**LAW459: Business Organizations**

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Sole Proprietorship

**Advantages:**

* Easy
* Inexpensive
* Full control over biz
* Tax benefit – if the business is losing money the sole proprietor can use the losses as deductions for personal income

**Disadvantages:**

* Unlimited liability → personally liable for all debts of the biz
* If SP wants to sell the biz, has to transfer the title of each individual property (real estate, cars, etc.) [Unnecessary w/corp.]
* Tax disadvantage – if the biz is profitable, usually pay higher taxes as SP than if it was incorporated
	+ Ex. lowest SP taxes = 19-26%; lowest incorporated taxes = 16-22%

Law of Agency

3 major players: **principal, agent, and third party**

FIRST QUESTION: WHEN DOES AN AGENCY RELATIONSHIP EXIST?

* Principal manifests assent to the agent that the agent should act on behalf of principal and subject to principal’s control
* Ex. investor hires professional managers to manage investments = professional agents of the investor

3 Elements to Form Agency

1. Consent by principal & agent
2. Action by the agent on behalf of the principal
3. Control by the principal

**NOTE: all must be present to = agency relationship**

*Basile v. H&R Block* (2000 - Pennsylvania) – Creation of Agency Relationship

Facts: B used ‘Rapid Refund’ program at H&R; received refund anticipation loan (RAL) from Melon Bank that H&R arranged for its customers. B filed class action against H&R/MB alleging that MB worked w/ H&R to deceive customers as to true nature of the loan. H&R didn’t disclose to RAL customers that it received payment from MB for each loan, shared in the profits of RAL, or that taxpayer’s endorsement on back of the loan proceeds check = signature on a loan agreement printed on reverse of check.

Issue: Did B have agency relationship w/H&R?

Ratio: **action that creates agency relationship must be a matter of consequence or trust. Facilitating a transaction doesn’t necessarily create an agency relationship.**

* H&R didn’t choose which option was pursued in the return process, customer did.
* H&R didn’t have ability to legally bind the customer w/o their consent (signature)

Dissent: Focused on **control** → agency relationship existed for preparing tax returns b/c H&R subject to control of customer

* H&R couldn’t file return w/o customer’s signature (analogous to control of principal over agent)
* Agent has duty to provide relevant information to the principal

WHAT DUTIES DOES AGENT OWE PRINCIPAL?

* Provide relevant info to the principal
* Obey instructions of the principal
* Act w/due care
* Act w/diligence, normally exercised by agents in similar circumstances unless the agent has special skills or knowledge
* Duty of loyalty

*Food Lion v. Capital Cities/ABC* (1999 – US Court of Appeal) – Governance Between Principal & Agent

Facts: 2 ABC reporters used false resumes to get jobs at Food Lion and secretly videotaped what appeared to be unwholesome food handling practices. ABC used some of the footage in a Prime-Time Live broadcast that was sharply critical of Food Lion. FL didn’t sue for defamation, but focused on how ABC gathered its info through claims of fraud, breach of duty of loyalty, trespass, and unfair trade practices.

Issue: can the reporters be held liable for breach of duty of loyalty to FL?

Analysis:

* 3 circumstances where disloyalty = tortious:
	1. When an employee competes directly w/employer (either solo or as agent of rival company)
	2. When employee misappropriates employer’s profits, property, or biz opportunities
	3. When employee breaches employer’s confidences (ex. stealing trade secret)
* Conduct of defendants doesn’t fall into above categories, but it’s comparable → interests of ABC were adverse to FL in fundamental way, even though they weren’t direct competitors

Ratio: **Must be intent to act against interest of 2nd employer, for the benefit of main employer, to be held liable in tort for disloyalty**

BINDING THE PRINCIPAL TO THIRD PARTIES

Liability in Tort

* Where a principal authorizes agent to engage in conduct that is tortious, principal is liable even though principal may not have intended conduct to be tortious (ex. intentional torts that don’t involve physical injury to people or property)
* Principal also liable for torts committed by agent acting w/apparent authority where ability to commit the tort is sufficiently related to the agency relationship (ex. misrepresentation, defamation, conversion)
* Agent rarely has actual authority to commit torts that cause physical injury to persons/property - usually too remote from agent’s apparent authority to render principal liable
* However, there are exceptions: **vicarious liability**

**Question: whether the principal is responsible for the agent’s act?**

* Distinguish between principal’s own negligence and liability for agent’s tort
* When 3rd party wants to hold principal liable, is it b/c of the principal’s own negligence or through vicarious liability?
* Is the agent an employee or independent contractor?

*Fisher v. Townsends* (1997 – Delaware) – Vicarious Liability

Facts: Fisher was seriously injured in MVA. Passenger in a pickup truck driven by Reid, employee of Townsends. F alleges that T was vicariously liable for R’s negligent conduct while driving the truck. R drove to work sites in vehicles that he owned. That day R was driving a pickup truck with no seatbelts. F & 6 other employees sat in the back bed of the pickup truck. R was on his way to T’s processing plant to pick up a work order when the accident occurred

Issue: Can T be held vicariously liable for R? Is R an agent (employee)?

Ratio: **extent of control & actions of the party determine principal/agent relationship**

* Doesn’t matter what the terms of the K are; if characterized as employer/employee by actions taken by the parties = VL

*Choc v. Hudbay* (2013 – ONSC)

Agency argument for parent/subsidiary

Liability in Contract

**Principal is liable when agent has actual or apparent authority to enter into K on principal’s behalf**

**Apparent Authority:** power held by an agent or other actor to affect a principal’s legal relationships w/3rd parties when 3rd party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal’s manifestations.

*CSX Transport v. Recovery Express* (2006 – Mass) – Vicarious Liability

Facts: A, a “partner” at IDEC (IDEC & Recovery shared offices in Boston) emailed CSX expressing interest in buying “rail cars as scrap”. A represented himself to be from “interstate demolition and recovery express”. CSX prepared and forwarded sales order forms which “confirm[ed] the agreed[-]upon terms [of the sale] to IDEC”. Railcars were delivered to location A specified, Recovery claims this location is CSX’s own railyard. After delivery CSX sent invoices for the scrap cars to IDEC address. IDEC attempted to contact CSX rep Whitehead, but he didn’t respond until after A’s cheque bounced that was supposed to pay for the cars.

Issue: Was there apparent authority for A to act on behalf of Recovery?

Analysis:

* CSX attempting to shift consequences through K doctrine of **apparent authority**
* Email domain name not sufficient by itself to cloak a purported agent w/apparent authority
* CSX was unreasonable to rely solely on email domain name – not sufficient to sustain claim of apparent authority (comparable to biz card, which is also not sufficient)

RELATIONSHIP BETWEEN AGENT AND THIRD PARTIES

Under what circumstances would agent be liable on a K entered into on behalf of the principal?

**If Agent has Authority:**

* If identity of principal is disclosed = agent not liable
	+ If principal refuses to follow through w/K, is agent liable? NO b/c agent not party to K
* If identity not disclosed = agent liable

**If Agent doesn’t have Authority:**

* If principal refuses to perform K b/c agent has no authority to make K, agent not liable → doesn’t mean agent doesn’t have any liability (could be warranty of authority)
* **Warranty of Authority:** agent who enters into a K w/ a 3rd party (for and on behalf of a principal) by implication warrants that they have the authority to do so. If this is not the case, 3rd party has right to sue agent for breach of warranty of authority.

AGENCY IN ECONOMICS

* What is agency?
	+ When one acts for another
* What is an agency problem?
	+ Conflict of interest
		- Agent wouldn’t act in the best interest of the principal
	+ Information asymmetry
		- Agent has better info about how well the agent performs the task than is given to the principal – this is how agents can get away w/ not acting in the best interest of the principal
* Agency Cost
	+ Example: employee stealing from employer
	+ Cost of disciplining and monitoring agent – in order to prevent employee stealing from employer, install video monitors (type of agency cost)
* How to mitigate the problem?
	+ Agency problems arise when the interests of principal aren’t aligned w/interest of the agent – straightforward solution is to align the interest of the agent & principal (ex. employees share profits of the company)
	+ Another solution is dealing w/information asymmetry – law may require agent to disclose any conflict of interest

Partnerships

**Multilateral agency relationship → all partners are agents for each other for matters related to the partnership**

* **BCPA s. 7(1):** A partner is an agent of the firm & other partners for the purpose of the business of the partnership

By definition has more than 1 person = different from sole proprietorship

* Similar to SP in fact that partners carry on business themselves directly; not a legal entity separate from its partners
* Results in unlimited liability of each of the partners for debts & obligations of the partnership

WHAT IS A PARTNERSHIP?

**BCPA s. 2:** “Partnership is the relation which subsists between persons carrying on business in common w/a view of profit”

* “Persons” includes legal entities like corporations
* “Business” includes every trade, occupation, or profession
	+ Co-ownership of land = factor in favour of partnership, but not automatic
* “In Common” = together
* “View of profit” = purpose of partnership is to make profit
	+ Non-profit associations not treated as partnerships
	+ Profits don’t actually have to be made, just must have a “view to profit”

**Partnership = contractual relationship → must agree expressly or by conduct to doing business for profit**

* HOWEVER, partnerships can exist w/o participants knowledge that the partnership label applies; can apply even if parties specifically say they are NOT partnership
* As long as the business relationship has the key characteristics of a partnership, then it’s a partnership

**BCPA s. 4:** outlines rules fro determining whether partnership exists

1. Co-ownership doesn’t of itself create a partnership
2. Sharing of profits obtained from joint property doesn’t of itself create a partnership
3. Profit sharing itself doesn’t = partnership, in particular: (***Cox v. Hickman***)
	1. Where someone receives money for debts
	2. K for payment of employee doesn’t make employee liable as partner
	3. Spouse/child of deceased partner who gets $$ doesn’t become a partner
	4. Advance of $$ by way of loan to person doesn’t make the lender a partner w/person carrying on the biz

Historical Common Law – Definition of Partnership

*Cox & Wheatcroft v. Hickman* (1860 – HL England) – Profit-Sharing Not Sufficient

Facts: Creditors entered into arrangement where trustees ran biz of S&S, who owed a bunch of $$ to creditors. During trustee arrangement, someone supplied goods to S&S on credit. Invoice was marked as “accepted,” and converted into negotiable instrument, that was then endorsed to Hickamn, who paid $$ for the endorsement. Invoice wasn’t paid, H sued for amount on invoice, claimed against 2 creditors.

Issue: Are the creditors partners in the iron foundry biz?

Ratio: **In order to be considered a partner, persons acting on behalf of the purported partner must carry on the biz. Profit-sharing alone is not sufficient to = partnership.**

* Look to purpose of profit-sharing → in this case it was just to pay off the debt, once that was accomplished, creditors don’t share in profits anymore

*Pooley v. Driver* (1867 –England) – Relationship & Actual Actions

Facts: Drivers advanced $2500 on terms of a separate deed that detailed arrangements under which loan was advanced to B&H. Incorporated terms of partnership agreement between B&H by reference, and required B&H to observe terms of the partnership agreement. Also provided that bankruptcy of the lender would = termination of the loan agreement (although partnership would still be required to repay the loan). On liquidation of partnership loan was to be repaid out of assets of partnership remaining after payment of other creditors of the partnership.

Plaintiff (Pooley) held several bills drawn/accepted/endorsed by B’s firm. Total = $5000. October 1873 – B’s firm liquidated by arrangement. P applied to Drivers for payment of $ due on the bills, on the ground that the above-mentioned deeds constituted them partners in the firm. Drivers repudiated any liability as partners, alleging they were mere lenders of $$ upon a “contract in writing”.

Issue: Are Drivers partners in the firm of B?

Analysis:

* If people form association for purpose of carrying on biz & they share in profits, then *prima facie* = partnership UNLESS there are surrounding circumstances that show they’re not really partners
	+ **Law will look at body & substances of arrangements;** can’t just contract out of partnership
* **Dormant Partner:** liable to a limited extent to loss and w/a guarantee of their capital from the active partners
* Every partner = agent of partnership; virtually embrace character of partner/agent → **Test:** whether he was to receive in whole/part profits from the K entered into.

Ratio:  **Look to relationship of parties/actual actions – can’t share in profits & benefits of partnership w/o also being held liable**

* Relationship characterized as “dormant & active” partners, not creditor/debtor

Modern Common Law – Definition of Partnership

*LePage v. Kamex Developments* (1977 –ONCA)

Facts: One of the appellants executed exclusive leasing agreement w/o agreement of other partners – does this bind the partnership?

Ratio: Mere fact that property is owned in common & profits derived therefrom doesn’t of itself constitute co-owners as partners

* Determination of existence of partnership **depends on their intentions as disclosed by all facts of the case**
* **Was intention to “carry on biz”** or simply to provide agreement for regulation of their rights & obligations as co-owners?
* Partners can’t transfer property to 3rd parties w/o consent of all partners → fact that these owners could sell to 3rd party w/o consent (just have to offer right of first refusal) = co-ownership, not partnership

*Volzke Construction v. Westlock Foods* (1986 –ABCA)

Facts: Westlock Foods bought 20% interest in Westlock Shopping Centre from Bonel; paid $32k. Bank account opened in name of Bonel & Westlock Foods – only principals of Bonel had signing authority. Each of Volzke’s accounts was paid from this account until Dec 22, 1978, when Shefsky (Westlock Foods) died. Final account rendered after Dec. 22, 1978 remained unpaid. V sued WF as partner w/B.

Ratio: **Lack of control does not negate existence of partnership**

* Nothing in *Partnership Act* that requires control for existence of partnership → you can have silent or managing partners

*Lansing Building Supply v. Ierullo* (1989 –Ont. Dist. Ct.)

Facts: Agreement entered: plaintiff would supply building materials to a group called Courtyard Joint Venture. Credit agreement was signed by William Barnett; indicated that CJV was a partnership & that the partners were the 3 named defendants.

Issue: are actions of Mr. B binding on other defendants?

Analysis: Must look at **intention of parties as disclosed in their agreement & conduct** to determine existence of partnership

* Co-ownership agreement has many of the attributes associated w/partnerships: parties to agreement own property as tenants in common, and are involved in the affairs of biz through co-owner reps. Also, rights of co-owners to deal w/their interest in the land severely restricted – transfer/sale/disposition of interest in Courtyard & Pickering Village Project dependent on unanimous written approval of the co-owners. Co-owners also prevented from applying for partition or sale of the property
* When considered all together, clauses in combination are consistent w/a partnership & not a mere co-ownership arrangement
* Fact that individuals are parties to the agreement = something more than co-ownership agreement as individuals don’t own the land in their individual capacities, rather it is owned by the 3 numbered companies. If it’s only the numbered corporations that form the partnership, named defendants may escape liability
* Actions of parties consistent w/existence of partnership
* Distinguish from *Kamex* based on intention → in this instance was clearly the purpose to “carry on biz” w/in meaning of s. 2

Ratio: **intention decisive in determining existence of partnership; look at the agreement as a whole to determine its purpose**

LEGAL STATUS OF PARTNERSHIPS

**Partnership is not recognized as a separate legal entity (*Thorne*)**

* Liability: partners’ personally liable for the partnership’s debts
* Property: owned by all partners
	+ Even if it was someone’s personal property before it was decided to be used for the partnership
* Dissolution: if a partner dies, resigns or a new partner joins
* Tax: only partners pay tax, not partnership
* Partners can’t be employees of the partnership **(*Thorne*)**
* Litigation: partnership can’t be sued (sue all the partners), but for convenience action can be brought in partnership’s name

*Re Thorne and New Brunswick Workmen’s Compensation Board* (1962 NBCA)

Ratio: **Partnerships are not separate legal entities – a person can’t occupy the position of being both an employer (as partner), and employee for the purposes of the Act**

* Person can’t enter into a K w/himself or be his own employer; can’t sue himself
* Can’t be both a principal and agent = conflict of interest

RELATIONSHIP BETWEEN PARTNERS

**BCPA** provides set of **default rules** that will govern relationship between partners to extent that they haven’t explicitly/implicitly agreed otherwise

* **Section 21:** “The mutual rights and duties of partners, whether ascertained by agreement or defined by this Part, may be varied by the consent of all the partners and the consent may be either express or inferred from a course of dealing”
* Rules based on assumption that partners are equal re:
	+ Capital contributions
	+ Rights to participate in management of the biz
	+ Rights to share in profits

Default Rules – s. 27

* Equal sharing in profits & losses (**s. 27(a))**
* No new partner unless unanimous consent (**s. 27(g))**
* Management right (**s. 27(e))**
* Majority vote for ordinary matters; unanimous consent for fundamental change (**s. 27(h))**
* Majority can’t expel partner, unless power to do so has been conferred by express agreement between the partners & power is exercised in good faith (**s. 28**)
	+ **NOTE:** you can circumscribe this provision in a separate agreement, or you can dissolve the partnership & reform

**Can’t contract out of fiduciary duties:**

* Act w/utmost fairness & good faith **(s. 22)**
* Duty of full disclosure **(s. 31)**
* Duty to account for unconsented benefits **(s. 32)**
* Duty to not compete, unless consent **(s. 33)**
	+ **NOTE:** Partners CAN contract out of s. 33 by saying a partner can compete against partnership **if all the partners consent**

**Assignment of Partnership Interests:**

* Partnership interests can be assigned, but doesn’t result in assignee becoming a partner **(s. 34)**

**Dissolution:**

* **By the partners themselves:**
	+ Can set a fixed term for the partnership (**s. 35(1)(a))**
		- At end of fixed term partnership dissolves unless partners agree otherwise
	+ Partners can agree that partnership will be dissolved at end of a particular venture **(s. 35(b))**
* **On death, bankruptcy, or dissolution of a partner:**
	+ Partnership dissolved automatically upon death, bankruptcy, or dissolution of a partner **(s. 36)**
	+ If whole partnership is dissolved, an entirely new partnership agreement among the remaining partners would be required in order to continue
	+ This standard form provision frequently overridden by express agreement between the partners that the death, bankruptcy or dissolution of a partner **does not** result in the dissolution of the partnership as between the remaining partners
	+ Where there are more than 2 partners, death/bankruptcy/dissolution of partner only dissolves partnership between the deceased/bankrupt/dissolved partner and the remaining partners (partnership agreement continues to apply for remaining partners) (**s. 36(b)**)

RELATIONSHIP BETWEEN PARTNERS AND THIRD PARTIES

**Liability:**

* Partners are personally liable to all partnership debts
* Partners are jointly and severally liable for partnership debts arising from partner misconduct & misallocation; jointly liable for all other partnership debts (**ss. 11, 12, 14**)
* Each partner can be held liable for full amount of partnership debt. Difference is:
	+ **Jointly & severally** = creditor can pursue any of the partners individually as defendants → doesn’t have to included all partners as defendants in lawsuit. If creditor releases claim against one partner, doesn’t release claim against others.
	+ **Jointly** = must include all partners as defendants in the same lawsuit. If creditor releases claim against any of the partners, it releases the claim against all partners

Liability in Contract

**BCPA ss. 7-10:** potential defenses to liability in K

**S. 7: Apparent Authority of Partners**

* Every partner is an agent of the firm & other partners for the purposes of the partnership biz
* Binds the firm & partners UNLESS:
	+ Partner had no authority to act for the firm in the particular matter, and
	+ Third party either knew the person dealt w/had no authority or didn’t know/believe them to be a partner
		- If partner was doing something not associated w/biz of the firm, reliance by 3rd party is not reasonable

**S. 8: Actual Authority of Partners**

* “An act or instrument relating to the biz of the firm and done or executed in the firm name, or in any other manner showing an intention to bind the firm by a person thereto authorized, whether a partner or not, is binding on the firm and all the partners”
* Doesn’t limit authority to actual authority; appears to cover actual & ostensible authority

**S. 10: Third-party notice of restriction on authority of partner**

* If 3rd party has notice of a restriction on power of the partner, partner’s actions in contravention of the restriction don’t bind firm
* Even w/o specific “notice”, as long as third party had knowledge of the restriction of power = sufficient to not bind firm

**S. 11: Joint liability for debts of partnership**

* Every partner is jointly liable w/other partners for all debts & obligations of the firm as long as they’re a partner
* After partner’s death, estate also severally liable subject to prior payment of partner’s separate debts

**S. 12**: **If there is no actual/apparent authority = no liability for partnership**

**S. 19: Liability of new partners and retired partners**

* Person who joins an existing partnership is not liable to creditors for debts of the partnership that arose before the person joined the firm
* Once a person is a member of the firm, person doesn’t cease to be a party to Ks entered by the partnership just b/c they leave

Liability in Tort

**S. 12**: Partnership **liable** for wrongful acts/omissions **where a partner acted w/the authority** of the other partners **or acted in the ordinary course of business for the firm**

* **S. 14:** Liability for wrongs isjoint & several

*Ernst & Young v. Falconi* (1994 On Gen. Div.)

Facts: F was lawyer in firm KFA. Plead guilty to charge under Bankruptcy Act, K had no personal involvement w/the transactions, but each transaction involved the legal services of KFA. K argued that the acts of F in assisting clients make fraudulent transfers couldn’t be considered w/in scope of the biz of the law firm.

Ratio: Sufficient if partner used facilities of the law firm to perform services normally performed by a law firm in carrying out the transactions → activities of F were of the nature of the normal legal services provided by a lawyer

* Fact that actions of F were for improper purposes & w/intent to defraud creditors of the bankrupts doesn’t take the acts themselves out of the ordinary course of biz if they’re in the nature of acts normally performed in the ordinary course of biz
* **Improper purpose doesn’t negate “ordinary course of biz” as long as acts are ones usually performed**

Other Matters

* **Indemnification**: when a partner is found liable the partner is liable for the full amount. Liability of a partner is independent of any right of the partner to seek indemnification or contribution from the other partners. If a partner is required to satisfy obligation (of payment?) they may seek indemnification/contribution according to the terms of partnership agreement
* **“Holding Out”:** Person who represents themselves to be a partner (orally/in writing/by conduct) or who knowingly allows themselves to be represented as a partner, will be liable to anyone who has given credit on the faith of the representation.
	+ **Can occur even where there is no partnership (s. 16)**
		- Ex. Person w/rep for good credit might permit use of their name by a sole proprietor to help the SP get credit. If credit is advanced on faith of such a use of the person’s name, person may be liable to SP’s creditor

Retirement of Partners

Partner who retires doesn’t cease to be liable for partnership debts/obligations incurred prior to retirement

* Third parties dealing w/firm may be unaware that partner has retired and rely on retired partner as still being a partner
* **S. 19(2):** retiring partner can also be liable for debts/obligations of partnership even after partner has left partnership

**Steps to Avoid Liability:**

1. Provide actual notice to everyone who’s had prior dealings w/firm
2. Place notice of retirement in the Gazette
3. File a revised registration statement removing the name of the retired partner from list of partners of the firm

Can also enter into agreement w/remaining partners & creditors relieving retiring partner from liability

Limited Partnerships

LPs are means of circumventing unlimited liability of the partners in an ordinary partnership. Allows some partners to have limited liability, provided the firm adds suffix “Limited Partnership” to its name (to alert creditors & investors).

|  |  |
| --- | --- |
| **General Partnership** | **LP** |
| No formalities; factual determinationAlthough BC requires registration, it is not a prerequisite for the existence of a partnership.Each partner is personally liable for the debts of the partnership.Absent a contrary agreement, each partner may take part in management and have the power to bind the partnership for ordinary biz matters. Each partner has fiduciary duties to all other partners Absent a contrary agreement, share profits equally  | Partnership agreement and filed w/the registrar a certificate signed by each general partner.**1+ general partner****1+ limited partner**General partners are personally liable. Limited partners are not personally liable; **liability limited to the amount of capital contribution (s. 63)**. Limited partners would become personally liable:1. Defective formation
2. Take part in management (**s. 64**)
3. Last name in firm name (**s. 53**) & 3rd party doesn’t know limited partner is not general partner
4. False statement in certificate (**s. 74**) – lose limited liability protection if limited partner knew of false statement in certificate and didn’t act to amend

Absent a contrary agreement, both the day-to-day management and the power to bind the LP are reserved to general partners. Limited partners don’t take part in “management”; if they do, then at risk of losing limited liability (**s. 64**)General partners have fiduciary duties to general and limited partners, but limited partners generally do not owe fiduciary duties * **s. 60** – limited partners can engage in conflict of interest biz

Absent contrary agreement, partners share profits in proportion to their respective capital contribution  |

**Liability:**

* K liability operates the same as general partnership; LP still not a separate legal entity
* Tort liability: limited partners will not incur tort liability if they do not get involved in management/control of the biz
* **In any context, liability of limited partners is restricted to amount they contributed to LP**

CONSEQUENCES OF LIMITED PARTNER’S PARTICIPATION IN MANAGEMENT

**BCPA s. 64:** A limited partner is not liable as a general partner unless they take part in the **management of the biz**

*Haughton Graphics v. Zivot* (1986 – Ont. HC)

Facts: Marshall (limited), Zivot (limited), Lifestyle (general) = Printcast LP

* In order to avoid personal liability, Zivot formed Lifestyle to be the general partner, which he controlled
* If LP doesn’t have sufficient funds to cover debts creditors will go after partners to hold them personally liable

Held: M & Z were responsible as general partners b/c of the amount of control they exerted over the biz

* Also held themselves out to be president/VP of Printcast, implying control over the company & general partnership

*Nordile Holdings v. Breckenridge* (1992 – BCCA)

Facts: Debt, LP in default, claim against limited partners based on assertion that b/c they’re officers & directors of the general partner corp. that was a general partner in the LP, they managed and controlled the LP to the point where they = general partners

Held: Not liable, because they were acting in their capacity as directors of the general partner, not as general partners themselves in the LP.

