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# 3 Types of Business Organization

## Sole Proprietorship

* Simplest—only 1 owner
* Create by registering your business name (PA s 88)—costs $40
* Pros:
  + Easy & simple
  + Full control
  + Tax benefits—if operating at a loss
* Cons:
  + Unlimited liability—personally liable for business liabilities
  + Limited life—if owner dies business ends
  + Difficult to transfer ownership
  + Tax, if profitable—19-26%, vs. 16%-22% as a corporation

## Partnerships

* Two or more people carrying on business together for profit
* 3 kinds:
  + General partnership
    - No registration required
  + Limited partnerships
    - Registration requirements
  + Limited liability partnerships
    - Registration requirements
* Pros:
  + Two or more people can do business together
* Cons:
  + Each partner personally liable for all the liability of the partnership business (unless limited liability)

## Corporation

* Defined by 5 features:
  + Separate legal entity from the other actors
  + Perpetual existence—continues on if people die
  + Share transferability—easy to change ownership
  + Limited liability—shareholders not personally liable
  + Centralized management—management power with BOD, not owners; ownership and control are separate
* How to create:
  + Formal procedures for incorporation
* Pros:
  + Limited liability—shareholders not personally liable for debts of business—only liable for the amount they have invested into the business
  + Tax benefits—pay less income tax if profitable
* Cons:
  + Some costs with incorporation process
  + Formalities to maintain operation of business (BOD meetings, shareholder meetings)

# Agency

Def’n from Canadian Common Law: the relationship that exists between two persons when one, called the agent, is considered in law to represent the other, called the principal, in such a way as to be able to affect the principal’s legal position by the making of contracts or the disposition of property

Alternate Def’n: **the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.**

3 Basic Elements:

1. Consent by principal and agent
   1. Both must consent
   2. Principal must manifest consent to the agent in some form so that agent can consent—can be oral, written, or implied
   3. Principal consents first, then agent consents
2. Action by agent on behalf of principal
   1. Must act primarily for benefit of principal
3. Control by principal
   1. High degree of control: agent has v. little discretion = employee/servant
   2. Medium level of control: agent has some discretion = independent contractor

Duties of Principal:

* Duty to compensate
* Duty to indemnify (in certain circumstances)

Duties of Agent:

* Duty of loyalty
  + May not benefit from its efforts on behalf of the principal
  + may not use the confidential information that belongs to the principal for the agent’s own benefit
  + may not act for anyone whose interests might conflict with the interests of the principal
  + may not compete with the principal in any matter within the scope of the agency relationship
* Duty of care
* Duty to act within authority
* Duty to obey instructions
* Duty of disclosure

Liability of principals:

Liability in tort:

* Liable for torts committed by Employees
* Not liable for torts committed by independent contractors

Liable in contract if there is Actual or Apparent Authority

* Actual authority = express or implied authority to do something
* Apparent Authority = authority a reasonable third party would infer from the actions or statements from the principal

Liability of agents:

* Not liable if principal is disclosed
* Liable if principal not disclosed
* Liable if agent does not have the purported authority
* Liable in tort as the tortfeasor
* Not liable for breaches of contract committed by the principal (agent is not a party to the contract)

Warranty of authority

* agent warrants that they actually have the authority to act on behalf of the principal that they purport to have
  + If principal is bound, agent does not breach warranty of authority
  + If principal is not bound, agent breaches warranty of authority
  + If agent is an employee, they are liable in tort for torts committed (they are the tortfeasor)—is a tort law question

Agency Problem: differing interests/priorities between agent and principal

**Agency Problem includes Agency Costs:**

* **cost of agent misusing his or her position**
  + e.g. employee has access to company bank account and steals money
* **Cost of monitoring and disciplining the agent**
  + e.g. surveillance cameras etc

**Causes of agency problem/agency costs:**

* **Conflict of interest**
  + Agent wants highest price for least effort; principal wants lowest cost
* **Information asymmetry**
  + Agent has more information about how the agent does their job than the principal does

**How to Reduce Agency Costs:**

* **Try to reduce conflict of interests between principal and agent**—try and align the interests of principal and agent (e.g. profit sharing)
* **Deal with/reduce information asymmetry**: require agent to disclose information about how they perform the job and any conflicts of interest

## Food Lion Inc v Capital Cities/ABC Inc

F: undercover food reporters

I: did the two employees breach the duty of loyalty?

R: can have two principals as long as their interests don’t conflict; must put interests of principal ahead of own interests

A: put ABC’s interest ahead of food lion’s interest—these conflicting interests breached duty of loyalty to food lion

C: yes there was a breach

## Fisher v Townsends Inc

F: chicken contractor accident

I: was Reid an employee or independent contractor?

R: in determining whether someone was an employee or independent contractor, examine:

Written contracts that may be in place—not determinative—labels assigned by the parties don’t always fit the relationship—may be reflective of the intentions of the parties

Exercising of control over how they perform their job—look at what employer supplied and how much flexibility the agent has in performing their job

C: employee—principal liable for tort committed by Reid

# Partnership

### What is a partnership?

Def’n: when two or more persons carry on business in common with a view of profit ***(s 2)***

* Persons = humans or corporations
  + Does not include partnerships (not separate legal entity)
* Business includes every trade, occupation, or profession (broad definition)
* Don’t actually have to generate profit—must simply have a view to profit in the future **(*Backman v R)***
* No formal requirements to create partnership
  + Apparent registration requirement under section 81 of the PA
    - not registering just creates doubt/uncertainty

PA s7(1): a partner is an agent of the firm and other partners for the purpose of the business

Typical Characteristics of a Partnership:

* **Intention**—can be express or inferred
  + look at whether the parties intend or do not intend to have a partnership
  + can also look at how parties represent themselves
* **Profit Sharing (is KEY) (s 4(b))**
  + No profit sharing, no partnership
  + Prima facie evidence that parties are partners—creates a rebuttable presumption of partnership ***(s 4(c))***
  + Essential, but not conclusive evidence of a partnership
* **Loss sharing**
  + probably not required, but is typical
* **Right of Management**
  + Generally sharing management power is a feature of partnership, but not determinative
  + BC PA ***s 27(e)***: subject to any agreement express or implied between the partners, every partner may take part in the management of the partnership business
    - Default rule that there is equal right in management for all partners
    - Can vary this by express or implied agreement
  + If a party is totally excluded from management, it may be that they are not actually a partner ***(Voltzke v Westlock)***
  + Does not require hands on participation, but just the right to manage—can delegate power to an executive committee that is elected by the partners
  + Typically make decisions by majority vote
* Treat partnership property as indivisible ***(Le Page v Kamex) (s 4(a))***
* Bankruptcy ends the partnership ***(Pooley v Driver)***
* Able to receive residual assets on termination of the partnership ***(Pooley v Driver)***

Rules of Partnership

* Come primarily from common law and equity
  + These laws continue as long as they are not conflicting to provisions in the partnership act ***(s 91)***
* ***S. 4***–outlines what should be examined when determining whether something is or is not a partnership
  + (a) joint tenancy, tenancy in common, joint property, common property, or part ownership does not in itself create a partnership
  + (b) Sharing of gross returns does not itself create a partnership
  + (c) receipt of share of profits is proof of partnership in absence of evidence to the contrary
  + Exceptions for profit-sharing presumption:
    - Receiving a portion of profits in installments to pay back a debt
    - Profit sharing contracts with employees
    - Spouses or children of a deceased partner who receive shares of profits that the deceased was entitled to
    - Profits received as per a lending agreement that is in writing and signed by all of the contractual parties
    - Receiving profits in exchange for a sale of goodwill of the business

#### A.E. LePage Ltd v Kamex Developments Ltd.

F: listing for sale of a property signed by whom?

I: Do the appellants constitute a partnership? Did March sign the listing as a partner, thus binding the partnership?

R: just because the people own property in common and the property generates profits does not automatically make them a partnership

* depends on whether or not they intended to carry on business, or to merely provide an agreement that regulates their rights and obligations as co-owners;
  + treated their interests as separate;
  + **right of first refusal is incompatible with partnership—means interests are divisible and interests in a partnership are not divisible**

C: Co-owners were not partners in this case

Note: LePage could have sued March for breach of warranty of authority as he purported to be an agent of the others

#### Volzke Construction Ltd. v Westlock Foods Ltd.

F: shopping centre co-owners build an expansion

I: Were westlock and Bonel partners in the operation of the shopping centre?

R: Must look at actions and intentions of the parties when determining if there is a partnership; control/signing authority has nothing to do with whether or not there is a partnership

A: had joint bank account, printed cheques in both their names, co-signed independent financing loan together, sending prospective tenants to Bonel and dealing with issues on the spot; cost-sharing and profit-sharing according to their interests; just because westlock did not have signing authority/control over the bank account, does not mean that they were not partners

C: Yes, they were partners in owning the entire shopping centre

### Lenders as Partners?

#### Pooley v Driver

F: atypical loan to partnership  
I: Did the written agreement Driver entered into make them partners in the partnership?  
R: merely being a lender and receiving a percentage of the profits in exchange does not in itself make the lender a partner—need something more: look at behaviour of parties  
A: in this case:

* had some control over the capital of the company
* Agreement allowed the Drivers to have benefits that partners have
* also had an arbitration clause which was unusual for a loan;
* profit sharing is not limited by the amount of the loan (this is not typical for lenders—usually capped at principal plus interest);
* loan agreement incorporated partnership agreement, lender’s bankruptcy would end the loan agreement (typical of a partnership);
* if business comes to end, loan repaid out of residual assets of business (typical of a partnership)
* no co-management (not typical of partnership);

the loan was not a true loan—got the benefits of partnership and should assume the risks;   
C: Drivers were partners and were liable to Pooley

### Legal Status of a Partnership

* Partnership is not a separate legal entity—is just an aggregation of individual partners
* Partners cannot be employees of the partnership—cannot simultaneously be employer and employee ***(Thorne v NB (WCB))***
* Partners cannot be creditors or debtors of partnership—cannot lend money to yourself
* Liability: Partners are personally liable for the partnership’s debts
* Dissolution occurs if a partner dies, resigns, or a new partner joins
* Tax: only partners pay tax on income from the partnership, not the partnership
* Cannot sue a partnership, but for convenience, you can bring a suit in the partnership name to indicate that each of the partners is named in the judgement and are bound by the decision
* *Partnership cannot own property*—property owned by all partners in proportional interests on an undivided basis
  + ***(S 1.1)* “partnership property”**—property and rights and interests in property originally brought into the partnership stock, acquired, whether by purchase or otherwise, on account of the firm, or acquired for the purposes and in the course of the partnership business
  + upon the dissolution of the partnership, all assets must be sold and the money divided between the partners according to their percentage share
  + partnership property must be used exclusively for the purpose of the partnership (unless other partners consent)

#### Thorne v NB (Workman’s Compensation Board)

F: partner injured working in a mill

I: was Thorne a workman employed by the partnership and thus entitled to compensation?

R: A partnership is not a separate legal entity;

* partners are not employees of their own firm;
* use of a collective name is merely for convenience

A: Previous case law had dictated that a partner could not be an employee of his own firm (cannot be both employer and employee)

* agreements to pay partners their wages is just a way of allocating profits amongst partners;
* use of a collective name is merely for business convenience and does not create a separate legal entity

C: No, not employed and not entitled to compensation

### Default Rules for Partnership Agreement:

* A partnership is a contract among the parties (partners)!
  + Governed by partnership agreement (express or inferred by conduct) and Partnership Act
  + ***s 21 of PA***: if partners wish to deviate from the provisions in the act, the partners must all consent to do so
    - Default Rules:
      * Equal profit sharing and loss sharing ***(s 27(a))***—this applies even if the partners did not contribute the same amount to the partnership
      * Each partner has equal Management right ***(s 27(e))***
      * Majority vote needed for ordinary matters; unanimous consent needed for fundamental change ***(s 27(h))***
      * No new partners unless unanimous consent among existing partners ***(s 27(g))***
      * Majority cannot expel a partner ***(s 28)***
        + Unless such power given in partnership agreement and exercised in good faith
    - Can contract out of any of the default rules, but you run the risk of denying the existence of the partnership (court may determine you no longer have a partnership)
  + Fiduciary duties cannot be contracted out:
    - Must act with utmost fairness and good faith ***(s 22)***
    - Duty of full disclosure ***(s 31)***
    - Duty to account for benefits acquired by a partner in a partnership transaction, if the other partners did not consent ***(s 32)***
    - Duty to not compete, unless the other partners consent ***(s 33)***

### Dissolution of partnership:

* fixed term of partnership in the partnership agreement ***(s 35(1)(a))***
* ends at the completion of a particular goal or task ***(s 35(1)(b))***
* can call the partnership to an end at any time if not otherwise specified ***(s 35(1)(c))***
* On death, bankruptcy, or disassociation of a partner ***(s 36)***
* If it becomes unlawful to continue on with the partnership, ***(s 37)***
* Judicial dissolution—apply to court ***(s 38(1)(f))***

### 4 main principles of Partnership

#### Equality

* Right and obligation to share equally in the profits and losses of the business
* Right to participate in the management of the business
* Right to have access to partnership books
* Duty to render to each other true accounts and full information of all things affecting the partnership

#### Consensualism

* Mutual rights and duties can be varied by consent of all of the partners
* Can add partners by unanimous partner consent
* Can change the fundamental character of the business with unanimous partner consent
* Cannot expel a partner by majority consent unless expressly written in the agreement
* Exception to unanimous consent: ordinary matters connected to the partnership business can be determined by majority opinion

#### Fiduciary Character

* Owe duties of loyalty and care to each of the other partners
* Each partner is an agent of all the other partners

#### Personal Character

* Partnership automatically dissolved on death or insolvency of one of the partners
* Tough to assign a partner’s interest in a partnership to someone else
* Can counter some of the instability created by statute with a clear agreement of what happens in the event new partners are added, existing partners retire, what happens in the event of death/bankruptcy etc.

### Liability to Third Parties:

Section 7 to 10 of PA govern liability of partnership to third parties—mimic the principles of agency law

* ***S 7(1)***—partners are agents of the partnership and other partners for the purpose of the partnership business
* ***S 7(2)***—if a partner’s act is an ordinary business matter, the partner has apparent authority and the partnership is bound UNLESS
  + ***2(a)***: the partner has no authority in the particular matter AND
  + ***2(b)***: third party knows the partner has no authority OR does not know or believe the person is a partner
* ***S 8(1)***—act or instrument relating to the firm and done or executed in firm name or in any other matter showing an intention to bind the firm, by any person authorized to do so, whether partner or not is binding on firm and all partners
  + Also covers agency relationship with employees of the partnership
  + If partner or agent of partnership has actual or apparent authority, partnership is bound
* ***S 8(2)***—does not affect general rules of law relating to execution of deeds or negotiable instruments
* ***S 9(1)***—one partner pledges credit of the firm for a purpose **apparently not connected with the firm’s ordinary course of business,** firm not bound **unless partner is specially authorized** by other partners
  + If extraordinary business matter, 3rd party cannot reasonably believe partner is authorized—no apparent authority
* ***S 9(2)***—9 (1) does not affect any personal liability incurred by an individual partner
* ***S 10***—if agreed between partners that a restriction placed on any one or more of partners to bind the firm, an act done in contravention of the agreement is not binding on the firm with respect to persons having notice of the agreement
  + if 3rd party does know the restrictions, partnership not bound

Summary:

* If person actually authorized to do something 🡪 bound ***(s 8)***
* Ordinary business matters (apparent authority) 🡪 bound, unless no actual authority and 3rd party knows it ***(s 7)***
* Unrelated business matter (no apparent authority) 🡪 not bound, unless actually authorized ***(s 9)***
* Restriction on authority (no actual authority) 🡪 not bound, if 3rd party knows no actual authority ***(s 10)***

### Partnership Liability

* Pre-Partnership Liability
  + Not liable for things the partnership did before you became a partner (***s 19(1)***)
  + Still liable even after retirement if the act occurred while you were still an active partner ***(s 19(2))***;
  + not liable for new debts incurred after retirement ***(s 19(3))***
* Liability as a Partner
  + Personally liable for all debts and obligations entered into by the firm at the time you were a partner
  + Partners jointly and severally liable for partnership debts arising from partner misconduct ***(s 12, 14)*** and misallocation ***(s 13, 14)*** and merely jointly liable for all other partnership debts ***(s 11)***
    - Jointly and severally—creditor can sue any one of the partners for the money they are owed and the partner can then sue the other partners to recover the portion of money the other partners owe; if release claim against one partner, does not release the claim against other partners
    - Jointly—must sue all of the partners in order to pursue any of the partners; if creditor releases claim against one partner, the claim is released against all partners
* “Holding out” Liability
  + If you hold yourself out as a partner of a firm, you are liable as a partner of that firm, even if you were never actually a partner ***(s 16(1))***
* Liability of Apparent Partner
  + \*Extension of holding out principle—can remain liable even after retiring from the partnership ***(s 19(3))***
* Posthumous Liability
  + Deceased partner’s estate is not liable for post-death partnership debts, only those incurred before the partner’s death ***(s 16(3))***

Partners’ Tort Liability:

* S 12: if by any wrongful act or omission, **any partner acting in ordinary course of business of the firm or with authority of his or her partners**, loss or injury caused by person who is not partner in the firm or any penalty is incurred, firm is liable for that loss, injury or penalty to the same extent as the partner so acting or omitting to act
  + Partner is always liable as the tortfeasor

## Limited Partnerships

* Is not a separate legal person
* Consists of at least one limited partner and at least one general partner ***(s 50(2))***
* Formed by a partnership agreement AND filing a certificate with the registrar signed by each general partner ***(s 51)***
  + If don’t file with registrar, can still form general partnership if requirements met
* Can be a general partner and limited partner at the same time in the same limited partnership ***(s 52(1))***
  + Difference between person who is GP/LP vs GP only—person who is both is a general partner is treated as general partner for all purposes **other than** entitlements for distribution of profits and return of capital contributions—does not affect liability, only the relationship between the partners ***(s 52(2))***
    - E.g. hiring of employee—dual partner is general partner
* General partners = personally liable ***(s 7)***
* limited partner = only liable to the extent of contribution to the business ***(S 57)***
  + protection lost if takes part in the management of the business ***(s 64)***
  + protection lost if the partnership is defectively formed (e.g. registration process not done properly or not completed) ***(consequence of s 51)***
  + protection lost if last name appears in the firm name ***(s 53(4))***
  + protection lost if false statement in certificate and did not take steps to amend ***(s 74)***
* can assign his or her rights to another ***(s 66(1))***
  + transferee has limited rights unless the partnership agreement allows for this and all of the other partners consent to it in writing
* if withdrawing, has the right to receive the return of his/her contribution from the firm\*:
  + on dissolution ***(s 62(2)(a))***
    - after creditors are satisfied, LP’s have priority over GP’s in receiving return of capital and profits (default rule) ***(s 62(1))***
  + if the partnership agreement provides for it ***(s 62(2)(b))***
  + if no other procedure is specified in the partnership agreement, 6 months after giving notice to all of the other partners ***(s 62(2)(c))***
  + if all of the partners consents to the return ***(s 63(b))***
* \*cannot withdraw if there are not sufficient partnership assets to cover all of the liabilities
* Dissolution of limited partnership:
  + Dissolved upon:
    - death, retirement or mental incompetence of a general partner or dissolution of a corporate general partner ***(s 67)***
      * However, remaining general partners can continue the business if specified in certificate ***(s 67(a))*** and remaining partners consent ***(s 67(b))***
    - All of the limited partners have withdrawn from the partnership ***(s 69(b))***
    - Limited partner does not receive return of contribution he or she is entitled to ***(s 62(4)(a))***
    - Partnership assets are insufficient to return contribution to limited partner and limited partner would otherwise be entitled to them ***(s 62(4)(b))***

