possible for an argument that they failed to consider other alternatives.. so their decision was upheld. There was no evidence that the debenture holders had a reasonable expectation that the corp would maintain the value of the debts which means the oppression remedy argument fails. The best interests of the corp arguably favoured acceptance of the offer and it was within reasonable alternatives… which means the directors did do what was best

**Difficulties from this case:**

* Unclear whether directors must or may consider best interests of stakeholders
* Seems to confound fiduciary duty and fairness under the oppression remedy
  + Fiduciary duty is determined subjectively, oppression remedy objectively
  + Court suggests fiduciary duty owed to corporation, not to other constituents; similarly defines oppression remedy, even though the **s. 241(3)** seems to allow it for more than just the corporation
* How will BJR operate in unison with a pluralistic fiduciary duty?

“*Act honestly and in good faith”* – 2 types of cases

1. **Interested Directors’ Contracts** – Corporation itself is a party to a contract
   1. Directors who enter into contract with own corporation – immediately has possibility of conflict between duty and interest
   2. At common law, was voidable at option of the company (to put company in best possible position – if favourable, company could adopt, if unfavourable, could reject)
2. **Corporate Opportunities** – Corporation is not a party to a contract
   1. Directors cannot use their position to take on business opportunities that properly belong to the director’s corporation (i.e., steer business to personal pocket)

### Interested Director’s Contracts

CBCA s. 120/OBCA s.132

s. 120(1) - Managers have to disclose the nature and extent of any interest that they may have in regard to every material contract or transaction that the board of directors/officers is proposing

(a) If the D/O is a party to the transaction

(b) If they are a D/O of a party to the transaction

(c) If they had a **material interest** in a party to the contract/transaction

* + “Material” = not limited to pecuniary interests
    - Material to whom? Seems like it should be to the corporation, but some commentators think it means to the directors, and possibly family members too
  + Exceptions (things that D/O don’t have to list in the information circular) – Form 51-102F5
  + Transactions with prices fixed by law or determined by bids
  + Transactions that don’t involve significant remuneration
    - (v)(c)(III) – the transaction was less than 10% of the total sales/purchases made by the company that fiscal year

s. 120 (2) – Directors have to share their interests: (first meeting where you had an interest)

(a) at the directors’ meeting where the transaction is proposed

(b) if they didn’t have an interest when they first proposed it (according to (a), at the first possible meeting

(d) if they became a director after the proposal, at the first meeting they attend as a director

s. 120 (3) – Officers have the same timing requirements as directors do under s. 120(2)

* Little harder to satisfy because officers don’t have the same meetings as directors

s. 120 (4) – If the directors’ proposal at the meeting is one that does not require a vote/approval, a director with a personal interest can submit a disclosure in the minutes of the meeting (lower duty)

s. 120 (5) – A director required to make a disclosure under subsection (1) shall not vote on any resolution to approve the contract or transaction unless the contract or transaction

(a) relates primarily to his/her own remuneration as director, officer, employee

(b) is for indemnity or insurance

(c) An affiliate of the corporation

OBCA s. 132(5) – if director has an interest, cannot vote unless action relates primarily to his/her own remuneration as a director of the corporation (does NOT include officer etc. – e.g., CEO can vote)

* Dickerson committee – directors can set compensation for other directors because otherwise there would be charade where each person has to leave the room when voting on each other’s salaries (and all directors’ salaries are the same)

s. 120(6) – The delivery of one general notice which disclosed their interest in a particular transaction/proposal is a sufficient declaration

1. the D/O is a party to the transaction, or has a material interest in a party (1(b) and (c))
2. the director or officer has a material interest in the party; or
3. there has been a material change in the nature of the director’s or the officers interest in the party

s. 120 (6.1) Exception to shareholders being disallowed from viewing director meeting minutes: The shareholders can examine the minutes of any director meeting that contain these type of ‘one-time’ conflict of interest disclosures, during the usual business hours of the corporation. They are generally not allowed to see directors minutes but they can see them here but only the portion which has to do with disclosure

* Contrasts the standard for directors’ minutes, which are usually withheld from shareholders to ensure that shareholders of multiple companies cannot look into inside info of multiple companies to their advantage

s. 120(7)/ OBCA s. 132(7) A contract will not be struck down by the court in regard to s. 122(1)(a)’s fiduciary duty

* (a) If D/O’s followed the disclosure requirements for material Ks in subsections (1)-(6)
* (b) the directors approved the contract or transaction
* (c) If the contract was ‘reasonable and fair’ to the corporation at the time it was approved
* OBCA has different language in this section, they use the word “only” but CBCA does not use that word

Issue – If a director/officer followed (1)-(6) except for (5) (they voted), is s. 120(7) voided? The wording seems to allow a D/O to not follow (5) as long as they properly disclosed otherwise

S.120 does not trump S.122(1)(a) – it just protects D/O when they are making good faith decisions that they have a conflict of interests’ in (**Dickerson Committee’s** intention for s. 120)

S. 120 (7.1) – Even if the D/O didn’t fully satisfy s. 120(7), the contract won’t be voided solely because of their personal interest by reason only if:

(a) the shareholders still approved the contract at a shareholder meeting or by special resolution (2/3rds majority), and

(b) disclosure was made to the shareholders in a way that indicated its nature before the contract was approved, and

(c) The contract was reasonable and fair to the corporation when approved

S.120(8) – If a D/O fails to comply with this section/ isn’t saved by s. 120(7.1), the contract will be voided, the D/O will be liable for any personal profit they made on it, or both.

# Corporate Social Responsibility

* Classical economists means free market, everyone tries to maximize their own self interest
* The problem with saying that everyone works to maximize their own utility is that utility can mean anything. It it a tautology. So to make it have some predictive value
* In the 1950’s, it was said that the idea that firms maximize profit is problematic because profit just means net earnings on an income statement. Profit means revenues minus expenses. You cannot maximize profit as it has no meaning
* They said that the real purpose rather than maximizing should be maximizing shareholders wealth as measured by the shareholders
* Financial economists said that every time they take on a project they should ask if the project would maximize shareholders wealth. This idea became incredibly power and influential
* This became textbook corporate finance
* The argument that corporations should just maximize profit is harder to understand because it seems to be greedy

### Berle/Dodd – Shareholders First vs Broad Approach

* Adolfe Berle is the most famous corporate law professor ever
* Merrick Dodd corporate law professor at Harvard
* Berle was on the side that the shareholders are the first to be paid. He didn't think he was launching into a debate about shareholder primacy and CSR he was going into something specific. He was looking at equitable limitation of corporate power which means that directors have absolute power and control and the shareholders have various ways to control their actions (first article). Even though it looks like directors are given absolute power, courts have recognized that this is a power in trust and so if they re not excising these powers in the interest of the shareholders the courts will strike them down. That is what he thought he was talking about.
* Merrick Dodd then enters this as a debate and adds a different view. He comes in with a broader approach and the argument that to do good things for people other than the sharheodelrs directors need a certain about of freedom. Dodd was make both a positive argument about how things are and a normative argument about how they should be.
* there was no conflict between acting for the shareholders and acting for the employees etc. The way I create long term shareholder value is by having happy employees so there is no conflict. Doing good things for my employees and my customers and my supplies and community helped my company
* Dodd’s position cannot be reduced to saying that the parties are harmonious. He recognizes that some of the things companies do are selfish but thinks that they are observing directors who are genuinely concerned with serving other interests even if the shareholders are put at a disadvantage and he says that is ok
* Dodd’s positions cannot be deduced to enlightened shareholder interests. Directors are permitted to sacrifice shareholder value and give it to the community at large
* what Dodd appears to be saying is let corporate directors do whatever they want, they will do the right thing which is a difficult principle because there is no accountability
* Berle’s response was that while it may be that just simply having this rule that we have to constantly only care about sharheodelrs interests is not adequate we cannot just a aondon it in favour of nothing. We need an alternative. There would be a gap in accountability. The problem is that there is not a legal principle for what Dodd is saying
* Berle’s argument is a call for, let all smart minds direct themselves to this problem. We know what we are doing now is not working because we have injustices income inequality and abuses of corporate power so figure out a way of thinking about this problem in a new way

### Brookings Institution Study (Daryl West)

* Daryl West’s message was that in American schools especially they re taught that directors duties to maximize shareholder profits is troubling
* he says that it is troubling because directors actually do owe a duty to community environment etc, other than shareholders
* he thinks that raw capitalism encourages the notion of maximizing shareholder profits and raw capitalism is not practical moving forward
* his surveyed the American business and law schools and says this is what they are teaching
* interesting to note is that professors team that directors obligations is to maximize shareholder profit BUT they actually are on the other side of the debate (Dodd side)
* his results show him that this is happening more in law schools that in business schools, it is more frequent in law schools that directors duty is only to shareholders. It is frequent in both but less frequent in business schools and this is troubling because it might be mistaken.
* at the law schools, he discovered that they were teaching the students that directors duty is to maximize shareholder profit and it is mistaken as a proposition of law
* he says that he knows it is wrong because one professor said that this view was wrong and thats the answer he liked

### Alternative for Profit Organizations: (Benefit Corporations, Community Interest Companies (CIC) and Community Contribution Companies (CCC)

* in 2010 the state of Maryland allowed the incorporation of benefit corporations which are for profit corporations but which are also required to pursue a public benefit they must put that in their articles
  + currently we have no benefit corporation legislation in Canada
  + BC has community contribution contribution which is similar to a Uk CIC
  + Nova Scotia also has CIC
* in the UK, in 2005, they passed legislation allowing for CCC which re also for profit vehicles which pursue a pubic service or charitable function. They re not the same as benefit corporations they re much for regulated. They have restrictions on certain money they have to retain and what interests rate they can pay to debt holders etc.