Ratio:

* Determine roles by looking at **behaviour toward 3rd parties**, how they hold themselves out to third parties (ex. on biz cards/titles, etc.)
* Doesn’t require “control”

RELATIONS AMONG PARTNERS

* **S. 51** – all general partners need to sign a certificate to form LP
	+ (4)(c) requires that right to admit additional limited partners must be set out in the LP certificate
* **S. 55** – limited partner’s contributions
* **S. 56** – what a general partner can’t do in an LP
	+ Can’t perform an act that makes it impossible to carry on the partnership biz/consent to a judgment against the partnership
	+ Can’t possess partnership property or dispose of it for other than a partnership purpose
	+ Constraints not subject to alteration in the partnership certificate; varying these provisions requires consent of all limited partners
	+ (d) General partner has no authority to admit a person as a general partner or limited partner unless the right to do so has been given in the certificate
* **S. 58** – (1)(c) provides limited partner w/same right as general partner to obtain dissolution & winding up of LP by court order
	+ Limited partners also given right to inspect the books
* **S. 66** – assignee doesn’t become a partner until name is recorded on the certificate
	+ Partner can’t assign interest in the partnership w/o consent of the other partners
	+ If assignment permitted in partnership agreement, **s. 51(4)(b)** provides that certificate must set out provisions concerning the right to make such an assignment, and the terms/conditions of the assignment.
* **S. 67** – death etc. doesn’t necessarily dissolve LP if the general partners want to continue the biz

**Separation of Ownership & Control**

* Limited partners usually major contributors of capital = “owners” of the biz; but they don’t and can’t “control” the biz
* Left to the parties to contract for protections they see fit & appropriate for the particular context

Limited Liability Partnerships

**BCPA s. 104: each partner is not personally liable for debts of the partnership, except for negligence/misconduct by himself**

**Formation:** file a registration statement

Originated in the US, began as partial shield to protect partner against liability for debts & obligations of the partnership that arose from negligence, omission, or wrongful acts of another partner. Expanded to create a “full shield” protection: included coverage of ordinary contractual debts of the partnership. Canada then adopted this “full shield” approach in the late 1990s and early 2000s.

**Hamilton:** original conception of LLP is that it provides “peace of mind” insurance for innocent partners. Designed to avoid the fear by a partner that personal assets may be at risk b/c of negligence of another partner over whom they have no control, possibly never met.

* LLP direct outgrowth of collapse of real estate & energy prices in late 1980s and the concomitant disaster that befell Texas’ banks and savings/loans institutions. Claim against lawyers/accountants to recover the lost money as a result of this collapse for malpractice and breach of duty were attractive b/c individual professionals sometimes had been deeply involved in the affairs of their clients. Also likely had deep malpractice insurance.
* Argued that LLP protection allowed lawyers to “have their cake and eat it too” → “if you want to swim with the sharks, you should recognize that you might get eaten by them”

**Rhode:** absence of appropriate standards of 3rd-party liability for lawyers who passively acquiesce in client fraud contributed to Enron disaster. LLPs effectively eliminate personal financial exposure for partners in firms implicated in malpractice proceedings. Absolve non-supervising lawyers of any financial responsibility for colleagues’ ethical violations, and deprive victims of remedies if those who commit the violations lack adequate assets or insurance coverage.

* **LLPs privilege professional over public interests**
* Benefits of LLP system flows disproportionately to the largest law firms
* Reducing insulation from accountability could give lawyers greater incentives to address collegial misconduct and establish the internal oversight structures that can check abuses

*McCormick v. Fasken* (2014 – SCC)

Facts: M worked at F, equity partner. Party to Partnership Agreement, which requires retirement at age 65. M complained that partnership agreement = age discrimination in employment under s. 13 of the Human Rights Code.

* F argued that M was not an employee; he was part of the partnership. Couldn’t contract w/himself to be an employee
* M argued that he was owner “in name only” → exec committee had sufficient control over M to = employee

Ratio: SCC required **“genuine control”** over someone to constitute an employee

* Factors considered:
	+ Right to participate in management
		- Right to vote on important matters including mandatory retirement policy
		- Right to select board members
* Other partners owed M a duty to render accounts
* Right not to be subject to discipline or dismissal
* Right to his share of firm’s capital account when he left firm
* Protection that he couldn’t be expelled from Partnership w/o special resolution passed by meeting of all equity partners
* Run for economic benefit of partners, including M
* Income from profits of Partnership and was liable for its debts & losses
* Entitled to share in Partnership’s assets if P dissolved

Corporations – Basic Characteristics

**Basic Corporate Characteristics:**

* Operated for profit
* Separate legal entity
* Limited liability
* Perpetual existence
* Transferability of share interests
* Centralized management

**Comparison:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Characteristics**  | **General Partnership** | **Limited Partnership** | **Corporation** |
| Separate Legal Personality | No | No |  Yes |
| Perpetual Existence (not affected by comings & goings of constituents) | No | No | Yes |
| Limited Liability | No | Partial | Yes |
| Free Transferability of Interests | No | No  | Yes |
| Centralized Management under Board | No | No | Yes |

**Creditor Payment Priority:**

* Secured creditors
* Unsecured creditors
* Shareholders

OPERATED FOR PROFIT

**Milton Friedman:** “there is one and only one social responsibility of biz – to use its resources and engage in activities designed to increase its profits so long as it stays w/in the rules of the game, which is to say, engages in open and free competition w/o deception or fraud”

* “Corporation” doesn’t necessarily = “for profit”; can also be a not-for-profit organization that is a corporation
* Business managers should have to make policy decisions beyond requirements of the law; if higher standards are desirable, change the law & corps will follow that law

SEPARATE LEGAL ENTITY

**Consequences of Separate Legal Entity:**

* Limited liability
* Perpetual existence
* Can contract (including w/shareholders)
* Corp. assets owned by the company, not its shareholders or creditors
* Capacity to sue
* Separate tax entity – important consideration in choosing between unincorporated & incorporated form (partnership vs. corp.)
* **CBCA s. 15:**  Corporation has the capacity and, subject to this Act, the **rights, powers and privileges of a natural person**

*Salomon v. Salomon & Co.* (1895-1899 – HL) – One Man Corp./Separate Legal Entity

Facts: Aron Salomon formed limited company w/family. Each family member had 1 share; S had the rest. S held debentures against the company. It failed, was wound up w/in a year. If amount from sale of assets applied to S’s debenture, there would be nothing left for ordinary creditors.

Issue: Is S personally liable for company’s debts?

Ratio: **corporation = separate legal entity + one-man company can be a limited liability corporation** as long as the requirements of statute are fulfilled.

* Court was unsympathetic to unsecured creditors b/c could have looked into the debentures before lending out $$

Other Consequences of Incorporation & Separate Legal Entity

*Lee v. Lee’s Air Farming* (1961 – AUSTRALIA) – Corp. Distinct from Controlling Shareholders

Facts: Lee formed the company, held 2,999 of the company’s 3,000 shares, also company’s sole director, officer, and manager. He was employed as chief pilot of the company. Killed while piloting the company aircraft, widow claimed compensation under *Workers’ Compensation Act*. NZCA held that since he owned all shares and directed, he couldn’t be an employee and thus, no workers’ compensation.

Issue: Can a man be employed by a corporation that he entirely owns?

Held: Yes.

Ratio: As long as the corporation is not a sham or mere agent, it may make contracts with its directors/shareholders. The fact that a director is a sole director/owner does not change the separate legal capacity of the corporation per se. As long as that director is acting as an agent of the corporation, he may make contracts with himself. An individual may hold multiple distinct identities within a corporation.

*Macaura v. Northern Assurance* (1925 – HL) – Corp. Owns Its Own Property

Facts: M was a shareholder in a timber company, bought insurance policies against fire for timber material owned by the company. Fire occurred, he tried to claim compensation; insurance companies were not down.

He was both a creditor & shareholder.

Issue: Whether M had insurable interest in goods that were subject to the policies?

Ratio: Neither a simple creditor of, nor a shareholder in, a company has any insurable interest in a particular asset that the company holds.

*Kosmopoulos v. Constitution Insurance Co.* (1987 – SCC) – Corp. Owns Its Own Property/Piercing

Facts: K ran a leather goods company as a sole proprietor, incorporated the company on advice of his solicitor. Continued to hold the lease in his own name, and considered himself the owner of the assets. Took out an insurance policy against fire, characterized as Andreas Kosmopoulos O/A Spring Leather Goods. Fire occurred, K wants to recover.

Issue: Whether sole shareholder of a corp. has an insurable interest in the assets of that corp.?

Ratio: Can displace *Salomon* rule if it would be a flagrant opposition to justice not to pierce the corporate veil

* The best that can be said is that the “separate entities” principle is not enforced when it would yield a result “**too flagrantly opposed to justice, convenience or the interest of the Revenue"**
* Doesn’t apply “Macaura Principle” (see above) → shareholder does have insurable interest in the property of the corp.

**NOTE:** As member of insurance law, shareholders have insurable interest in assets (just don’t have ownership interests)

LIMITED LIABILITY

**Benefits:**

* Reduces need to monitor agents (managers)
* Reduces need to monitor other shareholders
* Makes shares fungible (also facilitates takeovers)
* Facilitates diversification (w/o limited liability, minimize exposure by holding only one company)
* Enlists creditors in monitoring managers (b/c creditors bear some downside risk)
* No constraint on extent to which shareholder can become involved in management of biz (unlike LP)

Limited Liability: Theories & Consequences

* Criticism of *Salomon* – Prof. Kahn-Freund said that “the courts have failed to give that protection to the biz creditors which should be the corollary of the privilege of limited liability”
	+ Suggested a “minimum stated capital” requirement as a solution = on incorporation, the corp. would be required to receive at least a stipulated amount as consideration for the issuing of shares → occurred in some jurisdictions, but didn’t last long
* Danger of limited liability may be overstated, as parties can contract around it
	+ Ex. in small companies the principals often required to provide company’s bank w/ personal guarantees of company’s indebtedness, effectively replaces company’s limited liability
* Most apparent benefit of limited liability = permits risk of default from organizers/promoters of a corp. to shoulders of creditors
	+ Shareholders may have more to lose → not just value of investment, but often their job/livelihood will be lost
* Separation of ownership & control in widely held corp. introduces “agency cost” problem, since firm managers (as agents) have imperfect incentives to maximize the interest of all claimholders (as principals)
	+ One strategy to help mitigate agency cost = claimholder monitoring
		- Firm managers are monitored/supervised for misbehavior by claimholders
* Halpern, Trebilcock, Turnbull argue:
	+ Limited liability = shareholder liability insurance b/c effect of limiting liability of shareholders is to shift risk of loss from shareholders to creditors
	+ Limited liability was most efficient, particularly for corp.’s voluntary creditors (lenders, trade creditors, employees), although not for involuntary creditors (tort claimants)

Frank Easterbrook & Daniel Fishcel – “Limited Liability and the Corporation"

* Publicly held corp. facilitates division of labour
	+ Distinct functions of managerial skills & provision of capital (& bearing of risk) can be separated & assigned to diff. people
* Separation of functions is not costless → requires firms to create devices by which these participants monitor each other & guarantee their own performance – neither group perfectly trustworthy
	+ Costs of separation of investment & management (**agency costs**) may be substantial
	+ Costs generated by agency relations are outweighed by the gains from separation & specialization of function
* Limited liability reduces the costs of this separation & specialization:
1. Decreases need to monitor – limited liability makes diversification and passivity a more rational strategy & so potentially reduces cost of operation
2. Reduces costs of monitoring other shareholders
3. Gives managers incentives to act efficiently by promoting free transfers of shares
	1. As long as shares are tied to votes, poorly run firms will attract new investors who can assemble large blocs at a discount & install new managerial teams
	2. Potential for displacement gives existing managers incentives to operate efficiently in order to keep share prices high
	3. Limited liability reduces costs of purchasing shares, b/c value of shares is determined by present value of the income stream generated by a firm’s assets (w/unlimited liability, shares wouldn’t be fungible – value would be a function of the present value of future cash flows *and* of the wealth of the shareholders)
4. Makes it possible for market prices to impound additional info about the value of firms
5. Allows for more efficient diversification
6. Facilitates optimal investment decisions
	1. When investors hold diversified portfolios, managers maximize investors’ welfare by investing in any project w/a positive net present value

PERPETUAL EXISTENCE

Corporation, as separate legal entity, can exist indefinitely. Status of shareholders won’t affect continued existence of the corp.

* Shares can be transferred/sold to other people and corp. continues as it had before; subsequent debts or obligations incurred in the carrying on of biz through corp. would be debts or obligations of corp. just as they had been before the transfer of the shares

**Benefits:**

* Continues even after changes in corp. constituents
* Allows long-term plan for growth b/c managers know corp. will still exist long into the future

**Lifespan:**

* Corp. can die – only possibility of perpetual existence
* Average lifespan = 40-50 years; most often dies b/c acquired by another, bigger company

TRANSFERABILITY OF SHARE INTERESTS

**Benefits:**

* Allows shareholders to exit w/o disrupting biz
* Permits takeovers → disciplines management
* Facilitates active stock markets, increasing liquidity

CENTRALIZED MANAGEMENT

**CBCA s. 102(1):** Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the biz and affairs of a corporation

* **S. 146(1):** Management powers of directors may be restricted, in whole or in part, by a written unanimous shareholder agreement
* Shareholders don’t participate in management of biz; **management power is w/BOD**
	+ **Shareholders are not agents of corporations –** don’t have power to bind the corp.

CORPORATIONS & CHARTER RIGHTS

Ask whether corporation fits w/in the definition of the defined rights holders:

* Everyone
	+ S. 2 (freedom of religion, expression, assembly and association)
	+ S. 8 (right to be protected against unreasonable search & seizure)
* Every citizen
	+ S. 3 (vote)
* Any person
	+ S. 11 (rights on being charged) ex. to trail w/in a reasonable time; right against self-discrimination
* Every individual
	+ S. 15 (equality right)
* Anyone
	+ S. 24 (right to seek a remedy if rights infringed)

Tim Hortons – Political Spending

Justifies making political contributions by classifying as still part of management duties

*Citizen United v. Federal Election Commission* (2010 – US Supreme Court) – Political Spending

Issue: should corporations be restricted in the amount of $$ they can spend politically?

Held: American corporations can spend unlimited amount on advocating for political candidates

* Arguments against allowing corp. to spend:

CORPORATIONS CHARACTERISTICS & CORPORATE TYPES

* + Anti-corruption rationale:
		- To prevent corruption or the appearance of corruption (rejected by the court)
	+ Anti-shareholder rationale:
		- To protect shareholders from being forced to spend money on political speech that they don’t agree w/
			* Rejected by the court: decision is w/BOD, but not all corp. have problem of separation of ownership & control. What is corp. has 1 shareholder, sits on the board, and makes all the decisions. This argument is overbroad.
	+ Anti-distortion rationale:
		- To prevent the “distorting effects of immense aggregations of wealth that are accumulated w/the help of the corporate form and that have little or no correlation to the public’s support for the corporation’s political ideas.”
			* Corporation doesn’t have independent will = will of the BOD
			* Court rejected this argument as well

|  |  |  |
| --- | --- | --- |
|  | **Private Corporation** | **Public Corporation** |
| **Alt Names** | “Closely held” | “Publicly traded”; “distributing company” |
| **Number of Shareholders** | Relatively small number (no more than 50) | Large number  |
| **Share Transferability** | Usually restricted | No restriction |
| **Centralized Management under the Board** | Shareholders take part in management  | Separation of ownership & control |
| **Operated for Profit + something else?** | Less problematic | More controversial |
| **Limited Liability** | More likely to pierce | Unlikely to pierce  |

Corporate Personality: Piercing the Corporate Veil

**Problem of Limited Liability = Moral Hazard**

* Economic actor shielded from risk may behave differently from how it would if it was fully exposed to it
* Opportunity for an economic actor to reap rewards of risky behaviour w/o bearing associated costs

**What is “piercing the corporate veil”?**

* + Typical:
		- Disregard the corp. as a separate legal entity and hold its shareholders liable for the corporation’s debt
	+ Variant:
		- Shareholders seek benefits or rights that would be denied if the corporate entity were respected
	+ Incorrect:
		- Directors/officers responsible for their act in the course of biz of the corporation

**What “piercing the corporate veil” doesn’t do**

* Doesn’t dissolve the corp.
* Doesn’t make the shareholders liable for all the corp.’s debts, **only liable for the specific claim at issue**

WHEN TO PIERCE?

US Empirical Evidence

Close corporation vs. Public corporation

No case involved public corporation

Parent corporation vs. Individual shareholder

28% vs. 50%

Contract cases vs. Tort cases

42% vs. 31% / no significant difference

Undercapitalization

Doesn’t play a significant role

**Canadian Experience**

Fraud or improper purpose/conduct

Sham or alter ego of the shareholder

Merely agent of the shareholder

Inadequate capitalization

Tort claims (involuntary creditors)

Single economic unit/enterprise liability

Equity or the interest of justice are better served

**NOTE:** Holistic Approach – investigate the totality of the circumstances to determine when it’s appropriate to pierce the veil

* Can relax the strict application of the principle from *Salomon*; instances relatively rare → courts have developed various “exceptions”:
	+ Cases that involve allegations of fraudulent conduct/objectionable purpose on the part of a company’s principals;
	+ Cases where a company existed as a “shell” and was clearly undercapitalized to meet its reasonable financial needs;
	+ Cases that involve tort claims against the company, particularly those where a director/shareholder/employee has committed an intentional tort, or the tort of inducing breach of K;
	+ Cases where the company was not incorporated for bona fide biz reasons but for other purposes (often to avoid taxation);
	+ Cases that involve non-arm’s length transactions between parent & subsidiary companies; and
	+ Cases where courts determine that equity or the interests of justice are better served by disregarding the corporate form
* Categories are not watertight; more recent cases of piercing appear to reflect a more holistic approach to the Q
* Courts seem more likely to pierce where there was a representation of unlimited liability (as opposed to situations where it was clear that there was some limitation on the liability of an entity)

*Clarkson v. Zhelka* (1967 – Ont. HC)

Facts: Selkirk incorporated/controlled St. George, Langstaff, Fidelity and Industrial (all corporations). Industrial bought land using cash advanced by L and St. G and the land was then conveyed to Selkirk’s sister, Z who wrote a promissory note in return. Z mortgaged the land to G. When G foreclosed part of the land sold, the cash was used to repay the mortgage/tax lien, and interest adjustments to Z somehow ended up with Fidelity. S later adjudged bankrupt and Clarkson was the trustee, who then sought declaration that the land registered was either held by Z or Industrial as trustee for S – Industrial was a mere agent/alter ego. S utilized to prejudice/confusion.

Issues: Are the corporate assets of Industrial available to S’s personal creditors through piercing of the corporate veil?

Holding: No, judgment for D.

Analysis: Nothing unlawful per se in the transfers between S’s corporations against his personal creditors, if anything, would prejudice shareholders/corporate creditors. There is no evidence of S’s personal assets transferring to his corporations – not a case where the debtor transferred personal assets to the corporation with the purpose of avoiding existing liability/obligations.

Ratio: Refuse to apply *Salomon* and pierce the corporate veil when to do otherwise would be “flagrantly opposed to justice” (ex: a **company is formed for the purpose of wrongful/unlawful acts** or those in control direct the corporation in such a matter), then individuals and corporations can be held liable – in such cases, or where a company is a **mere** **agent**, the corporation can be deemed a sham, cloak, or alter ego. Whether a company is an individual’s agent is a question of fact of each case; controlling/total share interest is not *prima facie* evidence to establish agency. Is the company being run solely in the interest of the sole shareholder?

* In questions of **property & capacity**, of acts done & rights acquired or liabilities assumed, company is always an entity distinct from its incorporators
* If company formed for express purpose of doing wrongful/unlawful act or, if when formed, those in control expressly direct a wrongful thing to be done, the individuals as well as the company are responsible to those to whom liability is legally owed.
* Where company is mere agent of a controlling corporator, then company = sham, cloak or alter ego/mere agent for conduct of his personal biz.

*Big Bend Hotel v. Security Mutual Casualty* (1980 – BCSC)

Facts: K was pres/sole shareholder of BB Hotel; sole asset was hotel in Golden. Got insurance w/o disclosing prior fire damage. K argued insurers owed on the policy despite not disclosing prior fire loss; BB and K&S Enterprises were separate entities & he couldn’t be expected to set out fire loss of K&S when app was made on behalf of BB. Defendant argued failure to complete loss record indicated there were no previous losses; if they’d known of the prior damage, would have denied coverage.

Issue: Can K be held liable for withholding info on the insurance form?

Ratio: Failure to disclose material fact was fraudulent = appropriate situation to lift the corporate veil b/c equity won’t allow an individual to use a company as a shield for improper conduct/fraud.

* **Test for Materiality:** what a reasonable insurer would have done or how a reasonable insurer would have reacted to the true facts
* **LIN →** said court didn’t need to pierce, fact that failure to disclose was fraudulent enough to void K

*Rockwell Developments v. Newtonbrook Plaza* (1972 – ONCA)

Facts: K incorporated company (Rockwell) for real estate development. R offered to purchase land from N. R had no assets except small bank account, K & partner paid solicitors of N and the deposit advanced in the deal from own funds, no entry in R’s books.

Issue: Is R a separate legal entity, or merely a sham for K?

Ratio: Can’t disregard *Salomon* principle lightly; when a company enters a K it is the contracting party, not the shareholders. Kelner couldn’t sue or be sued on the K, only the company. Fact that the bookkeeping was shoddy and no record of the transaction in Rockwell books not enough to pierce the corporate veil & find Kelner personally liable. Undercapitalization alone not sufficient to pierce.

*642947 Ont. Ltd. v. Fleischer* (2001 – ONCA)

Facts: # co. agreed to buy property; Sweet Dreams exercised right of first refusal but later terminated agreement. # Co. resubmitted original offer to F, accepted b/c said SD had spent first refusal. SD got injunction, property fell in value, # co. refused to close after injunction dissolved.

Issue*:* Are H&K (shareholders of SD) personally liable for damages flowing from injunction?

Ratio: **can pierce corp. veil b/c SD “completely dominated & controlled” and used as a “shield for fraudulent or improper conduct” by H&K**

* Decision to pierce corporate veil depends on context; not lightly set aside. TJ’s finding to pierce corporate veil supported in this case → partners tried to hide behind a shell company that they controlled in order to escape liability → “courts will disregard the separate legal personality of a corporate entity where it is completely dominated & controlled and being used as a shield for fraudulent or improper conduct” (*Transamerica Life Insurance v. Canada Life Assurance,* 1996)
* Undertakings can’t be lightly given to the Court to selfishly protect the self-interest of the parties giving the undertaking – would undermine power of the undertaking & the Court

*De Salaberry Realties v. Minister of National Revenue* (1974 – Fed. CA)

Facts: D was a subsidiary company, related to a number of other companies & ultimately controlled by Grandparent Company. Profit was made on sale of land, and Q was whether this income belonged to D, for purposes of *Income Tax Act*.

Issue: Was subsidiary an instrument doing biz on behalf of parent company, or was it a separate legal entity, distinct from sister & parent companies? → YES

Ratio: Courts are more willing to lift the corporate veil when the shareholders are other corporations. Based on the facts of the case, the courts determine if the subsidiary is a mere agent for the parent corporation. Potential indicators: Are the profits treated as parent company profits? Are the persons conducting business appointed by parent company? Was the parent company the head/brain of trading venture? Did the parent company govern the venture/decide what should be done/what capital should be used? Did the parent company make the profits make the profits by its own skill/direction? Was the parent company in effectual and constant control? Is the directing mind and will of the parent company reaching into/through the corporate façade of the subsidiary? Is there thin capitalization of the subsidiaries?

* Lack of agency of appellant company indication that it was just a puppet for parent corps → thin capitalization + purpose of just acquiring land regardless of zoning issues = sham front for the parent corps.
* Court could look behind the veil b/c of pyramiding structure – needed to look at conduct of whole group, not just one company.

*Smith, Stone and Knight Ltd. v. Birmingham Corp.* (1939 – England)

Ratio: Exception to the *Salomon* principle arises where the corp. is simply an agent of the shareholder. Suggested following tests:

* + Were the profits treated as profits of the parent company?
	+ Were the persons conducting the biz appointed by the parent company?
	+ Was the parent co the head & brain of the trading venture?
	+ Did the parent co govern the trading venture, decide what should be done, and what capital should be embarked on the venture?
	+ Did the parent co make profits by its skill & direction?
	+ Was the parent co in effectual and constant control?

*Alberta Gas Ethylene Co. v. MNR* (1990 – Fed. CA)

Facts: A wanted loan from USA, so created subsidiary in Delaware to get a lower interest rate

Held: Legal to do this b/c purpose behind creation of the company was proper → no reason to pierce corporate veil

*Gregorio v. Intrans-Corp.* (1984 – ONCA)

Facts: G bought a defective truck from IC, but IC didn’t manufacture the truck, ordered it from Paccar Canada. PC didn’t manufacture it, ordered it from Paccar Inc. (USA). G sues PC.

* Argument to make Paccar Canada responsible for the negligent manufacture of the truck was that it was the same as the parent company Paccar Inc.

Held: Unless subsidiary is under complete control of parent company & nothing more than a conduit, can’t use alter ego argument to pierce the veil

*Walkovsky v. Carlton* (1966 – NY)

Facts: Each corp. had 2 cabs, no assets, and minimum insurance. W was struck by a cab owned by Seon Corp (driven by Marchese), and W sued all 10 cab companies and Carlton.

* W argues he is entitled to hold the shareholders of the controlling corp. personally liable for the tortious misconduct of the taxicab operators b/c the multi-corporate structure constitutes an unlawful attempt “to defraud members of the general public” who might be injured by the cabs.
* Direct tortfeasor = Marchese
* If he was an employee of Seon Corp, that means W can sue Seon for vicarious liability

Issue: Can W hold shareholders personally liable for driver’s negligence?

