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# Types of Business Organizations // The Basics

## Sole Proprietorship

* Simplest form of biz org
* Business that is owned by 1 person, who gets all the revenues and all the debt
* There are no formalities required, except if you use a business name other than your own name, you must file a registration ($40) BC Partnership Act **s 88**
* **Advantages:**
	+ Easy, no formal requirements other than name filing
	+ Inexpensive to set up
	+ Full control over business and profits
	+ Tax benefit: if running a business at a loss, you may claim losses as deductions for personal income
* **Disadvantages:**
	+ Unlimited liability – owner is personally liable for all the debts of the business – creditors can go after personal assets, such as homes cars etc.
	+ No perpetual existence – if the owner dies then the business comes to an end
	+ Difficult to transfer ownership (have to transfer ownership in each individual property)
	+ Tax disadvantage: if running business as a surplus, income tax will go up. Tax brackets range from 20-53.3% for sole proprietors c.f with small business tax rates which are 13-19%

## Partnership

* At least two owners (=partners)
* *BC Partnerships Act* s.2: “The relation which subsists between two or more persons carrying on business in common with a view of profit”
	+ “persons” can be a human, or another legal entity such as a corporation
	+ A partnership CANNOT be a party to a partnership. A partnership is NOT a separate legal entity and NOT a legal person
* **It is a contractual relation**
	+ Formal or informal
	+ Express or implicit agreement
* Joint tenancy or common ownership of a property do not create a partnership (s.4(1))
* Partnerships are a multilateral agency relationship.
	+ Each partner is an **agent** of all other partners and the partnership.
	+ They must put the partnership’s interests ahead of his own personal interests.
* **Advantages**: you can have two or more people doing business together,
* **Disadvantages**: each partner can be personally liable in general partnerships
* Types:
	+ **General Partnerships**
		- To form, no registration requirement. Must only agree to carry on business together for profit. Can arise out of a handshake. This differs from LP and LLP, which has formal requirements.
	+ **Limited Partnerships**
	+ **Limited Liability Partnerships**
* Usually, professionals will form LLPs, because they are prohibited from forming corporations.

## Corporations

* Most complicated form of BO: involves a relationship between directors, shareholders, officers, and others.
* Corporations are legal entities unto themselves, separate from their constituent elements.
* Five defining features:
	+ Separate legal entity
	+ Perpetual existence: can exist indefinitely
	+ Share transferability
	+ Limited liability
	+ Centralized management: governed by board of directors, not shareholders.
* How to form a corporation 🡪 Must be registered (incorporation process)
* **Advantages:**
	+ Limited liability for shareholders: no personal liability for debts of the company.
	+ Tax benefits of corporations
* **Disadvantages:**
	+ Formal requirements of incorporation and management

# Agency

* Building block of partnerships and corporations
* People implicated in agency: principal, agent, 3rd party
* **When does an agency relationship arise? All elements must be present to form agency relationship**
	+ Manifestation of consent by the P and the A
		- Can be written, oral or by consent
	+ Action by A on behalf of P
		- A must be acting primarily for the benefit of P
		- A may get remuneration for the act, but the act itself is for P
	+ Control by the P
		- If P has right to control in detail the acts of A, the A is an employee
		- If P has limited right to control the acts of A, the A is an independent contractor
* the biggest consequence of forming an agency relationship is that **A owes fiduciary duties to the P**

Principal duties to agent

* + Compensate
	+ Indemnify

Agent duties to principal

* + Fiduciary duties:
		- Duty of Care 🡪 agent must act carefully, diligently
		- Duty of Loyalty 🡪 agent must put the principal’s interests ahead of his own (***Food Lion***)
	+ Act within authority
	+ Agent cannot compete with principal
	+ Agent may not become the other party to a transaction with the principal, unless the agent discloses his role and the principal consents.
	+ Obey instructions
* In a partnership, each partner is an agent of the other partners. As a result, they owe the above fiduciary duties. Similarly, in a company, directors are agents of the company.

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| ***Food Lion*** 1999 US Court of Appeal**🡪 Agent must put the principal’s interests ahead of its own**  |
| * ABC received a tip that Food Lion was using unsanitary food handling practices
* To investigate further, 2 reporters applied to Food Lion
* They submitted resumes that omitted their employment with ABC and misrepresented their educational level
* They were hired and used mini cameras at work to capture seemingly unwholesome food practices
* Instead of suing for defamation – sued for breach of loyalty (amongst other cause of action)
 |
| Did they breach their duty of loyalty to Food Lion? YES |
| * 3 circumstances where disloyalty = tortious:
	+ When an employee competes directly w/employer (either solo or as agent of rival company)
	+ When employee misappropriates employer’s profits, property, or biz opportunities
	+ When employee breaches employer’s confidences (ex. stealing trade secret)
* Conduct of defendants doesn’t fall into above categories, but it’s comparable → interests of ABC were adverse to FL in fundamental way, even though they weren’t direct competitors
* **HELD: an agent must put the principal’s interests ahead of his own**
* Note: now there are whistleblowing statutes in place that create an exception from the duty of loyalty
 |

## Principal’s Liability to Third Party – Binding the principal to 3rd parties

### Liability in tort:

* + **Direct liability**
		- If the principal directed the agent to commit a tort or new that the authorized act would cause a tort they are liable
		- The principal is also liable for his own negligence, incl. failure to adequately supervise agent or hiring incompetent people
	+ **Vicarious liability**
		- Depends on whether the agent is an employee or independent contractor
			* If agent is acting in the scope of their employment, then the principal is liable ***Fischer v Townsends***
			* If agent is acting outside the scope of their employment, then principal is NOT liable
			* If an independent contractor, then principal is not liable
		- ***Sagaz:*** Sets out a non-exhaustive list of factors to determine whether an agent is an employee or an independent contractor:
			* Here, AIM is IC because it was compensated by commission and remained free to carry on business for others.
			* Supreme Court also considered Sagaz’s direct liability, i.e., whether it authorized the act (fraud). There was no evidence of actual or apparent authority.
			* Take-away: liability hinges of IC vs employee; test for IC.

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| ***Fisher v Townsends*** 1997 Delaware**🡪 Agent acting in scope of employment = principal is vicariously liable (look to actions of the parties and not necessarily the terms of the K)** |
| * Fisher was seriously injured in MVA. Passenger in a pickup truck driven by Reid, employee of Townsends. F alleges that T was vicariously liable for R’s negligent conduct while driving the truck. R drove to work sites in vehicles that he owned. That day R was driving a pickup truck with no seatbelts. F & 6 other employees sat in the back bed of the pickup truck. R was on his way to T’s processing plant to pick up a work order when the accident occurred.
 |
| Can T be held vicariously liable for R? Is R an agent (employee)? YES |
| * Extent of control and actions of the party determine principal/agent relationship
* Doesn’t matter what the terms of the K are – if the actions make the parties look like an employer/employee rlsp then vicarious liability.
 |

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| ***Sagaz*** 2001 SCC**🡪 Independent contractor or employee? TEST No VL for the actions of an independent contractor** |
| **Major J** | Criteria (non-exhaustive) of an employee relationship:1. Control over the worker
2. Ownership of the tools/equipment used
3. Chance of profit/risk of loss remains with the employer

NO VL for acts of independent contractors  |

### Liability in contract: is the principal bound by a contract made by the agent?

* + **Principal is liable where the agent has actual or apparent authority to enter the K on the principal’s behalf**
	+ If the agent does NOT have actual / apparent authority, then the principal is NOT bound by the contract
		- **Actual authority**
			* Actual *express* authority
			* Actual *implied* authority – **the power to do things that are necessary to fulfill the agency**
			* May be conveyed orally or in writing
			* Created when principal manifests consent to agent taking actions on her behalf
		- **Apparent authority**
			* Principal has no agreement with the agent authorizing the action, but **a third party could reasonably infer from the principals/ conduct that the agent was authorized.**
			* Depends on the belief of the third party.
		- **Attribution**
			* When an agent has the authority to act on behalf of the principal

## Agent’s Liability to Third Party

* **In tort:**
	+ If an agent commits a tort in the course of employment then they will always be liable to the 3rd party even if the principal is also liable 🡪 *a tortfeasor is always a tortfeasor*
* **In contract**: Liability turns on whether the agent’s principal is disclosed to the 3rd party
	+ if the identity of the principal is **disclosed** to the 3rd party, then the principal is also liable – contract is between the principal and the 3rd party – **agent is not a party to the contract**
	+ if the principal is only partially disclosed or identified, then the agent is almost always liable for the contract
		- 3rd party is relying on the agent
* **Warranty of authority**: promise that the agent has the authority to act on behald of the principal
	+ if the agent has actual authority, then the principal is bound by the contract
	+ if the principal breaches the contract, then the agent is not liable since the agent is not a party to the contract
	+ if the principal refuses to perform the K since he argues that the agent has no authority, then the principal is not bound by K and the agent instead is liable
	+ when an agent purports to have authority to enter into a contract on behalf of another person, warranty of authority kicks in 🡪 when the agent makes a promise that he has the actual authority to act on behalf of the purported principal. If the purported principal is in fact not bound, and the agent does not have his authority, the agent breaches the warranty of authority (and is liable for damages)

## Agency in Economics

* Agency in Economics is used in a much broader sense than in law. Agency relationship exists wherever a person seeks someone else to carry out a task on his behalf (e.g. service providers are agents of the person who hired them).
* Agency Costs:
	+ Costs of agent misusing their position (e.g. losses from cashier stealing money from store)
	+ Costs of monitoring and disciplining agents (e.g. cost of installing cameras behind cash registers to prevent theft by agent)
* Why are there agency costs?
	+ Conflicts of interest between the agent and the principal, which will almost always exist (agent wants to minimize cost and effort and maximize profit; principal wants the opposite)
	+ Information asymmetry: the agent has more information about how they will perform the task than the principal, which means that the agent is in a better position than the principal to determine how well the task is being performed.
* How can agency costs be mitigated?
	+ Align the interests between the agent and the principal (e.g. through profit sharing model)
	+ Creating information disclosure mechanisms to diminish the asymmetry of information above.

# General Partnerships

**Partnerships are multilateral agency relationships 🡪 all partners are agents for each other wrt matters related to the partnership**

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

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

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

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

* Persons: real and artificial created entities
* Carrying on business: includes every trade, occupation, or profession as defined in PA (co-ownership of land is a factor in favour of partnership but not automatic)
* With a view of profit: excludes non-profits

**Partnership is a contractual relationship:** may be formal or informal, express or implicit agreement to a relationship that looks like that set out in PA

* + **Intent does not matter** – there does not need to be an agreement that the relationship is one of partnership, just need to agree to have a relationship that appears like one
* No registration required **BCPA ss 81 & 89**
	+ Registration can be used as evidence – practically determinative – that the partnership exists
	+ **S 81**: requires registration for trading, mining and manufacturing purposes. Hw, failure to register does not mean that a partnership does not exist
* DEfn in s 2 is v. broad and includes many types of relationships
* Determination is v. fact specific
* Case law is the primary source of partnership law: **BCPA 91**: the rules of equity and of common law applicable to partnership continue in force, except so far as they are inconsistent with the express provisions of this Act.

## Determination of a partnership – characteristics // no single determinative factor // look to the nature of the relationship

* ***BCPA* s.4** - what is a partnership:
	1. **Property ownership** - joint property, tenancy in common, joint property, common property, or part ownership **does NOT of itself create a partnership**
	2. **the sharing of gross returns does NOT of itself create a partnership**
	3. **profit sharing is proof of partnership in the absence if evidence to the contrary**, **but profit sharing itself does NOT automatically make a person a partner especially in certain situations:**
		1. Where someone receives money for debts
		2. K for payment of employee doesn’t make employee liable as partner
		3. Spouse/child of deceased partner who gets $$ doesn’t become a partner
		4. Advance of $$ by way of loan to person doesn’t make the lender a partner w/person carrying on the biz
* **Intention to form a partnership**
	+ Express:
		- Parties enter into written contract 🡪 likely to be determinative of fact of partnership
		- Even if agreement specifies that they are not a partnership, it may nevertheless exist
	+ Inferred:
* **profit sharing:** necessary but not sufficient
	+ **no profit sharing = no partnership**
	+ includes loss sharing
	+ prima facie evidence of subsistence of partnership
* **right of management**
	+ generally, partners share management
		- **BCPA s 27(e)** “Subject to an agreement express or implied between the partners…, every partner may take part in the management of the partnership business.”
			* This is the default rule, but is subject to agreement of partners
			* Taken literally, this suggests that a partner’s management rights can be completely taken away by agreement. However, if this happens, it may be evidence that the person is not a partner.
* **inability to sell share of business w/o consent of the other partners *LePage***
* **entitlement to residual assets**

## Legal Status

* A partnership is **NOT a separate legal entity**, it is an aggregation of individual partners
	+ (*Re Thorne and NB WCB)*
		- Person can’t enter into a K w/himself or be his own employer; can’t sue himself
		- Can’t be both a principal and agent = conflict of interest
* Being co-owners owners does not necessarily mean partners (depends on the circumstances)
	+ (*AE LePage v. Kamex)*
	+ *(Volzeke Construction v. Westlock Foods)*
* Partners cannot be creditors or debtors of the partnership
	+ *(Pooley v. Driver)*
* Partners cannot be employees of the partnership – cannot form a contract of employment with oneself
* Partners are **personally liabile** for the partnership’s debts
* If a partner dies, resigns, or a new partner joins 🡪 **dissolution** 🡪 partnership dissolves
* Only partners pay tax, not the partnership. **The partnership itself is not a taxable entity**
* Losses are treated as allocated among individual partners, who can each use as a deduction from his personal income
* **A partnership is not a separate legal entity, so it cannot be sued**, but for convenience, a lawsuit can be brought in the partnership’s name and all of the individual partners would be bound by the judgment
* Property owned by all partners, proportional interests on an undivided basis
	+ ***BCPA* s.1.1:** “partnership property” = property and rights and interests in property a) originally brought into the partnership stock, b) acquired whether by purchase or otherwise, on account of the firm or otherwise, or, c) acquired for the purposes and in the course of the partnership business.
	+ **This means:** when a partner contributes personal property to the partnership, it becomes partnership property // they cannot take it out of the partnership without consent or the partnership (even if registered in their own name) // when partnership is terminated, the personal property does not automatically come back to the partner that contributed it // First, the assets will be used to pay off debts of the partnership. Then, the property will be available to the partnership. However, the partners must agree about how the property will be distributed; otherwise, all assets must be sold and profits paid out to the partners proportionately.