# Corporate Opportunities [Case LAw]

* s. 122 CBCA and s. 134 OBCA
* Deals with situation where the corporation might have loved to have the contract but didn't get it because of the director
* Paradigm case: director of corporation and corporation is in the mining consulting business. Someone calls to hire someone. An individual takes a contract on individually rather than letting the corporation take on the contract. The individual came across the contract because of their involvement in the corporation.
  + Most real cases are far more subtle than that
* The old corporate opportunities cases set the standard extremely high
  + Directors could not even put themselves in a position where it was possible
* They are taking opportunities that deprive the corporation of taking those opportunities, thereby benefiting themselves at the expense of the corporation
* But it isn't clear what projects 'belong' to the corporation and which ones the managers can take
* There is fiduciary duty outlined in statute

In whose interest should the corporation operate?

* The corporate opportunity doctrine is the legal principle providing that [directors](https://en.wikipedia.org/wiki/Board_of_directors), officers, and controlling shareholders of a [corporation](https://en.wikipedia.org/wiki/Corporation) must not take for themselves any business opportunity that could benefit the corporation. The corporate opportunity doctrine is one application of the [fiduciary](https://en.wikipedia.org/wiki/Fiduciary) [duty of loyalty](https://en.wikipedia.org/wiki/Duty_of_loyalty).

***Corporate Opportunity - Directors must not appropriate an opportunity that belonged to the corporation.***

* If directors take advantage of an opportunity that they discovered by virtue of their position as directors and that opportunity is one that the corporation might conceivably have been interested in pursuing, the directors have acted **counter to their fiduciary duty** to the corporation. In a normal course of affairs, a project will be recommended to the corporation if the project’s benefits exceed its costs.
* **Main issue** is when Directors or Officers take a corporate opportunity of profit for themselves and away from the corporation.

## **Regal (Hastings) Ltd v Gulliver (1942) HL** – Strict standard against pursuing private opportunities. A director is in breach of his fiduciary duty if he takes advantage of an opportunity that the corporation would otherwise be interested in but was unable to take advantage of. If you are in a fiduciary position and you make a profit you are liable.

Facts: Regal Corporation wanted to purchase two theatres, and incorporated a subsidiary (a shell corporation) that was explicitly for the purchase of doing so. The landlord selling the theatres was uneasy selling to a shell, so he would only accept the deal if he was given £5,000 for the shares or if he received a directors’ guarantee. The directors were only willing to put down £2,000 on behalf of Regal (a decision made honestly and in good faith, according to the Courts). In order to keep the sale alive, 4 of the directors gave £500 each and Gulliver found a friend to contribute £500. Mr. Garton, the solicitor, give £500. Thus, there is now the full £5,000. At the same time of the sale, the directors accepted an offer for Regal’s interest in all theatres by way of selling all of its shares and the shell’s shares. The directors each made profit on their interest in the shell. Regal was now in the hands of a new owner. The buyers then sued the (now former) directors and solicitor for breaching their fiduciary duty for taking a corporate opportunity. TJ found for D. CA dismissed appeal by P.

Held: For P – all directors liable except Gulliver (since he did not purchase the shares for himself). Garton not liable either, because the duty does not extend to solicitors.

Ratio: A director is in breach of his fiduciary duty if he takes advantage of an opportunity that the corporation would otherwise be interested in but was unable to take advantage of.

Reasons: LORD RUSSELL OF KILLOWEN –

* The profit rule liability arises from the mere fact of a profit having been made regardless of a lack fraud or absence of bona fides. It is a strict rule.
  + Keech v Sandford – The corporate opportunities standard is very strict, to not open the floodgates to what equity would allow directors to do to achieve self-interests and profit
    - Facts: a lease of the profits of a market had been devised to a tutee for the benefit of an infant. A renewal on behalf of the infant was refused, it was unobtainable. The trustee, finding it was impossible to get a renewal took a lease for his own beneit. Though his duty to obtain it for the infant was incapable of performance, he was ordered to assign the lease to the infant, upon the bare ground that, if a trustee on the refusal to renew might have a lease for himself, few renewals would be made for the benefit of the cestuis que trust.
* The directors in acquiring the shares of the two theatres were only able to do so because of their role as directors of Regal
* directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason of the fact that they were directors of Regal and in the course of the execution of that office, are accountable for the profits which they have made out of them.
* held that each of the respondents is liable to account for the profit which they made on the sale of their 500 shares in Amalgamated
* in regards to Gulliver, Russel believes that his appeal should be dismissed because he made no profit for which he is accountable
* Held: (i) dismiss the appeal against the respondents Gulliver and Garton with costs, (ii) to allow it with costs against the other four respondents, (iii) to enter judgement as against each of these 4 respondents for the sumer of £1,402 1 s. 8d with interest at 4 percent

LORD SANKEY –

* The conflict rule - the directors were acting honestly and in good faith, but it does not matter. They were acting in conflict with the interests of those whom they were bound to protect
* he said that the respondents were in a fiduciary position and their liability to account does not depend on proof of mala fides
* general rule of equity is that no-one who has fiduciary duties is allowed to enter into engagements in which they have a personal interest conflicting with the interests to whom they are bound.

LORD MACMILLAN –

* The profit rule - if a fiduciary makes a profit as a result of their position they must account for that profit to their principle
* the point was not whether the directors had a duty to acquire shares in question for the company and entered into the transaction lawfully, in good faith and avowedly in the interests of the company . That does not absolve them from accountability for any profit which they made, if it was by reason and in virtue of their fiduciary office as directors that they entered into the transaction
* Lord James’ 1778 Principles of Equity reads “equity prohibits a trustee from making any profit by his management, directly or indirectly” – has to be strict, or the agency split will hurt shareholders
* Directors will be liable if the shareholders can prove: 1) what the directors did was a utilization of their opportunities and special knowledge provided for by their agency, and 2) they profited personally

LORD WRIGHT –

* Does not matter that the directors did not harm the shareholders, in law and equity, if a fiduciary makes a secret profit out of the relationship, the Court will not inquire whether the other party is damnified or has lost a profit which otherwise he would have gotten

Note: Nicholls – disappointing result. On the facts, purchasers who bought the shell company knew what was going on and agreed to a certain purchase price, then after having bought the company they turn around and sue the directors (essentially having the effect of lowering the price they paid – a completely unbargained-for windfall). Also, Gulliver’s refusal to give a guarantee necessitated this transaction, and yet he’s the only one who gets to keep his money. Finally, Mr. Garton’s advice that the deal should go ahead was incorrect, and yet he gets to keep his money.

* The self-serving individuals get to keep their own money and the virtuous ones do not…
* Courts thought it appropriate to characterize the directors a lot like trustees (Keech v Sandford)

Judges also said that if the shareholders had ratified the contract there would have been no liability. This has been criticized as well – the directors were the shareholders.

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

**Facts:** A prospector approached P’s corporate shareholders claiming he had identified a profitable mine for them to invest in. The board rejected it (on behalf of the shareholders) due to budgetary constraints. Cropper, a board member, set up his own company and bought it himself. It was highly profitable, and the shareholders sued him, claiming *Regal* should hold him liable to them for a breach of fiduciary duty.

**Held:** For D – did not breach fiduciary duty.

**Reasons:** Cartwright J – *Regal* is good law in Canada, but it is distinguishable here for 2 reasons:

1. The director did not obtain his investment only by reason of being a director of the uninterested corporation
   * + Lord Russell in *Regal* – profit obtained through executing opportunities obtained first by the corporation is owed to the corporation
     + Here, the shareholders turned down the opportunity, whereas in *Regal*, they made a part-offer
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

**Note:** How can the court measure what a good faith rejection is?

**Note:** At CA, Norris JA dissented, saying that the rules of *Keech v Sandford/Regal* must be applied rigidly in order to not allow for the complexities of modern day business to be used as a smokescreen for fraud.

## **Canadian Aero Services Ltd v O’Malley (1973) SCC** – Expanded the right of shareholders to sue for breaches of fiduciary duties, doesn’t matter if the corporation was unlikely to get the K itself. You cannot insulate yourself from opportunities doctrine by resigning and listed other factors to consider.

**Facts:** Ds worked as highest officers of P’s corporation. While surveying a business opportunity in Guyana, the defendants decided to leave their roles as officers and start their own company because it appeared as though Canadian Aero would be unsuccessful. They then issued a proposal for the project in Guyana and were accepted. P sued them for wrongfully taking the corporate benefit that they had only obtained as officers of the corporation.