Analysis: Courts rely on general rules of agency in determining whether to extend liability → “whenever anyone uses control of the corp. to further his own rather than the corp.’s biz, he will be liable for the corp.’s acts”

2 ways to argue this:

1. Corps not separate legal entities, actually part of a larger corporate combine that conducts the biz – in this instance can’t hold shareholders liable, just the larger corporate entity
2. Corp. is a “dummy” for individual stockholders who are carrying on the biz in their personal capacities for personal rather than corporate ends → in this scenario you can hold the stockholders liable

Corporate form can’t be disregarded merely b/c assets of corp. + mandatory insurance coverage of the vehicle are insufficient for plaintiff’s recovery → If coverage is inadequate problem is w/Legislature, not the courts

Plaintiff failed to prove corp. was acting as “agent” for shareholders

Ratio: **Corporate form can’t be disregarded merely b/c assets of corp. + mandatory insurance coverage of vehicle insufficient for plaintiff’s recovery**

*ADGA Systems International v. Valcom* (1999 – ONCA)

Facts: AGDA claims that V’s director and two senior employees procured ADGA’s employees to breach their contracts.

Issues: Can directors and/or employees be sued as individuals for torts committed during the normal course of their duties assuming those actions were genuinely directed to the best interests of their corporate employer?

Holding: Yes, they can be sued on these facts.

Ratio: *Said v Butt* doesn’t apply to economic torts where there is not a pre-existing relationship between D’s corporation and P – if that exception exists is left for another court to find based on an applicable set of facts. Determining liability of directors/officers is fact based. In general, employees/directors/officers are personally liable for tortious conduct causing physical injury, property damage, or a nuisance, even when done in the course of employment or in the company’s best interests (*London Drugs v Keuhne*).

Analysis: P relies upon establishing an independent cause of action against the principals of the company so the corporate veil is not threatened and the *Salomon* principle remains intact.

*Choc v. Hudbay* (2013 –Ont.)

Ratio: picks up on ***Gregorio*** → unless subsidiary under complete control of parent & is nothing more than a conduit used by parent to avoid liability, won’t be found to be alter ego of parent. Alter ego principle applied to prevent conduct akin to fraud.

* Ontario courts recognized 3 circumstances in which separate legal personality can be disregarded & corp. veil pierced:
	+ Where the corp. is “completely dominated and controlled and being used as a shield for fraudulent or improper conduct
	+ Where the corp. acted as the authorized agent of its controllers, corp. or human
	+ Where a statute or contract requires it
* “Complete control” requires more than ownership (***Transamerica***)
* “Conduct akin to fraud”
	+ Veil should be pierced where the very use of the corp. is to hide misappropriation of funds, not just b/c a corp. may have misappropriated funds

Incorporation Process

WHY INCORPORATE?

* Limited liability
* Perpetual existence
* Share transferability
* Shareholders alone can’t bind the corp.
* Shareholder can contract w/sue corporate body; partner can’t contract w/his firm
* Facilities for corp. to secure additional capital not possessed by a partnership
* Tax benefits

STEPS IN INCORPORATION PROCESS

Essential procedural elements of the incorporation process:

* 1. Filing articles of incorporation:
		+ Includes the company’s name, its registered office and so forth.
		+ For “simple CBCA corporations,” filling out “Form 1” is usually sufficient.
		+ **Section 6(1)** sets out the required articles:
			- Corp’s proposed name
			- Place in Canada where registered office is to be situated
			- Classes of shares & rights/restrictions on shares
			- Statement of any restriction on the transfer of shares
			- Number of directors (or min/max)
			- Restrictions on kind of biz that corp. may carry on
	2. Filing a notice of the registered office of the corporation,
	3. Filing a notice of directors, and
		+ Listing the names and addresses of the directors.
	4. Paying the prescribed fee.

**Who Can Incorporate?**

**Section 5:** Defines who can be an incorporator. Must be:

* Older than 18
* Can’t be bankrupt
* Of sound mind

Partnership cannot be an incorporator, b/c LPs/LLPs are not separate legal entities

PRE-INCORPORATION CONTRACTS

* Both contracting parties fully aware that the corporation has yet to be formed (***Kelner***)
* At least one (and usually both) of the parties mistakenly believes that the corporation has been validly formed (***Newborne, Black, Wickberg***)

**Two Major Issues:**

1. **Is the promoter personally liable under the K?**
	1. If both parties **knew** **company** **didn’t exist** at time of contracting, but both parties intended to have K enforceable, then promoters will be personally liable (***Kelner***)
	2. If parties intended to bind corp. itself, either evidence by form of promoter’s signature or the court’s interpretation of parties’ intent = promoters not liable personally under the K
2. **Is the company bound by the K?**
	1. **S. 14(2):** corp. may, w/in reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt a written K made before it came into existence in its name or on its behalf, and on such adoption.
		1. Corps has to adopt pre-incorp. Ks in order to remove personal liability of promoter

**S.14 (3)** 🡪 party to a contract may apply to the court for an order respecting the nature and extent of the liabilities under the contract. It simply says the court can apprortion liability between the promoter and corp upon application by the promoter or third party.

**S.14(4)** 🡪 someone isn’t bound. This section says promoters can contract out of personal liability. Promoters’ personal liability can be disclaimed by written agreement.

*Kelner v. Baxter* (1866 – England)

Facts: P and others were to be directors of a company that was to be formed to establish a hotel. P, a wine merchant, continued business, pending the sale of the business to D, and entered into an agreement for the transfer of the additional stock before the hotel company was incorporated. It was signed by the directors “on behalf of the Gravesend Royal Alexandra Hotel Company, Limited”. The agreement was later ratified once the company was incorporated. The company collapsed and P brought the action against D on the initial agreement.

Issue: Is the contract binding on the defendants personally?

Analysis: No principal b/c company didn’t exist yet, so not liable under agency law

* Court also rejects ratification argument – can’t ratify a K created before company came into existence (NOW YOU CAN –s. 14)
* Parties indicate intention to be bound – both parties knew company didn’t exist, but went ahead w/K anyway

Held: Yes, it was their intention to be bound personally.

Ratio: There was no company in existence at the time of the agreement and so it would be wholly inoperative unless it was held to be binding on the defendants personally. Where both parties are aware the company has not been incorporated, it will be held that the intention is for them to be bound personally.

**NOTE:** This case has been **overruled** by **CBCA s. 14(2)**

*Newborne v. Sensolid* (1953 – England CA) – Rule of Construction Approach

Facts: P formed a company, prior to registration entered into a K. Defendants refuse to follow through, P sues for specific performance.

Issue: Can P recover even though K was made in company’s name?

Ratio: B/c company was not in existence when K was signed, there never was a K. Can’t use *Kelner* to argue that everyone who signs when a company contracts is personally liable if the company isn’t in existence yet. Company can contract on its own, doesn’t require agency relationship.

*Black et al. v. Smallwood & Cooper* (1966 – Australia)

Facts: A purported to enter into an agreement for the sale of land with R to R’s company. The company had not been incorporated at the time but both parties believed that it had been. The transaction falls through and A argues that R is personally liable for the contract since the principal didn’t exist and R signed under the corporate name as directors.

Issues: Are the respondents personally liable for the contract?

Holding: No.

Analysis: *Kelner* is distinguished since the K was between 2 parties that both knew company was non-existent. Here, it’s impossible to regard respondents as having used the name of company as a mere pseudonym or firm name or as having intended to incur a personal liability. Looking at the writing on true construction could not be taken as showing intention to be personally bound – the contract is null.

Ratio: Where **both** **parties** are mistaken as to the existence of the corporation and the contract is for the corporation, the parties will not be personally liable – the contract will be void due to common mistake and never have come into existence.

*Wickberg v. Shatsky & Shatsky* (1969 – BCSC)

Facts: D bought a company & decided to carry on business under the name Rapid Data (Western) Ltd, but the company was never incorporated under that name. They hired P and executed a contract the company letterhead and it was signed by D as president. D later instructed P to drop the “Ltd” from the name and P was later fired when the business was unsuccessful.

Issue: Is D personally liable since they signed as an agent for a non-existent principal, or liable under breach of warranty of authority for warranting the existence of the corporation and D’s authority to sign? Or is D’s business actually a partnership and so should be personally liable?

Holding: P gets nominal damages for breach of warranty b/c P’s losses weren’t from the representation, it was because the business failed.

Ratio: Even if the promoter of the company is aware of the lack of incorporation, test = the construction of the K & whether it was the parties’ intentions that the promoter be personally liable. This doesn’t preclude liability for breach of warranty of authority or fraud.

*Sherwood Design Services v. 872935 Ontario* (1998 – ONCA) – s. 14(2): ratification

Issue: Was corp. bound by K?

Dissent: can’t assume apparent authority → to hold a company liable, must be established that the corp. that is now incorporated is the one on behalf of which the promoter entered into the K

Majority: Corp. bound by the K. Found that letter from solicitor to other solicitor was sufficient intention for binding (dissent argued threshold should be higher – require opportunity to accept/reject K terms0

POST-INCORPORATION STEPS - CBCA

**Section 104:** the issue of the certificate of incorporation is followed by a meeting of the directors, in which they may:

* 1. Make bylaws,
		+ An “important constitutional document of the corporation governing its internal procedures.”
		+ S. 103(1) sets out the areas that may be regulated, which includes procedures for directors’ meetings, the allotment and issuance of shares, the appointment of officers, and so on.
		+ Bylaws are effective from the date of the directors’ resolution, although they can be invalidated if the shareholders don’t approve.
	2. Adopts forms of security certificates and corporate records
		+ Although the articles have authorized the issue of shares, no shares have actually be issued yet. The directors decide on a share certificate form.
	3. Appoint officers,
		+ Directors act as a group, and have no individual power unless this is granted by the group. Thus, they appoint individual officers to carry out specific tasks for the company and grant them the authority to do so on the corporations behalf.
	4. Recordkeeping,
	5. Appoint an auditor,
	6. Make banking arrangements,
	7. Adopts a corporate seal,
	8. Enter into shareholders’ agreements, which may modify the CBCA rights of both parties.

Financing

**Three sources of corp. financing:**

1. Equity financing →issue shares of stock
2. Debt financing → borrow money
3. Corporate earnings → extra cash generated by the biz itself

**NOTE: for repayment, debt ranks ahead of equity** → creditors are paid out first, then shareholders

* Legal obligation to repay debt; no such obligation for equity

THE SHARE

Concept of corp. share connotes a common, divided, participation interest in corp.’s biz → connected to investment of $$ in corp.

* Share ownership doesn’t = proportionate share in the assets owned by corp. (corp. owns those assets as separate entity)
* On liquidation, shareholders entitled to proportionate distribution of **value** of assets after paying creditors = **residual property**, not portion of assets themselves
* Minority shareholders have no right to call for the property of the corp. in which they held shares to be distributed directly to them (***United Fuel Investments v. Union Gas Company of Canada***)

Share Rights

**Basic Rights**

* Voting
* Dividend
* Liquidation (entitled to residual property)

**Other Rights – Usually Attached to Preferred Shares**

* Pre-emptive rights, right to acquire shares when the corp issue new shares **(s.28(1)).**
	+ - Purpose is to protect existing shareholders’ rights in the same proportion like voting and financial rights.
		- Pre-emptive rights don’t arise in every situation.
* Redemption rights, an option to force the corp to repurchase the shares.
	+ Gives shareholders the option to force the corp.
	+ Usually exercisable upon certain events/time periods.
* Conversion rights, an option to convert shares into another security of the corp **(s.29).**
	+ Corps must have at least one class of shares. Shareholders in that class must have the rights to vote, declare dividends, and the right to residual property. **s.24(3).**
	+ If there’s more than one class, it must be in the articles. If there’s more than one class, all three rights don’t have to attach to one specific class. They can be broken up.
	+ Shares of the same class must be treated equally. **S. 24(3)** 🡪 where a corp has only one class, the rights of the holders are equal in all respects.

*Sparling v. Quebec (Caisse de depot)* (1988 – SCC) – Share is a Whole

Ratio: **share is an integral whole**; can’t split up the rights/liabilities attached to it. Share is not an isolated piece of property; it’s a “bundle” of interrelated rights & liabilities

* Act of purchasing a share is an implicit acceptance of the benefits of CBCA statutory regime; benefits are indissolubly intertwined w/restrictions attendant upon them

*Re Bowater Canadian v. R.L. Crain* (1987 – ONCA) – Rights Attach to Shares, not Shareholder

Facts: Bowater challenged voting provisions contained in Crain’s articles of incorp. → “Step-down” provision; original holder gets 10 votes per share, transferee gets 1 vote per share.

Ratio: **s. 24 (4)** should be interpreted so that rights attached to a class of shares must be provided equally to all shares of that class

* **Rights attach to the share, not the shareholder**; w/in same class, shares must be treated equally

FORMALITITES OF CAPITALIZATION

**Authorized Capital** = indicated how many shares the corp. was authorized to issue → must be stated in corp.’s articles

* Principal function: restrict directors’ discretion to issue shares

**Issued Capital** = shares actually issued (“outstanding”)

* Directors can issue shares to ceiling provided by authorized capital w/o seeking approval of shareholders; beyond that can’t issue shares w/o amending corp.’s constitution to increase authorized capital → requires special resolution approved by 2/3 of votes at shareholder meeting
* Not necessary to place an upward limit on number of shares that directors of a CBCA corp. issue, still possible to enshrine such restrictions in the articles under **s. 6(1)(c)**

COMMON SHARES vs. PREFERRED SHARES

**Preferred Shares:**  special rights/restrictions re: voting rights, dividends, and distributions on liquidation (ex. holders of preferred shares not typically entitled to share in the proceeds of a winding up beyond value of the amount initially invested & any accrued/unpaid dividends)

* + Senior securities → entitle holder to special rights (ex. being paid dividend before common shares)
* The rights of preferred shares are created in the articles. They’re contractual in nature.
	+ Not always good; non-voting shares may be referred to as preferred shares since they’re subject to special conditions
	+ Rights attached to preferred shares must be stated in articles under **s. 6(1)(c)(i)**
	+ Directors may determine the special rights attaching to preferred shares if the shares may be issued in series under **s. 6(1)(c)(ii)** → rights/restrictions can then be left unspecified until the shares are issued

**Preferred Shares Preferences:**

* **Dividend preference and Liquidation preference**
	+ The dividend must be paid before any dividends are paid to common shares.
* **Voting v. non-voting (typically non-voting)**
	+ Many preferred shares allow their holders to vote for directors in diverse financial situation. Like the company fails to pay a dividend for two consecutive years. Preferred shares have the right to vote on some matters under the statute.
* **Cumulative v. non-cumulative**
	+ Normally dividends are a matter of the board’s discretion. The board may decide whether to declare any dividends on preferred shares. Sometimes, preferred shareholders have a carry forward right to receive dividends. If the company doesn’t give them in a year dividends. This depends on whether the shares are cumulative or non-cumulative.
	+ Cumulative: if the company fails to pay a dividend in a given year, the company must make up for it at a later time.
* **Convertible v. Non-convertible**
	+ Preferred shares can be converted into common shares; allows preferred shares to have a claim on receivable profits of the company. Desirable to convert when company has strong earnings.
* **Redeemable v. Non-redeemable**
	+ Company will retain redeemable option. If the shareholders hold a redemption option, then the company will retain a sinking fund in which they’ll set aside a certain amount of money to make repurchase obligations
* **Participating v. Non-participating**
	+ Non-participating – in the event of liquidation, non-participating preferred shares will usually receive an amount equivalent to the initial
	+ Participating – allows preferred shareholders to double dip, can participate in distribution of residual property of corp.

**Hybrid Nature of Preferred Shares**

|  |  |
| --- | --- |
| Equity-like Characteristics | Debt-like Characteristics  |
| - Permanent capital; no fixed maturity date- Divides subject to board discretion- Cannot throw the corp. into bankruptcy for divided arrearage - May have voting rights- Treated as equity for accounting and tax purposes  | - Fixed dividend payments - Liquidation preference over common stockholders - Rights are contract based  |

**Common Shares:** generally free of all preferences/conditions

Pre-Emptive Rights

Focus on issuer’s existing shareholders → new issue of watered stock will dilute their financial interest in the corp., may radically affect control positions even if consideration is adequate

* Existing shareholders may seek relieve by an action to have issue set aside; OR may argue for rule of equal opportunity, w/right to have a proportionate number of shares issued to them on the same terms
	+ Options to purchase shares = **pre-emptive rights**
	+ Assertion of pre-emptive rights may be expensive remedy since shareholder might have to purchase a large number of shares to prevent dilution of his interest

**Section 28:** pre-emptive rights are a matter of K, w/presumption that they don’t arise unless specifically bargained for (permissive, rather than required)

* May be asserted as a remedy against oppressive conduct by management

*Stokes v. Continental Trust Co.* (1906 – NY) – Pre-emptive Right to Purchase New Issue of Shares

Ratio: Stockholder has an inherent right to a proportionate share of new stock issued for money only & not to purchase property for the purposes of the corp. or to effect a consolidation, and while he can waive that right, he can’t be deprived of it w/o his consent except when the stock is issued at a fixed price not less than par, and he is given the right to take at that price in proportion to his holding, or in some other equitable way that will enable him to protect his interest by acting on his own judgment & using his own resources.

Dividends (*Dodge v. Ford*)

**Dividend:** share of profits paid to shareholders

* Usually paid in cash
	+ Comes out of the assets of the corp.
* Can occasionally be paid by distributing other property = “dividend *in specie*”
	+ Most common = distribution of shares the corp. holds in a subsidiary corp. = “spinoff”
* Stock dividend also an option → company will have the same assets as before, but each shareholder will have more shares carrying residual rights to the proceeds from the same assets having the same value as before

**Section 43(1):** outlines legally permitted types of dividends (cash, stock, and property)

No specific section that allocates power to declare dividend → falls under general declaration of power to the directors in **s. 102(1)**

**Directors are not obligated to declare dividends →** must exercise their powers in the best interests of the corp. & in a way that’s not oppressive or unfairly prejudicial to shareholders

* **Fiduciary Duty:** director must act in the best interest of the corp., which could require payment of dividends (***Dodge v. Ford*** – US, 1919)
	+ Company had amassed substantial retained earnings, Ford wanted to keep the $$ in the corp. but had ring of charitable benefit for society, not for purpose of supporting best interests of the corp.
* **Oppression:** directors may be obliged to pay a dividend where a failure to do so would be oppressive or unfairly prejudicial to, or would unfairly disregard the interests of, one or more shareholders (***Ferguson v. Imax*,** 1983 – ONCA)

**Protection of Creditors:** dividends can’t be paid if the corp. would then be unable to pay its debts as they fall due (**s. 42**)

EQUITY FINANCING – HOW TO ISSUE SHARES?

**Section 25:** outlines:

* (1) – Directors can issue shares (subject to articles/bylaws/unanimous shareholder agreement)
* (2) – Shares issues are non-assessable and holders not liable to corp. or creditors in respect thereof
* (3) – Shares can’t be issued w/o consideration; transaction for shares must be paid in full
	+ Used to be **subscription agreements** → allowed for partly paid shares, which is now abolished.
	+ Pre-incorp subscription allowed through **s. 14** – allows ratification of pre-incorp K after incorporation. BUT the shares must then be paid for in full.
* (4) – Consideration can be money, property, or past services

How do shareholders realize profits?

* **Capital Gains v. Dividends**
	+ Dividend = distribution of company’s profits to shareholders
		- How does the board declare dividends?
			* Board resolution
				+ Declaration date – Record date – Payment date
				+ If you sell your shares between declaration & record, you don’t get a dividend b/c not on the record date
				+ If you buy after record, don’t get a dividend b/c not on the record
				+ If you have the shares until record date and then sell after, you get the full price for the shares + a dividend (but sale price would drop b/c not a possibility of getting name on the record)
* **Cash v. Stock [s. 43(1)]**
	+ Cash dividend = less assets for company
	+ Stock dividend = doesn’t reduce company assets
		- From a shareholder’s perspective, the diff. is tax → if you receive cash, you have to pay tax on it; if it’s stock, there is no tax – if the price goes up then you can make a profit
* **Restrictions on Dividend Payments**
	+ **Solvency test** [**s. 42(a)]**
		- Won’t pay dividends if the corp. is, or would after the payment be, unable to pay its liabilities as they came due
	+ **Capital Impairment test** [**s. 42(b)]**
		- Won’t pay dividends if the realizable value of the corp.’s assets would be less than the aggregate of its liabilities and stated capital of all classes
	+ Restrictions ONLY APPLICABLE TO CASH DIVIDENDS (b/c assets being taken out of company that creditors can’t access) – not applicable to stock dividends b/c doesn’t affect assets of the company

Other Ways to Distribute Money to Shareholders

* **Repurchase**
	+ Buying back outstanding shares
	+ Reduce the number of shares outstanding → boost earnings per share
* **Redemption**
	+ A forced sale initiated by the corporation, in accordance with the articles of incorporation
	+ Usually associated w/preferred shares
	+ Subject to restrictions – similar to those on dividend payments
* **Statutory Restrictions** [**ss. 34-36**]
	+ **S. 35**
		- **(1):** Some situations where company may repurchase shares (i.e. to settle a debt)
			* These are not the common reasons why corp. repurchases shares
	+ Some of the common reasons are:
		- Think the shares are cheaper than the value they deserve
		- Company wants to build a reserve of shares for future use

Corporate Governance

WHAT IS CORPORATE GOVERNANCE?

* “Corporate governance is the system by which companies are directed & controlled”
* “[It] specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making”
* Centralized management – power w/ BOD. Why is BOD granted management power? Under what circumstances should boards be limited? Should shareholders have a greater say?
* A system that governs the relationships among the various stakeholders of the corp.
	+ Stakeholders includes:
		- Directors
		- Officers
		- Shareholders
		- Employees
		- Creditors
		- Gov’ts
		- Consumers
		- Communities
	+ Often there are conflicts between stakeholders – how do you solve?

