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# Introduction

3 types of business organization:

|  |  |  |
| --- | --- | --- |
| **Sole Proprietership** | **Partnership** | **Corporation** |
| Simplest; 1 owner; create by registering business name (***s. 88***; $40) | 2+ people carrying on business together for profit3 Sub-types: 1. GP (no reg. reqs)
2. LP (reg. reqs)
3. LLP (reg reqs)
 | Defined by 5 features:1. Separate legal identity
2. Perpetual existence
3. Share transferability
4. Limited liability for shareholders
5. Centralized mgmt. – mgmt. with BOD not owners

Created through formal procedures of incorporation |
| **Pros** | **Cons** | **Pros** | **Cons** | **Pros** | **Cons** |
| * Easy
* Full Control
* Tax benefits (if operating at a loss)
 | * Unltd liability
* Limited life – biz over once owner dies
* Difficult to transfer ownership (can’t do it as a bundle – must transfer title to individual bits)
* Tax, if profitable is more (19-26% vs. 16-22% for corp)
 | 2 people can do business together | Each partner personally liable for debts of the partnership (unless LP/LLP) | * Ltd liability for shareholders
* Tax benefits – less income tax if profitable than if operating as SP
 | * Costs w/ incorporation process
* Formalities of maintaining operations
 |

# Agency

The relationship that exists between 2 persons where one, called A, is considered in law to represent the other, called P, in such a way as to be able to affect P’s legal position through the making of contracts or the disposition of property.

**3 BASIC ELEMENTS:**

|  |
| --- |
| 1. Consent by P + A
	1. Both must consent
	2. P must manifest consent to A in some form so that A can agree

→ can be written, oral, or implied |
| 1. Action by A on behalf of P: A must act primarily for the benefit of P
 |
| 1. Control by P:
	1. High degree of control by P + little discretion for A ∴ A = servant/employee
	2. Less control by P + more discretion for A ∴ A = independent contractor
 |

## Duties owed

**By P:** compensation and indemnification (in certain circs)

**By A:**

1. **DUTY OF LOYALTY:** no right to benefit from efforts taken on behalf of P, unless o/w agreed; includes:
	1. **May not use confidential info for own benefit**
	2. **May not act for anyone whose interest might conflict w/ P’s**
	3. **May not compete with P in any manner w/in the scope of the agency rel’nship**
	4. **May not become the other party to a transaction w/ P unless A discloses his role and P consents**
2. **DUTY OF CARE**
3. **DUTY TO ACT W/IN AUTHORITY**
4. **DUTY TO OBEY INSTRUCTIONS**
5. **DUTY OF DISCLOSURE**

### Food Lion

|  |  |
| --- | --- |
| **F** | ABC reporters got jobs at Food Lion; they recorded unsafe food practices and later exposed same through an ABC broadcast |
| **I** | Did the reporters breach their duty of loyalty to food lion, as employees? |
| **D** | Yes. |
| **RA** | Employees are disloyal when their acts are *inconsistent with promoting the best interests of the employer at a time when they were on its payroll.* |
| **RE** | The interests of ABC (the reporters’ real employer) were directly adverse to the interests of Food Lion Intentional betrayal of FL for benefit of ABC *NB:* whistleblower leg’n now protects people in these situations (where an agent’s duties to P conflict w/ duty of care to the public)  |

## Binding the principal to third parties

A has the ability to bind P to 3Ps and to bind 3Ps to P. The liability of A for their dealings w/ 3Ps differ depending on the nature of the underlying matter (K vs tort)

### liability of principal under tort

|  |  |
| --- | --- |
| **P’s Role in the Tort**  | **P’s Liability for the Tort** |
| P authorizes A’s tortious act**Why?** Delegating unlawful ≠ escaping liability |  P is directly liable |
| P negligent in selecting/controlling/supervising A |  P is directly liable  |
| P innocent of any wrongdoing | Dependent upon A’s status:if A is an employee/servant, acting w/in the scope of employment → P is indirectly/vicariously liable If A is an independent contractor → P is not liable  |

*NB:* in Canadian law, you can’t look at chains of agency relationships in order to determine liability

No liability for Franchisor unless there is a DIRECT agency relationship between Franchisor and employee

Employee

Franchisee

Franchisor

#### Sagaz Industries (2001) SCC

|  |  |
| --- | --- |
| **F** | * “Design”: Canadian Tire’s principal supplier of car seat covers
* “Sagaz”: CT’s New supplier
* “AIM”: marketing firm, employed by S; AIM got the K for S by bribing a manager @ CT
* Bribery discovered, mgr fired, but CT liked S’s seat covers better so stuck with them
* Design brought claim that, but for the bribe, they would still be CT’s supplier
 |
| **I** | There is an agency relationship between AIM and S; but should S be held liable to Design for AIM’s bribery?  |
| **D** | No. AIM is an independent contractor, not an employee ∴ S not vicariously liable |
| **RA** | In determining whether an agent is an employee or just an independent contractor, one must consider whether the person engaged to perform services is a person doing so on his own behalf. Factors: * Control by P?
* Does worker provide own equip?
* Does worker hire own helpers?
* Degree of financial risk taken by worker
* Degree of responsibility for investment and management
* Worker’s opportunity for profit in the performance of the task
 |
| **A** | DIRECT LIABILITY: * No, not contended that S knew/condoned/encouraged A’s bribery

INDIRECT LIABILITY: * Although S controlled *what* would be done, AIM controlled *how* it was done ∴ not an employee but an independent contractor → No indirect liability
 |

### Liability of principal under contract

Principal is liable on a K made by A with a 3P where A acts with **actual or apparent authority.**

**Actual Authority:** express or implied authority to do something

 Express: Conveyed orally/in writing

Implied: power to do those things necessary to fulfil the agency (e.g. there is actual express authority for A to run P’s restaurant biz; this includes the implied authority to hire employees, enter Ks with food distributors, etc.)

**Apparent Authority:** Authority that a reasonable 3P would infer from the actions or statements from the P (i.e. the manifestation of authority must somehow be traceable back to P)

### Liability of agents to 3ps

**In Contract:**

A is not liable if P is disclosed

A is liable for breaching WOA if P is not disclosed or is partially disclosed

*Why?* When P is disclosed, 3P knows that K is really with P. W/o knowing P’s ID, 3P enters into the K on the reliance of trustworthiness of A.

1. If A is **authorized** and P **breaches;** is A liable? → No. A is not a party to the K.
2. If A is **not authorized** and P **breaches**; is A liable? → Yes and No. A is still not a party to the K, so not liable under the actual K **BUT they are liable for breaching the warranty of authority** (implied by law whenever a person purports to enter a K on behalf of another)

**\**NB:*** even if the 3P could have discovered A’s lack of authority, they may still sue for breach of WOA.

∴ A’s authority will decide whether (a) A has breached WOA or (b) P is liable on the K

NO

YES

**In Tort**: A is still liable to 3P for their own tortious conduct. Committing a tort, even under the authority of P, or done for the purposes of protecting/furthering P’s interests, is still committing a tort.

## Agency in economics

Broader conceptualization than the legal one: **whenever** a person acts on behalf of another

**Agency Problem:** How do you motivate A to act in P’s best interests?

**Agency Costs:**

1. A misusing their position for their own gain
2. The costs of P having to monitor/discipline A

**Causes of Problems and Costs:**

1. Conflict of interest: Agent wants the highest pay rate for the least effort; P wants the maximum effort from A for the lowest cost
2. Information Asymmetry: A has more information about how the agent does their own job

= Greater agency costs

* 1. The more discretion A has
	2. The greater complexity of A’s tasks

**How to Reduce Problems and Costs:**

1. Reduce COI: Align interests of A + P (e.g. by doing profit-sharing)
2. Reduce information asymmetry: require A to disclose info about how they are performing

→ the underlying economic understanding of agency can help understand the role of law in regulating agency relationships (e.g. duty to disclose info = effort to minimize info asymmetry)

# Partnership – multilateral agency relationships

Partnership arises whenever 2 or more persons (real persons or corporations) carry on business (every trade, occupation, and profession) in common with a view of profit (does not have to be immediately profitable)

* Can be informal/formal; express/implicit (partners may not even know they are in a partnership)
* A contractual creature (vs. a statutory one, like a corp)
* No formal reqs to formation but if not reg’d, it just creates doubt (if it’s reg’d as a partnership, however, it’s definitely a partnership)
* A partner is an agent of the firm and the other partners for the purpose of the business

## Typical characteristics of a partnership

IS THIS THING A PARTNERSHIP?

* No single factor is determinative; each will be weighted differently
* The more factors present, the more likely it is to be a partnership
1. **Intention:** can be express or implied
* How do the parties represent themselves to 3Ps?
* Did they intend to enter into a partnership?
* How is the business managed?
1. **Profit-sharing**: a KEY FACTOR
* Necessary but not sufficient
* Prima facie evidence of partnership; created a rebuttable presumption of partnership (***s. 4(b); s. 4(c)***)
	+ EXCEPTIONS:
		- receiving portion of profits in installments as debt repayment
		- profit-sharing contracts w/ employees
		- spouses/children of deceased partner who receive share of profits that dec’d was entitled to
		- profits rec’d 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
1. **Loss-Sharing:** not req’d but typical; losses usually shared in the same way as profits
2. **Right of management:** generally present but not determinative
* ≠ equal management or voting rights or equal degrees of control; nor hands-on participation – just the right
* default rule of equal management power but can be varied by express or implied agments (***s. 27(e)***)
* If a party is totally excluded from mgmt., they’re probably not a partner
1. **Miscellaneous:**
* Treating partnership property as indivisible (***Le Page v Kamex; s. 4(a)***)
* Bankruptcy ends partnership (***Pooley v Driver***)
* Ability to receive residual assets after dissolution of a partnership (***Pooley v Driver***)

### A.E. LePage Ltd. v Kamex Developments (Co-owner = Partner?)

|  |  |
| --- | --- |
| **F** | * Kamex: created to hold property in trust for 4 co-owners; the 4 C-Os made an agment to manage the property
* Important terms of the K: shared profits + losses; decisions of the sale to be made by majority vote; right of first refusal (ability of a C-O to purchase a fellow C-O’s share on the same terms as offered by a 3P) and if the other C-Os didn’t exercise this right, the selling C-O could sell w/o the others’ consent
* One of the C-Os, M, signed an exclusive listing agment with Π w/o getting others’ consent; told Π that he was a partner and had the authority to act
* Eventually building sold through a different real estate agent and Π sued, arguing all C-Os bound by the agment made by M
 |
| **I** | Do the C-Os constitute a partnership? Did M bind the partnership in the K with Π? |
| **D** | No. Co-ownership only, no partnership. No partnership ∴ no authority ∴ Δs not bound  |
| **RA** | The mere fact of property being co-owned and that profits are derived therefrom does not of itself constitute the co-owners as partners. Partnership interests are indivisible and the right of first refusal is incompatible with this.  |
| **A** | * Partnership depends on an intention to carry on a business, whereas here Δs just intended to have an agment that regulated their rights and obligations as C-Os
* They treated their interests as separate – kept them separate for tax purposes
* Right of first refusal

***NB:*** M could have been sued for breaching WOA  |

### Volzke Construction v Westlock Foods Ltd

|  |  |
| --- | --- |
| **F** | * Shopping centre co-owners (Bonel + Westlock) built an expansion to the mall
* K between Bonel and Volzke for V’s construction of the expansion
* When V didn’t get paid for the work, he sued W for the payment, arguing he was liable as partner of B
 |
| **I** | Were W + B partners in the operation of the shopping centre? |
| **D** | Yes.  |
| **RA** | Partnership does not have to entail equal “control” of the business. In each case, the court must look at the actions and intentions of the parties to determine whether the relationship is a partnership.  |
| **A** | Aspects of the relationship supporting the conclusion they were partners: * Spoke of one another as partners
* Had joint bank acct from which cheques were printed in both W+B’s names (fact that W did not have signing authority on bank acct not dispositive)
* Co-signed independent financing loan together
* Prospective tenants sent by W to B
* Profit + cost sharing in proportion to respective interests
* Right of W to be consulted about new tenants
 |

### Pooley v Driver (Lender = partner?)

|  |  |
| --- | --- |
| **F** | Loan made by Δ to a partnership (B+H) Partnership supposedly owed Π money When B+H’s business dissolved, Π came after Δ for the debt  |
| **I** | Did the written “loan agreement” entered into by Δ and B+H make Δ a partner or just a lender? |
| **D** | Δ a partner ∴ liable for debt to Π |
| **RA** | Merely being a lender and receiving a % of the profits in exchange ≠ partnership; you need something more. Must always look at behavior and relationship of the parties.Where it is clear that a party intended to gain the benefits of partnership, he cannot then escape the risks.  |
| **A** | Factors considered: * Profit sharing not limited to amount of loan
* Loan agment incorporated the partnership agment between B+H
* Lender’s bankruptcy ends the loan (typical feature of partnership)
* If biz comes to end, loan paid out of residual assets (i.e. treated like a partner’s contribution rather than a regular creditor)
* No co-management right
* Some control over the business’ capital
 |

## Legal personality of partnership

~~Separate legal entity~~ vs. just an aggregation of individual partners

**Implications of Aggregation:**

1. Ps cannot be employees (one cannot form an employment K w/ oneself)
2. Ps ≠ creditors or debtors of the partnership
3. Each partner personally liable for all the debts of the partnership
4. Any change in the constitution of the group → partnership dissolved
5. Only partners pay tax (partnership itself is not a taxable entity)
6. Litigation: cannot be sued (but for convenience, actions can be brought in the partnership’s name and the judgment therefrom will be binding on all partners even though not all individually named)
7. Property: owned by all the partners, on an undivided basis, in proportion to their contributions

e.g. P1 owns 40% of the partnership and P2 owns 60%.

≠ P1 owns 40% of any individual item; it’s 40% ownership over the whole bundle

→ if P1 contributed a car to the partnership, P1 ceases to have a direct personal interest in the car and instead has an indirect one; he has no right to receive the car back upon the dissolution of the partnership (unless there is a specific agment for this)

### Thorne v NB (Workmans comp) 1962 NBCA

|  |  |
| --- | --- |
| **F** | 2 partners began a business together One was injured while working and applied to worker’s comp  |
| **I** | Was Π an employee of the partnership and ∴ entitled to worker’s comp? |
| **D** | No, he cannot be an employee. |
| **RA** | A partnership ≠ a separate legal entity. Partners cannot be employees of their own firm b/c that would mean that they are both employee and employer. The agment to pay partners their wages is only a way of allocating profits.  |

## Conduct of the business of the partnership

### Relationship of Partners to One Another

* A contractual relationship
* Governed by the partnership agreement (either express or implied) and the terms of the ***Partnership Act***, and the CL (to the extent it does not conflict with the ***PA*** (***s. 91***))

### Default rules

* Equal profit and loss sharing ***(s. 27(a))*** – applies even if Ps didn’t contribute equal amts
* Each P has equal management right ***(s. 27(e))***
* Majority vote needed for ordinary decisions; unanimous consent for fund’l changes ***(s. 27(h))***
* No new partners except w/ unanimous consent ***(s. 27(g))***
* Majority vote cannot expel a partner (***s. 28***)
	+ If Ps want to deviate from the terms of the act, they all have to consent (***s. 21***). However, deviation risks the relationship no longer qualifying as a partnership

**Fiduciary Duties** (Cannot be contracted out of b/c partnership req’s a high degree of trust):

* Utmost fairness and good faith (***s. 22***)
* Full disclosure (***s. 31***)
* Account for benefits acquired by a partner in a partnership transaction if other Ps didn’t consent (***s. 32***)
* Non-compete (unless others consent) ***(s. 33)***

### Dissolution

* By Partners:
	+ Fixed term in the partnership agreement (***s. 35(1)(a)***)
	+ Ends at the completion of a certain goal/task (***s. 35(1)(b)***)
	+ Can call it to an end at anytime if one is not specified (***s. 35(1)(c)***)
* On death/bankruptcy/dissociation of a partner (***s. 36***)
	+ If it’s between 2 Ps, it’s automatically dissolved
	+ If 2+ Ps, only dissolved as between the dissociated P and the other Ps
* If it becomes unlawful to continue on with the partnership (***s. 37***)
* Application for order for judicial dissolution (***s. 38(1)(f)***)

### 4 Principles of partnership

|  |  |
| --- | --- |
| **EQUALITY** | **CONSENSUALISM** |
| * equal profit and loss sharing
* equal management rights
* access to partnership books
* obligation to render to one another accounts and full information of all things affecting the Pship
 | * Mutual rights and duties can be varied by consent of all Ps
* Can add new P
* Can change the fund’l character of the biz
* Cannot expel w/o express written agment
* Majority opinion decides ordinary Pship matters
 |
| **FIDUCIARY CHARACTER** | **PERSONAL CHARACTER** |
| * Duty of care and loyalty to all other Ps
* Each partner is an agent of all other partners
 | * Partnership auto-dissolution upon character change
* Hard to assign interests of partnership
 |

## Binding the partnership to 3Ps

***ss. 7-10:*** Govern liability and mimic the principles of agency law

Where P is acting on ordinary business matters (i.e. has apparent authority) → Pship is bound unless there’s no actual authority and 3P knows (***s. 7***)

Where there is apparent or actual authority to do something → partnership bound (***s. 8***) [covers partners and other agents/employees who may be authorized]

Where P is doing something on an unrelated business matter (i.e. no apparent authority) → Pship not bound unless actually authorized (***s. 9***)

Pship placed restrictions on regular authority (no actual authority) and 3P knows (no apparent authority) → Pship not bound (***s. 10***)

## partners’ liability to partnership

1. **Pre-partnership liability:** no liability for things done pre-partnership (***s. 19(1)***); no liability after retirement – only if act occurred while still active partner ***(s. 19(2))***
2. **Liability as a Partner:** strict liability – if the act occurred while you were a partner, you’re liable for the mere fact of being a partner // partners are jointly and severally liable for partnerships arising from partner misconduct (***ss. 12, 14***) and misallocation (***ss. 13, 14***) and merely jointly liable for all other partnership debts (***s. 11***)
	1. **Joint and Several:** creditor can sue any one of the Ps individually and the partner can then sue other Ps for the recovery of the amt; if claim released against one P, it doesn’t release all claims
	2. **Joint:** must sue all Ps in order to pursue anyone of the Ps; claim released against one releases all

**→ in both, each P can be liable for the whole amt – the only difference lies in the steps the creditor needs to take in order to get compensation**

1. **Holding out Liability:** if you hold yourself out as a P, then you are liable as a P of the firm, even if you were never or are no longer a P ***(s. 16(1))***
2. **Apparent Partner Liability:** no liability for debts incurred after retirement (***s. 19(3)*** unless former P still being held out or represented as a P
3. **Posthumous Liability:** dec’d P’s estate not liable for posthumous debts – only those occurring before P’s death.