### Co-owners or Partners?

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| **LePage v Kamex** 1977 ONCA→ **distinguishing partnerships – did a partnership exist?** |
| * Kamex was created to hold a profit in trust
* Co-owners agreed that they would share profits and losses in proportion to their investment in the corp
* Any decisions on the sale of the building would be made through a majority vote
* There was a right of first refusal among the co-owners – if not exercised, owner may sell his/her interest
* The owners agreed to list the property for sale under a non-exclusive listing, but one co-owner, March, made an exclusive listing agreement with a real estate agent (LePage)
* At the time of executing the lisiting agreement, March told LePage that he was an agent for the partnership and had the authority to execute the agreement on behalf of the partners
* Eventually, the sale went through under another agent’s listing
* LePage sued, arguing that the co-owners were a partnership and were bound by the agreement made between March and LePage
 |
| Did a partnership exist? NO |
| **Blair JA** | * **HELD:** No partnership existed, why?
	+ **There are some features of a partnership –** eg. Profit/loss sharing
	+ Mere fact that property is owned in common and profits derived therefrom doesn’t itself create a partnership 🡪 look broader to the intention as disclosed by all facts of the case
	+ **The right of first refusal is incompatible with a partnership as the property is not divisible btw the partners**
		- * “A partner’s right is a right to a division of profits according to the special arrangement, and as regards to the corpus to a sale and division of the proceeds on dissolution after the discharge of liabilities. This right, a partner may assign, but he cannot transfer to another an undivided interest in the partnership property in specie.”
			* Partners can’t transfer property to 3rd parties w/o consent of all partners → fact that these owners could sell to 3rd party w/o consent (just have to offer right of first refusal) = co-ownership, not partnership

**Note: LePage could sue March for breach of warranty of authority** |

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| **Volzke v Westlock** 1986 ABCA→ **distinguishing partnerships – did a partnership exist? Look at intentions!** |
| * Westlock has 20% share of mall / Bonel has 80%
* V is a contractor, which was contracted by Bonel
* When Bonel failed to pay V, V sued Westlock for payment
* Parties agreed to share profits and losses – had joint bank account, referred to each other as partners and shared expenses of developing the shopping mall
 |
| Did a partnership exist? YES |
| **Moir JA** | * **HELD: there was a partnership**
	+ **Control is not part of the defn of a partnership // a partner does not have to be an active partner – can be silent/inactive**
	+ **Nothing in the PA requires control for the existence of a partnership**
 |

### Lenders as partners?

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| **Pooley v Driver** 1876 England HL→ **distinguishing partnerships – Lenders are NOT partners** |
| * Borret and Hagen formed a partnership and took out a loan
* The loan agreement:
	+ Incorporated the partnership agreement
	+ The lenders were to share profits
	+ The lenders bankruptcy would end the loan agreement
	+ If the business came to an end, the loan would be repaid by the residual assets
	+ The lender did not participate in the management
* When the business failed to pay Pooly, he sued the lenders, arguing that they were partners of the borrowers
 |
| Did a partnership exist? NO |
| * **HELD:** lenders are not partners – **creditors or debtors of the partnership are NOT partners**
* Analysis:
	+ The lenders shared profits out of the business. The share of the profits was not limited to the amount of the loan.
		- Usually, lenders will receive a fixed amount. This makes the lenders more like partners, who receive share of profit as long as the business subsists.
	+ Bankruptcy would trigger the dissolution of the loan agreement
		- A partner’s bankruptcy is a common trigger for the dissolution of the partnership, because they are personally liable for the debts of the business. If one partner is bankrupt, the personal assets of the other partner’s are more liable than otherwise.
	+ The residual assets
		- Residual assets are the assets left after creditors have been paid off.
 |

## Relationships between Partners

* A partnership is a contract
* ***BCPA* s.21**: Provides a set of default rules regarding mutual rights and duties can be **altered by unanimous consent**
	+ “The mutual rights and duties of partners, whether ascertained by agreement or defined by this Part, may be varied by the consent of all the partners and the consent may be either express or inferred from a course of dealing”
	+ Rules based on **assumptions** that partners are equal re:
		- Capital contributions
		- Rights to participate in management of the biz
		- Rights to share in profits
* **Absent a contrary agreement, partners have:**
	+ Equal sharing in profits and losses **(s.27(a))**
	+ Management rights **(s.27(e))**
	+ Majority vote for ordinary matters, must be unanimous consent for fundamental changes **(s.27(h))**
	+ No new partner unless unanimous consent **(s.27(g))**
	+ Majority cannot expel a partner, unless power to do so has been conferred by an express agreement and power is exercised in good faith **(s.28)**
		- **Workaround🡪 dissolve the partnership and reform it without the partner you want to expel**
* **Fiduciary duties cannot be contracted out of:**
	+ Act with utmost fairness and in good faith **(s.22)**
	+ Duty of full disclosure **(s.31)**
	+ Duty to account for unconsented benefits **(s.32)**
	+ Duty to not compete, unless consent is given **(s.33)**
* **Dissolution can only occur when:**
	+ Partners themselves agree: **(s.35)**
		- At a fixed term **(s. 35(1)(a))**
		- At a particular undertaking
		- At will
	+ On death, bankruptcy, or dissolution of a partner **(s.36)**
		- This standard form provision frequently overridden by express agreement between the partners that the death, bankruptcy or dissolution of a partner **does not** result in the dissolution of the partnership as between the remaining partners
		- Where there are more than 2 partners, death/bankruptcy/dissolution of partner only dissolves partnership between the deceased/bankrupt/dissolved partner and the remaining partners (partnership agreement continues to apply for remaining partners) (**s. 36(b)**)
	+ Becoming unlawful **(s.37**)
	+ Judicial dissolution **(s.38.1)**

## Relationship between Partners and Third Parties

* **Pre-partnership** **liability** – a person who joins a pre-existing partnership is not liable for the debts of the partnership from before he joined **(s.19(1))**
* **Retired partner liability** – once a person is a partner, the person does not cease to be liable for the debts of the partnership that occur before his retirement **(s.19(2)+(3))**
* **Posthumous** **liability** – a retired partner is not liable for new debts after the partner has retired except in some circumstances if he is being held out as an existing partner
* “**Holding out” liability** – a continuous liability for retired partners in some limited circumstances, i.e. if the retired partner’s name is still on the website, third parties may believe that the retired partner is still an active partner **(s.16**)
* **Current partner liability** – clearly liable
	+ Partners are personally liable for all partnership debts
	+ Partners are **joint and severally liable** for partnership debts arising from partner misconduct and misallocation, are merely jointly liable for all other partnership debts (**ss. 11, 12, 14**)
	+ **Jointly & severally** = creditor can pursue any of the partners individually as defendants → doesn’t have to included all partners as defendants in lawsuit. If creditor releases claim against one partner, doesn’t release claim against others.
	+ **Jointly** = must include all partners as defendants in the same lawsuit. If creditor releases claim against any of the partners, it releases the claim against all partners

## Partners Liability in Contract

* Drawn straight from agency law
* **BCPA ss. 7-10:** potential defenses to liability in K

**s 7 – Liability of partners – Apparent Authority**

1. A partner is an agent of the firm and the other partners for the purpose of the business of the partnership
2. The acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he or she is a member bind the firm and his or her partners, unless
	1. The partner so acting has in fact no authority to act for the firm in the particular matter, and
	2. The person with whom he or she is dealing either knows that the partner has no authority, or does not know of believe him to be a partner

**s 8 - Acts or instruments in firm name – Actual Authority**

(1) An act or instrument relating to the business of the firm and done or executed in the firm name, or in any other manner showing an intention to bind the firm, by any person authorized to do so, whether a partner or not, is binding on the firm and all the partners.

(2) This section does not affect any general rule of law relating to the execution of deeds or negotiable instruments.

* If the agent has apparent authority, then the partnership is bound

**S 9 - No pledge of credit for nonfirm business – No Apparent Authority**

(1) If one partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary course of business, the firm is not bound unless the partner is in fact specially authorized by the other partners.

(2) This section does not affect any personal liability incurred by an individual partner.

**S 10 - Notice of restriction of power of partner – No Actual Authority**

If it has been agreed between the partners that a restriction is to be placed on the power of any one or more of them to bind the firm, an act done in contravention of the agreement is not binding on the firm with respect to persons having notice of the agreement.

* Notice includes actual and deemed knowledge

**Summary:**

* S 7-10 deal with whether the partnership is bound by the contract entered into by a partner
	+ Actually authorized to do so 🡪 bound under s 8
	+ If the transaction is an ordinary business matter of the partnership (apparent authority) 🡪 bound, unless no actual authority and 3rd party knows that (s 7)
	+ Unrelated business matters (no apparent authority) 🡪 not bound unless actually authorized s 9
	+ Restriction on authority (no actual authority) 🡪 not bound, if 3rd party knows about the lac of authority (s 10)
* Need to understand agency to delve into this section, because s 7-10 are just more complex restatements of agency law

## Partners Liability in Tort – s 12

**Liability of firm – BCPA 12:**   If, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his or her partners, loss or injury is caused to any person who is not a partner in the firm or any penalty is incurred, the firm is liable for that loss, injury or penalty to the same extent as the partner so acting or omitting to act.

* **S 14:** liability is joint and several
* **Eg.** Partner hits a pedestrian while driving a delivery for the partnership. Are the other partners liable? – Yes, it is an act committed in the ordinary course of business of the partnership

### Other Matters

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

### Retirement of Partners

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

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

**Steps to Avoid Liability:**

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

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

# Limited Partnership & Limited Liability Partnerships

* LP and LLP are still subject to the same statutory requirements of a GP, unless

|  |  |  |  |
| --- | --- | --- | --- |
|  | **General Partnership** | **Limited Partnership** | **LLPs** |
| **Formation:** | No formalities, factual determination | Partnership agreement and filed with registrar a certificate signed by each general partner **(s.51)** | Need to file certificate  |
| Although BC requires registration for trading, manufacturing, and mining purposes, it is not a prerequisite for the existence of a partnership | 1+ general partner1+ limited partner **(s.50(2))** |  |
| **Personal Liability:** | Each partner is personally liable for all the debts of the partnership | Only general partners are personally liable (home, car, personal assets). Limited partners are not personally liable, limited to the amount of capital contribution (amount invested in the partnership). **(s 63)** Limited partners may become personally liable if:1. take part in management (**s 64)**
2. defective formation
3. last name appears in the firm name **(s.53)**
4. false statement in certificate **(s.74)**
 | Full-shield – no personal liability except for the exceptions below (see LLP) |
| **Management**: | Absent a contrary agreement, each partner may take part in management and have the power to bind the partnership for ordinary business matters | Absent a contrary agreement, both the day-to-day management and the power to bind the limited partnership are reserved to the general partners. Limited partners must be passive investors, they cannot be active investors. Limited partners do not take part in “management”, if do, then at the risk of losing limited liability **(s.64)** General partners have fiduciary duties to general and limited partners, but limited partners generally do not owe fiduciary duties * **s. 60** – limited partners can engage in conflict of interest biz
 | Statute is silent on how to arrange management – rules of GPs apply Each partner has an equal right to take part in the management of the business |
| **Profit sharing** | Equal sharing  | LP: share profits in proportion to their respective capital contribution GP: share profits equally  | Statute is silent on this - GP rules apply – equal sharing  |

## Limited Partner’s “Participation in Management”

* **K liability operates the same as a GP; LP is still not a separate legal entity**
* **Tort Liability is different – Limited partners will not incur tort liability if they do not get involved in management/control of the biz**
* **In any context the liability of limited partners is restricted to the amount they contributed to the LP**
* **BCPA (64)**
	+ **A limited partner is not liable as a general partner unless he or she takes part in the management of the business**
* Ontario Limited Partnerships Act (13.1)
	+ 13. (1) A limited partner is not liable as a general partner unless, in addition to exercising rights and powers as a limited partner, the limited partner takes part in the control of the business.
* Limited partners in BC are more likely to be subject to personal liability

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| **Haughton Graphic Ltd v Zivot** 1986 Ont HC → **“takes part in the management/control” – LP’s who hold themselves out to have control over the biz may still be held liable**  |
| * Ds wanted to launch a magazine to be published in the US
* Printcast LP was made up of (intended structure):
	+ Marshall – Limited partner (VP)
	+ Zivot – Limited partner (P)
	+ Lifestyle Corp. – General partner 🡪 Zivot (shareholder)
* Marshall and Zivot represented to an AB printing company that they were VP & P of Printcast LP
* Deal was struck between them and the printing company – but magazine LP went bankrupt, leaving the printing company unpaid
* Printing company sued the LPs personally to get their money back
* In order to avoid personal liability, Zivot formed Lifestyle to be the general partner, which he controlled- Zivot controlled that corporation which employed both defendants
 |
| Should the LPs in their personal capacity be held liable for debts owed by the LP (on the basis that they took part in the control of the business?)- YES |
| **Eberle J.** | * Held: M & Z were responsible as general partners b/c of the amount of control they exerted over the biz
* Also held themselves out to be president/VP of Printcast, implying control over the company & general partnership
* Haughton Graphic Ltd sues Printcast LP
* The partnership was governed by the AB Partnership Act (requires control, not simply taking part in the management)
* The court ruled that the two limited liability partners were personally liable because in their capacity as partners they made
 |

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| **Nordile Holdings v Breckenridge** 1992 BCCA → **“takes part in the management/control” – determine roles by looking at behavior towards 3rd parties // not liable if you are taking part in the management under another role (ie. officer/director of the GP) instead of as a LP** |
| Breckenridge was a limited partner of Arman Rental Properties LP and was also a minority shareholder and officer/director of Arman and Arbutus Management, the sole GP of Arman. Arman fell into default on a mortgage payable to Nordile. Nordile sued Breckenridge as a partner of Arman for recovery of the unpaid mortgage.Relationship: B = LP of ARP, B = minority GP and director of A&A, A&A = GP of ARP. |
| Was B, as a LP of Arman, shielded from liability? Yes, not liable.  |
| **Gibbs JA.** | * Held: Not liable, because they were acting in their capacity as directors of the general partner (A&A), not as general partners themselves in the LP (ARP)
* **Limited partners may be personally liable if they participate in the management of the partnership in their capacity of partners (instead of their capacity of director/officer etc)**
* How do you determine what capacity they were operating in? 🡪 Look to their behavior towards 3rd parties
 |

## Relationships amongst Partners – Forming the LP and adding new Partners

* **S. 51** – all general partners need to sign a certificate to form LP
	+ (4)(c) requires that right to admit additional limited partners must be set out in the LP certificate
* **S. 66** – assignee doesn’t become a partner until name is recorded on the certificate
	+ Partner can’t assign interest in the partnership w/o consent of the other partners
	+ If assignment permitted in partnership agreement, **s. 51(4)(b)** provides that certificate must set out provisions concerning the right to make such an assignment, and the terms/conditions of the assignment.
* **S. 67** – death etc. doesn’t necessarily dissolve LP if the general partners want to continue the biz

## Things that General Partners Can Do and Can’t Do: BCPA s 56

* **56** A general partner in a limited partnership has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership without limited partners except that, without the written consent to or ratification of the specific act by all the limited partners, a general partner has no authority to do any of the following:
	+ (a) to do an act which makes it impossible to carry on the business of the limited partnership;
	+ (b) to consent to a judgment against the limited partnership;
	+ (c) to possess limited partnership property, or to dispose of any rights in limited partnership property, for other than a partnership purpose;
	+ (d) to admit a person as a general partner or to admit a person as a limited partner, unless the right to do so is given in the certificate;
	+ (e) to continue the business of the limited partnership on the bankruptcy, death, retirement, mental incompetence or dissolution of a general partner, unless the right to do so is given in the certificate.