**Held:** For P – Fiduciary duty was breached.

**Reasons:** Laskin J – 4 Issues Were Addressed

1. What is the relationship between D’s and the P company?
   * High-ranking officers such as O’Malley and Zarzycki are not mere employers of the company, but rather are agents.
2. What duties did the D’s owe to the corporation?
   * 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
3. Since there was doubt surrounding the corporation’s actual ability to claim the opportunity, did the officers breach their fiduciary duty? Did the fiduciary duty continue after they had already left the company?
   * P does not have to prove that it suffered any loss – it is not what the corporation lost but what the fiduciary gained under circumstances where they pursued an opportunity that arose in the course of their duties and they left their duty in order to pursue a substantially similar deal
   * The company had not given up trying to attain the K, even if it seemed hopeless
     + Regardless, fiduciary duty is not built only on equity/ensuring corporations have genuine opportunities to make good investments
     + 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
   * *Industrial Development Consultants v Cooley* (1972) – Doesn’t matter if corporation was unlikely to secure the opportunity itself – D/O must avoid conflicts for society’s sake
     + Managing director resigned on false assertion of ill health and subsequently got the K for himself
   * They were still under duty as they entered competition for the project when they left the company all-the-while knowing that the company was still pursuing the K
4. What factors should the court use to judge whether officers were breaching their fiduciary duty when pursuing opportunities? 4 key factors:
   * Did the defendant hold the relevant office (director or officer)? What position was held
   * The nature/ripeness of the opportunity (did D gain a contract right after leaving? If so, likely an opportunity they only received as an agent of the corporation – liable)
   * Whether the rejection was tied closely to the officers’ duties (distinguishes *Peso*)

* In *Peso*, there was a good faith rejection of the opportunity, not so here.
* In *Peso*, the K was one of many deals put before the company on a regular basis and no single deal indicated the success or failure of the company
* Here, the deal was paramount to the company’s success
  + Amount of knowledge that D/O had (if they were tasked with scouting the opportunity, they clearly had a far better chance to see its potential that did the shareholders - inequitable)
  + the factor of time in the continuation of the fiduciary duty where the alleged breach occurs after termination of the relationship
  + and circumstances under which the relation was terminated

**Note:** LASKIN essentially fused the profit and conflict rules from *Regal*

**2(a): Competition**

* (1) Director serve on boards of two competing corporations; (2) Director or officer operating a business that competes with the corporation; (3) Director or officer having a material interest in an entity that competes with the corporation
  + Each involves a conflict of interest, so one would think that cost rule and profit rule would apply, making a breach of fiduciary duty
  + However, *London and Mashonaland*held that sitting on 2 boards (scenario #1) is not a breach of fiduciary duty to either corporation
* Today, CBCA s. 241 and OBCA s. 248 (oppression remedy) would likely step in, although *London Mashonaland* still has legs

## Peoples Department Stores: SCC rejects shareholder primacy view; fiduciary duty is at all times to the corporation (see more info) but not to mead read simply as best interests of shareholders

* No shareholder primacy duty in Canada
* At all times, D and O owe their fiduciary obligations to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders
* Duty: whether someone is acting with a view to the best interests of the corporation it may be legitimate given all the circumstances for the board of directors to consider, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment
* If corporation is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a better corp and not to favour the interests of any one group of stakeholders (but this is ambiguous)
* Doesn’t really make sense

## BCE v Debentureholders: rejection of shareholder primacy view; new directors required to act in best interest of the corporation as a good corporate citizen/responsible corporate citizen

* Directors may have to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean by good citizen
* But at end of day only owe duty to corporation
* Here it meant considering Debentureholders- all they had to do was consider didn’t have to oblige to what they wanted
* BCE appears to reject the law that says in a hostile takeover bid the duty of directors is to max shareholder value which is correct
* Best thing they are doing is just help guiding and reject the notion that it is just shareholders

# Shareholder Remedies

* + just confined to shareholders, so probably better called “Corporate Remedies”
  + Fundamental characteristics of the corporate form (e.g., separate legal entity, limited liability, centralized management elected by majority) create need for special corporate law remedies, esp. for minority shareholders, but also for other corporate stakeholders
    - Can’t be remedied by any traditional common law claims
  1. **Derivative Action** - CBCA ss. 239-240, OBCA ss. 246-247
  2. **Oppression Remedy** -CBCA s. 241/OBCA s. 248
  3. **Dissent Right (Appraisal Remedy)** – CBCA s. 190/OBCA s. 185
  4. **Compliance Order** – CBCA s. 247/OBCA s. 253 [s. 253(2) parallels CBCA s. 154]
     + Provision in corporate statutes that says if someone is not complying with the corporation statute, or articles of incorporation, or by-laws, or USA – you can go to court and force them to comply
     + Rarely used because the costs of attaining an order outweighs the benefits

|  |  |  |  |
| --- | --- | --- | --- |
| **Remedy** | **Statutory Reference** | **Harm Alleged** | **Who may bring?** |
| **Derivative Action** | CBCA s. 239 -240  OBCA s. 246-247 | Wrongs done TO the corporation | A “complainant” (as defined in statute) [leave of court required] |
| **Oppression Remedy** | CBCA s. 241  OBCA s. 248 | Acts committed BY the corporation, its affiliates that effects a result, or business or affairs or powers of directors of corporations 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 conception of “reasonable expectations” The SCC in BCE v 1976 Debenture holders formulated a two-print test for oppression claims: “(1) Does the evidence support the reasonable expectations 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 issue?” |
| **Dissent Right (Appraisal Remedy)** | CBCA s. 190  OBCA s. 185 | Certain specified fundamental corporate changes | A dissenting shareholder [“fair value” of shares must be determined] |
| **Compliance Order** | CBCA s. 247  OBCA s. 253 (s. 253(2) parallels CBCA s. 154) | Failure to comply with Act, articles, by-laws, USA, etc. | A "complainant" (as defined) or a creditor |

### Derivative Action

CBCA ss. 239-240, OBCA ss. 246-247

* Action that is nominally brought by the corporation itself, but the person who is really behind the action is not the corporation itself
  + That person’s ability to pursue that action derives from the corporation’s right
* although the human being who hires the lawyer is not the corporation, their right to sue derives from the corporation so it is really the corporation who is suing
* who can bring a derivative action under both the CBCA and OBCA? - a complainant as defined by the Act (CBCA s. 239)
  + complainant is a register owner or beneficial owner or former registered owner or beneficial owner of a security of a corporation or any of its affiliates
* Directors have an obligation only to the corporation
  + Directors decide who the corporation sues
  + But what if directors are in breach of obligation? They shouldn’t be able to decide to sue or not sue themselves. This is why the corporation is not the complainant suing
* s. 238/ 245 – who is a complainant? **[exact same section applies to Oppression Remedy]**
  + (a) shareholders and former shareholders
  + (b) director/officer, or former director/officer
  + (c) Director – government official who administers CBCA
  + (d) a proper person – other stakeholder who can satisfy court that they should be able to bring derivative action
    - Commonly are creditors
* s. 239(1)/ 246(1) – To raise a derivative action, the complainant has to be **granted leave** of a court
  + Leave = permission. Dickerson Committee wanted to avoid a proliferation of frivolous claims (“strike suits”) designed to extort money from corporations rather than to right a wrong
* s. 239(2)/246(2) – Before bringing action must satisfy court that:
  + (a) complainant has given notice to director of its intention to apply to the court not less than 14 days before bringing the application
    - Since you are bringing it on behalf of corporation, they must be aware given the opportunity to first bring it themselves
  + (b) complainant is acting in good faith
  + (c) bringing action must be in best interest of corporation
* s. 240/247– **Powers of the Court**
  + (a) Court can authorize the complainant or any other person to control the conduct of the action
  + (b) Court can direct the conduct of the action
  + (c) Court can order that amounts adjudged be payed to former/present security holders instead of the corporation
    - This provision deals with the problem in *Regal*
  + (d) Court can order that the corporation pay the complainant’s legal fees

## **Foss v Harbottle (1843)** – Need for derivate action arose from this case - Shareholders and their corporation are separate legal entities, meaning a harm done to the corporation is not a harm for which shareholders can be personal plaintiffs against

* the corporation is considered a distinct legal person and at common law it was almost impossible for corporate shareholders to bring a claim against someone whose actions had harmed the corporation, even when the most significant practical impact of that harm was that the value of their shares had fallen. The corporation alone was permitted to sue in most cases. this became known as the rule in *Foss v Harbottle*
* **The Rule in *Foss v Harbottle*** *-* the rule provides that individual shareholders have no cause of action in law for any wrongs done to the corporation and that if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action
* The Rule in *Foss v Harbottle* – Since the corporation is the proper complainant to harm it suffers, and majority shareholder votes dictate corporations’ internal views, minority shareholder views have no legal standing
* this rule was problematic because the person or persons whose actions harm a corporation might well be the directors or officers of the corporation itself but those are the very people who must normally decide whether or not the corporation will commence legal action (they would not be inclined to authorize the corporation to sue themselves)
* second prong to the rule in *Foss v Harbottle* is more problematic: at CL, where a wrong has been done to the corporation that wrong may effectively be expunged if it is waived (or ratified or confirmed) by the SHs in general meeting. Troubling because in cases where a director or officer has allegedly harmed the corporation, if they were also a SH, they could vote their shares at a SHs meeting convened for the purpose of ratifying the harmful action taken by that very director or officer