# Limited Partnerships

## General Features:

* Creation of statute – no CL concept of LP
* LP is still a Pship ∴ when statute is silent on a particular matter of LPs, then rules of GP apply
* Still not a separate legal person
* Needs to have at least one LP and one GP (***s. 50(2))***
* Formed by making a partnership agment and filing a certificate with the registrar (***s. 51***)
* Can be a GP and LP at the same time, within the same Pship (***s. 52(1))***
	+ Difference between GP/LP and GP is that GP/LP is treated as a reg GP for all purposes EXCEPT re: entitlements for distribution of profits and return of capital
* GP = **personally liable**
	+ NB: no rules for profit-sharing of GPs w/in LPship ∴ rules of GP apply – equal profit and loss sharing among GPs
* LP = only liable to the extent of contribution of the business (***s. 57***)
	+ But will lose protection if:
		- LP takes part in business mgmt.
		- Pship defectively formed [consequence of ***s. 51***]
		- If last name appears in Pship name (***s. 53(4)***)
		- If false statement made in certificate and didn’t take any steps to amend (***s. 74***)

|  |  |
| --- | --- |
| What GPs CAN’T Do  | What LP’s CAN(‘T) Do (without losing protection) |
| * Act making it impossible to carry on business of pship (***s. 56(a)***)
* Consent to a judgment against Pship (***s. 56(b)***)
* Possess LPship property, to dispose of any rights in LPship property other than for pship purpose (***s. 56(c)***)
* Admit someone as LP or GP (w/o allowance made in the certificate) (***s. 56(d)***)
* Continue business of Lpship on bankruptcy, death, retirement, mental incomp of GP unless they’re allowed to do so by cert (***s. 56(c)***)
* Anything contra the Pship agment
 | CANNOT: participate in mgmt. (***s. 64***) CAN: statutorily permitted rights and powers exercisable by LPs w/o losing protection: * Inspect books and receive specific information (***ss. 58(1)(a) & (b***))
* Obtain dissolution by ct order (***s. 58(1)(c***))
* Participate in profits in proportion to respective contributions and return of capital contrib (***ss. 59, 61, 62, 73***)
* Lend money to, borrow money from, and transact w/ Pship (***s. 60(1)***)
* Give consent on admission of new Ps (***s. 56***)
 |

## Transferability:

* P can assign rights to someone else but the assignee has limited rights unless the Pship agment allows for this and all of the other Ps agree in writing

## Withdrawal:

* If P withdraws, they have a right to receive return of their contribution:
* On dissolution (***s. 62(2)(a***))
	+ After creditors satisfied, LPs have priority over GP in receiving capital and profits
* If pship agment provides for it (***s. 62(2)(b)***)
* 6 mos after giving notice (if no other procedure specified in the pship agment (***s. 63(b)***)

\*\*\*cannot withdraw if there are insufficient Pship assets to cover all the liabilities

## Dissolution:

Pship dissolved upon:

* death, retirement, mental incompetence of GP or dissolution of a corporate GP ***(s. 67)***
	+ Remaining GPs can continue the business if allowance specified in certificate (***s. 67(a)***) and remaining Ps consent (***s. 67 (b)***)
* All LPs have withdrawn (***s. 69(b)***)
* LP does not receive return to which they are entitled (***s. 62 (4)(a)***)
* Pship assets are insufficient to return contribution to LP + LP would’ve o/w been entitled to it (***s. 62(4)(b)***)

## Taxation:

combine the advantage of limited liability with benefits of pship tax treatment (i.e. no double taxation); special incentives and tax credits flow through Pship to individual Ps.

## Asset Distribution Rules Upon Partnership Breakdown:

1. Creditors
2. LPs:
	1. Capital contributions
	2. Profits
3. GPs:
	1. Anything other than capital or profits
	2. Capital
	3. Profits

## GP Or LP? Case Law

### Haughton Graphic v Zivot

|  |  |
| --- | --- |
| **F** | Printcast: LPship Lifestyle: GP in Printcast; also a corporation controlled by Zivot Zivot and Marshall: LPs in Printcast M+Z represented themselves as VP and president of Printcast Nash: the president of Haughton (Π) Π and printcast entered into a K but PC goes bankrupt and that leaves Π unpaid Π knew that PC was an LPship *before* the K – though did not know that it was controlled by Z through a corporation (nor was Π told that M+Z were LPs in the Pship) |
| **I** | Can the Π sue Z+M (LPs in the LPship) for the money owed by the LPship itself? |
| **D** | Yes.  |
| **RA** | M+Z made general mgmt. decisions in their pship capacity. If an LP takes part in managing the business, he becomes liable as a GP. The creditor does not need to rely on someone being a GP for this liability to attach.  |
| **RE** | LP or GP?- Z+M directed Printcast and took care of managerial decisions + signed cheques on behalf of PC - represented selves as Pres and VP, not as officers/directors of the GP, lifestyle. |

### Nordile HOldings v Breckenridge

|  |  |
| --- | --- |
| **F** | * Vendor: Nordile
* Purchaser: Armanco (LPship) // Arbutus = GP // B+R = LPs; minority shareholders, officer + director of Arbutus
* B+R managed Arbutus and Arbutus managed Armanco
* But in agreed facts, when B+R participated in managing Armanco, they were doing so in their capacity as directors/officers of Arbutus
 |
| **I** | Did B+R take part in mgmt. of Arbutus ∴ losing their limited liability status?  |
| **D** | Mgmt. Yes, but only as directors/officers. |
| **RA** | Acting in one capacity (i.e. as officers + directors of the GP) is sufficient to exclude liability b/c acting solely in one capacity necessarily negates acting in any other capacity. Must determine the actor’s acting capacity in order to determine liability.  |

# limited liability partnerships

## Formation requirements

File a registration statement; name must end w/ LLP

## Liability

Partners not personally liable for the debts of the Pship **except:**

1. P’s own negligent/wrongful act/omission or
2. Another person in the Pship’s negligent/wrongful act/omission that
	1. The P seeking relief knew about and
	2. Did not take reasonable steps to prevent

## BC LLP Provisions

1. Available to all kinds of business activities (though, if you expand to a jurisdiction where LLP is restricted to only certain types of profession, you’ll be treated there as a GPship)
2. Offers **full shield** protection: partners in LLP have **no** personal liability except in 2 circs (***s. 104***)

***NB:*** Partial shield = liability for K liabilities of Pship but not for negligence of other Ps

## key differences between GP/LP/LLP \*\*SET UP YOUR EXAMS LIKE THIS\*\*

|  |  |  |  |
| --- | --- | --- | --- |
|  | **GP** | **LP** | **LLP** |
| Registration | 🗷 | 🗹 | 🗹 |
| Mgmt (default) | All Ps have equal mgmt. rights | GP: Mgmt rightsLP: no rights (w/o losing protection) | Statute silent ∴ same as GP (all have equal rights) |
| Liability | All Ps have personal liability | GP: Personal liabilityLP: No personal liability  | Full shield protection: No personal liability except for own misconduct or someone else’s that they failed to stop  |

→ no advantages left to forming a GP (vs. LP or LLP) ∴ mostly they’re formed now out of inadvertence or ignorance…

# Introduction to the corporate form

**Claimed by creditors**

LIABILITIES

 Dissolution

**Claimed by shareholders**

EQUITY

ASSETS

## Characteristics of business corporations

1. **Operated for profit**

Not an explicit/mandatory rule in the statute – it’s an implicit goal

1. **Separate Legal Entity:** has these important consequences:
	1. Limited liability
	2. Perpetual existence
	3. Can make Ks (including w/ SHs)
	4. Corporate assets owned by the corp (not SHs or creditors)
	5. Capacity to sue and be sued
	6. Separate tax entity
	7. …does the corp have constitutional rights, like a natural person? [***Citizens United v Federal Elections Commission 2010*** – allows corps to spend unltd amounts of money on political candidates – consider what this means in light of the purpose of corporations in society]

### Salomon v Salomon

|  |  |
| --- | --- |
| **F** | * Salomon owned a leather business, originally as SP.
* His son pestered him to create a corporation and he did.
* He incorporated the biz w/ 7 SHs: himself, wife, 5 kids.
* Sold the biz to the corp in return for 2,000 shares, $6,000 cash and 10,000 debentures (secured // backed by the company’s assets)
* Company failed and the debentures would be paid first out of assets, leaving no assets left for unsecured creditors
 |
| **I** | Bunch of unsecured creditors argued that the debentures were fraudulent and the company was created so that S could avoid personal liability…was the company validly formed? |
| **D** | Yes.  |
| **RA** | **The corporation is a separate legal entity. Valid formation can result even where SHs have no genuine interests in the company.** |
| **RE** | * 6 other SHs had negligible interests and all family members
* BUT S intended to salvage company ∴ not intentionally defrauding creditors
* The unsecured creditors have only themselves to blame – they knew they were dealing w/ a corp as unsecured creditors + could’ve protected their interests more effectively but that’s not S’s responsibility
 |

1. **Limited Liability for Shareholders:**

\*\*MOST IMPORTANT CONSEQUENCE\*\*

Benefits:

* Reduces the need to monitor managers (agents) b/c they have less at stake
* Reduces need for SHs to monitor each other (if SHs had personal liability, their personal asssets would be like personal guarantees – the more assets held by the group, the less likely that any single SH would be bankrupted, giving SHs incentive to ensure no one reduces their worth)
* Makes shares fungible (and facilitates takeovers)
* Facilitates diversification (if you don’t have to worry about backing each company you invest in, you can invest in more companies)
* Creditors become mindful of risk and monitor mgmt. (b/c they can’t reach into SHs’ pockets for debts if the corp fails)
* Corporation’s creditors have no claim on SH’s assets and SH’s personal creditors have no claim on Corp’s assets

***CBCA s. 45(1):*** The shareholders of a corporation are not, **as shareholders,** liable for any liability, act, or default of the corporation.

→ if a shareholder gets o/w involved in their individual capacity, they will be liable for things they do in that role

1. **Transferability of Share Interests:**

Benefits:

* SHs can exit w/o disrupting the business
* Permits takeovers (disciplines mgmt.)
* Facilitates active stock markets and increases liquidity
1. **Perpetual Existence:** Allows for long-term planning and growth by corporate mgmt.
2. **Centralized Management:**
* SHs do not manage the corporation – a board controls the mgmt.

At CL: SHs not allowed to fetter the mgmt. of directors

***CBCA s. 102(1):*** Subject to any unanimous SH agment, the directors shall manage or supervise the mgmt. of the business and affairs of the corporation.

***s. 146(1):*** Mgmt power of directors may be restricted wholly or partially) by unanimous written SH agment

## the corporate veil (separate legal personality)

* Limited liability results from distinct legal personality **but** it is a separate concept
* Ability to acquire, hold, and dispose of property
* Ability to enter into Ks, sue and be sued
* Ability to incur rights and obligations of its own (distinct from those of its constituents
	+ Corporations’ employees + creditors will be protected b/c the shield means SH’s personal creditors can’t dip into the assets of the corporation itself (i.e. business assets cannot be diverted to paying off SH’s creditors) → **truly essential function of organizational law**
* Creates a moral hazard: an economic actor shielded from risk may behave differently – opportunity to reap rewards of risky behavior w/o bearing costs
* Creates incentives for SHs to exploit creditors

### Piercing the corporate veil

The norm = no SH liability ∴ Piercing is the exception

2 distinct legal phenomena which may be seen as “disregarding the separate legal personality of a corporation” and one that’s 100% incorrect:

1. Typical: holding SHs responsible for the obligations of a corporation, despite statutory immunity
2. Variant: SHs seek benefits/rights that would be denied if the corporate entity respected (***Lee***)
3. Incorrect: Directors/officers responsible for their own tortious act in the course of business of the corporation (***ADGA***) – has nothing to do with piercing b/c holding a tortfeasor responsible does not require any piercing

**What piercing does not do:**

1. Dissolve the corporation
2. Make SHs liable for *all* the corporation’s debts (liability is **claim-specific**)

**Why do courts pierce?**

|  |  |
| --- | --- |
| * Fraud/improper purpose or conduct
* Sham/alter ego of SH
* Merely an agent of SH
* Inadequate capitalization
* Tort claims (involuntary creditors
 | * Single economic entity/enterprise liability (subsidiary + parent company acting as a single entity)
* Equity or the interests of justice (lots of discretion – wild card)
 |

For the purpose of imposing liability directly on SHs or if necessary for the correct construction or application of a legal standard…so, what are the legal justifications? Not super clear, can be:

In practice: Cts have never pierced the veil of a public corporation

* Relatedly, the more shareholders the corp has, the less likely ct is to pierce
* More likely to pierce where claimant is gov’t
	+ Less likely where it’s a corp, SH, or related corporation
* More likely to pierce if it’s a K claim (vs. statute/regulation/tort)
* Most frequently stated basis: SH domination/complete control (though this is very vague; no legal content)

### Clarkson Co. v Zhelka (ONHC)

|  |  |
| --- | --- |
| **F** | * Selkirk promoted, incorporated, and controlled several companies.
* One of them, **Industrial**, bought land and paid for it with money advanced by 2 other companies; the parcel of land is its **only asset**
* Industrial conveyed part of the land to **Zhelka – S’s sister** in return for $120K promissory note; Z then mortgages the land to G and eventually some money ends up back in one of the accounts of another of S’s companies
* S goes bankrupt and Clarkson is bankruptcy trustee;
 |
| **I** | Whether the land (reg’d in Z’s name) was being held by Z or by Industrial in trust for S; Industrial a mere agent and alter ego of S and directed by him to the prejudice and confusion of his personal creditors? (making the land S’s personal property ∴ available to S’s personal creditors) |
| **D** | No.  |
| **RA** | Whether an individual has constructed the company his agent is a question of fact. A controlling/total share interest does not in itself result in agency. The corporation is always separate from its corporators. If a corporation is formed for the express purpose of doing a wrongful thing or if, once formed, those in control direct a wrongful thing, then the individuals as well as the corporation are responsible for liability.  |
| **A** | What is the relationship between Industrial and S?* Validly formed
* S was solvent @ time of incorporation – no evidence that he incorp’d to evade creditors
* There were questionable transactions w/in and among his companies but those did not harm his personal creditors
* No personal money transferred by S to industrial ∴ no evidence it was a sham
 |
| **ETC** | Why would C need to pierce the veil? Could he not just force S to sell Industrial? → b/c the land may be more valuable than the shares of Industrial (share prices are based on SH equity; if liabilities > assets, equity will be negative and share prices low but land has a guaranteed value on its own) |

### Lee v Lee’s air farming

|  |  |
| --- | --- |
| **F** | * Lee formed the respondent company to carry on business of aerial top dressing;
* he held all issued shares except one; he appointed himself the governing director of the company for life and appointed himself to be a pilot at a salary that he arranged;
* he stated that this relationship was one of master and servant;
* Lee killed while piloting and his widow claimed compensation under NZ worker’s comp act
 |
| **I** | Was the deceased a worker or did his special position in the company preclude him from also being one of its servant?  |
| **RA** | One person may function in dual capacities. There is no reason to deny the possibility of a contractual relationship being created b/c the company is a separate legal entity. ∴ Lee could be both the company’s director and its employee.  |
| **RE** | The mere fact that someone is the director of a company is not an impediment to their making a separate contract with the company. It does not make a difference that he was the sole governing director – it’s still a separate legal entity. If he decided to appoint someone else as the director, that would’ve had no bearing on his status as an employee.  |

### De Salaberry Realties ltd v. minister of national revenue

|  |  |
| --- | --- |
| **F** | 2 families built a pyramid of corporations to avoid paying taxes |
| **I** | Was the appellant company an agent or instrument of his parent company? → Yes.  |
| **RA** | If a group of companies is merely an instrument for a parent and grandparent corporation, the corporate veil can be pierced and the companies treated as a single economic entity. In order to determine if this is true, consider the following aspects (from ***Smith, Stone, and Knight Ltd.***): 1. Profits treated as those of the parent company? (Yes)
2. Persons conducitng biz appointed by parent? (Yes)
3. Parent company the head and brain of the trading venture? (Yes)
4. Did the parent company govern the transaction? (Yes)
5. Did the company make profits by the skill and direction of the parent? (Yes)
6. Was the company under effectual and constant control of parent? (Yes)
 |
| **ETC** | Just meeting these criteria won’t usually be enough to tip the scales – most parent-subsidiary relationships will meet them ∴ need something more (policy concerns) – here, it was the suspicion that the purpose of the pyramid was tax avoidance |

### ADGA systems international ltd v Valcom (1999) ONCA

|  |  |
| --- | --- |
| **F** | * ADGA and Valcom were competing for a gov’t K
* ADGA alleged that Valcom, through its director and 2 sr. mgrs., poached their employees
* Valcom got the K
* ADGA sued for the tort of inducing ADGA’s employees to breach their FDs to ADGA
 |
| **I** | Assuming that the actions were genuinely directed to the best interests of their corporate employer, can the individuals be held liable?  |
| **D** | Yes.  |
| **RA** | Absent allegation which fit into est’d categories, officers or employees of companies are not protected from personal liability if their actions were tortious.  |
| **RE** | **General rule:** directors still personally liable for their own tortious conduct – corporate veil does not shield them ∴ no need to pierce * ***Said v Butt*** exception: If a director, acting in good faith, decides that their own corporation should breach a K b/c it’s in the corp’s best interests, then the director is not personally liable for ‘inducing’ the corporation to breach the K.
	+ Policy reason #1: sometimes inefficient to carry out a K ∴ have to let directors decide how to run corps w/o incurring personal liability
	+ Policy reason #2: other party is a kual partner – they are not involuntary creditors faced w/ limited liability
* This exception does not apply here
 |

# The process of incorporation

## Why incorporate?

|  |  |
| --- | --- |
| 1. Ltd liability
2. Perpetuity
3. Share transferability
 | 1. SHs can’t bind the corporation
2. SHs can contract w/ the corporation
3. Tax benefits
 |

## Place of Incorporation

* Federal vs provl
* Place of incorporation ≠ place of HQ or place of doing business
* So, why does location matter?
	+ Internal Affairs Doctrine: internal affairs of the company are governed by the law where the corporation was incorporated (not the place the corp is doing biz)
	+ Jurisdiction Shopping: no shopping for favourable corporate law in Canada (b/c the trend is more towards harmonization of corporate law, not competition);
		- but be aware of the “Delaware phenomenon” whereby states compete in their corporate laws to attract incorporation – Delaware is v mgmt.-friendly
		- internationally, tax law will also be important (but within Canada, taxation occurs through jurisdiction of doing business, not jurisdiction of incorp)
		- Some laws impose Canadian Nationality and/or residency requirements for directors (***CBCA s. 105(3); not* BC)**

**Extra-provincial licensing + filing Requirements:**

* Req’ment that a corporation be licensed as an extra-prov’l corp
* Triggered only if it’s “carrying on business” in a different jurisdiction
* ***CBCA s. 15(2):*** “a corporation may carry on business throughout Canada”
* ***BCBCA s.*** **375(1):** “A foreign entity must register as an extra-prov’l company…w/in 2 months after beginning to carry on business in BC.”
	+ A corporation incorporated under CBCA = a foreign entity under BCBCA

**Continuance under the Law of another Jurisdiction:**

* Can continue a corp’s existence under the law of another jurisdiction and it will not affect its prior obligations, property rights, involvement in all prior civil, criminal, or admin proceedings
* Who is affected by the move?
	+ SHs, directors, officers (b/c now they’re going to be governed by a new jurisdiction’s corporate law)
* 2 steps:
1. Emigrating corporation obtains permission from the jurisdiction it’s leaving (“export”)
2. It meets the req’ments of the fed/prov’l act under which it seeks to continue (“Import”)

***CBCA s. 188: Export Continuance:*** 3 levels of approval:

1. SH approval by special resolution (2/3 vote)
2. CBCA director approval (upon satisfaction that the move will have no adverse effects on directors, SHs, etc – i.e. that the assets and liabilities are going to remain intact)
3. Approval by the authority regulating that type of industry (e.g. the Minister of finance approves the export of a bank)

***CBCA s. 187: Import Continuance:*** Only one condition: Jurisdiction of original incorp must approve.

## Who can be an incorporator?

Anyone, as long as they are over 18 and have the capacity to do so. Cannot be a partnership. Can be a corporation. And they do not need to become directors/shareholders/officers.

## Corporate Names

* Legislation regulating corporate names is meant to protect the public from being misled by confusingly similar corporate names
* Likelihood of deception and intent to deceive: if there was no intent, public policy tends to favour validating Ks under the questionable name
* To prevent deception, ***BCBCA s. 27*** req’s that the corp’s full legal name be displayed on all official publications – failing to do so will expose the agent to liability (esp if they did not identify the company as having limited liability)
* Specific characteristics (knowledge and skill) of intended audience will also be taken into acct
* Lawyers have the responsibility to explain to low-info/sophistication clients the importance of using the full corporate name and the dangers of not doing so; lawyers themselves can be liable for breaching duty of care if they do not

## Incorporation models

### CBCA: Statutory Division of Powers Model

1. **File articles of incorporation (s. 6)** → sets out the corporate name, province of reg’d office, class + max # of shares to be issued; restrictions on share transferability; min – max # of directors (min 1 for private, 3 for public); restrictions on biz; other provisions (must be v careful about what is included here b/c difficult to amend – must be done by unanimous written consent of SH or special resolution)
2. **File a notice of the reg’d office of the incorporation (s. 19)**
3. **File a notice of the directors (s. 106)**
4. **Pay prescribed registration fees**

**→** if documents are in order, then once they are filed, the incorporating officer is req’d to issue a certificate of incorporation (***s. 9***); the date that the articles of incorporation are filed = the date it comes into existence.