## Things that Limited Partners Can Do and Can’t Do

* Lose LL if taking part in the management of the partnership
* **S. 55** – limited partner’s contributions: a LP can contribute money but not services
* Statutorily permitted activities:
	+ Right to inspect books and receive specific information **s 58(1)(a)&(b)**
	+ Right to obtain dissolution by court order **s 58(1)(c)**
	+ right to participate in profits and return of capital **s 59,61,62,73**
* **LPs have priority over GPs in asset distribution at dissolution of partnerships**
	+ Creditors get priority 🡪 then return capital to limited partners
	+ If assets still remain 🡪 pay out profits to limited partners
	+ If assets still remain 🡪 pay general partners for anything other than capital and profits eg. Any advances made by general partners to pay debts
	+ Any residual assets 🡪 Return capital to general partners then pay them profits
* A LP may lend money, borrow money and transact with the LP **s 60(1)**
* Give consent on certain matters (eg. Admit new partners) **s 56**

## Being a GP and LP at the same time

**BCPA** s 52:

**General and limited partners**

**52**  (1) A person may be a general partner and a limited partner at the same time in the same limited partnership.

(2) A person who is at the same time a general partner and a limited partner has the same rights and powers and is subject to the same restrictions as a general partner but in respect of the person's contribution as a limited partner, the person has the rights against the other partners that the person would have had if he or she were not also a general partner.

* We need to differentiate between 3 types of partners in a partnership
	+ At least 1 LP
	+ At least 1 GP
	+ But a partner can simultaneously be a GP and LP
		- The difference between these kinds of partners is based on the relationship amongst the partners
		- Persons with dual roles will be treated as a LP for matters dealing with entitlement to capital contribution
		- For other matters, they will be treated as a GP

## Limited Liability Partnership (LLP)

* **Formation**
	+ File a registration statement
* **Liability (s 104) (Full Shield in BC)**
	+ Each partner is **not** personally liable for the debts of the partnership, except
		1. For the partner’s own negligent or wrongful act or omission, or
		2. For the negligent or wrongful act or omission of another partner or an employee of the partnership if the partner seeking relief :
			- Knew of the act or omission, and
			- Did not take the actions that a RP would take to prevent it
* In BC, LLP are available to many different types of businesses
	+ In other jurisdictions, they are only available for self-governing professions
* In BC 🡪 Full-shield protection
	+ Partners have no personal liability except the two above situations
* Other provinces ie. Ontario 🡪 **Partial-shield**
	+ All partners are personally liable, except for another partner’s misconduct or negligence
		- No protection against contractual liability

## Other Forms of Partnerships

* Partnerships available in the US but not Can:
	+ LLLP
		- Began in 1993, in Texas
		- Requires registration of certificate
		- Limited liability is extended to GPs of a limited partnership in the same manner as it is to partners in an LLP
		- In all other respects, an LLLP is just like a regular LP
	+ LLC
		- Limited liability company
		- Available in all 50 states
		- Tax-driven
		- Need to file a certificate to create
		- Coexistence of partnership tax status
	+ In Canada we have ULC – same tax benefits as LLC, commonly used to purchase US company’s

## So why take the risks to form a GP, given the liability considerations?

* Historical answer 🡪 tax advantages
	+ Not currently much of an advantage
* Sometimes the arise inadvertently

# An Introduction to the Corporate Form: What is a Business Corporation?

* Investment vehicle for pooling of money and labour
* Assets = Liabilities + Equity
* Shareholders cannot receive returns until all creditors have been fulfilled
* If assets > liabilities
	+ Positive equity
* If assets < liabilities
	+ No equity
* Priority of asset allocation: Secured creditors 🡪 unsecured creditors 🡪 shareholders

## Characteristics:

### Operated for profit

* + Profit maximization as the single, exclusive goal?
		- Not always – can be a for profit corp, or a not for profit corporation
		- No statute mandates this goal – it is implicit

### Separate legal entity

* + Most important separation is the separation from shareholders
	+ ***Salomon v Salomon & Co* 1897 Eng HL**

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| **Saloman v Saloman** 1897 Eng HL → **1 man corporation // A corporation can be validly formed even where the shareholders have little genuine interest in the company (Mr. S’s has vast majority of shares 20,000 while his wife and children each held 1 share)** |
| * Mr. Salomon had a leather boot manufacturing business
* Mr. Salomon incorporated – statute required 7 shareholders (Mr. Salomon was 1, along with his wife and 5 children who each held 1 share)
* Mr. S held 20,000 shares and 10,00 **debentures** – made him a secured creditor of the corp
* Issue: was the company validly formed?
	+ If yes – Mr. S has no personal liability
	+ If no – then he would be liable to the unsecured creditors
* Secured creditors argued that the secured debentures were fraudulent 🡪 money should go to secured creditors ahead of Mr. S
 |
| Could Mr. S be held personally liable for the company’s debts? NO  |
| **Reasons** | * **Court holds** that the corporation can be validly formed even if the shareholders have little genuine interest in the company
* The efforts that Mr. S made to save his company (lending his own money, selling debentures) allowed the court to conclude that he did not fraudulently create the corporation
* HELD: corporation is valid, Mr. S has no personal liability
* Result: unsecured creditors should have protected themselves as they knew that they were dealing with a limited liability entity either by becoming secured creditors or contract out of limited liability – ask for a personal guarantee from Mr. S, or buy insurance
 |

### **Limited liability –** shareholders have no personal liability for the debts of the company

* + Benefits:
		- Reduces need to monitor agents (managers)
		- Reduces need to monitor other shareholders
		- Makes shares fungible (which also facilitates takeovers)
		- Facilitates diversification (dear to invest in many companies)
		- Gives creditors incentive in monitoring managers (because creditors bear some downside risk)
	+ **CBCA** 45(1) The Shareholders of a corporation are not *as shareholders,* liable for any liability, act or default of the corporation
	+ Corporation’s creditors have no claim on the shareholder’s assets and vice versa

### Perpetual existence

* + Benefits:
		- Continues even though changes in corporate constituents
		- Allows long-term plan
		- Doesn’t necessarily mean the company will exist perpetually but it can in theory

### Transferability of share interests

* + Benefits:
		- Allows shareholders to exit without disrupting business
		- Permits takeovers 🡪 disciplines management
		- Facilitates active stock markets, increasing liquidity

### Centralized management – BoDs

* + Common Law
		- Shareholders were not allowed to fetter the management discretion of directors
	+ **Canada Business Corporations Act (CBCA)**
		- Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of the business and affairs of a corp (102(1))
		- The management powers of directors, may be restricted, in whole or in part, by a written unanimous shareholder agreement (146(1))



## Consequences of Separate Legal Entity

* Limited liability
* Perpetual existence
* Can contract including with shareholders
* Corporate assets owned by the company
* Capacity to sue
* Separate tax entity
* What about rights?
	+ ***Citizen United v FEC*** (2010 USSC)
		- Can a corporation make a contribution to a political candidate
		- Should corporations have the same 1st amendment rights as people? (guaranteeing free speech)
		- Allowed corporations to donate significant funds to candidates
		- Raised the question 🡪 what is the role of a corporation in today’s society

# Piercing the Corporate Veil

* Piercing the corporate veil is an equitable remedy through which courts set aside the corporate personality and hold shareholders personally liable for debts of the company
* Most litigated issues in corporate law – challenges the fundamental attribute of a corp
* Guidelines are v vague
* To address the moral hazard problem

**Problems with limited liability**

* **Moral hazard**
	+ An economic actor shielded from risk may behave differently from how it would if it was fully exposed to it
	+ Opportunity for an economic actor to reap rewards of risky behavior without bearing associated costs

## What is piercing the corporate veil?

* Typical: disregard the corp as a separate legal entity and hold its shareholders liable for the corps debt
* Variant: shareholders seek benefits or rights that would be denied if the corp entity were respected
* *Incorrect:* directors/officers responsible for their act in the course of business of the corporation ***ADGA***
	+ Holding a director liable for their tortious act is not an example of piercing the corporate veil

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| **AGDA Systems International v Valcom** 1999 ONCA → **It is not “piercing the C veil” when you hold a director/officer/employee liable for a tortious act // a tortfeasor is a tortfeasor** |
| * AGDA alleged that Valcom’s director and two senior managers had approached AGDA’s senior employees before the submission of the bids for a government project
* AGDA had employees to complete the contract but Valcom did not (why Valcom tried to poach AGDA’s employees)
* Valcom won the contract from the govt
* AGDA sued the directors and the managers of Valcom in tort 🡪 alleged they committed a tort by inducing AGDA’s employees to breach their fiduciary duties to AGDA
 |
| Can directors and/or employees be sued as individuals for torts committed during the normal course of their duties? |
| **Reasons** | * HELD: **as a general rule directors/officers/employees can be liable for the same torts as their employers/coprs provided that their actions were also tortious even though they are acting in the best interest of the employer/corp**
	+ But, subject to an exception: **directors/officers/employees are not personally liable for causing the company to breach a contract with a 3rd party if they believe that such a breach is in the best interests of the corp**
		- **Eg.** A company failed to install adequate infrastructure and caused damage to residents in a community – company is liable // directors liable if they meet all the requirements of negligence (aware of harm and fail to act based on that knowledge to take reasonable protective measures) // has nothing to do with piercing the veil
			* **But** directors would not be liable for inducing the company to breach a contract 🡪 contracting parties are in a better position to protect themselves than involuntary creditors (tort victims) // ie. They can seek insurance
 |

## What Piercing the Corporate Veil does NOT do:

* It does NOT dissolve the corporation
* It does NOT make the shareholders liable for ALL the corporation’s debts, they are only liable for the specific claim at issue

## When to pierce (Canada):

* Fraud or improper purpose / conduct
* Sham or alter ego of the shareholder
* Merely agent of the shareholder
* Inadequate capitalization
* Tort claims (involuntary creditors)
* Single economic unit / enterprise liability ***Smith factors* see below**
* Equity or the interests of justice are better served \*\*(wild card)\*\* 🡪 creates uncertainty, gives court great discretion to pierce or not
* In practice, requires a holistic approach as to whether the court will pierce the veil 🡪 leads to great uncertainty!
	+ Canadian stats:
		- 619 cases relating to piercing the veil 🡪 courts pierced in 36% of the cases (comparable to US cases)
		- more shareholders 🡪 less likely to pierce
		- courts have never pierced the veil of a publically traded company
		- when the claimant is the govt 🡪 less likely to pierce
		- common belief is that courts are more likely to pierce when it is a tort claim 🡪 why? b/c involuntary creditors are affected (victims) // NOT TRUE on the stats

### Typical piercing vs Reverse Piercing

* Forward piercing: Corp’s creditor goes through the corporation itself to access the shareholder’s assets
* In Clarkson: the shareholder’s creditor wanted to pierce the veil to access the corporation’s assets // REVERSE PIERCING
	+ Usually less recognized than forward piercing but is not uncommon in Canada 🡪 1/5 cases successful. More likely where there is only 1 shareholder

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| **Clarkson Co v Zhelka** 1967 ON HC → **Piercing the C veil – more likely to pierce where transactions were questionable – where the C was created to defeat creditors** |
| * Selkirk incorporated numerous companies including Industrial and Fidelity
* Industrial’s only asset was a parcel of land, purchased using funds from the companies
* A part of this land was sold to Zhelka (Selkirk’s sister)
* Zhelka paid with a promissory note, later mortgaged the land
* Part of the land was sold in a foreclosure proceeding to pay off the mortgage, part of the proceeds of the sale ended up in Fidelity’s accounts
* Selkirk ended up going bankrupt
* Clarkson (bankruptcy trustee) argued that Selkirk’s personal property should be sold to pay the debts of the companies
 |
| Was the land owned by Industrial or Selkirk 🡪 should it be distributed to creditors? (If owned by Industrial then the court would need to pierce the corporate veil to gain access to the assets) |
| **Reasons** | * **First step 🡪 analyze the transaction between Industrial and Z**
	+ If it was fraudulent then it could be reversed
		- The transaction was voluntary and without consideration and was fraudulent – intended to defeat creditors; therefore, the land was still in Industrial’s possession
* **Second step 🡪 determine relationship between Industrial and Selkirk**
	+ HELD: found that the corp was validly formed // no veil piercing
		- *Insolvency at the time of incorp will provide evidence that incorporation was to defeat creditors*
		- Selkirk did not transfer money to industrial
		- **Court finds questionable transactions (comingling the assets within the companies), but not enough to pierce the veil b/c the creditors were not affected by the questionable transactions**
		- No evidence the corp was a sham
* This was not a typical piercing // reverse piercing
	+ By selling the land and not the shares in the company they could get $$$
	+ Personal creditor’s of S wanted access to Industrial’s corporate assets (reverse piercing)
 |

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| **Lee v Lee’s Air Farming Ltd** 1961 Australia → **Someone can be both a director of a company and its employee because the company is a separate legal entity. No piercing here – he was acting in the capacity of an employee – corp was not a sham** |
| * Lee was the pilot at Lee’s Air Farming
* He was the director, single shareholder
* Claimed under WCA for compensation after he was killed in the course of work
 |
| * Was Mr. Lee a worker (qualifying himself for worker’s comp?)? Was his corp a distinct entity from himself as a worker
 |
| **Reasons** | * HELD: corporation was not a sham, an individual does not lose their individual status by the mere fact that he incorporates
	+ Can wear different hats in the corporate structure
	+ Ask: **in what capacity was he acting at the time?**
		- Acting as pilot 🡪 employee
* Again an atypical situation of piercing – usually the shareholders
 |

## Single Economic Units / Enterprise Liability

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| **De Salaberry Realties v MNR** 1974 FCA **Piercing the C veil – needs threshold criteria + policy concern (ie. tax evasion)** |
| * Two family groups who set up subsidiaries to buy/sell land
* D was a subsidiary company, related to a number of other companies & ultimately controlled by Grandparent Company. Profit was made on sale of land, and Q was whether this income belonged to D, for purposes of *Income Tax Act*.
* Decision making power held by the parent/grandparent companies
* Was the subsidiary in the real estate business 🡪 then the proceeds would be taxable
* If not 🡪 the profits would be capital gains (not subject to taxation at that time)
 |
| Was subsidiary an instrument doing biz on behalf of the parent company, or was it a separate legal entity? YES it is an instrument |
| **Reasons** | * Court refers to factors from ***Smith, Stone and Knight Ltd. v. Birmingham Corporation*** (laid out exception to *Saloman)*
	+ Were the profits treated as profits of the parent company?
	+ Where the persons conducting the business appointed by the parent company?
		- Strong evidence if there is 100% overlap in the persons controlling/managing the businesses
	+ Was the parent company the head and brain of the trading venture?
	+ Did the parent company govern the trading venture, decide what should be done, and what capital should be embarked on the venture?
	+ Did the parent company make profits by its skill and direction?
	+ Was the parent company in effectual and constant control?
* HELD: yes the relationship between the subsidiary and the parent company was sufficient to meet these factors 🡪 **should be treated as a single economic unit**
* BUT in applying these criteria, any subsidiary would not have a separate legal entity from their parent company… not likely the intention of the court
* So what was the key reason why the court pierced the veil?
	+ **Policy concerns 🡪 purpose of the pyramidal business structure was to avoid/evade taxes**
		- Tax evasion is an improper purpose
* **So how to use these? Treat the criteria as a threshold to meet, but then you will likely need some policy concern to bring it over the top and justify piercing the veil.**
 |

# Mechanics of Incorporation

**Why Incorporate:** limited liability (this can be contracted away if the shareholders agree to it), perpetual existence, share transferability \*\* important perk 🡪 shares traded in the public stock market, shareholders alone cannot bind the corp UNLESS the shareholder is specifically authorized to act on behalf of the company, shareholders can contract with the corporation, tax benefits

## Where to incorporate

* Federal (***CBCA)*** or Provincial (or elsewhere 🡪 tax havens)
	+ Corp governed by the law of the place of incorporation
	+ Provincial income tax is based on the income earned by the company in that province 🡪 regardless of the place of incorporation 🡪 within Canada tax is not an important factor
	+ ***CBCA s.15(2):*** “a corporation may carry on business throughout Canada.”
		- ½ of the publically traded companies in Canada
	+ ***BCBCA s.375(1):*** “a foreign entity must register as an extraprovincial company in accordance with this Act within 2 months after the foreign entity begins to carry on business in British Columbia.”
		- You have to file the appropriate form in each province you wish to carry out business – added step for incorporating under federal CBCA
* Place of incorporation does NOT equal place of headquarters
* Jurisdictions may compete in corporate law in order to attract companies to incorporate in their province
	+ “Delaware phenomenon”🡪 more than 50% of publically traded companies are incorporated in Deleware
		- why?
			* Offers a management friendly corporate law – gives directors wide discretion
			* Lower taxes
* **Types of Canadian Corporate Statutes:**
	+ Statutory division of powers model (USA)
		- ***CBCA*** and other provinces
		- Rights and responsibilities of directors, shareholders, etc., are well defined and specified by the statute. Leaving little room to be modified by the corporation.
	+ Contractarian model (Old English)
		- BC and Nova Scotia
		- Permits more contractual freedom than statutory model
		- Allows more flexibility to arrange the relationships amongst directors and officers
* Corporation can move other places once incorporated (USA – re-incorporation)
	+ ***CBCA s.187*** Import Continuance
		- Move into CBCA
	+ ***CBCA s.188*** Export Continuance
		- Move out of CBCA
	+ Continuance does not affect a company’s relationship to third parties, such as creditors. It really only affects shareholders, directors, and officers (internal governance).