What General Partners Can and Can’t Do:

* Cannot:
  + Do an act which makes it impossible to carry on the business of the limited partnership ***(s 56(a))***
  + To consent to a judgement against the limited partnership ***(s 56(b))***
  + To possess limited partnership property, to dispose of any rights in limited partnership property other than for a partnership purpose ***(s 56(c))***
  + To admit person as general partner or limited partner unless right to do so is given in certificate ***(s 56(d))***
  + Continue business of LP on bankruptcy, death, retirement, mental incompetence or dissolution of general partner, unless right given in certificate ***(s 56(e))***
* Cannot do things which go against partnership agreement

What Limited Partners Can and Can’t Do:

* Can:
  + Statutorily permitted activities
    - Right to inspect books and receive specific information ***(ss 58(1)(a) & 55(1)(b))***
    - Right to obtain dissolution by court order ***(s 58(1)(c))***
    - Right to participate in profits and return of capital ***(ss 59, 61, 62, 73)***
    - Lend money, borrow money, and transact with LPs ***(s 60(1))***
    - Give consent on admitting new partners ***(s 56)***
* Cannot:
  + Participate in management unless they want to lose their liability protection ***(s 64)***

### Taxation of Limited Partnerships

* Combine the advantage of limited liability with benefits of partnership tax treatment
  + Avoid double taxation—partners report their share of profits or losses on their personal taxes
  + Special incentives and tax credits flow through the partnership directly to the partners

**Asset distribution upon limited partnership breakdown:**

* **Creditors**
* **LPs**
  + **LPs capital**
  + **Profit LP**
* **GP**
  + **GP’s capital (return capital to GPs)**
  + **GP – profits (distribute profits to GPs)**
* **LPs have priority over > GPs in receiving capital/profits**

### Haughton Graphic Ltd v Zivot

F: one person, two hats

I: can Haughton Graphic sue the limited partners, Zivot and Marshall, for the money they are owed? (yes)

R: Factors to consider when determining whether acting as LP or GP:

* Zivot and Marshall directed the partnership, took care of the managerial decisions, and signed cheques on behalf of printcast,
* presented themselves as president and VP of limited partnership, not officers/directors of the general partner—therefore, are liable as general partners;
  + reliance on a limited partner being a general partner is not required

### Nordile Holdings Ltd v Breckenridge

Nordile sued arbutus and was given a judgement, but this judgement was not satisfied—then tried suing limited partners

Did the limited partners take part in the management of the business? Are they liable?

* Because the two LP’s managed in their capacity as directors/officers of the general partner, rather than their capacity as limited partners, they were not managing the business—they were not liable
* Must look at how the LP’s represent themselves to third parties (as directors/officers or as limited partners); look at how the documents were signed

## Limited Liability Partnerships

* Creature of statute
* LLP is a separate legal entity
* Members of LLP are agents of the LLP and not of each other
* Generally, not personally liable for the debts and obligations of the LLP ***(s 104(1))***
  + Except—for partner’s own negligent or wrongful act or omission ***(s 104(2)(a))***
  + For negligent wrongful act or omission of another partner or an employee of the partnership if the partner seeking relief ***(s 104(2)(b))***:
    - Knew of the act or omission AND
    - Did not take actions that a reasonable person would take to prevent it
* Members can also be employees of the LLP
* Requirements of forming an LLP
  + Written agreement between two or more partners stating that they are forming an LLP governed by statute
  + Must be formed to carry on a profession whose governing act permits them to practice an LLP and is governed by a body that requires members to carry a minimum level of insurance ***(s 97)***
  + Name must be registered ***(s 96)***
  + Name must include “limited liability partnership” or “LLP” ***(s 100)***

|  |  |  |  |
| --- | --- | --- | --- |
|  | GP | LP | LLP |
| Formation—Registration Required? | No | Yes (***s 51)*** | Yes ***(s 96)*** |
| Management—default rule? | Equal right to manage (***s27(e))*** | Only general partners ***(s 64)*** | Equal right to manage (***s27(e))*** |
| Profit Sharing—default rule | Equal share ***(s 27(a))*** | LP: Shared in proportion to contribution ***(s 59)***  GP: Equal share ***(s 27(a))*** | Equal share ***(s 27(a))*** |
| Liability to 3rd party | Personal liablity for debts of partnership ***(s 7)*** | LP: no personal liability ***(s 57)***  GP: Personal liability ***(s 7)*** | No personal liability, except 2 situations ***(s 104)*** (negligence/misconduct of self or other partner’s negligence/misconduct and didn’t try and prevent) |

Why form a general partnership if there is so much risk?

* Historically, is because of:
  + tax advantages (partnership is not taxable entity, so there is no double taxing)
  + Flexibility—partners have very strong flexibility to structure their arrangement as they see fit
  + Availability—professionals were required to practice as GP, rather than LLP—this has changed
  + Inadvertence—people didn’t know they were creating GP and were ignorant about their potential liability—no registration requirement to form

# Corporations

* Executives and employees provide human (labour capital)
* Shareholders and creditors provide money capital
  + Shareholders = equity investors
  + Creditors = liability investors
* Assets of a corporation (cash, inventory, equipment, land, accounts receivable) = liabilities + equity
  + Upon dissolution, creditors paid first, shareholders paid second
  + If assets are greater than liability, there is positive equity
  + If assets are lesser than liability, there is negative equity/no equity

## Characteristics:

* **Operated for profit**
  + Profit maximization as sole, exclusive goal?
    - Friedman—business managers not in a position to make public policy decisions, so this cannot be their purpose; society is better off if corporations make more profits, because they pay more tax and this benefits the public (highly criticized)
* **Is a separate legal entity** *(Salomon v Salomon & Co)*
  + in Canada, there is no minimum number of shareholders or minimum capital requirement to form corporation
* **Limited liability for shareholders**--no personal liability
  + CBCA ***s 45(1)***—shareholders of corp, IN CAPACITY AS SHAREHOLDERS, not liable for any liability, act or default of the corporation
    - If commits a tort or enters into a contract in their personal capacity, they are still personally liable for this
  + Corporation’s creditors cannot make claims against shareholder’s personal assets
  + Shareholder’s personal creditors cannot make claims against corporation’s assets
  + Benefits:
    - Reduces need to monitor agents (managers/employees)—more efficient
    - Reduces need to monitor other shareholders
    - Makes shares interchangeable (which also facilitates takeovers)--easy to sell shares to others
    - Facilitates diversification—without LL, would want to minimize exposure to liability by holding only one company; if have LL, can hold shares in many companies to hopefully average profits across all companies
    - incentivizes creditors to monitor managers
      * because creditors bear some risks they want companies to do well
* **Perpetual existence**
  + Benefits:
    - Continues even with changes in corporate constituents
    - Allows long-term planning
* **Easy transferability of share interests** 
  + Does not require permission of other shareholders—unless specified in agreement
  + Benefits:
    - Allows shareholders to exit without disrupting business
    - Permits takeovers—disciplines management
      * if shareholders unhappy with managers, they can sell to another owner who may fire all of the managers
    - Facilitates active stock markets, increasing liquidity—can quickly convert shares to cash on the stock market
* **Centralized management**—managed by board of directors
  + Common law
    - Traditionally, shareholders not allowed to fetter the management discretion of directors
  + CBCA
    - ***S 102(1)***—directors manage the business or supervise management of business unless there is a unanimous shareholder agreement to the contrary
    - ***S 146(1)***—management power of directors can be restricted, in whole or part, by written unanimous shareholder agreement

## Consequences of Separate Legal Entity:

* Limited liability
* Perpetual existence
* Can contract
  + Can make employment contracts with shareholders—can be employee of corporation
* Assets owned by company, not its shareholders or creditors
* Has capacity to sue
* Separate tax entity (is taxable)
* Do they have constitutional rights like people?
  + Corporation has capacity and rights, powers, and privileges of a natural person
  + In the US—case looking at whether corporations can back a political candidate like a person can (Citizens United v FEC—SCOTUS says yes—corporations can spend unlimited amount of money to endorse a candidate); does this square with the role of a company in society?
  + Corporations have huge public policy impacts

## Corporate Personality and Limited Liability

### Salomon v Salomon & Co.

F: Salomon created a corporation (Salomon & Co.) and sold it to company whose shareholders were himself, his wife, and 5 children; Salomon held most of the shares; Salomon was paid partially with IOU secured with company assets; when company went under, ordinary creditors were paid first, so Salomon sued

I: Is the company an alias or an agent of Salomon? Was the company validly formed?

R: a company is not an alias for its members, it is its own separate legal entity

* first case to recognize legitimacy of one man corporation (in Canada, there is no minimum number of shareholders or minimum capital requirement)

A: does not matter whether shareholders are relatives or strangers if corp is validly formed; Creditors of company not creditors of shareholders; the law affords protection to companies not available to people; nothing to suggest that Salomon acted fraudulently or dishonestly (he lent money to the company—tried to save it when it was failing)—unsecured creditors were fully aware that they were now dealing with a corporation with limited liability and they lent the money and assumed the risk—creditors should have taken measures to protect themselves (e.g. secure the loans with collateral, due diligence, demand personal guarantee, buy insurance); should not treat this as any differently than a regular corporation just because it is predominantly one person with some nominal shareholders

C: No; yes

## Piercing the Corporate Veil

* consequences of limited liability:
  + moral hazards
    - an economic actor shielded from liability/risk may behave differently than those exposed to liability
      * example:
        + holders of fire insurance may be less concerned with fire safety/fire avoidance
  + gives an economic actor to possibility to reap rewards of risky behaviour without having to bear the associated costs
    - may have opportunity to defraud creditors
* piercing the corporate veil is a solution to moral hazards/consequences of limited liability

### What is Piercing the Corporate Veil

* an equitable remedy
* Disregarding the separate legal personality of a corporation and imposing liability on shareholders for obligations of the corporation

Variant Form:

* Shareholders seek benefits or rights that would be denied if the corporate entity were respected ***(Lee v Lee’s Air Farming Ltd.)***

Incorrect (strictly speaking):

* Directors/officers responsible for their act in the course of the business of the corporation
  + Wrong because a tortfeasor is liable for the tort anyway

### What Piercing the Corporate Veil DOES NOT Do

* Does not dissolve the corporation
* Does not make shareholders liable for all the debts of the corporation—only for the plaintiff’s claim against the corporation
  + Is claim specific

### When Will the Court Pierce the Corporate Veil?

* Potential reasons to pierce the corporate veil:
  + Fraud or improper purpose/conduct
  + Cases where corporation is a sham or alter ego of shareholder
  + Corporation is an agent of the shareholder
  + Company is inadequately capitalized
  + Tort Claims (tort victims are involuntary creditors of the corporation, so it may be fair to pierce the veil in tort claims in order to give victims compensation)
  + Single economic unit/enterprise liability (with parent companies and subsidiary companies)
  + Equity or interests of justice are better served

### Analyzing piercing the corporate veil questions

Determine in what capacity a person can be liable:

* As individual
  + In contract—if is a party to the contract
  + In tort—if they are the tortfeasor
* As a shareholder
  + Have no personal liability unless piercing the corporate veil
* As a director
  + Contract:
    - if making contract on behalf of company, and the company breaches the contract, the director has no liability because they are not a party to the contract (are an agent of the company)
  + Tort:
    - if they are the tortfeasor, they are personally liable;
    - exception: not liable for the tort of inducement to breach contract if they act in the best interest of the company and in good faith

### Clarkson Co v Zhelka

* Case is about reverse piercing, which is a controversial practice

Facts:

* Selkirk incorporated and controlled many companies;
* one of the companies was Industrial Limited and another was Fidelity
* Industrial Limited had only one asset—a piece of land
  + part of this land was sold to Zhelka (selkirk’s sister) in exchange for a promissory note
  + Zhelka later mortgaged this land; land was foreclosed on and some of the money ended up in the Fidelity bank accounts
* Later, Selkirk went bankrupt and the bankruptcy trustee was Clark
* Clark argued the land owned by Industrial Limited should be included in the bankruptcy estate because it was a personal asset of Selkirk

Issue:

* Is the land owned by Industrial Limited the personal property of Selkirk?

Analysis:

* Relationship between Industrial Limited and Zhelka?
  + Was the transaction fraudulent?
    - Yes—was voluntary and without consideration and intended to delay the creditors of Industrial limited
    - Land is still owned by Industrial Limited (transaction reversed)
* Relationship between Industrial Limited and Selkirk?
  + Selkirk owns 100% of shares in Industrial Ltd.—shares in the corporation are personal assets and included in the bankruptcy estate
  + Corporation is separate legal entity unless the veil is pierced
  + Selkirk’s creditors would not have a claim to the land unless the corporate veil was pierced
    - Wanted the land to be included in Selkirk’s personal assets because selling the company shares wouldn’t result in any money—shares are worthless if the company has no assets and many liabilities (negative equity)

Why didn’t the Court Pierce the Veil?

* Followed rule in Salomon
* Company was properly incorporated—at time of incorporation, Selkirk was solvent and wasn’t trying to use the corporate form to defraud his personal creditors
* No evidence that Selkirk’s personal money was transferred to Industrial Limited
  + Purchase money for land was advanced by other companies and this money was repaid
  + Were some questionable transactions amongst the companies, and some of the companies paid Selkirk’s personal clothing bills, but no money flowed from Selkirk to the companies (cash flow from the companies to Selkirk is fine)

This was not a typical situation of piercing the corporate veil—shareholder’s creditor wants to pierce the veil, not a corporation’s creditor (this is a reverse piercing)

Can pierce if:

* corporation formed for the express purpose of doing a wrongful or unlawful act
* when formed, those in control expressly direct a wrongful thing to be done
* company is the agent of a single person (fact specific)
  + having a single shareholder is not enough to prove agency

### Lee vs Lee’s Air Farming Ltd

F: Lee died while piloting aircraft

I: Is Mr. Lee an employee of the corporation? Should the corporate veil be pierced?

R:

* Corporation not a sham or mere alter ego
* Individual can act in multiple capacities within a single corporation
  + someone can be both a director of a company and its employee because the company is a separate legal entity from the employee

C: Mr. Lee was entitled to benefits

### De Salaberry Realties Ltd. V Minister of National Revenue

F: Hierarchy of corporations to avoid paying taxes

I: Is the appellant company an agent or instrument of the parent company? YES

A: if a group of corporations is merely an instrument for a parent and grandparent corporation, the corporate veil can be pierced and companies treated as single economic entity

* + i.e. the corporations are an agent for a parent or grandparent corporation
  + take into account ***(from Smith, Stone, and Knight Ltd v Birmingham Corporation):***
    - profits treated as part of the parent company? yes
    - Persons conducting business appointed by parent company? yes
    - Parent company head and brain of trading venture? Yes, made policies
    - Did the parent company govern the transaction? Yes, made the policies
    - Did the company make profits by the skill and direction of parent company? yes
    - Was the company under the effectual and constant control of parent company? Yes
* In this case, there was a policy concern that the purpose of all of the companies in the hierarchy was for tax avoidance, which was an improper purpose
  + Didn’t want them to have the protection of the corporate veil
* In practice, most parent/subsidiary relationships meet all these criteria—just meeting all the criteria is not enough—will still look at policy concerns to tip the scales one way or another

### ADGA Systems International Ltd v Valcom Ltd

F: Two companies competing for same gov’t contract; employee poaching

I: Are directors and senior managers able to be held personally liable without piercing the corporate veil? YES

A: General rule: Directors still personally liable for their own tortious conduct—corporate veil does not limit their liability in this instance

* + No need to pierce the corporate veil to hold directors liable
  + Not immune from liability just because they were acting in the best interest of their company
* ***Said v Butt Exception***—if the director acts in good faith in deciding a corporation should breach a contract because it is in the corporation’s best interest, the director is not personally liable for the tort of inducement to breach a contract
  + Policy concern—need to give directors discretion to make decisions in best interest of corporation—sometimes not economically beneficial to carry out a contract
  + Policy concern—other parties to contracts are voluntary creditors and can assign risk how they choose; but tort victims are involuntary creditors and have no choice in how risk is allocated
* Breach of contract by corporations—directors are not personally liable because they are not parties to the contract

### Personal Liability:

* As individual
  + In contract—if is a party to the contract
  + In tort—if they are the tortfeasor
* As a shareholder
  + Have no personal liability unless piercing the corporate veil
* As a director
  + Contract: if making contract on behalf of company, and the company breaches the contract, the director has no liability because they are not a party to the contract (are an agent of the company)
  + Tort: if they are the tortfeasor, they are personally liable; exception: not liable for the tort of inducement to breach contract if they act in the best interest of the company and in good faith

## Process of Incorporation

### Why Incorporate?

* **Limited liability**—shareholders not personally liable
  + However, can contract away limited liability—shareholder may be required to provide personal guarantee by a creditor
* **Perpetual existence**—company doesn’t end when an owner dies
* **Share transferability**—very easy to sell or transfer shares in a public company unless they are specially restricted
  + Private companies usually have some restrictions on share transferability
* **Shareholders alone cannot bind the corporation**
  + corp is artificial entity and is controlled by agents directors/officers/employees;
  + shareholders are not agents of the corporation unless given specific authorization to do so
* **Shareholders can contract with the corporation**
  + Corp is separate legal entity so shareholders can be employees of the corp
* **Tax benefits**:
  + Lower tax rate for corporate earnings

### Where to Incorporate?

* Federal or provincial?
  + Different provinces have different requirements for directors’ residency requirements
  + In Canada, tax is not a big consideration, because income earned in each province, it is subject to provincial income tax—typically people incorporate locally for small businesses (i.e. where they want to do business)
    - Different provinces have different rates
  + Large companies tend to incorporate federally under CBCA
* Place of incorporation is not the same as Place of Headquarters
* Why does location matter?
  + Internal affairs doctrine—choose which statutes and case law govern internal disputes
  + Jurisdiction shopping—can incorporate in a place that best fits your needs
    - Tax is very important consideration when choosing where to incorporate