### BCBCA: Contractarian Model

***s. 10:*** memorandum of association is now replaced with “notice of articles” – it’s a const’l document of the corporation, including the name, capital structure, and statement of proposed business – not publicly filed.

*BASIC DIFF:* no contract between the company and SHs under CBCA (rights and obligations exist well enough defined in the statute ∴ relatively little room for modification via K; BCBCA offers more flexibility/discretion to arrange the relationship between the SHs and the corp)

## Pre-Incorporation Contracts

Corporation does not exist until a certificate of incorporation has been filed → is it possible for a company to enter into an enforceable K **before** the company incorporated?

3 Distinguishable Situations:

1. Both parties know that the corp does not exist (***Kelner***)
2. Promoter knows but contracting party does not
3. Neither party knows – promoter mistakenly believes the corp exists + the contracting party relies on the promoter’s reps (***Shatsky; Black v Smallwood***)

### Kelner v Baxter

|  |  |
| --- | --- |
| **F** | Group of company promoters for a new hotel business entered into a K, purportedly on behalf of the corp to purchase wine. Neither party thought the company existed. Wine consumed before it was fully paid for and the company went into liquidation. Promoters were sued but they stated that any personal liability was passed to the company.  |
| **I** | Were the promoters personally liable on the K? → Yes. |
| **RA** | A K made before incorporation will not be binding on the company. However, someone professing to sign as an “agent” for the nonexistent corp will become personally bound **if** the writing of the K discloses an intention for the K to be enforceable. This is true even if the “principal” company comes into existence later.  |
| **RE** | The promoters were contracting as principals – they were not substituted as such. B/c both parties knew the company didn’t exist (∴ promoters could not have been agents) the K must have been with the promoters themselves.  |

### Black v Smallwood

|  |  |
| --- | --- |
| **F** | A= vendors of the land // R = purported directors of a company Company was not yet incorp’d but both A+R believed it was. A wanted specific performance of K + argued Rs were personally liable as purported agents for a nonexistent company.  |
| **I** | Are the promoters liable? → No. |
| **RA** | The rule is not that agents for nonexistent corps are automatically personally liable on the K. There needs to be an intention of the agents to bind themselves personally. Can’t have intention w/o knowledge. The company was the intended party to the K.  |
| **RE** | The doc signed by Rs does not purport to be a K made by them as agents for the supposed company. They thought the company existed and they were the directors ∴ were not using company as a mere pseudonym, intending to incur personal liability.  |

### Wickberg v Shatsky & Shatsky

|  |  |
| --- | --- |
| **F** | Shatskys purchased an interest and became directors in a corporation called Rapid Addressing Systems then decided to carry on business under the name Rapid Data (Western) Ltd. but they never actually incorporated under this name. They hired Π to be mgr of new corp and executed an employment K on Rapid Data’s letterhead, signed by L. Shatsky as president of Rapid Data Δs told Π to take “Ltd” out of the biz name Shit goes south, they have to fire Π but offer to keep him on on a commission basis  |
| **I** | Whether L Shatsky is liable as a party to the K b/c he signed as purported agent of a non-existent corp→ noAre both Shatskys liable for breaching WOA b/c they warranted the existence of the company (+L’s ability to sign therefor)? → YesWas the company actually a partnership, making each liable for the loss? → Yes. |
| **RA** | The intended party to the K was the company, not the director. But the company did not exist ∴ contract is invalid. Δs are liable for breaching WOA but Π only entitled to nominal damages b/c there is no causal connection between the breached WOA and the damage he suffered. He suffered b/c the business didn’t do well, not because of WOA. |
| **RE** | The parties did not have the same view of the facts at the time the K was entered into. However, neither party showed intent that the individual director be the one bound.  |

**REDUX:**

1. When is the promoter liable?
	1. When both promoter and the contracting party knew the company did not exist **AND** NTL intended it to be enforceable against the promoter → yes.
	2. At least one party believed the corp was validly formed → No.
2. When is the corporation liable?
	1. Under neither situation. According to ***Kelner***, nor could a corporation affirm a K after incorporation.

### Legislative Reform

Law insufficiently protecting the interests of parties to pre-incorporation Ks

***CBCA s. 14(1)***: Does not matter who knew if the corp was not validly formed; if the promoter purports to enter into a K for a nonexistent company, the promoter is personally bound. *Only applies to written contracts.*

***s. 14(2):*** a corporation is allowed to adopt a pre-incorporation K; once it’s adopted, the promoter no longer has any rights or obligations under it. Intention to be bound by the K after incorporation can be express or implied.

***(b)***: retroactive adoption of liability (if promoter breached before adoption, the corporation assumes the liability for that breach after adoption)

***s. 14(3):*** Can ask the court to determine the extent of liability, as between the promoter and corporation, whether or not the corporation adopted the K.

***s. 14(4):*** If expressly provided in the K, the promoter and 3P can decide that the promoter is to have no personal liability.

**REDUX:** Default rule is that promoters are liable on pre-incorp Ks. This liability ends if/when corporation adopts the K. But promoters can take themselves out of the equation beforehand by agreement in K.

***BCBCA s. 20:*** Applies to both oral and written Ks; promoters are **not liable on K –** they are liable for breaching WoA.

# Introduction to Corporate Governance & Purpose

## Publicly traded vs Privately Held Companies

Public companies – differently defined in different parts of CBCA but see regs, pt 2(1): “distributing corporations”

|  |  |  |
| --- | --- | --- |
|  | **PRIVATE** | **PUBLIC** |
| Alt names | Closely held | Publicly held; distributing corporation |
| # of SHs | Small (<50) | Large |
| Share transferability | Usually restricted  | Unrestricted |
| Liability  | More likely to pierce b/c SHs have more control over private cos b/c they’re also off’s and directors | Less likely (never happened) |
| Centralized management by BoD | SHs take part in mgmt. | Separation of operation and control |
| Operated for profit or something else? | Less problematic to have other purpose b/c SHs have more control | More controversial b/c if mgrs. Look like they’re doing something not for profit, it appears to be them using SH money for a cause not shared by SHs |

## What is Corporate Governance?

“Corporate governance is the system by which companies are directed and controlled”

Specifies the distribution of rights + responsibilities among the different participants in the organization – the board, mgrs., SHs, and other stakeholders – and lays down the rules and procedures for decision-making.

→ Raises the normative question: For whose interests should the corporation be directed?

Problem at the heart of the corporation is ensuring the accountability of mgrs. To the particular goals to which the corporation is devoted. Corporate law can serve to limit the scope of such issues

**Corporate Governance Concerns:**

Public: reducing agency costs between SH interests and mgmt. interests

Private: majority SH exploitation of minority SHs

## Why does Corporate Governance Matter?

The cautionary tale of Enron: why couldn’t SHs protect themselves from the accounting fraud? They had no information or management power. Usually the securities regulations are supposed to ensure that mgmt. can’t lie or cheat but auditors and lawyers were all self-interested. Shows the huge importance of corporate governance.

**Problem of Berle & Means:**

* Considerable scope for unfettered discretion that mgrs. Of the largest corps enjoy b/c of the separation of ownership and control
* Growing dispersion of share ownership dulls the incentive for any single SH to assume responsibility of controlling the affairs of the corp (they become passive principals in the corps they own)
* Mgmt elite who lack a direct interest in the corporation are not motivated to advance the welfare of the corp and its owners

## Dominant theory of the Corporation: Contractarian

* Corporation = a nexus of contracts
* ∴ the purpose of corporate law is to enable the making of such Ks by providing a set of default rules
	+ Not meant to regulate corporate behaviour
* The willingness of a party to enter into a K reflects reliance on agency fidelity → reliance on the idea that managerial agency problems will be mitigated efficiently
* Incentives exist for corporations to choose sensible govnance structures
	+ Restrictive rules for managers = higher share values b/c an assessment of risk of mgr self-serving built into share valued
	+ But sometimes restrictive rules are not the best way to regulate managerial P-A problems; need to ensure that by trying to minimize P-A issues, you aren’t exacerbating other issues

### Mechanisms for Controlling Corporate Agency Problems

1. **Legal instruments:** statutory and CL rules imposing duties (typically restrain managerial opportunism by imposing heavy ex-post costs on mgrs. Engaging in such activities)
	1. **Disclosure rules:** in securities law, req’s mgrs. To publish detailed info about the company
	2. **Voting rights and FD in corporate law:** Voting on events which could subst’lly change the corp’s structure limits the ability of mgmt. and supra-majority rules can limit P-A issues among SHs (majority SHs can’t dominate)
2. **Market Instruments:** operate at 2 levels:
	1. **Impose costs by direct intervention** on self-serving management
	2. **Giving info to principals:** enhances supervision quality (and operates independently of collective action problems among free-riding SHs)
		1. **Capital Market**

If perfectly efficient, will ensure that the price of securities fully reflects the magnitude of expected costs generated by agency conflict – signals corporate performance

* If shares outperform competition = mgrs. Competent (opposite true for underperforming shares)
* Only a subset of investors need to be able to accurately predict agency costs (and then the price they pay also needs to not diverge from the price paid by less informed investors)
	+ 1. **Product market**

Poor product performance sends signal to investors about mgrl performance, esp if product faltering while competition thriving. SHs can use this to threaten to alter board composition (and if the company fails entirely, mgrs. Will be replaced)

* + 1. **Labour market**

The threat of having to compete among other mgrs. encourages a manager to not self-serve b/c the gains of doing so are offset by a reduction in their own human capital.

* + 1. **Market for Corporate Control**

Operates by transferring control of mismanaged corps (i.e. those suffering from high agency costs) to owners more willing/able to discipline bad mgmt. // done through hostile takeover which operates w/o mgmt. consent and usually elects new mgmt.

### The role of Corporate Law

Why do we need Corporate law as a separate body of law, distinct from K law if mgrs. and investors are able to agree on terms that maximize value and minimize costs?

1. Market mechanisms only operate b/c of the law
2. Corporate law provides important value in giving a set of default rules and the ability to make different ones if needed
3. Corporate rules are complex and it would be crazy and inefficient to expect corporate parties to reproduce it in each K

### Critique of the Contractarian Model

**Empirical**

Markets aren’t able to effectively control agency costs

* Product and managerial: structurally imperfect
* Capital: inefficient in furnishing certain types of info
* Corporate control: only kicks in after super high agency costs already incurred
* Legal rules incorrectly applied/articulated

**Normative:**

Fails to acct for values which are unrelated to contract – e.g. trust and loyalty – which are NTL important in corporate contexts.

### Purpose of the corporation according to contractarians

* Neutral about what the goal *should* be – merely that once the choice is made, one party should not have the power to unilaterally modify the purpose.
* If a goal explicitly adopted @ outset, no investor allowed to complain about it
* Given the goal of investors in for-profit corps is to realize a return on their investment, it is reasonable to assume that the goal of a corporation is to make profits
* Therefore, the classic view is that the goal *is* to maximize SH profits

## Corporate Social Responsibility

No clear agreed upon definition but, all definitions include at least two aspects:

1. Corporate governance goes beyond compliance with the law
2. Corporate purpose goes beyond SH wealth maximization

|  |  |
| --- | --- |
| Arguments Against CSR  | Arguments for CSR  |
| Increasing SH wealth = increasing all stakeholders’ wealth | * Assumes reinvestment of SH profits into stakeholders’ hands
* SHs getting more $ does not mean the pie is any bigger – SHs could be getting a bigger piece of the same sized pie (and ∴ decreasing stakeholder wealth)
 |
| No one can serve two masters. To force managers to prioritize more than one thing would force them to “play stakeholders off one another” and would result in mgrs. not achieving either goal well.  | * Conflicts with the first argument (which assumes alignment between SH and stakeholder interests)
* People routinely have multiple obligations in business settings
* Demanding more information from the managers ensures that stakeholders can have a better idea of performance instead of just trusting the mgr who plays them off one another
 |
| Managers ill-suited to make “public policy decisions”  | * Can ask for help or seek more information
* Also not empirically true – mgrs. probably have a better idea of what’s going on and who needs what w/in the corporate context than anyone else
 |
| Stakeholders can seek protection through contracting with companies or by looking to other areas of law for compensation.  | * Not easy to negotiate a fair K with a corp
* It’s not easy to change laws/regs
* Not every interest group has access to political power
* More efficient to have fair distribution w/in the company than to rely on redistribution after the fact through social welfare laws
 |
| Managers have no right to spend SH’s money for the benefit of other stakeholders  | * Right to residual profits is illusory – SHs cannot demand the dividends – it is up to directors’ discretion ∴ no such thing as “SH money”
* Residual profits are just revenue - expenses and it’s up to directors to decide which expenses to incur
 |

### Dodge v Ford Motor Company (1919) Michigan Supreme Ct

|  |  |
| --- | --- |
| **F** | Company declared special dividends on increased capital but Ford (who controlled the BoD as controlling SH) declared no more because he wanted to reinvest $ in the company and increase wages. 2 minority SHs brought suit to declare a special dividend.  |
| **I** | Can Π SHs force Δ to declare special dividends instead of reinvesting? Yes. |
| **RA** | Ford breached his FD to the minority SHs – classic case of oppression by majority SH. Frequently cited for the SH-profit maximization quote (which was actually given in obiter…): “a business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the non-distribution of profits among SHs in order to devote them to other purposes.”  |

### Parke v Daily News Ltd (1962) UK

|  |  |
| --- | --- |
| **F** | Δ (DN) sold their newspaper to AN. DN decided that they would (after meeting all the necessary expenses arising from the cessation of the paper) use the balance of the sale price to pay the staff and pensioners of the newspapers. DN told its SHs after the fact and told them to disburse the remaining funds accordingly.  |
| **RA** | 1. A company’s funds can’t be used to make ex gratia payments as such
2. A ct will inquire into the motives behind making a gratuitous payment and the objectives it is intended to achieve
3. The ct will uphold the validity of such payments only if the following is met
	1. Transaction reasonably incidental to the carrying on of the company’s business
	2. It’s a bona fide transaction
	3. It’s done for the benefit and to promote the prosperity of the company
	4. The onus of upholding the validity of such payments is w/ the person asserting it.

→ if the expenditure does not meet the test, it can’t be ratified by majority SH.  |
| **A** | Compensation and a gratuity generally (w/o reference to services rendered during winding up) ≠ charges/expenditures reasonably incident to the carrying on of – not the business of the old company – but the business of the company once sold  |
| **ETC** | No longer good law; now we have the “enlightened stockholder value” – recognition that directors *should* consider the best interests of other stakeholders in the interest of long-term SH interest, including current OR former employees |

### RE: Peoples Department Stores (2004) SCC

|  |  |
| --- | --- |
| **F** | Wise stores (managed by the Wise bros [“WB”]) bought PDS and things didn’t go well. Eventually both went bankrupt. PDS’ trustee argued that WB favoured wise stores over PDS’ to the detriment of PDS’ creditors and contra s. 122(1).  |
| **I** | Whether the directors of a corporation owe a fiduciary duty to the corporation  |
| **D** | A duty of care is owed, but not FD.  |
| **RA** | Directors are bound by statute to act in the best interests of the corp ≠ best interests of SHs. In determining what the best interests of the corporation are, it may be legit to consider the interests of SHs, employees, suppliers, creditors, consumers, gov’ts, and the environment. However, their basic FD is owed to the corporation and never changes.  |
| **RE** | * Interests of various stakeholders will be aligned when things are going well but not when the corporation is in the vicinity of insolvency. Even in such circs, the director’s FD does not change when the interests are no longer aligned.
* Any good faith and honest attempt to rescue the corporation will be beneficial for all, but failing at this task ≠ breach of FD
* Directors must be careful not to favour any one group of stakeholders over another.
 |

Restatement of this in ***BCE (2008, SCC)***: commitment to all stakeholders – where there is conflict among such interests, directors must resolve the issue in accordance with their FD to act in the best interests of the corporation, viewed as a “good corporate citizen.”

## Benefit Corporation and Community Contribution Corporation

**Delaware General Corporations Act §362(a):** “Public benefit corporation” = for-profit corporation intended to produce public benefits and operate in a responsible and sustainable manner. Should be managed in a way which balances SH’s pecuniary interests, best interests of those materially affected by the corp’s conduct, and the public benefits identified in its certificate.

***Community Contribution Company, BCBCA (C3):***

***s. 51.91:*** community purpose must be set out in certificate; must set out C3 status in name

***s. 51.94:*** can accept equity investments, issue shares, and distribute dividends BUT limit dividends to 40% of annual profits (unless SH being issued divs is a charity)

***s. 51.93:*** Upon dissolution, at least 60% of assets need to go to a “community purpose” (a charity or other C3)

***s. 51.96:*** Community contribution report: dividends, assets, identity of SHs who receive divs, anyone earning >$70K per year

Taxed like a regular corporation.

# Powers of Officers and Directors

## Qualifications of directors

***CBCA s. 105 (1)*** Individual, of sound mind, >18 yo, not bankrupt

***(2)***Unless articles provide o/w, directors not req’d to be SHs

***(3)*** Canadian residency requirements: 25%

## Election and removal of Directors

***CBCA s. 106(3)*** Election occurs through ordinary resolution = the majority of the total # of votes cast (∴ absentees and abstentions don’t count towards the denominator – unless o/w set out in the articles)

* Directors must be elected at least every 3 years
* AGM must occur at least every 15 months and must occur no later than 6 mos after year’s end

***s. 106(4)*** Elections may be staggered (e.g. there are 3 classes of directors; every year, only one class is up for reelection – this is structured in order to avoid hostile takeovers b/c stretching out the time req’d to replace the board adds costs to a potential outside buyer) – though in practice, no staggered boards in Canada

***s. 6(3)*** If the articles or USA alter the default rule of majority election rule in s. 106(3), the articles/USA prevail.

***s. 106(9)*** Director must consent to act as a director

BUT being at the meeting and not refusing the appointment = consent // acting as a director after the election = consent

***s. 111(1) Filling Vacancies***: If

1. There is a quorum of directors remaining *and*

2. The vacancy does not result from an increase in the # of directors req’d in the articles or failure of SH to elect the req’d # of directors:

→ the board may fill the vacancy

\*\*NB: If the departing and incoming directors cooperate, they can sequence themselves so as to avoid SH approval – the director-appointed replacements will stay on until the next AGM (at least)

***s. 108(1) Director ceases to be a director when they:***

(a) die or resign

(b) removed, per s. 109; or

(c) become disqualified under s. 105(1)

(2) Resignation effective at the time the written resignation is sent to the corp OR at the time specified in the resignation, whichever is later.