CORPORATE GOVERNANCE THEORIES

Shareholder Wealth Maximization Theory

Posner – “Values & Consequences: An Introduction to the Economic Analysis of Law”

* Economic analysis of law has both positive (descriptive) and normative aspects
	+ Tries to explain and predict the behaviour of participants in & persons regulated by the law
	+ Also tries to improve law by pointing out respects in which existing or proposed laws have unintended or undesirable consequences – on economic efficiency, or distribution of income/wealth, or other values
* Law & economics movement has influenced: antitrust, regulation of public utilities & common carriers, environmental regulation, computation of damages in personal injury suits, regulation of securities market, federal sentencing guidelines, division of property & calculation of alimony in divorce cases, law governing investment by pension funds & other trustees
	+ Significant factor in deregulation movement & in free-market ideology generally
* Law & economics theory has its basis in primacy of wealth maximization as rationale for using the corporation as a vehicle for economic activity
* Normative basis = utilitarianism

Posner – “The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication”

* System of wealth maximization consists of institutions that facilitate, or where that is infeasible approximate, the operations of a free market and thus maximize autonomous, utility-seeking behaviour
	+ Utility seeking in a market requires inducing others to enter into transactions advantageous to them → wealth automatically transferred to those who have productive assets (goods/time)
	+ Those w/no productive assets have no ethical claim on the assets of others
	+ Consistent w/desire (rooted in principles of autonomy & consent) to minimize coercion
* Constrained utilitarianism → constraint is supplied by principle of consent = people may seek to promote their utility only through the market/institutions modeled on the market

**Role of law in business:** “facilitate, or where that is infeasible approximate, the operations of a free market” → economic conception of corporation as a “nexus of contracts”

Agency Theory

* Managers as agents; shareholders as principles → based on theory that everyone is acting in his/her own interest
	+ Shareholders hire managers as agents to run daily management of the biz
	+ Conflicts of interest between management and shareholders
		- Managers want highest remuneration w/lowest effort
		- Shareholders want highest profit w/lowest costs
* Information asymmetry b/c shareholders can’t monitor managers
	+ B/c of this, managers will act in their own interest
	+ Value of company not maximized = agency cost
* To minimize agency cost, managers must act in best interest of shareholders
* Agents subject to principal’s control → are managers subject to shareholders’ control? Yes, they have the power to elect/remove directors.
	+ Dividend – directors have the power to declare them; w/in directors discretion to pay or not pay a dividend
		- How can shareholders be the principal w/o control of this matter?
* Agency costs = monitoring costs + bonding costs + residual costs
* Agency cost theory assumes that managers are the agents of undiversified shareholders, and that governance can be measured by control of agency costs as a means of enhancing economic efficiency

**Strategies to Reduce Agency Costs**

* Firm can adopt harm prevention measures aimed at lowering agency costs:
	+ Liability strategies
		- Bonding tactics in which firm managers promise efficient performance backed up by an imposition of liability on breach of that promise → manager’s assets serve as a bond of their fidelity to the promise
		- Civil liability under securities legislation = form of bonding b/c gives investors an opportunity to seek damages from directors personally for particular kinds of conduct
	+ Governance structures
		- Attributing monitoring duties to claimholders (i.e. granting voting rights to one set of claimholders, or imposing gatekeeping responsibilities on directors/auditors)
	+ Compensation
		- Can minimize agent misbehavior through special forms of executive compensation (i.e. bonus plans – tie the manager’s salary to firm performance)

**Agency Cost Strategies and Efficient Capital Markets**

* Markets frequently not efficient, in that stakeholders don’t have full info and don’t have bargaining power to require corp. to adopt efficient governance, liability, and compensation strategies to reduce agency costs
	+ If markets efficient, firm will bear all agency costs and it would voluntarily agree to adopt optimal harm prevention strategies
	+ If markets informed of agency costs of particular firm, then that firm will bear them itself in its cost of capital and debt; firm would want to take efficient preventive measures to reduce agency costs
	+ If markets inefficient, firm may lack incentive to take these measures

Contractarian Theory

* Nexus of Ks = web of interrelated Ks among various stakeholders
* Each stakeholder makes some contribution to the company in exchange for right to get certain output. Details depend on K.
	+ Shareholders not “owners” of the corp., just one type of investment → contribute assets in exchange for right to receive residual profit of corp.
	+ Employees contribute labour in exchange for salaries
	+ Supplies contribute materials in exchange for fixed payments
	+ Communities contribute civil servants in exchange for taxes
* Corp. law = set of default rules (like a form K) → each stakeholder can contract around these rules
* Role of corporate law in this theory is enabling → should contain the terms that people would have negotiated in their contractual relationship w/the firm, were the costs of negotiating at arm’s length for every contingency sufficiently low
* Markets & private contractual relations should govern corp., NOT public regulation
	+ Public regulation should be facilitating only → goal of the law is to allow corps to function more easily, not to restrict corporate activity
* Shareholders given primacy as residual claimants to corp.’s assets & as the parties that are least able to contract to protect their inputs into the corp.
	+ Reason shareholders have exclusive voting rights is b/c they are the residual claimants to the firm’s income → should have appropriate incentives to make discretionary decisions
* Managers are agents of the corp. → shareholders need to control the agency costs of managerial self-dealing/shirking since increased agency cost decreases their return
* Theory fails to take account of other stakeholders who are equally unable to fully contract their relationship w/the firm, and who, depending on the firm’s solvency, may be the residual claimholders rather than the shareholders

William W. Bratton Jr. – “The New Economic Theory of the Firm: Perspectives from History”

* Neoclassical variant’s central point = firm is a legal fiction, serves as **nexus for set of contracting relations** among individual factors of production
	+ Displaces management-centered conception of corps.
	+ Contracting nexus – not necessarily a hierarchy in which authority determines terms by fiat
	+ Reconceives management as a continuous process of negotiation of successive contracts
* Create a model of the management corp.
	+ Find parties & terms for their firm of Ks by drawing on economists’ basic assumptions about the behaviour of marketplace actors and the nature of marketplace Ks
		- Actors are rational economic actors – self-interested individuals w/divergent interests
		- Ks are equilibrium Ks that rational economic actors enter into when dealing in markets – instantaneous exchanges between maximizing parties
		- Parties make complete choices, dealing w/unknown factors in the exchange price
	+ Theorists also assume that effective competition exists, and apply the principle of natural selection (rational economic actors solve problems in process of pursuing wealth maximization – only optimal contracting strategies survive)
	+ W/in framework, firm Ks take forms determined by the now well-known imperative of agency cost reduction
		- Risk allocating Ks have winners & losers – maximizing losers tend to “shirk”: take actions to avoid having to perform their promises fully
		- Agency costs = cost of shirking
		- Since rational economic actors are aware of shirking, they factor it into costs against contracting partners ahead of time
		- Competition – party who reduces the agency costs has the edge
* Using this model, theorists have rationalized the positive law of relations among shareholders, boards of directors, and officers; the internal decision-making structures, policies, and procedures of corporate bureaucracies; and the Ks firms make w/employees, suppliers, and creditors
	+ Managers act as agents to shareholder principals. When securities are sold publicly by management groups to outside shareholder principals, the purchasing shareholders assume that managers will maximize their own welfare; purchasers therefore bid down price of securities
	+ Management bears costs of its own misconduct & has incentive to control its own behaviour → increases selling price of its securities by offering monitoring devices (independent directors & accountants, legal rules against self-dealing, etc.)
* Neoclassical picture also implies limited role for corporate law – doesn’t invest & legitimize power in hierarchical superiors; appears as just another term of the contract governing equity capital input
* Model affords no basis for intervention by gov’t for protection of shareholders
* **Neoclassical new economic theory:** corporation exists to maximize the wealth of its shareholders, and the corporation’s management ought to act as the shareholders’ economic agent in pursuing this end

Team Production Theory

BOD acts as mediator, allocates the risks/rents among the participants in the corp.

* Directors have to allocate rents in a fair way in order to treat corp. coalition as a whole
* Scope of beneficiaries broader than shareholders
* Theory views corp. as a team → includes managers, shareholders, employees, and creditors who pool their resources to produced goods/services for mutual gain
	+ Corporate officers = “mediating hierarchy” in advancing the productive activities and interests of team members
	+ Role of other members is to maximize production but also to act as a control on managerial shirking & rent seeking (managing in a manner that brings personal benefit to the managers rather than making decisions in the best interests of the corp.)

Blair & Stout – “A Team Production Theory of Corporate Law”

* Building on idea of corp. as “nexus of Ks”
* Gaps in explicit Ks can be filled by assigning residual control rights (“property rights”) to one of the parties to the transaction
* B & S explore a diff. option → assigning control rights to a third party – the board of directors – which is largely insulated from the direct control of any of the various economic interests that constitute the corporation
* Essential “contract” to the nature of public corps. = “pactum subjectionis” under which shareholders, managers, employees, and other groups that make firm-specific investments yield control over both those investments and the resulting output to the corps. Internal governing hierarchy
* Shareholder primacy norm is based on 2 aspects of law that seem to give shareholders unique rights to exercise control over the board: derivative suits for breach of fiduciary duty and shareholder voting rights → B & S say these rights are so limited as to be basically non-existent
	+ Corporate law thus leaves boards of directors largely free to pursue whatever projects & directions they choose, subject only to the limitation that they not use their positions for own personal enrichment
* Criticism:
	+ Corporate law fails to grant shareholders sufficient protection from the depredations of their own “agents”, the BOD
	+ Employees as well as shareholders should be given voting rights, explicit rep on corporate boards, or standing to bring suits for breach of fiduciary duty
* Corporate law not designed primarily to protect shareholders – designed to protect the corp. coalition by allowing directors to allocate rents among various stakeholders, while guarding the coalition as a whole only from gross self-dealing by directors
* Lessons offered by **mediating hierarchy approach**:
1. Highlights importance of team production dynamics in rise of public corp. as a vehicle for doing biz → significant economic advantages to public corp. in spite of/because of the requirement of ceding control to an independent BOD
2. Fundamentally political nature of the corp. → corps. Mediate among the competing interests of various groups/individuals that risk firm-specific investments in a joint enterprise; should look into the study of corp. governance w/attention to use of political tools, and role of cultural norms in reducing/resolving conflict
3. Restructuring process in the 1980s after a couple decades of lazy Corporate America → how should corp. scholars interpret, and lawmakers respond to, these events? Mediating hierarchy approach suggests 2 possibilities:
	1. Corp. directors as mediating hierarchs enjoy considerable discretion in deciding which members of the corp. coalition receive what portion of the economic surplus resulting from team production. Return to any particular corp. stakeholder from participating in the corp. will be determined not only by market forces, but by political forces. Shareholders as a class have acquired additional political power that allows them to capture a larger share of the rents from the corporate enterprise and have grown richer, while employees as a class have lost political power, and thus grown relatively poorer
	2. Response to changing market forces that altered various team members’ opportunity costs and thus, the minimum rewards they must receive to have an incentive to remain in the team
* Shift in balance of power toward shareholders not the result of directors’ sudden recognition that shareholders are “owners” of the corp., but a result of changing economic & political forces that have improved shareholders’ relative bargaining power vis-à-vis other coalition members
* Mediating hierarchy model suggests that public corp. viewed most usefully as a nexus of firm-specific investments made by many & varied individuals who give up control over those resources to a decision-making process in hopes of sharing in the benefits that can be had from team production
	+ In the collective interest of team members to minimize shirking/rent-seeking b/c those can erode gains made by team production
* Public corp. law = mechanism for filling in the gaps where team members have found explicit contracting difficult or impossible → still consistent w/”nexus of contracts” approach to corp. law
* Primary job of BOD of a public corp. is NOT to act as agents who ruthlessly pursue shareholders’ interests at the expense of employees, creditors, or other team members → Directors = trustees for the corp. itself; mediating hierarchs who work to balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together
* Criticism: allocation of the surplus is a matter of power, as participants compete to strike the best bargain w/the BOD → parties already vulnerable likely to continue to be vulnerable

CORPORATE SOCIAL RESPONSIBILITY

* Beyond compliance w/the law
* Beyond shareholder wealth maximization
* Idea that corps. should do more than bare-minimum required by law

|  |  |
| --- | --- |
| **Against** | **For** |
| Improving shareholders’ wealth also improves stakeholders’ wealth. Employees make more, have better benefits, more job security. | Can transfer wealth from other stakeholders; shareholders have disproportionate gains vs. other stakeholders. |
| “No one can serve two masters.” Directors/Managers are agents; communities, employees, shareholders = principals. | In conflict w/first argument. Interests of various principals are not necessarily in conflict.  |
| Managers are ill-qualified to make public policy decisions. | Could argue that managers know their corps. the best – know if they have the capacity to improve certain aspects. |
| Stakeholders can seek protection through contracting w/companies or other laws outside corp. law.  | Alternative remedies can be time-consuming, but the unbalanced bargaining positions of employees/employers make contractual protection unlikely. |
| Managers have no right to spend shareholders’ money for stakeholders’ benefits. | In order to make money you have to invest money; part of the regular corp. cost - $$ donated to CSR leads to higher return in long run. Expenses defined w/in discretion of managers. |

Daniel Fischel – “The Corporate Governance Movement”

* Those who argue for corporate social responsibility assume that corps are capable of having social & moral obligations → Fischel says this is WRONG
* Corp. is nothing more than a “legal fiction” = a nexus for a mass of Ks which various individuals have voluntarily entered into for their mutual benefit
	+ Only people can have moral obligations & bear the costs of non wealth-maximizing behaviour → corp. is more akin to an inanimate object than a person
* Not an issue of public policy, but of contract law → Do investors, as long as corps lawfully may be formed for profit, have any duty to sacrifice profitable opportunities to benefit some other parties? And do managers, acting as agents for investors, have any right or duty to sacrifice profitable opportunities to benefit some other party?
	+ NO – **managers should act to maximize the wealth of investors pursuant to the terms of the K of their agency relationship**

Emerging Third Way of Governance?

**Progressive Approach:**

* Challenges shareholder primacy on grounds that corp. is not a private entity, but a public entity
* Kelley Testy identifies unifying characteristics of “progressive corporate law”:
	+ View of the corp. as at least a quasi-public entity
	+ View that corporate law has a substantive job rather than only enabling private bargaining
	+ Support for stakeholders over shareholders
	+ BOD as trustees for society
	+ Concentration on anti-democratic uses of corporate power
	+ Focus on corporate illegality & immorality
	+ Interest in wealth disparities
	+ Interest in environmental & worker externalities

Testy – “Capitalism & Freedom: For Whom? Feminist Legal Theory & Progressive Corporate Law”

1. Challenge to shareholder primacy → corp. decision making should consider a wider array of constituents w/o hierarchy of shareholder primacy model
2. Critique of shortcoming of existing fiduciary duty law; argue feminist insights into concepts of care/connection can & should give increased substantive context to director & officer duties
3. Critique of concentrations of undemocratic corporate power together w/an argument that to the extent that power works hardships on individuals in society, those hardships fall disproportionately on women (especially 3rd world)

Directors act in best interests of the corp., but in determining best interest, consider the implications of particular decisions on corp.’s employees, investors, customers and creditors

**Power Coalition Theory:**

Lynne Dallas – “Two Models of Corporate Governance: Beyond Berle and Means”

* Corporate governance structures persist b/c:
	+ They’re demanded by those in positions of power;
	+ Become the traditional/accepted ways of doing things;
	+ Changing structures would require the adoption of values not reinforced by existing structures that tend to generate their own value system; OR
	+ They’re buffered from the effects of competition
* Power model depicts firm as an institution w/own internal structure that seeks to decrease its uncertainty by increasing its own autonomy & discretion over its environment
* Organizations constrained by political/legal/economic environment, but law, legitimacy, political outcomes & economic climate reflect in part actions taken by organizations to modify these environmental components for their own survival/growth
* Organizations are proactive, not just reactive

*Dodge v. Ford* (1919 – Michigan) – Best Interests of the Corp.

Facts: Company discontinued special dividend, retained the $58 million for re-investment; Dodge challenged that and said Ford should pay a dividend. Ford said no, he wanted to use the money to make cheaper cars and employ more people.

Held: Court ordered the corp. to pay the dividend

Ratio: “A business corp. is organized and carried on *primarily for the profit of the stockholders*. The powers of the directors are to be employed for that end. Discretion of directors is to be exercised in the choice of means to attain that end, and doesn’t extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes” (bad evidence – this came from Michigan Supreme Court – no reputation in American corporate law, Delaware is the best, then California & NYC)

* **NOTE:** Often believed that America wants to maximize wealth of shareholders, some states have “other constituency” statute → allows corps to consider non-shareholder interests when making biz decisions
* Pennsylvania → can consider long & short term interests of the company
* General Rule: BOD may, in considering *the best interests of the corp.*, consider to the extent they deem appropriate:
* Effects of actions on groups such as shareholders
* Short & long-term effects

Best Interests of the Corp.

**Section 122(1):** Every director & officer of a corp. in exercising their powers & discharging their duties shall:

* **Act honestly and in good faith** w/a view to the **best interests of the corp.**

***Peoples Department Stores v. Wise* (SCC 2004)**

* “In determining whether they are acting with a view to the best interests of the corp. it may be legit, given all the circumstances of a given case, for the BOD to consider, *inter alia*, the interest of shareholders, employees, suppliers, creditors, consumers, gov’ts, and the environment
* PRO stakeholders

***BCE Inc. v. 1976 Debentureholders* (SCC 2008)**

* “Where the conflict involves the interests of the corp., it falls to the directors to resolve them in accordance w/their fiduciary duty to act in the bests interests of the corp., viewed as a good corporate citizen”
* No elaboration on what “good corporate citizen”

**Benefit Corp.**

* Delaware General Corp Act s. 362(a)
	+ “Public benefit corp.” is a for-benefit corp…intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. PBC shall be managed in a manner that balances the stockholders’ pecuniary interest, the best interests of those materially affected by the corp.’s conduct, and the public benefit or public benefits identified in its certificate of incorporation
	+ Regular corp. can be converted if articles are amended – requires 90% affirmative vote

**Community Contribution Company (C3) in BC**

* Features:
	+ Community purpose (s. 51.19)
	+ Dividends permitted subject to restrictions (s. 51.94)
	+ Asset lock when dissolution (s. 51.95(3))
	+ Community contribution report (s. 51.96)
	+ Taxed like regular for-profit biz, not as not-for-profit
* Community Purpose - BCBCA s. 51.91
	+ Must have a purpose beneficial to society at large or a segment of society that is broader than the group of persons who are related to the community contribution company
* Dividends
	+ CCC Regulations s. 4 = restrictions on dividends
	+ Can’t declare a divided unless total amount of all dividends declared
* Asset lock – BCBCA 51.95
	+ Can distribute max. 40% of assets to shareholders; purpose of this is to ensure most of the assets remain dedicated to community purposes
* Community contribution report – BCBCA 51.96
	+ Must annually produce and publish a report w/details about C3 activities like transfers of assets etc.
* Tax
	+ To be taxed as a NFP can’t distribute any dividends, must be wholly dedicated to social welfare
	+ C3 doesn’t qualify

Powers of Directors & Officers

WHO CAN BE DIRECTORS?

* Basic Qualifications [**s. 105(1)]**
	+ Must be at least 18 years old, of sound mind, and not bankrupt
	+ Corp. can’t be a director
* Shareholding Requirements [**s. 105(2)]**
	+ Unless the articles otherwise provide, a director of a corp. is not required to hold shares issued by the corp.
* Residency Requirements [**s. 105(3)]**
1. **Election:**
	1. After the first meeting of shareholders, directors and officers are elected by ordinary resolution **(s. 106(3)),** denoting the majority of votes cast by shareholders who votes on the resolution (**s. 2(1)).**
	2. Shareholders must elect directors at each annual meeting (**s. 106(3)).**
	3. The same person can hold two or more offices of the corporation **(s. 121(c)).**
2. **Term of office,**
	1. Commonly runs from point of election to the subsequent annual meeting. However, the articles may provide for a term up to 3 years **(s. 106(3) and (5))** and if no successor is elected, the incumbent stays in office **(s. 106(6)).**
	2. Note the possibility of staggered boards, which prevents the complete ousting of a board by shareholders in one meeting.
3. **Filling of vacancies,**
	1. A closely held corporation needs one or more directors, while a distributing corporation (provided that the issued securities are held by more than one person needs three or more directors, at least two of which aren’t also officers of employees of the corporation or its affiliates **(s. 102(2)).**
	2. Directors generally have the power to fill vacancies on the board **(s. 111(1)).**
	3. However, if the vacancy arises from an increase in the allowable amount of directors or if the shareholders failed to elect directors sufficient for a quorum, the directors must call a meeting of shareholders to do so **(s. 111(2)).**
4. A director ceases to hold office during their term if they die, resign, become disqualified, or is removed by resolution (**s. 108**).
5. **Removal,**
	1. Shareholders may remove directors by ordinary resolution **(s. 109(1)),** and may in the same meeting also appoint a replacement **(s. 109(3))** – or the directors may do so.
	2. The articles may not require a higher (i.e. special) majority for the removal of directors **(s. 6(4)).**
	3. ***Bushell v Faith* (UK)** observed that clauses in the article modifying the voting power attached to shares in a given context (specifically a tripling of voting power of a shareholder acting as director who is the subject of a removal vote) did not offend the comparable UK statute.
		1. Clause allowing removal of director by ordinary voting power = *Bushell v. Faith* clause
			1. Only practical for private companies, not public

STRUCTURE OF THE BOARD

Number of Board Members

* **S. 102(2):** Corp. shall have one or more directors but a distributing corp. shall have not fewer than 3 directors, at least two of whom are not officers or employees of the corp. or its affiliates
	+ Private – min. director = 1
	+ Public – min. director = 3 (2 must be outside)

Outside Director

* **Outside Director** = not officers or employees of the company
* Not necessarily independent directors; but independent directors must be outside directors

Independent Director

* TSX listing requirements:
* Not a member of management, free from any biz interest or other relationship that could reasonably be perceived to interfere materially w/their ability to act in the best interest of your company; and
* Is a beneficial holder, directly or indirectly, collectively of 10% or less of the votes of all issued and outstanding securities of your company
* Stricter standards than outside directors – no material interest at all; whereas outside directors just can’t be officers or employees

Why do we need outside/independent directors?

* In the past board members were managers, since turn of century there has been a shift from managing board to monitory function
* If everyone is a manager, can’t monitor themselves
* Purpose is to monitor management – why? So that management makes better decisions. End goal is that company will have better performance.
* Trade off between inside knowledge & outside independence

Committees

* Audit committee [**s.171**]
	+ **(1)** Min. 3 directors; majority must be outside directors
	+ **(3)** = Function of audit committee → review financial statements before they’re approved under s. 158 by BOD

WHAT ARE THE POWERS OF DIRECTORS?

* General managerial authority [s.102(1)]
	+ “Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the biz and affairs of a corp.”
* Some important powers:
	+ Adopt, amend, or repeal bylaws [**s.103**]
	+ Declare dividends
	+ Issue securities [**s.25**]
	+ Appoint/remove officers
	+ Remuneration [**s.125**]
* Delegation and restrictions [**ss.115 & 121**] – particularly **s. 115(3**)
	+ What’s not delegable?
		- Power to declare dividends
		- Issue securities
		- Adopting/amending/repealing bylaws
* Board meetings constitute the principal vehicle for the exercise of directors’ powers. Subject to the articles, a quorum is the majority of the board **(s. 114(2)).**
* An alternative to board meetings is a unanimous written resolution, as per **s. 117(1**), denoting a written resolution signed by all directors.
* All directors are deemed to have consented to and are liable for resolutions passed by the majority unless they are entered into the minutes as having dissented or send a written dissent during or immediately after the meeting is adjourned. A director who was not present is deemed to have consented unless they enter a dissent within seven days of adjournment **(s. 123).**
* Certain categories of actions and appointments are of no force and effect because they are **beyond the powers** of directors. Note, however, that acts of directors and officers are valid despite deficiencies in their appointment or qualifications **(s. 116**) – amounting to deemed actual authority to bund the corporation. The applicability of **s. 116** has limits, and will, for example, not apply where there was no act purporting to appoint a director (***Morris***).
* Bonus content,
	+ **No constructive notice** of documents filed by a director or available for inspection at the corporate offices is imputed onto anyone **(s. 17).**
	+ The corporation, in denying a claimant a given right, may not rely on appointment deficiencies or a claim that an ostensible agent did not have authority while they conducted customary business **(s. 18).**

HOW DO DIRECTORS EXERCISE THEIR POWERS?

* Generally collectively, not individually
* Mechanics of board meetings
	+ Place and notice
	+ Means of participation [**s. 114(9**)]
	+ Quorum [**s. 114(2)]** → majority of directors required in articles of incorporation, regardless of # required for quorum, can’t carry on biz unless 25% of directors present are resident Canadians – can be satisfied if required number of Canadian directors approve the resolution
	+ Resolutions
	+ Dissent **[s. 123]**
		- When a resolution is passed by simple majority, if there is any personal liability resulting from the resolution, all directors are liable unless director has a valid dissent. Must be entered in the minutes of the meeting.
* Alternative to board meetings – unanimous written resolutions [**s. 117(1)]**
	+ Every director has right to be heard

BEYOND THE POWERS

* Sources of acting outside the authority:
	+ **Ultra Vires Doctrine**
	+ Defective appointments [**s.116**]
		- Doesn’t affect directors authority to act
	+ Defective decision-making procedures [*Royal British Bank*]
* Agency law kicks in again!
	+ Indoor management rule [**ss. 17-18**]
		- S. 18: not entirely abolished *ultra vires*
	+ Apparent authority

Ultra Vires Doctrine

**Ultra Vires:** Developed as a rule that a corp. had no legal capacity to act in any fashion not specifically authorized by the incorporating docs (***Ashbury*)**

* Ex. When manager acted in disregard of such a restriction, action was said to be *ultra vire*s the corp. signifying that the manager went not only beyond the scope of his own authority, but also beyond the powers of the corp. as well

**Doctrine largely abolished (s. 15 –** rights of natural person**); s. 16 provides some restriction on authority of majority of BOD**

**Section 16**

* 1. Not necessary for a by-law to be passed in order to confer any particular power on the corp. or its directors
	2. Corp. can’t carry on biz that is restricted by its articles
	3. No act of a corp. is invalid by reason only that the act or transfer is contrary to its articles or this Act

*Ashbury Ry. Carriage & Iron Co. v. Riche* (1875 – England)

Example of *ultra vires* doctrine → covenant is not merely that every member will observe the conditions upon which the company was established, but that no change shall be made in those conditions – nothing can be pursued that is outside the company articles

**NOTE:** in response to this case, corps sought to avoid the consequences through the proper drafting of an objects clause

AUTHORITY OF AGENTS TO CONTRACT FOR THE CORP.

Who can bind corps is matter of agency law as applied to corps

**Actual Authority:**

* May be determined by officer’s K of employment of formal board resolution
* Merely appointing a person to serve as officer = actual authority to make biz decisions that a person in that position usually makes, unless that authority is expressly restricted in some way by the corp.
* Officer also has actual authority when he exceeds authority w/knowledge & acquiescence of the corp.

**Defective Appointments:**

* **S. 116:** where a properly appointed officer/director would have authority to bind the corp. in a particular matter, that authority remains intact even if there has been some irregularity in the appointment/election of the particular person = **deemed actual authority**
* Has its limits → ex. in a case w/ 2 boards due to a fall out, s. 116 won’t validate the actions of both boards

**Ostensible Authority: The Indoor Management Rule**

* ***Royal British Bank v. Turquand* (**1856 – Excheq. Ct.) = Indoor management rule → where an outsider dealing w/a corp. satisfies himself that the transaction is valid on its face to bind the corp., he need not inquire as to whether all of the preconditions to validity that the corp.’s internal law might call for have been satisfied
* **Indoor rule** codified in **s. 18:**  corporation, in denying a claimant a given right, may not rely on appointment deficiencies or a claim that an ostensible agent did not have authority while they conducted customary business
* **S. 17:**  provides that no person is deemed “to have notice or knowledge of the contents of a doc concerning a corp. by reason only that the doc has been filed” publicly

Directors’ Duties

DUTY OF CARE – s. 122(1)(b)

**Section 122(1):** Every director in exercising their powers/discharging their duties shall:

1. Act **honestly & in good faith** w/a view to the **best interests of the corp.** (**duty of loyalty; statutory fiduciary duty**)
2. Exercise the **care, diligence & skill** that a **reasonably prudent person** would exercise in **comparable circumstances** (**duty of care**)

Duties are credible means of protecting corps from various forms of managerial self-dealing:

* **Shirking** – underinvest in managerial competence & care
* **Excessive risk aversion** in their investment decisions as a consequence of a conflict of interest between themselves & other claimholders less concerned about risk of firm failure
* **Looting (fraud)** – also embraces more innocuous breaches of strict equitable rules
* **Control transactions** – insurgent seeks to wrest the levers of corporate power from incumbent management
	+ Can service efficiency goals, so claimholders’ bargain will limit discretion of managers to adopt defensive tactics to defeat insurgents = **“proper purposes doctrine”**

|  |  |  |
| --- | --- | --- |
| **What?** | **To whom?** | **Enforce?** |
| Duty of loyalty | Corp. | Derivative action (shareholders sue on behalf of the corp. b/c directors won’t sue themselves) |
| Duty of care | Corp. + other constituents (ex. creditors)  | Derivative or direct action (through tort)  |

**Section 122(1)(b):** Exercise the **care, diligence & skill** that a **reasonably prudent person** would exercise in **comparable circumstances**

**To whom is the duty owed?**

* + ***Peoples***: owed to creditors & other constituents → expansion of corp. law DOC

***Re BCE Inc* (2008 – SCC)**

Ratio: ***Peoples*** – the directors’ duty is clearly to the corporation – they must consider the best interests of the corporation, but it may also be appropriate although not mandatory, to consider the impact of corporate decisions on shareholders or other particular groups of stakeholders. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests. Oppression Remedy: the corporation and shareholders are entitled to maximize profit and share value, but not by treating individual stakeholders unfairly. Fair treatment is most fundamentally what stakeholders care entitled to reasonably expect. Directors owe a fiduciary duty to the corporation and only to the corporation.