## Who Can Incorporate

* ***CBCA s.5***: “(1) One or more individuals not one of whom
	+ (*a*) is less than eighteen years of age,
	+ (*b*) is of unsound mind and has been so found by a court in Canada or elsewhere, or
	+ (*c*) has the status of bankrupt,

…may incorporate a corporation by signing articles of incorporation and complying with section 7.

* + 1. One or more bodies corporate may incorporate a corporation by signing articles of incorporation and complying with section 7.
	+ Note: partnerships cannot incorporate because they are not separate legal entities
* **Steps of incorporation:**
	+ File the articles of incorporation (s.6 sets out the required articles)
		- Include corporate name
			* Must include signaling word denoting limited liability
		- Province of registered office
		- Class and maximum number of shares that the corporation is authorized to issue
		- Restrictions on share transferability
		- Minimum and maximum number of directors (min=1, unless public company min=3)
		- Restrictions on business (usually none)
		- Other provisions
		- Signatures
		- Date at which the company comes into existence - important to get this date accurate
	+ File a notice of the registered office of the corporation (s.19)
	+ File a notice of directors (s.106)
	+ Pay the prescribed fees
	+ Certificate of incorporation issued (s.9)

# Pre-incorporation Contracts

## Under the Common Law and Statute

* When is the **promoter** personally liable to the contract:
	+ Both parties knew the company did not exist and intended to be enforceable 🡪 liable
		- (*Kelner v. Baxter*)
	+ At least one party mistakenly believed the corporation was validly formed 🡪 NOT liable
		- (*Black v. Smallwood, Wickberg v. Shatsky*)
* When is the **corporation** liable / bound by the pre-incorporation contract:
	+ No way to bind a corporation to a pre-incorporation contract under common law 🡪 NEVER liable
		- Common law struggles with this question. Still uncertain, but the help of modern corporate statutes clarifies. Common law still plays an important role, especially for unwritten oral contracts. As a promoter, it is best to wait until the corporation has been formed to enter into any contracts. **Do not enter into any pre-incorporation contracts, if possible.**
	+ **S 14(1): subject to this section, a person who enters or purports to enter a written contract in the name of or on behalf of a corporation, before it comes into existence is personally bound by the contract and is entitled to its benefits**
	+ **S. 14(2):** corp. may, w/in reasonable time after it comes into existence, **by any action or conduct signifying its intention to be bound thereby**, adopt a **written K** made before it came into existence in its name or on its behalf, and on such adoption.
		- **Corps has to adopt pre-incorp. Ks in order to remove personal liability of promoter**
	+ **S.14 (3)** 🡪 party to a contract may apply to the court for an order respecting the nature and extent of the liabilities under the contract. It simply says the court can apportion liability between the promoter and corp upon application by the promoter or third party.
	+ **S.14(4)** 🡪 This section says promoters can contract out of personal liability. Promoters’ personal liability can be disclaimed **by written agreement.**
* Default rule: promoter is liable until the corporation comes into existence
* But at the very beginning the promoter can contract out of this liability from the very beginning

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| **Kelner v Baxter** 1866 England 🡪 Look to the intentions of promoters and K signers to determine whether to hold the promoters liable personally |
| * Contract made for sale of wine to a hotel chain (D’s hotel chain)
* Defendant promoters signed “on behalf of the hotel company”
* Both contracting parties were fully aware that the corporation had not yet formed
* Hotel company when bankrupt
* Promoters argues they did not enter into the contract as individuals 🡪 should not be personally liable
 |
| Is the pre-incorporation contract binding on the promoters personally? YES  |
| **Reasons** | * Court considers 3 lines or argument:
	+ No principal b/c company didn’t exist yet, so not liable under agency law
	+ Court also rejects ratification argument – can’t ratify a K created before company came into existence (NOW YOU CAN –s. 14(2))
	+ **Intention: Parties indicate intention to be bound – both parties knew company didn’t exist, but went ahead w/K anyway and intended it to be enforceable**
* **HELD:** contract is enforceable b/c of the intentions of the parties // K would be wholly inoperative unless it was held to be binding on the defendants personally
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| **Black v Smallwood** 1966 Australia 🡪 Look to the intentions of promoters and K signers to determine whether to hold the promoters liable personally // bookend case to Kelner – diff end result // if the company is the signatory and that company does not yet exist then the K is invalid (unless ratified under 14(2)) |
| * Promoters signed a lease for land but the transaction falls through
* Signatory was the company – not the promoters individually or “on behalf of the company”
 |
| Is the pre-incorporation contract binding on the promoters personally? NO |
| **Reasons** | * HELD: promoters were not liable b/c in the way the promoters signed the contract indicated that they were Directors of the company
	+ **Intention is key = Company was the intended signatory**
	+ **K was invalid because the company did not exist at the time the K was created**
	+ Judge distinguished Kelner – parties in Kelner knew the company did not exist but still entered the K
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| **Wickberg v Shatsky** 1969 BCSC 🡪 employment K with pre-incorporation company = invalid because company does not exist at the time the contract is made // distinguishing Kelner // still can sue promoter for breach of warranty of authority  |
| * New company that was supposed to take over the old company, but new company was never formed “Rapid Data (Western) Ltd”
* Employment K between the new company and the plaintiff was entered into – Director signed as the “President”
* P argued that the Director who signed the K would be personally liable as in ***Kelner***
 |
| Is the pre-incorporation contract binding on the promoters personally? NO |
| **Dryer J** | * HELD: rule from Kelner does not apply in this case
	+ In this case the P thought the new company existed at the time that the K was entered into, court applied ***Smallwood***
		- Based on ***Smallwood,*** there was no intention that the Director would be personally liable – intention was to bind the company, not the Director personally
		- This was a K with a non-existent entity, the defendants were not personally liable
		- But the Director could be personally liable for breaching the warranty of authority
			* Director was not liable under agency law either because the P’s damages were not caused by the breach of warranty
* Note this does not preclude the ability to sue for breach of warranty of authority of fraud! [the P here got nominal damages for the losses stemming from the representation]
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| **Sherwoon Design Services**  1998 ONCA 🡪 s 14(2) ratification // use of shell # companies  |
| * Sherwood was dealing with 3 promoters who were dealing with the lawyer –Mr. N
* In a letter between Mr. N and Sherwood, Mr. N stated that a shell # company was going to complete the transaction
* The contract was not completed, so Mr. Sherwood sold the assets to a 3rd party instead for less money and Mr. Sherwood went after the 3 promoters
* Sherwood sued shell company for breaching the contract
	+ But shell company was never assigned to the promotors’ company—was given to a third party instead
 |
| Did the # company ratified the contract such that it is now bound? YES  |
| **Reasons** | * Majority + concurring —said shelf company was bound
	+ HELD: indoor management rule 🡪 Mr. N held out the authority to speak on behalf of the company (power to speak for his clients and for the company as the nominal director was a partner at his firm)
		- At the time that the letter was sent to Sherwood – the # company was still under the law firms control (he was the agent of the shell company)
* LOOK AT CONCURRING JUDGEMENT
	+ Shell company was bound by the contract, which meant that the third party who was actually assigned the company was liable—could sue law firm for negligent practice
* Dissent—numbered company should not be bound because the documents were unsigned—should have had notice that the resolution was not ratified

Important practical tip = make sure the shell company is clean when you use it – negligence beware! |

# Corporate Governance

Is the system by which companies are directed and controlled (Cadbury Report)

“[It] specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.” (OECD Glossary 2005)

* Private Companies
	+ “closely held”
* Public Companies
	+ “distributing corporation”
		- definition in CBCA s.2 directs to CBCA Regulations s.2(1)

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| * **(1)** For the purpose of the definition **distributing corporation** in [subsection 2(1)](https://www.canlii.org/en/ca/laws/regu/sor-2001-512/latest/sor-2001-512.html#sec2subsec1_smooth) of the Act and subject to subsection (2), **distributing corporation** means
	+ **(a)** a corporation that is a **reporting issuer** under any legislation that is set out in column 2 of an item of Schedule 1; or
	+ **(b)** in the case of a corporation that is not a **reporting issuer** referred to in paragraph (a), a corporation
		- **(i)** that has filed a prospectus or registration statement under provincial legislation or under the laws of a jurisdiction outside Canada,
		- **(ii)** any of the securities of which are listed and posted for trading on a stock exchange in or outside Canada, or
		- **(iii)** that is involved in, formed for, resulting from or continued after an amalgamation, a reorganization, an arrangement or a statutory
 |

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|  | **Private Corporation** | **Public Corporation** |
| **Alternative Names** | “closely held” | “publicly traded,” “distributing corporation” |
| **Number of Shareholders** | A relatively small number  | A large number  |
| **Share Transferability** | Usually restricted  | No restriction |
| **Limited Liability**  | More likely to pierce | Unlikely to pierce (never done in practice) |
| **Centralized Management under the Board** | Shareholders take part in management | Separation of ownership and control |
| **Operated for Profit + something else?** | Less problematic  | More controversial  |

## Why is corporate governance important? Consider the collapse of Enron – example of poor CSR

* Engaged in a series of accounting frauds that made Enron appear to be very profitable. Hid debts off balance sheets.
* Why couldn’t shareholders protect themselves? Because they didn’t have information! They only had the information in the financial reports, which Arther Anderson (accounting firm) had fraudulently drawn up
* Many people were supposed to say to not the fraud, but didn’t. This included:
	+ Lawyers
	+ Accountants
	+ Board of Directors: appeared like a model board on surface
		- Only 3 inside directors; the rest (14) were independent (outside) directors, which means that they were supposed to have had no pecuniary interest in the company.
		- All very financially savvy
		- Also includes an audit committee, headed by accounting prof at Stanford
		- Investigation showed that the board never questioned the managers dealings, even though the auditor frequently raised concerns about the data the managers were supplying.
* Need to ensure checks and balances to ensure public/shareholders are not defrauded

Theories of Corp Governance

### DOMINANT THEORY: Contractarian Theory

* Govt can regulate the management of corporations
	+ But, most US corporate statutes are a set of default rules that enable managers to create their own rules on how to manage the company
* Corporation = Nexus of Ks = web of interrelated Ks among various stakeholders
	+ Managers are agents of the corporation that negotiate the contracts
	+ **Corporate law exists to facilitate negotiation of contractual relationships**
		- law reduces negotiating cost by providing standard terms of contract
	+ shareholders are not owners, just investors
		- contribute money for residual rights
		- Reason shareholders have exclusive voting rights is b/c they are the residual claimants to the firm’s income → should have appropriate incentives to make discretionary decisions
	+ employees are also investors
		- contribute labour for money
* Corp. law = set of default rules (like a form K) → each stakeholder can contract around these rules
	+ Role of corporate law in this theory is enabling → should contain the terms that people would have negotiated in their contractual relationship w/the firm, were the costs of negotiating at arm’s length for every contingency sufficiently low
	+ Markets & private contractual relations should govern corp., NOT public regulation
		- Public regulation should be facilitating only → goal of the law is to allow corps to function more easily, not to restrict corporate activity

**Why do investors invest in corporations?**

* Why give more discretion to self-interested parties and give up your $$?
* ANSWER:
	+ Corporation as a “nexus of contract”
	+ A complex set of explicit and implicit contracts
	+ Managers as the agent of the corporation
	+ Corporate law as enabling law, as the standard form of contract
	+ **Shareholder wealth maximization as the purpose**

## Mechanisms that Constrain Management Self-Interest

* **Legal constraints**
	+ Disclosure rules in security law
	+ Voting rights and fiduciary duties in corporate law
* **Market constraints**
	+ Capital market
	+ Product market
	+ Labour market
	+ Market for corporate control
		- If the company performs poorly, stock price goes down 🡪 makes it easier to acquire the company

## The Corporate Purpose Debate

* Shareholder wealth maximization vs. stakeholder wealth maximization

### Corporate Social Responsibility (CSR)

* + Beyond compliance with the law, beyond shareholder wealth maximization

**Arguments for/against CSR:**

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

### The CL and CSR – What purpose does a corp serve?

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| **Dodge v Ford** 1919 US-Michigan 🡪 Purpose of the corporation is to maximize shareholder wealth – but don’t cite it for that! (see LL comment) // better off to use the oppression remedy than to argue purpose of corporation |
| * Ford was highly profitable in the early 1900s
* Ford was the largest shareholder
* Dodge brothers were also shareholders
* The company (Ford) stopped providing special dividends to shareholders, instead to employ more workers 🡪 “help them build up their lives and their homes”
 |
| Can Ford stop paying dividends and instead use the money to make cars cheaper and hire more employees? NO |
| **Reasons** | * HELD:
	+ Ordered the company to pay special dividends to the shareholder’s – justified on a different legal ground (H. Ford breached fiduciary duties to minority shareholders)
	+ Obiter: **“A business corp is organized and carried on primarily for the profit of stockholders. The powers of directors are to be employed for that end”** – LL: don’t cite this case for that proposition, issue Michigan Supreme Court’s decision 🡪 **not very influential in the corporate law sphere;** also this statement was dicta
* Under the CBCA, the Dodge bros could argue that they were unfairly treated by the controlling shareholder (oppression remedy)
* Some states have “other constituency” statutes 🡪 ie. Pennsylvania (see below)
	+ Allows corp to consider both the short term and long term interests of the corp
 |