(i.e. the corporation does not have to acknowledge receipt)

***s. 109(1):*** Only SHs have the ability to remove directors, subject to s. 107(g), SHs can remove any director(s) at any time by ordinary resolution

***s. 6(4):*** The articles CAN’T set a threshold # of votes above 50% for removing a director

Ways around the prohibition of board removing directors:

1. In a corp’s code of conduct, it’s normal to state that a director may be removed if they breach the code
2. Can set out beforehand by consensus that a director may be removed by board, according to a fair process
3. Articles may set out mandatory resignation reqs for certain circs

### Bushell v Faith (1970) AC HL

|  |  |
| --- | --- |
| **F** | Company owned by 3 sibs: Bushell, Faith, and Bayne. 300 shares split equally among them. Bayne and Bushell vote Faith out as a director but the corp’s articles state that where there’s a resolution to remove a director, the director’s shares carry the right to three votes per share on a poll of that resolution. (∴ vote = 2:1 but poll = 300:200) |
| **I** | Whether the special voting article was valid or overridden by s. 184(1) of the companies act, which states that a company may by ordinary resolution remove a director, notwithstanding anything in the articles. → Articles prevail.  |
| **RA** | While the leg’n states that a director may be removed by ordinary resolution (i.e. simple majority vote of members eligible to vote, where each member is entitled to a single vote, regardless of shareholding), the voting powers attached to any class of shares depends on the way the articles define the classes. If parliament had intended to take away the ability to give special rights when voting to remove a director to ensure that each share would be equal to one vote, they would have explicitly set that out in the statute.  |

## Structure of the board

***s. 102(2):* # of directors required**: at least one (3 for public, at least 2 of whom must not be officers or employees of the corp or its affiliates [i.e. an o/s director]

* Public stock exchanges: most require at least 1 **independent director** [stricter than o/s director concept]: not a member of mgmt. and free from any 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 and is a beneficial holder, directly, or indirectly, collectively of 10% or fewer of the votes of all issued or outstanding securities of the company
* **Why are these important**? → in the past, there was a high degree of overlap between mgrs. and directors = “managing board”
	+ Now, the rule has shifted from mgmt. to monitoring – can’t expect insiders to, in essence, monitor themselves ∴ need to rely on outsiders
	+ Reflected in ***s. 102(1)***: “subject to any USA, the directors shall manage or supervise the management of the business and affairs of the corp.”
* **Why do you need monitoring?** P-A problems; through monitoring, we assume that mgrs. will work harder for the company’s interest and the company will do better…mixed empirical results on whether this is true:
	+ **Trade-off** between insider knowledge and o/s independence
	+ **Outsiders are part-timers** – they’re not intensively focused on the operation of the company and rely on info provided by mgrs.
	+ **Too much emphasis on structure of the board** and not enough on the DM processes

### Audit CommiTtees

* Req’d for public companies
* ***S. 171(1):*** must be composed of not less than 3 directors, the majority of whom are not officers/employees of the corp or any of its affiliates

***(3):*** Main function is to review financial statements before they are approved by the board

***(6):*** a director/officer must notify the audit committee and the auditor of any error or misstatement of which the officer/director becomes aware in a financial statement that the auditor or a former auditor has reported on.

***(7):*** If an auditor becomes aware of an error, and it is material, they must inform each director accordingly

***(8):*** when, under (7), the auditor informs the directors of error/misstatement, the directors shall:

 ***(a)*** prepare and issue a revised financial statement or

 ***(b)*** otherwise inform the SHs and, if the corp is req’d to comply w/ s. 160, it shall inform the director of the error or misstatement in the same manner as it informs the SHs

***(9):*** Every director/officer who knowingly fails to comply w/ (6) or (8) is guilty of an offence and liable on summary conviction to a fine ≤$5K or imprisonment of ≤6 mos, or both

## Powers of directors

### General Management Powers [s. 102(1)]

Default rule (subject to a USA): directors have the power to make any daily mgmt. decisions and SHs have no right to interfere with that power.

### Unanimous Shareholder agreements [s. 146]

**Requires three elements:**

1. Must be in writing and o/w lawful;
2. Must be among all the SHs (and possibly others); and
3. Must restrict, in whole or in part, the powers of directors to manage or supervise the business and affairs of the corp

**Features of the USA:**

* It’s const’l in nature - ∴ can enforce compliance through a breach of K claim or through statutory compliance order
* Binds parties other than the original signatories (***ss. 146(3) – (4)***) but ***ss(4)*** gives a share transferee the ability to rescind the transaction by which she acquired the shares
* The powers taken from the directors, and the corresponding liabilities transfer to SHs (***s. 146(5)***)

***NB:*** USAs don’t exist under ***BCBCA,*** but, under ***s. 137***, SHs can restrict directors’ mgmt. powers

**Issues Raised:**

* Can USA provide for subsequent amendments to be effected with less than unanimous agreement?
* If this is the ultimate end goal (i.e. to wrest management away from directors), what’s the point of requiring them at all?
* CBCA does not provide for how USA may be amended
* But the court has the authority, under the oppression remedy, to make an order creating or amending a USA (***s. 24(3)(c)***)

### Important Statutory Powers

***s. 103:* Adopt/amend/repeal bylaws:**

* Bylaws are not defined in CBCA but their function and process of enacting them is stipulated
* **Purpose:** to regulate the internal affairs of the corp
* Differences between bylaws and articles:
	+ Amendments to rules in articles requires special resolution by SH vs unilateral ability of the directors to change the bylaws
	+ Immediately effective and remain so unless rejected by SH meeting
	+ Articles are publicly filed but bylaws are not (unless it’s a public corp)

***s. 115(3)(d); s. 171(1):* Declare dividends:** Ability to determine whether and how much to distribute to SHs in dividends

***s. 25:* Issue Securities:** Whether and how many shares to issue

***s. 121:* Appoint or remove officers & *s. 125*: decide their remuneration**

### Delegation and Restriction

Board may delegate mgmt. power to a committee or a managing director, but cannot delegate certain powers (Highlighted powers above ≠ delegable)

## Mechanics of board meetings

How does the board exercise its management powers? → collectively, at board meetings

1. **Notice:** time and place must be included, and must be given to each director. Purpose of meeting not necessary. Notice can be waived or deemed to have been waived (***s. 114(6)***). No restrictions on where meetings can be held.
2. **Means of Participation *(s. 114(9):*** Multiple ways to participate. **With all directors’ consent**, can happen by any means of electronic communication **as long as it allows for effective communication among directors**.
3. **Quorum *(s. 114(2))*:** Can be set out in articles or bylaws, but default under CBCA it’s a majority, if the corp has a fixed number of directors. Cannot carry on business unless 25% of directors present at the meeting are resident Canadians. Residency can be met if the business decided at the meeting is agreed to by those req’d CDNs after the meeting.
4. **Resolutions:** President usually chairs; the articles and bylaws may determine how many directors must consent to effect which kind of decisions.
5. **Dissent (*s. 123*):**
	* When a majority makes a decision, **all directors are personally liable** for any liability arising from the resolution
	* The only way to avoid this is through having dissent formally recorded (***s. 123(1)***)
		1. Requests that dissent be entered into the minutes or it has been entered into the minutes
		2. Director sends a written dissent to the secretary of the meeting before the meeting is adjourned; or
		3. The Director sends dissent by registered mail or delivers it to the reg’d office of the corp immediately after the meeting is adjourned.
	* ***S. 123(3)*** covers directors who were absent at the meeting; they are deemed to have consented unless, w/in 7 days of becoming aware of the resolution, they:
6. Causes dissent to be placed in minutes
7. Sends dissent by reg’d mail or delivers it to reg’d corp office.
8. **Alternative to Board Meetings: Unanimous Written Resolutions *(s. 117(1))*:** Written resolutions, signed by all directors entitled to vote on such a resolution, is as valid as if it had been passed at a meeting. Unanimity is req’d in order to protect right to dissent.

## Acting outside authority

**Ultra Vires Doctrine:**

Rule that held that a corp had no legal capacity to act in any way that was not specifically authorized by its incorporating docs → this is not the case anymore; ***ss. 15-16*** assume the corp has the powers of a natural person. ∴ they possess Powers to do anything - unless powers are specifically restricted in the articles/USA.

**Defective Appointments *(s. 116):***

* Defective appointment of a director does not affect the validity of that person’s actions as a director (Apparent authority)

### Defective Decision-Making Procedures/Indoor Management Rule:

An outsider dealing in good faith is entitled to assume that the company’s internal procedures have been complied with. (apparent authority ∴ not req’d to look into what the company actually required for such a decision) – ***Royal British Bank***

**IMR does not protect:**

* A party with **actual or imputed knowledge** of the lack of authority (though the corp must prove this was true)
* An insider (i.e. employee/officer) of the corp

#### Sherwood Design Services v 872935 Ontario Ltd. (1998) ONCA

|  |  |
| --- | --- |
| **F** | * K for the sale of assets of Π, signed by three individuals (K/M/P) “in trust for a corporation to be incorporated”
* KMP sign a promissory note, payable on demand in the event that the transaction doesn’t close; no reference to the company on that note
* KMP hired a law firm to help w/ the deal; law firm incorporated the Δcorp to purchase Π’s assets
	+ Lawyer sent a letter to Π’s lawyer saying that the Δ corp was assigned as the corp, by the law form, as the corp which will complete the asset purchase
* Letter included unsigned copies of Δ’s director’s resolution adopting the asset purchase agreement
* Transaction didn’t go through
* Δ corp assigned to different clients of the law firm, for a different real estate deal – that deal went through and the corp then had assets
 |
| **I** | Meaning and purpose of the indoor management rule (analogous to ***s. 18*** of ***CBCA***)Did the corporation effectively ratify the pre-incorporation K?  |
| **D** | Split judgment but 2 agree in the result that Δ is liable on the K.  |
| **RA** | A corporation may not assert against a person dealing with the corporation, or with any person who has acquired rights from the corporation, that a person held out as agent does not have the authority to exercise the powers that are usual for such an agent.  |
| **RE** | Abella: Decided that on the rules of pre-incorp Ks, Δ had ratified K. Carthy: agreed but also made comments about IMR: * the letter held out ostensible authority ∴ the recipients were entitled to adopt its terms at face value
* Lawyer spoke as having authority to act on behalf of corp b/c the letter referred to it as a creature of his law firm
* The lawyer also had ostensible authority to act for KMP
 |
| **DIS** | Not bound by the pre-incorp rules and IMR irrelevant:* Unsigned draft resolution enough to put Π on notice that the corp hadn’t adopted the pre-incorp K
* IMR premised on the Π having had direct dealings with an agent of a principal, such that they were under the impression that the agent was authorized to take whatever action // the agent here is the lawyer, but the principal corporation was never involved in the dealings – the individuals were the ones Π dealt with
* Adoption principles are premised on the fact that Π could not have had direct dealings with the corp b/c it didn’t exist
* Nothing to connect KMP to the corporation, for which the lawyer purported to act
 |

# Corporate Financing and Shareholders’ Financial Rights

CEO pay skyrocketed in 1990s, why? → Companies began compensating CEOs with stocks and stock options

* Why? → To align SH and mgmt. interests by tying CEO compensation to stock prices
	+ But this creates perverse incentives b/c they have all the inside info and stand to gain from manipulating financial information that’s released to the public

## Equity and Debt Financing

When considering which to use to finance the corp, consider:

1. How to allocate risk
2. How to allocate returns from the business
3. Where control of the business should be
4. Duration of each participant’s investment

|  |  |
| --- | --- |
| **Debt:** | **Equity:** |
| the obligation to repay money that the company has borrowed (debt financing = raising money by borrowing it) | SH interests (equity financing = raising money by issuing shares to purchasers) |

**Differences between Debt and Equity:**

1. Debt repaid before equity when corp wound up
2. Debt **must** be repaid (it’s a legal obligation) but $ rec’d in exchange for issuing shares = permanent capital
3. Interest payments on a loan = tax deduction (∴ $1 paid to creditor costs the corp <$1 after taxes) // no deductions for selling shares
4. Debtholders receiving interest payments = taxed as ordinary income // dividends are given a tax break to acc’t for the fact that profits have already been taxed as part of corp income
5. Issuing new equity dilutes control of the corp // not a concern for debt
6. Issuing new shares also dilutes earnings (assuming value of the corp is exactly the same as it would have been w/o issuing extra shares)
7. The way that debt and equity are presented in financial statements differs

### Issuing Shares

3 Distinct Steps:

1. Subscription: offer to purchase some # of shares at a specific price
2. Allotment and
3. Issuance: once corp accepts the offer and rec’s the share price, it will allot and issue shares

***s. 25(1)* Director’s authority** (Non-delegable): Subject to articles, bylaws, and any USA, directors have the authority to decide (a) to whom to issue shares and (b) on what financial terms.

***s. 25(3)* Consideration is determined by board:** CBCA no longer permits corps to offer shares on unpaid/partially paid basis. Consideration must be **fully paid** in **money or past services.** Property ≠ promissory note, promise to pay, or future services (***s. 25(5)***)

***s. 24(1)* Par value no longer used:** Useless measure; investors only care about market value.

***s. 26(2)* Stated Capital account:** hx total of the consideration paid into the company for the issuance of shares

* Company can spend the money it receives, which has no effect on the balance – in other words, SCA has **no bearing** on the true, market value of the company or how much is in its bank acct
* Used to prevent companies from distributing profits, property to SHs if there will be difficulty in meeting debts

## Corporate Earnings

Extra cash generated by the corporation, itself.

## Defintion and Classification of shares

**SHARE:** not an isolated piece of property but a **bundle of rights and liabilities** created by the Act (***Sparling v Quebec***). SHs do not have any **direct ownership interest** in the corp.

### Basic Rights attached to Shares

1. Right to vote at SH meeting, including voting to:
	1. Elect directors
	2. Approve fund’l changes to corp
	3. Submit SH proposals
	4. Make bylaws and change articles
2. Right to receive a dividend declared by the corp. (this is limited in law and in fact: legally, only right to dividends **as declared by the board** which has no obligations to so declare)
3. Right to receive remaining property of the corp on dissolution

### Other Rights commonly attached to Shares (Not automatically Provided by CBCA)

1. Preemptive rights (***s. 28(1)***): Allows existing SHs to acquire shares on a new offering, in the proportion that their current holdings bear to the total # of issued and outstanding shares. This protects the financial and voting rights of SHs from dissolution.
2. Redemption Rights: An option that forces the corp to buy back SH’s shares
3. Conversion Rights (***s. 29***): Option to convert share into another security of the corp

### Classification of Shares

Not all shares have the same rights – a corp can give diff rights to diff classes of shares.

**Share Conditions**: Must be in the articles (***s. 24(4)***). If there is only one class of shares, then CBCA (***S. 24(3)***) req’s that those shares have the following attributes:

1. Right to vote on election of directors
2. Right to receive divs if/when declared
3. Right to receive remaining property of corp after payment of debts

→ If >1 class of shares, these attributes must be found among them (not all classes need to have all three, but between them, the 3 attributes must be found)

### Class Rights

**Class** = a subgroup of shares w/ rights and conditions in common, which distinguish them from other shares.

* All shares presumed equal, subject to share conditions in articles
* Shares of a single class must be treated alike
* Rights attach to **shares** themselves, not SHs

∴ paying more for a share ≠ more residual rights at winding up (***Muljo v Sunwest***)

### Share Series

**Series** = subclass of shares; will have some common class rights but will also have distinct series rights attached

* Allows directors to respond quickly to financial market conditions b/c no they’re not req’d to file series descriptors/rights in articles; they can be crafted on the fly, w/o SH approval

### Preferred v Common Shares

**Preferred shares**: usually refers to the following 2 aspects:

1. **Preferential payment on dividends** – get div payments before common SHs
2. **Preferential payment of capital** – get capital returned before common SHs’
* Not statutorily defined
* Features look like a hybrid between regular shares and debt

|  |  |
| --- | --- |
| **Equity-Like Characteristics** | **Debt-Like Characteristics** |
| * Permanent capital – no fixed maturity date
* Dividends still subject to board discretion
* Cannot throw corp into bankruptcy over dividend arrearage
* May have voting rights
* Treated as equity for tax + accounting purposes
 | * Fixed dividend payments
* Liquidation preference over common SHs
* Rights are contract-based
 |

**General Features, Possibly Found in Preferred Shares:**

1. Cumulative vs Non: If cumulative, then directors obligated to pay cumulative divs **before** any other div payout in next declared dividend

e.g. $10 cumulative pref shares and other common shares in Company A

Year 1: no dividends declared ($10 owed)

Year 2: no dividends declared ($10 owed)

Year 3: divs declared: must pay $20 outstanding to the preferred shareholders before giving any dividends to common shareholders

1. Convertible vs Non: ability to convert shares into common shares, allowing SH to participate in residual profits instead of getting just a fixed amount (desirable if corp has strong earnings)
2. Participating vs Non: on winding up, non-participating shares will only receive a return of their capital investment and any accrued and unpaid dividends; if participating, they also get to double dip into a portion of the residual assets, like a common SH.

**Dual-Share Structure for Companies [Facebook Example]**

* Why would this be desirable?
	+ Allows corp to raise money through equity financing while maintaining corporate control
* Why would Mark Zuckerberg want to have convertible shares?
	+ B/c he can’t sell one class publicly ∴ gives him the ability to convert his pref shares to common ones in order to raise money (i.e. gives liquidity)

## Financial Rights

**How do SHs realize profits?**

1. Capital gains: selling shares for more $ than originally paid
2. Dividends

### Dividends

**How do dividend payments work?**

* Matter of internal management, within the discretion of directors (unless articles provide o/w)
* Once decision made to declare dividends, the decision will be evidenced like all board decisions, with a formal resolution, specifying 3 things:
1. AMOUNT of dividend/share
2. DATE on which dividend will be paid
3. RECORD DATE (date on which the names of eligible SHs will be determined)
* ***NB:*** In practice, must have purchased shares at least 3 days prior to record date (called ex-dividend date) b/c it takes 2 biz days to complete the translation

### Cash v Stock Dividends

**Cash:** Reduces the corp’s capital ∴ value of shares goes **down.** Also, SHs have to pay taxes on cash divs.

**Stock:** increases the # of shares, but does not change the value of the company (i.e. SH w/ 100 shares, issued a 10% stock dividend will gain 10 shares but the actual value of their shares remains the same)

Benefit of Stock Dividends?

* Gives SH the option to either keep extra shares, hoping the value will go up or can sell the additional shares they rec’d to create a dividend
* No taxes
* Considered better than cash divs

### Restrictions on Paying Dividends

***s. 42:*** Addresses the question of when divs may lawfully be declared and paid…shall **not declare or pay** a dividend, if there are reasonable grounds for believing that:

(a) the corp is or would (after payment) be unable to pay liabilities as they come due [Liquidity test]; or

(b) the realizable value of the corp’s assets would thereby be less than the aggregate of its liabilities and stated capital of all classes [solvency test – can’t reduce assets below the amt req’d to pay outstanding debts and return SH capital on liquidation]

\* If div paid contrary to ***s. 42***: director may be held personally liable – jointly and severally (***s. 118(2)(c)***). Director can apply to ct for an order that SHs who rec’d divs be obliged to return the amts rec’d to director (***s. 118(4) & (5)***)

\* Both tests must be satisfied at time **dividend declared** and at the time **dividend paid**

Are these restrictions applicable to stock dividends?

Money or property payments **reduce assets** ∴ less money to pay creditors, so should be controlled. But stock dividends have no effect on corporate assets b/c SH will be entitled to more after creditors paid, but creditors still have access to same pool of money. ∴ no compelling reason to apply tests, but unclear whether ***s. 43(1)*** req’s it.

### Repurchase or Redemption of Shares

**Repurchase:** **Voluntary** decision **made by SHs** to sell their shares back to corporation. Immediate effect – decreases # of shares ∴ increases earnings per share.

**Redemption:** Decision **made by corp** that **forces** SHs to sell shares back to the corp. (usually assoc’d w/ preferential, not common shares)

Why would a corp want to repurchase shares?

* If they think shares undervalued
* To build a reserve of shares for later use (e.g. giving stock option to employees)
* Retaining earnings, instead of paying out to SHs

***s. 39:*** What happens to repurchased/redeemed shares? Shall be **cancelled.** Or, if articles limit # of authorized shares, can restore the shares to status of **authorized but unissued.**

- restriction on repurchase/redemption: specifically prescribed to ensure that the repurchase/redemption ≠ insolvency

## E. Shareholders’ Voting Rights

### On what matters can SHs Vote?

1. **Electing Directors:** A powerful mechanism for controlling corp (gives directors incentives to act in SHs’ interests)
* When? Annual SH meetings (***s. 106(3)***)
* How many directors? Staggered board (***s. 106(4)***)
	+ Doesn’t happen in practice in Canadian public companies b/c TSX req’s that all directors be elected @ AGM
* How many votes? Ordinary resolution (***s. 106(3); s. 6(3)***)
	+ i.e. majority of votes **cast;** do votes cast include abstentions/withheld votes?
	+ Depends on the company’s articles; CBCA does not provide a formula

*Plurality v Majority Vote:* SHs not provided with the option to vote *against* a candidate – it’s either approve or withhold

* + If withheld votes INCLUDED in denominator (i.e. $\frac{votes for}{votes for+withheld}$ ), then it’s by majority
	+ If withheld votes EXCLUDED – it’s by plurality

*Uncontested Elections:* If vote is by plurality and election is uncontested; it could only take ONE VOTE to elect a candidate

* + E.g. 100 voteable shares: uncontested plurality voting
		- 60 for – 40 withheld = $\frac{60}{60}$ = 100%
		- 40 for – 60 withheld = $\frac{40}{40}$ = 100%
		- 1 for – 99 withheld = $\frac{1}{1}$ = 100%

→ to remedy this situation, TSX req’s that uncontested elections be done by MAJORITY

*Slate Voting v. Individual*:

* + candidates A, B, C, D, E: you have 100 shares, your only choice is to back all of the candidates w/ your 100 shares or withhold your votes from all = slate
	+ Ability to pick and choose among the candidates = individual

*Straight v Cumulative Voting (****s. 107****)*:

* + **Straight:** ABC has 100 shares: X owns 65; Y owns 35. ABC has a 2-person board, elected annually. 1 vote = 1 share.

|  |  |  |
| --- | --- | --- |
| Candidate A | Candidate B | Candidate C |
| X: 65 votesY: X | X: 65 votesY: X | X: XY: 35 votes |

→ A and B elected; if it’s by plurality vote, A + B win b/c they’re the top 2 vote-earners and if by majority vote, A+B still win.