**Statutory Derivative Action**

* CBCA hoped to address the rigidities and potential injustices of the common law rule in *Foss* *v* *Harbottle* by providing for statutorily prescribed derivative action which is a representative action commenced by 1 or more SHs or other complainants but which derives from the corporation’s own right to sue and is brought in the name of the corporation

### Meaning of “Complainant”

## **First Edmonton Place Ltd v 315888 Alberta Ltd (1988)** Creditors count as “complainants” under CBCA s. 238 on specific conditions

**Facts:** The corporation was a tenant and the landlord gave them money to move into their building and fix up the building and also gave them a rent free period. The corporation, a group of lawyers, took the money and distributed it to the shareholders (themselves) and moved out at the end of the rent-free period. The landlord (creditor) was left with nothing and brought the oppression action. The argument was that the wrong that has been done to the numbered company was that the lawyers took the money that was given to them as the inducement and they paid it out to themselves without consultation of their shareholders and so that money that they took stands as an unlawful gain on their part. First Edmonton’s argument is really to just get money back into the numbered company so that it is no longer judgement proofed.

**Issue:** How does one determine if a party is a “proper person” to bring an oppression action?

**FEP’s Argument:** that the actions of the three lawyers who were the sole shareholders of the numbered company, as directors of the numbered company, in causing the corporation to allow their firm to occupy the premises with no lease and without requiring rent to be paid during the rent free period and causing the corporation to pay out the proceeds of the cash inducements to themselves,, constituted deliberate breaches of their obligations as directors of the corporation

Problem in this case: FEP is clearly not within the meaning of the term “complainant” within s. 231(b)(ii) so they can only satisfy this requirement if they can come within s. 231(b)(i) or (iii)

**Basic Principle:** We will recognize if someone is a proper person if you are a shareholder, director or former of either of these two can automatically bring a derivative action but for everyone else they will have to convince the court.

* is the applicant a “complainant” within the meaning of s. 231(b)(i)
  + this section defines “complainant” as “a registered holder or beneficial owner, or a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates”
* Creditor can be a complainant only if it holds or is the beneficial owner of a security of the corporation and if the security is of a type which is capable of being registered with the Registrar of Corporations and in the register of mortgages specifically affecting property of the corporation
* Criterion to be applied: 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
* 2 circumstances in which justice and equity would entitle a creditor to be a “proper person”
  + (1) If the conduct of directors or management constituted using corporation for committing a fraud upon applicant
  + (2) If the act/conduct of directors or management constituted a breach of the underlying expectation of the applicant arising from the circumstances in which the applicant’s relationship with the corporation arose? (i.e., was he able to protect his interests against the occurrence of which he now complains?)

### Costs in Derivative Actions

* High costs, thus the average shareholder with a small stake will not have resources or incentives to commence litigation
  + Larger SHs have both resources and incentives, but they are often part of the group accused of wrongdoing
  + Institutional shareholders (pension funds, banks, trust and insurance companies) might also sue, but will likely sell their holdings if dissatisfied with management rather than sue - but this is changing, and institutional shareholders are now more likely to be confrontational towards management and controlling shareholders
* Costs rules can attenuate free rider problem (when a low stake SH negates to bring the derivative action, due to costliness and effort etc., because they think that someone else might bring it forward, and everyone benefits when it is brought):
  1. Allow recovery of costs by P from all those who stand to benefit from favourable judgment
  2. Corporation pays for cost of litigation
     + But this creates the problem of shareholders bringing forward “strike suits” lacking any merit
       - Requirement for good faith helps attenuate this effect

## **Turner et al v Mailhot et al (1985) – Ont HC -** SHs and others are entitled to indemnification if the action was “a reasonle and prudent course to take in the interests of the company”

**Facts:** P and wife owned 30% of shares, D and wife owned 70%. After 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).

**Held:** P gets ½ the indemnity he requested since company funds were paid to D for his defence.

**Reasons:** Compares to *Wallersteiner v Moir* – in that case, it was a large public company and Moir was a minority shareholder, so any advantage to him would be trivial. He was clearly operating in the benefit of the corporation.

* Here, P is 1 of 2 shareholders, and this appears to be more of a struggle for each parties’ own advantage with the company used as a vehicle, rather than an attack by an almost lone altruist upon an entrenched and devious miscreant for the advantage of the company.
* It must be evident to the Court that directors of the company refused to bring the action, that the complainant is acting in good faith, and that the actions is in the best interest of the company
  + 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, benefit sought appears to be more for P than company

**Reasoning:** the purpose of derivative action is not to benefit P more than the company- litigation costs should be covered for personal matters. It is inappropriate to play out company funds for personal matters. A derivative action prima facie can be brought, but for full indemnification was rooted in a personal issue and P was not acting as an agent for the company, but rather, for himself

### Relationship Between Complainant and the Corporation

* the fact that a company’s name is used as a plaintiff should not obscure substance of litigation. Since C has conduct of action, it will be instructing its counsel as plaintiffs counsel. They will not take instructions from the Corporation (even if same counsel) and corporation should not seek advice from them
* representative acting on behalf of company is not responsible to take care of all of tis interests because they cannot be in fiduciary and adversarial role

### Statutory Derivative Action after BCE

*BCE v 1976 Debentureholders* (2008) SCC

* Normally only the beneficiary of a fiduciary duty can enforce the duty. But in the corporate context, the directors who control the corporation are unlikely to bring an action against themselves for breach of their own fiduciary duty
  + Shareholders cannot control directors other than in votes at shareholder meetings
  + Other stakeholders do not have this privilege
* To address stakeholder interests, special remedies have been developed
* Derivative Action - bringing an action on behalf of the company when directors unwilling to enforce a right of the corporation, including the rights that stem from the directors’ duties to the corporation
* (Also breach of duty of care under s. 122(1)(b), which, unlike fiduciary duty, can be applied to non-shareholder stakeholders)
* Oppression Remedy - focuses on harm to the legal and equitable interests of the stakeholders affected by oppressive acts of a corporation or its directors

**Implications of this case (MacIntosh):** now impossible to distinguish between a personal and derivative action in any meaningful way

* Before, a personal action was when a single shareholder/subset of shareholders was hurt, and a derivative action was when shareholders were hurt indirectly but equally
* Now, hard to see what constitutes harm to the corporation since the SCC said harm to the interests of the corporation should not be confused with harm to the interests of creditors or other stakeholders

### What Can the Court Order in Derivative Actions

* CBCA s. 240/ 247 - the court may make any order including some procedural orders, but also (c) an order directing an amount shall be paid in whole or in part to security holders of the corporation rather than to the corporation
  + the court can say that it is not the corporation that should get the money it is the former or present security holders
* at CL, if SHs say that directors are absolved that is enough but by statutory regulation by reason only that the alleged breach or duty owed to the corporation has been or may have been approved by the Shs is not enough, may be a factor but not conclusive

### Oppression Remedy- single most important remedy

* CBCA s. 241/OBCA s. 248
* A catch-all remedy – a line of first defense. It is a statutory remedy, there is no common law oppression remedy (there was a common law derivative action but not for oppression remedy)
* Available to corporate shareholders and other corporate “complainants”
* the harm alleged in the oppression remedy are acts or omissions BY the corporation, or its affiliates that effects a result, or business or 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, creditors, director or officer” **(IMPORTANT NOTE: OBCA includes threatened harm)**
* a “complainant” as defined by the Act, can bring an oppression remedy
* it is a broad equitable remedy: courts have said this many times : it invokes the courts broad equitable jurisdiction (the jurisdiction to do what is right, not to get tied up in the technicalities of what the law requires, this is really about fairness)
* protection of the “reasonable expectations” of “complainants” (this does not appear in the statute but it is now baked into the Canadian law of oppression- it evolved from common law and the judges interpretation of the statute)
* The corporation or its affiliates conducted itself in a manner that was “oppressive or unfairly prejudicial or unfairly disregarded the interests of a security holder, creditor, director or officer”
  + In *BCE*, tried to reposition the remedy so that people would refocus on the statute rather than solely this judicial reasonable expectation standard
* Derived from UK *Companies Act* 1948 – equitable remedy that could succeed if a minority shareholder could prove that they were oppressed to the point that the corporation would have been ordered to wind up under the old law (because of it being intolerable to work there). It was meant to be a shareholder remedy for people who do not have a controlling interest but that is not what the Canadian one is now. Canadian one is much broader now.
* **key to the remedy:** If a court decided that they were satisfied that a winding up of the corporation could be ordered: instead of winding up, **end the oppression, not the corporation**
  + End the oppression, not the corporation
* Jenkins Committee explained 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 (could not be an isolated event)
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