Notes:

* In *Peoples* the court said it was permissive but not mandatory to take into account other people’s interests, but in *BCE* the court concluded the directors had a duty to consider the best interests of the debenture holders – WHAT IS THE LAW?!
* Fiduciary duty is subjective but the oppression remedy is objective

|  |  |
| --- | --- |
| **Plaintiff’s Allegation** | **Defendant’s Defenses**  |
| **Breach of the duty of care** | Common Law – **Business Judgment Rule** Judges respect this rule b/c they’re not biz experts, defer to directors and their expertise. Also, lots of decisions made in the moment w/ incomplete info that seemed reasonable at the time, but in hindsight look terrible. |
| **Breach → injury** | Statute: - Good faith reliance s. 123(5)- Good diligence reliance s. 123(4) → Can rely on reports given by professionals. Relates specifically to issuance of shares or liability related to repurchase of shares/dividend payment etc.- Dissent on record s. 123(1-3) |

Duty of Skill

S. 122(1)(b) intended to upgrade directors’ duties of skill & care (following *Cardiff Savings Bank* and *Brazilian Rubber* – DOC was only linked to knowledge & expertise, not bound to attend director meetings or bring special qualifications)

* Following Enron scandals in early 2000s, additional regulation re: skill levels of certain directors on the audit committee in publicly traded companies was implemented in securities reg
* Must be financially literate or acquire financial literacy w/in a reasonable time if you want to be on audit committee
	+ Financial literacy = “if he or she has the ability to read & understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth & complexity of the issues that can reasonably be expected to be raised by the issuer’s financial statements.

Duty of Care

Judicial statements of duty of care in English cases didn’t impose heavy standards on management

* ***Overend & Gurney Co. v. Gibb***(1872) → criterion of liability is:
	+ Whether or not the directors exceeded the power entrusted to them, or whether if they didn’t exceed their powers they were cognizant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men w/any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they did?
	+ *Barnes* goes beyond this standard, imposes **duty of diligence** on directors as well

*Barnes v. Andrews* (1924 – NY) – Duty of Diligence

Facts: Defendant only went to 1 meeting of directors, was friend of the prez. During that period, $500k was raised by sales of stock of the company. Hired a bunch of officers & employees and factory was equipped w/machinery. Starter parts began to be produced, but there were delays – funds steadily depleted by running costs. Plaintiff was appointed as receiver after defendant resigned. Found company w/o funds, realized only a small amount on the sale of its assets.

Issue: Can defendant be held liable for corp.’s failure?

Analysis: Defendant’s general liability for collapse of the enterprise

* Can’t be charged w/ neglect in attending directors’ meetings b/c there were only 2, was present at 1 and had a good excuse for missing the other (mother’s death)
* Courts don’t want to interfere individually in the actual conduct of a biz’s affairs
* Not enough to content oneself w/general answers about the biz, must get more details
* Made no effort to keep advised of the actual conduct of the corp. affairs, carried along as a figurehead
	+ B/c he accepted a post of confidence, he’s charged w/ an **active duty** to learn whether the company is moving to production, and why it was not, what could be done to avoid conflicts among personnel etc.
* Plaintiff must go further than to show that defendant should have been more active in his duties; **must accept the burden of showing that the performance of the defendant’s duties would have avoided loss**, and what loss it would have avoided
* -When a biz fails from general mismanagement, biz incapacity, or bad judgment, how is it possible to say that a single director could have made the corp. successful? → For this case to work, must show defendant could have made the corp. prosper, or at least made its fall not so bad
* Didn’t give an implied warranty of special fitness upon accepting the position of director (didn’t have a lot of experience)

Ratio: **Liability must depend on his failure in general to keep advised of he conduct of the corp. affairs; has active duty to be informed about the corp. = duty of diligence**

* Reliance on someone must be in **good faith**, not blind faith
* In order to be held liable, must also be a connection between the loss and the director’s negligence

*Peoples Department Stores* (2004 – SCC) – Who is Owed Duty of Care?

Facts: Wise stores bought Peoples store but the contract between the two companies forbade W from merging operations with P until the purchase price was paid. W went to C, VP of admin and finance for advice on an inventory problem and C came up with a solution – P would buy everything and W would pay P back for their share of the stock. W and P ended up going into bankruptcy. Trustee alleged that W had breached their duty of loyalty to P under *CBCA* 122(1)(a) and their duty of care under *CBCA* 122(1)(b).

Issues: Did W breach their duty of care/loyalty to P?

Held: Nope

Ratio: **Directors & officers will not be held to be in breach of duty of care under s. 122(1)(b) if they act** **prudently & on a reasonably informed basis**. Decisions must be reasonable biz decisions in light of all the circumstances about which the directors/officers knew or ought to have known. Perfection is not demanded.

* Also affirm that “business judgment rule” is applicable in Canada.
* Included **creditors** as a possible stakeholder that directors can include in their view to the “best interests of the corp.”
	+ Owe duty to creditors, but it is not a fiduciary duty

**LIN**: says this is likely a mistake, bad conflation of the concept of DOC under tort law w/DOC under corp. law

*Re BCE Inc.* (2008 – SCC) – Who is Owed Duty of Care?

Facts: BCE was to be bought through a leveraged buyout that would involve its wholly owned subsidiary Bell guaranteeing a significant debt. The sale was approved by BCE directors and shareholders. Bell’s debenture holders argued that the sale would reduce the short-term trading value of their debentures.

Issues: What duties do directors have to stakeholders?

Holding: BCE wins.

Ratio: Directors owe a sole fiduciary duty to the corporation and may consider the impact of corporate decisions on shareholders or particular groups of stakeholders (not mandatory). Business judgment rule accords deference to a business decision, so long as it lies within a range of reasonable alternatives (***Pente Investment Management Ltd***). The oppression remedy recognizes that a corporation is an entity that encompasses and affects various individuals and groups, some of whose interests may conflict with others. Fair treatment is most fundamentally what stakeholders are entitled to reasonably expect. **The duty of directors to act in the best interest of the corporation includes a duty to treat individual stakeholders affected by corporate actions equitably and fairly.**

Objective vs. Subjective Standard of Care

Prior to ***Peoples***, thought standard had a subjective aspect (*Re City Equitable Fire)* → now SCC interpreted “in comparable circumstances” as an **objective standard** (***Peoples***)

* Allows for context to be taken into account
* DOC measured objectively, required to exercise degree of care that a **reasonable person** would exercise in comparable circumstances
	+ Not required to possess greater skill than expected of a reasonably prudent person, but they still need to have the necessary skills to act w/due care
	+ No longer “dummy” directors → automatically bear the responsibility of exercising due care
* **Objective minimum standard** (but, if director is an expert & on board of company in her field, then court likely to hold her to higher standard)

**NOTE: Stat standard of care under s. 122(1) can’t be made less demanding in the corp.’s articles or bylaws [s. 122(3)]**

*Re City Equitable Fire Insurance Co.* (1925 – UK) – Subjective Standard (BAD LAW)

Facts: An order was made for the winding up of an insurance company that was once very profitable – investigation showed a deficit at the time there were large trading profits. This was because there was a depreciation in investments and a managing director diverted funds to another company (he was jailed). The trustee brought the action against the directors/auditors for negligence and breach of duty.

Issue: What is the standard of care for directors?

Ratio: Directors owe a fiduciary duty to the company – their actual duties will vary according to the business of the company. Consider the nature of the company’s business and the manner in which the work of the company is in fact distributed between directors and other officials (assuming the distribution is reasonable). A director must act honestly and with some degree of both skill and diligence. The **standard of care is “reasonable care” – measured by what an ordinary man might be expected to do in the circumstances on own behalf:**

1. A director doesn’t need to exhibit more skill than the reasonable person and is not liable for mere errors of judgment.
2. They are not bound to give continuous attention to the company
3. Can, absent grounds for suspicion, rely on officers to honestly conduct/report business.

**Ex.** If director doesn’t have any expertise about finance and is on the board of a finance company, **no obligation under CL to get any experience/knowledge** (**this has changed w/CBCA s. 122) → more knowledge = increased liability**

Causation of Loss

Plaintiff must show that **breach of duty was a proximate cause of the loss**

*Joint Stock Discount Co. v. Brown* (1869 – UK)

Facts: P investment company held great deal of commercial paper from bank w/serious financial difficulties. Scheme was devised to prop up bank by having P & another creditor underwrite public issue of its securities. This was to advantage of the inside group of monitoring creditors, but not the other creditors, who relied on bank’s solvency & assumed major creditors would see bank was wound up if insolvent.

Analysis:

* + Good example of how, when one group of claimants free rides on the monitoring services provided by a 2nd group, a risk of monitor misbehavior may arise through a coalition between monitor & agent
	+ One director, Brown, had supported a preliminary resolution but ultimately objected to the scheme (he was absent from meetings where it was approved) → argued that there was nothing he could do beyond the letter he wrote to the BOD explaining his dissent.
	+ Judge didn’t buy it – said he should have put his letter on the record & insisted on taking vote of the directors after those letters

Non-Attendance at Meetings

* ***Re Dominion Trust Co.,* (1916)** → BCCA upheld dismissal of an action for negligence against those directors who attended no board meetings, while directors who did attend were found negligent for failing to ensure that trust moneys were segregated from corporate funds
	+ Analogous to duty to rescue – no affirmative duty, but if you undertake it you’re liable for failure to exercise reasonable care
	+ Could infer that directors are under no duty to attend board meetings, but must take care if they do
* Non-attendance more likely to ground liability in negligence today → ***Re City Equitable Fire Ins. Co****.*, [1925]:
	+ Director not bound to attend all meetings, but “he ought to attend whenever, in the circumstances, he is reasonably able to do so”
* **CBCA** may impose liability on non-attending directors through deemed assent provisions
	+ **S. 123(3):** director who isn’t present at a meeting at which a resolution was passed or action taken is deemed to have consented to it unless, w/in 7 days after they become aware of it, they note their dissent

Reliance by Directors on Officers/Professional Opinions

In general, directors are entitled to trust corp.’s officers, but where is the line?

* Directors do not need to demand full accounts of corp.’s activities from management, nor, in absence of suspicion, do they need to verify what management has said
* **S. 123(5): Good faith reliance defense**
* **S. 123(4):** defence to liability imposed by s. 118(2) for certain improper corporate payments
	+ If the director exercised the care, diligence, and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on financial statements of the corp. that were represented by an officer or auditor of the corp. fairly to reflect its financial position or on a report of a lawyer/accountant/engineer/appraiser/other person whose profession lends credibility to statements made by them
* ***Peoples*** → defendants argued that they relied on judgment of their VP of finance Clement – SCC said that his Bachelor’s of commerce & 15 years of experience in admin & finance didn’t correspond to the level of professionalism required to allow the directors to rely on his advice as a bar to a suit under the DOC
	+ Clement was not one of the professions listed in **s. 123(4)(b)**
	+ Title of VP of finance shouldn’t automatically = that Clement was a person “whose profession lends credibility to a statement made by him”
		- Important that word “profession” is used instead of “position”
* ***UPM*** → DOC requires decision be made on an informed & reasonable basis; expert advice doesn’t absolve directors of their personal responsibility to perform due diligence

BUSINESS JUDGMENT RULE

**BJR:** courts **will not interfere** in the management of a corp. **in the absence of an allegation** that the director’s **actions have been tainted w/fraud, illegality, or conflict of interest** (***Shlensky v. Wrigley,* 1968 – USA**)

In USA presumed that biz directors are protected by the rule. If P fails to overturn this presumption, then directors won’t breach DOC.

In Canada it’s unclear who has to displace – **is there a presumption of BJR**?

* + SCC applied the term to a form of deference to business judgments by directors developed by Canadian courts (***Peoples***)
	+ Courts in Canada insistent that the facts demonstrate that directors were diligent and acted on reasonable grounds before the rule will be applied in absence of fraud/illegality/conflict of interest

*UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002 – ONSC)

Facts: The board approved a compensation package for Mr. Berg. The board relied on the opinion of the compensation committee who relied on the opinion of a compensation consultant. The consultant was unaware the agreement was contentious, but the board approved it without further investigation.

Issue: Is the Board’s decision protected by the business judgment rule?

Holding: Nope

Ratio: Duty of care requires that directors make decision on an informed and reasoned basis. **A board is entitled to get advice but it doesn’t relieve them of their obligation to exercise reasonable diligence**. The court, when using the BJR, look to see if the directors made a reasonable decision, not a perfect one. Directors are only protected to the extent that their actions actually evidence their business judgment – their decisions are still subject to scrutiny, just not with perfect hindsight. The board and committee could have learned that they couldn’t afford Mr. Berg, but they didn’t. BJR can’t apply where the board acts on the advice of a director’s committee that makes an uninformed recommendation.

*Smith v. Van Gorkum* (1985 – Delaware)

Facts: Attempted leveraged buyout. VG proposed a price of $55/share. VG and CFO didn’t bother to do any research to see how much the company was worth. VG didn’t even inform his company’s legal department about the transaction. $55/share only around 60% of what company was later appraised at, but at time of merger, stock was selling for $37.25, so $55 seemed like a lot. VG called emergency meeting of BOD, proposed merger, directors gave him prelim approval but he didn’t disclose a number of things at board meeting (no basis for $55 price, objections by management of corp. that was being bought out).

Issue: Were directors grossly negligent in approving the merger? Can they invoke the BJR?

Ratio: BJR = "presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.' → in order to overcome this presumption, must rebut that judgment was an informed one

* No protection under BJR for directors who made an unintelligent or unadvised judgment
* Ask: **was there an adequate decision-making process?**
	+ In order to hide behind BJR must show that you made an informed decision based on principle of biz. If you randomly pull numbers out of thin air or cast votes w/o due diligence, then courts can (& will often) overturn your decisions.
	+ Can’t escape responsibility by claiming that the shareholders also approved the merger.

**NOTE:** Following *Van Gorkom* there was an amendment to the Delaware corps statute permitting a corp.’s charter to limit or eliminate the personal liability of directors for specified breaches → similar to CBCA s. 118

* + Leaves to the corp. the decision of how much monitoring from directors it wishes
	+ Limited liability for managers prohibited by CBCA s. 122(3)
* Managers & directors of corps subject to securities law also have liability to security holders for misrep. or omission in continuous disclosure obligations

SHIFTABLE LIABILITY: INDEMNITY & INSURANCE

Shiftable liability/combination of the imposition of primary duties on managers & devices like indemnification or insurance to pass on the burden of such liability to other parties may appear to under cut the distributional & efficiency motives for imposing liability in first place

* + Ex. manager transfers $$ from the firm to himself through looting; transfer reversed through damages award; award undone through indemnification
	+ Incentive goals of mgmt liability strategies may seem frustrated if manager may pass liability on to firm/insurance company

For this reason, underwriter who had been sued for misreps in a prospectus was not permitted to seek an indemnity against the issuer pursuant to a contractual indemnification right in ***Globus v. Law Research Service***

* + Issuer had promised to indemnify the underwriter for any loss arising out of defects in the prospectus, except for those attributable to the underwriter’s “willful misfeasance, bad faith or gross negligence…or…reckless disregard of its obligations under the agreement”
	+ Court found that underwriter had actual knowledge of material misstatements → can’t seek indemnity b/c would thwart the purpose of the act and the aim of being a deterrent for negligence

**Defences of Shiftable Liability:**

* Provides a safety valve against the possibility that excessively high duties will be imposed on managers → ex. *Van Gorkom*: care standards inefficient b/c they lead managers to adopt an overcautious investment policy, director & officer (D&O) insurance might be purchased to realign management incentives w/those of the firm
	+ Doesn’t provide a plausible justification for shiftable liability, since errors in liability standards could more easily be cured by a firm through limited liability provisions
	+ If Canadian firms insure/indemnify for this reason, it is only b/c limitations of liability are prohibited by **CBCA s. 122(3)**
		- Limited liability strategies are inappropriate where liability is imposed on the manager in the first instance as a response to incentive costs of limited shareholder liability
* D&O insurance inappropriate in case of breaches of anti-looting policies → liability for overt self-dealing should be non-shiftable when the purpose of the duty is to prevent management from expropriating the firm’s residual value

Indemnification

* Mandatory [**s. 124(5)]**
	+ For successful defense → Directors/officers entitled to indemnity as a right ONLY where individual “was substantially successful on the merits in his defense”
	+ Narrower in scope than scope of discretionary indemnification
* Permissive
	+ For unsuccessful defense → where entitlement to indemnity is in dispute, onus on the corp. to establish that actions of defendant were not honest, in good faith, or with a view to the best interests of the corp. → absent evidence, manager will be presumed to have acted in good faith
	+ 3rd party action **[s. 124(1)]**
		- Corp. may indemnify director against all costs, charges & expenses, including an amount paid to settle an action or satisfy a judgment
* Actions by or on behalf of the corporation [**s. 124(4)]**
	+ - Indemnity only permitted by the court, and only covers cost of litigation – doesn’t include judgment or settlement

**S. 124(3)**

* Can’t indemnify under (1) unless individual
	+ Acted honestly and in good faith w/ a view to the best interests of the corp.
	+ Individual had reasonable grounds for believing that the individual’s conduct was lawful

**S. 124(2)**

* Corp. can advance money to a director for cots s of proceeding referred to in (1); individual must repay the $$ if the individual doesn’t fulfill conditions of (3)

Insurance

Two types:

* Cover claims not covered by indemnification
	+ Covered: Directors & officers
	+ At risk: Personal assets
* Claims are covered by indemnification
	+ Insured: company
	+ At risk: company assets

DUTY OF LOYALTY – s. 122(1)(a)

**S. 122(1)(a):** Every director in exercising their powers/discharging their duties shall:

1. Act **honestly & in good faith** w/a view to the **best interests of the corp.** (**duty of loyalty; statutory fiduciary duty**)

**NOTE:** duty shifts to creditors when corp. close to insolvency (not the case in the USA)

**2 Situations:**

1. Interested directors’ contracts
	1. Director has interest to sell products at highest price, but company has interest to buy at lowest price = conflict of interest
2. Corporate Opportunities

Interested Director’ Contracts

**CL:** harsh principle – originally couldn’t have any contract between a director’s corp. and any party in which the director had an interest (***Aberdeen***). Relaxed in ***North-West***, which allowed for a company to affirm an interested director’s K as long as the affirmance of the K was not brought about by improper means, but didn’t consider whether the K was fair or good/bad for the corp.

**S. 120:** mitigates the harshness of the strict equitable rules under CL

* Provides a mechanism whereby interested Ks may be upheld on a review of their substantive fairness = **BOD Approval Process** **(s. 120(7))**
* **S. 120(7.1) - Shareholders’ Confirmation Process:** K in which a director/officer has material interest not voidable “by reason only of that relationship” where:
	+ The D/O has made written disclosure of their interest in the K
	+ After such disclosure the K has been approved either by a disinterested majority of the board or by a majority of the shareholders
	+ The K was reasonable and fair to the corp. at the time it was approved
* On board ratification, the interested directors may be counted toward a quorum

**NOTE: Not all Ks trigger obligation for disclosure, only material Ks or transaction →** CBCA doesn’t define “material”

* **Ask:** whether there is reasonable ground for concern that interest may affect director’s ability to perform her duty to corp.

**S. 120**

* **s. 120(4):** as long as K is material, director has obligation to disclose interest, doesn’t matter if K would be subject to board or shareholder approval
* **(6):** director is also director of another corp. that is a supplier of the first corp. → can send a general notice to the directors declaring interest, don’t have to make repeated notice of interest
* **(1):** must disclose what the interest is, and how far it goes, can’t just say they have an interest
	+ Disclosure made to other directors, also available to shareholders
* **(5):** allowed to participate in voting on their compensation, but in practice best to abstain

**SUBSTANTIVE FAIRNESS → WHAT DOES THIS MEAN?**

* Consider surrounding circumstances in which K was entered into
* Managers will often adopt some of the techniques of directorial review discussed in *Van Gorkom* → major interested Ks will often be approved by a committee of independent directors & certified as fair in a fairness opinion from a securities firm or investment banker

*Aberdeen Railway v. Blaikie Brothers* (1854 – UK) – No Ks w/Director’s Interest

Facts: Company enters into K w/partnership in which one of the directors was a partner in the partnership

Ratio: **Director can’t contract w/himself or a party he has an interest in** → any K voidable at CL when director held interest

* Agency law = can’t be promoting interests of the principal if agent has interest in the outcome as well that could conflict
* Principle so strict that didn’t matter whether transaction was fair
* Voidable at option of the company

*North-West Transpo v. Beatty* (1887 – UK) – Possible K as long as not Improper

Ratio: Relaxed harsh principle of *Aberdeen* → **company can affirm dealings with a corp. that director has personal interest in as long as the affirmance is not brought about by improper means**

*UPM* (2002 – ONSC) – Duty to Disclose

Issue: How much must a director disclose in order to enjoy the protection of s. 120?

Analysis:

* Duties of disclosure: **declaration must make his colleagues “fully informed of the real state of things**” (*Gray v. New Augarita*)
* If it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed
	+ Berg’s conduct falls far short – Repap directors not fully informed of “the real state of things” → it was material to their judgment to know about the comments of management & prior Board members on his comp package; that Mercer hadn’t done any research, benchmarking or analysis of comparable companies; that Agreement was different from earlier version
* No answer to the duty to disclose to say that directors could have discovered info for themselves
* **Duty to disclose is absolute**

How Interested Does Director Have to Be?

* Interest doesn’t have to be pecuniary

***Transvaal Lands Co. v. New Belgium (Transvaal) Land and Development Co****.* [1914]

* Held: where a director of a corporation holds shares in another corporate party to a K as trustee, rather than beneficially, that interest is sufficient to attract the conflict of interest prohibition.

***Exide Canada Inc. v. Hilts*** [2005]

* Facts: CEO of Exide & his exec assistant signed a corporate cheque for $1.3million and deposited it into a joint account in their names. Later transferred $300k of that to a corp. controlled by the exec assistant & then executed a K on behalf of Exide w/the corp. controlled by the exec assistant w/o the knowledge of Exide’s board.
* Held: Directors will be held to have a material interest in a K w/their corp., even when that interest is based on a close personal relationship w/the principal of the counterparty
	+ CEO had a material interest in the crop. controlled by the exec assistant b/c he directed $300k of Exide’s $$ to it while the K was being negotiated & b/c he had a close personal relationships w/ the exec assistant

**S. 120(1)(b):** directorship in another corporate party to the transaction = an interest

* **S. 120(1)(a):** refers more generally to material interests of officers/directors in material Ks w/corp.
	+ “Material” not defined – presumably means substantial or significant

***Zysko v. Thorarinson*** [2003] AJ → interpreted legislation virtually identical to CBCA and adopted this definition:

* “**Material**” = Q of fact that extends beyond more commonly held notion of financially material. If there is a possibility that the director was to benefit from the K more than *de minimis* then the transaction should be disclosed to the corp.
* Whatever might be relevant to corp.’s decision-making process → if corp. would undertake additional due diligence to determine whether the K or any of its terms is truly in its best interest or if it would assign another director/officer to handle negotiations, K = material & must be disclosed

Corporate Opportunities

**Corporate Opportunity:** any biz opportunity that comes to the director in his role as a director of the company (***Regal***)

**When does an opportunity cease to belong to the corp.?**

* In personal capacity
* Corp. rejection
* Corp. impossibility
* Resignation

*Regal Hastings v. Gulliver* (1942 – UK) – Corp. Opportunity

Ratio: **any biz opportunity that comes to director in his capacity as director = corp. opportunity**

* Directors couldn’t step in and take up the opportunity EVEN IF CORP COULDN’T PURSUE IT
* Shareholders would benefit if directors returned profits to the corp. – Q is which shareholders?
	+ New shareholders b/c company was sold to a group of new shareholders → new management sued former directors
	+ Before sale of company, directors usurped the corporate opportunity
	+ New shareholders didn’t get hurt → windfall to the new shareholders

*Zwicker v. Stanbury* (1953 – SCC) – Adopts *Regal*

Facts: defendants were directors of corp. that owned a hotel, CP owned significant # of shares & owned mortgage on the hotel. Donated mortgage back to the corp. b/c CP wrote it off as a loss, directors put it under their own name instead of the corp. Re-financing was successful, directors profited.

* How many conflicts of interest transactions?
	+ CP giving the shares back
		- Directors breached duty of loyalty – had opportunity to acquire the shares, should have been returned to the company directly instead of the directors personally.
	+ Mortgage
		- Directors acquired at ½ price, know that CP placed low value on mortgage, that’s why they could acquire at such a low price

Ratio: Affirms rule in ***Regal*** → any biz opp. that comes to director in capacity as director = corp. opp., even if company unable to pursue it

*Peso Silver Mines v. Cropper* (1966 – SCC)

Facts: Offer made by prospector to purchase land from Peso, BOD assessed & decided not to purchase. Cropper (managing director) approached by 3rd parties to participate in purchase of land in an individual capacity. Peso sues Cropper, wanted account of profits.