* + **Cumulative:** ABC corp: X has 130 votes & Y has 70
		- Y can successfully elect his preferred candidate (C)
		- Can X still dominate the board? No. B/c X would need 71 votes to put behind both A and B in order to edge out C.

**Cumulative Voting Formula:** $\frac{total \# of shares authorized to vote}{total \# of directors in election+1}+fraction \left(or 1\right)$

**→** if you want 1 seat in ABC corp: $\frac{100}{2+1}+1=34$

***s. 107:*** straight voting is the default. But, where articles provide, cumulative voting gives the SH of votes attached to shares MULTIPLIED by number of directors to be elected; may cast their votes in favour of 1 candidate or distribute them (***s. 107(b)***)

***s. 107(g);(h)*** Decreasing # of directors **decreases** minority SHs’ voting power, so there are meant to protect minority SH voting.

\*\*THE PURPOSE OF CUMULATIVE VOTING = PROTECTION OF MINORITY SHS’ VOTING RIGHTS\*\*

1. **Removing Directors:**
* When? At any time, at a SH meeting
* Why? Can be with or w/o cause
* How many votes are required? Only need an ordinary resolution (***s. 109***) and articles cannot increase the # of votes req’d to remove
1. **Other Matters:**
2. Amendment of Articles (***s. 173***): must be by special resolution (either 2/3 of votes cast or unanimous written agreement)
3. Amending bylaws (***s. 103***): process is directors make change, which takes effect immediately and then they are req’d to submit the change to SHs @ their next meeting; SHs can then reject or accept by ordinary resolution (***s. 103(2)***)
4. SH proposals (***s. 137; s. 103(5)***): resolution that will be put forward by a SH @ SH meeting
5. Fundamental Changes:
	1. *Amalgamation****(s. 183(5)***):
	2. *Sale of all company’s assets (****ss. 189(3); (8)***)
	3. *Liquidation/dissolution (****s. 211****)*
	4. *Continuance (****s. 188****)*

→ A note about SHs’ options when they disagree w/ a vote on fund’l change: they can sell their shares back to the company @ an appraised price (**appraisal remedy**)

### Which SHs can vote?

Although non-voting SHs are not normally able to vote, there are some matters where CBCA invests such shares w/ voting rights:

|  |  |
| --- | --- |
| * ***S. 183(3)*** Amalgamation
* ***S. 189(6)*** sale of assets
 | * ***S. 211(3)*** dissolution/liquidation
* ***S. 188(4)*** continuance
 |

**Separate Class Voting Rights:** Where SHs of a certain class of shares are able to vote as a separate group on a given matter:

* Changes in class structure and rights (***s. 176(1)***): If there are proposed changes to a class structure or rights, then this class votes as a class separately (even if not ordinarily able to vote)
* Fundamental changes (***s. 183(4)***): when a merger agment would change the structure or rights of a particular class of shares, then that class is entitled to vote separately on it
* Sale of assets (***s. 189(7)***): If a class is affected by the sale in a manner different from the shares of another class/series

e.g. Company A: common class: voting rights // preferred class: no voting

* Company A+B enter into a merger agment
* According to the merger agment, preferred shares will be converted into common ones
* Who is allowed to vote?
	+ **General merger vote:** All shares allowed [common always allowed to vote // pref shares allowed to vote b/c it’s a fund’l change (***s. 183(3)***)
	+ **Class vote**: b/c the merger will affect preferred SHs’ class rights, they also vote separately (***s. 183(4)***)

**→ 2 votes required; both must pass by special resolution in order to pass merger**

### How many votes is each share worth?

**DEFAULT RULE:** (***s. 140***): one share = one vote

* In reality, many companies entitle some shares w/ enhance voting rights (e.g. Facebook’s dual class structure)
* Some companies also cap voting rights (i.e. limit the votes the SH allowed to cast, regardless of how many votes that SH might be entitled to under the default rule)

→ Cap and enhance are tools to help incumbent mgmt. retain control over company

### What is the effect of a sh vote – is it binding on the board?

**Fundamental Issue:** directors’ mgmt. powers (***s. 102(1)***) vs. SHs’ voting rights

→ when a matter **req’s SH approval – board bound;** when a matter is usually w/in the scope of the board’s discretion, it will not be bound

***Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuninghame* [1906]**

|  |  |
| --- | --- |
| **F** | SH wants to sell some of the company’s assets and came to a preliminary agreement with a buyer; passed by ordinary resolution among SHs. Board refused to carry out the resolution. SHs sue the board and company to try and force the board to go through w/ sale. **Article 96 of the company’s articles:** mgmt. of biz and control of company shall be vested in the directors, subject to the regulations as may time to time be made by **extraordinary resolution** (75% of SHs)  |
| **I** | Are directors bound to carry out SH resolution?→ No |
| **RA** | Decision of whether to sell assets is normally w/in directors’ mgmt. power. Majority of SHs can’t alter the mandate given to the directors by the articles of association. Directors’ general authority is made subject only to resolutions passed by extraordinary resolution. |

***Scott v Scott* [1943]:** Resolution authorizing dividend be paid to preferred SHs passed @ AGM. Power to declare interim dividends is directors’ power ∴ resolution not binding.

***Bioartificial Gel Technologies (Bagtech) Inc. c R2012 (Tax Court)***: even if a resolution is unanimous, SHs cannot fetter the board’s power to manage or supervise the mgmt. of the business and affairs of the corp or prevent it from performing its legal duty to do so.

→ **until SHs**  vote to **amend the articles** to take away, for the future, certain powers from the directors, the reigning directors may take whatever steps they want, disregarding the wishes and instructions of SHs on all matters which do not req’re SH approval. However, amending articles in this way is v. difficult in practice b/c of mgmt’s power over proxy voting machinery

### How can SHs combine their votes?

***s. 145.1***: Agments among 2+ SHs as to how share will be voted – lawful BUT must be written and made for a lawful purpose [generally valid as long as they relate to matters on which SHs have the right to vote; if RE: matter under directors’ power, the agreement may be invalid].

**A. VOTING TRUST:** SHs transfer legal title of their shares to a voting trustee in exchange for a certificate noting their beneficial ownership.

* The trustee then holds, for a defined period of time and under specific instructions, exclusive voting power over the shares (the other SH rights remain w/ beneficial owners)
* More formal device for concentrating control than agment
* Generally, trust terms can’t be altered during the life of a trust

Benefits: self-enforcing; separating of ownership + voting power can be useful (e.g. a parent wanting to give financial benefits to a child but not control)

* 3 specific situations where VT useful:
	+ intervention of o/s/independent trustee is desirable
	+ where a company is incorporated for objects which require, for their proper implementation, the cont’d control of persons holding certain beliefs/opinions
	+ Where SHs are large in # and dispersed in area, SH interests may be more effectively + continually safeguarded by trustees

**B. VOTING POOL AGREEMENTS:**  way for minority SHs to acquire majority control

***Ringuet v Bergeron* (1960) SCC**

|  |  |
| --- | --- |
| **F** | * Corp has 6 SHs
	+ 3 of them (R, P, B) have an agment to elect each other as directors, to elect one another to sr. mgmt. offices; agreed on their salaries as officers; agreed to vote unanimously at all meetings
* Later, B excluded from mgmt. so sues R+P for reneging on the agment
* R+P argue that agment was contrary to public policy ∴ unenforceable
 |
| **I** | Whether an agment among a group of SHs providing for the direction + control of a company in these circs is contrary to public order or whether it’s acceptable.  |
| **RA** | The agment was only meant to govern the SHs’ actions as SHs, not as directors. This is just an agment among SHs owning or proposing to own the majority of the shares of a company to unite on a course of policy or action and on the officers they will elect. Nothing illegal about it.  |
| **RE** | The fact that this agment may potentially harm a minority SH doesn’t render it illegal or contrary to public order – there are separate remedies for a minority SH who alleges departure from the standards req’d of majority SHs and director  |
| **ETC** | This happened prior to CBCA – it wouldn’t have been valid under current law: * Electing directors → allowed
* Electing sr. officers → not allowed – directors have authority to appt sr. officers
* Salaries → not allowed; directors fix salaries
* Unanimous voting → would be okay if only applicable to SH meetings; if trying to bind directors, it would not be allowed

→ SHs can only limit directors’ mgmt. powers w/ a USA  |

### Proxy Voting

* Important for SHs of public companies to exercise their voting rights
	+ Most SHs of such companies vote by proxy
* At CL, there was no right to proxy voting

**A. SOLICITATION:** concept central to the proxy voting system

* If a communication **is** a proxy solicitation, it triggers various statutory req’ments
1. Is it a proxy solicitation? ***S. 147***

*“proxy” = a completed form of proxy by which a SH appoints a proxyholder to attend and act on SH’s behalf at SH mtg*

*“SH” = reg’d owner,* ***not*** *beneficial owner*

***(b)*** *Things that do not count as solicitation*

*-* sending docs referred to in ***s. 153*** by an intermediary (intermediary = reg’d owner) – i.e. if a reg’d owner sends bene owner a request for direction on how to vote (***ss. (iii)***)

*-* public announcement of how a SH intends to vote (***ss. (v)***)

- communication for the purpose of obtaining the # of shares req’d for submitting a SH proposal under ***s. 137(1.1)(v)***

1. If it is a solicitation
	1. Who is the solicitor?
		1. **MGMT:** (***s. 149(1)***) – mandatory for every meeting for mgmt. to solicit proxy from each SH who is entitled to vote @ that meeting (unless company is private w/ < 50 SHs [***s. 149(2)***] // can also get an exemption from the CBCA director
		2. **Dissident SH:** If it is a solicitation, proxies must be solicited from all SHs
	2. Does a proxy information circular have to be sent?
		1. **MGMT:** Yes. (***s. 150(1)***); regs part 7 states what info is req’d in a proxy circular. **IF there is an exemption from soliciting proxies, then it’s obviously not req’d to distribute the proxy circular**
		2. **Dissident:** Also required, unless an exemption applies.
			1. If soliciting ≤15 proxies, no circular req’d (***s. 150(1.1)***)
			2. If soliciting by public broadcast, no circular req’d (***s. 150(1.2)***)
			3. If dissident applies for exemption, director may be exempted (***s. 151(1)***)

**B. Carol Hansell’s 5 Criteria for an effective proxy voting system**

1. investors must be in a position to make an informed decision;

2. the rules of the voting system must be suff’ly explained to SHs

3. An investor’s vote must have full weight @ SHs’ meeting

4. Votes attached to securities must be cast by those who have an economic interest in that security

5. the system must be transparent enough to inspire confidence

### VII. Do Shs have incentives to vote?

→ How enfranchising SHs **theoretically** = oversight of mgmt.:

* + - * 1. SHs w/ large blocks of shares (i.e. inst’l investors) have much greater incentives to use voting power effectively to ensure only people w/ proven success are elcted as directors of the corp
				2. Facilitates replacement of mgmt. through hostile takeover mechanism
				3. Facilitates replacement of mgmt. through **proxy battle** [dissident SH or group of SHs attempts to replace mgmt. by securing the proxies of other SHs in order to vote in a n alternative slate of directors]
* Empirical evidence shows that SH voting has little/no positive effect on corporate activity
	+ Only inst’l SHs (like hedge funds) are really taking an interest in activist shareholding
* Classic collective action problem
* Most SHs attend meetings by proxy
	+ Mgmt solicits proxies who will vote for mgmt’s choices
* It will be beyond most SHs to nominate alternative candidates before the meeting (b/c need ≥5% in order to nominate – ***s. 137(4)***)
	+ Even where SHs do make nominations, they will probably be doomed where mgmt. has solicited proxies ∴ w/o mounting a proxy battle, the slate of candidates nominated by mgmt. will run unopposed and be elected
* **Rational SH Apathy:** share ownership is usually v fragmented; the costs of becoming fully informed in order to vote effectively are high and the benefits are tenuous (b/c the likelihood of making a difference is v low)
	+ To the extent that benefits accrue from using one’s vote carefully, those benefits are distributed among all SHs (creating free-rider problem)

#  Shareholder Meetings

Designed, at least in theory, to provide a forum for SHs to discuss matters relating to the business and affairs of the corp ∴ they have a right of discussion and a right to submit proposals to be discussed at SH meetings

**2 Types:**

1. Annual: Must occur every 15 months (***s. 133(1)(b)***); called by directors; at least 3 items of business must be conducted (in addition to approving any other matters submitted):
	1. Election of directors (***s. 106(3)***)
	2. Appointment of auditors (***s. 162(1)***)
	3. Presentation of financial statements and auditor’s reports to SHs (***s. 155(1)***)
2. Special: when important business arises between annual meetings (***s. 133(2)***)
* Typically held when mgmt. contemplating a fund’l change, requiring SH approval
* Holders of ≥ 5% of shares carrying the right to vote at a meeting sought to be held may requisition a SH meeting (***s. 143***) to transact the business stated in the requisition; but see exceptions in ***s. 143(3)***
* When a proper requisition is rec’d, directors must call a shareholders’ meeting (***s. 143(3)***) as soon as possible (***s. 143(5)***)
	+ If they don’t, then any SH who signed the requisition can call it
* A director, SH entitled to vote may petition the ct to call a meeting (***s. 144(1)***)

**Who can decide when the meeting is to be held?**

→ the directors.

* If it’s SHs who are requisitioning the board to call a meeting for the purpose of removing directors, they **must** call the meeting but still get to decide when the meeting is held.

**Notice:**

* ***s. 135***: every SH entitled to vote at the meeting, each director, and the auditor are entitled to notice
	+ *How to determine which SHs entitled to vote?*
		- Easily determined in private companies, w/ only a few SHs. In large public companies, composition of SHs may change from day to day ∴ resolved by using a record date (***s. 134; Regs. 43***)
			* Date used to determine who is eligible to vote – must be between 60 and 21 days before meeting date
				+ Note: if a SH is on the list on the record date and sells the shares before the meeting date, they’re still eligible to vote (empty voting)
	+ *When do you send out notice?* → between 60 and 21 days before meeting date (***s. 135(1), (1.1); Regs. 44***)
	+ *What information needs to be included?*
		- Time and place (***s. 135(1)***) [can be anywhere in Canada]
		- Special business (***ss. 135(5) & (6)***)
			* All matters are “special business”, except: consideration of financial statements, auditor’s report, election of directors, and reappointment of an incumbent auditor
			* Must state business in enough detail to allow SHs to form reasoned opinion

### Unanimous Shareholders’ Resolutions



***Eisenberg v Bank of Nova Scotia* [1965] SCC**

|  |  |
| --- | --- |
| **F** | * Company had 4 directors: E and 3 employees
* E was also the **sole SH** of the company
* E and his brother got a loan from a bank, using the company’s assets as security
* All the docs submitted to the bank for the loan carried the corporate seal and suggested that the company’s board had approved the assignment of the company’s assets for the loan [there was never any SH meeting or board meeting]
* Later, company went bankrupt; trustee sued the bank to recover some money the bank had realized from selling some of the company’s assets

→ CA decided that the indoor management rule was sufficient to bind the company b/c the bank had reasonable grounds for believing that the loan had been lawfully authorized (i.e. apparent authority)  |
| **I** | Was the transaction between the company and the bank valid?  |
| **RA** | The matter does not need to be decided through IMR. It was meaningless to hold a SH or directors meeting b/c it would’ve been redundant, given the extent of control E had over the company. There was **actual authority** in this case b/c it was authorized by a unanimous SH resolution. Assent to such resolutions can be informal.  |
| **ETC** | Is this case still applicable under the CBCA? → No; under ***s. 142,*** resolution must be **written** and **signed** by all SHs entitled to vote  |

### Requisitioned Meetings

* SHs may requisition directors to call meetings under CBCA ***s 143***
* Limited to SHs of 5% or more of the issued voting shares
* When a proper requisition is rec’d, directors must call a shareholders’ meeting (***s. 143(3)***) as soon as possible (***s. 143(5)***)
	+ If they don’t, then any SH who signed the requisition can call it
* Business that can be conducted at SH-requisitioned meeting is limited in the same way that SH proposals are (***CBCA s. 102***)

***Airline Industry Revitalization Co. v. Air Canada* [1999] ONSCJ**

|  |  |
| --- | --- |
| **F** | * Airco was a corp created by 2 companies to acquire and merge Air Canada w/ Canadian Airlines
* Airco sought to take over Air Canada and bought a bunch of its shares
* Airco then sent a takeover bid that was set to expire on November 9
* On August 30, board of Air Canada had a meeting and fixed a **record date** on Nov. 18 for a meeting to take place on Jan 7
* August 31, Airco and a group of SHs requisitioned the board to call a special meeting in order to amend the articles of incorporation (needed to change the article which was unfriendly to possible takeovers)
* Board rejected the requisition and Airco brought an application for an order req’ing the directors to call the meeting or for the ct to do so
 |
| **I** | 1. Whether, b/c the board had already fixed a date for a meeting to consider the takeover bid, they could refuse to call the meeting.
2. Also whether the purpose of the meeting (amending the articles) was o/s the SHs’ authority to consider at a special meeting.
 |
| **D** | 1. Meeting for which a record date was fixed was to consider the takeover bid, not to amend the articles. The exemption only applies if the meeting that already has a date is set to discuss the same matter as the meeting requisitioned.
2. No limit on the subject matter to be considered at a special mtg.