* Dickerson Committee recommendations:

1. Don’t need to prove company would have wound up
2. No course of conduct requirement – one instance is enough
3. Standard for oppression – complainant does not have to prove extreme company fault – onus has been relaxed so that what they need to prove is unfair prejudice or disregard
4. The Dickerson Committee said the oppression remedy: “will be invoked most frequently- but not always- in respect of a corporation the shares of which are held by only a relatively small number of persons, a so-called “close corporation”, since it usually objective is to remedy any wrong done to minority shareholders”. Therefore oppression remedy applies to both offering and non offering corporations (OBCA) and distributing and non distributing corporation (CBCA)
   1. Most of the cases rarely find strict oppression
5. Complainant does not have to show that it suffered harm in its capacity as a shareholder

* Lawrence Committee (Ontario) recommended that the oppression remedy raises as many problems as it solves and is creeping socialism (like BJR, businesspeople should run things unimpeded). Today, however, Ontario has one of the most severe oppression remedies.
* CBCA Oppression Remedy now:
  + gives court broad remedial powers which “have one common object: to enable the court to apply a remedy that will offer continuing relief or indemnity to the complainant and, at the same time, render unnecessary the liquidation and dissolution of the corporation, which in practice often constitutes…”
* Why bring an oppression remedy instead of derivative action?
  + Avoid leave requirement
  + Access to court’s broad power when it comes to oppression remedy
* Oppression remedy is an application rather than an action
  + But the Courts will sometimes convert it into an action if it is complex

s. 238/245 “Complainant” definition same definition as derivative action: (a) 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, or (d) any other person who, in the discretion of a court is a proper person to make an application under this Part

* However, in derivative action, “proper person” means someone who can represent the interests of the corporation and is defined my more narrowly than here
* 80% of oppression remedies are shareholders (Puri, Ben-Ishali)
* 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)

s. 241(1)/248(1) Complainant can apply to the court for an order. (in the case of offering corporation under OBCA, the Commission can also bring a complaint

s. 241(2)/248(2)  **The complainant must satisfy one of three enumerated grounds for an oppression remedy:**

* (a) Act or omission by the corporation/affiliate affected a result
* (b) Business or affairs of the corporation/affiliate have been conducted in a manner
* (c) Powers of the Directors of the corporation/affiliate were exercised in a manner
* that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to ratify the matters complained of

Courts have very broad power as to what they can order in oppression remedy cases.

s. 241(3)/ 248(3) **– Court can order:**

* (c) – to regulate corporation’s affairs by amending articles or by-laws or creating or amending a unanimous shareholder agreement
  + court can make a USA and say not only are the subject to the law but that they have agreed to this agreement
* (e) – to appoint directors in place of or in addition to all or any directors
* (h) – to vary or set aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract
* (j) – to compensate an aggrieved person
  + does not necessarily have to be the complainant
* But this is interesting – why would any proper person be able to make a claim, yet the oppression has to be shown to be against one of these categories of people? (see *Nannef*)

OBCA s. 248

* Same as the CBCA onus on a claimant, but it adds “threatened” oppressive/unfair acts as valid grounds for a claim – easier for a complainant to claim
  + Applies not only actions that have occurred, but also those that have been threatened to occur
  + Makes the OBCA particularly broad

## **BCE v 1976 Debentureholders (2008) SCC** – Oppression = reasonable expectations of the complainant were violated by conduct that falls within “oppressive/unfair prejudice/disregard

Facts: BCE Inc was the subject of multiple offers involving a leveraged buyout, for which an auction process was held and offers were submitted by 3 groups. All three offers contemplated the addition of a substantial amount of new debt for which Bell Canada, a wholly owned subsidiary of BCE, would be liable. One of the offers, which involved a consortium of 3 investors, was determined by BCE’s directors to be in the best interests of BCE and BCE’s shareholders. This was to be implemented by a plan of arrangement under s. 192 of CBCA which was approved by 97.93% of BCE’s shareholders, but was opposed by a group of financial and other institutions that held debentures issued by Bell Canada. These debenture holders sought relief under the oppression remedy under s. 241 of CBCA. They also alleged that the arrangement was not “fair and reasonable” and opposed s. 192 approval by the court. Their main complaint was that, upon the completion of the arrangement, the short term trading value of the debentures would decline by an average of 20% and could lose investment grade status.

Prior Proceedings: Superior Court of Quebec approve the arrangement as fair and dismissed the claim for oppression. The Quebec Court of Appeal held that the arrangement had now been shown to be fair and held that it should not have been approached, that the directors had not only the duty to ensure that the debenture holders’ contractual rights would be respected but also to consider their reasonable expectations, and since the requirements of s. 192 of the CBCA were not met, the court found it unnecessary to consider the oppression claim. BCE and Bell Canada appealed the overturning of the TJ’s approval of the plan of arrangement, and the debenture holders cross appealed the dismissal of the claims for oppression.

Held: In a unanimous decision, the SCC ruled that the appeals should be allowed and the cross appeals dismissed.

Reasons: Held that the s. 241 oppression action and the s. 192 requirement for court approval of a change to the corporate structure are different type of proceedings, engaging different inquiries. The CA’s decision sets on an approach that erroneously combined the substance of the s. 241 oppression remedy with the ones of the s. 192 arrangement approval process, resulting in a conclusion that could not have been sustained under either provision, read on its own terms. Court held that in assessing a claim of oppression, a court must answer two questions: (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? Where conflicting interests arise, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, “viewed as a good corporate citizen”.

* Debenture holders’ s. 241(2)(c) oppression claim: BCE’s directors exercised their powers in a way that was in disregard of its security holders
* Oppression remedy protects not just what is legal, but what is fair (i.e., equitable) – thus, courts should look at business realities, not merely narrow legalities
* 2-step test:
  + (1) Evidence must establish a complainant’s expectation and that the expectation was objectively reasonable based on the facts
    - Reasonableness is tough to decipher corporation and shareholders are entitled to maximize profit, but not by treating individual stakeholders unfairly
    - Stakeholders’ reasonable expectation is simply that the directors act in the best interests of the corporation
  + (2) Reasonable expectation must have been thwarted in a manner that was oppressive, unfairly prejudicial, or unfairly disregarded complainant’s interest
    - Included this second point because SCC was troubled that cases were only relying on thwarting of reasonable expectations and ignoring statute. MUST anchor this standard with the *Act* to establish oppression/unfair disregard/prejudice
* **Court found that there was no oppression:**
  + Corporations have many groups of interested parties; there will almost always be conflicting subjective standard for what each group thinks they were owed reasonably
* **Note:** Oppression was not argued by P or D. Argued on grounds of satisfaction/dissatisfaction of s. 192 of CBCA.

## **Ebrahimi v Westbourne Galleries Ltd (1973) – UK**

* Instead of confining minority interests to the rights they had explicitly contracted for, shareholder expectations may be a source of rights as well
* Emphasized that corporations have human beings behind them – must not forget this. This is the core reason why we have the oppression remedy
* The oppression remedy recognizes that, behind a corporation, there are individuals with “rights, expectations and obligations inter se which are not necessarily submerged in the company structure”
* the remedy of oppression was described as, “The words [“just and equitable”] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.”

## **Peoples Department Stores Inc v Wise (2004) – SCC**

* SCC referred to availability of oppression remedy to creditors, endorsing the statement that “The oppression remedy of s. 241(1)(c) of the CBCA and the similar provisions of provincial legislation regarding corporations grant the broadest rights to creditors of any common law jurisdiction”
* this case concerned the latitude of discretion accorded to corporate directors, providing that they follow certain procedural steps.