**Pensylvania “Other Constituency” Statute – allows corp to consider both ST and LT interests**

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| General Rule. -- In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a business corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate: (1) The effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located. (2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.  |

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| **Parke v Dailey News Ltd** 1962 UK 🡪 “enlightened shareholder values” in UK – consider other stakeholder interest too (like employees!) in pursuing long term shareholder value  |
| * Business was closed and the proceeds of the asset sales were distributed to employees of the company
 |
| Can proceeds of an asset sale be distributed to employees? NO – not in line with benefiting the corporation (cannot benefit corporation if the corporation no longer exists |
| **Reasons** | * injunction against distribution granted:
	+ - benefiting the employees must be in line with the benefit to the corporation
		- in this case, the corporation no longer existed and the distribution did not benefit the corporation
* NOW: UK Companies Act 🡪 s 172: purpose of a UK company is to pursue long-term shareholder value, and when pursuing this, directors should consider other stakeholder interests
 |

## Corporate Purpose in Canada

* **CBCA 122(1):** every director and officer of a C in exercising their powers and discharging their duties shall

(a) act honestly and in good faith with a view to the best interests of the C 🡪 **statutory fiduciary duty**

**SCC has interpreted this provision in 2 important cases:**

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| **Peoples Department Store v Wise**  2004 SCC 🡪 statutory fiduciary duty is owed only to the corporation (not it’s creditors) // purpose of corporations in Canada is not limited to single minded pursuit of shareholder wealth (in determining the C’s best interests directors may consider other stakeholders/environment) |
| * Wise stores was owned by the Wise brothers, who were shareholders and directors of the C
* Wise acquired Peoples
* Wise stores sought advice from the VP of Wise 🡪 VP recommended merging the inventory systems of the two stores
* Wise stores made purchases from overseas suppliers, Peoples made purchases from N-A suppliers
* Because of this merging of inventory, Peoples became heavily in debt (more product purchased in N-A)
* In this time, Walmart came to Canada and both companies went bankrupt
* Peoples’ trustee in bankruptcy sued the Directors of Peoples arguing they breached their fiduciary duty
 |
| Do directors owe a fiduciary duty to the company’s creditors under s 122 of the CBCA? NO |
| **Major and Deschamps JJ** | * HELD:
	+ Statutory fiduciary duty under s 122 is only owed to the company, not the company’s creditors
	+ **BUT When determining the best interests of the company, directors may consider the interests of other people – employees, suppliers, creditors, consumers, govt, and the environment**
	+ **The purpose in Canada is not to single mindedly pursue the interests of shareholders.**
 |

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| **BCE Inc v 1996 Debentureholders**  2008 SCC 🡪 Consider the best interests of the C, viewed as a “good corporate citizen” 🡪 lends support for the idea that shareholder wealth maximization is not the single exclusive goal in Canadian corp law |
| **Reasons** | * In considering what is in the best interests of the C, directors can look to other interests beyond shareholdrs.
* Falls to the directors of the C to revolve conflicts in accordance with their fiduciary duty to act in the best interests of the C, viewed as a **good corporate citizen**
	+ Unclear how to interpret this, but lends support for the idea that shareholder wealth maximization is not the single exclusive goal in Canadian corp law
 |

## New Corporate Forms Aligned with CSR – Benefit Corporations

* Ie. ***Delaware General Corporations Act* s 362(a) – Benefit Corporation – “B Corporation”**
	+ A for profit corporation that is intended to produce a public benefit and to operate in a responsible and sustainable manner
	+ Managed in a manner that balances the stockholder’s pecuniary interests, the best interests of those materially affected by the C’s conduct, and the public benefit identified in its certificate of incorporation
	+ Existing corp can become a B corp by amending articles of incorporation\
	+ Releases some of the pressure to serve shareholders – easier to justify allocating profits to something other than shareholders’ pockets
* In BC, **Community Contribution Company (C3 Companies) - *BCBCA***
	+ Features
		- Community purpose **s 51.19** – purpose beneficial to society at large
			* Must be set out in certificate of incorporation
			* Must include CCC in the name
			* 3 board members minimun
		- Dividends permitted subject to restrictions **s. 51.94**
			* Dividend cannot be greater than 40% of companies annual profits unless the shareholder receiving the benefit is a non-profit
		- Asset lock when dissolution **s. 51.95**
			* At dissolution, 60% of the company’s value must go towards charity or CCC
			* Remaining assets can go to shareholders
		- Community Contribution Report **s. 51.96**
		- Taxed like a regular for-profit business, not as a not-for-profit org.

# Powers of Directors and Officers

## Who can be Directors:

* **Basic Qualifications** (s.105(1))
	+ An individual must be at least **18 years old, of sound mind, and not bankrupt**
* **Shareholding Requirements** (s.105(2))
	+ Unless the articles otherwise provide, a director of a corporation is NOT required to hold shares issued by the corporation
* **Residency Requirements** (s.105(3))
	+ At least 25% of directors must be resident Canadians
	+ Other exceptions in prescribed industries require a majority of directors to be resident Canadians
	+ Differs by province
	+ If the board has fewer than 4 directors, then must have at least one resident Canadian
	+ BC has completely eliminated residency requirements under BCBCA

## How to Elect and Remove Directors:

* Directors are elected by shareholders and only by shareholders. It is their most important right
* Election and voting
	+ Default rule Elected by ordinary resolution (simple majority vote—majority of the votes cast) at annual meetings 106(3))
	+ Can require a greater number of votes in the articles or in unanimous shareholder agreement (s 6(3))
	+ Individuals cannot be made directors without their consent [s.106(9)]
	+ Can consent by:
		- At meeting where appointment took place and didn’t refuse OR
		- Must consent in writing in advance or within 10 days after OR
		- If they have acted as a director pursuant to the election or appointment, deemed to have consented
* Term of office [ss.106(3-6)]
	+ (3): Term expiring not later than the close of the third annual meeting of shareholders following the election **(3 years)**
	+ (4): not necessary that all directors elected at a meeting of shareholders hold office for the same term (staggered boards)
	+ (5): if no term of office, term ends at the next annual shareholder meeting
	+ (6): are incumbent until replacement begins
* Filling of vacancies [s.111]
	+ Default rule: BoDs has the power to fill vacancies (s 111(1))
	+ **BoDs do not have the power to fill vacancies in 3 situations – where the directors must call a meeting of shareholders to do so** (s 11(1(2))
		- Not a sufficient quorum of directors – quorum set out in articles of incorporation or pursuant to **s 114(2)** a majority of the number of directors
		- Vacancy is the result of an increase in the # of directors required by the articles of incorporation
		- If the articles of incorporation changed the default rule
	+ Following the default rule you can change the whole board without shareholder approval
* Ceasing to hold office [s.108 (1)]
	1. Director dies or resigns
		+ (2) A resignation of a director becomes effective at the time a written resignation is sent to the corporation, or at the time specified in the resignation, whichever is later.
	2. Director removed [s.109]
		+ Shareholders of a corp may by ordinary resolution at a special meeting remove any director(s) from office
	3. Director becomes disqualified [s.105(1)] (due to <18yrs, not of sound mind, not an individual or is bankrupt)
* Removal of directors by shareholders at any time [s.109] (***Bushell v. Faith***)
	+ By ordinary resolution by shareholders at a special meeting
	+ [s.6(4)] The articles of incorporation may not require a greater number of votes of shareholders to remove a director
		- but there are many ways to get around this ie. articles of incorporation can set out mandatory resignations under which circumstances the director must resign

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| **Bushell v Faith**  1970 UK-HoL 🡪 only relevant for private companies – super-voting rights provisions in the AoI are allowed in UK |
| * sister 1 – 100 shares
* sister 2 – 100 shares
* brother – 100 shares
* Sisters wanted to remove brother, but he had the supervoting power as director (according the the articles of incorporation - gave the director to be removed X3 votes )
 |
| Was the provision in the articles of incorp providing for a director’s supervoting power valid? YES  |
| **Reasons** | * UK *Companies Act* said that a director could be removed regardless of the articles of incorporation
* But this provision did not alter the voting rights of the other shareholders // t/f the supervoting rights were ok
* ***Bushell v Faith Clause*** 🡪 likely to be found in the shareholder agreement – gives supervoting rights to the director to be removed (weighted by a factor large enough so that the necessary majority cannot be reached)
	+ *Only relevant for private companies, public companies cannot list shares if there are super-voting provisions*

No Canadian courts have addresses the enforceability of these provisions |

## Board Structure:

### Number of Board members [s.102(2)]

* Private company at least 1
* Public company (distributing corporation), at least 3 (2 **outside directors** who are not an officer or employee of company)
* Some companies require **independent directors** (TSX definition = 1. is not a member of management, and is 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 your company; and 2. is a beneficial holder, directly or indirectly, collectively of **10% or less of the votes** of all issued and outstanding securities of your company)
	+ Outside directors =/= independent directors, but independent directors ARE outside directors

### Outsides v Insiders

* The role of directors today is more about monitoring the company, contrasted with historically “managing boards”
	+ Older provision actually said “directors should manage the affairs of a corp”
	+ 2001 amendment 🡪 added “supervise” the affairs of a corp s. 102(1)
* but studies do not show a robust association between independent Boards and corporate performance
	+ why? Independent directors rely on information provided by the companies’ managers
		- insiders have better knowledge of internal operations
* independent directors are part timers – people with otherwise full time jobs 🡪 requires full time attention to understand the company
* tradeoff: insider knowledge and outsider independence

### Committees

* Board can delegate powers to a committee
* **Audit Committee** is required for public companies [s.171]
	+ (1) **Composition:** Composed of not less than 3 directors of the corporation + A majority of whose members are not officers or employees of the corporation or any of its affiliates (outside directors)
	+ (3): **Duty**: to review financial statements before they are approved

When errors in financial statements are found:

* + (6): **Director to notify audit committee when errors/misstatements made:** A director or an officer of a corporation shall forthwith notify the audit committee and the auditor of any error or mis-statement of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on.
	+ (7): **Auditor to notify director of error:** An auditor or former auditor of a corporation who is notified or becomes aware of an error or mis-statement in a financial statement on which they have reported, if in their opinion the error or mis-statement is material, shall inform each director accordingly.
	+ (8): **Director recourse when error found:** when under s 7 the auditor or former auditor informs the director, the director shall:
		- **(a)** prepare and issue revised financial statements; or
		- **(b)** otherwise inform the shareholders and, if the corporation is one that is required to comply with section 160, it shall inform the Director of the error or mis-statement in the same manner as it informs the shareholders.
	+ (9): knowingly failing to comply with s 6-8 is an offence – fine and imprisonment ($5000/6mos)

## Powers of Directors

* General managerial authority s 102(1)
	+ Subject to unanimous shareholder agreement, directors manage or supervise the management of a company
	+ Shareholders, even with a majority resolution, cannot tell the directors how to manage the company 🡪 requires unanimous agreement
* Unanimous Shareholder Agreements restricting managerial powers
	+ s.146(1): “An otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and one or more persons who are not shareholders, that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation is valid.”
	+ **Requirements:**
		- 1. In writing
			2. Among ALL shareholders of the corporation
			3. Used to restrict, in whole or in part, the powers of directors to manage or supervise the business and affairs of the corporation
	+ Features:
		- Constitutional in nature
		- Binding parties other than the original signatories [ss.146(3)-(4)]
			* Binds directors, binds the corporation, binds share transferees
		- Powers taken away from directors (also corresponding liabilities) reside in shareholders [s.146(5)]
	+ Does not exist under BCBCA
		- have a functional equivalent under ***s 137***
			* articles of company can transfer the directors’ management abilities to others
* Statutory Powers
	+ **Non-delegable:**
		- Adopt, amend, or repeal bylaws [s.103]
			* What are bylaws?
				+ Regulate the internal affairs of the company 🡪 requirements for certain positions, how to hold a meeting (procedural elements), procedure for dividing profits
				+ Rules can be in the by-laws or in the articles of incorporation

Harder to amend if it is in the articles of incorporation – requires shareholder agreement by special resolution (2/3rds)

By-laws 🡪 directors have powers to amend or repeal – takes effect immediately

Articles of incorporation are filed publically while by-laws are private documents generally (unless it is a public company – securities regulators require by-laws to be filed publicly)

* + - Declare dividends [s.115(3)(d); s.171(1)]
			* Only directors have the power to distribute profits to shareholders
		- Issue securities [s.25]
	+ **Delegable: [**s.115(1) BoDs can delegate powers to committees or indivs // s.121 subject to the articles, by-laws or unanimous shareholder agreements directors may delegate biz duties to officers except for the restrictions in s 115(3)]
		- Appoint and remove officers [s.121]
		- Remuneration [s.125]
		- Limits [s 115(3)]

###### **Limits on authority (limits to delegation)**

**(3)** Notwithstanding subsection (1), no managing director and no committee of directors has authority to

**(a)** submit to the shareholders any question or matter requiring the approval of the shareholders;

**(b)** fill a vacancy among the directors or in the office of auditor, or appoint additional directors;

**(c)** issue securities except as authorized by the directors;

**(c.1)** issue shares of a series under section 27 except as authorized by the directors;

**(d)** declare dividends;

**(e)** purchase, redeem or otherwise acquire shares issued by the corporation;

**(f)** pay a commission referred to in section 41 except as authorized by the directors;

**(g)** approve a management proxy circular referred to in Part XIII;

**(h)** approve a take-over bid circular or directors’ circular referred to in Part XVII;

**(i)** approve any financial statements referred to in section 155; or

**(j)** adopt, amend or repeal by-laws.

How do directors exercise their powers?