Held: At time of offer, Peso under financial strain, didn’t have financial means to pursue this particular opportunity

* Board explicitly rejected opportunity **in good faith**, directors didn’t reject out of the motivation to pursue the opportunity themselves

*Irving Trust v. Deutsch* (1934 – USA)

Facts: Patents owned are essential to operation of company; directors breached duty of loyalty by failing to get the funds necessary to acquire the company & patent rights

Ratio: BOD had duty to make best efforts to pursue the opportunity, especially when opp. is essential to operation of the biz

*Abbey Glen Property v. Stumborg* (1978 – Alberta)

Held: Directors liable for their profits b/c they used connections w/the corp. to get info & then made a new corp. to make the deal

*Canadian Aero Services v. O’Malley* (1974 – SCC)

Facts: Rs assigned to Guyana to develop and procure a contract of mapping that country (Canaero’s primary business). Rs were the President and executive VP for two years prior to resignation. They were found to be top management and not merely employees. They later resigned and incorporated their own company that beat of Canaero in the bid for the mapping contract.

Issues: What was the relationship between Rs and Canaero? Any duties arising from that relationship? What, if any, liability is there for a breach of those duties?

Holding: Judgement for Canaero

Ratio: Unless modified by statute or contract, the **officers owe a similar duty to corporation as directors**. General standard of loyalty, good faith, and avoidance conflict duty/self-interest (profit/conflict rule) tested each case by **factors**: 1) position or office held, 2) the nature of the corporate opportunity (ripeness, specificity, the director’s or managerial officer’s relation to it), 3) the amount of knowledge possessed, the circumstance in which it was obtained and whether it was special or private, 4) the factor of time in the continuation of the fiduciary duty if the alleged breach is after terminating the relationship, and 5) the circumstances under which the relationship was terminated (retirement, resignation, discharge). The Rs continued to be under a fiduciary duty even after quitting.

* Directors can’t avoid personal liability by resigning; BUT if they resign for other reasons and then another initiative emerges later, director won’t be held liable of usurping corp. opp. (in this case it wasn’t a new initiative)

DIRECTORS’ PERSONAL LIABILITIES

* Breach of Duty of Loyalty **[s.122(1)(a)]**
	+ Courts more likely to intervene b/c cases involve self-dealing (stealing from the company)
	+ No need to show damages (applys to corp. opps & directors’ interested Ks)
* Breach of Duty of Care [**s. 122(1)(b)]**
	+ Procedural duty → about the decision making process
* Other Liabilities in Corporate Statutes
	+ Unpaid wages & vacation pay [**s.119]**
		- Can be jointly & severally liable for wages/pay up to 6 months
	+ Various illegal payments [**s.118(2)]**
* Other Statutory Liabilities
	+ Torts
		- ***ADGA***

Enforcement Using Derivative Actions

**CBCA ss. 238-240 & 242** codify rules governing shareholder derivative actions

* Complainant under **s. 238** can start a derivative action w/leave of court under **s. 239** → only permit action under **s. 239(2)** if:
	+ (a) Complainant gives reasonable notice to directors of intention to apply to court if directors didn’t prosecute the action
	+ (b) Must act in good faith
	+ (c) Action appears to be in best interest of corp.

STATUTORY DERIVATIVE ACTION

**Who may initiate a derivative action?**

* **CBCA s. 238**
	+ “Complainant” means
		- Registered holder/beneficial owner (current or former), of a security of a corp. or any of its affiliates,
		- Director or officer (current or former) of corp. or any of its affiliates,
		- Director,
		- Any other person who, in the discretion of a court, is a proper person to make an application
* When can a creditor be deemed a “proper person” for Q of derivative action?
	+ When corp. close to bankruptcy, courts should exercise discretion to grant creditors standing to bring derivative action (***Peoples***)

**What steps to take?**

* **CBCA s. 239:**
	+ Must apply to court for leave
	+ Before derivative action can be pursued, must:
		- Give notice to directors no less than 14 days before bringing application (most prov. statutes just say “reasonable notice”, don’t set a day standard)
			* Gives board chance to pursue action themselves
			* Idea is that BOD has better knowledge about whether this action is in best interest of the corp.
			* Removes need for notice when all directors being named as defendants (not a provision in CBCA)
		- Complainant acting in good faith
		- Application appears to be in interests of the corp.

**What remedies are available?**

* Recovery goes to corp. – **s. 240** allows court to address problem of unfairness this rule may create
* **S. 240** → court can make variety of order to govern the conduct of the action, including:
	+ Corp. should pay complainant’s reasonable legal fees
	+ Amount of any recovery should be paid to its present or former security holders instead of the corp.
		- Avoids an incongruous result where either the defendants are major shareholders in the corp. or shareholders at time of injury are not the shareholders at time of action
* **S. 242** → court may order corp. to pay the complainant’s interim costs, including legal fees & disbursements
	+ **(2):** derivative action can’t be settled except w/approval of the court
		- Designed to obviate possibility of collusive settlements between a derivative plaintiff & corp. whereby corp. might buy off the plaintiff to settle a nuisance suit or even a meritorious suit for less than the total damages by offering plaintiff more than the loss of his particular investment, but less than total loss for all the shareholders
		- Suits brought for purpose of settlement = “strike suits”
* **S. 242(1)** changes rule in ***Foss v. Harbottle*** →derivative litigation shall not be dismissed by reason only that the conduct complained of has been or may be ratified by the shareholders
	+ Ratification can be taken into account by court as a factor in determining whether the proposed litigation would be in the best interests of the corp. (***Re Northwest Forest Products***)

*Foss v. Harbottle* (1843 – UK) – Initial Approach re: Derivative Actions

Facts: Plaintiffs were 2 minority shareholders in company called “The Victoria Park Co” – formed to buy land for use as a pleasure park. Company’s articles of incorp gave shareholders power in a general meeting to commence legal proceedings. Plaintiffs alleged defendant directors had engineered a fraudulent scheme: defendants had caused the company to buy land from themselves at an inflated price. act resulted in loss of the company.

Issue: Did minority shareholders have standing to bring derivative action against directors?

Ratio: **Proper Plaintiff Rule →** a suit to redress a wrong done to the corp. may not be brought by a shareholder thereto, and can be brought only by corp. itself

* **Internal Management Principle →** in any case where wrong may be ratified by an ordinary majority of shareholders in general meeting, P can’t bring suit
	+ **Exceptions (*Edwards v. Halliwell*):**
		- Ultra vires transactions
			* Can’t be ratified by ordinary majority
		- Actions that could validly be taken only w/approval of a special majority of shareholders
		- Actions in contravention of the personal rights shareholders
			* Direct suit – not really an exception
		- Fraud on the minority
			* **Only true exception**

*Re Northwest Forest Products* (1975 – BCSC) – Reasonable Notice

Issue: Did Mr. Ross give reasonable notice to the directors?

Held: YES. Sufficient b/c identified the cause of action in the letter, language in the requisition letter & language in the motion to the court were substantially the same

*Primex Investments v. Northwest Sports Enterprises* (1995 – BCSC) – CURRENT DERIVATIVE ACTION

Facts: 2 conflict of interest transactions:

* Bid for NBA team → defendant usurped corporate opp. w/o making full disclosure of his plan
* Takeover bid →director stands on 2 sides of transaction. Buys the shares of company in which he’s also a director

Issue: Whether derivative action was brought in good faith & in the interests of the corp.?

Analysis:

* **Good Faith**:
	+ Didn’t use litigation as threat to company in order to gain some special benefit
	+ Intention was to raise takeover price for benefit of all minority shareholders
	+ **Self-interest is okay as long as it aligns w/interests of the corp.**
* **Interests of the Corp.:**
	+ Reasonable prospect of success? Yes. As long as case isn’t frivolous & argument wouldn’t be dismissed out of hand.

SHAREHOLDER RATIFICATION

**NOTE**: Inference from this case is that only kind of shareholder approval that would bar a derivative plaintiff would be approval by a **disinterested shareholder majority** = one that included votes cast neither by proposed defendant directors nor by shareholders w/a direct pecuniary interest in the conduct complained of

* Intent of stat provision for derivative actions = to liberalize availability of redress for corporate wrongs @ instance of a minority shareholder
	+ Intent not to make irrelevant the views of the shareholder majority as to whether the corp. should pursue claims against its managers
* **Value of shareholder ratification** **under s. 242** is that it **may be evidence of fairness** of transaction or of desirability of forgiving a breach
	+ Persuasiveness of evidence depends on factors:
		- Adequacy of proxy disclosure
		- How outside shareholders have voted
		- Nature of impeached transaction
	+ Would ratification of directorial conduct by a shareholder majority, including directors in Q, preclude minority shareholder challenges to the transaction if the transaction were apparently fair? (*North-West Transpo*)
* **Q of shareholder ratification = 2 Qs:**
	+ Must minority shareholders make a demand on the other shareholders either to join them or to attempt to cause the company to sue, as a condition of being permitted to maintain a derivative action?
	+ What effect is to be given to ratification by a shareholder majority?
* **CL:** if minority shareholder seeks to sue on behalf of corp. under “fraud on the minority” exception to rule in ***Foss v. Harbottle***, must show either that they had put to the corp. in general meeting a motion that the action should be commenced or that such a demand would have been futile b/c wrongdoers were in control of the share majority
	+ If alleged wrongdoers not in control of share majority and a demand on shareholders had to be made, negative decision by general meeting would preclude further litigation
	+ ***Foss v. Harbottle***: corp.’s causes of action, like other assets, belong to it & not shareholders. Corp. must asset cause of action, unless it can’t b/c wrongdoers won’t permit it to proceed against themselves

DERIVATIVE ACTION IN THE USA

Demand Required → BOD decides fate of the claim, subject to the review of the BJD rule by the court

Demand Excused → Court allows the claim to go forward; and board can’t dismiss the claim

* Allowed if demand is futile → when is demand futile?
	+ If plaintiff can prove that board can’t make a reasonable decision (ex. board = defendants)
* Plaintiff can go straight to the court and argue demand is futile

*Auerbach v. Bennett* (1979 – NYCA)

Held: Court wouldn’t review substantive decision made by special lit committee (BJR), but would review independence of committee & procedures used

* No problem w/independence
* Procedure was efficient

*Zapata Corp. v. Maldonado* (1981 – Delaware)

Facts: Derivative action properly commenced, demand was excused b/c all directors on the board involved in alleged breach of duty of loyalty. Later, board appointed special lit committee composed of 2 independent, outside directors.

Issue: To what extent should court defer to committee’s decision?

Ratio: Need to strike balance between P’s right to proceed w/BOD’s right to terminate frivolous litigation

* **2-step Test to Assess Motion to Dismiss:**
	1. Court should inquire into independence & good faith of committee & bases supporting its conclusion. Corp. has burden of proving independence, good faith & reasonable investigation (not presumed). If first step satisfied, move onto next.
	2. Court should determine, applying its own independent biz judgment, whether the motion should be granted. (Intended to thwart instances where corp. actions meet criteria of step 1, but result doesn’t appear to satisfy its spirit, or where corp. actions would simply prematurely terminate a stockholder grievance deserving of further consideration in corp.’s interest). Court can give special consideration to matters of law & public policy in addition to corp.’s best interests where appropriate.

Oppression Remedy

**Section 241:** provides statutory mandate to the **court to intervene where the conduct of directors/officers is oppressive, unfairly prejudicial, or unfairly disregards particular interests**.

* Designed to address situation where majority shareholder(s) oppress the minority

OPPRESSION REMEDY vs. DERIVATIVE ACTION

Likely you can advance both claims when directors engage in self-dealing Ks

* Can advance both simultaneously, but OR generally preferred b/c it’s easier & cheaper

|  |  |
| --- | --- |
| **Oppression Remedy** | **Derivative Action** |
| 1. Personal claim
2. Standard of liability: courts’ primary consideration is whether reasonable expectation has been violated by oppressive act
3. No leave requirement
4. Court has no statutory power to intervene in conduct of application (Exception: **s. 242(2):** requires court approval of any settlement, discontinuance, or abandonment of OR application)
5. Can pursue claim for personal compensation for harm to complainant’s interests from OR actions
6. Can’t seek remedy for past wrongs
7. Remedies Available: courts have unlimited discretion
8. Costs: complainant pays fees (b/c personal claim)
 | 1. Corporation claim
2. Standard of liability: must prove violation of legal right
3. In order to bring DA, complainant must seek leave of the court
4. Court exercises a statutory supervisory jurisdiction over the DA that enables it to issue orders concerning issues such as the manner in which the action is conducted, which party will have conduct of the action, and who will receive any damages awarded in the DA (**s. 242(2)** also applies to DA)
5. Damages awarded in DA ordinarily go to the corp. in whose name action was begun, unless court orders otherwise
6. Claim belongs to corp., so it doesn’t matter who the shareholder is when claim initiated (can be a new shareholder that sues on behalf of corp. & still entitled to remedy, even if it results in windfall for new shareholders)
7. Remedies Available: limited by statute remedies available for cause of action pleaded
8. Costs: courts always award attorney’s fees to complainant in successful claim
 |

**NOTE:** Actions that comply w/**duty of loyalty** can give rise to OR claims

* OR – courts focus on effects of corp. actions (whether acts are oppressive/unfairly prejudicial/disregard protected interests)
* Duty of Loyalty – courts assessing motivation of the director
* Thus, there are a number of cases where courts found directors were acting in good faith in corp.’s interests, but also found the **effects** of their actions on complainant’s interests = oppressive
	+ Remedies in these cases against the corp. (ex. redemption of shares, unwinding corp. transactions – not against directors personally)

Who Can Initiate an Oppressive Remedy?

**Section 238**: **who has standing to bring OR claim?**

* “Complainant”:
	+ Current/former registered holder/beneficial owner
	+ Current/former director/officer
	+ Director
	+ Any other person who, in discretion of a court, is a proper person to make application

**Creditors + OR?** → most common situation where creditors seek OR is when directors transfer company’s assets to themselves w/purpose of defeating the creditors

* Creditors normally not granted standing – only if justice & equity require it
* In the **US**, **only shareholders granted standing**, not creditors

*First Edmonton Place v. 315888 Alberta* (1988 – Alta. QB) – Creditor Can Have Standing

Facts: Landlord gave incentive package to lawyers to sign a 10yr lease. Included 18 months rent-free, leasehold improvement allowance, cash payment of $140, 126. Lawyers used the premises for the rent-free period + 3 months, then vacated w/o having entered into a formal lease. Landlord sought leave to bring oppression action or derivative action; alleged that actions of the 3 lawyers as directors of numbered company were unfairly prejudicial to or unfairly disregarded the landlord’s interests.

Issue: What is availability of OR to creditors?

Analysis: Criteria for Creditor to be a “proper person” → **must be required by justice & equity**. 2 circumstances this would occur:

1. If the act or conduct of directors/management of corp. constituted using the corp. as a vehicle for committing a fraud *upon the applicant*
2. If the act constituted a breach of the underlying expectation of the applicant arising from the circumstances in which the applicant’s relationship w/the corp. arose (ex. Was creditor prevented from taking adequate steps when he entered agreement to protect interests? Did creditor entertain an expectation that, assuming fair dealing, his chances of repayment wouldn’t be frustrated by kind of conduct that subsequently occurred?)

Ratio: Not a “proper person” to make OR application unless Court is satisfied that there was some evidence of oppression/unfair prejudice/disregard for interests of a security holder/creditor/director/officer → creditor can have standing, but only if required by justice

* Further, applicant must have interest as a creditor **at the time the acts complained of occurred**

*Downtown Eatery v. Ontario* (2001 – ONCA)

Facts: Respondents (Grad & Grosman) owned & operated 2 nightclubs (Landing Strip & For Your Eyes Only). Grad offered appellant Alouche position as manager of nightclub FYEO in Dec 1992. K also provided that A would receive health care & insurance benefits available “in our sister organization”, which wasn’t identified by name. A received pay cheques from Best Beaver Mgmt, company controlled by G&G. A dismissed for cause in June 1993, commenced wrongful dismissal action against BB. G&G reorganized corp. entities twice before judgment, BB no longer operating at time A became entitled to receive his damage award from the corp.

Issue: What is availability of OR to dismissed employee in context of corp. reorganization, which has effect of denying employee any recovery of judgment, obtained from wrongful dismissal trial?

Analysis: **Test of Unfair Prejudice/Disregard Interests Considerations:**

* Protection of the underlying expectation of a creditor in its arrangement w/corp.
* Extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts
* Detriments to the interests of the creditor

Ratio: **As long as it’s established that complainant has a reasonable expectation that a company’s affairs will be conducted w/a view to protecting his interests, conduct complained of need not be undertaken w/intention of harming the plaintiff.**

* Even though the respondents did the restructuring for legit biz purposes, irrelevant to whether those acts were oppressive to P

**NOTE:** Courts more likely to grant standing to involuntary creditors over voluntary b/c voluntary usually have better ability to protect themselves.

*Clitheroe v. Hydro One Inc.* (2002 – ONSC) – Requirement for “Protected Interests”

Facts: Plaintiff employed by Ontario Hydro. Hydro divided into 5 companies April 1999; plaintiff promoted to CEO of Hydro One. P also became director of that corp. P had written K providing 3 years’ compensation if she was terminated for reasons other than material breach of her obligations or conviction of a criminal offence that impaired her ability to discharge her employment duties. After K signed, Ontario legislature passed legislation directing board of Hydro 1 to negotiate new employment Ks w/designated officers, including P, w/express purpose that new Ks would substantially reduce remuneration & benefits. Provided that no individual to whom the act applies can advance any claim for compensation relating to termination of employment until new Ks in place.

Issue: Does conduct invoke “protected interests” of P to constitute use of OR?

Ratio: OR not designed to provide a mechanism where employees who have been terminated may bring an application for wrongful dismissal → employment grievances only appropriate for OR if **part of a larger “oppressive” pattern**

What is the Statutory Test for Oppression Remedy?

*BCE Inc. v. 1976 Debentureholders* (2008 – SCC) – Test of Oppression Remedy

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 three 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 three 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 debentureholders sought relief under the oppression remedy under s. 241 of the *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 percent and could lose investment grade status.

Issue: What is the use & test of the statutory oppression remedy?

Ratio: **Two-stage test**:

1) Look first to the principles underlying the oppression remedy, and in particular the concept of reasonable expectations. **Does the evidence support the reasonable expectation asserted by the claimant***?*

* Factors to consider in determining this:
	+ Commercial practice → is it a departure from normal biz practice?
	+ Size/nature/structure of corp. → courts give more latitude to small corps
	+ Relationship between parties → if there’s a close & personal relationship, might be diff. expectations (can consider family ties, not just legal relationship)
	+ Past practice between the parties → corp. can diverge from past practice though
	+ Preventative steps → could complainant have done anything to protect themselves?
	+ Representations → look at agreements, what does it say?
	+ Fair resolution of conflict of interest → connects fiduciary duty & duty of loyalty

2) If a breach of a reasonable expectation is established, one must consider whether the conduct complained of amounts to “oppression”, “unfair prejudice” or “unfair disregard” as set out in **s. 241(2).** **Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms of a relevant interest***?*

* No one particular group shall prevail → if BOD properly informed & follows appropriate procedures, then court will respect corp. decision (BJR)
* Analysis: Did they have a reasonable expectation of maintaining market rate, and value of debentures? Running through the factors:
* Leveraged buyout was not unforeseeable – part of commercial practice
* Means to protect themselves – debentures could bargain w/the corp. → rights arise from Ks, not from corporate law
* Expectation that debentures’ economic interest would be considered based on the K terms, no further commitments beyond that → BOD met this expectation
* Bell Canada had to assume huge amount of additional debt w/all the offers
	+ BOD had no choice, no better alternative. Decision still w/in reasonable choices, so according to BJD rule, court will respect decision.
* Representation & agreement → all statements made by BC to debentures suggesting the rate would be maintained were accompanied by warnings, so this is okay

What Constitutes Oppressive Conduct?

*Scottish Co-op v. Meyer* (1959 – UK) – Breach of Directors’ Duties to Corp.

Facts: Co-op wanted to get into the rayon trade in 1946, wanted help of Meyer & Lucas. Co-op incorporated a subsidiary, gave 4,000 shares to itself and 3,900 to M&L. M&L also occupied 2 of the 5 seats on the subsidiary’s board. Later co-op decided to get rid of M&L, offered to buy out their shares. M&L rejected offer, said price was inadequate. Co-op then established internal dept. that entered rayon trade; led to diminution in subsidiary’s profits. M&L petitioned for order to be made that co-op buy the shares in subsidiary at price to be determined w/o reference to damage that had recently been inflicted upon the subsidiary by the co-op’s competition.

Analysis: 3 directors of subsidiary also directors of the co-op → fine as long as interests of both companies aligned

* As soon as the interests conflict, nominee directors placed in an impossible position → duty to subsidiary was to get highest price for the shares, duty to the co-op was to get shares for lowest price
* 3 directors couldn’t do their duty by both companies, and they put their duty to the co-op above their duty to the subsidiary → did nothing to defend the interests of the textile company against conduct of the co-op
* By subordinating the interests of the textile company to those of the co-op, they conducted the affairs of the textile company in a manner oppressive to other shareholders
* Statute doesn’t mean that OR is limited to cases where corp. still in active biz

Ratio: Oppressive conduct = directors doing nothing to defend company’s interests when they have a duty to do something

* Remedy for oppression should still be available even when company is put out of action altogether as a result of the oppression

**Other Options?**

* Oppressed shareholders could have sought court order to wind up corp., but that order would unfairly prejudice minority shareholders in this case
	+ Even through this order minority shareholders couldn’t get fair price b/c would only recover break-up value of shares
* What claims could they make under CBCA?
	+ Derivative action → argue that nominee directors of controlling shareholder breached duty of loyalty to subsidiary
		- When interest of subsidiary & parent are consistent, there’s no problem. When they are in conflict, there is a problem for directors sitting on both boards in discharging their fiduciary duties
	+ Is this preferable over oppression?
		- W/ derivative remedies are more limited and needs approval of the court
		- Prefer oppression b/c minority shareholders were asking majority to purchase shares back at “fair price” → remedy not available under derivative action
	+ Breach of duty of loyalty gave rise to oppression remedy
		- Does breach of fiduciary duty always give rise to oppression claim?
			* No b/c director could breach fiduciary duty to entire corp., harm only to corp. = no oppression remedy
			* In oppression remedy, complainants must show they suffered special harm, not just harm to the corp.

*Ferguson v. Imax* (1983 – ONCA) – Oppression, Unfairness & “Reasonable Expectations”

Facts: Dominant shareholder refused to pay dividends to minority shareholder, terminated employment, and forced her to sell shares at discounted price. Relationship was ex-wife (minority shareholder)/ex-husband (president/majority shareholder).

Analysis: No evidence as to why resolution had been put before shareholders, evidence of possible benefits of resolution not enough to justify it. Fact that company is profitable and that it may be timely for company to redeem some of its equity holding doesn’t insulate the company from dealing fairly w/the appellant (minority shareholder).

* Did Mrs. Ferguson have reasonable expectation as a shareholder?
	+ Family run venture of which she was a participant, reasonable expectation that she would share in company’s profits and future growth
* Was Mr. Ferguson’s conduct was oppressive?
	+ Pattern of oppressive acts (refusing to pay dividend, terminating employment, forcing minority shareholder to sell)
	+ Resolution to redeem class B shares was act that led appellant’s claim
	+ Not oppressive to other class B shareholders b/c they have common shares or their spouse has common stock that they can share the profits through

Ratio: Court can consider relationship between shareholders, not simply legal rights – section should be interpreted broadly when considering interests of minority shareholders. Court must consider bona fides of the corp. transaction in Q to determine whether the act of the corp./directors = a result which is oppressive/unfairly prejudicial to minority shareholder.

*Naneff v. Con-Crete Holdings* (1993 – ONSC) – Family Relationship + “Reasonable Expectations”

Facts: Father started the biz, brought 2 sons into it, gave them each 50% of common shares in corp. P had shady lifestyle, terminated w/o severance. Father & other bro caused family corp. to cease payment of bonuses, which was how P had been given access to corp. profits prior to being cut out of family, began paying themselves salaries. Also refused to pay P any amounts from past bonuses.

Issue: Are these actions oppressive?

Held: Yes.

Ratio: Desire to chastise & correct actual & perceived failing of a son or bro in his personal life is not a basis for ignoring the duties & obligations they owe in their corporate capacities to the son & bro in his corp. capacity → strictures of statute & corp. law override family desires.

What Remedies are Available?

**CBCA s. 241(3):**

* Court has unlimited power in fashioning remedies, section just lists some common possible remedies – not exhaustive list
	+ In practice, most common remedy is purchase of shares by the company or majority shareholder (**s. 241(3)(f))**
	+ What if company doesn’t have $$ to buy the shares? Court will order dissolution of the company.

*Naneff v. Con-Crete Holdings* (1995 – ONCA) – Appropriate Remedy

ONCA varied remedy grantcd by ONSC (that Alex be given opp. to buy control of family biz + remedies compensating him for losses suffered as a result of his dismissal & exclusion from access to corp.’s earnings) to an order that he sell his shares to the corp. at fair value. Made the variation based on analysis of Alex’s reasonable expectations.