#### Extra-Provincial Registration:

E.g. if a business incorporated in another province or federally wants to carry on business in BC

* If incorporated federally:
  + ***CBCA 15(2)***—corporation may carry on business throughout Canada
* If incorporated provincially:
  + ***BCBCA 375(1)***—foreign entity must register as an extra-provincial company in accordance with this act within 2 months after the foreign entity begins to carry on business in BC

#### Types of Canadian Corporate Statutes

* **Statutory division of powers model**
  + Used by CBCA and other provinces
  + Rights and responsibilities of directors and shareholders are well-specified by the statute and there is very little flexibility
* **Contractarian Model** (based on Old English Company Legislation)
  + Used by BC and Nova Scotia
  + Permits more contractual freedom but does contain some limitations on the rights and responsibilities of directors and shareholders

#### Moving a Corporation (Continuance)

* **CBCA** **s 187**—import continuance
  + Moving into CBCA jurisdiction (from foreign or provincial)
  + Only condition—laws of export jurisdiction must authorize the continuance
* **CBCA s 188**—export continuance
  + Moving out of CBCA jurisdiction (to foreign or provincial)
  + For continuance, corporation needs to get *approval from 3 levels*:
    - *shareholder approval by special resolution* (approved by 2/3 of votes cast or by written unanimous consensus)
    - *from CBCA director*—must be satisfied the company will continue to be liable for their existing obligations
    - *approval by authorities that regulate the particular industry* (e.g. Financial institution must get approval from minister of finance)
* Continuance does not affect the company’s relationship with third parties
  + *Only affects internal governance of the corporation* (i.e. directors, shareholders, and officers)

### Who Can Incorporate?

* ***CBCA s 5***—incorporators
  + One or more individuals; none of them can be:
    - Under 18 years old
    - Of unsound mind
    - Is not bankrupt
  + Corporate bodies can also incorporate
  + Partnerships cannot be incorporators
* Incorporator needs to file documents and pay a fee

### Steps of Incorporation

Under CBCA

* File the articles of incorporation ***(s 6)***
  + Like the constitution of a company
  + Includes filling out Form 1 with:
    - *Name of corporation*
      * Ends with Ltd or Inc
      * Must be distinct name (can use number)
    - *province of registered office*
      * doesn’t need to be the company’s actual office
      * often use solicitor’s office as registered office
    - *class and max number of shares that the corp is authorized to issue*
    - *restrictions on share transferability, if any*
      * if publicly traded company, cannot impose restrictions
    - *min and max number of directors*
      * statutory min is 1 under CBCA
      * if publicly traded company, min is 3
    - *restrictions on business corporation can carry on*
      * typically none are listed
    - *other provisions*
      * if incorporators want to include any special provisions
      * must be very careful, especially for public companies, because it is hard to amend articles of incorporation
    - *signatures*
      * incorporators must sign and file with CBCA director
* File a notice of the registered office of the corporation ***(s 19)***
* File a notice of directors ***(s 106)***
* Pay prescribed fees ***(s 106)***
* Certificate of incorporation issued ***(s 9)***
  + Date on the certificate is very important—company does not exist prior to this date

## Pre-Incorporation Contracts

* Contracts that are enacted prior to the incorporation of the company
* Who is liable on these contracts?
  + Is it the promoter or the company?
    - Both common law and statute govern this
      * CBCA only governs written contracts
      * Common Law governs unwritten contracts
* 3 types of Pre-Incorporation contracts
  + Both contracting parties fully aware corporation has not yet been formed ***(Kelner v Baxter)***
    - Promoters bound
  + Promoter knows company not been formed, but contracting party does not
  + At least 1 and usually both parties mistakenly believe the corporation has been validly formed **(*Smallwood, Shatsky*)**

### Under Common Law

* When is a promotor liable?
  + If both parties know company does not exist but intend contract to be enforceable, promotors liable ***(Kelner)***
  + At least one party mistakenly believed the corporation was validly formed, but it was not, promotor not liable ***(Smallwood; Shatsky & Shatsky)***
* When is the corporation bound by the pre-incorporation contract?
  + Under common law, corporations not bound by pre-incorporation contracts
  + To bind the corporation—new corporation makes a new contract with the third party after formation
    - Is no obligation to make a new contract (for either the company or the promotors)

#### Kelner v Baxter

Facts: Promotors sign contracts on behalf of company not formed

Issue:

* Is the contract enforceable against the promotors (i.e. are they personally liable)? YES

Analysis

Court looked at 3 viewpoints:

* Agency law does not apply because there is no corporation
* Ratification—Impossible for a corporation to ratify a contract previously made when the corporation does not exist
* Intention—at the time of the signing of the contract, all parties knew the company did not exist, and all parties at the time wanted the contract to be enforceable, only way to make the contract enforceable is to make the promoters personally liable

#### Black v Smallwood

Facts: Promotors signed as directors of company that never formed; everyone believed company was validly formed

Analysis

* Promotors not personally liable because the way the promotors signed the contract was that the company was the party to the company
* Contract was invalid because one of the parties was non-existent
* Differentiated between Kelner because in Kelner both parties knew the company did not exist
* Does not mean promotors have no liability at all

#### Wickberg v Shatsky & Shatsky

Facts: Director of old company signed employment contract under new company name; terminated employee sues director saying director personally liable

Analysis:

* Court disagreed—rule in Kelner not applicable
  + In Kelner, both parties knew company did not exist but wanted to bind the promotors to make the contract enforceable
  + Directors knew the company did not exist, but the employee did not
    - Applied the rule in smallwood instead
    - no intention to make the director personally liable—intended to bind the company
  + contract invalid because it was a contract with a non-existent entity
* was a breach of warranty of authority, but court only awarded nominal damages
  + didn’t lose his job because of the non-existence of the company, would have lost his job anyway—no causal connection between the breach of warranty of authority and the loss of the job

### Under CBCA s 14

* (1) person who enters into a WRITTEN contract on behalf of a company before its formation is personally bound by the contract and entitled to its benefits
  + promotors liable
  + ONLY WRITTEN CONTRACTS COVERED
* (2) Corporation can ratify the contract within a reasonable time following the incorporation
  + Corporation becomes bound and the promotor is no longer liable
  + Ratification of contract is retroactive—once ratification occurs, company can sue the other party and can be sued by the other party for the actions of the promotor
    - E.g. promotor breaches the contract before ratification; after ratification, company is liable for the breach
* (3) Whether or not contract ratified, court can apportion liability between the company and the promotor, on an application by the promotor or third party
* (4) If expressly provided in the written contract, promotors can contract away their liability and entitlement to the benefits by express WRITTEN agreement

### Under BCBCA s 20

* (1) Provisions applicable to both written and unwritten contracts (unlike CBCA)
* (2) Promotors not personally liable on the contracts entered into before the formation of the company, only liable for breaching warranty (unlike CBCA)
  + (a) Warranty:
    - Company will come into existence within a reasonable time
    - Adopt the contract within a reasonable time after the company comes into existence
  + (c) Damages for breach of warranty are the same as if:
    - Company exists when the purported contract was entered into
    - If the person who entered into the purported contract in the name of or on behalf of the company had no authority to do so
    - The company refused to ratify the purported contract
* (3) Allows company to adopt the contract within a reasonable time (like CBCA)
  + Can do so through any act or conduct signifying its intention to be bound
* (4) After adoption
  + New company liable retroactively
  + Promotor has no liability or benefit entitlement
* (5) If not adopted within a reasonable time, a party to the contract can apply to the court for an order directing the new company to return any benefit they received to the applicant

## Corporate Governance

### Publicly-Traded vs Closely-Held Corporations

|  |  |  |
| --- | --- | --- |
|  | **Publicly-Traded (Distributing)** | **Closely-Held (Private)** |
| Shareholders | Many; shares traded on market | Few; Not traded on market |
| Share Transferability | No Restrictions | Usually Restricted |
| Piercing Corporate Veil | Less Likely | More Likely |
| Ownership and Control | Separate; agency problem | No separation; majority SH rules |
| Corporate Goal | Profits; other goals problematic | Profits; other goal of SH/board |

### What is Corporate Governance

* System by which companies are directed and controlled (Cadbury Report)
* Specifies distribution of rights and responsibilities among the different participants in the organization (e.g. board, managers, shareholders, and other stakeholders) and lays down the rules and procedures for decision-making (OECD Glossary)

### Why Does Corporate Governance Matter?

* Enron scandal
  + Need to ensure checks and balances to ensure public/shareholders are not defrauded

### What is the Theory of the Corporation?

* Why do investors dare to invest in a public company, since they are powerless WRT the management of the company?

#### Contractarian Theory

* Can regulate the management of corporations
  + But, most US corporate statutes are a set of default rules that enable managers to create their own rules on how to manage the company
* THEREFORE: Corporation is a Nexus of Contract
  + Managers are agents of the corporation that negotiate the contracts
  + Corporate law exists to facilitate negotiation of contractual relationships
    - law reduces negotiating cost by providing standard terms of contract
  + shareholders are not owners, just investors
    - contribute money for residual rights
  + employees are also investors
    - contribute labour for money
  + Shareholder wealth maximization is the purpose of the corporation (controversial)
    - Corporation exists to maximize societal wealth (tough to measure)
      * proxy for societal wealth is shareholder wealth, even though most people in society are not shareholders
        + based on the idea that shareholders are residual claimants—employees receive fixed salaries, suppliers receive fixed payments, shareholders receive variable payments
        + if company is doing poorly, everyone loses out
        + bear both the risks and benefits of the company, so they are the best indicator of societal wealth
        + often the shareholder and employee/supplier interests align, but sometimes they do not
      * employee and supplier wealth are poor proxies for societal wealth because their wealth is fixed

#### Mechanisms for Constraining Managerial Self-Interest

* Legal constraints
  + Disclosure rules in securities law
  + Voting rights and fiduciary duties in corporate law
* Market constraints
  + Capital market—must perform well to encourage investors to put up capital
  + Product market—must produce competitive products to keep the company from suffering
  + Labour market—must do well to attract best employees
  + Market for corporate control—if don’t do well, company likely to be taken over and the management team will be fired

### Purpose of the Corporation?

**Shareholder Wealth Maximization vs. Stakeholder Wealth Maximization**

* Sometimes the priorities of shareholders and stakeholders do not align

**Corporate Social Responsibility (CSR)**

* Goes beyond compliance with the law
  + expected to do more than they are required to do by statute—e.g. pay more than minimum wage, better environmental protection standards
* Goes beyond shareholder wealth maximization
  + Decisions consider all stakeholder interests

**Arguments For and Against CSR**

|  |  |
| --- | --- |
| Against | For |
| * Improving shareholders’ wealth also improves stakeholders’ wealth | * Increasing shareholders’ wealth does not necessarily increase stakeholders’ wealth—must redistribute wealth |
| * No one can serve two masters (based on agency theory) | * Inconsistent with first argument—if interests of Shareholders and stakeholders always overlap, why can they not serve both * We often have multiple responsibilities that conflict and we are able to balance these |
| * Managers are ill-qualified to make public policy decisions, which are at the root of CSR—should be the job of politicians | * Make public policy decisions all of the time—they know more about the business than politicians do |
| * Stakeholders can seek protection through contracting with companies or other laws outside corporate law (e.g. tort) | * Costs for dealing with outside contracts or laws would be greater than simply dealing with it within the corporation |
| * Managers have no right to spend shareholders’ money for stakeholders’ benefits | * Shareholders have no right to demand any profit from the company—is up to the directors discretion how to distribute the money—directors decide about expenses and profits are whatever is left over after expenses are deducted from revenues |

#### Dodge v Ford (1919)

Famous US case WRT corporate purpose—cited for evidence that the purpose of corporation is to maximize shareholder wealth—incorrect

* Business corporation is organized and carried on primarily for the profit of stockholders—this was obiter—ruling was based on a breach of fiduciary duty to minority shareholders by Ford (majority shareholders)
  + If this was in Canada, the Dodge Bros could have brought this claim under the oppression remedy

#### Pennsylvania “Other Constituency” Statute

* Directors can consider the effect of actions on shareholders, employees, suppliers, customers, communities and creditors
* Can consider the short-term and long-term interests of the corporation
* Statutes like this are controversial

US View

* Where there are conflicts between interests of shareholders and others, interests of shareholders trump

#### Parke v Daily News Ltd.

* closed business and distributed proceeds of asset sales to employees
  + injunction against distribution granted:
    - benefiting the employees must be in line with the benefit to the corporation
    - in this case, the corporation no longer existed and the distribution did not benefit the corporation

\*\*\*NOTE: This is no longer good law—has been replaced by UK statute—can make provision for current or former employees

* Corporation should seek goals of “Enlightened Shareholder Value”
  + Should maximize long-term shareholder value

#### In Canada: Statutory Fiduciary Duty under CBCA s 122(1)

* Directors shall act in good faith with a view to the best interests of the corporation ***(s. 122(1))***
  + What are the best interests of the corporation?
    - SCC interpreted this section in 2 important cases

##### Peoples Department Stores v Wise

* Two companies with same owners exchanging supplies—one gets a better deal
* To whom do directors owe fiduciary duties under s 122(1)?
  + corporation, not to creditors or shareholders
    - does not shift even if on verge of bankruptcy
  + Best interest of corporation **may** consider the interests of other constituents
    - shareholders, employees, suppliers, creditors, consumers, governments, and the environment
  + Purpose of corporation is not to maximize shareholder wealth
    - not the exclusive purpose
  + When a company isn’t profitable, the interests of all parties are consistent with each other; when profitable, there will be conflicts between the interests of all parties
    - Regardless, the fiduciary duty is to the company—not to any one group of people

##### BCE Inc v 1976 Debentureholders

* “A good corporate citizen”—typically appears in things associated with CSR—unclear how to interpret this phase in this case
  + BUT—lends support for the idea that shareholder wealth maximization is not the single exclusive goal in Canadian corporate law

## Corporate Forms for Profit and Social Benefit

### Benefit Corporation “B Corporation”

* Delaware General Corporations Act s 362(a)
  + Public benefit corporation = for profit corporation that is intended to product public benefit and to operate in a responsible and sustainable manner
    - Manage in a manner that balances stockholders’ interest, best interests of those affected by corporation’s conduct, and the public benefit identified in the certificate of incorporation
  + Existing corp can become a B corp by amending articles of incorporation
* Releases a bit of the pressure to serve shareholders—easier to justify allocating profits to something other than shareholders’ pockets

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

* + Features:
    - Community purpose ***(s 51.19)***
      * Purpose beneficial to society at large or a segment of society that is larger than the group of persons related to the C3 company
    - Dividends permitted subject to restrictions ***(s 51.94)***
      * Can distribute profits to members, but this must not be greater than 40% of annual profits, unless paid out to a registered charity
    - Asset lock when dissolution ***(s 51.95(3))***
      * When dissolved, at least 60% of assets are distributed to social purposes (another C3 company or charity); other 40% can go to shareholders
    - Community Contribution Report ***(s 51.96)***
      * Must produce a yearly report on the company’s financial activities
    - Taxed like regular for-profit business, not as a not-for-profit
      * No tax benefits

## Powers of Directors and Officers

### Who can be directors?

* Basic qualification ***(s 105(1))***
  + *A person at least 18 years old*
    - Only individuals—not corporations
  + *Of sound mind*
    - If declared of unsound mind while in office, automatically lose office as director
  + *Not bankrupt*
    - If bankrupt while in office, automatically lose office as director, but can still act as an officer of the corp
* Shareholding Requirements ***(s 105(2))***
  + Directors not required to hold shares unless articles of incorporation specify they must
* Residency Requirements ***(s 105(3))***
  + 25% of directors need to be Canadian residents
    - Exception: if the board has fewer than 4 directors—at least one must be resident Canadian
    - Exception: company in prescribed industry (e.g. uranium mining)—must be majority resident Canadians
  + BC—has completely eliminated residency requirements

### How to elect and remove directors?

#### Election of Directors

* Elected by shareholders
  + Elected by ordinary resolution (simple majority vote—majority of the votes cast) at annual meeting ***(CBCA s 106(3))***
  + Can require a greater number of votes in the articles or in unanimous shareholder agreement ***(CBCA s 6(3))***
* Individuals cannot be made directors without their consent ***(s 106(9))***
  + Can consent by:
    - At meeting where appointment took place and didn’t refuse OR
    - Must consent in writing in advance or within 10 days after OR
    - If they have acted as a director pursuant to the election or appointment, deemed to have consented
* Term of Office ***(ss 106(3-6))***
  + Can be up to 3 years
  + Typically, must be re-elected annually at shareholder meeting unless otherwise specified in agreement or articles ***(s. 106(3))***
    - Annual shareholder mtgs held max of 16 months apart—cannot be more than 6 months after end of previous fiscal year
  + Not necessary that all directors hold office for the same time ***(s. 106(4))***
    - board can be staggered—classified into 3 groups of directors
      * each group includes 1/3 of directors and only one group is up for re-election each year—replacing board takes 3 years
      * used to fend off hostile takeover—acquirer will have to wait 3 years to replace the whole board
  + if there is no term of office, term ends at next annual shareholder meeting ***(s. 106(5))***
  + are incumbent until replacement begins ***(s. 106(6))***
* Filling of Vacancies ***(s 111)***
  + If there is no quorum of directors or articles of incorporation cause increase in number of directors
    - shareholders must fill vacancy with special shareholders’ meeting
  + If there is a quorum and the increase was not caused by change to articles of incorporation
    - quorum of directors can fill the vacancy
    - Typically must be approved by shareholders, but if can coordinate among incoming and outgoing directors, directors can replace entire board without shareholder approval
  + As long as there is a quorum, board can act even if there are vacancies

#### Removal of DIrectors

* Ceasing to Hold office ***(s 108)***
  + Director ceases to hold office when:
    - Dies
    - Resigns
    - Removed in accordance in s 109
    - Becomes disqualified under 105(1)
  + Resignation is effective at the time of a written resignation sent to corporation, or at time specified in resignation, whichever is later
* Removal ***(s 109 CBCA)***
  + Removed by ordinary resolution at a special meeting of the shareholders
  + Directors cannot remove other directors
    - Are ways to get around this—
      * company’s code of conduct states that breach of code of conduct can result in a director’s removal by the board
      * director may agree in advance that he can be removed by the board as long as the grounds for removal are set out in advance
      * articles of incorporation may set out circumstances for mandatory resignation
  + Articles cannot require a greater number of votes of shareholders to remove director than the number required by section 109 ***(CBCA s 6(4))***
    - Are ways to get around this provision ***(Bushell v Faith)***