∴ Airco required to call a meeting to discuss the business in the requisition. And Airco is also at liberty to call the meeting. The ct will not intervene at this stage, when Airco is able to act for itself.  |
| **ETC** | After this decision, subsection (c) was added to ***s. 143(3)*** which give the directors the ability to refuse to call meeting when the requisition is for improper matters, listed in ***s. 137(5)(b) to (e)***. \*\*SEE SH PROPOSALS\*\* |

### Conduct of Meetings & The Right of Discussion

***s. 139(1)***: Quorum: usually state in the bylaws; if not, the default rule is the **holders of a majority of shares** entitled to vote at the meeting are present in person or represented by proxy

***s. 139(2)***: quorum at beginning of meeting is good enough (Meant to preclude a dissatisfied group of SHs from leaving in the middle of a meeting and being able to defeat a resolution they disagree with)

***(3)*** If no quorum, no business may be transacted

***(4)*** If there’s only 1 SH, then a meeting with just the one person is legit

Rules of conduct: the chairman is req’d to conduct themselves in good faith

***Wall v London and Northern Assets Corp.* [1898] CA**

|  |  |
| --- | --- |
| **F** | * Meeting held to discuss the proposal to sell company’s assets
* Wall and a minority of SHs dissented; after their views were heard, the chair put forward a motion that debate be terminated
* Motion to terminate debate was passed and the proposal of sale was also passed
* Confirmation of the resolution was sought at another meeting – confirmation granted
* Wall began an action arguing that the minority SHs’ right to discussion had been curtailed ∴ the resolution was invalid
 |
| **I** | Was the resolution invalid b/c the chairman interfered w/ SHs’ right to discuss? |
| **D** | No. the matter had been sufficiently discussed ∴ the chairman’s conduct was not oppressive.  |
| **RA** | All SHs who have different views on a resolution should be able to express their views, and when there has been sufficient discussion, the chairman is able to move for terminating the debate. Neither the majority nor the minority should be tyrannical. The dissenters can be shut down at a certain point b/c it would be obstructive to the corp’s business to let them continue. The rule is not that any dissenters can hold up the meeting until they feel they are done. |

### Shareholder Proposals

Usually mgmt. matters originate with mgmt., but in order to foster SH democracy, the CBCA allows SHs to make proposals to be considered at SH meetings (***s. 137***)

|  |  |
| --- | --- |
| **4 categories of SH proposals** | **Are the proposals, once passed, binding on mgmt.? → depends on whether the matter ordinarily requires SH approval** |
| 1. Amending articles (***s. 175(1)***)
 | Yes |
| 1. That a bylaw be made, amended, repealed (***s. 103(5)***)
 | Yes |
| 1. SHs holding at least of 5% of voteable shares may make nominations for directors (***s. 137(4)***)
 | Yes  |
| 1. Residual category: if the proposal does no relate to the business or affairs of the corp, mgmt. may refuse to circulate; must be circulated unless runs afoul of technical limits in ***s. 137(5)***
 | In practice, most SHs in the residual category are non-binding; may still create pressure on mgmt. to adopt it.  |

1. **Who can submit a SH proposal?**

***s. 137(1.1); Regs. S. 46:***

* May be made by reg’d or beneficial owners
* SH must continually hold >$2,000 or 1% of the total # of outstanding voteable shares, whichever is less, for 6 months (***regs. S. 46***)
	+ If these req’s met, SH(s) can move the resolution from the floor
* Support from other SHs can be counted towards eligibility req’s (***s. 137(1.1)(b)***)
* *Why are there eligibility restrictions?* → to prevent mgmt. from being harassed by frivolous SHs (i.e. those who have no real stake); corp ∴ has the right to demand proof that the req’s met
* *Additional req’ment for director nomination proposal (****s. 137(4)***):
	+ MUST hold >5% of the voteable shares
1. **What information must be included in a proposal?**

***s. 137(1.2)***: a proposal must be accompanied by the following info:

***(a)*** Name and address of the person and person’s supporters, if applicable;

***(b)*** number of shares held and the date the shares acq’d;

1. **How are proposals circulated?**
* By SH’s proxy circular
* By mgmt’s proxy circular (***s. 137(3)***); can also request that a supportive statement be attached (<500 wds)
	+ Mgmt **must** circulate SH proposals to SHs except in certain circs (see ***s. 137(5)***)
1. **Under what circumstances can mgmt. refuse to circulate?**

***s. 137(5):*** A corporation is not req’d to comply w. ss (2) and (3) if:

***(a)*** the proposal was not submitted at least 90 days before the anniversary date of the last annual SH meeting

***(b)*** primary purpose of proposal is enforcing a personal claim or redressing a personal grievance against the corp, its directors, officers, or security holders

***(b.1)*** it clearly appears that the proposal does not relate in a significant way to the business or affairs of the corp

***(c)*** If the person failed to present at a meeting, a proposal that was put in the circular at their request.

***(d)*** substantially the same proposal was submitted in the mgmt. proxy or a dissident’s proxy relating to a meeting of SHs held not more than the prescribed period before the receipt of the new proposal and did not receive the minimum amount of support at the meeting:

|  |  |
| --- | --- |
| # of annual meetings at which proposal presented | Proportion of shares in favour req’d  |
| 1 annual meeting in the last 5 years | 3% or more |
| 2 in the last 5 years | 6% or more on the last submission |
| 3+ in the last 5 years | 10% or more on the last submission  |

***(e)*** the proposal is being abused in order to secure publicity

\****NB:*** *many proposals attract public attention; the fact of a proposal attracting att’n does not mean it’s abusive. Abuse req’d frivolity or an intent to embarrass the corp.*

* 1. **If mgmt. refuses to circulate, what remedies does the proposing SH have?**

***s. 137(8):*** the person whose proposal was refused may apply to court and the court may restrain the holding of the meeting to which the proposal is sought to be presented and make any other order it thinks fit.

***s. 137(9):*** the corp or any person claiming to be aggrieved by the proposal may apply to court for an order permitting the corp to omit the proposal from the mgmt. proxy circular and, if it is satisfied the (5) applies, may make any order it thinks fit.

***Varity Corp v Jesuit Fathers of Upper Canada* [1987] ONCA**

|  |  |
| --- | --- |
| **F** | * Varity made an application for an order permitting its exclusion of a SH proposal from the circular
* Proposal was that the corp end its investments in S Africa
* They wanted exemption b/c the proposal was submitted “primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes” and in particular the abolition of apartheid in S Africa.
 |
| **I** | Whether the order should be made → yes; order allowed.  |
| **L** | Before 2001, ***s. 131(5)(b)*** allowed corps to exclude SH proposals if they were submitted “primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes” |
| **RA** | The legislation is clear that if the primary purpose is one of those listed, however commendable either the general or specific purpose may be, the company cannot be compelled to pay for taking the first step towards achieving it.  |

Example of SH proposal for an amendment of a bylaw or article will include:

* Article # and title
* Currently read as: “…”
* Proposed amendment:
* Rationale

→ short and sweet; formal and direct language

Options for SHs Wanting to Oppose a Board Action

Is the subject matter entirely w/in the board’s discretion **OR** does it require SH approval? If latter, then SHs can just vote against it. But, if former, then responses are more complicated…

1. Propose to **amend the articles** restricting **business activities** allowed
2. Proposal to **amend by-laws** (But note that if the matter is wholly w/in the power of directors, then amendment to bylaws which restricts directors’ authority may be invalid)
3. **USA** (only avail for private – not public) // the only way to restrict directors’ authority
4. **Advisory proposal**
5. **Remove directors** at a special meeting
6. At next AGM **elect new directors**
7. **Walk away**

#  Shareholders’ Information Rights

Information is important for at least 2 basic reasons:

1. Allows SHs and securities market as a whole to evaluate the enterprise and ∴ make informed investment decisions
2. Allows SHs to evaluate corp’s directors and officers ∴ exercise rights to hold mgmt. accountable

Four Statutory responses:

1. SHs have right to inspect company records
2. Giving SHs ability to requisition meetings and circulate proposals
3. Requiring disclosure of financial and insider trading info
4. Right to appoint inspectors and auditors to investigate corporate affairs

Which records?

***s. 20(1)(a)*** Articles, bylaws, all amendments thereto, and a copy of any USA;

***(b)*** Minutes of meetings and resolutions of SHs;

***(c)*** Copies of all notices req’d by ss. 106 or 113; and

***(d)*** a securities register that complies w/ s. 50.

***s. 21(3)*** Shareholder list [gives the list of SHs, # of shares they own, and their addresses – important for circulating dissident proposal]

***s. 155(1)*** Right to receive financial reports before every AGM

 ***s. 159*** – sent no later than 21 days before AGM

***Regs 71(1); Canadian Generally Accepted Accounting Principles; Regs. 72(1)*** Info to be included: Balance sheet; statement of retained earnings; income statement; and a statement of changes in financial position.

→ **all financial reports** of a **distributing** company **must be audited** by an independent auditor

How to SHs get access?

***s. 21(1)*** SHs, creditors, their personal reps, and the director may examine records in s. 20(1); may take extracts free of charge, and if it’s a distributing company, any other person may do so on a payment of a reasonable fee. (∴ if it’s a private corp, only SHs + creditors can access and they do so for free)

***s. 21(1.1)*** Securities Register is restricted: must make a request to the corporation w/ an affidavit (described in (7)). Then the corp can grant access and charge a fee for taking any extracts.

## A. Right to appoint Auditors

* Auditors req’d for distributing companies; o/w optional (***s. 163(1)***)
* Auditors ensure that information in financial reports is presented fairly; meant to enhance credibility of financial report ∴ independence is important (see ***s. 161(1)***)
	+ If the auditing firm is providing auditing **and** non-auditing services, there are questions about independence/possible COI; in Canada, there are safeguards against this happening b/c non-auditing services must be approved by auditing committee
* Auditors cease to hold office on:
	+ Death, resignation (***s. 164(2)),*** or removal (***s. 165-66; s. 168(5)-(5)***)
		- An incumbent director who resigns/is removed has the right to submit a written statement to the company explaining his departure
			* SHs may pass an ordinary resolution at a special or general meeting which has been called for the purpose of removing the auditor ***(ss. 161(4), s. 165(1));*** If a reporting corp, notice must be given in the information circular w/ the name of the mgmt’s new nominee placed on the proxy (***s. 168(5), (6)***)
		- No incoming auditor can replace an incumbent w/o first requesting the opinion of the incumbent re: reasons for the replacement
		- Stock prices usually react negatively when an auditor leaves b/c it implies financial problems ∴ companies rarely change auditors
* Auditors have the right to receive notice of and attend every meeting and to be heard on matters relating to their duties (***s. 168(1)***); SHs and directors can also request the auditor’s attendance and explanation of those matters
* Auditors have information rights (***s. 170***): can demand info and explanation from directors, officers, employees, or agents of the corp’ also has access to records, docs, books, accounts and vouchers of the corp or any of its subsidiaries which are necessary to enable him to make the examination and give the report
* Auditors have a duty to report (***s. 169***)

Liability?

* Is the auditor bound only to verify information presented by mgmt. or is he also under a duty to investigate and ensure that the information is reliable?
	+ auditor expected to have an inquiring mind and cannot be confined to just arithmetical computations
	+ SH expects to receive an unbiased and uninfluenced assessment by the expert on the financial position of the corp – and it is only the auditor who can do this
* Curious that standard of care for auditors is not laid out b/c directors may be relieved of liability if they rely on an auditor’s report;
	+ If SHs are expected to rely on auditors’ report and directors and exempted from liability if ht ey have relied upon them, then auditors ought to have a duty to conduct their work in a manner which can be relied upon with confidence
* To whom is the duty owed?
	+ Kual relationship is with the corp, duty to report is to the SHs not the corporation
		- So, does auditor owe SH a duty of care, a breach of which would give the SH a cause of action in his own right? → unclear.

**Audit Committees (*s. 171*):**

* Mandatory for distributing companies
* Majority of members must be **outside directors**
	+ Securities laws require stricter rules for independence (disallowing any “material relationship” which could interfere w/ a member’s independent judgment)

Functions: reviews (does not approve) financial statements; directly oversees the work of the external auditor; resolves disagreements between mgmt. and external auditor; pre-approves non-audit services provided by auditor

#  Duties of Directors and Officers

FOR FINAL EXAMS – SHE WILL TEST HEAVILY IN THIS AREA

***S. 122(1)(a)*** Act honestly and in good faith with a view to the best interests of the corp (**duty of loyalty**)

***(b)*** Exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances (**duty of care**)

→ Failure to meet these duties = directors personally liable for the damages resulting from the breach

**Why impose FD**: Separation of ownership and control – SHs rely on the directors and officers for their expertise = agency issues

* must balance mgmt. accountability and mgmt. discretion
	+ Directors are agents of the corp and owe FDs to the corp

**How to Enforce?**

→ Δ director’s defenses:

**Common Law:** Business judgment rule

 **Statutory:** Good faith reliance (***s. 123(5)***)

 Good diligence reliance (***s. 123(4)***)

 Dissent on record (***s. 123(1)***)

Π’s allegation: breach of duty of care + causation of loss

In court; a typical lawsuit =

## Duty of Care: Traditional Common law – City Equitable Fire Insurance Co.

1. Director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of **his knowledge and experience.** An objective/subjective standard: meant that someone w/ little-no biz knowledge could be appointed and would have no obligation to acquire greater skills to perform the job w/o breaching DOC
2. Director **not bound to pay continuous attention** to the affairs of the corporation. His duties are of an intermittent nature to be performed at periodic board meetings.
3. Directors may properly delegate all of his duties to some other, and so long as there are no grounds for suspicion, they are entitled to trust the officer will perform them honestly.

### Business Judgment Rule

When there is no evidence of fraud, illegality, or conflict of interest in respect of a given corporate action involving biz judgment the directors are presumed to have acted in good faith and on a reasonable basis (∴ no breach of FD)

Why would it be bad for cts to engage in business analysis?

* Decisions often made by directors w/o complete info and under time constraints
* No basis for assuming judges better at making decisions
* Over-litigating it would lead to directors being too risk averse
* Talented people don’t want to be directors for fear of liability

### Statutory Defences

1. **Good Faith Reliance** – the most general defence

***s. 123(5)*** Director has not breached FDs if they **relied in good faith on**

***(a)*** financial statements of the corp represented to director by an officer of the corp or in a written report of the auditor reflecting the financial condition of the corp or

***(b)*** a report of a person whose **profession lends credibility** to a statement

∴ reliance cannot be in **bad or blind** faith. If a director has suspicions about a report, even if it came from the auditor, they have to investigate it further

1. **Good Diligence Reliance**

***s. 123(4)*** Director is not liable under ss. 118, 119, 122(1) if they exercised the care, diligence, and skill that a reasonably prudent person would have exercised in comparable circumstances, including good faith reliance on:

***(a)*** financial statements and ***(b)*** report of professionals

→ **only available for the following situations:** issuance of shares for consideration other than money; repurchase of shares; dividend payment; unpaid wages to employees

1. **Dissent on Record**

***s. 123(1-3):*** All directors, including those at the meeting who voted against; for; abstained; and those not at the meeting must have a formal dissent recorded in order to get this defence. O/w they are deemed to have consented.

### Cases

***Peoples Department Stores***

|  |  |
| --- | --- |
| **F** | * Wise stores owned by 3 Wise Bros (3WB)
* Wise bought Peoples and 3WB became the sole directors and SHs of Peoples
* Needed some new inventory system because things were not going well
* VP of wise put forward a proposal for a new billing system whereby Peoples would pay for the inventory bought from N. America and then W would reimburse for their share
* 3WB accepted this, on reliance of VP’s skills
* System resulted in W always owing P money; both went bankrupt and W owed P $4Mil
* Intercorporate debt = prejudice to P’s ‘real creditors’ b/c if Wise hadn’t owed them money, there would be $4Mil more in P’s bank account to pay them
* P’s trustee in bankruptcy sued 3WB as directors
 |
| **I** | Whether, in adopting the new policy, 3WB breached their duty of care to P → No.  |
| **RA** | Implementation of the new policy was reasonable decision made w/ a view to rectifying a serious and urgent business problem. There was little to no incentive for WB to jeopardize the interests of P b/c their financial fates were intertwined.  |
| **RE** | **Standard of Care in s. 122(1)(b)**: Objective w/ contextual factors (like prevailing socioeconomic conditions); creates an objective minimum standard: a director must **at least possess** knowledge of a reasonable person **but** if the director also has professional expertise, they may be held to a higher standard **Do any statutory defenses apply?** Good diligence (X; not an applicable situation) // dissent on record (X: they all consented) // Good faith reliance → despite VP having a bachelor’s degree in commerce and 15 yrs exp w/ Wise, that’s not enough. He’s not subject to any professional regulatory oversight, didn’t carry independent insurance coverage for professional negligence, not an accountant. **Common Law?** BJR: directors will not be held in breach of DOC under s. 122(1)(b) if they act prudently and on a reasonably informed basis |
| **ETC** | **Possible causation issue:** not dealt w/ but if they **had** been found liable, it would have been difficult to prove that the inventory method was actually the cause of losses * Under s. 237.1 Δs only liable for damages attributable to their own conduct + there were far more serious issues facing the companies – like the emergence of Walmart in Canada.

**To whom are these duties owed?** * Before Peoples, it was clear that they were owed to the company; that is still the case for s. 122(1)(a) – loyalty to the company – but in s. 122(1)(b), there is no designated “beneficiary” for the DOC
* “more open-ended and it appears obvious that it must include creditors”
* Traditional paradigm holds that directors owe FDs to the corporation

Why is this weird?* Corporation is an artificial entity and acts through agents; **directors** have the authority to initiate litigation
* Directors can’t be expected to sue themselves ∴ right given to SHs to be able to sue
	+ And b/c their right is derived from the corporation’s right, it’s called a **derivative action**
		- **Now,** creditors can also sue but the claim here was not a derivative action, it was a negligence claim in tort
		- Many people think the ct confused the two b/c they can’t use s. 122(1)(b) to sue
 |

***Smith v Van Gorkom***

|  |  |
| --- | --- |
| **F** | * VG (Δ) was chairman of TransUnion, which was entitled to tax credits that it wanted to use but couldn’t
* VG thought the best way to go = sell the company and approaches Pritzker to ask if he’s interested in buying it for $55/share; P agreed to make such an offer
* VG met w/ senior mgmt. and only 2 people agreed
	+ CFO reported that he looked at a range of prices and thought it was in the fair range
	+ But this didn’t = a valuation of the company
* VG goes to the directors + gives a presentation on the reasoning behind the price; CFO made same oral presentation but no written reports were circulated
* TU’s attorney advised board that they could be sued for turning down the offer
* Directors pass resolution but SHs sue directors for breaching DOC
 |
| **I** | Whether DOC breached and if so, whether they were protected by BJR |
| **D** | No. They acted in an uninformed manner.  |
| **RA** | Given the surrounding circs (hastily calling the meeting w/o prior notice of its subject matter; proposed sale of corp w/o any prior consideration or necessity therefor; urgent time constraints imposed by the buyer; total absence of any documentation) the directors were duty bound to make reasonable inquiry of VG + CFO. If they had done so, they would have seen the inadequacy of their claims. |
| **RE** | 1. **BJR:**
* Determination of whether decision was informed depends on whether directors have actually informed themselves prior to making the decision, of all the material info reasonably available to them
* Duty to inform oneself derives from FD
* Fulfilment of FD req’s not just absence of bad faith but **positive obligation** to protect corp’s financial interests
1. **Price diff between offer and market price of share:**
* In the absence of other sound valuation info, the mark-up alone does not provide an adequate basis on which to assess the fairness of an offering price
* Price of selling majority stake ≠ price of selling minority interest b/c need to account for the control premium
* Didn't ask CFO to carry out valuation study or review
* Accepted VG’s representation about price which was basically just his intuition

→ directors allowed to rely on an official’s opinion as long as it’s reached on a **reasonable basis** 1. **Collective expertise of directors**

Unfounded reliance on both the mark-up and market test as the basis for accepting the proposal undermined the argument about expertise and sophistication leading them to an informed and reasonable decision. 1. **Reliance on legal advice**

Meant only to convey that directors may be sued for rejecting any offer and does not connote judgment about the chance such a claim would be successful or whether it meant they should go ahead.  |
| **DIS** | Ct should defer to BJ of directors.  |

***UPM-Kymmene Corp* 2002 ONCA**

|  |  |
| --- | --- |
| **F** | Repap’s board considering a compensation pkg for a proposed chairman, Berg. Agment had v. generous salary, large bonus structure, and a change of control provision that would’ve bankrupted the corp if effected. **2 board meetings:**1. Board did not approve; decided to retain independent compensation consultant to investigate further; 2 directors resigned in protest.
2. Board reconstructed; relied on the opinion of the compensation committee who in turn relied on opinion of a compensation consultant who approved the agment but the consultant did not do adequate research + board didn’t look into it. Also failed to inform themselves of the opposition by former board members.
 |
| **I** | Did directors breach their FD in approving the agment → not an informed decision ∴ the breached DOC |
| **RA** | Board entitled and encouraged to retain advisors but this does not relieve them of the obligation to exercise reasonable diligence. Directors must oversee the o/s advice + inform themselves of material info. BJR can’t apply where a board acts on the unfounded advice of a committee. |
| **RE** | * W/ minimal effort, the committee AND the board could’ve learned that the company couldn’t afford nor did it actually need Berg’s services
* Committee never met to discuss the agment, and had no subst’ve involvement in the making of it
* In order to act in the best interests of the corp, each director was req’d to understand the terms + meaning of the agment + to consider it carefully against the circs of the corp
 |

## Duty of Loyalty

* FDs are legal norms imposed on corporate actors to ensure that they carry out duties w/ good faith, do not put themselves in COI, and do not derive secret profits from their office
* If we can’t realistically define a duty that ensures global wealth maximization, then how do we do something that comes close in the widest range of situations?
	+ Promoting SH wealth b/c they are only constituency w/ a residual interest in corporate profits – maximizing the residual assets tends to, in a plurality of situations, maximize the aggregate value of all claims
	+ SH primacy is also purported to be a gap-filling mechanism: whereas other parties contracting w/ the corp are able to protect themselves through contractual claims, SHs are more exposed
	+ Traditionally, FD understood as being owed to the corp (aka the SHs)

### Common Law Understanding:

At least 4 phases of substantive content in FD:

1. Corporate FD modeled after trust law and ∴ borrowed concept of the conflict rule and the profit rule. Very strict view w/ severe consequences, based in part on the evidentiary difficulty in producing objective evidence to contradict self-serving statements of officers
2. More flexible standard that simply req’d directors and officers to act in good faith and w/ a view to the best interests of the company. Based on SH primacy; SHs seen as “owners” of the corp and corp seen as organs of wealth generation ∴ mgrs. = agents of SHs, charged w/ duty of maximizing SH wealth
3. Incorporation of CL into statutory FD provisions; basically the CL standard reflects SH primacy and the new statutory standard would do so as well
4. Rejection of SH primacy. Treatment of the corp as an abstract entity and mgrs. req’d to determine the best course of conduct for that entity which may be coincident w/ one constituency, many, or none. Conceptually indeterminate – how do mgrs. and cts define the law in order to guide corporate conduct?