* Generally collectively, not individually
	+ Unless given special authorization
	+ Usually exercise powers at board meetings
* **Mechanics of board meetings**
	+ Place and notice
		- Depends on bylaws
		- Notice of meeting must be sent to each director- info to be included = place and time of mtg
		- Notice can be waived by attendance at a meeting unless director is protesting the meeting
	+ Means of participation (s.114(9))
		- If all directors consent, can participate by electronic means that permits effective communication among Ds
	+ Quorum (s.114(2))
		- Under CBCA, quorum is a majority of directors if articles have fixed number of directors; or majority of minimum number of directors if not fixed
		- S 114(3)—25% of directors must be resident Canadians for business to be conducted UNLESS the required number of resident Canadians approve the transactions after the meeting (not a BC rule though)
	+ Resolutions (s.117(1))
		- A resolution in writing, signed by all the directors entitled to vote on that resolution at a meeting of directors or committee of directors, is as valid as if it had been passed at a meeting of directors or committee of directors.
	+ Dissent (s.123)
		- When a resolution is passed – all directors are responsible for any personal liability arising from that resolution, regardless on their actual vote (even if they were absent)
		- Need to have the dissent formally recorded in order to absolve liability – v. important for a director to know how to dissent
			* Entering a dissent:
				+ If attending meeting:

Director requests dissent be recorded or it is recorded in the minutes of the meeting

Director sends written dissent to secretary before meeting adjourned

Director sends written dissent by registered mail or delivers it to registered office of corporation immediately after the meeting is adjourned

* + - * + If not attending meeting:

After becoming aware of resolution, have 7 days to:

Cause dissent to be placed in the meeting minutes

Send written dissent by registered mail or deliver it to registered office of corporation immediately after the meeting is adjourned

* Alternative to Board meetings are **unanimous written resolutions** [s.117(1)]
	+ In writing
	+ Signed by ALL directors – require unanimity
* **Going beyond Board’s powers**
	+ Ultra vires doctrine [ss.15, 16]
		- Historically, most jurisdictions required the company to specify its objects/purposes in the articles of incorporation – could not carry out purposes otherwise inconsistent with their incorporated purpose – positivist approach (articles of incorp must include all purposes)
		- Now, this doctrine has been abandoned – C is given the legal capacity of a natural person (s 15), **articles of incorp only list things the C cannot do (negative approach) (**s 16**)**
		- S 16(1): because the C has the legal powers of a natural person it is not necessary to confer power to the C using by-laws (2): cannot carry on any business that is contrary to its articles; (3) no act is invalid by reasons only that the act or transfer is contrary to its articles or this act
	+ Defective appointments [s.116]
		- A defective appointment does not affect the validity of his action – apparent authority
	+ Defective decision-making procedures
		- Agency law kicks in – apparent authority
			* **The Indoor Management Rule** s.17 + s.18 (*Sherwood Design v. Ontario*) = a party may not assert that a person held out as agent of the company does not have authority to exercise the powers that are usual for such an agent. This common law rule holds that parties dealing with a corporation, acting in good faith and without knowledge of any irregularity, are entitled to assume that a corporation’s internal policies and proceedings have been followed and complied with
			* 17: **no constructive notice**: no person is deemed to have notice of knowledge of the contents of a doc concerning a C by reason only that the document has been filed publically
			* 18: **authority of directors officers and agents**

(1) No corporation and no guarantor of an obligation of a corporation may assert against a person dealing with the corporation or against a person who acquired rights from the corporation that

(a) the articles, by-laws and any unanimous shareholder agreement have not been complied with;

(b) the persons named in the most recent notice sent to the Director under section 106 or 113 are not the directors of the corporation;

(c) the place named in the most recent notice sent to the Director under section 19 is not the registered office of the corporation;

(d) a person held out by a corporation as a director, officer, agent or mandatary of the corporation has not been duly appointed or has no authority to exercise the powers and perform the duties that are customary in the business of the corporation or usual for a director, officer, agent or mandatary;

* (e) a document issued by any director, officer, agent or mandatary of a corporation with actual or usual authority to issue the document is not valid or genuine; or

(f) a sale, lease or exchange of property referred to in subsection 189(3) was not authorized.

**Exception**

(2) Subsection (1) **does not apply in respect of a person who has, or ought to have, knowledge of a situation described in that subsection by virtue of their relationship to the corporation.**

|  |
| --- |
| **Royal British Bank v Turquand** 1856 UK 🡪 indoor management rule: an outsider dealing in good faith is entitled to presume that a companies internal procedures have been followed based on apparent authority |
| * C’s articles of incorp provided that the directors could borrow money on behalf of the company – but this should be approved by shareholders from time to time
 |
| * Is the C bound by a loan agreement made by a director?
 |
|  | * An outsider dealing in good faith is entitled to presume that the companies internal procedures have been followed – ***Indoor Management Rule*** based on apparent authority
* Now codified in the CBCA
 |

|  |
| --- |
| **Sherwood Design Services**  1998 ONCA 🡪 s 14(2) ratification // use of shell # companies  |
| * Sherwood was dealing with 3 promoters who were dealing with the lawyer –Mr. N
* In a letter between Mr. N and Sherwood, Mr. N stated that a shell # company was going to complete the transaction
* The contract was not completed, so Mr. Sherwood sold the assets to a 3rd party instead for less money and Mr. Sherwood went after the 3 promoters
* Sherwood sued shell company for breaching the contract
	+ But shell company was never assigned to the promotors’ company—was given to a third party instead
 |
| Did the # company ratified the contract such that it is now bound? YES  |
| **Reasons** | * Majority + concurring —said shelf company was bound
	+ HELD: indoor management rule 🡪 Mr. N held out the authority to speak on behalf of the company (power to speak for his clients and for the company as the nominal director was a partner at his firm)
		- At the time that the letter was sent to Sherwood – the # company was still under the law firms control (he was the agent of the shell company)
* LOOK AT CONCURRING JUDGEMENT
	+ Shell company was bound by the contract, which meant that the third party who was actually assigned the company was liable—could sue law firm for negligent practice
* Dissent—numbered company should not be bound because the documents were unsigned—should have had notice that the resolution was not ratified

Important practical tip = make sure the shell company is clean when you use it – negligence beware! |

Diversity on Board of Directors FP500 Boards

* improvement from 11% 🡪 22% female directors
* importance?
	+ Empirical evidence shows companies with more female directors are better corporate citizens
		- Employees treated better
		- Better environmental outcomes

## Executive Compensation

* BoD has power to determine executive salaries

# Corporate Finance and Shareholders’ Financial Rights

* Three sources
	+ Equity financing
		- Issue shares of stock
	+ Debt financing
		- Borrow money
	+ Corporate earnings
		- Extra cash generated by the business itself
* Choice of financing strategy depends on the stage of business
	+ Start up stage 🡪 equity and internal debt financing
	+ As the business establishes 🡪 external debt financing becomes more available as the company builds a credit history
	+ Corporate earnings are typically the main source of financing
* We will focus on equity financing

## Equity Financing

Raising money by issuing shares of stock

* a share is not an isolated piece of property but a bundle of rights and liabilities created by the act ***Sparling v Quebec***

### Basic rights Attached to Shares

***CBCA s 24(3)***

* rights to **vote** at any shareholder’s meeting (voting rights)
	+ right to elect directors
	+ right to approve fundamental changes
	+ right to submit shareholder proposals
	+ right to make the bylaws and the articles of incorporation
* right to **receive dividend** declared by the corporation (dividend right)
	+ two major ways to gain profit
		- sell shares to make capital gain
		- dividends- entirely up to the board’s discretion to declare dividends
			* shareholders cannot demand dividends – they have the right to receive payment after the BoD declares them
* Right to **receive the remaining property** of the corporation on dissolution (right to residual property)

### Other Rights Commonly Attached to Shares

* **Preemptive rights** **(s 28(1))**
	+ Right to acquire shares when the corporation issues new shares – right to maintain your % of ownership
	+ Opt in approach – unless the articles of incorporation include preemptive rights, then no preemptive rights
	+ Preemptive rights make the issuance of new shares complex – that’s why the default rule is that there is no preemptive right
	+ No preemptive rights IF **s 28(2)**
		1. Shares are issued for consideration other than money; or
		2. Issued as a share dividend
		3. shares are issued pursuant to the exercise of conversion rights – gives shareholders the option to convert one type of security into another
* **Conversion rights** **s 29**
	+ an option to convert the shares into another security of the corporation
* **Redemption rights** - an option to force the C to repurchase the shares

Classes of Shares

* C can create different classes of shares – each company must have at least 1 class of shares
	+ If only 1 🡪 shareholders in that class must have the 3 basic stat rights **S 24(3)**
	+ If >1 class of shares 🡪 **s 24(4)**
		- The rights, privileges and restrictions must be in the articles of incorp
		- The 3 basic rights must be attached to at least 1 class of shares, but not all 3 rights are required to be attached to one class
		- Shares of the same class must be treated equally
		- **27(3)** although corporations may grant distinctive rights to series within a class, such rights will not give a series priority in receiving dividends/return of capital within a class of shares
			* **but different series can receive diff % dividends, distinctive series rights**

### Common Shares v Preferred Shares

* the terms common/preferred shares is used by business convention – not a legal term
* If you only have one class of shares, those shares are called *common shares*

**Preferred Shares**

* Preferred shares – entitles holders to specific rights
	+ Dividend preference
		- Pay regular fixed dividends that have priority over common shares – preferred shareholders get paid first
	+ Liquidation preference
		- If the company is liquidates, preferred shareholders have priority over common shareholders to receive return of their financial capital
* Contractual in nature 🡪 in the articles of incorp
* Commonly used terms in contracts
	+ **Voting vs non-voting**
		- Typically preferred shares do not have voting rights, BUT
			* Usually allowed to elect a director under adverse financial conditions (ie. If they fail to pay dividends for numerous years)
			* Can vote with respect to amendments of the articles of incorp if the amendment affects their rights
			* Can vote on fundamental changes of the C
	+ **Cumulative vs non-cumulative**
		- Cumulative preferred – Board has an obligation to pay all overdue dividends before paying other shareholders
	+ **Convertible vs non-convertible**
		- Convertible: Preferred shares can convert to common shares – desirable when the company has strong earnings (allows you to receive % of earnings instead of fixed amount)
	+ **Redeemable vs non-redeemable**
		- Redeemable - allows the issuer to buy back the stock at a certain price and retire it
	+ **Participating vs non-participating**
		- Participating**:** in addition to receiving their initial capital and the unpaid dividends, upon dissolution, these shareholders can dip into common shareholder residual assets/proceeds (non-participating only receives initial capital and dividends, no residual asset distribution)

**Hybrid Nature of Preferred Shares**

|  |  |
| --- | --- |
| **Equity-like Characteristics of Preferred Shares** | **Debt-like Characteristics of Preferred Shares** |
| * Permanent capital; no fixed maturity date
* Dividends subject to board discretion
* Cannot throw the corp into bankruptcy for dividend arrearage
* May have voting rights
* Treated as equity for accounting and tax purposes
 | * Fixed, regular, dividend payments
* liquidation preference over common stockholders
* rights are contract based
 |

**Facebook Example**

* Facebook has a dual-class share structure
	+ Class A – publically traded, 1 share =1 vote
	+ Class B – privately traded, 1 share =10 votes
* Zuckerberg has predominantly class B shares, that are convertible
* Why?
	+ Zuckerberg maintains control (61.9% of voting power, with only 16.7% ownership)

Issuing Shares

* **S 25(1) CBCA:**
	+ Subject to articles, bylaws and any unanimous shareholder agreement, shares are issued by the Board of Directors
		- Not delegable
		- Issued in Form 1 – states the name and the max number the company is authorized to issue
	+ How many shares can be issued?
		- Theoretically unlimited – not limited by the CBCA
		- In practice, usually limited
		- No longer required to have share certificates to prove ownership
* **Process:**
	+ Depends on the type of company – public v private
	+ If publically traded – governed by securities regulations – complex disclosure requirements – prepare and file and deliver a prospectus
	+ Whether or not the shares will be offered to the public, the following steps apply:
		- *Subscription* – offer to purchase a certain # of new shares
			* A company cannot issue shares until the consideration has been paid in full
		- *Allotment:* if accepting the subscription offer, shares are allotted to the buyer
		- *Issuance:*
			* **25(3)**
				+ corps **cannot issue shares on an unpaid basis** – consideration needs to be paid in full

consideration can be money, property or services

* + - * + **(4):** whether property or past services are the fair equivalent of a money consideration – Board’s responsibility to decide the fair value of the consideration paid in property or services
				+ **(5):** property does not include promissory notes, two kinds of consideration are unacceptable
				+ future services are not acceptable as consideration
			* Used to issue share certificates to prove ownership of shares—now this is not required, as the transactions are recorded electronically
				+ Is expensive to produce and creates a lot of paperwork
				+ Have the right to obtain a share certificate at a fee **(s 49(1))**
		- Par value: is the face value of the share
			* Companies are not allowed to issue par value shares as of 2001 (CBCA)
			* In some jurisdictions (BCBCA), still allowed to issue par value shares
			* Market value is what is relevant
				+ Par value is often an arbitrary value assigned to the share
	+ Must maintain a separate stated capital account for each class of shares **(s 26)**
		- Is the historical total of the value of consideration received for the issued shares
		- Is a bookkeeping record
		- E.g.

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

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

## Corporate Earnings

**How Shareholders Realize Profit:**

* **Capital gains:** selling the shares at a higher price than what the shareholder paid for them
* **Dividends:** money given back to shareholders per share
	+ Board resolution
		- Specifying: amount to be paid, date they will be issued, records date (for determining who is eligible)
			* To be eligible you must have your name on the company record as a shareholder on the record date
	+ Cash vs. stock (s.43(1))
		- Can pay dividends in cash or property – in practice cash and stocks are the two main kinds of dividends:
			* Cash:
				+ lowers the capital account/value of the company (reduces their assets) and this may upset the creditors;
				+ will also likely reduce the price of the shares by the amount of the cash dividend;
				+ have to pay personal income taxes on cash dividends
			* Stock:
				+ have no effect on assets/value of the company;
				+ increases the number of shares issued by the company, so it slightly decreases the price per stock, but each shareholder owns more stocks, so their overall holdings do not decrease
				+ do not pay personal income taxes on the shares received

S 42: **Restrictions on dividend payments** – corporations shall not declare or pay a dividend if *there are reasonable grounds* for believing that: [must meet both tests]

* + Cash-flow test (s.42(a)): the corporation is, or would after the payment be, unable to pay its liabilities *as they become due*
		- This test is essentially about whether the company has enough assets readably convertible to cash to pay off its debts as they come due
		- **Test: after dividend payments, will the company be able to pay the debts as due?**
		- Directors could argue based on “as they become due” – adjust timeline, project future earnings, show that their assets will increase etc.
	+ Capital impairment test (s.42(b))
		- Aka balance sheet test
		- The company must be able to repay all of its liabilities and return its capital to its shareholders 🡪 the realizable value of the company’s assets must be greater than the companies liabilities plus stated capital (amount to return to shareholders)
	+ *Do these restrictions apply for the issuance of stock dividends?*
		- *Because stock dividends to not reduce the company’s assets, this does not affect the rights of creditors, so in theory, these restrictions may not apply to stock dividends, but it is not entirely clear—there are no court cases dealing with this point*

**Other ways to distribute money to shareholders:**

* Repurchase
	+ Buying back outstanding shares
	+ Reduce the number of shares outstanding 🡪 boost earnings per share
* Redemption
	+ A forced sale initiated by the corporation, in accordance with the articles of incorporation
* Statutory restrictions
	+ Following a repurchase or redemption, companies acquire shares in their own company, traditionally this was not allowed, but it is now (subject to restrictions ss.34-36)
	+ s.39(6): “Shares or fractions thereof of any class or series of shares issued by a corporation and purchased, redeemed or otherwise acquired by it shall be cancelled or, if the articles limit the number of authorized shares, may be restored to the status of authorized but unissued shares of the class.