#### Bushell v Faith

* 3 sibs with equal shares—2 tried to remove 1; articles have a super-voting provision
* Is the director validly removed by the resolution? Is the super-voting provision in the articles valid?
  + Yes, super-voting provision was valid—UK company act provided that director could be removed by ordinary resolution, but it does not impose restraints on modifications to voting strength of shares
    - If they wanted to restrict super-voting provisions, they would have done so in the statute

\*\*\*NOTE: Only private companies can have super-voting provisions in articles—public companies cannot list shares if there are super-voting provisions

### Structure of the board?

* Number of board members ***(s 102(2) CBCA)***
  + Closely-Held Corporation:
    - Minimum is 1
  + Distributing corporations:
    - need at least 3 directors, and at least two of them must be outside directors
* Outside Directors ***(S 102(2))***
  + Not be officers or employees of the corporation or its affiliates
* Independent Directors (stricter than outside director)
  + Not member of management
  + Free from business interest or other relationship that could reasonably be perceived to interfere materially with his or her ability to act in the best interest of the company
  + Beneficial holder of 10% or less of the votes of all issued and outstanding securities of the company
* Rationale for outside directors and independent directors
  + Movement from managing board to monitoring board—less focus on actual management and more of a focus on supervising the management of the corporation—outside directors and independent directors are in a better position to monitor (not really effective at monitoring if you are also managing)
  + Ensures the shareholders’ interests are protected and the financial performance of the company is maximized—managers have incentives to deceive
  + However, doesn’t always work—Enron had 14 of 17 directors as independent, but enron scandal still occurred
    - Insiders have more knowledge of what is going on internally; independent directors are only part-time participants of the company and have limited knowledge of the company—independents are less invested in the company
    - Has more to do with decision making process than whether director is independent or internal
* Committees
  + Can set up committees and delegate tasks to committees
  + Public companies MUST set up an audit committee ***(s 171 CBCA)***
    - Have *at least 3 directors who are outside directors*
    - Must *review financial statements before they are approved* under s 158
    - *Directors must notify committee of any errors in the statement*
      * Auditor must notify the board of any material errors in the statements
      * Directors must prepare and issue revised financial statements
    - Failing to comply is guilty of a criminal offence

### Powers of directors?

* General managerial authority ***(s 102(1) of CBCA)***
  + Subject to unanimous shareholder agreement, directors manage or supervise management of company
    - Can make any ordinary business decision for the company—shareholders cannot override this and do not have a say, BUT can remove directors if they are really unhappy
  + ***S 146(1) of CBCA—unanimous shareholder agreement***
    - Must be otherwise *lawful and be in writing*
    - Must *include all shareholders*
    - Must *restrict full or partial power* of directors
      * If the purpose is not to limit directors’ power, is not a unanimous shareholder agreement under CBCA
    - Features:
      * Constitutional in nature—is one of the constituent documents of the company—comparable status to articles of incorp and bylaws
      * Binding parties other than the original signatories ***(ss 146(3)-(4))***
        + Binds directors, binds the corporation, and binds share transferees (transferee is deemed to be a party to the agreement, but they can opt-out within 30 days)
      * Powers taken away from directors (and corresponding liabilities) reside in shareholders ***(s 146(5))***
  + Unanimous Shareholder Agreement to Limit Directors’ Power
    - Does not exist under BCBCA
      * have a functional equivalent under ***s 137***
        + articles of company can transfer the directors’ management abilities to others
* Power to adopt, amend, or repeal bylaws ***(s 103)***
  + Bylaws regulate internal affairs of the company
* Declare dividends ***(s 115(3)(d); s 171(1))***
  + Only directors have the power to distribute profits to shareholders
* Issue securities ***(s 25)***
* Appoint and remove officers ***(s 121)***
* Remuneration ***(s 125)***
  + Determine compensation of officers
* Delegation and restrictions
  + Can delegate powers to others ***(s 115 and 121)***
  + BUT some powers are not delegable, including: ***(s 115(3))***
    - Adopting, amending and repealing bylaws
    - Issuing securities
    - Declaring dividends

### How do directors exercise their powers?

* Generally collectively
  + Unless given special authorization
  + Usually done at board meetings

#### Board Meetings

* Place and notice
  + Depends on bylaws
  + Notice of meeting must be sent to each director—information to be included = place and time of meeting
  + Proper notice is required, but notice may be waived by attendance at a meeting unless director is protesting the meeting
* Means of participation ***(s 114(9))***
  + If all directors consent, can participate by electronic means that permits effective communication among directors
* Quorum ***(s 114(2))***
  + Under CBCA, quorum is a majority of directors if articles have fixed number of directors; or majority of minimum number of directors if not fixed
  + ***S 114(3)***—25% of directors must be resident Canadians for business to be conducted UNLESS the required number of resident Canadians approve the transactions after the meeting
* Resolutions
  + Some resolutions require supermajority votes
* Dissent ***(s 123)***
  + If resolution passed by majority, all directors on board are personally responsible for liabilities resulting from the resolution
    - Doesn’t matter whether the director attended the meeting or not, whether they voted for or against, or whether they abstained
    - Only way to avoid personal responsibility is to record a director’s dissent in accordance with CBCA—if voting for a resolution, lose right to dissent
  + Entering a dissent:
    - If attending meeting:
      * Director requests dissent be recorded or it is recorded in the minutes of the meeting
      * Director sends written dissent to secretary before meeting adjourned
      * Director sends written dissent by registered mail or delivers it to registered office of corporation immediately after the meeting is adjourned
    - If not attending meeting:
      * After becoming aware of resolution, have 7 days to:
        + Cause dissent to be placed in the meeting minutes
      * send written dissent by registered mail or deliver it to registered office of corporation immediately after the meeting is adjourned

#### Unanimous written resolutions **(s 117(1))**

* Ensures each director’s voice is heard—at a meeting, a dissenter may be able to change the other directors’ minds through discussion, but if there is no meeting, this cannot happen
* Must be in writing
* Must be signed by all of the directors entitled to vote on the resolution

### Acting beyond the powers

* Ultra Vires Doctrine ***(ss 15 & 16)***
  + In the past, any transaction conducted outside of the purpose of the company according to the articles of incorporation was invalid because it was ultra vires
    - This has been abandoned
  + In the past, the articles of incorporation listed things the corporation could do
    - Now, the articles list things the corporation CANNOT do
  + Can do anything that isn’t restricted by the articles ***(s 16)***
* Defective appointments ***(s 116)***
  + Have no impact on the validity of directors’ actions
  + If directors are improperly appointed, the director’s actions are considered valid
    - Company is bound by this person’s actions because they hold them out as a director
* Defective decision-making procedures
  + Agency law kicks in again—apparent authority
  + The indoor management rule ***(s 18; s 17; Royal British Bank v Turgand)***
    - 3rd party dealing in good faith with the company is entitled to assume company’s internal procedures have been followed—**do not have to investigate whether company’s procedures have been followed, unless they have actual knowledge to the contrary or ought to have that knowledge**
      * Corporation has burden of proof to show that the third party had actual knowledge that the procedures were not followed
    - Corporation held out person as an agent of the company and they conducted an ordinary business matter, so the company must be bound
    - Indoor management rule not applicable for insiders ***(s 18(2))***
      * e.g. employees of the company cannot rely on the indoor management rule in making contracts with the company

#### Sherwood Design Services

* Made a contract with 3 promotors of a corporation which was not incorporated yet
* lawyer sent a letter to Sherwood that indicated a particular shelf company was assigned to the promotors’ company & sent drafts of an unsigned resolution authorizing the transaction
  + BUT—the transaction did not go through, so Sherwood sold their assets to another company for less money
* Sherwood sued shelf company for breaching the contract
  + But shelf company was never assigned to the promotors’ company—was given to a third party instead
* Was the shelf company liable on the contract? Did the lawyers’ documents constitute appropriate ratification?
* Majority—said shelf company was bound
* LOOK AT CONCURRING JUDGEMENT
  + Relies on indoor management rule/apparent authority—solicitor held out the authority to speak on behalf of the corporation—was a clear inference that the law firm was the shareholder of the shelf company
  + Shelf company was still under the law firms’ control—lawyer was an agent of the shelf company
  + Shelf company was bound by the contract, which meant that the third party who was actually assigned the company was liable—could sue law firm for negligent practice
* Dissent—numbered company should not be bound because the documents were unsigned—should have had notice that the resolution was not ratified

## Shareholders’ Financial Rights

* Sources of Financing:
  + Equity financing
    - Issue shares of stock in return for money
  + Debt financing
    - Borrowing money from somewhere like a bank
  + Corporate earnings
    - Cash generated by the business itself (profits that are reinvested)

### Equity Financing

#### What is a share?

* A bundle or rights and liabilities created by the Act **(*Sparling v Quebec*)**
* NOT an isolated piece of property—do not have any ownership right in any particular asset of the company

#### Basic rights attached to shares **(CBCA s 24(3))**

* Voting rights
  + including right to elect directors
  + right to approve fundamental transactions (selling most of company assets, mergers, etc)
  + right to submit shareholder proposals
  + right to make bylaws and amend the articles of incorporation
* Dividend right
  + Right to receive dividend declared by the corporation
    - Up to the board’s discretion to declare dividends
* Right to Residual Property/Liquidation Right
  + Right to residual property of the corporation on dissolution

#### Other rights attached to shares:

* Pre-emptive Rights ***(s 28(1))***
  + Right to acquire shares when the corporation issues new shares
    - Helps existing shareholders retain their existing proportional interest in the company
  + No default rule for pre-emptive rights—*s 28* stipulates it must be in articles of incorporation
  + Do not arise in all situations—no pre-emptive rights IF:
    - If the shares are issued for a consideration other than money or
    - Issued as a share dividend
    - Issued pursuant to the exercise of conversion privileges, options, or rights previously granted by the corporation
* Redemption rights
  + An option to force the corporation to buy back the shares of a shareholder
* Conversion rights ***(s 29)***
  + An option to convert shares into another security of the corporation

#### Classes of Shares

* Must have at least one class of shares and it must include rights in ***s 24(3)***
* If more than one class of shares ***(s 24(4))***
  + The rights, privileges and restrictions must be in the articles of incorporation
  + The 3 basic rights must be attached to at least one class of shares, but not all the 3 rights are required to attached to one class
* **Shares of the same class must be treated equally**

##### Series of Shares

* A series is a subclass of shares
  + One class of shares can be divided into multiple series
* Common class rights but distinct series rights
* Issuing shares in series enables the board to quickly respond to the market condition
  + Can issue new series, rather than new classes of shares (which must be listed in the articles of incorporation)
    - Details of a series only needs to be listed in the bylaws
* A series cannot have priority over other series in the same class in receiving dividends etc.***(s 27(3))***

#### Common Shares v Preferred Shares

* If only have one class of shares, those shares are called common shares (general business practice)
* Preferred shares are a class that entitle the holders to some rights in preference to the rights of a more junior class of shares (e.g. common shares)
  + Two preferences that typically come with preferred shares:
    - Dividend preference
      * receive regular **fixed** amount of dividends before common shareholders receive dividends
      * E.g. “$10 Preferred”—entitled to $10 per year as a dividend
    - Liquidation preference
      * if company is liquidated, preferred shareholders have priority over common shareholders to receive return of their financial capital

##### Voting v Non-Voting

* Preferred shares may or may not have voting rights
  + In practice, most preferred shares do not have voting rights
  + BUT, if there are adverse financial conditions, preferred shareholders may have voting rights on electing directors
    - E.g. If there is a proposed amendment to articles that affects preferred shareholders, they can vote on the amendment

##### Cumulative v Non-Cumulative

* Cumulative = carry forward right
  + E.g. “$10 preferred cumulative”—year 1—no declared dividends (entitlement is $10 in arrears; year 2—no declared dividends (further entitlement of $10 in arrears); year 3—declares dividends (entitled to $30--$10 from each year; $30 must be paid before common shareholders are paid)
* Non-cumulative = no carry forward right
  + E.g. “$10 preferred non-cumulative”—year 1—no declared dividends (no entitlement); year 2—no declared dividends (no entitlement); year 3—declares dividends (entitled to $10 from year 3 only)

##### Convertible vs non-convertible

* Convertible = can change from preferred to common shares
  + E.g. company is making lots of money and wants to distribute $500 to its shareholders; 2 classes of shares: preferred and common, each has 10 shares); Preferred = “$10 preferred”; $100 is given to preferred shareholders—common shareholders share the $400—each gets $40 in earnings per share; WHEN COMPANY MAKES A LOT OF MONEY, BETTER TO BE A COMMON SHAREHOLDER
  + E.g. company not doing so well, and distributes only $100; same structure as example above; only preferred shareholders are paid—nothing left for common shareholders

##### Redeemable vs Non-redeemable

* Redeemable = shares can be redeemed at the option of the corporation or the shareholders
* Redemption right is “claw option” (for corporation buying back) or “put option” (for shareholders selling back)

##### Participating v Non-participating

* Participating = entitled to return of capital, unpaid dividends, and residual assets shared with common shareholders (is a double-dip upon liquidation)
* Non-participating = only entitled to receive return of capital and unpaid dividends upon liquidation

#### Hybrid Nature of Preferred Shares:

|  |  |
| --- | --- |
| **Equity-Like Characteristics** | **Debt-Like Characteristics** |
| Permanent Capital—no fixed maturity date | Fixed dividend payments (like creditors receiving fixed amount of interest) |
| Dividends subject to board discretion | Liquidation preference over common SH |
| Cannot force corporation into bankruptcy for dividend arrearage | Rights are contract-based (in articles) |
| May have voting rights |  |
| Treated as equity for accounting and tax purposes |  |

#### How to Issue Shares

* Directors issue shares
  + ***S 25(1)***: directors have authority to issue shares; power is not delegable
* How many shares can be issued?
  + No statutory limit
  + Max listed in articles
* What is the process?
  + If shares are to be sold to the public, it also triggers complex disclosure processes
  + Generally, there are 3 steps
    - *Subscription*
      * offer to purchase a certain number of shares at a price specified in subscription document
    - *Allotment*
      * If accepting the subscription offer, shares are allotted to the buyer
    - *Issuance* ***(s 25(3))***
      * Once shares are fully paid for, the shares are issued to the buyer
      * Cannot issue a share until consideration for the share is fully received
        + consideration can be paid in money, property, or in past services
        + property does not include promissory notes or promises to pay made by someone to whom a share is issued; ***(s 25(5))***
        + future services not acceptable as consideration
      * Used to issue share certificates to prove ownership of shares—now this is not required, as the transactions are recorded electronically
        + Is expensive to produce and creates a lot of paperwork
        + Have the right to obtain a share certificate at a fee ***(s 49(1))***
    - Par value: is the face value of the share
      * Companies are not allowed to issue par value shares as of 2001 (CBCA)
      * In some jurisdictions (BCBCA), still allowed to issue par value shares
      * Market value is what is relevant
        + Par value is often an arbitrary value assigned to the share
  + Must maintain a separate stated capital account for each class of shares ***(s 26)***
    - Is the historical total of the value of consideration received for the issued shares
    - Is a bookkeeping record
    - E.g.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Corporate Action | Price | Stated Capital Adjustment |
| Jan 1st, 2013 | 100 shares issued | $5/share | 100x5 = $500 |
| July 23rd, 2013 | 100 shares issued | $10/share | 100x10 = $1000 |
| July 1st, 2014 | 50 shares repurchased | $10/share | 50x10 = -$500 |
| Total | 150 shares issued (100+100-50) |  | $1000 stated capital (500+1000-500) |

* + - If consideration paid in services, board has to determine the fair value for services rendered and has to record the value per share in the stated capital adjustment
    - CBCA uses the stated capital to determine if company is eligible to issue dividends to shareholders

### How do Shareholders Realize Profits?

* Capital gains v dividends
  + Capital Gains: Sell the shares at a higher price than the shareholder paid for them
  + Dividend: money given to shareholders per share

#### Declaring Dividends

* + By board resolution
    - Specifies:
    - amount to be paid
    - date the dividends will be issued
    - record date (date for determining shareholders are eligible to receive dividends)
  + To be eligible, must have your name on the company record as a shareholder on the record date
    - If you purchase shares in a company after the record date but before the payment date, you do not get the dividends to be issued
    - Usually takes time (about 2 business days) to have your name appear on the record after purchasing
      * ex-dividend date—date on which you must purchase by to have your name reflected on the record; on this date, the price of the shares likely drops by the dividend amount so that buyers pay a smaller amount
* cash v stock ***(s 43 (1))***
  + can pay dividends in cash or property
  + in practice, cash and stocks are the two main kinds of dividends
    - cash dividend
      * lowers the capital account/value of the company (reduces their assets) and this may upset the creditors;
      * will also likely reduce the price of the shares by the amount of the cash dividend;
      * have to pay personal income taxes on cash dividends
    - stock dividends
      * have no effect on assets/value of the company;
      * increases the number of shares issued by the company, so it slightly decreases the price per stock, but each shareholder owns more stocks, so their overall holdings do not decrease
      * do not pay personal income taxes on the shares received

#### Restrictions on Dividend Payments

* + Cash-flow test ***(s 42(a))***
    - If a corporation is, or would be, unable to pay its liabilities after a dividend payment, cannot issue dividends
  + Capital impairment tests ***(s 42(b))***
    - If the value of the corporation’s assets would be less than the total liabilities and stated capital of all classes, cannot issue dividends
  + Must meet both tests to be able to issue dividends
    - If resolution issuing dividends is passed but company doesn’t meet these requirements, directors are jointly and severaly liable for amounts owing
  + Do these restrictions apply for the issuance of stock dividends?
    - Because stock dividends to not reduce the company’s assets, this does not affect the rights of creditors, so in theory, these restrictions may not apply to stock dividends, but it is not entirely clear—there are no court cases dealing with this point
* Other ways to distribute money to shareholders:
  + Repurchase
    - Buying back outstanding shares—up to the shareholder whether or not they want to sell
    - Reduces the number of outstanding shares—increases the earnings per share
  + Redemption
    - A forced sale initiated by the corporation, in accordance with the articles of incorporation
      * Sale is not voluntary—is mandatory
  + Following a repurchase or redemption, companies acquire shares in their own company—traditionally this was not allowed, but it is now (subject to restrictions in ***ss 34-36***)
    - ***S 39***—shares purchased, redeemed, or otherwise acquired by the company shall be cancelled or, if the articles limit the number of authorized shares, may be restored to the status of authorized but unissued shares of the class
      * Company cannot hold authorized and issued shares

## Shareholders’ Voting Rights

### Election of directors

* + - helps hold directors accountable and aligns the interests of directors and shareholders
    - When to vote?
      * Usually at annual shareholders’ meetings ***(s 106(3))***
    - How many directors to elect?
      * Staggered board ***(s 106(4))***—board classified into several groups so only one class of directors is up for election (discourages hostile takeovers)
    - How many votes are required?
      * Can elect directors by ordinary resolution ***(s 106(3); s 6(3))***—must have majority of votes cast on a particular resolution
      * Plurality voting v majority voting
        + Shareholder can vote for the candidate or withhold the vote
      * if withheld votes are not counted, this is *plurality voting*

If it is uncontested, only need 1 vote to be elected under plurality voting

E.g. if 1 person votes for and 99 withhold, the director is elected under plurality voting with a one share one vote rule

* + - * + Public companies listed on TSX, must have majority voting—withheld votes are considered as against votes
      * Slate voting v individual voting
        + If there are 5 directors:

Slate voting—all 5 directors are in one resolution, must vote for all of the candidates or none of the candidates

Individual voting—vote for or withhold votes for each individual candidate

Traditionally slate voting was adopted

Companies listed on TSX must use individual voting

* + - * Straight voting v cumulative voting ***(s 107)***
        + *Straight voting*

E.g. X owns 65 shares, Y owns 35 shares—trying to elect two directors by individual election—X nominates A & B who get 65 votes, Y nominates C who gets 35 votes—minority shareholder can never outvote the majority shareholder in straight voting

* + - * + *Cumulative voting* ***(s 107)***

Can cast a number of votes equal to the number of votes held by a shareholder multiplied by number of directors to be elected—can vote for one candidate or distribute them among candidates in any manner

If not specified, deemed to distribute votes equally

E.g. X owns 65 shares, Y owns 35 shares—trying to elect two directors by individual election—X gets 130 (65x2) votes; Y gets 70 votes (35x2); if Y gives all his votes to C, X cannot have both of his directors elected—gives minority shareholders a chance to have their candidate elected (protects minority shareholders)

A director elected by cumulative voting cannot be removed by ordinary resolution;

### Removal of directors:

* with or without case, at any time
* usually at annual or special shareholder meeting
* how many votes required?
  + Ordinary resolution ***(s 109)*** default rule
  + Cannot require more votes than are required by s 109 ***(s. 6(4))***
  + Cumulative voting ***(s 107(g))***—need threshold higher than ordinary resolution with cumulative voting

Amendment of the articles of incorporation ***(s 173)***

* + - Special resolution—2/3 of votes cast on the resolution at the meeting; or unanimous written approval from all shareholders

Amendment of bylaws ***(s 103)***

* + - Directors can make, amend, or repeal—change takes effect immediately, but shareholders must approve this at the next meeting

Shareholder proposals ***(s 137, s 103(5))***

Fundamental changes—need special resolution

* + - Amalgamation with another company ***(s 183(5))***
    - Sale or lease of all or substantially all of the company’s assets ***(s 189(3),(8))***
    - Liquidation or dissolution of the company ***(s 211)***
    - Continuance of the corporation under the laws of another jurisdiction ***(s 188)***

What sort of shareholders can vote?