## **Budd v Gentra Inc**

* the personal liability of directors under the oppression remedy was looked at in this case
* Judge rejected the proposition that common law principles as to when directors will bear personal liability applied equally in an oppression case and rejected the view that a director’s conduct must reveal a separate identity or interest from that of the corporation by falling outside the normal scope of their duties in order to attract personal liability
* **Held:** A director or officer may be personally liable for a monetary order.. if that director or officers is implicated in the conduct said to constitute the oppression and if in all of the circumstances, rectification of the harm done by the oppressive conduct is appropriately made by an order requiring the director or officer to personally compensate the aggrieved parties
* two requirements of the *Budd* test:
  + (1) That the director or officer must be implicated in the oppressive conduct meaning the oppressive conduct must be attributable to the individual director because of their action or inaction
  + (2) The order must be fit in all of the circumstances
* five situations in which personal orders against directors might be appropriate:
  + (1) where directors obtain a personal benefit from their conduct
  + (2) where directors have increased their control of the corporation by the oppressive conduct
  + (3) where directors have breached a personal duty they have as directors
  + (4) where directors have misused a corporate power
  + (5) where a remedy against the corporation would prejudice other security holders
  + (6) in closely held corporations where a director or officer has virtually total control over the corporation \*\* (maybe)

## **Ernst & Young v Essar Global Fund Ltd, 2017 ONCA 1014**- Oppression + Derivative Remedies not mutually exclusive

* the derivative action and the oppression remedy are not mutually exclusive and that there may be circumstances giving rise to overlapping derivative actions and oppression remedies where harm is done both to the corporation and to stakeholders in their separate stakeholder capacities.
* The wrong must both harm the corporation and must also affect the claimant’s “individualized personal interests”. The individualized harm is to be distinct from conduct harming only the body corporate, i.e., the collectivity of shareholders as a whole and the complainant must be directly affected “in a manner that was different from the indirect effect of the conduct on similarly placed complainants”
* It does not mean the type of harm suffered by claimant has to be different from the individualized personal harms suffered by others in the same class to pursue an oppression remedy.
* Referred to *Rea v Wildeboer*, “Consistent with a number of other authorities, this court expressly re-affirmed the principles that the derivative action and the oppression remedy are not mutually exclusive and that there may be circumstances giving rise to overlapping derivative actions and oppression remedies where harm is done both to the corporation and to stakeholders in their separate stakeholder capacities”

### Meaning 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

## **Westfair Foods Ltd v Watt (1991) – Alta CA**

**Facts:** A corporation applied for declarations determining the rights and obligations attached to the Class A preference shares and the common shares of the corporation. A group of Class A shareholders applied under s. 241 of the CBCA, claiming the corporations policies respecting dividends and borrowing were oppressive and unfairly prejudicial to and disregard the interests of the Class A shareholders. A Class A shareholder applied under the Act for an order liquidating the corporation or, alternatively, for an order that the corporation buy out all Class A shareholders at a fair price. The actions were consolidated.

**Prior Proceedings:** Alberta Court of Queen’s Bench held that the dividend and borrowing policies unfairly prejudiced and disregarded the interests of Class A shareholders. The court ordered that the corporation purchase all Class A shares at a value to be determined by a court-appointed auditor or accountant. The corporation appealed.

**Held: Appeal dismissed and force purchase order confirmed.**

**Reasons:** The court disagreed that the dividend and borrowing policies unfairly prejudiced the interests of Class A shareholders (no oppression). The court did not find that the corporation unfairly disregarded the interests of the preference shareholders.“We regulate voluntary relationships by regard to the expectations raised in the mind of a party by the word or deed of the other, and which the first party ordinarily would realize it was encouraging by its words and deeds. This is what we can reasonable expectations, or expectations deserving of protection”

## **Wilson v Alharayeri – SCC** – when a director can be found personally liable in an oppression case

**Facts:** Appellant is a public corporation that had 2 classes of shares – class A shares 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.

**Reasons:** SCC considered when it is “fit” to hold a director of a corporation personally liable for oppressive conduct. Courts must be broad and liberal about interpreting “unfair, oppressive, or prejudicial.”

* The complaint here is not from a minority who has been outvoted, but rather an entire class of shares in competition with another class of shares
* Reasonable expectations:Shareholders enter a relationship with a company voluntarily – voluntary relationships must be regulated by regard to the expectations raised in the mind of a party by the word or deed of the other, and which the first party ordinarily would realize it was encouraging by its words and deeds
  + Always fact-specific
* Here, 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

### Meaning of “Oppression”

## **Brant Investments Ltd v KeepRite Inc (1991) – ONCA**

* Do not need to show “want of probity” [i.e., do not need to show that there was a legal wrong] (echoes *Westfair*)
  + this is just another way of saying that you do not have to show that the oppression was the result of a wrongful act, it is the effect that matters you just have to show that you have suffered
* Oppression remedy is all about effects, not intention/motivation of perpetrators
* There is no requirement of a lack of *bona fides* when assessing unfair treatment – sometimes lack of *bona fides* will indicate unfair treatment, but there are also cases of unfair treatment where there has been no bad faith whatsoever on the part of the actors

## **Diligenti v RWMD Operations Kelowna Ltd (1976) – BCSC**

**Facts:** D was one of four partners in a business that was formed to operate a Keg and Cleaver restaurant in Kelowna. Later acquired a second franchise in Prince George. D was entitled to remuneration for his managerial duties; claimed to have done the main work in obtaining franchises and getting them going. Disagreements arose. D ousted. Removed as a manager at a shareholders’ meeting, as a director. Other 3 directors formed management company + charged restaurants a 2 1/2 % management fee for managing business. D sued under oppression remedy.

**Held:** D’s equitable rights had been interfered with in his removal as a director. No explicit agreement for all shareholders to participate in management. No longstanding partnership between shareholders.“Unfairly prejudicial” is broader than “oppressive” – imports notion of equitable rights – Diligenti’s equitable rights had been interfered with in his removal as director, and this constituted unfair prejudice

* The whole business began as a joint venture partnership, with each of 4 partners sharing equally in continuing management and direction of affairs
* There are rights, expectations, and obligations – among the rights are the rights to continue to participate in the direction of the company’s affairs
* Diverting money and disallowing Diligenti from all enjoyment of such moneys is *prima facie* evidence of an act at least unfairly prejudicial, if not oppressive, to him

## **Ferguson v IMAX (1983) SCC** – Private Corp Oppression = mala fide disregard of minority interests

Brooke JA – Oppression within private corporations is usually a question of *bona fides* – here, did the oppression come about as a result of the personal relationship between the small group of shareholders, or was it a valid decision made as a good corporate citizen?

* As a business matter, P had not done anything to hurt the business. She was ‘sacrificed’ by the business as the ex-wife of one of the shareholders and the Court said that is not allowed

**Facts:** Imax was incorporated to exploit the IMAX film technology and the original shareholders were several couples. Husbands were given common voting shares and the wives were given non-voting preferred shares. F divorced and the company dismissed her and attempted to squeeze her out through the pressure of the ex-husband. She brought an action under the oppression remedy.

**At Trial:** Held President/CEO and chairperson of the audit committee personally liable for respondent’s loss, as they were the only 2 people on the audit committee. They used their influential position to advocate against converting respondent’s shares.

**Issue:** What extent of conduct is covered by oppression?

**Ratio:** Oppression is not simply a codification of the common law standard – it is broader and should be interpreted as such in an enabling manner. Each case turns on its own facts – what is oppressive or unfairly prejudicial in one case may not necessarily be so in the slightly different setting of another. The relationship between the parties is important – look to the history of transactions, is the impugned corporate action *bona fide*? Here it was a closed corporation and the actions were obviously for the sole purpose of ousting the ex-wife – the resolutions made by the shareholders were declared invalid.

**Held:** Appeal dismissed, for Mr. Alharayeri.

**Reasons:** An order made under s. 241(3) [oppression remedy] should go no further than necessary to correct the injustice or unfairness between parties

* Rule: (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’? The following circumstances:

(a) where directors obtain a personal benefit from their conduct;

(b) where directors have increased their control of the corporation by the oppressive conduct;

(c) where directors have breached a personal duty they have as directors;

(d) where directors have misused a corporate power; and

(e) where a remedy against the corporation would prejudice other security holders.

* + However, “the oppression remedy exists to rectify harm to the complainant. It is not a gain-based remedy. Treating a personal benefit as a necessary condition to a director’s personal liability inappropriately emphasizes the gain to the director, at the expense of considering the oppressive conduct leading to the complainant’s loss.”
* 4 general principles:
  + (1) Must be fair
  + (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.

### Overlap Between Oppression Remedy and Derivative Action

* Dickerson Committee: “Scrutiny of these examples show that there is no clear dividing line between the cases. Diversion of corporate profits is clearly a wrong to a corporation that normally would be remedied by a derivative action…a refusal to declare dividends in order to squeeze out minority shareholders would call for an application for an oppression remedy. But the payment of excessive salaries to dominant shareholders who appoint themselves officers is a borderline case: it may constitute a wrong to the corporation and at the same time may have as its specific goal the squeezing out of minority shareholders…In such case the aggrieved person [complainant] may select the remedy that will best solve its problem.”
* Dickerson Committee said that the plaintiff can choose the best one for them and their specific action
* *Malata v Jung* (2008) – ONCA
  + In a small privately-held company, will be a lot of overlap, but can often bring as an oppression remedy (i.e., derivative action gives way to oppression remedy)
  + Also, the small number of shareholders in a closely-held company minimizes the risk of frivolous lawsuits against the corporation, thus weakening the main rationale for requiring a claim to proceed as a derivative action
  + Although there is “not a bright line distinction between the claims that may be advanced under the derivative section… and those that may be advanced under the oppression remedy provisions”
* *Rea v Wildeboer* (2015) ONCA – narrows *Malata* 
  + While there may be overlap in closely-held corporations, have not obliterated the use of derivative action (i.e., when there is harm to the corporation rather than the complainant)
  + True that the two are not mutually-exclusive, but need to differentiate when it comes to public corporations
    - The leave requirement of derivative actions is important to (i) prevent strike suits; (2) prevent meritless suits; (3) avoid multiplicity of proceedings
    - These concerns are less acute for closely-held corporations
  + “Where… the claim asserted seeks tor recover solely for wrongs done to a public corporation, the thrust of the relief sought is solely for the benefit of that corporation and there is no allegation that the complainant’s individualized personal interests have been affected by the wrongful conduct” such a claim must be pursued by way of derivative action (and therefore be subject to the requirement to obtain leave of the court)
  + To pursue a claim for an oppression remedy, “the harm mist impact the interests of the complainant personally - giving rise to a personal action - and not simply the combinant’s interests as a part of the collectivity of stakeholders as a whole”
  + If you want an oppression remedy the harm MUST have injured the complainant personally – must have suffered harm in some way different than the collective shareholders
    - That is not the case here
    - Cannot use oppression remedy to sidestep the requirement to obtain leave for derivative action