2 Considerations re: Expectations:

* Alex fully understood that until death or voluntary retirement his father retained ultimate control over biz even to extent of deciding what dividends would be paid & what would be done w/any of those dividends
	+ Alex’s expectations couldn’t include right to control family biz while his father was alive & active
* Family biz built by his father
	+ Couldn’t expect paternal bounty forever → especially if family ties severed; can’t expect to continue working in family biz if no longer in relationship w/family

 Assessment of Remedy:

* Remedy did more than simply rectify oppression → gave shareholder something that he never could have reasonably expected (opportunity to obtain full control of the family biz)
	+ Obviously punitive towards Nick b/c puts at risk very condition upon which Nick exercised his bounty in favour of his sons – his total control of biz during active life
* Remedy attempts to protect Alex’s interest in family biz as a son & family member; in addition to protecting his interest as a shareholder as such
	+ Remedy of public sale allows Alex to obtain control while out of his father’s favour, which couldn’t have been an expectation of Alex’s

Mergers & Acquisitions - Friendly

**Merger** – usually refers to situation of mutual combination

**Acquisition** – usually refers to situation where much larger company purchases smaller company

* **Friendly**: negotiated between the boards of 2 companies
* **Hostile**: take place despite disagreement from target corp.

Most deals are friendly → fewer than 2% are initiated by hostile takeovers

* Hostile takeovers = division of power, who has power to decide future of company?
* Whether directors breach fiduciary duty = big Q in context of M&As

Merger/Acquisition can describe virtually any biz combo, whether achieved through:

* + Purchase/sale of shares
	+ Purchase/sale of assets
	+ Amalgamation
	+ Acquisition effected by way of a court-approved plan of arrangement

**Motives of M&A:**

* Efficiency
	+ Economies of scale, vertical integration, replacing bad management, diversification, etc.
* Redistributive
	+ Shifting value from gov’t, creditors, or consumers, etc.
* Bad motives
	+ Hubris, overestimation of synergies, etc.

**\*\*ASK: Is the merger agreement made in reasonably informed manner (DOC) & did directors act in best interest of corp. (duty of loyalty)?\*\***

When is Shareholder Approval Required?

**NOTE: M&A REQUIRES SHAREHOLDER APPROVAL WHEN SALE OF ASSETS/AMALGAMATION**

* Too big & too important to not require it → could change nature of the biz
* More like investment decisions than management decisions
* Also possibility of conflict-of-interest transactions
* Doesn’t need shareholder approval when it’s just an offer for sale of share, b/c shares = personal property
	+ Acquiring company this way essentially amounts to making an offer to purchase to each individual shareholder
	+ Also exceptions re: amalgamation **(s. 184)** for vertical/horizontal amalgamation of parent corp. w/wholly owned subsidiary
* **Needs approval when sale is of company assets**
	+ **Target company shareholders** must vote & approve sale by 2/3 majority → every shareholder has right to vote (regardless of type of share they hold)
	+ Shareholders of acquiring company have no say b/c it’s the BOD’s decision to acquire (w/in management decision)

**\*\*TESTS TO DETERMINE WHETHER SHAREHOLDER APPROVAL REQUIRED\*\***

***1. The Quantitative Test***

* Involves comparison of the value of the property sold, leased, or exchanged w/the value of the overall property of the corp.
	+ Comparison of book value of assets sold & book value of total assets of corp.
	+ Comparison between contribution to the gross revenue by the assets sold & the total gross revenues of the corp.
	+ Impact upon profitability or net income as a result of the sale of the assets

***2. The Qualitative Test***

* When should managers be required to submit a transaction for shareholder approval?
* Sell off more likely to require shareholder consent where the divisions represents core assets (***Katz v. Bregman*** – **USA**)
* Shareholder ratification waived on a defensive sell-off of core assets in ***Re Olympia & York Enterprises Ltd.* (1986**) → sell-off one of the devices used to resist a takeover
	+ Fallacious to suggest that when a holding company that has 3 distinct divisions and sells one of 3 divisions for 2.6 billion out of 6 billion total worth it could possibly fall w/in **s. 189(3)**

SALE OF SHARES

* Sale of a controlling block of shares in 1 corp. to another or to the latter’s shareholders will vest control of the 2 enterprises in common hands
	+ If seller receives purely monetary compensation, they’ll have no interest in merged corp.
	+ If they receive shares of the purchaser for consideration, then they continue to participate in combined corp.
* Tax liability can be deferred through share-for-share exchange until one disposes of new shares received
* Since shares are personal property, transaction pursuant to which shareholders propose to sell their shares to a purchaser doesn’t require shareholder approval by all via special resolution
	+ Sale may trigger duties of compliance w/legislation governing takeover bids
	+ Offer to purchase shares that, when aggregated w/offeror’s existing shares in target corp. exceed 20% of target’s outstanding voting securities = takeover bid under prov. securities legislation. Offeror then required to make same offer to all shareholders of class of securities sought, w/special duties of disclosure in takeover bid circular
* Further concern when controlling block of shares sold at premium above market price → since premium paid for control block not offered to non-controlling shareholders, 2 classes not accorded equal treatment

SALE OF ASSETS – s. 189

* 2 corps may combine if one sells to the other all or substantially all of its assets
	+ Can also be structured as lease of assets if term of lease is so long that lessor obtains substantially all of the economic value of leased biz
* Can receive either cash or shares of purchasing corp.
	+ If shares received are distributed to shareholders = **share-for-share amalgamation**
	+ Even w/o distribution, sale of assets for share = financially identical to amalgamation b/c selling film will become a holding corp. whose only asset is shares in the purchasing corp.
* **S. 189(3):** Sale/lease of all or substantially all of assets of target company requires **approval by 2/3 of votes** cast by shareholders
	+ Even non-voting shares endowed w/voting rights under **s. 189(6)**
	+ B/c corp. disposing of very biz that the shareholders invested in
	+ If shareholder dissents from special resolution, may subsequently require corp. to repurchase shares by asserting appraisal rights under **s. 190(1)(e)**

**Questions to Ask when Considering if the Sale = Substantially All the Assets of Corp. (Gannage)**

* Does it strike “at the heart of the corp. existence and purpose of” the Company?
* Would it remove company’s “ability to accomplish the purposes or objects for which it was incorporated” and “have the effect of destroying the corp.’s biz”?
* Would its effect “fundamentally alter the nature of the company from an operating company to a holding company” and destroy “the company’s main biz”?
* Would its consequence “be the effective destruction of the company’s biz”?
* Would it “radically and fundamentally alter” the Company?
* Does it constitute “a fundamental change which strikes at the very heart of the company and…would substantially affect the corp. existence and purpose”?
* Will it “have the effect of fundamentally changing or destroying the nature of the corp.’s biz” and is it “tantamount to the winding-up of the corp.’s biz”?
* Will it destroy or alter the company so that it no longer does “what it was originally created for”?

AMALGAMATION – s. 182, 184, 186

**S. 182: amalgamation** agreement must be **approved by special resolution of the shareholders of** **both corps**

* Widely held: requires full disclosure of details of the amalgamation & prospectus-level financial disclosure in the information circular that must be sent to shareholders being asked to vote on the matter

**Exception: CBCA** provides 2 forms of “short-form” amalgamation exempt from shareholder approval:

* **S. 184 – Vertical**
	+ Wholly owned subsidiary may be merged into parent corp. w/o shareholder approval (only one shareholder of subsidiary = parent company; no big difference for shareholders of the parent corp.)
* **S. 184(2) – Horizontal**
	+ Merger between wholly owned subsidiary by same parent corp.

**S. 186:** As of date set out in certificate of amalgamation, 2 corps continue as 1 corp. that possesses all the rights & property and is subject to all the liabilities of each of the 2 amalgamating corps

*R v. Black and Decker Mfg. Co.* (1975 – SCC)

Issue: Can B be held liable for offences committed by company with which they amalgamated?

Ratio: Criminal liability survives amalgamation, statute considered to be all embracing and supporting of general principle that companies continue in their plenitude during amalgamations.

* **Amalgamation doesn’t = death of the companies that were amalgamated**
* Effect of the statute is to have the amalgamating companies continue w/o subtraction in the amalgamated company, w/all their strengths & weaknesses, perfections/imperfections

OTHER TECHNIQUES

Plan of Arrangement – s. 192

**S. 192:** provides for court-approved plan of arrangement that can be used to implement M&A transaction

* + Allows parties to have courts approve M&A that can’t readily be effected using standard techniques b/c it would be impracticable to attempt the transaction w/o being able to deviate from the procedures that must normally be followed
	+ Transactions that involve complex structuring designed to achieve a desirable tax outcome will be implemented by way of a plan of arrangement
	+ Courts typically require shareholder approval of these kind of transactions

**S. 192(1) – Plan of Arrangement includes:**

* Amendment to articles of corp.
* Amalgamation of 2 or more corps
* Amalgamation of body corp. w/a corp. that results in an amalgamated corp. subject to this act
* Division of the biz carried on by a corp.
* Liquidation
* Any combo of the above

**When to Use?**

**S. 192(3):** Where it is not practicable for corp. that is not insolvent to effect a fundamental change in the nature of arrangement under any other provision of this Act

**What is the Court Procedure?**

**S. 192(4):** Court may make any interim or final order it thinks fit

* Order permitting a shareholder to dissent under **s. 190**
* Order approving an arrangement as proposed by the corp. or as amended in any manner the court may direct

**Advantage = flexibility**

* Allows 2 merging corps to deal w/shareholders & other stakeholders

*BCE Inc. v. 1976 Debentureholders* (2008 – SCC) – Plan of Arrangement

**Approval Process for Plan of Arrangement:**

* Onus on the corp. to establish that:
	+ Statutory procedures have been met
	+ Application has been put forth in good faith
	+ Arrangement is “fair and reasonable”
* To approve a plan, courts must be satisfied that:
	+ The arrangement has a valid biz purpose AND
	+ Objections of those whose legal rights are being arranged are being resolved in a fair & balanced way

Courts on **s. 192** applications should refrain from substituting their views of the “best” arrangement, but should not surrender their duty to scrutinize the arrangement. Under **s. 192,** only security holders whose legal rights stand to be affected by the proposal are envisioned. It is a fact that the corporation is permitted to alter individual rights that places the matter beyond the power of the directors and creates the need for shareholder and court approval. However, in some circumstances, interests that are not strictly legal could be considered. The fact that a group whose legal rights are left intact faces a reduction in the trading value of its securities generally does not, without more, constitute a circumstance where non‑legal interests should be considered on a s. 192 application.

Reverse Acquisition

Reverses the normal procedure → smaller corp. purchases larger corp.

* As long as consideration is the smaller corp.’s shares and the larger corp.’s entire biz/assets are acquired, makes relatively little diff. who purchase whom
* Requirement of shareholder ratification & appraisal remedy will then arise in case of the larger corp., possibly smaller corp. → if large corp. not widely held or incorporated in jurisdiction that lack appraisal remedy, this could be real advantage

Triangular Merger

Involves subsidiary of one of the merging corps → b/c merger is between target & subsidiary, has nothing to do w/the parent corp. so it has no say in the transaction. Only the BOD of the parent corp. has power as controlling shareholder.

* Advantages:
	+ Parent corp. insulated from the target’s liabilities → those are assumed by the subsidiary
	+ Transaction wouldn’t have to be approved by a shareholder meeting of the parent corp. & shareholders couldn’t assert appraisal remedy
* Could also have a situation where the shareholders of the target corp. are issued shares of the parent corp. & not the new subsidiary to make the amalgamation more palatable (sometimes done in US, but complicated in Canada)
	+ Can be accomplished under **s. 182(1)(d)** → expressly contemplates that shareholders of an amalgamating corp. may receive securities of a corp. other than the amalgamated corp. (could permit the target corp. to receive parent corp.’s shares w/o triggering prohibited issue of transferring parent’s shares to subsidiary)

APPRAISAL REMEDY

**S. 190:** shareholders who dissent re: certain kinds of transactions have the right to require corp. to repurchase their shares rather than having to hold shares in a new entity in which they don’t wish to hold an interest

* Rights triggered by “fundamental” corp. transactions (ex. amalgamations, sales of substantially all of firm’s assets)
* Remedy of limited benefit to shareholder → so complicated & technical; also reward is taxable
	+ Preferable to sell shares on the market, but that may not be a viable option, so this is a seen as a last resort in cases of emergency (Eisenberg) → sees rights as no-fault buyout right, where a shareholder who suspects oppression may exercise a “put” option by requiring the corp. to repurchase shares w/o demonstrating unfairness

**Who has dissent & appraisal rights?**

* Sale of share: NO
* Sale of assets/amalgamations: YES
* Plan of arrangement: YES
* Language of **s. 190(1)** implies that **only registered shareholders have right to appraisal remedy**

**What is the procedure for exercising appraisal rights?**

* **S. 190(5):** written objection
	+ Dissenting shareholder must send written objection to the resolution for sale/amalgamation/plan
* **S. 190(6) & (7):** Must send demand for payment w/in 20 days of receiving resolution from corp. before corp. has any obligation to purchase the shares
* **S. 190(8):** return share certificate

**NOTE:** if shareholder fails to do **any** of these steps, they lose appraisal rights

* If shareholder can sell shares on market, they should do that b/c these steps are onerous and technical

Mergers & Acquisitions - Hostile

Typical takeover premiums = 20-60% above market price (bidding war can drive it even higher)

**ASK: If BOD of target corp. adopts defensive strategy, does it breach duty of loyalty**?

* Is the defense in the best interest of the corp., or is it just so directors can retain their jobs?

PROXY CONTEST

Acquirer can nominate own slate of directors & solicit proxy, persuade other shareholders that they will be under better management w/new BOD → if successful, the new BOD can enter into merger w/acquiring corp.

* Not popular – could be due to shareholder apathy, or that if a control transaction is motivated by anticipated merger gains, the insurgents won’t share in them directly unless they acquire an equity interest in the firm
* Sometimes used to supplement takeover bids

TAKEOVER BIDS

Hostile takeover bids are rare – heavily regulated by prov. securities laws, no provisions on takeover bids in CBCA

* Shareholders entitled to adequate time, info & equal treatment
* Every formal **takeover bid** must **remain open for at least 35 days**
* Must deliver disclosure doc = takeover bid circular
	+ Management of target corp. has obligation to send its own circular explaining value of offer & recommending either acceptance or rejection
* Often that takeover bids are subject to a condition that a specified number of shares are tendered to the bid, and if that % is not met, offeror doesn’t have to take any of the shares

**Different Types of Bids:**

* **Friendly** = uncontested by the target, which will issue a directors’ circular indicating its support for the offer. More likely to succeed; also have better idea of firm value.
	+ “Casual Pass” = vague indication that a tender offer is contemplated or some other form of biz union is desired. Price not specified, and if target doesn’t want to pursue it, no public disclosure is necessary
	+ “Bear hug” = target management notified of proposed takeover bid at stated price, but w/o an immediate public announcement by the purchaser
* **Unfriendly** = contested bid; target’s management attempts to defeat the takeover bid through defensive maneuvers
	+ Usually commenced w/o any communication to target management apart from a courtesy call
	+ Longer periods prescribed for bids to remain open (ex. 35 days in OSA)
	+ Price to be offered:
		- “Blowout bid” = sizeable premium over current trading price of target company’s shares → seeks to make it clear to 3rd parties that if they enter the fray they’ll overpay for company and also puts pressure on target’s BOD to acknowledge that bid will provide shareholders w/fair value for their shares
		- Alternatively, they’ll wait to see if any other bidders come forward and then design the bid
* “**Partial offer**” = made subject to the condition that a specified number of shares are tendered to the bid (ex 50%) → if condition not met, offeror not obligated to take up the shares; if more than that number are tendered, offeror must take them up on a *pro rata* basis under OSA s. 95.7
	+ Also possibility that offeror will have the option of taking up all shares tendered at the offer price if more than the stipulated amount is tendered
* “**Any-or-all offer**” = made for all of the shares that are tendered, so that offeror must purchase all such shares even if they are not sufficient to amount to a control block
* “**Two-tier offer**” = partial bid where offeror announces that if they obtain control, they’ll freeze out non-tendering shareholders

**Are Hostile Takeovers Good or Bad?**

* Good
	+ Discipline inefficient management
	+ Synergy
* Bad
	+ Market myopia
	+ Hubris
		- Bidders often overpay for targets
	+ Unjust wealth redistribution

DEFENSIVE TACTICS

1. **Making the target seem attractive**
	1. If it appears like it’s doing well, not suitable candidate for a takeover motivated by offeror’s belief that they can manage the firm more efficiently (ex. dividend payout or share repurchase that eliminates free cash flow)
2. **Making the target seem unattractive (revise capital structure)**
	1. Target could sell off particular division that was attractive to possible takeover offeror
		1. Buy new biz or sell crown jewels (most precious assets of corp.) to 3rd party
	2. Accelerate or increase management’s employment benefits (**golden parachutes**)
	3. Repurchase shares w/cash → would use up cash of the company & make it less attractive to corp. bidders
	4. “**Poison pill**” (**shareholder rights plan**) → device in which the acquisition of control in a takeover triggers contractual rights that may decrease firm value (ex. target might issue new kinds of securities that are convertible into voting shares on change of control by all holders other than the bidder = dilution of voting power for the bidder)
		1. Gives holder the right to purchase new shares at greatly discounted price (usually 50% off)
		2. **Flip-over Pill**: triggered when bidder acquires specified % of shares & target company is subsequently merged into acquirer = dilutes voting power of bidder
		3. **Flip**-**in Pill:** triggered if bigger corp. acquires specific % - shareholders of target corp. (excluding bidder) can purchase shares of target corp. at discount
			1. This is what is used in Canada almost exclusively
		4. Purpose of poison pill is to make it extremely unattractive for a bidder to proceed w/ a bid w/o having convinced the target company’s BOD to do away w/the rights plan
		5. **Lollipop**: issue of retractable preferred shares in a stock dividend, w/holders given the right to resell the shares to the corp. on specified control transactions
		6. **Back-end Pill:** similar to lollipop but preferred shares are not retractable, they are convertible to common shares
		7. **Poison Debt:** shareholders issued shares that, on control transactions, are convertible into debt securities or notes
		8. All of these pills feature rights/privileges that permit their holders to acquire new interests at an attractive price
		9. All pills accomplished by board action w/o need for shareholder approval, but most Canadian companies ask for shareholder ratification anyway
			1. In Canada, often companies adopt rights plans that contain a “**permitted bid” provision** = allows bidder to acquire more than the % of shares that would otherwise trigger the shareholder rights plan in the event that the bid satisfies a number of conditions
			2. Provisions used to be detailed, now they’re pretty minimal (ex. keeping bid open for fixed period & that, in the event that more than 50% of shares were tendered to that bid, bid be extended for further 10 days – allows remaining shareholders to participate in the bid, eliminating possibility that shareholders might feel obliged to tender to an inadequate bid, but ensuring they tender if it becomes clear that others have accepted the bid)
3. **Offensive tactics**
	1. Propaganda campaign attacking capacity of offeror to increase firm value
		1. Claim violation of regulations or misleading info in the bidder’s circular
	2. Target might bring defensive lawsuits
	3. Seek injunction to prevent bid from continuing if there‘s a misrep in circular (or even if there’s not)
4. **Share transactions**
	1. Issue shares to investors friendly to management or to an employee stock ownership plan/pension plan (**white squire**)
	2. Find a palatable buyer - Ex. new issue of securities to an inside group/ally (“**white knight**”) better disposed to incumbent management
		1. Option to purchase parts of corp. at huge discount price if triggering event occurs
	3. Solicitation of a rival takeover bid
	4. Management LBO – launch own bid, often financed by debt (leveraged buyout) to buy target corp.
	5. Buy out the bidder (**greenmail**) → repurchase bidder’s shares at a premium. Target corp. will enter standstill agreement requiring bidder not to acquire more shares for a specific period of time – tempers the takeover
5. **Revise the corporate governance structure (“shark repellents”)**
	1. Staggered board → slows process of replacing BOD
		1. More commonly used in US than Canada b/c much harder for bidder to have a rights plan set aside in US than in Canada, so US bidders often marry a bid w/a proxy contest designed to replace target’s BOD
	2. Supermajority vote → if bidder gets regular majority and an approval needs 90%, buyer won’t reach the threshold
	3. Fair price → requires price at least equal to the takeover bid price in any backend transactions
	4. Shark repellent variety greater in US than Canada, b/c it’s easier in Canada to acquire control of corp. and then amend these provisions away

*Hogg v. Cramphorn* (1967 – UK) – White Squire Defense

Ratio: New shares issued by directors are invalid. Directors violated their duties as directors by issuing shares for the purpose of preventing the takeover, despite also having a *bona fide* belief that the issue was in the best interests of the corp. & shareholders (this belief was not contested).

* Issue of shares improper BUT breach was held to be ratifiable & directors permitted “to convene a general meeting to consider such resolutions as may be submitted to it” → shareholders ratified and adopted every act & deed done by the directors
* Employed the white squire defensive strategy → buy enough shares to stop someone from taking over company, but not a majority stake

*Teck Corp. v. Millar* (1972 – BCSC)

Facts: Afton mines was a junior mining corporation seeking to issue controlling block of shares major corp to allow for development/exploitation of claims and had two potential suitors. Millar (director of Afton) preferred C and believed was most capable suitor. Afton required funds and sold a non-controlling block to C at $3/share, even though Teck had offered $4/share. Teck pursued controlling interest through market purchases and Millar proposed a controlling block sale to C, which was accepted on May 30 and signed June 1. Teck sent letter May 29 saying that they could arrange better terms than anyone else. On same day Teck delivered letter that they had acquired controlling interest and that no action should be taken until requisitioned shareholders’ meeting held. Despite this, Afton’s solicitor advised that they could go through with deal if they genuinely thought it in the best interest of Afton.

Issues: Did the board have the right to enter the deal and issue the shares to C?

Holding: Yes.

Ratio: **A board is not prohibited from issuing shares to frustrate a takeover bid – although they must show that the purpose of frustrating the bid was in the view of the best interest of the corporation.**

* **TEST**: directors must act in good faith and there must be reasonable grounds for their belief – they need to **provide objective evidence of their good faith and these reasonable grounds**; some sort of documentation of their consideration. Directors are not bound to the will of the majority shareholder(s) – not agents of any stakeholder/shareholder. Directors are allowed to inquire who is taking over and why – and make judgments re the potential acquirer’s experience, reputation, and policies

Notes: No allegation that sole concern was to protect own interests; but if in addition to pursuing your interests an action also promotes the best interests of the corporation, then you have fulfilled your fiduciary obligation. The **lynchpin is the purpose/intention of the director**. Directors are allowed to inquire/consider who is seeking to take control and why - if they can show that that purchase would not be in the best interests of the corporation, then they are entitled to fight it. Something more than an assertion of good faith is required - the court should apply: **Directors must act in good faith; there must be reasonable grounds for their belief,** if there is none adduced then it justifies a conclusion that the action was taken for an improper purpose. Usually requires reports, statements, independent outside advice etc.

Shareholders’ Voting Rights

**Shareholder Rights:**

* Economic rights
	+ Right to sell
	+ Dividends if declared by the board
	+ Right to residual property on dissolution
* Voting Rights
* Information Rights
	+ Access to certain corp. records
* Litigation Rights
	+ Direct suit
	+ Derivative litigation
	+ Oppression remedy

**What are the purposes of shareholder voting?**

* Important mechanism to protect shareholder interest
* 3 strategies to deal w/dissatisfaction:
	+ Sell (sometimes there are restrictions on this)
	+ Sue (if shareholder can find ground for action)
	+ Vote (express opinion on how company should be directed by exercising voting right

**2 Models of Corporate Governance for Voting**

* Anglo-Saxon Model (Canada, UK, USA)
	+ Shareholders → BOD
* Continental European Model (Germany, France, Netherlands, Finland)
	+ Employees & Shareholders vote for a Supervisory Board; that board then elects members for Management Board

WHAT CAN SHAREHOLDERS VOTE ON?

Election/Removal of Directors

**Voting Procedure:**

* When to vote?
	+ Vote at AGM (**s. 106(3)**)
* How many directors to be elected?
	+ With a **staggered board**, usually takes about 3 years to replace the whole board (**s. 106(4)**)
* How many votes required?
	+ **Ordinary resolution** (**s. 106(3); s. 6(3)**)
	+ Uncontested election
* Types of Voting:
	+ Slate voting vs. Individual voting
		- Slate: cast the # of votes you hold for each candidate (ex. 100 shares = each candidate of the slate gets 100 votes) → have to vote for entire slate though, can’t pick & choose candidates
	+ Plurality voting vs. Majority voting
		- Plurality: whoever gets most number of votes (don’t need majority)
			* Vote or abstain – abstentions are not counted in the votes
		- Majority: majority of votes is necessary to win
	+ Straight voting vs. Cumulative voting
		- Cumulative: **s. 107** → each shareholder entitled to vote has right to case number of votes equal to number of votes attached to the shares held by the shareholder multiplied by the number of directors to be elected
			* Formula: To elect N # of directors, shareholder needs:
				+ N x (total number of shares authorized to vote) / (number of directors + 1) + fraction (or 1) =

**S. 140: unless otherwise specified in the articles, each share of a corp. = one vote at shareholder meeting**

**Removal of Directors:**

* When to remove?
	+ **S. 109**: With/without cause, at any time, by ordinary resolution, subject to **s. 107(g)** (director can be removed may majority of votes)
	+ Shareholder meeting
* How many votes required?
	+ Majority of votes of shareholders

Can Also Vote On…

* Amendment of the articles of incorp. (**s. 173**)
	+ Special resolution required (2/3 of votes cast at shareholder meeting)
* Amendments of bylaws (**s. 103**)
* Sahreholder proposals (**s. 137; s. 103(5)**)
* Fundamental changes:
	+ Amalgamation w/another company (**s. 183(5)**)
	+ Sale/lease of all or substantially all of the company’s assets (**s. 189(3) & (8)**)
	+ Liquidation/dissolution of company (**s. 211**)
	+ Continuance of corp. under laws of another jurisdiction (**s. 188**)

WHAT SORT OF SHAREHOLDERS CAN VOTE?