* Voting shares and non-voting shares
  + Typically non-voting shares cannot vote
    - exception, fundamental changes
      * Amalgamation with another company ***(s 183(3))***
      * Sale or lease of all or substantially all of the company’s assets ***(s 189(6))***
      * Liquidation or dissolution of the company ***(s 211(3))***
      * Continuance of the corporation under the laws of another jurisdiction ***(s 188(4))***
* Separate class voting rights
  + Changes in class structure and rights
    - ***S 176(1); S 176(5)***—can vote separately as a class or series on matters that affect a separate class or series of shares
  + Fundamental changes—in certain fundamental changes, all shareholders (even those who do not normally have voting rights) are entitled to vote
    - Merger agreement would change structure or rights of class that requires amendments to the articles—can vote separately ***(s 183(4))***
    - Can vote separately in the event a class is differentially effected by the sale, lease or exchange of assets ***(s 189(7))***
  + E.g. merger between corporation A & corp B that seek to abolish preferred shares; common shareholders are voting, preferred shareholders are non-voting
    - Merger = Fundamental change of company—everyone votes together (s 183(3))
    - Abolishment of Preferred shares—preferred shareholders vote separately as a class because they are affected in a way that is different than the other shareholders (s 183(4))
* Equal Treatment and Voting restrictions
  + One share one vote—default rule under ***CBCA S 140***
    - Articles of incorporation can change this
* What is the effect of a shareholder vote?
  + Is a shareholder vote binding or non-binding on Board?
    - If the matter requires shareholder approval, vote is binding on the board
    - Unanimous shareholder agreement to remove power from board is binding ***(s. 102(1))***

### Automatic Self-Cleasning Filter Syndicate Co v Cunninghame

F: shareholders voted in favour of a resolution, board refused to carry it out, shareholder sued

I: is the board bound to carry out the resolution?

A: Article 96: general power of management is vested in Directors unless the regulation is made by extraordinary resolution(more than ¾ of the votes cast)

* + in this case, resolution was only passed by ordinary resolution

C: board is not bound

Note: if the third party had approached the board with the offer to purchase some of the assets, there is no obligation to pass this on to the board for shareholder approval; different if it was an offer to purchase all assets of the company

* What is the voting process?
* How to increase voting power?
  + Vote-pooling agreements
    - ***S 145.1***—a **written** agreement between two or more shareholders may provide that in exercising voting rights the shares held by them shall be voted as provided in the agreement
      * Invalid if agreement is beyond matters where shareholders have voting rights
  + ***Ringuet v Bergeron***
    - 3 shareholders make agreement to vote for each other as directors & don’t follow through
    - Is the shareholder agreement enforceable?
      * “while the majority shareholders may agree to vote their shares for certain purposes, they cannot by this agreement tie the hands of directors and compel them to exercise the power of management of the company in a particular way”
      * Agreement was to govern how the parties exercise their rights as shareholders, not in their capacity as directors
      * Nothing illegal or contrary to public order—clause about voting together was interpreted to be only referencing shareholders meetings and not directors meetings
    - Note: under CBCA directors have powers to appoint which directors will be CEO etc. and to set salaries—this contract would not be enforceable because this contract would restrict the power of directors
      * In order to restrict the power of directors, need written unanimous shareholder agreement—there were 6 shareholders total, so would need agreement amongst all 6 to restrict this power
  + Voting trusts
    - Shareholders transfer legal title to their shares to a voting trustee
      * Trustee, for a defined period and according to specific instructions, has the exclusive voting power over the transferred shares
    - Advantages:
      * voting trust is self-enforcing—don’t need court ordered specific performance—trustee has exclusive voting power
      * all shareholders who are parties to the trust must agree in order to end the trust
      * allows transfer of ownership without giving up voting control (separation of ownership and voting power)
        + can benefit financially without voting power
* Do shareholders have incentives to vote?
  + Shareholder passivity and shareholder activism
    - Why were shareholders typically passive?
      * Feel that their voice does not count or has little impact on management
      * If there is a strong controlling interest in the company, vote won’t be able to change the result
    - Increase in shareholder activism in recent years
      * Increase in shareholder proposals

### Proxy Voting

* Authorizes someone other than the shareholder to vote on behalf of the shareholder at the shareholder meeting
  + Very important for public companies—have thousands of shareholders and it can be tough to get to the meeting
  + so common that votes often depend on which proxy side ends up with the most votes
* key concept is solicitation
  + if a given communication is a solicitation, unless there is an exception available, it will trigger proxy solicitation protocols
* what is a proxy?
  + “proxy” means a completed and executed or, in Quebec, signed form of proxy by means of which a shareholder appoints a proxyholder to attend and act on the shareholder’s behalf at a meeting of shareholders;
* is a given communication a proxy solicitation? ***(s 147)***
  + if no, communication will not trigger regulatory requirements
  + if yes, may trigger regulatory requirements
* What is a solicitation?
  + (a) includes
    - (i) a request for a proxy whether or not accompanied by or included in a form of proxy,
    - (ii) a request to execute or not to execute or, in Quebec, to sign or not to sign a form of proxy or to revoke a proxy,
    - (iii) the sending of a form of proxy or other communication to a shareholder under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy, and
    - (iv) the sending of a form of proxy to a shareholder under section 149; but
  + (b) does not include
    - (i) the sending of a form of proxy in response to an unsolicited request made by or on behalf of a shareholder,
    - (ii) the performance of administrative acts or professional services on behalf of a person soliciting a proxy,
    - (iii) the sending by an intermediary of the documents referred to in section 153,
    - (iv) a solicitation by a person in respect of shares of which the person is the beneficial owner,
    - (v) a public announcement, as prescribed, by a shareholder of how the shareholder intends to vote and the reasons for that decision,
    - (vi) a communication for the purposes of obtaining the number of shares required for a shareholder proposal under subsection 137(1.1), or
    - (vii) a communication, other than a solicitation by or on behalf of the management of the corporation, that is made to shareholders, in any circumstances that may be prescribed;
* Shareholders holding at least 1% of shares are eligible to submit a shareholder proposal—typically requires multiple shareholders to meet this threshold
  + Communication to reach 1% of shares is not a solicitation
* Who is a solicitor?
  + Management: mandatory ***(s 149(1))***
    - Management required to solicit proxies at each shareholder meeting from each shareholder who is entitled to receive notice of the meeting
      * This way the management cannot cherry pick shareholders to form a proxy
  + Dissident shareholders can solicit proxies from whoever they like
    - Dissident shareholders are those that disagree with the recommendations put forth by management
* Any exemption?
  + Management ***(s 149(2))***
    - Not required to send a form of proxy if it is not a distributing corporation AND
    - there are 50 or fewer shareholders entitled to vote at a meeting (2 or more joint holders are counted as 1 shareholder)
  + Dissident shareholders ***(s 150(1.1)(1.2))***
    - Can solicit proxies from up to 15 shareholders before triggering regulatory requirements
    - Can solicit proxies by way of public broadcast, speech, or publication without having to send out a proxy circular
  + By application ***(s 151(1))***
    - CBCA director can exempt a person on application from any of the requirements in s 149 or ss 150(1); exemption may have retrospective effect
* Use of proxy circular ***(s 150(1))***
  + Regulations part 7—use form 51-102F5
  + Every public company must file documents with SEDAR (database)

#### Summary of Proxy Solicitation

* Authorization of another person to vote on shareholder’s behalf
* Determine if a communication is solicitation (s 147 has definition)
  + If No, all good to go!
  + If Yes, determine identity of solicitor?
    - Management
      * Mandatory to solicit proxy from all shareholders
      * Must prepare and distribute information circular to each shareholder
        + Unless there is an exemption available

Non-distributing company AND 50 or fewer shareholders

Application to CBCA director for exemption

* + - Dissident shareholder
      * Can solicit proxy from some shareholders
      * Must prepare and distribute information circular to selected shareholders
        + Unless, there is exemptions available:

Can solicit proxies from up to 15 shareholders

Solicitation by public statement or speech/press release

Application to CBCA director for exemption

### Shareholder Meetings

#### Eisenberg v Bank of Nova Scotia

F: Company got loan from bank

* Sole shareholder provided many documents with company seal to bank, suggesting the board approved resolutions approving company assets as security for the loan
  + There was no such resolution or meeting

I: Was the company bound by the resolution?

* SCC did not rely on indoor management rule—could rely on actual authority
  + Was not necessary to investigate whether the bank can rely on the indoor management rule
    - Was meaningless to hold these meetings—other directors were just appointees of Mr. Ernest—if any of the directors had voted against the transaction, the director would be removed by Mr. Ernest
      * No point to have shareholder or director meetings
    - Mr. Ernest would have approved the transaction by unanimous shareholder resolution
    - Mr. Ernest had actual authority to make the transaction—**shareholder could give assent to the resolution by conduct**
* Case was made before enactment of CBCA—language in CBCA is much narrower than the rule outlined by the SCC
  + ***CBCA s 142***—unanimous resolutions must be in writing in order to replace the need for a shareholder vote at a shareholder meeting
    - Subject to two exceptions:
    - Actual meetings are required for
      * ***S 110(2)***--if director resigns or has to be removed from office
      * ***S 168(5)***—if auditor resigns or has to be removed from office

Types of Meetings

* Annual meetings
  + Elect directors
  + Appoint auditors
  + Receive financial statements
  + Approve other matters submitted to the meeting
* Special meetings
  + Vote on specific matters not in the ordinary course of business (e.g. mergers, remove directors)

Who May Call a Meeting?

* Directors
  + annual meetings ***(s 133(1))***
    - Not later than 18 months after corporation comes into existence
    - Not later than 15 months after holding the last annual meeting, but no later than 6 months after the end of the preceding financial year
  + special meetings ***(s 133(2))***
* Shareholders
  + ***S 143***—holders of at least 5% of issued voting shares have the right to requisition the board to call a meeting
    - Directors must call meeting within 21 days or shareholder can call the meeting
  + Exceptions ***(s 143(3))***
    - Purpose is for personal claim or redress or personal grievance against corp or directors/officers or security holders
    - Proposal does not relate in a significant way to the business affairs of the corporation
      * E.g. meeting to consider human rights issues to the operation of the company
    - A shareholder had previously (recently) requisitioned a meeting but failed to attend, in person or by proxy, at a meeting of shareholders
    - If the business is substantially the same that was considered in the past few years that did not receive a minimum amount of support
    - Right is being abused to secure publicity
* Courts
  + Director, shareholder entitled to vote, or CBCA director may petition the court to call a meeting if it is impracticable to call a meeting in another manner ***(s 144)***

How to Choose a Meeting Date

* Generally directors have authority to determine meeting date
* If shareholder’s requisition a meeting to remove incumbent directors, but directors want to keep their positions, they can just set the meeting date for far into the future in the hopes that they can employ a lot of strategies to undermine the plan
  + But, date must be reasonable

#### Air Corp

F: AirCorp made offer to board to take over AirCanada; board fixed a meeting date several months in the future; AirCorp requisitioned board to hold special mtg,

* Board refused to hold the special meeting
  + Argued that a record date had already been fixed as per s 143(3)(a)
  + Could only amend articles in annual meeting, rather than a special meeting—improper subject matter for a special meeting
* Court said:
  + Yes, there was a record date fixed, but the record date was for a meeting where the business that was the subject of the requisition would not be discussed
    - record date exemption did not count
    - record date must be for a meeting that will consider the business outlined in the requisition
  + CBCA does not preclude articles from being amended in a special meeting—is no limitation on subject matter to be transacted at a special meeting ***(s 143)***
    - This ruling is no longer good—now have ***s 143(c)***
    - Can refuse a requisition on following grounds:
      * Personal claim or redress or personal grievance against corp or directors/officers or security holders
      * Proposal does not relate in a significant way to the business affairs of the corporation
        + E.g. meeting to consider human rights issues to the operation of the company
      * A shareholder had previously (recently) requisitioned a meeting but failed to attend, in person or by proxy, at a meeting of shareholders
      * If the business is substantially the same that was considered in the past few years that did not receive a minimum amount of support
      * Right is being abused to secure publicity
  + AirCorp’s requisition was validly and properly made—board required to call meeting within 21 days or the shareholders who signed the requisition could call meeting themselves
    - Court refused to intervene because the shareholders could call meeting by themselves

Notice of Meeting

* Who should receive the notice?
  + ***S 135(1)***—sent to each shareholder entitled to vote, each director, and company auditor
  + Record Date ***(s 134; Regs 43)***—to be entitled to vote, must have name as owner of voting share by the record date
    - No more than 60 days and not less than 21 days before the meeting date
    - If a shareholder sells shares before meeting date, but after record date, shareholder is still entitled to vote (“empty voting”—has no financial stake but has voting rights)
      * Buyer for closely-held companies can require that the seller include a proxy for voting with the shares when selling
  + Shareholder list ***(s 138)***
    - List of shareholders entitled to vote on the record date
    - If no record date is given, it will be the date the notice is given
    - If no notice is given, record date will be the meeting date
  + Waiver of notice ***(s 136)***
    - Can waive notice for any matter
    - Can waive by attendance, unless purpose is to protest…
* When to send notice?
  + Must be sent no less than 21 days before meeting date and no more than 60 days before meeting
* What information?
  + Time and place of the meeting ***(s 135(1))***
    - Must be within Canada, unless modified by articles
  + Special business ***(s 135(5)&(6))***
    - State nature of special business in enough detail to allow shareholders to form reasoned judgement about the matter
    - All business transacted at special meeting and at annual meeting is special business, except:
      * consideration of financial statements,
      * auditor’s report,
      * election of directors, and
      * reappointment of the incumbent auditor are special business

Quorum and Conduct

* must be a quorum to hold a valid meeting
* quorum ***(s 139(1-4))***
  + unless the by-laws otherwise provide, a majority of shares entitled to vote at the meeting are present in person or by proxy
  + if quorum is present at the opening of a meeting, this is sufficient, even if the quorum is not present at the entire meeting (unless bylaws otherwise provide)
  + if quorum not present at opening of meeting, shareholders can adjourn the meeting to fix a time and place, but cannot carry on business
  + if corporation only has one shareholder, the shareholder present in person or by proxy constitutes a meeting
* Rules of Conduct
  + Each corporation has their own rules including topics like:
    - How long each person may speak
    - Is it okay to video tape meeting
    - Is it okay to use cell phones
  + Chairman has duties to act impartially and in good faith ***(discussed in Wall v London)***

#### Wall v London and Northern Assets Corp

* Discussion of objections to selling company assets by two shareholders was interrupted by a call for a vote from other shareholders
* Chairperson motioned to end the discussion
* Shareholders voted to end the discussion and the shareholders voted on the resolution
* At another meeting shareholders voted to confirm the resolution
* Did the chairman conduct meeting in an impartial way?
  + Chairman allowed to terminate discussion because subject matter was sufficiently discussed—was not oppressive to minority shareholder

## Shareholder Proposals

What is a shareholder proposal?

* Something put forward to propose some kind of change that affects the corp—discussed at a meeting and voted on by shareholders
  + Amendments to articles ***(s 175(1))***
  + Amendments to bylaws ***(s 103(5))***
  + Nominations of directors ***(s 137(4))***
  + Other proposals

What is the effect of shareholder proposal?

* Binding or not binding?
  + Depends if shareholder approval is required for the matter to take effect
    - Proposals for election of directors or amendments/by-laws to articles are binding
    - Matters like recommendations for compensation for executives are non-binding
  + Vast majority of proposals are non-binding

Who can submit?

* Not all shareholders can submit
* ***S 137 (1.1); Reg s 46***—requires:
  + Registered or beneficial owner, individual or collectively own, lesser of:
    - 1% of total outstanding voting shares or $2000 worth of shares
      * For at least 6 months immediately before the day of submission
* Restrictions intended to prevent management from being harassed by frivolous proposals
* Additional requirement for director nomination proposal ***(s 137(4))***
  + Need at least 5% of holders (registered shareholders) of shares in the company, or 5% of the shares of a class of shares entitled to vote in order to nominate directors
  + Does not preclude nominations made at meeting of shareholders
    - unless the corporation has a bylaw that precludes this

What should be included in the proposal?