***Peoples Department Store:***

* If conflict between majority and minority SHs, it is safe for directors and officers to act to make the corporation a “better corporation”
* In ***s. 122(1)(a)***, “best interests of the corp” should be read not simply as the “best interests of SHs”
* It would be a breach of duty for directors to **totally disregard** the SHs’ interests in order to confer a benefit on another constituency but if they are observing decent respect for other interests beyond SHs’, that does not mean they’ve breached FD
	+ it may be legitimate for the board to consider the interests of SHs, employees, suppliers, creditors, consumers, gov’ts, and the environment

### Self-Dealing Transactions

* Ks or transactions concluded between directors and officers of a corp, either directly or through their interest in another entity, and the corporation itself → clear risk of diverting corporate wealth
	+ Requiring directors to hold direct stake in the corp dulls incentive to divert but doesn’t eradicate it
	+ Price differential at the corporation’s expense = unbargained for diversion of wealth from SHs to the interested party ∴ also a type of agency cost
* Under trad’l CL, interested directors’ K was automatically voidable at the option of the company (it does not matter whether the K was good or fair) and the director would be accountable for any profits

***Aberdeen Railway Co.*** Blaikie was director of Aberdeen railway and partner of Blaikie Bros, a firm which had just sold railway chairs to Aberdeen. As director of A, Blaikie had an interest in seeking the lowest possible price but as partner of B, wanted to get the highest price = clear conflict of interest. Classic self-dealing transaction. K void b/c of COI.

**→ Statutory Safe Harbour**: if it’s approved by the board **or** SHs in the prescribed manner, under ***s. 120***, then the K is not voidable and the director is not accountable for profits

**DISCLOSING INTEREST IN K OR T**

1. Under what circs must director disclose an interest in a K/T? ***(s. 120(1))***:

Any interest he has in a **material K or T** if he is:

* + - 1. A party to K/T; or
			2. Is acting as dir/off of a party to K/T; or
			3. Has a **material interest** in a party to K/T

∴ not every K must be disclosed, only those which meet the two materiality reqments (material to corp and director possesses material interest)

Determining materiality: No bright line rule; look at the size of K vs size of corp; revenue; profits

1. What to Disclose (***s. 120(4)***):
* The nature and extent of the interest;
	+ “I am an interested director” = insuff. “I have been a controlling SH of X corp since 2001; I have held 70% of the issued shares since that time”
* Under s. 120(6), directors are allowed to give **general notice** that they must be regarded as interested [helpful where frequent transactions between 2 companies b/c general notice allows them to do a blanket disclosure instead of going through each time]
1. To whom to Disclose? (***s. 120(1); (6.1)***):
* To the board: in writing or minutes of the board meeting (***s. 120(1)***)
* To SHs: SHs may examine the portions of any minutes of mtgs of directors that contain disclosures under this section and any other docs that contain such disclosures (***s. 120(6.1)***)

**HOW CAN INTERESTED DIRECTORS’ K/TS BE APPROVED?**

**Board’s Approval Process (*s. 120(7))*:**

1. Disclosure in writing/minutes
2. Abstention from voting (general rule)
	* Exceptions under ***s. 120(5)***: interested director can vote if the K/T
		1. relates to his/her remuneration as a director, officer, employee, agent, or mandatary of the corp or an affiliate [board has authority to set its own comp; each director gets identical comp pkg; non delegable task]
		2. is for indemnity or insurance under ***s. 124*** [also under board auth + non-delegable]; or
		3. is with an affiliate [enough overlap between boards? Also possible that boards are mirror images of one another]
3. Substantive Fairness [**NB:** No bright line rule on what constitutes fairness]
4. Approved by a majority of **disinterested** directors

→ **If K fails the board approval process, it can still be saved by SH confirmation**

**Shareholders’ Confirmation Process (*s. 120(7.1)*):**

1. Adequate disclosure
2. K substantively fair to corp
3. Approved by **special resolution** [***NB:*** interested SHs are allowed to vote on these matters]

→ if it passes a SH confirmation, K cannot be voided @ option of the corp…

* **BUT** even if it fails ALL processes of approval, K is not automatically void. Instead, the corp or any SH has to apply to ct to have K set aside (discretionary remedy under ***s. 120(8)***)
* Factors the ct may consider:
	+ K’s reasonableness/fairness
	+ Any compelling corporate necessity?
	+ Ability to restore parties to pre-K/T position
	+ Adverse effects on 3Ps if K/T voided
	+ Directors’ awareness of non-compliance when K made

### Corporate Opportunities

**Core Q: when** does the opportunity “belong” to the corp?

2 conflicting desires: directors should be devoted to maximizing corporate gains but are also supposed to have freedom to pursue their own personal biz opportunities which, in turn, purportedly expands entrepreneurialism

***Regal v Gulliver* [encapsulates the traditional CL view]**

|  |  |
| --- | --- |
| **F** | Regal owned a movie theatre; it had 5 directors who set up a subsidiary in order to secure a lease on 2 new theatres. Subsid didn’t have enough money to secure the lease b/c LL wanted it to have a minimum capital amt. Regal couldn’t buy shares of subsidiary so in order to inject capital, 4 directors bought shares in the subsid (the other director had other folks, including Regal’s solicitor, buy into the corp). Later on, Regal was sold and old directors replaced; new SHs sued former directors for usurping corporate opportunity (buying subsid’s shares) |
| **I** | Did the solicitor usurp a corp. opp? Did the directors? [and ∴ breach the duty of loyalty?] |
| **D** | Solicitor owed no FD to corp ∴ no breach; 4 directors who purchased did breach.  |
| **RA** | A corporate opportunity = **any** business opportunity that comes to the director in his capacity as director. Despite the fact that (a) they acted in good faith and (b) Regal could not have pursued the opportunity, their **fiduciary position** meant they improperly usurped the corporate opportunity and are liable for the profits they made off same. |
| **RE** | * Regal didn’t have capital to secure lese or finance subsid
* Profits disgorged by directors went to **new** SHs despite the fact that the old SHs were the ones harmed by the usurpation (subsid could have garnered a higher price if it were wholly owned by Regal, meaning they missed out on income; conversely means that new SHs got a lower price for ownership **AND** profits that should have made the company more expensive for them)
* Implies that corporate incapacity ≠ license to take up corp opps
* Also suggestion that if a director had rejected the opportunity, they would still have been unable to personally pursue it
 |

***Peso Mines v Cropper* (1966) BCCA**

|  |  |
| --- | --- |
| **F** | * Peso had three directors (Cropper, W, V)
* P owned mining claims in Yukon
* Dickson made offer to sell some of its claims to P → board considered and rejected D’s offer (not enough $ to pursue)
* 6 weeks later, Dr. Aho (P’s geologist) approaches the directors and proposes forming new company to buy the D offer
* P sold to new owners and new SHs sue C for usurpation (SHs had already shaken W+V down successfully)
 |
| **I** | Did C breach his FD to P in usurping a corporate opportunity (the D offer)? → No.  |
| **RA** | D offer expressly rejected by P board in good faith, which offers the best evidence that any later dealing in the D offer would not be against P’s interests. If a corp **ceases to have an interest,** the law can’t prohibit a director from taking it merely b/c he **learned of it as a director.** In order to be a true usurpation, the **whole transaction** must be known **only because of director’s position** as director and must be **in the course of execution of that office**.  |
| **RE** | * Rejection decision must have been made in good faith w/ view to corp’s best interests
* After corp rejected, directors free to take it as long as no breach of confidentiality
* Merely having knowledge dealing w/ the subject matter does not mean it occurred in the execution of director’s office
* Opportunity came up 6 weeks after proposed to corp
* Value + nature of opportunity
	+ Not essential to Peso’s operations; they got such offers 2-3X weekly
	+ Claims speculative and risky (unproven profitability)
 |
| **ETC** | **Differences from Regal:** 1. Prior rejection by corp’s board
2. Personal capacity
3. Speculative nature of opportunity
 |

***Canadian Aero Services v O’Malley* (1973) SCC**

|  |  |
| --- | --- |
| **F** | Π a topographical mapping + geophysical exploration Δs (O+Z) assigned to Guyana for purpose of pursuing + developing a K for mapping the country Δs resigned and, unbeknownst to Π, started new company (Terra) to map Guyana Πs claimed usurpation of corporate opportunity |
| **I** | 1. What are O+Z’s relationship to Π?
2. Duty owed by reason of above relationship?
3. Breach of duty, if any exists, b/c of O+Z’s getting the Guyana gig?
4. Liability if breach est’d?
 |
| **RA** | A fiduciary (director/officer of the corp) cannot use opportunities acquired from their position as a fiduciary to compete w/ the corp. This is an exception to the general rule that directors and officers can resign + start competing  |
| **RE** | 1. They were in top mgmt. positions, not just employees.
2. FDs apply to any officials auth’d to act on company’s behalf + esp. if also acting in managerial capacity ∴ agents not just employees.
	1. Still owed post-resignation: cont’d to be under FD to respect Π’s priority as against them and Terra in seeking to capture the Guyana K.

FD of dir/off does not terminate upon resignation + can’t be renounced at will. 1. No single standard of determining a breach; instead, a list of non-exhaustive factors
	1. **Type of position/office held** (i.e. reg. employee or dir/off?) While employees gen’lly don’t owe FD preventing them from competition, they are bound to respect non-compete provisions if they exist in their employment K (but that's K law, not corporate law)
	2. **Corporate opportunity:** nature/ripeness/specificity/director’s involvement in or relation to it

**→** not a ***Peso*** situation where such unsolicited offers being made all the time; Π devoted itself to pursuing **this particular deal** + it was captured by the same employees who had had conduct of the matter as corp agents* 1. **Knowledge:** amount of knowledge possessed, circs under which it was obtained (special/private?) → subst’l info gleaned b/c they were officers of corp
	2. **Alleged breach after termination:** how much time has passed? Circumstances of termination and motivation therefor (i.e. are directors leaving **because** they want to pursue the corp opp?)
 |

### Competition

|  |  |
| --- | --- |
| Competition by former officer/directors | Competition by current officers/directors |
| **General rule:** free to compete, post-departure as long as no non-compete K, use of former employer’s trade secrets, or confidential information. \*\**but note* ***Canaero****’s exception*  | * Sitting on board of 2 competing companies (***Mashonaland:*** it’s okay; sitting on a rival co’s board ≠ breach of loyalty, there must be more specific facts which suggest that the dir/off did not act in the corp’s best interests)
* Operating a business that competes w/ corp
* Having material interest in a competing corp
 |

#### Scottish Coop Wholesale Society v Meyer

|  |  |
| --- | --- |
| **F** | * Π formed a subsidiary company to enable it to participate in Rayon trade; they needed expert help to do this and appointed M+L (Δs) joint managing directors
* In addition to M+L, Π appointed 3 directors who were also directors of Π’s board
* subsid had 25,000 shares, of which 7,900 were issued: M got 3,450; L got 450; Π kept 4000
* Π decides they don’t need the expertise anymore + try to buy M+L out of the subsidiary; M+L rejected the offer + Π formed a new internal dept to directly compete w/ the subsid which forced down value
 |
| **I** | Is a director of 2 rival companies able to act for both? |
| **RA** | Directors breached their duty by subordinating the interests of the subsidiary to those of the coop. They conducted the affairs of the subsidiary in a manner oppressive to its SHs. Oppression can occur through neglecting to act as a proper fiduciary.  |

### Hostile Takeovers

Bidder makes offer to SHs of corp for their shares; wants to acquire a controlling share of corp which allows them to replace the board

Vs. Friendly takeover: a merger/acquisition concluded through negotiation w/ the board, after which a proposal submitted to SHs for approval

**Takeover Defence: Poison pill:**

Issuance of rights to company’s existing SHs, effected through adopting/amending bylaws, that gives them the option to purchase more shares at a steep discount if/when an acquirer obtains more than a certain percentage of the company’s shares (**flip in event**). → the bidder has just paid a serious premium for shares and had their control diluted.

Poison pill may have a “permitted bid” function which allows a bidder to acquire the flipping in amount of shares w/o triggering the pill, so long as certain bidding conditions are met.

**Motivation for Defending Against Takeover Bid – MacIntosh:**

1. SH/Corporate Protection: trying to prevent a bidder from coercing SHs into an unfair deal and/or prejudicing the interests of the corporation; directors force bidders to deal with mgmt. b/c they’re the guardians of the corp?
2. Mgmt Entrenchment: mgrs. just trying to preserve own interests; creates a loss to SHs on potential profit from sale; and insulates mgmt. from market for corporate control (meaning SHs effectively stuck w/ inefficient mgrs., which may drive share prices down even lower)

→ Empirically, poison pills used against regular bids, not coercive ones, which indicates mgmt. entrenchment more accurate hypothesis

#### Teck Corp v Millar (1972) BCSC

|  |  |
| --- | --- |
| **F** | * Afton = junior mining company, run by Millar, courted by 2 larger mining companies (Canex and Teck)
* A strongly favoured C, but not yet ready for an ultimate deal;
* A, however, needed operating funds – sold non-controlling block of shares to C for $3/share, despite the fact that T had initially offered $4 and then increased offer to $6
* T goes and buys a controlling share of A’s stock on the public market
* Meanwhile, A + C’s subsidiary (P) began discussing an ultimate deal where P would be issued 70% of new stock
* T got mad and told M not to sell; tried to requisition SH meeting, sent a letter stating T could get a better offer; and that M couldn’t sell w/o seeking T’s permission as majority SH
* Ultimate deal between A + P signed and T launched action seeking declaration that deal invalid
 |
| **I** | Whether directors have the authority to issue new shares in a corp in order to defeat a takeover  |
| **RA** | Directors **are** allowed to issue shares in order to defeat a takeover bid, so long as their purpose for doing so is not improper. If directors **act in good faith towards the best interests of the corp,** and have a **reasonable basis** for believing they are, it is okay. In determining whether a bid is in the corp’s best interests, directors are entitled to take into account factors other than the price being offered by the bidder(s).  |
| **RE** | In order to find out whether there is improper purpose, ct can look to the reasonably held, good faith belief of directors, as est’d by the reputation, experience, policies, of the bidder, not just the asking price  |
| **A** | * A’s directors genuinely believed C was a better partner
* Frustrating T’s intended acquisition was not the ultimate purpose, it was rather an effect of the decision the directors made in exercising their best judgment.
* Directors are nor agents bound to accede to the direction of majority SHs.
 |

## Directors’ Personal Liabilities

### Types of Actionable breach

* + 1. **Breach of duty of loyalty** (***s. 122(1)(a)***): **STRICT** liability;
	+ Accountable for profits unlawfully gained
	+ Higher probability of finding liability here than under DOC (ct takes more interventionist approach)
		1. **Breach of duty of care** (***s. 122(1)(b)***): Proof of damage req’d;
	+ Probability of liability much lower b/c of operation of business judgment rule
		1. **Authorising Improper Payments** (***s. 118***): must be started w/in 2 years; Joint + several liability;
			1. unfair non-money consideration for shares (i.e. worth less than cash value)
			2. Dividend payments when corp insolvent or which make it insolvent; liability for any unreturned amt from SHs
		2. **Debts owing to employees** (***s. 119***): joint and several liability;
	+ Debts owing for services rendered by employees to corp
	+ Not > 6mos wages payable to each employee
	+ Responsible only for debts incurred while a director
	+ 2 year limitation date
	+ Secondary obligator: employees must first exhaust all collection actions against corp before pursuing
	+ Statutory rights of subrogation ***(5)*** and contribution ***(6)***
		1. **Other liabilities owed under other statutes or through tort**

### Relief from Liability

* + 1. **SHAREHOLDER RATIFICATION OF FIDUCIARY BREACH:**

Note that collective action problems that exist for other types of SH action apply equally here (which draws suspicion RE: the validity of ratification)

**Hx @ common law:** Strong majoritarian bias; cts believed that majority of SHS should have final say on matters of corporate policy and internal disputes b/w SHs and dirs./offs

#### Foss v Harbottle

* Where the company suffers harm, the company itself is only true and proper Π. ∴ SHs cannot generally sue for wrongs done to the company
* Where the alleged wrong is a transaction which a simple majority of SHs either HAD or COULD ratify, no individual SH has standing to assert breach of FD ∴ **NO CL DERIVATIVE ACTION**
* One exception: where dirs./offs also SHs; the dirs. Steal assets from the corp and then ratify the misappropriation as SHs = **fraud on the minority**
	+ Ct deems such transactions void ab initio (not merely voidable) ∴ ratification had no effect (b/c can’t ratify a legal nullity) → super limited

#### North-West Transportation Co v Beatty (1887) PC

|  |  |
| --- | --- |
| **F** | * Π a transport co. Δ a director who sold a steamboat to Π (self-dealing transaction)
* @ SHs’ mtg, they pass a resolution w/ simple majority vote, approving the sale
* Δ was also a controlling S who voted to confirm his own transaction but had only just acquired the shares to do so
* An opposing SH sought to have the sale set aside
 |
| **RA** | A majority of SHs may sanction what would have o/w been that their own breaches of FD as directors. The only limit is that the ratification cannot have been brought about by unfair or improper means, nor can it be illegal/fraudulent/oppressive towards opposing SHs. Voting control ≠ oppression  |

***s. 120(7.1)*** takes the same approach, allowing interested SHs to ratify but must be by **special resolution.**

***s. 120*** only applies self-dealing transactions – what happens if SHs try to ratify a different sort of breach? → Uncertain, it will depend on the circumstances of the case @ hand:

***s. 242(1)***: actions will not be dismissed just b/c a breach has been or may be approved by SHs, but evidence of purported ratification will be taken into account.

Generally, if ratification is by majority of **disinterested** SHs, more likely that ratification was effective vs. where interested SHs make up majority of ratifiers

* + 1. **EXCULPATION CLAUSE:**

Clause in articles/bylaws that relieves directors from liability for breaching duties (NOT PERMITTED – ***s. 122(3)***)

* + 1. **STATUTORY DEFENCES:** \*\*ONLY AVAIL FOR DIRECTORS, NOT OFFICERS\*\*

1. Dissent (***s. 123(1)***)

2. Due diligence (***s. 123(4)***) for breaches of ***s. 118, 119, 122(2)***

3. Good Faith reliance (***s. 123(5)***)

### Indemnification and Insurance

1. **INDEMNIFICATION:** Promise to reimburse a director/officer for expenses if s/he sued

**→ *s. 124(3)***: requires that the director must have acted in good faith and in the best interests of the corp. if it is a criminal/administrative action, enforced by monetary penalty, individual must have also had reasonable grounds for believing the conduct to be lawful

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| TYPE | COVERS | TIMING | REIMBURSES | DEFAULT? |
| Mandatory (*s. 124(5)*)  | A **successful defence.** SUCCESS: director can’t admit/be found to have committed any fault at all  | B/c it’s result-dependent, can only get reimbursed after the fact | ALL COSTS: litigation costs + settlement | Statutory right |
| Permissive(provided by articles/bylaws) | Unsuccessful defence | Allows advances to cover costs | Depends on Claimant: 1. **3P:** corp *may* indemnify for ALL costs 2. **Corporation/corporate rep:** indemnity req/s ct approval and ltd to litigation costs only | Not a default rule  |

1. **INSURANCE: Directors’ and Officers’ Insurance (D+O)**
* No limitations on circumstances in which insurance can be provided
* Types of insurance available will depend on whether indemnification is available
	+ - 1. **Indemnification unavailable:** D+Os insured; personal assets insured; covers non-indemnifiable liability of D+Os
			2. **Indemnification available:** *company* insured; covers corporate assets; pays for the company’s reimbursement of the directors’ costs

# Shareholders’ Remedies

Major ways of ensuring that SHs actually get the rights to which they are entitled and of ensuring FD are met.