* **Voting vs. Non-Voting Shares**
	+ No requirement that equity interests must always bear voting rights
		- Preferred shares often non-voting & even common shareholders may be disenfranchised
	+ **Note:** if company only has one class of shares, automatically = voting shares
* **Voting Rights Anyway** – doesn’t matter what class of share in following instances:
	+ **Fundamental Changes → everyone votes** [**ss. 183(3), 189(6), 188(4), 211(3)]**
* **Separate Class Voting Rights**
	+ Changes in class structure & rights (**s. 176(5) & (1)**)
		- Increase/decrease # of authorized shares of the class
		- Add, change or remove rights/privileges/restrictions/conditions
		- Increase authorized number of shares of a class having rights equal/superior to the particular class
		- Increase rights/privileges of the class
		- Create a new class that’s equal to or superior to the shares of the voting class
			* Separate vote for series of shares required where one would be affected differently from other shares in same class (right to vote separately applies whether or not shares carry right to vote)
	+ Fundamental changes
		- **S. 189(7):** entitled to vote separately in respect of sale/lease/exchange only if class is affected differently
		- **S. 183(4**): if merger agreement would change class structure of this particular class, then that class can vote separately
* **Equal Treatment & Voting Restrictions**
	+ Usually used to fend off takeovers
	+ Super voting rights (ex. Facebook)
		- Endow a class of shares held by firm insiders w/more than 1 vote per share
	+ Capped voting rights (***Jacobsen***)
		- Limits the voting rights of large shareholders

*Automatic Self-Cleansing Filter Syndicate v. Cunninghame* (1906 – UK)

Facts: Plaintiff McDiarmid wanted the assets of company to be sold, so he arranged a K w/a purchaser → commissioned a meeting of the shareholders, resolution to sell the assets on the terms of the proposed K was passed by a vote of 1502 for & 1198 against. Directors thought proposed K was not in company’s best interests, declined to carry out the resolution. Plaintiff suing to compel the defendant directors to carry the resolution out.

Issue: Can shareholder override director authority through mere majority vote in ordinary meeting?

Held: NOPE – articles of incorp held that extraordinary resolution was required

Ratio: BOD has authority over shareholders, to alter the power of the directors would need an **extraordinary resolution**, not just one from a majority at an ordinary shareholder meeting

* Board may act independently of the views of the majority of shareholders, even in opposition to them

**NOTE: s. 102(1)** codifies this case & the authority of BOD over management of corp.

*Jacobsen v. United Canso Oil & Gas Ltd.* (1980 – Alta. QB) – Voting Restrictions

Ratio: **S. 24(3)** stands for the proposition that shareholders have the right to vote on the basis of number of shares they possess. Can’t prescribe limitations on voting rights if there’s only 1 class of shares.

WHAT IS THE EFFECT OF A SHAREHOLDER VOTE?

If shareholder approval is required, then the vote is binding on the BOD (ex. fundamental changes)

* Generally, shareholder proposal votes are not binding on BOD
	+ Ex. wages fork workers (w/in managerial discretion of directors)

Unanimous Shareholder Agreements

**S. 102** is subject to a unanimous shareholder agreement (USA)

* Shareholders can agree to remove authority from BOD & give primary managerial responsibility to shareholders (**s. 146**)
	+ Directors absolved of managerial duties, shareholders assume them along w/statutory liabilities
* Requirement of unanimity restricts its scope to small issuers
* Only exception to s. 102 allocation of power is USA

Shareholders’ Meetings

**Types of Shareholders’ Meetings**

* Annual general meetings – at this meeting shareholders:
	+ Elect directors (**s. 106(3))**
	+ Appoint auditors **(s. 162(1))**
	+ Receive the financial statements of the corp. (**s. 155(1))**
	+ Usually just ordinary resolution (majority) that’s required
* Special meetings (**s. 133(2)**)
	+ Called to approve some transaction not in the ordinary course of biz & that the incorporating docs require shareholder approval for
	+ Special resolutions (2/3 votes)

**Place of Meeting**

* **S. 132:** meeting must be held in Canada designated in the bylaws, or if there’s no provision in place then place can be determined by the directors
* **S. 132(2):** can be held outside of Canada if place is specified in the articles or all shareholders agree to hold it there

**Quorum**

* **S. 139(1):** quorum is present if holders of a majority of the shares entitled to vote at the meeting are present or are represented by proxy → doesn’t have to stay for whole meeting, just the start

**Intermediary Voting**

* **S. 153:** intermediary can’t vote the shares that the hold for the beneficial owner until they’ve received written instructions

WHO MAY CALL MEETINGS?

**Directors:**

* **S. 133(1)**: AGM must be called no later than 18 months after the corp. comes into existence & subsequently no later than 15 months after last AGM
	+ Directors can choose date of AGM
* **S. 133(2):** Special meetings

**Shareholders:**

* CBCA permits holder of certain proportion of voting shares to requisition board to call a shareholders’ meeting → w/o this right it would be difficult to remove BOD before end of term
* **S. 143:** must have **5% or more of the shares** in order to requisition a shareholder meeting → directors then obligated to call meeting w/in 21 days of receiving requisition

**Court:**

* **S.** **144:** shareholder can petition the court to order a shareholders’ meeting be called
	+ Order can be made either if it’s “impracticable” to call or conduct a meeting in another way or “for any other reason a court thinks fit” (***Re Canadian Javeline Ltd.***)
* **S. 145:** corp./shareholder/director can apply to court to determine any controversy re: election/appointment of a director or auditor of the corp.
	+ **(2):** Court can make any order it thinks fit, including order requiring new election/appointment

NOTICE OF THE MEETING

* Who should receive the notice & when?
	+ **S. 135:** Actual notice must be sent between 50-21 days → must specify “the nature of that biz in sufficient detail to permit the shareholder to form a reasoned judgment thereon” (**s. 135(6)**)
	+ Shareholder list (**s. 138**)
	+ Record date (**s. 134; reg. 43**)
		- **S. 134:** “record date” = no more than 50, no less than 21 days before the meeting is to be held, for determining who is entitled to receive notice of the meeting
* What information?
	+ Time and place (**s. 135(1)**)
	+ Special business (**s. 135(6)**)
		- “**Special biz”** = all biz to be transacted at a special meeting & all biz to be transacted at an annual meeting except consideration of the financial statement/auditor’s report, reappointment of incumbent auditor & election of directors

CONDUCT OF THE MEETING

* Chair of meetings of shareholders (usually president/CEO) is under a **general duty** to assist the meeting in achieving its objectives. Duties are:
	+ To **preserve order**;
	+ To see that the **proceedings are regularly conducted**;
	+ To take care that the sense of the meeting is properly ascertained w/regard to any question properly before it; and
	+ To decide incidental questions arising for decision during the meeting
* In exercising duties, **chair is to act in good faith & in an impartial manner**
* Usually concerns re: conduct of meetings will only arise where control is disputed
	+ Control at a shareholders’ meeting in a public corp. vests in the party that has secured the most proxies, chair’s conduct has most often been challenged when they reject proxies
* Shareholders can speak to any matter, but not unconstrained → chair acting in good faith & impartially just needs to allow reasonable time

*Re Marshall* (1981 – Ont.) – Chair’s Duties

Facts: Vote re: election of BOD. Director/shareholder applied for an order from the court for the tabulation of votes based on escrowed common shares in accordance w/certain written directions of the beneficial owners & not as voted by the registered owners of the shares.

Issue: Is the chair required to look behind the share register & accept written directions from beneficial owners as to the manner in which their vote shall be cast?

Held; NO.

Ratio: **Chair at an AGM is not to be placed in position of determining the legal rights of beneficial owners of shares registered in the name of other**s. Entitled to rely on the votes as cast by the registered owner of those shares.

*Blair v. Consolidated Enfield Corp.* (1993 – ONCA)

Facts: Blair was prez/chair of Consolidated Enfield, got advice from solicitors that proxies could only be voted for the management slate of directors & couldn’t vote to replace Blair. At the meeting, votes were cast to replace Blair. Blair, acting on advice of solicitors for the corp., declared that he & the rest of the management slate of directors had been elected. Canadian Express brought action to declare that ballot cast for CE was validly cast in favour of replacing slate of directors. Court determined it was validly cast; CE now had control over Consolidated → sought costs against Blair. Blair sought indemnity for costs from Consolidated under s. 136(1) of OBCA. Under s. 136(1) a director can be indemnified against the costs of an action if the director acted honestly & in good faith w/a view to the best interests of the corp. Court denied indemnity, refused declaration that he was entitled to indemnification on basis that Blair hadn’t acted in best interests of the corp.

Issue: Did Blair act in good faith & the best interests of the corp.?

Ratio: duty owed by chair = **duty as one of honesty & fairness** to all individual interests, directed generally to the **best interests of the corp.**

* Duty related to the decision-making process & the conduct of a proper corporate meeting
* Legal advice doesn’t automatically sanctify conduct based upon it as honest & in good faith for purposes of claiming indemnity under **s. 136** → should be considered in assessment though

MEETINGS BY ORDER OF THE COURT

**S. 144:** Court can intervene and order shareholder meeting if it is “impracticable” to call or conduct a meeting in another way or “for any other reason a court thinks fit”

*Re Morris Funeral Services* (1957 – ONCA)

Ratio: Except in extraordinary circumstances, the corp. statute may not be invoked successfully for the express & sole purpose of placing in control of the corp.’s directorate & affairs 1 of 2 or more contending factions among the shareholders

* Court will exercise its discretion in ordering a meeting, but it has jurisdiction to alter quorum & notice requirements

INTERVENTION ON BASIS OF FAULT

Closely Held Corporations

Should court be more ready to intervene in circumstances where one of the parties seems more at fault than the other?

* ***Re Routley’s Holdings Ltd.* [1960]** → Boland was president, hadn’t called AGM in a long time, 2 of the 4 holders threatened litigation unless meeting was called. Boland held it at corp. HQ, which was also his law office. At the meeting he rejected the proxies of Routley’s Ltd. & Clara Routley (2 shareholders) even though they were valid. Continued w/o quorum.
	+ Court ordered meeting be held at neutral locale, and lowered quorum to 2 shareholders w/ 50% of shares (from 3 w/ at least 50%) lest the Bolands attempt to thwart the meeting by refusing to attend. Emphasized Boland’s clear breaches of law in his conduct of the previous meeting.
* ***Re B. Love Ltd.* (1982)** → applicant obtained an interlocutory injunction restraining a director from certain breaches of fiduciary duty
	+ Court gave serious consideration to “the substantial case of prejudice” to the corp. occasioned by the director’s improper conduct

Whether a court should refuse to order a meeting under **CBCA s. 144** where the applicant possesses a sufficient number of shares to requisition a meeting themselves under **s. 143**

* ***Athabasca Holdings Ltd. v. ENA Datasystems Inc.* (1980)** → meeting might be ordered where the requisition procedure would be futile to secure a meeting that would actually be held, as opposed to merely called

Widely Held Corporations

*Re Canadian Javelin Ltd* (1976 – QCSC)

Facts: Shares widely held in Canada & USA – effectively had 2 BODs. June 1975 AGM, 11 people were elected to the board. Deep split of 6 vs. 5 developed. Both boards purported to act for the corp., were removing each other from officer/director positions. Applied to court to order AGM. Even though the petitioning shareholders owned a sufficient number of shares to entitle them to requisition a meeting, court found it would be “impracticable” to conduct a meeting fairly except under court order. Court appointed a neutral chair & made numerous orders as to the solicitation & receipt of proxies, including that no person/group would be allowed to solicit proxies under the name of “management”.

Analysis: What did the court consider in ordering the meeting?

* Urgent that AGM be called in order to stop damage being called by 2 BODs making contradictory decisions;
* Corp. will be in default of holding an AGM after June 30, 1976 and Company has made no moves to call that meeting;
* Animosity among the directors make it impossible for a fair meeting;
* In the best interest of the Company that a special general meeting be called to give a clear mandate to the people the shareholders wish to manage the Company;
* They’ve got someone who can act as impartial chair;
* Court, when ordering the calling of the meeting or directing the conduct, must be careful to do as little violence as possible to the corporate articles/regulations
* Recommended date of meeting for July to give enough time for corp. to prepare required docs for the meeting

*Charlebois v. Bienvenu* (1968 – ONCA) – Constitutional Requirements

Issue: Can a court-ordered meeting consider a matter assigned to the competence of the board by CBCA s. 102(1)?

Ratio: **s. 144** is aimed & limited to the removal of difficulties militating against the calling of a shareholders meeting or militating against the conducting of biz which lawfully might come before the meeting. Once difficulties removed, open to the shareholders present to conduct only such biz that could have been conducted at a meeting legally called “in any other manner”

* “For all purposes” limited in application to establishing the legality of the meeting so far as the calling, holding and conducting thereof as a meeting is concerned
* More is necessary to sanction the Court to “order” shareholders to do in a meeting what they otherwise would have no power to do simply b/c it had been established that w/o the help of the Court it was “impracticable” to call/hold/conduct the meeting

ACCESS TO THE LIST OF SHAREHOLDERS

* Access is critical for any shareholder who wants to communicate w/fellow shareholders concerning management of the corp. or their desire to change management
* **S. 21(3)** → corp. must furnish a current list of shareholders w/addresses & numbers of shares owned, to “shareholders & creditors…their personal representatives, the Director and, if the corp. is a distributing corp., any other person, upon payment of a reasonable fee.”
	+ Only limitation is that request must be accompanied by requestor’s affidavit stating that the list will not be used “except in connection w/…[a] matter relating to the affairs of the corp.” [**s. 21(9)]**

*1. Mechanics of Access*

* CBCA provides 2 ways a shareholder might gain access to the list:
	+ Shareholder might assert a right to examine the list and to take extracts from it [**ss. 21(1) & 138(4)]**
	+ Might require the corp., on 10 days notice, to provide a copy of the list of shareholders, saving the trouble of having to make extracts, but has the drawback of giving the corp. 10 days notice that something is up

SHAREHOLDER PASSIVITY & GROWTH OF INSTITUTIONAL INVESTMENT

* Shareholder passivity linked w/stake in the company → bigger the stake, the less rational shareholder passivity is; gains from monitoring become more significant relative to the costs
* Institutional investors (banks, trust companies, pension funds, insurance companies, mutual funds, private equity funds) have grown significantly in size & importance in North America → increasing influence on corp. decision making
	+ Large block shareholders do have an effect on the monitoring of corp. managers

**Institutional Investor Monitoring**

* 1/3 of shares of Canada’s major corps held by institutional investors → many of these investors = “patient” capital – interested in advancing long-term investment returns through responsible corp. governance
* Institutions constrained in acquisition of substantial stakes in corps by laws that impose ownership limits on banks, trust companies, and insurance companies
	+ Mutual funds also subject to limits
* Securities laws also place limitations
	+ Shareholder = an “insider” if they own 10% or more of the voting securities of a corp. → leads to new disclosure requirements and insider reporting obligations + restriction on insider trading
		- Can’t sell when it has undisclosed material info concerning corp.
	+ 20% or more = subject to takeover bid requirements. Require institution to make an offer to buy the shares of all holders of shares of that class
		- “Control person” – subject to rules that constrain sale of shares
* Person can be a “control person” w/less percentage of shares if they’re in the position to affect materially the control of the corp. (ex. institutional investor having on or more directors on the BOD of the corp.)
* Canadian Coalition for Good Governance – goal = promote best corporate governance practice in Canada & align interests of corporate boards w/investors
	+ Advocated for effective, committed & independent directors w/ high degree of integrity & ethical standards
	+ Board succession planning that ensures maintenance of appropriate balance of skills & expertise
	+ Also promoted mandatory share ownership for directors, to align director & investor interest
	+ Advocates that corp. boards have a majority of independent directors
	+ Separation of CEO and board chair
	+ Independent board committees w/clear mandates
	+ Independent & experience audit committee members
	+ Ongoing performance evaluation of boards, committees, and individual directors
	+ Officer succession planning
	+ Management oversight & strategic planning
	+ Oversight of management evaluation & compensation
	+ Transparency in reporting governance policies & practices to shareholders

Voting Arrangements & Governance in Closely Held Corporations

**Closely Held Corps:** no universal definition, normally have the following characteristics:

* Relatively few shareholders
* Most or all of them participate actively in the management of the corp.
* No established market for the shares of the corp.
* Frequently, there is a restriction on the transfer of the shares of the corp.

CORPORATE GOVERNANCE MODIFICATIONS FOR CLOSELY HELD CORPS

* Differences from widely held corps:
	+ Less need for monitoring devices imposed in context of widely held corps, such as mandatory proxy solicitation
	+ Efficiencies achieved by allocating management of biz to directors & their delegated officers not as significant where there’s only a few shareholders
	+ Small group may more readily assemble to deal w/array of matters of management nature
	+ Individual shareholders usually have a significant stake in corp., incentive to protect their investments through more active participate in day-to-day affairs
* “Private corp.” as defined in statutes usually had upper limit of 25-50 shareholders; in reality for shareholders who want to maintain a real identity # more like 10-12
* Courts reluctant to interfere w/closely held companies & arrangements made among shareholders to protect their interests

**Special Requirements under CBCA:**

* **S. 102(2):** Directors on board
* **S. 162(1):** Auditor appointment
* **S. 171:** Audit committee
* **S. 160:** Public filing of financial statements
* **S. 21(1):** Access to corp. records
* **S. 149(2):** Proxy solicitation

*Re Barsh and Feldman* (1986 – Ont.)

Facts: Application under s. 106(1) of CBCA for an order requiring a meeting of the shareholders, and a variation of the quorum so that only 2 shareholders w/ 51% are required, instead of the original 3 shareholders. 3 shareholders (Feldman, Ben Barsh & Harvey Barsh), each w/one common share. 2 invested $20k each; Harvey was to perform services in lieu of capital contribution. Ben died in 1983, Harvey exercised an option under the will to purchase his share → holds it as a bare trustee (1/2 interest to his sister, ¼ to his bro). Barsh wanted to develop land, Feldman wasn’t into it, so Barsh offered to buy him out. Feldman didn’t return resolution to approve transfer of the share from Ben to Harvey, nor to elect corp. solicitor as a director – at this time that Barsh requisitioned meeting of shareholders. Negotiations continued for purchase of Feldman’s share & change to the by-law. Feldman has now given an undertaking through counsel to sign a resolution for the annual meeting, approving the annual financial statements

Ratio: Courts should respect structure of corp. & the purpose behind corp. bylaws

* Purpose of quorum in this case was not to permit attendance of a shareholder, but to ensure that there would be no corp. action w/o unanimous consent

Statutory Modifications Available to Closely Held Corps

1. ***Waiver of Notice to Shareholder Meetings***: shareholder can waive notice to a shareholder meeting [**s. 136**]. Shareholders in widely held corps can use this, but more likely for closely held where shareholders can be more readily contact re: meeting.
2. ***Resolutions by Unanimous Consent in Lieu of Meeting***: shareholders’ resolutions can be passed by having the resolution in writing signed by all the shareholders entitled to vote on the resolution. Unanimous consent by writing would be tough for widely held corps, so that’s why this is usually only used by closely held [**s. 142**].
3. ***Avoiding Proxy Solicitation Requirements****:* expense of proxy solicitation & prep of a proxy circular likely to outweigh substantially any possible gains for shareholders in closely held corps when the shareholders have a sufficient stake in the corp. to keep themselves well informed & exercise their voting rights. **S. 149(2)** specifies that corps that have not made a distribution of their shares to the public are not subject to the mandatory proxy solicitation requirements.
4. ***Dispensing w/an Auditor***: if no public distribution of shares, can dispense w/requirement of having an auditor (limited to corps w/assets not exceeding $2.5 million & gross operating revenues not exceeding $5 million). Provision most often used by closely held corps where it is possible to avoid what can be substantial costs of a full audit [**s. 163**].
5. ***Financial Disclosure***: can also avoid having to publicly file its financial statements if no public shares. Statutes also explicitly recognize single shareholder corps and provide that where there’s only 1 shareholder, their presence in person/by proxy = a meeting [**s. 139(4)].**

CONTROL DEVICES IN CLOSELY HELD CORPS

* Supermajority
* Shareholder agreements
* Voting trusts
* Class voting
* Share transfer restrictions

Shareholders’ Agreements

Most significant mods for closely held corps are statutory provisions that allow a closely held corp. to modify the default allocation of the power to manage the biz and affairs of the corp. to the directors

* **S. 145.1:** vote-pooling agreements
* **S. 146(2): shareholders can unanimously agree to remove management powers from directors & allocate them to the shareholders (**inspired by ***Ringuet v. Bergeron*** →**vote must be unanimous**)
* Agreement will be binding on prospective investors if they’re given **actual notice** of the agreement (**s. 146(3)** & **s. 49(8)**)
	+ If notice not given, then purchaser/transferee can rescind transaction by which they acquired shares w/in 30 days of becoming aware of the unanimous shareholder agreement
* If a shareholders’ agreement is not unanimous, not clear that actual notice of it will bind the purchaser of shares → ***Greenhalgh v. Mallard* [1943]**
	+ Agreement to vote so that plaintiff would get control, then one of the parties sold their shares to someone not party to the agreement. Plaintiff sued for a declaration that the purchaser was bound by the voting agreement.
	+ Court held that no intention was revealed on the face of the agreement either that its duration should be longer than the period during which a particular party would continue to own their shares, or that a party was to be restrained from selling their shares

**Common Matters:**

* Nomination & election of directors
* Voting threshold/veto rights
* Dividend payments
* Preemptive rights
* Departure of a shareholder due to death, etc.
* Restrictions of share transfer
* Non-competition & confidentiality undertakings
* Deadlock

Share Transfer Restrictions

* Where shareholders are active in management, identity will affect firm value, restrictions put on share transfer as a result
	+ Restrictions also may make it possible for the owners to maintain their relative share ownership & power w/in the entity = to pre-emptive rights in this way
	+ Transfer restrictions also required if a firm is to take advantage of securities law private issuer exemptions (avoid costly prospectus requirements)
* 5 types of transfer restrictions:
1. *Absolute Restrictions*: shareholder can’t sell – rarely used except possibly in start-up phase of new corp.
2. *Consent Restrictions*: transfer of shares may be made only on approval of the corp.’s board
3. *First Option Restrictions*: most common type. Shareholder may not sell their shares or may not sell them to any person not already a shareholder w/o first offering them to the corp. or to the remaining shareholders. Remaining shareholders have the option to buy the shares, either at the price offered or at price fixed by a valuer (often company’s auditor)
4. *Buy*-*sell Agreements*: similar to first option but corp. or other shareholders must buy the shares of the selling shareholder when the triggering event occurs. Popular as a form of protection against the death of a shareholder – estate of deceased shareholder would be obliged to sell shares, and corp./shareholders would have to buy them.
5. *Buyback Rights*: corp. is given right to repurchase shares on occurrence of certain events, even if shareholder doesn’t want to sell (ex. termination of shareholder’s employment w/the firm)
* Share transfer restriction may not be adopted by a firm that has made a public distribution of its shares [CBCA s. 49(9)]
	+ Public corp. may constrain the issuance/transfer of shares to person who are not resident Canadians, in order to qualify under any fed/prov. law making a specified level of Canadian ownership a prereq for receipt of license or other benefit [CBCA ss. 46, 47, 49(9-11), 174]
	+ Constrained share provision is drastic b/c directors are authorized to sell as if the corp. was the owner of the constrained shares [s. 46(1)]
	+ Shares to be sold must be selected by directors “in good faith” and proceeds of sale are to be held in trust for benefit of ex-shareholders who must bear the costs of administration for the trust fund [s. 47]

**Validity**

* US courts are suspicious of share transfer restrictions b/c they view shares more as property, and the restrictions look liked restraints on alienation of property
* English courts tend to view shares as primarily contractual in nature, relatively untroubled by doubts as to validity of share transfer restrictions
* ***Edmonton Country Club v. Case* [1975**] → SCC considered validity of an article of a public company that prohibited the transfer of shares to anyone w/o consent of the directors
	+ Dickson: rejected attack that article was *ultra vires* b/c no evidence directors had ever acted in bad faith or abused their power
	+ Laskin: would have struck the article b/c power was arbitrary on its face, didn’t consider whether the power had been used in a particular way
* CBCA and Alberta act don’t permit a share transfer restriction in a public corp.
* CBCA corp. that wants restrictions must put them in its articles [s. 6(d)]
* Restriction must be noted conspicuously on all share certificates; otherwise it is ineffective [s. 49(8)]

CLOSELY HELD vs. WIDELY HELD CORP.

* **Reasons to go public:**
	+ Firm will go public only when doing so increases the value of the shares that were issued prior to the public distribution
	+ Cost of regulation for public corps acts as a factor in decisions whether to go public
	+ One of the main advantages of a public market arises through efficiencies in information production – in efficient markets, free riding takes the form of trading in widely held shares by lay investors who don’t investigate share quality and seek only to craft a suitably diversified portfolio of securities
	+ Availability of a resale market in securities of widely held firms is another advantage; shares in a closely held corp. often made inalienable by firm’s charter
	+ Widely held corps also have easier access to capital markets
* **Reasons to stay private:**
	+ Primary reason to remain or become a closely held corp. is to economize on agency costs → costs arise as a consequence of the separation of ownership and control

**Concerns:**

* Concern for the protection of minority shareholders in closely held corps:
	+ Inability to sell shares
	+ Management opportunism is a risk as a consequence of the greater valuation uncertainties surrounding closely held corps
* Closely held may also wish to adopt different liability rules – ex. Matters left to management’s biz judgment in a public corp. might be subjected to strict rules in a closely held corp.