* ***S 137(1.2)***
  + Name and address of shareholder filing proposal
  + Number of shares held by proposing shareholder
  + Date shares were acquired

How to Circulate Proposal

* By shareholder’s own proxy circular
  + Must use own money to fund
* By management’s proxy circular ***(s 137(3))***
  + Management shall include a proposal in proxy circular by person submitting proposal requests it
  + Maximum number of words for proposal and supporting statement cannot be longer than 500 words
  + company will cover the cost of the proxy circular

Excluding shareholder proposal from management proxy circular

* ***S 137(5)***
  + Proposal is not submitted to the corporation at least the prescribed number of days (90 days) before the anniversary date of the notice of meeting sent to shareholders in connection with previous annual meeting of shareholders
  + Purpose of proposal is to enforce a personal claim or redress a personal grievance against the corporation, directors, officers, or security holders
  + Proposal does not relate in significant way to business affairs of the corporation
  + If person had previously failed to present, in person or by proxy, at a meeting of shareholders, a proposal that at the person’s request, had been included in a management proxy circular relating to the meeting
  + If substantially the same proposal was submitted in a previous annual meeting and did not receive the prescribed minimum support at the meeting
  + Proposal mechanism is being abused to secure publicity
    - Many proposals attract publicity, but the mere fact that a proposal attracts attention is not enough to be considered abuse of proposal system

If Management refuses to include the proposal in management proxy circular:

* Must notify the person within 21 days with notice stating reasons for refusal
  + Can appeal in court
  + Court can postpone the meeting or make another order
  + Can issue an order to permit or omit the proposal’s inclusion in the management proxy circular

### Varity Corp

F: 2 shareholders requested company to stop doing business in South Africa due to the apartheid regime

* Management wanted to exclude proposal from proxy circular under s 131(5)(b)

R: Court ruled—as long as primary purpose was to promote economic, political, religious, social, or similar causes, proposal could be excluded; whether specific or general

* In this case, the proposal was excluded under the old provision
  + Probably would not be excluded under new provision (s 131(5(b.1))

## Shareholder Information Rights

### Access to Corporate Records

* What records shareholders have access to:
  + ***S 20(1)***
    - Articles, bylaws, and amendments and copy of any unanimous shareholder agreement
    - Minutes of meetings and resolutions of shareholders
      * Only have access to portions of the meeting’s minutes
    - Copies of notices required under *s 106 or 113*
    - Securities register complying with *s 50*
      * Contains info about # of shares of each class, and # of shares held by each holder, transfer histories of shares, shareholder’s address
  + ***S 21(3)*** Shareholder list
    - Important for soliciting proxies
    - Only contains part of the information of the securities register--# of shares held & shareholder addresses
* How to access:
  + ***S 21(1)***
    - Shareholders and creditors of a corporation, their personal representatives and the Director may examine records under s 20(1) during usual business hours and may take extracts from the records free of charge
      * If corporation is a distributing corporation, any other person may do so on payment of a reasonable fee
  + ***S 21(1.1)***
    - Any person wants to examine securities register of distributing company, must first make request to corporation , accompanied by affidavit saying that the information will only be used for approved functions

### Financial Disclosure

* Right to receive financial reports ***(s 155(1))***
* Must send them no later than 21 days before the AGM ***(s 159)***
* ***S 71(1) Canadian GAAP***
  + Annual financial statements, must be prepared in accordance with generally accepted accounting principles
* ***S 72(1) Canadian GAAP***
  + Must include:
  + balance sheet,
  + income statement,
  + changes in financial position, and
  + statement of retained earnings
* Financial statements published by distributing company must be certified by an independent auditor

### Auditors

* Auditor required?
  + Mandatory for distributing company
  + Optional for non-distributing company ***(s 163(1))***
* Who is an auditor?
  + Usually an accounting firm
* What does auditor do?
  + Give opinion on whether financial position is reported fairly
  + Enhances credibility of financial statements
* Auditor qualification = independence ***(s 161)***
  + Is a question of fact
  + Typically, providing both audit and non-audit services to a company means not independent
    - Can do both if it is pre-approved by the auditing committee (made up of independent directors) and the fees for the services must be disclosed
  + Deemed not to be independent if he or his business partner is a director, officer, or employee of the corporation or its affiliates, or business partner of any director, officer, or employee of company or affiliates
  + Beneficially owns or controls material interest in securities of the corporation or its affiliates = deemed not independent
  + Is a receiver, receiver/manager, sequestrator, liquidator, or trustee in bankruptcy for the corporation or any of its affiliates within two years of person’s proposed appointment = deemed not independent
* Ceasing to hold office
  + Death
  + Resignation ***(s 164(2))***
    - May send written resignation
    - Takes effect when delivered to corp, or on date specified—whichever is later
    - Is a big deal for a corporation-- suggests something is wrong with company’s statements
  + Removal ***(ss 165-166)(s 168(5)-(9))***
    - Shareholders can remove auditor at special meeting, unless auditor is appointed by the court
    - Shareholders can fill auditor vacancy at special meeting
      * If not, directors can fill vacancy, court can fill vacancy, or shareholders can hold another special meeting to fill vacancy
    - ***S 168***—makes it harder to remove an auditor
      * (5)—auditor can submit reasons for resignation or opposing removal
      * (7)—new auditor cannot take over until requesting and receiving written statement for reasons, in auditor’s opinion, for their replacement
    - Is a big deal to remove an auditor—suggests something is wrong with company’s statements
* Right to receive notice of and attend every shareholder meeting ***(s 168(1))***
  + At company’s expense
  + Must give notice at 21-60 days prior to meeting
  + May be required to attend meeting to report on their duties—must attend or commit an offence
* Right to information ***(s 170)***
  + Auditors have access to info to perform their duties
* Duty to report ***(s 169)***
  + On company’s financial statements

### Audit Committee ***(s 171)***

* Mandatory for distribution companies
* Optional for non-distributing companies
* Composition
  + Majority as outside directors
* Functions
  + Review, but does not approve financial statements
  + Oversees work of external auditors
  + Resolves disagreements between management and the external auditor
  + Pre-approve all non-audit services provided by the auditor

## Directors’ Duty of Care and Business Judgement Rule

### Directors’ Duties?

* Duty of care ***(s 122)(1)(b)***
* Duty of loyalty/statutory fiduciary duty ***(s 122)(1)(a)***

### Why impose such duties?

* Separation of functions within a modern corporation
  + Separation of management (directors) and financial risk-taking (shareholders)
  + This separation creates a tension between directors and shareholders
    - Agency law tries to address this through duties owed by agent to principle
    - We view directors as agents of the corp
      * Directors owe duties to corporation

#### Re City Equitable Fire Insurance Co Ltd

* **principles in this case no longer good law**
* “A director need not exhibit in the performance in his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience”
* Director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed
* In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly

### Directors’ Defences to alleged Breach of Duty

* Common law:
  + Business judgement rule
    - If there is no evidence of fraud, conflict of interest, or bad faith, court will defer to a reasonable, informed decision made by board and not assign liability to the directors (decision must be reasonable at the time the decision was made)
      * Rationale: judges are not business experts
      * Encourages qualified people to serve as directors
    - directors are not presumed to be protected by BJR; directors must show that they made the decision in a reasonable and informed manner
* Statutory
  + Good faith reliance ***(s 123(5))***
    - Comply with duties if relied in good faith on:
      * financial statements presented by officer of the corporation, or in a written report of the auditor of the corporation to fairly reflect financial condition of the corporation
      * report of a person whose profession lends the credibility to a statement made by the professional person
    - if suspect there is something wrong with statements, have an obligation to investigate, or the reliance won’t be seen as good faith
    - ***S 123***—“professional person” = must be subject to regulation of professional association and carry insurance against professional negligence
  + Due diligence defense ***(s 123(4))***
    - Comply with duties if director exercised care, diligence, and skill that a reasonably prudent person would have exercised in comparable circumstances including reliance in good faith on:
      * financial statements presented by officer of the corporation, or in a written report of the auditor of the corporation to fairly reflect financial condition of the corporation
      * report of a person whose profession lends the credibility to a statement made by the professional person
  + Dissent on Record ***(s 123(1-3))***
    - If a director dissents, not liable

### To whom do directors owe the duties?

#### Peoples Departments Stores Inc v Wise

F: companies w/ same owners exchange inventories; directors got advice from VP of finance (15 years work experience, but not an accountant); companies go bankrupt & directors get sued

Issues:

* To whom do directors owe duties of care and loyalty?
  + Duty of loyalty owed to corporation in statute
  + Duty of care—statute is ambiguous about who the duty is owed to
    - Traditional understanding was that it was owed to corporation
* Is s 122(1)(b) a subjective or objective test?

Analysis:

* SCC
  + Duty of care is much more open-ended and it is obvious that duty of care must be owed to other constituents, eg. creditors
    - Many commentators see this part of the decision as a mistake—this equates duty of care under CBCA and duty of care in negligence/Quebec civil code—suggests there is a second cause of action other than under CBCA
    - Implies that creditors and other constituents could sue directors using derivative action
  + ***S 122*** just sets the standard of care, the action should come from somewhere else (e.g. Quebec civil code, negligence etc.)
* in this case, the plaintiff sued under QB civil code (article 1475—looks like negligence) and not through derivative action
* article 1475 should be read broadly to include directors, officers, and creditors; rules of conduct in this case are the duties under s 122
* to sue successfully under article 1475, must meet 3 criteria
  + breach of rules of conduct
    - applicable rules in this case, is duty of care under s 122(1)(b)
    - was no breach of duty in this case
  + damage/loss
    - was damages
  + causation
    - if there was a breach, would not be primary cause of damages
* ***s 122(1)(b)*** is an objective standard—more precisely objective minimum standard
  + comparable circumstances are contextual circumstances
  + not being competent or not having knowledge to effectively discharge duties is not an excuse
    - have obligation to acquire the necessary knowledge
  + BUT, if director is also a professional, e.g. CPA, and fails to notice an accounting error that a CPA should catch, it would be likely he would be held to a higher standard

Defences:

* Due diligence defence not available—only available in certain circumstances
* Dissent on record not available—all directors consented
* Good faith reliance—not available—Clements was not a qualified professional—not licensed/subject to professional regulations and did not carry malpractice insurance
* Business Judgement Rule
  + Was reasonable decision at the time—directors could be protected by business judgement rule, as there was no fraud, or conflict of interest
* Also argued that the decision was not a proximate cause of the loss
  + Court agreed decision was not the primary cause
    - Company was already in financial difficulty
    - Entry of Walmart on to the market was also a cause
* ***S 237.1***—directors percentage of liability—only liable for portion of damage attributable to their decision

Summary:

* Other constituents and creditors can sue under derivative action
* S 122 standard of care is objective
* S 123—“professional person” = must be subject to regulation of professional association and carry insurance against professional negligence
* SCC confirms status of Business Judgement Rule in Canada
* S 237.1—directors percentage of liability—only liable for portion of damage attributable to their decision
* Purpose of corporation in Canada—not just to maximize shareholder wealth--directors have the ability to consider other constituents or other factors when making decisions
  + Considered this when discussing the duty of loyalty

Following Peoples’—OBCA changed to state “discharging his or her duties *to the corporation* shall,”

### Under what circumstances would a director be liable for breaching the duties?

#### Smith v Van Gorkam

F: Jerome Van Gorken was CEO of Trans Union; TU looking for way to get access to unused tax credits; Van Gorken decided best way was to sell the company; approached Jay Pritzker (potential buyer); JVG proposed sale to JP @ price of $55 per share—at time, market price of share was $38 per share; Prev. rsch showed $55-65 per share was fair price; one shareholder sued the directors for not making a reasonable and informed decision

Court ruled the board’s decision could not be protected by BJR because decision was not an informed decision—directors failed to investigate the intrinsic value of the company, and JVG arrived at number on intuition; had lots of time to investigate, as company was not in financial trouble—didn’t have to sell quickly

Board argued:

* Proposed price was 45% above market price
  + But, were indications that market price was undervalued--$38 was not adequate benchmark—was a reflection of the value of a minority position in the company, but in this case, they were selling the controlling stake of the company
    - Idea of “control premium” = difference between selling the controlling stake and selling a minority stake
      * Relates to private benefit of control—majority shareholder can appoint whoever they want as CEO and director, is a powerful position (not the same for a minority shareholders)
* They were experienced business people and knew the company well, so they didn’t need to do intensive investigation
  + Court said no—directors cannot make decisions so casually, must make serious decisions

DUTY OF CARE IS LIKE A PROCEDURAL OBLIGATION

#### UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc

Deals with exec compensation and how it is determined

F: proposed employment contract @ two board meetings--@ first meeting, board did not approve the agreement & decided to retain independent consultant for advice; compensation committee decided to do more research; Board was reconstituted; new board held meeting, and approved contract based on advice of compensation committee, but did not inform itself that the consultant did not have time to make a report and that the agreement was met with opposition by old board

Shareholder sued board to have employment contract set aside—did directors of new board breach duty of care?

* Court said: directors had breached duty of care because they did not question/discuss the reasonableness of compensation package
* Board approved agreement that gave someone they did not know a lengthy contract with high pay and benefits when company was in financial trouble

## Directors’ Duty of Loyalty

* ***S 122(1)(a)***: act honestly and in good faith with a view to the best interests of the corporation
  + Requires directors/officers to put corporations interests ahead of their own interests

### Two Whom is the Duty of Loyalty Owed?

* Peoples’ Department Store
  + “best interests of the corporation means the maximization of the value of the corporation”
    - Duty of loyalty only owed to the corporation
    - but may consider the interests of non-shareholder constituents (“stakeholder wealth maximization”)
  + Duty does not change when nearing insolvency
* Reconfirmed in BCE

### Typical Situations Where a Breach of Duty of Loyalty May Arise

#### Self Dealing Transactions (Interest Directors Contracts)

* Self-dealing transactions (interested directors contracts)
  + E.g. corporation makes contract with a director or officer to buy parcel of land owned by director (director stands on both sides of the transaction)
    - Obviously, director wants to sell at highest possible price and corp wants to buy at lowest possible price
  + E.g. corp A wants to buy land from corp B; is a director that sits on boards of each company; both companies have conflicting interests, and the director cannot serve two masters with conflicting interests

##### Aberdeen Railway v Blaikie Brothers

* Is the contract voidable by company?
  + Traditionally, directors are prohibited from entering into contracts with corp they serve, so contracts were voidable
  + In this case, directors were not allowed to enter into conflict of interest transaction with company they serve—strict rule
    - Contract voidable by company and directors should disgorge profits
  + Do not look at the fairness of the contract at all

Statutory safe harbour

* ***CBCA s 120***
  + Board’s approval process ***(s 120(7))***-- if requirements met, contract is not voidable simply because of a conflict
    - Written disclosure of conflict
    - Abstention from voting
    - Substantive fairness (good deal for corporation)
  + Shareholders’ confirmation process ***(s 120(7.1))***—if board requirements not met, could still be saved by shareholder process meeting all 3 elements
    - Disclosure of conflict
    - Approved by special resolution
    - Substantive fairness
* CBCA ***s 120(1)***
  + Rules for when disclosure is required
    - 2 materiality requirements
      * Contract or transaction must be material to the corporation AND
        + Generally, size or importance of transaction relative to company’s size or financial condition
      * Director has material interest in a party to the contract or transaction
        + Has material interest if:

Is a party

Is a director of other party

Others (e.g. is a shareholder of a party; has a close relationship with a director of other party, like close relative or friend)

* + - If both met, must disclose
* CBCA ***(s 120(2))***
  + Timing of disclosure for directors
    - Directors should disclose at first meeting after director becomes interestd
* CBCA ***(s 120(3))***
  + Timing of disclosure for officers
    - Immediately after becoming interested in transaction
* CBCA ***(s 120(4))***
  + Even if in ordinary course of business and transaction is not required to be approved by shareholders, must disclose immediately after becoming aware of interest
* CBCA ***(s 120(6))***
  + Director or officer can give general notice/disclosure of conflict of interest with a long-term or frequent supplier and this will be sufficient

What Information must be disclosed?

* Nature and extent of any interest in material contract

To Whom the Disclosure is Made?

* To directors and shareholders
  + ***S. 120(6.1)*** gives shareholders access to portions of minutes from board meetings relating to disclosure of directors conflict of interests in particular transactions
    - Typically shareholders do not have access to minutes

Abstention from Voting

* Generally required to abstain
  + Exceptions from abstention ***(s 120(5))***
    - Directors remuneration
      * each director essentially has same compensation and insurance/indemnity contracts, so there is no need to abstain, as these decisions are not delegable to officers
      * in practice, is good idea to abstain anyway
    - Indemnity or insurance contracts under s 124
      * each director essentially has same compensation and insurance/indemnity contracts, so there is no need to abstain, as these decisions are not delegable to officers
    - Contracts with an affiliate

Substantive Fairness

* Transaction must be fair and reasonable—little judicial guidance on this
  + In determining fair and reasonable, examine surrounding circumstances when the contract was made

Shareholder Confirmation Process

* If transaction does not meet 3 elements of board approval process, can still be saved by shareholder confirmation process
* Disclosure to shareholders
* Must be approved by special resolution (2/3 of votes cast or unanimous written consent) and interested shareholders can vote
  + In NB, standard is by simple resolution, but interested shareholders cannot vote

Remedies

* What if s 120 requirements are not satisfied?
  + Contract is not automatically void
    - Corporation or any of its shareholders may apply to court to set aside the transaction and court has discretion whether or not to set aside transaction and on what terms ***(s 120(8))***

#### Corporate Opportunities

* Corporate opportunities
  + Directors usurp opportunities that might have gone to the corporation they serve
  + E.g. third party makes offer to corporation to sell parcel of land; director of corp thinks it is a great deal and instead of acquiring the land on behalf of the corporation, the director makes a personal contract with the third party to buy the land
* Corporate expansion v Manager entrepreneurialism
  + Corporation expects managers to prioritize expansion and growth of the company
  + Managers want to be free to pursue outside business opportunities
* Directors should not usurp any corporate opportunity
* What is corporate opportunity?
  + Any business 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 corporation?
  + Obtained through personal capacity
  + Corporation rejected opportunity
  + Corporate impossibility (barred by articles)
  + Resignation before pursuing opportunity

##### Regal (Hastings) Ltd v Gulliver

F: Regal owned movie theatre; Regal had 5 directors; set up a subsidiary to acquire a long term lease on two cinemas (subsidiary makes contract with LL for the 2 property leases); subsidiary had very little capital, so LL demanded the directors of Regal give personal guarantees for the lease payments; directors decided to purchase shares of the subsidiary (only Gulliver did not); Gulliver arranged for 3 outside investors and the company’s solicitor to purchase shares of the subsidiary; later the company and subsidiary were purchased and the new shareholders sued the directors for usurping a corporate opportunity (purchasing the shares)

I: Did the solicitor usurp the corporate opportunity?