## Derivative Actions

* Corporation itself that’s harmed by dir’s breach of FD ∴ corp has the right to sue and the right to any recovery from the action
* SHs do not have much incentive to pursue DA b/c while they will indirectly benefit if they win, they have to front the costs of litigation
	+ In recognizing the value of DA in terms of good corporate gov’nance, cts routinely award fees to successful Πs in DA.
		- This leads to the risk that lawyers will be incentivized to take on non-meritorious claims in the interests of the potential awards (“strike suits”) ∴ statute sets out procedural req’s to prevent such abuses

### At Common Law

***Foss v Harbottle*** → 2 major rules:

1. **Proper Π:** only proper Π is the corp where wrong is committed against the corporation ∴ SHs have no standing to sue
2. **Majority Rule:** If alleged wrong either was or could be ratified by an ordinary majority vote @ general mtg, the ct will not intervene

**→ not good law anymore!**

### Statutory Derivative Action

* + - 1. **Who can initiate a derivative action? *s. 238*** “Complainant” includes:

***(a)*** Former or current security-holder: if a former SH, must have held interest @ the time of the wrongdoing;

Reg’d and beneficial owners;

Security-holders: equity (shares) OR debt securities (e.g. bonds)

Of the corporation or its affiliates: parent-subsidiary rel’nship = affiliation // 2 corporations are subsidiaries of the same parent = affiliation

***(b)*** Director/officer or former d/o of corporation or any affiliate;

***(c)*** the Director; or

***(d)*** Any other person the ct considers proper: *may* include creditors if the corporation is insolvent or *near-insolvent* (***Peoples***)

* + - 1. **Complainant must also follow 3 process requirements:** ***s. 239:***
		1. Give board ≥ 14 days’ notice of intent to apply for leave re: derivative action
		2. If board refuses, apply for leave from ct; and
		3. Be acting in good faith and in an action that appears to be in the interests of the corp

#### RE: Bellman and Western Approaches (1981) BCCA

|  |  |
| --- | --- |
| **F** | * Private, closely held company;
* **Bellman group =** minority SHs; nominate 3 of the bd’s 8 directors
* **Duke group =** majority SHs; nominate the remaining 5 directors on the board
* Duke’s directors make a loan agment w/ the bank that includes agment to be bank-friendly
* B group sends notice to corp of intent to begin derivative action
* Duke’s directors set up a special committee of 4 of the 5 of them to consider this and acquire advice from an accounting firm and a law firm
* Board decides they’re not going to take action so B starts derivative action
 |
| **RE** | Notice: * Despite the fact that one allegation against the D directors was not in the notice, notice was sufficient. Failure to specify each and every cause of action in a notice ≠ invalidation

Interests of the corp: * Sufficient to show that an arguable case exists by:
	+ Looking at the decision of the directors to refuse to carry out the right of action: was the **decision impartial?**
		- No; they were nominated by the D group
		- The independence of the lawyers and accountants also questionable as they were hired by those same directors and their reports were v limited (did not go to the substantive issue of whether directors breached FD)
	+ There was a potential loss resulting from the loan deal ∴ enough to show that the action was in the corp’s interests
 |

* ***Schadegg v Alaska Apollo Resources (1994) BCSC:*** Financing scheme approved by >80% of SHs of a widely-held corp; the overwhelming approval of the decision and corresponding scant approval of the complainant’s petition indicates that derivative action *not* in corp’s interests. However, *not a bar.*
* Onus of showing good faith is on the applicant but it’s assumed that if they have a reasonable claim, they are coming w/ good faith
	+ - 1. **What remedies exist?**

General principle: b/c the cause of action belongs to the corp, any compensation also goes to the corp

Except, under ***s. 240(c)***: Ct may give compensation directly to former and present security-holders **instead of to the corp**. → helps to alleviate any unfairness that would result if the former SHs were the ones who actually suffered, while the benefit of compensation only flows to the current SHs.

* + - 1. **Costs?**

***s. 242(3):*** Complainant not req’d to give security for costs

 ***(4):*** Ct can order that corporation pay interim costs to the complainant

#### Turner et al v Mailhot et al (1985) ONHC

|  |  |
| --- | --- |
| **F** | * Π and his wife owned 30% of corp; Δ and his wife owned remainder
* Π + Δ had a disagreement and Πs were fired and got locked out of company’s premises
* Π sought and obtained leave to bring derivative action against Δ for the corporation’s lost income that was diverted to Δ and also applied for indemnity for costs
 |
| **I** | Is Π entitled to indemnification for costs of the action? |
| **D** | Partial indemnification allowed.  |
| **RA** | Being given leave to bring a derivative action creates a prima facie right to indemnity, but the ct still has to look at whether there are reasons to grant it. Ct looks at 2 indicia: (1) complainant’s ability to pay and [though capacity to pay should not necessarily deprive Π of indemnification] (2) whether the action is brought for the corporation’s benefit or whether the complainant stands to personally benefit.  |
| **A** | 1. Π had ability to pay; no claim re: financial hardship
2. Action more about settling a struggle between the 2 SH groups than about the corporation.

∴ half of the incurred and future costs allowed BUT if Π’s financial situation changed, could again seek indemnification  |

* + - 1. **Court approval required to discontinue:** ***s. 242(2):*** Application can’t be discontinued w/o approval

## Personal Actions

Create higher incentives to pursue personal actions vs derivative?

|  |  |
| --- | --- |
| **Personal Actions** | **Derivative Actions** |
| Enforcing rights as SH | Enforcing rights on corporation’s behalf |
| Recovery goes to SH | Recovery goes to corporation |
| No leave requirements | Must apply to ct for leave  |

**Examples of Personal Actions:**

* Compelling payment of declared dividends which weren’t distributed
* Compelling inspection of SHs’ lists or corporate records/books
* Requiring SH meeting to be held
* Challenging corporate restrictions on share transferability

### Goldex Mines v Revill (1974)

|  |  |
| --- | --- |
| **F** | * Π was a SH of Probe mines
* Probe’s directors in dispute over whether to purchase some mining claims from a company that’s controlled by a former Probe director
* Π alleged breach of duty of directors and Δ SHs
 |
| **I** | Whether the claims were derivative or personal actions  |
| **RA** | Where the injury to SH is **not incidental** to an injury to the corporation (i.e. not arising simply because the corporation itself has been damaged and as a consequence of the damage to it), an individual cause of action exists. The “individual” wrong does not need to be unique to the Π; it can affect many SHs.  |
| **RE** | * SHs are personally injured if they do not receive info from the corporation that is truthfully and fairly presented → information rights violated ∴ personal action exists
* Preparation and circulation of false/misleading annual reports also undoubtedly a wrong to the corporation → duty of loyalty breached ∴ derivative action exists
 |
| **A** | Because leave is required in order to maintain a derivative action, the claim must evince whether it is one. There was no attempt made by Π to differentiate between those claims which were derivative and those which were personal. The ct is not going to sort through it for them.  |

## The oppression Remedy

**Typical Oppression Case:**  closely-held corp where the majority SH(s) exclude minority SH(s) from participating in the company’s mgmt., dividend payments, or are removed from office. Min.SH may want to leave but given it’s a private corp, there are many barriers to being able to exit w/o massive losses (restricted share transferability; no stock market to liquidated into; hard to find buyer who wants to buy into a corp w/ hostile majority SH)

→ How to solve the problem? Typically, there were 2 rules that were applicable:

* + 1. Majority Rule: minority SHs must accept their fate…
		2. Judicial wind-up on just and equitable grounds: a drastic remedy

→ oppression comes in as a way of protecting w/o destroying the corp

### Who can bring oppression?

→ The original intention of oppression remedy was to protect minority SHs in their capacity as dir/off/SHs; practical implication is that cts v reluctant about granting remedy to non-SHs.

***S. 238*** definition of ‘claimant’ also applies to oppression remedy;

2 questions come up: (1) When are employees proper claimants? (2) When are creditors proper claimants?

**Employees:** Suggests no, b/c the interests of employees are not listed under ***s. 241***. BUT, where it’s a closely-held corp, where employees are also likely SHs, can employees use the oppression remedy to protect their interests as employees? → **only** when there is a **pattern of oppressive acts**

**Creditors:** creditors usually have remedies available under k/tort law – why would they want oppression? → unltd discretion of ct to craft remedies

What is the concern w/ granting standing to creditors? → replacing the remedies in tort/Klaw?

**How does the court determine *which* creditors deserve standing?**

#### First Edmonton Place v 315888 Alberta Ltd (1988) ABQB

|  |  |
| --- | --- |
| **F** | * LL corp + tenant corp
* T corp controlled by 3 dir/SHs
* LL tried to induce T into entering a 10-year lease of office space by offering 3 incentives (18 mos free rent; improvement allowance; cash payment)
* T stayed for 21 months, then left w/o signing K and LL sued for oppression
 |
| **I** | Is LL a proper person to bring oppression remedy application? → NO.  |
| **RA** | **2 Types of Creditor:**1. Debt Security-Holder: security issued by a corp to the public to borrow money; they are security-holders ∴ definitely come w/in the definition of claimant (***s. 238(a)***)
2. LL/Banks/Suppliers: May meet qualification for standing if:
	1. They can show corp is being used as **a tool to commit fraud** against the creditor; or
	2. If creditor has **reasonable expectations** arising from circumstances surrounding creditor + corp’s relationship
 |
| **A** | 1. Not a security-holder
2. Proper person?
	1. No fraud
	2. Reasonable expectations?
* LL could have protected self by getting personal guarantee from dir/SHs
* No evidence LL expected the cash incentives to stay w/in the company (they were actually just pocketed by the dir/SHs personally)
* No expectation that lease would last beyond the rent-free period
 |

### What constitutes Oppressive conduct?

***s. 241(1)*** Application to court re: oppression

***(2)*** grounds:

***(a)*** any act or omission of the corp or any of its affiliates that effects a result; [i.e. isolated acts count]

***(b)*** business or affairs of the corp/affiliates are/have been carried on/conducted in a manner; or

***(c)*** powers of the directors of the corp/affiliates are or have been exercised in a manner

that is **oppressive**, or **unfairly prejudicial** to or **unfairly disregards** the interests of any security holder, creditor, director, or officer, the ct may make an order to rectify the matters complained of.

→ The interests protected include **legal rights and reasonable expectations**

#### Ferguson v Imax Systems Corp.

|  |  |
| --- | --- |
| **F** | * Imax: a private, closely held corp founded + owned/run by Π, her then-husband, and 2 other couples
* Each husband got 700 common shares + each wife got 700 class B shares (non-voting; dividend of 5% in priority to common shares; equal share in divs and liquidation thereafter)
* Shares non-redeemable (corp has no obligation or right to repurchase shares\_
* Π had knowledge and participated in running the corp
* Π + husband divorced and he tried to squeeze her out of the corp
	+ discharged from employment
	+ he tried to force her to sell shares to him during divorce settlement
	+ She was told by other SHs that husband would not declare any divs as long as she remained a SH
	+ Board passed a resolution freezing the class B shares and ordering them to be redeemed
 |
| **I** | Whether corp + directors were oppressive  |
| **D** | Yes; they intended to exclude her from any participation in the corp. Π gets costs + corp prohibited rom implementing the resolution.  |
| **RE** | * In dealing w/ closely-held companies, ct may consider the rel’nships between the SHs + not just their legal rights as such
* Long course of unfair conduct, of which the resolution is just one example
* She is the only one affected by the change:
	+ Although the other wives would also lose SH status after resolution, they could still enjoy the financial benefits of the corp through their spouse’s shareholding
 |

#### BCE v 1976 debenture-holders (2008) SCC

**Debenture-holder:** debs = type of debt security, used to by corps to raise money by borrowing from public

**Indenture:** the agmt/K between issuer and deb-holder that governs the rights, rel’nships + obligs of the parties

**Leveraged Buyout (LBO):** acquisition by company that req’s the target company to finance its own buyout by backing the acquiring corp’s loan

|  |  |
| --- | --- |
| **F** | * BCE: public company; BCE Canada: subsidiary: issued debentures to group of debenture-holder
* Group looked like it was looking to do a takeover (Teachers)
* Board wanted an auction to try and garner best price
* 3 bidders in all; all 3 proposed LO and Teachers ended up winning
* BCE’s SHs approved T’s acquisition of the company
	+ Acquisition deal req’d BCE to provide guarantee for $30bil loan
	+ This negatively impacted BCE’s financial condition, increasing its default risk
	+ Debentures downgraded and their value decreased by 20% ∴ deb-holders sued BCE directors for oppression
 |
| **I** | Whether the deb-holders were oppressed by the actions of directors. |
| **D** | Alleged expectation that investment grade of debs would be maintained not supported by the evidence.  |
| **RA** | 2-pronged inquiry to determine whether conduct was oppressive: 1. Does the evidence support the claimant having a **reasonable expectation** that their interests would be protected by the company? If yes;
2. Does the evidence establish that the reasonable expectation was **violated by conduct** that was **oppressive, unfairly prejudicial to, or that unfairly disregarded** a relevant interest?
 |
| **RE** | * Oppression is fact-specific; different contexts and conduct and relationships will result in diff results
* Stakeholders enter into rel’nships with corps on the basis of understandings and expectations upon which they are entitled to rely, as long as they’re reasonable
* Directors only owe FD to the company ∴ the reasonable expectations of stakeholders is simply that the directors act in the company’s best interests ∴ they **can’t** have RE that directors would give them special treatment
1. **Proof of reasonable expectations:**

Actual unlawfulness is not req’d; just wrongfulness **but** not all harmful conduct = oppression. Factors for determining whether RE exist: * 1. General Commercial Practice: Common industry practice to protect this interest? Departure from normal biz practices that undermine complainant’s exercise of legal rights will usually (not always) = remedy.
	2. Nature of the Corp: > latitude to directors of small, closely-held corps to deviate from strict formalities.
	3. Relationships b/w Parties: rel’ns based on family ties may be governed differently than relationship of arms-length SH of public corp
	4. Past Practice: Esp relevant for closely held corps in matters of SH participation in corp profits + governance. **But** if valid commercial reasons exist for departure from past practice and that does not undermine claimant’s rights, no RE exists that directors stick to past practice
	5. Preventive Steps: Could secured creditor have negotiated protections against the prejudice it suffered?
	6. Representations and agreements: Expectations created by SH agments; reps made in promotional material, prospectus, circulars, other communications
	7. Fair resolution of Conflicting Interests: No rule that one set of stakeholder’s interests should prevail over others. Instead, this is dependent on what situation directors are facing and whether they exercised their business judgment responsibly.
1. **Leading to consequences:**
2. Oppression: Connotes harsh and abusive conduct
3. Unfair Prejudice: Less offensive conduct than a (e.g. squeezing out minority SHs; failing to disclose related party transax; changing corp structure to alter div ratios; adopting poison pill; paying divs w/o declaration; paying dir’s fees >industry standard)
4. Unfair Disregard: Least serious (e.g. favouring a dir. By failing to properly prosecute claims; improper reduction nof SH’s div; failing to deliver property belonging to the claimant)
 |
| **A** | 1. **RE?**
	1. Public co.
	2. LBOs not uncommon for public corps ∴ not unpredictable event
	3. Past practice can change, esp. given fast-changing capital markets
	4. Relnship governed by indenture – they could’ve negotiated a better one
	5. Corp’s statements about maintaining deb’s status always accomp’d by warnings that they can’t be taken to create RE; K had term that all kual terms will be honoured – that was not breached.
	6. Conflicts of interests of different stakeholders + would be impossible to please all in the circs

**Result:** all offers req’d LBO that was w/in the range of reasonable choices ∴ ct will not interfere.  |

### What remedies are available?

***s. 241(3):*** Virtually unlimited…Most common request is (f): repurchase of shares (b/c usually closely held corp w/o market ∴ creates an artificial market). If corp or majority SH doesn’t have enough $ to buy shares back, ct will liquidate.

→ remedies will be fact-specific.

#### naneff v Non-crete Holdings Ltd

|  |  |
| --- | --- |
| **F** | * Family biz, run by dad; he has 2 sons: Alex and Boris, who also work for company
* Dad, through trust, gives them equity in non-voting shares but retains all control
* A started dating a woman that dad didn’t like so dad removed him from office and mgmt. of corp and cut off his dividend payments
* A sued Dad
* TJ: Dad, as dominant director, was oppressive ∴ ct ordered public sale of company and A allowed to participate in the sale and purchase company’s shares
 |
| **I** | Was the remedy crafted by TJ correct? |
| **D** | No. Remedy went beyond rectifying oppression b/c it was beyond A’s reasonable expectations and was more a punishment of Dad. Appropriate remedy is to give A compensation for wrongful dismissal and lost dividend payments. |
| **RA** | When using discretionary powers under the oppression remedy, there are 2 important limits: 1. Must only rectify oppression
2. They may only protect the complainant’ interests as a SH/director/officer, as such.

→ **Reasonable expectations** of the parties must be **considered** both in finding oppression AND when **crafting a remedy**.  |
| **RE** | * In this case, the understanding was that A + B would ultimately be co-owners of the biz, it was fully understood that Dad would retain full control until death or voluntary requirement
* Reasonable expectations of A: not that he could gain control before then
* Reasonable E of dad: that he would keep control
* Job of ct is to even the balance, not to tip the scales in favour of the oppressed party
* Cannot give > complainant could have reasonably expected or > interests of a SH as such
* In construing RE, w/ closely-held corp, ct may consider the personal relationships between the parties
	+ Family business context is relevant to the extent that it relates to the RE of the parties
 |

### Oppression vs. Derivative Action

#### Rea v Wildeboer (2015) ONCA

|  |  |
| --- | --- |
| **F** | * Public company; complainant (Rea) alleged that corp insiders, including dirs. And officers of Martinrae misappropriated $10mil in corporate funds
* Rae brought oppression remedy but did not argue he was personally harmed – nor did he ask for personal remedy
 |
| **I** | Did Π have standing to bring oppression remedy, despite not alleging any personal harm?  |
| **D** | No. His action was clearly derivative in nature.  |
| **RE** | Complainant argued that harm to corp usually = harm to SH ∴ complainant has choice of whether to sue under DA or oppression → No. DA + opp can exist simultaneously; the typical situation is a closely held corp where majority SH misappropriates corporate assets and in that case minority SH hurt in a **unique way** (value of shares decreased would also impact majority SHs but they’ve already stolen from the corp) * Where it’s a public company, hard to see that complainant actually suffered personal harm
* Relaxation in approach to simultaneous DA and oppression does not apply where there is not actually any oppression
* The distinction remains important for public companies b/c of the leave req’ment for DA – leave, in such circs fulfills 3 purposes:
	+ - 1. Preventing strike suits
			2. Preventing meritless suits and
			3. Avoiding multiplicity of proceedings
* In private companies, the small 3 of SHs minimizes the risk of frivolous lawsuits ∴ weakens the rationale for requiring leave
* The conduct needs to be oppressive **to the interests of the complainant** (i.e. personally as SH/director)
* At heart, the allegation is misappropriation of corporate property by insider Δs and remedy sought = disgorgement of ill-gotten gains back to corp.
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|  |  |  |
| --- | --- | --- |
|  | **OPPRESSION** | **DERIVATIVE ACTION**  |
| Type of harm | Personal  | Corporate |
| Standard of liability | Lower | Req’s proof of damage |
| Timing | Complainant must have been present @ time of harm | Complainant can ‘buy in’ after harm + still do DA (b/c it’s about the corp itself being harmed)  |
| Costs | Personal action ∴ costs must be covered by complainant  | Cts routinely award costs to successful claimants |
| Leave | No leave req’ment | Leave of ct req’d  |