# Shareholders’ Rights

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

## Voting Rights

* Purpose?
	+ Hold management accountable to shareholders – mechanism to protect shareholders’ interests
	+ A shareholder has 3 choices when they are dissatisfied with the company:
		- Sell shares
			* More available to public shareholders – can simply sell shares on the stock market
		- Sue
		- Vote
* On what matters can shareholders vote?
	+ **Election of directors** (Anglo-Saxon Model/1 tier board model)
		- Term of office is normally 1 year, but articles of incorp can be changed up to 3 years
		- When to vote:
			* Vote at annual shareholders’ meetings (s.106(3))
		- Number of directors elected determined by:
			* Staggered board (s.106(4))
				+ Director positions are classified into groups and each year only one class of group is up for election – discourages hostile takeovers
		- Number of votes required determined by:
			* Ordinary resolution (s.106(3); s.6(3))
				+ Majority of votes cast by the shareholders in that resolution (not all of those eligible to vote, only the ones who actually vote)
			* Plurality voting v. majority voting
				+ Usually shareholders only have 2 options when voting: “for” or “withhold”

If withheld votes are not counted – plurality voting

Director is elected in plurality voting if they receive the most votes

* + - * Uncontested election
				+ Uncontested elections with plurality voting – you only need 1 vote to get elected – absurd result

TSX changed its listing rules to require majority voting in uncontested elections

* + - * Slate voting v. individual voting
				+ TSX has eliminated slate voting
			* Straight voting v. cumulative voting (s.107)
				+ S 107 (b) Cumulative voting = each shareholder entitled to vote at an election of directors has the **right to cast a number of votes equal to the number of votes attached to the shares held by the shareholder multiplied by the number of directors to be elected**, and may cast all of those votes in favour of one candidate or distribute them among the candidates in any manner;
				+ Cumulative voting formula: 1 x n (where n=number of total shares)

 ---------------------------------------------------= num shares req

 x (where x=number of positions) + 1

* + Why do only the shareholders get the right to elect a Board of Directors in the Anglo-Saxon model? (and not employees too as in the Continental European Model/2 tier board structure)
		- Historical reasons
		- Logistical issues: politics in the boardroom – board cannot fxn like parliament
	+ **Removal of directors**
		- When to remove:
			* With or without cause, at any time
			* Shareholder meeting
		- How many votes required:
			* Ordinary resolution is the default rule (s.109)
			* Cannot raise the bar – cannot require more votes than are required by s 109 (s.6(4))
			* Cumulative voting – if cumulative voting is provided for then you need a higher threshold than ordinary resolution (s.107(g))
	+ **Amendment of the articles of incorporation** (s.173)
		- Need a special resolution (2/3 of votes cast; or unanimous written approval from all shareholders)
	+ **Amendment of bylaws** (s.103)
		- Directors can make, amend, or repeal – changes take effect immediately but shareholders must approve this at their next meeting (by ordinary resolution)
	+ **Shareholder proposals** (s.137, s.103(5))
		- Shareholders entitled to vote at an AGM make make proposals to amend, make or repeal a by-law.
	+ **Fundamental changes**, i.e.: (need special resolution (2/3 votes cast or unanimous written agreement)
		- Amalgamation with another company (s.183(5))
		- Sale or lease of all or substantially all of the company’s assets (s.189(3), s.189(8))
		- Liquidation or dissolution of the company (s.211)
		- Continuance of the corporation under the laws of another jurisdiction (s.188)
* Which shareholders can vote?
	+ Preferred shares usually do NOT have voting rights
	+ Common shares usually have voting rights
	+ Non-voting shareholders normally do not vote, but they can vote when there are **fundamental** **changes** in the company:
		- s.183(6) – company merges with another
		- s.189(6) – company sells or leases all or substantially all of the company’s assets
		- s.211 (3) - Liquidation or dissolution of the company
		- s.188(4) - Continuance of the corporation under the laws of another jurisdiction
		- ALL shareholders can vote on such fundamental matters
	+ **Separate class voting rights**
		- Changes in class structure and rights (s.176(1), s.176(5))
			* If there is any change to a class structure leading to a change to the rights of a particular class – then that particular class is entitled to vote separately as a class
		- Fundamental changes in the company (s.183(4), s.189(7) – if a class of shares is affected in a different manner than others)
			* Merger agreement would change structure or rights of class that requires amendments to the articles—can vote separately (s 183(4))
			* Can vote separately in the event a class is differentially effected by the sale, lease or exchange of assets (s 189(7))
			* E.g. merger between corporation A & corp B that seek to abolish preferred shares; common shareholders are voting, preferred shareholders are non-voting
				+ Merger = Fundamental change of company—everyone votes together (s 183(3))
				+ Abolishment of Preferred shares—preferred shareholders vote separately as a class because they are affected in a way that is different than the other shareholders (s 183(4))
	+ **Equal treatment and voting restrictions**
		- Default rule: “One share one vote” (s.140)
		- In practice many Cs offer super voting rights (i.e. Facebook)
		- Capped voting rights
* What is the effect of a shareholder vote?
	+ Is the shareholder vote binding or non-binding on the board? Depends on whether the matter requires shareholder approval.
	+ Directors’ management powers (s.102(1)) vs. shareholders’ voting right
		- It depends whether the subject matter requires shareholder approval
		- *Automatic Self-Cleaning Filter Syndicate Co. Ltd:* Board’s power can only be overturned by extraordinary resolution (> ¾ of the votes cast)

|  |
| --- |
| **Automatic Self-Cleaning Filter Syndicate**  1906 UK 🡪 where AoI provide for it, the SHs can compel Board to do something if they pass an extraordinary resolution (>3/4 of votes cast) |
| * Shareholders voted in favour of a resolution – board refused to carry it out so the SHs sued
* A decision to sell assets is usually within the BoD’s management authority but here the AoI stated the SHs could compel the board to do something using extraordinary resolution
 |
| Is the board bound to carry out the resolution? Can SHs tell board what to do? Yes but not in this case – needs extraordinary resolution because the articles of incorporation provided so. |
| **Reasons** | Article 96 of AoI: general power of management is vested in Directors unless the regulation is made by **extraordinary resolution** (more than ¾ of the votes cast)* + in this case, resolution was only passed by ordinary resolution

Court concludes that the board is not bound Note: if the third party had approached the board with the offer to purchase some of the assets, there is no obligation to pass this on to the board for shareholder approval; different if it was an offer to purchase all assets of the company |

* How to increase voting power?
	+ **Vote-Pooling Agreements**
		- s.145.1: “A written agreement between two or more shareholders may provide that in exercising voting rights the shares held by them shall be voted as provided in the agreement.”
		- Important, and primarily used in electing directors
		- *Ringuet v. Bergeron*: While majority shareholders may agree to vote their shares for certain purposes, they cannot by this agreement tie the hands of directors and compel them to exercise the power of management of the company in a particular way.
	+ **Voting Trusts**
		- Shareholders transfer legal title to their shares to a voting trustee; the trustee, for a defined period and according to specified instructions, has the exclusive voting power over the transferred shares
		- Advantages: self-enforcing, separation of ownership and voting power
* Do shareholders have incentives to vote?
	+ Shareholder passivity (traditional)
		- SHs felt voice did not count for much, strong controlling interests meant that their votes had little power
	+ Shareholder activism (modern)
		- Increase in # of SH proposals

|  |
| --- |
| **Ringuet v Bergeron**  1960 SCC 🡪 cannot make voting agreements that tie the hands of directors and compel them to exercise management power in a particular way  |
| * The company had 6 shareholders, 3 (R,P,B) reached an agreement to elect eachother as directors and positions/salaries and to vote unanimously in all meetings
* Later B sued R, P for not following through with their agreement
 |
| Was the voting agreement enforceable? YES |
| **Judson J (majority)** | * Does the shareholder agreement interfere with the board’s discretion?
* Judson J. “while the majority shareholders may agree to vote their shares for certain purposes, they cannot by this agreement tie the hands of directors and compel them to exercise the power of management of the company in a particular way” (l judgment)
* **Majority:** The clause specifying unanimity in voting did not mention “director’s meetings” – therefore the contract was not against public order – contract was valid
* **Dissent:** the requirement of the agreement to vote unanimously applied to directors’ meetings as well – which is contrary to the fiduciary relationship which directors have towards a company
* Case was before the enactment of the CBCA
* Would it still be valid under the CBCA?
	+ No – directors have the power to appoint management positions or choose salaries – not shareholders
 |

Proxy Voting

* Shareholder authorizes someone to attend the meeting on his behalf to exercise voting rights
* Most important mechanism for shareholders to exercise their voting rights, especially for large public companies where not all shareholders can attend the meetings in person
* Heavily regulated by statute and securities regulations because the outcome is so central to corporate governance
* Important for public companies – thousands of SHs and it can be tough to get everyone to a meeting
* Key concept is a solicitation – if a given communication is a solicitation, unless there is an exception available, it will trigger proxy solicitation protocols

### Proxy solicitation:

* First determine if a given communication is a proxy solicitation – if yes, then stat requirements kick in
	+ s.147: ““proxy” means a completed and executed or, in Quebec, signed form of proxy by means of which a shareholder appoints a proxyholder to attend and act on the shareholder’s behalf at a meeting of shareholders”
	+ Solicit / solicitation includes (a) / does not include: (b)
	+ (a) includes: request for a proxy, request to execute or not execute, sending of a form of proxy or other communication to a SH reasonable calculated to procure a proxy
	+ (b) Important ones: sending by an intermediary of the documents referred to in s 153 – requests sent by intermediaries to a shareholder – not solicitation // a public announcement of how the shareholder intends to vote **// a communication for the purposes of obtaining the number of shares required for a shareholder proposal under s 137(1.1)**
	+ If the communication IS a solicitation, may trigger regulatory requirements including circulating proxy circulars
	+ If NOT, then the communication should be fine, will not trigger regulatory requirements
* Determine who is the solicitor
	+ Management: mandatory (s.149(1))
		- Management required to solicit proxies at each shareholder meeting from each shareholder who is entitled to receive notice of the meeting
			* This way the management cannot cherry pick shareholders to form a proxy
	+ Dissident shareholders
		- Can solicit proxies from some of the shareholders but not each shareholder entitled to vote
* Determine if there are any exemptions
	+ Management exemption (s.149(2))
		- Management is not required to send a proxy if the company is not a distributing company and has fifty or fewer shareholders entitled to vote at a meeting
	+ Dissident shareholder exemption (s.150)
		- Very important exemption – a dissident shareholder can solicit up to 15 shareholders without distributing an information circular
	+ Either may apply to CBCA Director for exemption (s.151(1))
	+ Public broadcasting
* Use of proxy circular (s.150(1))
	+ Regulations part 7—use form 51-102F5
	+ Every public company must file documents with SEDAR (database)

***Summary of Proxy Solicitation***

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

Non-distributing company AND 50 or fewer shareholders

Application to CBCA director for exemption

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

Can solicit proxies from up to 15 shareholders

Solicitation by public statement or speech/press release

Application to CBCA director for exemption

Shareholder Meetings

### How do Shareholders make Resolutions?

* In meetings
	+ Calling Annual meetings (s.133(1))
	+ Calling Special meetings (s.133(2))
	+ **Calling annual meetings**

**133** **(1)** The directors of a corporation shall call an annual meeting of shareholders

**(a)** not later than eighteen months after the corporation comes into existence; and

**(b)** subsequently, not later than fifteen months after holding the last preceding annual meeting but no later than six months after the end of the corporation’s preceding financial year.

* **Calling special meetings**

**(2)** The directors of a corporation may at any time call a special meeting of shareholders.

* In writing
	+ If in writing, must be unanimous written agreements (s.142)

|  |
| --- |
| **Eisenberg v Bank of Nova Scotia**  1965 SCC 🡪 CL rules for when a SH meeting is required are relaxed compared to requirements under s 142  |
| * C had 4 directors: E and 3 other employees
* Only 1 shareholder – E
* E and his brother used the C’s assets to obtain a loan from the bank
* All the documents carried the corporate seal
* There was no board meeting/shareholder meeting approving this loan
* The C goes bankrupt
* The trustee sues the bank to get some of the assets used as security for the loan
 |
| Was the corporation bound by the loan? Yes |
| **Reasons**  | * SCC did not rely on indoor management rule—could rely on actual authority
	+ Was not necessary to investigate whether the bank can rely on the indoor management rule
		- Was meaningless to hold these meetings—other directors were just appointees of Mr. Ernest—if any of the directors had voted against the transaction, the director would be removed by Mr. Ernest
			* No point to have shareholder or director meetings
		- Mr. Ernest would have approved the transaction by unanimous shareholder resolution
		- Mr. Ernest had actual authority to make the transaction—**shareholder could give assent to the resolution by conduct**
* Case was made before enactment of CBCA—language in CBCA is much narrower than the rule outlined by the SCC
 |
| **CBCA s 142**—unanimous resolutions must be in writing in order to replace the need for a shareholder vote at a shareholder meeting* + - Subject to two exceptions:
		- Actual meetings are required for
			* **S 110(2)**: if director resigns or has to be removed from office
			* **S 168(5):** if auditor resigns or has to be removed from office
 |

Shareholder’s Meetings

* Two types:
	+ **Annual general meetings** (s 135(5))
		- Elect directors
		- Appoint auditors
		- Receive financial statements
		- Approve other matters submitted to the meeting
	+ Special meetings
		- Vote on specific matters not in the ordinary course of business, e.g. mergers
		- *Eisenberg v. Bank of Nova Scotia(above)*
* Who calls a meeting?
	+ **Directors**
	+ **Annual meetings**

**133** **(1)** The directors of a corporation shall call an annual meeting of shareholders

**(a)** not later than eighteen months after the corporation comes into existence; and

**(b)** subsequently, not later than fifteen months after holding the last preceding annual meeting but no later than six months after the end of the corporation’s preceding financial year.

* **Calling special meetings**

**(2)** The directors of a corporation may at any time call a special meeting of shareholders.

* + **Shareholders**
		- If holding not less than **5%** of the issued shares that carry the right to vote may requisition the directors to call a meeting [s.143(1)]
			* S 143(4) – directors must call the meeting within 21 days
		- Exceptions [s.143(3)]

**(3)** On receiving the requisition referred to in subsection (1), the directors shall call a meeting of shareholders to transact the business stated in the requisition, unless

* **(a)** a record date has been fixed under paragraph 134(1)(c) and notice of it has been given under subsection 134(3);
* **(b)** the directors have called a meeting of shareholders and have given notice thereof under section 135; or
* **(c)** the business of the meeting as stated in the requisition includes matters described in paragraphs 137(5)(b) to (e).
	+ **Courts**
		- A director, a shareholder entitled to vote or the director may petition (s.144(1))
		- *Airline Industry Revitalization Co. v. Air Canada*
* How to Choose a Meeting Date
* Generally directors have authority to determine meeting date
* If shareholder’s requisition a meeting to remove incumbent directors, but directors want to keep their positions, they can just set the meeting date for far into the future in the hopes that they can employ a lot of strategies to undermine the plan
	+ But, date must be reasonable

|  |
| --- |
| **Airline Industry Revitalization Co v Air Canada**  1999 ONSC 🡪 Grounds for refusing a meeting requisitioned by SHs |
| AirCorp made offer to board to take over AirCanada; board fixed a meeting date several months in the future; AirCorp requisitioned board to hold special mtg.* Board refused to hold the special meeting
	+ Argued that a record date had already been fixed as per **s 143(3)(a)**
	+ Could only amend articles in annual meeting, rather than a special meeting—improper subject matter for a special meeting
 |
| Is the Board required to call and hold the meeting since there was already a meeting called? If not, can AirCo call it on its own? – Air Co could call one on their own as shareholders |
| **Reasons**  | * Court said:
	+ Yes, there was a record date fixed, but the record date was for a meeting where the business that was the subject of the requisition would not be discussed
		- record date exemption did not count
		- record date must be for a meeting that will consider the business outlined in the requisition
	+ CBCA does not preclude articles from being amended in a special meeting—is no limitation on subject matter to be transacted at a special meeting ***(s 143)***
		- This ruling is no longer good—now have added into ***s 143***
			* Can refuse a requisition on following grounds:
				+ Personal claim or redress or personal grievance against corp or directors/officers or security holders
				+ Proposal does not relate in a significant way to the business affairs of the corporation