C: No, he was not a director/officer, he was just the solicitor—owes no fiduciary duty to the company

* Gulliver was not liable—did not purchase shares, so he did not usurp corporate opportunity
* Other 4 directors—only had the opportunity because they were directors—even though they acted in good faith, they still usurped the corporate opportunity and had to return profits they earned from purchasing the shares
* Regal did not have the capital/resources to secure the lease payments or finance the subsidiary
* Profits returned to the company went to the new shareholders, even though the old shareholders were the ones who were harmed by the directors usurping the opportunity
  + Company could have been sold at a better price if the subsidiary was wholly owned by Regal, so the old shareholders missed out on income

suggests if BOD decides not to invest, director deciding to invest using own money is still liable and must return profits (hypothetical question in this case)

**Important Implication: Even when the company does not have the resources to pursue the corporate opportunity, the directors still cannot take up the opportunity (very strict standard)**

##### Peso Silver Mines Ltd v Cropper

F: Peso had 3 directors (Cropper, Walker, and V); Peso owned mining claims in Yukon; 3rd party (Dickson) made offer to Peso to sell some claims that were near their existing claims; board considered the offer, but rejected it—did not have financial resources to buy additional claims; 6 weeks later, the 3 directors formed a company with Peso’s consulting geologist (Dr. Aho), in order to acquire the Dickson claims; Peso sold and the new board sued Cropper for usurping an opportunity (W & V had already returned the money to the company, but Cropper refused)

I: did Cropper breach duty of loyalty?

C: In this case, SCC ruled that Cropper was not liable for breaching duty of loyalty—**opportunity was expressly rejected by the board in good faith** (rejected not because they wanted to pursue opportunity personally; they believed it was in the best interest of the corporation not to pursue the deal)

* Rejection decision was a conflict of interest decision
  + Must be made in good faith, with view to corporation’s best interest
* Directors were free to take up the opportunity if the corporation had rejected the opportunity in good faith
  + Corporation had first dibs
* How the opportunity came to the directors:
  + After company rejected opportunity, the geologist approached cropper as a private person, rather than in his capacity as director
  + Was no evidence that cropper used any confidential information derived from his role as Peso’s director
    - **Acquired opportunity in individual capacity**
  + Opportunity arose 6 weeks after the original opportunity
* Value/Nature of the opportunity
  + **Opportunity was not essential to operation of Peso**—they frequently get these types of opportunities/offers—cannot accept every offer—claims were very speculative and unproven—nature of opportunity was highly speculative and risky
    - Different from Regal—opportunities were essential to the business in regal

##### Canadian Aero Services v O’Malley

F: related to aerial mapping in South America—corporation had sought out this opportunity; defendant directors left the corporation and sought the opportunity for themselves; directors were liable and had to account profits to the corporation

* Officers owe fiduciary duties (does not matter if they are not appointed directors)
* Fiduciary duty of a director or officer does not terminate upon resignation and it cannot be renounced at will by the termination of employment ***(SCC citing American Case: Raines v Toney)***
* Was there a breach?
  + No single stringent standard for determining if there is a breach—is list of factors:
    - *Position or office held*
      * Generally, ordinary employees do not have fiduciary duties
      * Also look at whether employee signed a non-compete agreement
        + Breach of this agreement results in the company being able to recover compensation for lost profits (different from breach of fiduciary duty, where company is entitled to accounting of profits)
    - *Corporate opportunities*
      * Its nature, ripeness, specificness, director’s or officer’s relation to it
      * In this case, the opportunity was very ripe and the company had been actively pursuing it
      * Defendants became familiar with the opportunity because of their participation in the company’s project
    - *Knowledge*
      * Amount of knowledge possessed, circumstances in which it was obtained, whether special or private
        + In this case, the defendants used the information gained from their position as officers to gain the opportunity
    - *Alleged breach after employment termination*
      * Time in continuation of fiduciary duty
      * Circumstances under which the employment was terminated (retirement, resignation, or discharge)
      * If the opportunity prompted the resignation, likely liable
* The factors outlined are helpful, but not exhaustive

#### Competition

* Competition
  + Corp A and Corp B—two companies compete against each other; is a director that sits on the boards of both companies; cannot serve two masters when the interests are in conflict
* Competition by former directors and officers (post-departure competition)
  + General rule: employee free to compete after departure, provided the employee did not sign a covenant not to compete
    - Cannot use former employer’s trade secrets and confidential information
  + CanAero: higher standards for directors and officers
* Competition by current directors and officers
  + Sitting on the boards of two competing companies
    - Is okay for a director to sit on board of two competing companies ***(London and Mashonaland v New Mashonaland)***
    - but if there are other specific facts that raise concerns about the director’s ability to put the company’s best interest ahead of the interests of the competing company, director may be liable ***(Scottish Co-op Wholesale Society v Meyer)***
  + Operating a business that competes with the company
  + Having a material interest in any entity that competes with the company (e.g. spouse is owner of competing company)

##### Scottish Co-operative v Meyer

F: Scottish Co-op created a subsidiary; subsidiary hired two experts (Meyer and Lucas)—they were appointed as directors and given 3900 shares; society held 4000 shares; society appointed 3 directors of the subsidiary, who were also directors of the parent company; became clear that the help provided by the experts became dispensable; wanted to get rid of the experts; Scottish Co-op offered to buy out the shares of the experts; Scottish Co-op set up its own unit to compete with the subsidiary—the 3 directors who were on both boards were now on the boards of two competing companies;

* these three directors breached the duty of loyalty—failed to put interest of subsidiary ahead of the parent company’s interest—should have protested the creation of the unit
  + when the interests of both companies are consistent—no breach
  + when the interests of both companies diverge—problematic

#### Hostile Takeovers

* controversial area of corporate law
* hostile takeover:
  + company taken over by determined bidder in spite of resistance by target company’s board
    - bidder makes offer directly to shareholders and bypasses negotiating with BOD
    - offer is usually 40-50% above market price
      * if successful in acquiring a majority, will likely replace the entire board—bidder believes he can manage the company better than the existing board
  + hostile to the management/board of target company
  + in practice, most M&A’s are not hostile, most are friendly
* Friendly Takeover:
  + Two boards negotiate the deal to reach an agreement
  + Target board submits agreement to shareholders for approval (will recommend the shareholders accept the deal)

##### Strategies to Fend Off Hostile Takeovers

* *Revise the capital structure*
  + Repurchasing shares
    - eliminates the cash in hand to make company less attractive
  + Poison pill
    - *Flip-over pill*
      * Triggered when the bidder acquires a certain % of shares (20%ish) in target company without the approval of the board
      * When target company is merged with acquiring company, the shareholders of the target company, are entitled to purchase shares in the acquiring company at a huge discount price
        + Purpose is to dilute the shares held by the shareholders of the acquiring company
      * Discourages companies from acquiring the company
    - *Flip-in pill*
      * Triggered when acquiring company acquires a certain % of shares of target company (~20%) without approval of the board—shareholders of target company are entitled to purchase shares of target company at huge discount price—acquirer is excluded from this right
        + Discourages a takeover, because the bidder’s share percentage is diluted
        + Becomes more expensive to take-over the company
    - In practice, bidders will condition their offers on the poison pill not being triggered—thus, poison pills are generally never triggered
* *Revise the Corporate Governance Structure*
  + Shark repellent
    - Staggered board
    - Articles of incorporation amended to require supermajority vote for any merger agreements
* *Alter the shareholder mix*
  + Issue shares to investors friendly to management or to an employee stock ownership plan/pension plan
* *Find a Palatable Buyer*
  + White Knight
    - Friendly bidder who the board can come to an agreement with to buy the company and keep the directors
* *Buy new business or sell crown jewels*
  + Buy junk businesses that are undesirable and depreciate value of company
  + Sell assets of company to third party at a huge discount price to make it less desirable
* *Accelerate or increase management’s employment benefits*
  + Golden parachutes
    - large compensation packages triggered by a takeover/merger for existing board members
* *Buy out bidder*
  + Greenmail
    - buy back a large number of shares so the bidder can’t buy them
* *Attack the bidder*
  + Argue there is misleading information in the bidder’s circular to discourage shareholders from selling
  + Takeovers regulated by securities regulation--violation of regulations would impact takeover deal

##### Pros and Cons of Hostile Takeovers

|  |  |
| --- | --- |
| **Pros** | **Cons** |
| * Discipline inefficient management   + If not running company efficiently, stock price will be supressed and company attractive to corporate raiders | * Market myopia   + Stock market systematically undervalues long-term prospects of a company—provides incentive to focus on immediate growth & profit which may damage company long-term |
| * Synergy   + Target company and acquiring company may work well together (e.g. target company is a supplier for the acquiring company) | * Hubris   + Bidder is often over-confident on their ability to run the company & overpays for the company |
|  | * Unjust wealth redistribution   + Shareholders benefit from takeover bit, but do so at expense of employees, creditors etc. |

##### Teck Corp v Millar

F: 2 companies make competing offers to co-develop a project with company A—company A selects offer that pays less, because they liked the company better; company with higher offer sued for breach of duty of loyalty

* Teck relied on the rule set out in *Hogg v Cramphorn*
  + Rule was that directors have no right to issue shares for the purpose of defeating a hostile takeover, even if the directors believed it was in the best interest of the corp.
    - To maintain control is an improper purpose for issuing shares
  + In this case, the court disagreed with the opinion in Hogg: as long as the decision is in the best interest of the corporation, they should be okay
    - Changed rule in Hogg
    - **Something more than an assertion of good faith required; must show there is reasonable grounds for their belief that a decision in in the best interests of the corp and acting in good faith**
    - **court held directors entitled to consider the reputation and experience of anyone seeking to take over the company in addition to price; if they believe a takeover would damage the company, they can take steps to prevent the takeover**

C: no breach in this case

##### Pente Investment Management v Schneider Corp

* No Revlon duty in Canada
  + Under Revlon, if company is up for sale (sale is inevitable), board has obligation to maximize shareholder wealth by selling the company to the highest bidder in auction—this does not apply in Canada
* As long as decision made in good faith, on reasonable basis, on an informed basis and without conflict of interest, decision protected by BJR—no breach of duty of loyalty
  + if directors act in good faith and make decisions in a reasonable manner, decision is protected by business judgment rule
  + in this case, the court looks at decision making process for any potential conflict of interests
    - set up special committee with independent directors leans towards protection of BJR
      * helps to show there was a lack of conflict of interest and that the directors acted in good faith
      * not required and does not guarantee protection—court always investigates each decision
    - also looked at the rationality of setting up the data room—committee acted independently in setting this up—did not seek board or family’s consent to do so—was useful for companies who were not familiar with Schneider—was done in good faith with reasonable grounds
  + principle that directors are allowed to consider factors such as corporate culture when making decisions about which offer to accept

### Other Sources of Personal Liability

* Breach of Duty of Loyalty ***(s 122(1)(a))***
  + Is strict liability
  + Most cases deal with the breach of this duty
* Breach of Duty of Care ***(s 122(1)(b))***
  + Proof of damage is required
  + Very few cases where directors are held liable for these breaches due to operation of BJR
* Other liabilities in corporate statutes
  + Various illegal payments ***(CBCA s 118)***
    - Illegal to issue shares for consideration other than money, unless the value of the property or past services is not less than the value of the money that would have been received
      * Jointly and severally, or solidarily, liable if director votes for or consents to a resolution authorizing this
    - ***S 118(2)***—other illegal payments where directors can be held as jointly and severally liable or solidarily liable
      * See subsections (a)-(e)
    - ***S 118(3)***—directors can sue other directors who also voted for or consented to the resolution on which the judgement was based to recover the money they paid out to satisfy a judgement
    - ***S 118(4)***--Directors may apply to court to compel shareholders who illegally received dividend payments to return the money to the corporation
    - ***S 118(6)***--If director can prove that he did not know, or could not have known that the share was issued for consideration less than the fair equivalent of the money that the corp would have received, director is not liable
    - ***S 118(7)***--Complaint must be raised within 2 years of the date of the resolution authorizing the action complained of
  + Debts owing to employees ***(CBCA s 119)***
    - Unpaid wages or vacation pay
    - ***S 119(1)***--Directors jointly or severally liable, or solidarily liable, to employees of corporation for all debts not exceeding 6 months wages for services performed for the corporation
      * Can be severance pay, vacation pay, benefits etc.
      * Only liable for debts accrued while the person was a director
    - ***S 119(2)***—further exemptions:
      * Must sue for debt within 6 months after it has become due
      * Corporation has commenced liquidation and dissolution proceedings
      * Corporation has made an assignment or a bankruptcy order has been made against it
    - Employees must collect debts from corporation (directors not primarily liable)
      * ***S 119(5)***—if director pays the debt, can recover from the company in bankruptcy with the same claim as the employee would have had
      * ***S 119(6)***—can sue other directors who were also liable after satisfying the debt
* Other statutory liabilities
  + Environmental statutes etc.
* Tort liability
  + See: ADGA systems international v Valcom Ltd
  + Tort-feasor is a tort-feasor

### Relief From Liability

* Shareholder ratification (depends on type of breach)
  + **Interested director’s contracts**— Transactions with directors, officers, controlling shareholders or corporate affiliates
    - If transaction was approved by shareholders by special resolution it was disclosed, and the transaction was fair and reasonable to the corporation, the transaction is not invalidated and director is not liable for breaching duty of loyalty ***(see s 120(7.1))***
    - Interested directors may still vote on the matter
    - ***S 120*** only covers interested directors transactions; other breaches covered by other statutes
  + **If director usurps corporate opportunity** (breaches duty of loyalty), and this was approved by majority of shareholders, shareholders who opposed the resolution can still sue the directors
    - Court must take into account the fact that shareholders ratified the breach in determining whether directors are liable ***(s 242(1))***

#### North-West Transportation Co v Beatty

F: Corp director & maj. Shareholder = James Beatty; Corp made contract with company owned by Beatty to purchase a steamer ship

* In the shareholder meeting, shareholders passed a bylaw to approve the sale and bylaw was approved by majority of shareholders including Beatty
  + Beatty was in conflict of interest—was he allowed to vote on the matter?
    - Privy Council--vote of majority must prevail unless the adoption was brought about by unfair or improper means
* Was the ratification was by unfair or improper means?
  + Only possible unfairness was Beatty possessed majority voting power
  + Before the meeting, Beatty was not a majority shareholder, but, right before the meeting, Beatty actively acquired a large number of shares to cross the majority threshold
    - Beatty had a right to do this—not illegal
    - Beatty was entitled to vote on the matter, even tho he had a conflict of interest

***CBCA rule—S 120***

* Interested director’s transaction must be approved by special resolution
  + Does not exclude interested directors from voting
* Exculpation clauses ***(CBCA s 122(3))***
  + Including provision in articles or bylaws to say that directors are not personally liable for breaching duties
    - ***S 122(3)***—no provision in articles, bylaw, or contract will absolve directors’ personal liability, subject to s 146(5)
    - **Exculpation clauses not allowed under CBCA**

#### Statutory defenses (s 123)

* + Are 3 that are **ONLY AVAILABLE TO DIRECTORS (NOT OFFICERS**):
    - **Dissent *(s 123(1))***
      * Must do so in prescribed manner
    - **Due diligence defence *(s 123(4))***
      * Only available in certain situations:
        + S 118—improper issuance of shares and payment
        + S 119—unpaid employee wages, vacation pay, reimbursement
        + S 122(2)—compliance with the Act, the articles, by-laws or USA)
    - **Good faith reliance defence *(s 123(5))***
      * More generally available than due diligence
      * Can rely in good faith on reports prepared by professional persons
        + Peoples’ Department Store—qualifications for professional—must be regulated and carry insurance
* Indemnification and Insurance ***(s 124)***
  + Indemnification is allowed under s 124
  + Indemnification = company’s promise to reimburse for litigation expenses and personal liability if the person is sued for being a director
    - Indemnification right persists even after someone ceases to be director
  + 2 kinds of indemnification:
    - **Mandatory (s 124(5))—for successful defence**
      * If director successfully defends himself, has right to be reimbursed by corporation
      * Director must be found to not have committed any fault or not to have omitted to do anything that the individual ought to have done
      * Depends on finding at end of proceeding—must wait to be reimbursed
      * does not need to be in by-laws/articles—is a statutory right
      * ***s 124(3)***—must act in good faith with view to best interests of corporation to be indemnified
    - **Permissive—for unsuccessful defence** 
      * ***S 124(2)***—do not have to wait to be reimbursed
        + Can advance money to director for cost of proceedings
        + Must pay back the money if director found to not be acting in good faith with view to best interest of corporation
      * ***s 124(3)***—must act in good faith with view to best interests to be indemnified
      * must be specifically included in by-laws or articles
        + in practice, many companies make permissive indemnification mandatory in the bylaws
      * **Third-Party Suit *(s 124(1))***
        + may indemnify if action brought by a third party (not corporation or person on behalf of corporation; can reimburse against all costs, charges, and expenses, including settlement amounts or amount to satisfy a judgement
      * **Suit by Corporation or Person on Behalf of Corporation--*S 124(4)***
        + Indemnity is permitted only with court approval
        + Limited to litigation expenses, not judgement amount or settlement amount

Would make litigation meaningless if judgement amounts were covered

* + - * + ***S 124(2)***—do not have to wait to be reimbursed

Can advance money to director for cost of proceedings

Must pay back the money if director found to not be acting in good faith with view to best interest of corporation

* + D&O Insurance (Directors & Officers)
    - No limitations imposed by CBCA on when insurance should be available
    - 2 types of Insurance:
      * Depends on if indemnification available
      * Not available
        + D&O’s insured
        + Personal assets are insured
        + Insurances covers non-indemnifiable liability of D&O’s
      * Available
        + Companies are insured
        + Company’s assets are insured
        + Insurance covers company reimbursement of directors’ costs

### Advice for Directors and Officers

* Review corporation’s bylaws
  + If bylaws permit indemnification, try and get an indemnification agreement
* Obtain D&O insurance
  + Most well drafted bylaws will require company to get insurance—will ensure D&Os are indemnified even if company cannot afford to pay
    - Indemnified D&O’s are unsecured creditors if company goes bankrupt
* Collect sufficient info when making decisions
  + want protection of BJR
* have good faith reliance on expert reports
  + for good faith reliance defence
* make sure dissent properly recorded
  + for dissent defence
* unanimous shareholder agreement
  + if power is restricted by unanimous shareholder agreement, directors are not personally liable for liabilities arising from management power shifted to shareholders
* resign
  + no limitation on freedom to resign
  + not full protection—still liable for liabilities arising from events occurring during time as a director—only prevents against future liabilities