### Oppression Remedy the Better Strategy (Puri and Ben-Ishai)

1. Oppression remedy may be commenced by application, without pleadings or discovery, and as a result may proceed more quickly if no significant factual issues
2. Oppression remedy relief is broader and more flexible
3. Canadian law blurry on the nature and type of fiduciary duties owed to non-shareholder stakeholders

**Questions for Thought:**

1. Do the oppressed interests have to be those of the complainant him/herself? **- no they do not**
2. What is the relationship between fiduciary duty, the business judgment rule, and oppression? - if I do something honestly and in good faith and it has an effect that someone does not like can I be sued for oppression?
   1. Old rule was that oppression was totally separate from fiduciary duty – could still have an oppression remedy even if everyone acted in accordance with their duty (since oppression remedy is about effects)
   2. But newer cases suggest a link between the two, fundamentally undermining that oppression remedy is about effect and not motivation of its perpetrators
      1. The acts of senior officers are, in effect, acts of the corporation. Thus, acts of officers that are breaches of fiduciary duty are also drawn into the oppression remedy
      2. Allegations of breach of fiduciary duty often accompanied by allegation of oppression
   3. *Slowly, oppression remedy slowly swallowing up the law of fiduciary duties* since breach of fiduciary duty is almost certain to be characterized as oppression, the oppression remedy offers a broader substantive cause of action than does the law of fiduciary duties. The remedies available are broader. The courts have allowed derivative-type actions to proceed under oppression provision

### Compliance Order – CBCA s. 247/OBCA s. 253

* if a corporation or its directors or officers are not acting in compliance with the Act, its bylaws or UAM then a complainant or a creditor can get an order saying make them comply with the act, regulations or bylaws
* not used often b/c no money in it, they are just forced to do what they are supposed to be doing anyways

# Corporate Law Quick Sheet

### General Partnerships (Partnership Act)

1. Partnership is the relation that subsists between persons carrying on business in common with a view to profit (*PA s. 2*)

(a) If partners incorporate, they are no longer in a partnership

1. Just because you own property together with someone else, does not necessarily mean you are in a partnership (*AE LePage*)
2. Profit sharing does not, by itself, prove a partnership (*Cox*)
3. If you do all of the things that the law says denotes a partnership, you are in a partnership whether you understood all the legal ramifications or not (*Westlock Foods*)
4. A partnership is not a separate entity, it is just a collection/aggregate/relationship of individuals (*Thorne, Lee*)
5. Corporations can be in partnership with other corporations because corporations are persons

### Other Types of Partnerships

1. A sole proprietorship is run by one person and that person is exposed to unlimited liability
2. A General partnership exposes all partners to unlimited liability and is governed by fiduciary responsibility (*Partnership Act*)
3. LPs can only be sued for the difference between what they have agreed to invest and what they have already invested
4. If a limited partner takes control of the business of a partnership they comes a general partner and they are exposed to unlimited liability, unless they contract out of it (*Haughton, Nordile*)
5. A limited partner is not the same as a limited liability partnership
6. in a LLP each partner is liable only for the errors and omissions of themselves and the people working directly under them
7. ULC in which shareholders do not have limited liability operate in Nova Scotia, Alberta and BC
8. LLC offer limited liability for ever member even if they conduct the business of the company, operate in USA only.

### Corporate Characteristics across All Countries

1. Separate Legal Entity (Salomon)
2. Limited Liability for Shareholders
3. Perpetual existence
4. Transferability of Shares
5. Centralized Management

### Key Aspect of Incorporation

1. Cannot have the same name as another corporation
2. The corporate name must have a cautionary suffix
3. A corporation can do business as a business name, which is what the public will know them as
4. Private issuers are entitled to an exemption under the securities act so they do not have to have a prospectus, but they must have less than 50 shareholders (not including employees or former employees)
5. When a corporation becomes insolvent, the secured creditors get paid first
6. Debt before Equity (*People’s Department Stores*)

### Piercing the Corporate Veil

1. Corporations are legally separate and distinct from the shareholders, employees, directors, operators and agents running them (*Companies Act 1862*, *Salomon*)

(a) Even if the only employee is also the only director of the corporation (*Lee*)

1. If a person chooses to advertise and hold himself out to the public without identifying the name of the company with which he is associated, he runs the risk of being held personally liable (*Moir*)
2. Employees not personally liable when acting within scope of their duties, except under very specific circumstances. eg. committing a tort (*Said*)
3. Officers, directors and employees of a corporation are responsible for their tortious conduct even though that conduct was directed in a bona fide manner to the best interests of the company, always subject to the Said v Butt exception (*ADGA*)
4. The mere fact that the employee is performing the “very essence” of a contract between the plaintiff and his or her employer does not, in itself, necessarily preclude a conclusion that a duty of care was present (*London Drugs Ltd*)
5. Outlier? - Directors and officers cannot be sued unless they exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own (*Scotia McLeod)*
6. The corporate veil will be lifted when the corporation was a sham (*Clarkson*)

(a) The corporate veil will be lifted when the corporation was just an agent (*Clarkson*)

1. The corporate veil cannot be listed using equitable principles (*Transamerica*)
2. Even when a plaintiff against a corporation should be able to collect damages but cannot, the human running the corporation is still not liable (*Rockwell, Walkovsky*)
3. Parent companies may establish subsidiaries to protect them from tort liability (*Transamerica*, *Cape*)
4. The corporate veil will be pierced when it works an injustice in family law (*Lynch*)

### Criminal and Tort Liability

1. Corporations can commit crimes and torts (*Liebeck v McDonald’s Restaurants*- 1994)
2. Identification Doctrine: For mens rea offences, the directing mind and will of a human who has policy making authority or manages a significant portion of the business counts as the mens rea (*Canadian Dredge & Dock Co*)
3. Why should we hold corporations criminally responsible at all? Because they are capable of carrying out actions that deserve the social stigma of a criminal conviction
4. For criminal responsibility see CC RSC 1985 Section 22.1(a)(ii)

### Corporate Contracts at Common Law

1. Agents of a corporation may legally bind the corporation, but not if the corporate entity does not (yet) exist (*Kelner*)

(a) Pre-incorporation contracts are generally not valid, a fresh contract must be created

(b) Where there is a pre- incorporation contract, and both parties knew there was no corporation, but had intention to be bound by the contract, the promoter can be personally liable (*Kelner*)

(c) Where there is a pre-incorporation contract and one or neither of the parties knows that there is no contract, there can be no intention to be bound and therefore, the promoter cannot be personally liable (*Smallwood, Shatsky*)

1. Corporations sign documents per executive officers or by seal
2. The people who can sign documents are limited

### Corporate Contract Statutory Reform

1. Humans who sign on behalf of corporations that do not exist incur personal liability under the contract (CBCA s. 14)
2. Corporations can adopt pre-incorporation contracts (CBCA s. 14(2))
3. Restrictions on who can bind the corporation in the articles of incorporation re not considered to be known by everyone who contracts with the corporation (CBCA s. 17)

(a) If the contracting party had actual knowledge that the individual could not sign on behalf of the corporation, the contract will not be valid.

1. The corporation cannot say that someone they held out to be a director/ agent later was not b/c is suits them (S. 18(1) and (2))

(a) Someone with actual authority must lead you to believe that another person without actual authority has authority

(b) It is sometimes possible for the agent themselves to hold themselves out to be an agent of the corporation - there are a few number of cases where it would be very unfair to the plaintiff to follow the rule strictly

(i) e.g. the agent had authority but lost it in the middle of negotiations and signed a contract, the contract will still be valid. This is an example of ostensible authority.