## Derivative Actions

* those who sue directors on behalf of the corporation (e.g. shareholders) sue through derivative action
* any recovered funds from a derivative action goes to the company
  + Shareholders would have to bear whole litigation costs with benefit obtained being proportionate to interest in the company
    - Little incentive to sue
* Benefits:
  + Provides compensation to an injured company
  + Creates fear of personal liability—deters future breaches
* Attorney costs typically awarded to successful plaintiffs in a derivative action
  + Lawyers would encourage shareholders to sue
  + Settlements would only happen if defendants pay attorney costs

### Derivative Actions at Common Law

#### Foss v Hartbottle

* Involves interested director transaction—shareholders sued director
* RULES:
  + Proper plaintiff rule: only the corporation has standing to sue
    - Based on idea that corp is separate legal entity
  + Internal management rule: courts will not interfere if the breach may be (COULD BE) ratified by simple majority of shareholders
    - Changed in ***s. 242(1)***—will be taken into account as a factor, but is not determinative
* “Exceptions” to RULES from Edwards v Halliwell:
  + Ultra vires transactions
    - transactions beyond company’s capacity (prohibited by articles)
  + Actions that could be validly taken only with the approval of a special majority of shareholders
    - E.g. if approved by simple majority, but should have been approved by special majority, shareholders can bring the action
  + Actions in contravention of the personal rights of shareholders
    - Not about derivative actions—about direct actions
  + Fraud on the minority
    - Some kinds of fraud may be ratified by majority shareholders on false pretenses—minority can sue

### Derivative Actions under CBCA

#### Who may initiate Derivative Action:

* ***CBCA s 238***:
  + Complainant =
    - Present Registered holder or beneficial owner, former registered holder or beneficial owner, of a security of a corporation or any of its affiliates
      * Registered holder (name appears on books); beneficial owner (actual owner)
      * Security
        + 2 kinds:

Equity security = share

Debt security = corporate bonds (issued to borrow money from a large number of investors)

* + - Former registered holder or beneficial owner
      * Timing of alleged wrongdoing and holding of shares must coincide—if wrongdoing occurred before you sold, you can sue
    - Corporation and affiliates
      * Affiliates = companies owned/controlled by the corporation
    - Director or an officer or former director or officer of corporation or any of its affiliates
    - CBCA director
    - Any other person, at the discretion of the court
      * In practice, no one has been successful under this provision
      * BUT—creditors **may** have standing as per Peoples’ Department Store (unresolved)

#### What Steps to Take:

* ***CBCA S 239***
  + Complainant must apply to court for leave ***(s 239(1))***
    - Screens out frivolous suits that may have been encouraged by overzealous lawyers
  + Complainant must give notice to directors at least 14 days before application is made ***(s 239(2)(a))***
    - Directors may be in a better position to determine whether it is in the interest of the corporation to pursue the action—allows them the opportunity to bring the suit themselves
      * Under Ontario BCA, if all directors are named as defendants, notice requirement is waived
  + Court must be satisfied complainant is acting in good faith ***(s 239(2)(b))*** AND
  + Court must be satisfied the suit appears to be in the best interests of the corporation or subsidiary ***(s 239(2)(c))***
* ***CBCA s 242(1)***
  + Should not dismiss a derivative action just because the breach was ratified by majority of shareholders—abandons rule in Foss v Harbottle
    - Court can take into account whether action that is a breach was approved or not

##### Re Northwest Forest Products Ltd

* Had Mr. Ross made reasonable efforts to cause the director of the corporation to commence the action?
  + Yes, there was reasonable efforts—both his letter and the resolution contained language mentioning fraud (cause of action) and both the letter and resolution had very similar language
    - This was reasonable notice
* Was it prima facie in the interest of the company that an action be brought?
  + Court was satisfied that action was prima facie consistent with interests of company—directors appeared to have failed to look for other bids and to find out the current market price of the shares

##### Re Bellman and Western Approaches Ltd.

* Bellman group sued under derivative action
* Did bellman meet requirements?:
  + Notice given was reasonable—not required to specify each and every cause of action in the letter
  + Good faith?
    - in this case, complainant made two actions (derivative and direct(oppression remedy))
    - damage sought in derivative action and oppression remedy were not the same, so it did not raise an issue about the good faith of complainant
    - requirement met
  + appears to be in best interests?
    - Did board make decision not to pursue action independently?
      * Independent committee with outside experts had concluded that it was not—but should the court defer to this?
        + BUT court said 4 directors were not independent—were nominees of controlling group
        + Retained outside experts, but the reports prepared were very limited—did not address/consider potential breach of fiduciary duties
      * Decision not made in impartial way
    - Appeared to be in interest of corporation to pursue the action
* To what extent should court defer to decision of board not to pursue an action?
  + Should this be protected by business judgement rule?
  + Discussed in note 1 on page 715-716
    - In US, companies set up special litigation committees of independent directors—if decision is challenged, court investigates whether committee is independent and reasonableness of decision
      * If committee is found independent, court will defer to board’s decision
      * This case bears similarity to US jurisprudence, as court investigated independence and way decision was made
  + Independence is context specific

#### What Remedies Available?

* ***CBCA s 240***
  + Court can make any order it thinks fit in derivative actions, including but not limited to:
    - (a) Order authorizing complainant or any other person to control the conduct of the action
    - (b) Order giving directions for the conduct of the action
    - (c) Order directing that any amount adjudged payable by a defendant in the action shall be paid directly to former and present security holders (instead of to corporation or subsidiaries)
      * Ensures fairness when shares have been sold (paying to corporation would be a windfall to new shareholders and a loss for old shareholders)
    - (d) Order requiring corporation to pay reasonable legal fees incurred by complainant
      * Encourages derivative actions
* ***CBCA s 242 (3) & (4)***
  + (3) complainant not required to give security for costs in a derivative actions
  + (4) court may make interim order as to costs
    - Allows corporation to seek indemnity from corporation for costs, but may be held accountable for this order at the conclusion of case

##### Turner v Mailhot

* Filed derivative action and filed for interim costs
  + After derivative action is filed, there is a prima facie presumption of indemnity
    - Factors:
      * **Financial ability of complainant to carry on lawsuit**
        + In this case, no issue as to financial ability
        + If financial ability changes, can seek more comprehensive indemnity later
      * **Is the benefit sought more for the corporation or the complainant**
        + Minority shareholder entitled to indemnity to half of the future fees and costs—in this case, it was more about a dispute between minority and majority, and less about the corporation
* ***CBCA s 242(2)***
  + Court must approve any stay, discontinuation, settlement, or dismissal of the case under derivative action

#### How Common are Statutory Derivative Actions in Canada?

* General sense is that most of the statutory derivative actions have failed to make any real impact in Canadian law
  + Tend to prefer oppression remedy, as with derivative action you need leave and the compensation typically goes to the company

#### Distinction between Personal and Derivative Actions:

|  |  |
| --- | --- |
| **Personal Actions** | **Derivative Actions** |
| Enforcing rights as shareholders | Enforcing rights on behalf of corporation |
| Recovery goes to shareholders | Recovery goes to the corporation |
| No leave requirement | Leave requirement |

##### Examples of Personal Actions/Direct Suits

* Compel payments of dividends declared but not distributed
* Compel inspection of shareholders’ list, or corporate books and records
* Require the holding of a shareholder meeting
* Challenge corporate restrictions on share transferability
* Challenge fraud on shareholders in connection with their voting, sale, or purchase of securities
* Challenge the sale of the corporation in a merger where directors structure a transaction that was unfair
* Challenge the denial or dilution of voting rights, such as when substantially all of the corporations assets are sold without shareholder approval

##### Goldex Mines Ltd Revill (1974)

* Plaintiff did not make it clear whether claim was personal or derivative and did not seek leave
  + Was leave required?
    - Sending false and misleading annual report in proxy solicitation was a breach of fiduciary duty and breach of shareholder information right
  + Necessary to distinguish each cause of action in statement of claim
* Where legal wrong done to shareholders by director or other shareholders, injured shareholders suffer a personal wrong and may seek redress for it in personal action
* Derivative action, on the other hand, in which the wrong is done to the company
* **If injury is not incidental to the corporation, an individual cause of action exists**
  + Not incidental to an injury to the corporation = not arising simply because the corporation itself has been damaged, and as a consequence of damage to company, its shareholders have been injured (indirect harm)
* Key question: who suffered the alleged harm?
* Used to be that plaintiff shareholder had to suffer some unique special harm to bring personal action
  + This was rejected—must ask who suffered the alleged harm and whether this harm was incidental or not

## Oppression Remedy

* Intended to address majority shareholder of closely-held corporation terminating minority shareholder’s employment and refusing to pay dividends
  + Protects interest of minority shareholder in closely-held corporation
  + Is no readily available market to sell shares—no one wants to buy shares where majority shareholder has manifested hostility towards minority shareholders
    - If can sell, will have to sell for a low price
* Traditional Policies:
  + Bear with it—you chose to be minority shareholder so DEAL WITH IT
  + Judicial dissolution—apply to have company dissolved as your solution—very drastic
* Oppression remedy—court has power to intervene where conduct of director or officer is oppressive or prejudicial against particular stakeholder

### Who Can Initiate Oppression Action?

* ***CBCA s 238***
  + Applies to both oppression remedy and derivative action
  + Complainant =
    - Present Registered holder or beneficial owner, former registered holder or beneficial owner, of a security of a corporation or any of its affiliates
      * Registered holder (name appears on books); beneficial owner (actual owner)
    - Former registered holder or beneficial owner
      * Timing of alleged wrongdoing and holding of shares must coincide—if wrongdoing occurred before you sold, you can sue
    - Security
      * 2 kinds:
        + Equity security = share
        + Debt security = corporate bonds (issued to borrow money from a large number of investors)
    - Corporation and affiliates
      * Affiliates = companies owned/controlled by the corporation
    - Director or an officer or former director or officer of corporation or any of its affiliates
    - CBCA director
    - Any other “proper person”, at the discretion of the court
      * What about employees or creditors?
      * Most creditors can bring lawsuit on contract with the company or sue under tort law, so why do they have an incentive to sue under oppression remedy?
        + Court has unlimited flexibility in deciding a remedy under oppression remedy, not constrained like in contract or tort
        + Commonly try for oppression remedy when assets of company are transferred to personal assets of directors to defeat creditors

Will look at whether there has been fraud perpetrated against creditor

* ***CBCA s 241(2)***
  + Seems to say that employees cannot bring an oppression remedy: does not mention employees, only protecting interests of security holder, creditor, director, or officer
    - Wrongful dismissal claim cannot be brought under oppression remedy unless dismissal is part of a pattern of oppressive acts
      * E.g. employee is terminated and employee sues corporation and wins, but corporation transfers assets to avoid paying

#### First Edmonton Place Ltd v 315888 Alberta

* Company called First Edmonton Place (FEP)
* Another company : #’d Alberta company controlled by three lawyers who were directors
* FEP provided incentives to #’d company to sign 10 year lease for office space
  + 18 months’ rent free
  + Improvement allowance
  + Cash payment
* Lawyers took money and stayed in officer for 21 months without signing lease and then left
* FEP sought oppression remedy to hold company liable
  + Do they have standing as a landlord/creditor to bring oppression remedy?
    - **2 kinds of creditors:**
      * **Holders of debt securities (bond-holders; debenture-holders)**
        + **Fall under s 238(a) as security holders—have standing to bring oppression remedy**
      * **Trade Creditors: Employees, suppliers, landlords etc.**
        + **Fall under s 238(d)—are they proper persons? Subject to approval of the court to bring oppression remedy**
    - **2 circumstances to grant standing for Trade Creditors:**
      * **If conduct of directors/management constitutes using corporation to commit fraud against the applicant creditor**
      * **If there was a breach of reasonable expectation arising from the circumstances in which the creditors’ relationship with the company arose**

### What Constitutes Oppressive Conduct?

* ***CBCA s 241(2)***
  + Any act or omission of the corporation or affiliates that effects a result
  + Business or affairs of the corporation or affiliates are or have been carried on or conducted in a manner
  + Powers of the directors of the corporation or affiliates are or have been exercised in a manner
    - That is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director, or officer

#### Ferguson v Imax

* Imax owned by 3 couples (Fergusons, Kroiters, Kerrs)
  + Were 2 classes of shares (common and preferred)
    - Preferred shares
      * Had dividend priority over common shares (5% per year)
      * Non-redeemable (no right to force sell back to company)
      * Non-voting, but (see case for exclusion)
  + Each of the husbands held 700 common shares
  + Each of the wives held 700 preferred shares
  + All husbands participated in management of company
* Fergusons divorced
  + Mrs. Alleged Mr. cooperated with other shareholders to try and force her out of company
    - Argued that she got fired by company (used to be an employee)
    - During divorce negotiation, Mr. tried to get Mrs. to sell the shares to him
    - Mr. stopped all dividend declarations and blocked dividend payments, because he did not want Mrs. to get any money
  + Shareholders passed a resolution to make the preferred shares redeemable and to freeze the value of the preferred shares
* Were Mr. Ferguson’s actions oppressive?
  + Was the resolution oppressive to preferred shareholders?
    - Was not really oppressive to other preferred shareholders—other shareholders could still get value from the company through their husband’s holdings of common shares (spousal assets)
      * Consider their social relationship

#### BCE Inc

* SCC provides a framework for how to determine whether an act is oppressive
* Provides insight into relationship between fiduciary duties and oppression remedy

Jargon:

* Debenture holder
  + Holder of a type of debt security
* Indenture
  + Contract between issuer and debenture holder
  + Sets out terms of relationship
* Leverage Buyout (LBO)
  + To acquire a company with a huge amount of debt
  + Acquiring company uses own assets and target company’s assets to secure loans to purchase the company

Facts:

* Company BCE has subsidiary called Bell Canada
* Bell had a group of debenture holders
* In april 2007, a group of investors led by Teachers’ Private Capital started to acquire shares of BCE on open market
  + Indicated that they intended to take over BCE
* BCE’s board decided to conduct an auction to attract competing bidders
  + Attracted 2 other bidders and TPC
* All 3 bidders offered LBOs
  + TPC won the auction b/c they offered the highest price
  + But, TPC required Bell Canada to provide guarantees of $30 billion to support the loan to acquire BCE
    - These guarantees would downgrade the debenture holders and the value of the debentures decreased by 20%
      * More risky, because there was a creditor who had priority over them in the event of insolvency
* Shareholders of BCE approved the transaction (~98% in favour)
* Debenture holders brought oppression remedy against directors of BCE
  + Were the actions of the directors oppressive to the debenture holders?

Analysis:

* **Test for determining whether actions are oppressive:**
  + **Did the claimant have a reasonable expectation that his interests would be protected?**
    - **Reasonableness is fact-specific/context-specific**
    - **Reasonableness Factors:**
      * **Consider general commercial practice**
        + **Is this common practice?**
      * **Consider nature of corporation (public or private)**
      * **Relationship between the parties?**
        + **Not only legal relationships, but also social relationships**
      * **Past practice**
        + **How did the company handle issues like this in the past?**
      * **Self-protection measures**
        + **Did the claimant take any steps to protect themselves?**
      * **Representation & agreements**
        + **Consider statements made by company and contract governing their relationship**
      * **Fair resolution of conflicting interests between stakeholders**
    - **Is there a violation of this reasonable expectation that resulted in unfair/prejudicial consequences for the complainant?**
* Did the claimant have a reasonable expectation that his interests would be protected?
  + Debenture holders did not have reasonable expectation
    - LBO’s are quite a common practice—are not unforeseeable
      * Debenture holders could have foreseen possibility of LBO
    - Representations—company made some statements suggesting a commitment to maintain investment grade, but all statements were accompanied by warnings
    - Contractual terms of debenture holders were met and not further commitment could be made
    - Debenture holders could have protected themselves by acquiring better terms in the contract for investment grade and trading price
    - Past practice—in the past, the investment grade was maintained
      * Past practice can be reasonably changed by changing market conditions
    - Is a public company—common for public companies to have leverage buyouts
    - Fair resolution? There were conflicts of interests between stakeholders, but directors have fiduciary duties to the corporation and they may consider the various interests of stakeholders, but no particular group’s interests should be favoured at the expense of other stakeholders
      * As long as decision is within range of reasonable choices for best interests of the company, the courts should defer to board’s decision, unless alternative transaction that is more beneficial to company was available
* Court reaffirmed position in People’s
  + Duty of loyalty owed to the corporation only—have discretion to consider interests of various stakeholders
    - Shareholder wealth maximization is not the only corporate purpose

### What Remedies are Available for Oppressive Actions?

* ***S 241(3)***
  + Any order it sees fit, including, but without limiting:
    - Order restraining conduct complained of
    - Order appointing receiver or receiver-manager
    - Purchase of complainant’s shares by the corporation/majority shareholder

#### Naneff v Con-Crete Holdings Ltd.

* Son ousted from family business because father didn’t like his GF
* Was the act oppressive?
  + Yes
  + Trial court ordered a public sale of the company’s shares and allowed alex to purchase shares
  + Appeal court reversed the order—this order was more than rectifying the oppression act
    - Alex did not have reasonable expectation that he would take over the company during his lifetime
    - This order punished the father—did not expect to give up control of company during his lifetime
    - Appropriate remedy was to compensate alex for his losses due to exclusion and termination

#### Scottish Coop Wholesale Society v Meyer

* Meyer and Lucas sought oppression remedy
  + Wanted controlling shareholder to purchase their shares at a reasonable price
    - Fair price was value they shares would have had at the date of the petition, if there had been no oppression
  + Oppressed shareholders could have sought an order to wind up the company
    - BUT, the value of the subsidiary had already been reduced due to the competition with the competitor, so selling the assets and distributing them to the shareholders would have been unfair to Meyer and Lucas

Oppression Remedy vs Derivative Action

|  |  |  |
| --- | --- | --- |
|  | **Oppression Remedy** | **Derivative Action** |
| Harm | Personal harm | Corporate harm |
| Standard of liability | Proof of violation of legal right or reasonable expectation | Proof of violation of legal right |
| Remedies available | Unlimited discretion | Limited to standard remedies based on cause of action pleaded |
| Timing of conduct complained of | Does not allow complainant to seek remedy for past wrongs (must have an interest in company when act complained of took placed) | Current interest allows you to seek remedy for past wrongs |
| Costs | Complainant must pay all the costs of litigation, but court may award filing fees and costs of accessing court system in some cases (no attorney costs) | Fees and Attorney Costs Paid for by the corporation if the plaintiff wins |
| Leave requirement | None | Yes, required to get leave to bring action |

\*\*\*actions are not mutually exclusive—can happen simultaneously

* When multiple remedies are available, plaintiffs prefer oppression remedy
  + No leave requirement
  + Compensation goes to complainant rather than the corporation