### Corporate Finance

1. Balance sheets are helpful but not determinative in showing how much a company is worth
2. Shareholders equity= assets - liabilities

(a) more assets than liabilities = positive shareholders equity (how much they can distribute to shareholders

(b) Retained earnings= cash

(c) Payable = liabilities = bills not paid yet

(d) Contributing surplus = what shareholders have generated in excess of the amount paid for shares

(e) Absorption of another company accumulated other comprehensive income

1. Assets= liabilities + equity
2. Net income/loss= revenues - expenses
3. At least one class of shareholders must have the right to vote in the directors
4. Shares must be non-assessable - they can only ever be assets, never liabilities (CBCA s. 25(2))
5. A share is not fully issued unless it is fully paid for (There are cases that go both ways on this)
6. Lenders can sue a corporation if the corporation doesn't pay interest, but shareholders cannot sue a corporation for not paying out dividends

(a) The issuance of shares by a corporation does not give rise to pre-emptive rights (*Harris v Sumner)*

(b) Shareholders can sue on the basis of managers not managing in good faith or on the basis of oppression(CBCA s. 241)

1. If the directors are acting honestly and in good faith, they are able to issue rights offerings even tough they will dilute the value of the shares of shareholders (*Olson*)
2. All shares are equal and equitable, even if they are labelled “preferential” unless the articles say otherwise (Birch, Ontario securities Commission, CBCA s. 28)

(a) Or adopted by USA (OBCA s. 26)

### Shares

1. Shareholders who are unhappy can exit or voice
2. Not every shareholder can bring a proposal under CBCA, but any shareholder can bring proposal under OBCA
3. The articles of association/by-laws are the paramount way through which directors’ activities are directed, shareholders with regard to the rights the shareholder holds (*Kelly, Automatic Self-Cleaning Filter*)
4. Only different classes of shares can have different voting rights, all shares within the same class must be treated equally with regard to the rights the shareholder holds (*Bowater*)
5. The matters normally dealt with at shareholder meetings can be dealt with through unanimous shareholder resolutions (*Eisenberg*)
6. At a shareholders meeting the majority must not be tyrannical, but if there is a majority they will be preferred (*Wall*)
7. Canadian Common Law: the issuance of shares by a corporation does not give rise to pre-emptive rights (*Harris* *v* *Sumner*)

### Corporate Governance

1. Shareholders elect directors, directors oversee management

(a) Shareholders fire directors when they don’t think that they are effectively reeling in the managers

1. When the managers and owners are different people, agency costs are incurred

(a) Monitoring costs

(b) Bonding costs

1. Separation of ownership and control allows managers to shirk and shark
2. The directors call annual shareholder meetings (CBCA s. 133)
3. Shareholders who are unhappy can exit or voice
4. Not ever shareholder can bring a proposal under CBCA, but any shareholder can bring a proposal under OBCA
5. The articles of association/by-laws are the paramount way through which directors’ activities are directed, shareholders with regard to the rights the shareholder holds (*Kelly, Automatic Self-Cleaning Filter*)
6. Only different classes of shares can have different voting rights, all shares within the same class must be treated equally with regard to the rights the shareholder holds (*Bowater*)
7. The matters normally dealt with at shareholder meetings can be dealt with through unanimous shareholder resolutions (*Eisenberg*)
8. At a shareholders meeting the majority must not be tyrannical, but if there is a majority they will be preferred (*Wall*)
9. Canadian Common Law: the issuance of shares by a corporation does not give rise to pre-emptive rights (*Harris* *v* *Sumner*)

### Directors and Officers

1. Officers of the corporation are appointed by Directors (CBCA s. 121, OBCA s. 133)
2. Directors can delegate their authorities to officers, within some limitations (CBCA s. 115(3))
3. A corporation cannot be the director of another corporation (CBCA s. 105(1)(c))
4. A corporation must have at least 25% of the directors be Canadians

(a) Where there are less than 4 directors, 1 must be Canadian

1. A distributing corporation must not have fewer than three directors, at least 2 must not be officers or employees (CBCA s. 102(2))
2. Directors are removed through ordinary resolution (CBCA s. 109)
3. Directors that issue shares for value other than money are personally liable for the difference in value if the shares are issued for less (CBCA s. 118)
4. Directors are personally liable for wages not paid to employees (CBCA s. 119, OBCA s. 131)

(a) They are also personally liable for not remitting taxed from employees’ paycheques to the government

1. CBCA s. 122: Directors must act honestly and in good faith with a view to the best interests of the corporation, and exercise the care, diligence and skill that a reasonably prudent person would exercise in similar circumstances
2. The common law standard for director duty of care was very lax (*City Equitable Fire Insurance Co Ltd, Re Brazilian Rubber Plantations and Estates, Ltd*)
3. The duty of loyalty does not extend to creditors. So long as the directors act in the best interests of the corporation, even if creditors take a loss, the directors are not personally liable for their decisions

### The Business Judgement Rule

1. Delaware Business Judgement Rule: the court asks is there any possible business reason for the decision. This is a complex rule where judges refer to the decisions of officers and directors unless there are specific circumstances, in which case they have two other rules they can use
2. The Canadian Business Judgement Rule is still evolving and is not nearly as carefully developed as the Delaware version, but it is much less deferential to directors and officers. Canada does not have the same robust presumption that directors made decisions on a reasonable basis

(a) Looks like Delaware Enhanced Scrutiny rule

1. The courts can overrule decisions by directors and officers if the process was bad (*Gorkom*)
2. Judges look to see whether directors made a reasonable decision, not a perfect one (*UPM*)

(a) In general, judge do not second guess the honest good faith decisions of managers

(b) Directors must exercise diligent judgement in order to be protected by the BJR

(c) Process is more important than substance

(d) Examination, but not microscopic examination

(e) Directors are only protected to the extent that their actions evidence their decision (UPM)

(f) The relevant question is whether the directors of the target companies took steps to insulate themselves from the conflict. Usually this takes the form of a separate committee with no officers of the corporation on it (*Brandt*)

1. Making no decision is not protected

### Interested Directors Contracts

1. AT COMMON LAW: whenever a director enters into an interested directors contract, it is violable unless the articles say otherwise
2. CBCA SECTION 120: detailed protocol for dealing with interested directors contracts

(a) Disclosure: Your colleagues must know the full extent of your conflict, whether it is personal or another corporation that you are a part of (CBCA s. 120(1))

(b) Time of Disclosure (Directors): Directors must disclose their interest at the first opportunity (CBCA s. 120(2))

(i) Disclosure only needs to be made once (CBCA s. 120(6))

(c) Time of Disclosure (Officers): Officers must disclose their interest at the first opportunity by advising the board (CBCA s. 120(3))

(d) Voting: interest directors must recuse themselves from a vote in which they have an interest, unless it is the directors own salary, their indemnity or insurance, or with an affiliate (CBCA s. 120(5))

(e) Reasonable and Fair: Directors and officers do not have to disclose if the contract is reasonable and fair (CBCA s. 120(7))

(f) Shareholders: If there was a failure to disclose when the contract was approved, the shareholders can confirm the contract by special resolution (CBCA s. 120(7.1))

### Corporate Opportunities

1. If the corporation ejects the opportunity, the directors are at liberty to pick it up (*Peso*)
2. Directors’ duty survives even if they are no longer a director (*Krasinski*)

### To Whom is the Fiduciary Duty Owed?

1. Economic Model: There is agreement that the purpose of a corporations Shareholder Wealth Maximization (Craiglist [US])

(a) So long as they operate within the bounds of law and morality- the precondition of internalizing externalities

1. The best interests of the corporation should be read not simply as the best interests of the shareholder. There is no shareholder primacy in Canada (*Peoples*)
2. When a company is close to insolvency, the directors must consider the interests of the debenture holders and weigh it against everything else to make a good decision (*BCE*)

### Types of Corporations

1. Most corporations are small private corporations
2. The rules for corporations under the CBCa and OBCA are the same for all corporations except for 10 exceptions:

(a) Proxy rules

(b) Auditors

(c) Number of directors

(d) Audit committees

(e) Insider trading rules

(f) Notice of annual meetings

(g) OBCA proxies

(h) Filing annual financial statements

(i) Compulsory Acquisitions

(j) Share transfer restrictions

1. In private companies, a USA removes power from the Directors of a corporation (CBCA s. 146) so they can order things the way they would just like a partnership agreement

(a) Directors may or may not be liable, it is undecided

1. Directors can exercise their discretion completely as long as they are acting bona fide in the best interests of the company (*Smith v Fawcett*)

### Derivative Actions

1. The corporation is the wronged person, a shareholder or stakeholder can step into shoes of the corporation and sue

(a) A stakeholder other than a shareholder may bring an action

(b) A shareholder that was not a shareholder at the time of the wrong may bring the action

1. The rule in *Foss v Harbottle*: In any action in which a wrong is alleged to have been done to a company, the proper claimant is the company itself

(a) Secondary rule: Where the corporation has been harmed by an action where the shareholders could have ratified it, the shareholders cannot bring an action

1. Exceptions to *Foss v Harbottle*: The derivative action, where a minority shareholder may sue on behalf of company
2. Derivative Action Procedure:

(a) A shareholder bringing an action must give 14 days notice to the directors

(b) Directors must deny to bring the action then apply for leave, get approval from the court to bring the action, then bring the action

(c) The court must deem that the complainant’s interests are synonymous with the corporation’s interests (*First* *Edmonton* *Place*)

(d) Complainant must be acting in good faith

1. Complainant may seem an interim cost order (*Turner*)

### Oppression Remedy

1. Under the right set of circumstances, a creditor can bring an oppression application (*Royal Trust, Peoples*)
2. Under the right set of circumstances the corporation may bring an oppression action (*Calmont, Gainers*)
3. Oppression Act does not require oppression, it requires oppression, unfair predjudice, or unfair disregard (*BCE*)