E.g. meeting to consider human rights issues to the operation of the company* + - * + A shareholder had previously (recently) requisitioned a meeting but failed to attend, in person or by proxy, at a meeting of shareholders
				+ If the business is substantially the same that was considered in the past few years that did not receive a minimum amount of support
				+ Right is being abused to secure publicity
	+ AirCorp’s requisition was validly and properly made—board required to call meeting within 21 days or the shareholders who signed the requisition could call meeting themselves
		- Court refused to intervene because the shareholders could call meeting by themselves
 |

* Notice of meeting
	+ Notice of meetings should be sent to each shareholder entitled to vote at the meeting; each director; and the auditor of the corporation [s.135]
		- Easy question if it is a private company – composition of shareholders is quite stable 🡪 easy to identify who are the shareholders
		- Challenging with public companies 🡪 composition of shareholders can change from day to day
	+ Record date (s.143, regs.43): date used to identify shareholders
		- No more than **60 days** and not less than **21 days** before the meeting date (for distributing public companies)
	+ Who should receive this notice?
		- Shareholder list (s.138)
		- Waiver of notice (s.136) – if you attend a meeting then you are proving you had notice and are waiving notice – unless you only attended the meeting to say that it was unlawfully called
		- Directors
		- Auditors
* When to send out?
	+ (ss.135(1), (1.1); regs. 44) have to send out notice during the prescribed period (if a private company – can make time period shorter if specified in the AoI or by-laws)
	+ Must be sent no less than 21 days before meeting date and no more than 60 days before meeting
* What information?
	+ Time and place (s.135(1)) – must be within Canada, unless articles of incorporation otherwise specify
	+ Special business (ss.135(5) & (6)) – must provide enough detail to understand the nature of the business
		- Only 4 things are not special business:
			* Election of directors
			* Reappointment of auditors
			* Consideration of financial statements
			* Consideration of financial
* Quorum and conduct
	+ s.139(1) is the default rule unless changed by bylaws – quorum requirement is provided in bylaws, but if they are silent the default rule is **a majority of votes that are entitled to vote at that meeting are present in person or represented by proxy**
		- 139(2): use the opening quorum (in case ppl change their mind and leave) unless the bylaws say otherwise
		- 139(3)&(4)
			* if quorum not present at opening of meeting, shareholders can adjourn the meeting to fix a time and place, but cannot carry on business
			* if corporation only has one shareholder, the shareholder present in person or by proxy constitutes a meeting
	+ **At the meeting: rules of conduct**
	+ Each corporation has their own rules including topics like:
		- How long each person may speak
		- Is it okay to video tape meeting
		- Is it okay to use cell phones
	+ Chairman has duties to act impartially and in good faith and allow all views to be given reasonable opportunity to be heard *Wall v. London and Northern Assets Corp.*

|  |
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| **Wall v London and Northern Assets Corp** 🡪 Chairman’s conduct needs to be impartial; good faith; give all views reasonable opp to be heard |
| * Shareholder meeting was convened to approve the sale of assets
* Mr. Wall was against the transaction
	+ He explained his objections
	+ Discussion was interrupted by a group of shareholders calling for a vote
	+ The vote passed – so they moved on from the issue
* Mr. Wall sought to have the resolution declared invalid
 |
| Did the chairman conduct the meeting properly? Was the matter sufficiently discussed? YES |
| **Reasons**  | * HELD: yes, Chairman’s conduct was not oppressive to the rights of minority view holders 🡪 **all views need to be given reasonable opportunity to be heard.**
 |

## Shareholder Proposals

* What is a shareholder proposal? 🡪 Resolution put forward by shareholder(s) for consideration at a meeting
	+ Types of shareholder proposals:
		- Amendments to the articles of incorporation (s.175(1))
		- Amendments to the bylaws (s.103(5))
		- Nominations of directors (s.137(4))
		- Other proposals
* What is the effect of a shareholder proposal? Binding or non-binding if passed?
	+ Proposals that are fundamental are binding.
		- Proposals for election of directors or amendments/by-laws to articles are binding
		- Matters like recommendations for compensation for executives are non-binding
	+ Majority of proposals are non-binding
	+ Non-binding proposals still create pressure on the Board to adopt the proposal
* Who can submit a shareholder proposal?
	+ **Requirements for all proposals** (s.137(1.1), Regs. s.46)
		- Registered or beneficial owner, individually or collectively own,
		- The lesser of either **1%** of total outstanding voting shares or **$2000** worth of shares
		- For at least **6 months** immediately before the day of submission
	+ Additional requirement **for director nomination proposals** (s.137(4))
		- Need at least 5% of holders (registered shareholders) of shares in the company, or 5% of the shares of a class of shares entitled to vote in order to nominate directors
		- Does not preclude nominations made at meeting of shareholders
			* unless the corporation has a bylaw that precludes this
			* **If they want to include beneficial shareholders the CBCA explicitly says so**
* What information should be included in the proposal? [s.137(1.2)]
	+ The name and address of the person and of the person’s supporters, if applicable; and
	+ The number of shares held or owned by the person and the person’s supporters, if applicable, and the date the shares were acquired.
	+ For a binding proposal – it must be written in a way that does not “invite” – it is clearly worded and outlines the proposed changes
* How to circulate the proposal?
	+ By the shareholder’s own proxy circular
	+ By the management’s proxy circular (s.137(3))
		- Cannot be longer than 500 words
		- Saves $$$
* Under what circumstances can management exclude a shareholder proposal from its proxy circular? [s.137(5)]
	+ (a) The proposal is **not submitted to the corporation at least the prescribed number of days** before the anniversary date of the notice of meeting that was sent to shareholders in connection with the previous annual meeting of shareholders; (90 days!)
	+ (b) It clearly appears that the primary **purpose of the proposal is to enforce a personal claim or redress a personal grievance against the corporation or its directors, officers or security holders**;
		- b.1 the proposal **does not relate in a significant way to the business or affairs** of the corporation;
	+ If person had previously failed to present, in person or by proxy, at a meeting of shareholders, a proposal that at the person’s request, had been included in a management proxy circular relating to the meeting management proxy circular relating to the meeting;
	+ **If substantially the same proposal** was submitted in a previous annual meeting and did not receive the prescribed minimum support at the meeting
	+ The **rights conferred by this section are being abused to secure publicity.**
	+ If management refuses to include the proposal [ss.137(8) + (9)]
		- Must notify the person within 21 days with notice stating reasons for refusal
			* Can appeal in court
			* Court can postpone the meeting or make another order
			* Can issue an order to permit or omit the proposal’s inclusion in the management proxy circular
	+ *Varity Corp. v. Jesuit Fathers of Upper Canada*
* **On avg, most shareholder proposals fail to get approval**

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| **Variety Corp v Jesuit Fathers of Upper Canada** 🡪 management excluding SH proposal from circular 🡪 can exclude where primary purpose is to promote econ/religious/political purposes (unless b.1 kicks in) |
| * 2 SHs wanted to request the company stop doing biz in S.A. due to apartheid regime (put in SH proposal)
* Mgt wanted to exclude the proposal from the proxy circular under s 137(5)(b)
* **As long as the primary purpose is to promote economic, religious, or political purposes, it may be excluded**
* Here the primary purpose was to abolish apartheid in SA – proposal could be validly excluded
* Arguable under the new b.1 🡪 could make an argument that making a political statement affects the business
 |

### What to do when the shareholders disagree with Board action

* Determine whether the subject matter is within the Board’s discretion or does it require shareholder approval?
* If it requires shareholder approval 🡪 vote against it!
* IF the subject matter is within Board’s discretion, then:
	+ Make a proposal to amend the AOI
	+ Make a proposal to amend bylaws (if it’s not within the Board’s discretion, would be problematic if the decision was within the Board’s discretion)
	+ Make a unanimous shareholder agreement – hard to do in public companies
	+ Advisory proposal to the Board – tells the Board you are unhappy with the decision – not binding
	+ Remove directors at a special meeting
	+ Sell your shares

# Shareholder Information Rights

## Access to Corporate Records

* s.20(1): **what records do shareholders have access to?:**
	+ - Articles, bylaws, and amendments and copy of any unanimous shareholder agreement
		- Minutes of meetings and resolutions of shareholders
			* Only have access to portions of the meeting’s minutes
		- Copies of notices required under *s 106 or 113*
		- Securities register complying with *s 50*
			* Contains info about # of shares of each class, and # of shares held by each holder, transfer histories of shares, shareholder’s address
* s.21(3): **shareholder list** – access to this list is important for sharing proxy circulars
* s.21(1): **how to access:** accessible to shareholders and creditors can examine company’s records free of charge. Others can access for a fee (distributing companies)
	+ Distributing company – shareholders and creditors can examine corporate records free of charge, anyone else can still see them – with a fee.
	+ Non-distributing company - only shareholders and creditors have access to the records free of charge
* s.21(1.1): **how to access corporate records** if a person wishes to examine the securities register of a distributing company, he must first make a request to the corporation. Also must swear by affidavit that the list may only be used for shareholder voting, corporate business, etc (approved functions)

## Financial Disclosure

* shareholder’s have the right to receive financial reports [s.155(1)]
* Send no later than **21 days before AGM** [s.159]
* What is the required financial information [GAAP Regs. 71(1)- have to be done in accordance with Canadian GAAP)
	+ and GAAP Reg 72(1)]: must include:
		- (a) a balance sheet;
		- (b) a statement of retained earnings;
		- (c) an income statement; and
		- (d) a statement of changes in financial position.
* Distributing companies’ financial report must be audited by an independent auditor
	+ Private companies are exempt from this

# Auditors

* Is an auditor appointment required?
	+ Mandatory for distributing companies
	+ Optional for non-distributing companies [s.163(1)]
* Who is an auditor? Usually an accounting firm
* What does an auditor do?
	+ Give an opinion on whether the company’s financial statements are presented fairly and in accordance with generally accepted accounting principles
* Auditor qualification [s.161]
	+ Must be **independent** of the company
	+ 161(1): independence is a question of fact – deemed not to be independent if he or his business partner is
		- a business partner/director/officer of the C
		- beneficially owns or controls an interests in a C
		- has been a receiver/liquidator etc to the C
	+ Can provide both audit and non-audit services to the same company, with some restrictions and regulations to limit conflicts of interest – most common reason that independence broken 🡪 incentives to give incorrect opinions on financial statements of the C because the auditor is receiving employment in another respect from the C.
		- Non-audit services must be pre-approved by the company’s audit committee
		- Fees associated must be pre-determined, governed by securities regulation
* Auditor ceasing to hold office – companies rarely change their auditor
	+ Death
	+ Resignation [s.164(2)]
		- May send written resignation
		- Takes effect when delivered to corp, or on date specified—whichever is later
		- Is a big deal for a corporation-- suggests something is wrong with company’s statements
	+ Removal [ss.165-166][s.168(5)-(9)]
		- Shareholders can remove auditor at special meeting, unless auditor is appointed by the court
		- Shareholders can fill auditor vacancy at special meeting
			* If not, directors can fill vacancy, court can fill vacancy, or shareholders can hold another special meeting to fill vacancy
		- ***S 168***—makes it harder to remove an auditor
			* (5)—auditor can submit reasons for resignation or opposing removal
			* (7)—new auditor cannot take over until requesting and receiving written statement for reasons, in auditor’s opinion, for their replacement
		- Is a big deal to remove an auditor—suggests something is wrong with company’s statements
* Auditor’s right to receive notice of and attend every meeting [s.168(1)]
	+ If a distributing company, auditor has the right to receive notice of the meeting no less than **21 days** and no more than **60 days** before the meeting
	+ At company’s expense
* Auditor’s right to information [s.170]
	+ Auditors have access to info necessary to perform their duties
* Auditor’s duty to report [s.169]
	+ On company’s financial statements

## Audit Committee:

(within the Board) [s.171]

* Mandatory for distributing companies
* Optional for non-distributing companies
* Composition:
	+ (1) No less than 3 directors; A majority of the committee members as outside directors
	+ (3) Function of audit committee → review financial statements before they’re approved under s. 158 by BOD
* Functions:
	+ Review but not approve the financial statements
	+ Oversee the work of the external auditor
	+ Resolve disagreement between management and the external auditor
	+ Pre-approve all non-audit services provided by the auditor
	+ May call a meeting of the audit committee. External auditor may also call a meeting. All are required to attend.

# Director’s Fiduciary Duties

* Directors’ Duties under CBCA s.122(1) are: fiduciary duties (duty of care + duty of loyalty)

**(1)** Every director and officer of a corporation in exercising their powers and discharging their duties shall

**(a)** act honestly and in good faith with a view to the best interests of the corporation; [ duty of loyalty; aka statutory fiduciary duty] and

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

* We impose these duties to strike a balance between management accountability and management discretion
	+ For management overreaching – judicial intervention is appropriate
		- judges are good at determining whether a person steals money from a company
		- higher standard of review when reviewing decisions made by the Board
	+ For regular business decisions – judicial intervention not appropriate
		- Judges are not experts in business decisions
* Who these duties are owed to:
	+ *Peoples Dept. Store v. Wise* says that directors of a corporation **only owe fiduciary duties** to the corporation
	+ CBCA still follows rule from *Peoples v. Wise*: Duty of care + duty of loyalty owed to corporation, but that the Duty of care **also** extends to creditors, suppliers, and other constituents (see case brief below for discussion of why this might be a mistake

|  |
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| **Re City Equitable Fire Insurance Co Ltd (1925) *// traditional CL no longer good law**** “a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.”
* Directors have no obligation to obtain necessary knowledge about corporate finance – standard is what could reasonably be expected from him
* “a director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meeting of any committee of the board”
* “in respect of all duties that, having regard to the exigencies of business, and the AOI, may properly be left to some other official, a director is, in the absence of grounds fro suspicion, justified in trusting that official to perform such duties honestly”
* Traditional DoC was v. low
* Responsibility now are much higher
 |

|  |
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| **Peoples Dept Store v Wise** SCC 2004🡪 Framework for breach of fiduciary duties questions // to whom the duties are owed // requirements under s 122 are evaluated on an obj std with contextual elements |
| * + Wise Stores – major shareholders and directors were the Wise Brothers (3)
	+ In 1992, Wise acquired Peoples (Peoples became a subsidiary) 🡪 Wise brothers were the directors
	+ The brothers realized it was difficult to operate both companies, they sought advise from a VP (David Clement) of Wise Stores (he had a BA in Commerce and 15 years of work experience in finance and admin with Wise, but he was not an accountant)
	+ Clement suggested the companies merge their inventory systems
	+ As a result, Wise was used to make purchases from foreign overseas suppliers and Peoples bought from local suppliers. This resulted in People’s owing to Wise
	+ At the same time, Walmart came to Canada
	+ Both companies went bankrupt
	+ Trustee in bankruptcy for People’s sued the directors for breaching the DoC (argued the inventory policy caused damage resulting in the bankruptcy)
 |
| * Did the defendant director’s breach their DoC? no
 |
| **Major and Deschamps JJ.** | * **Framework for analysis:**
	+ Is there a stat defence?
		- No issuance of shares so the good diligence defence is out
		- All directors agreed to the new inventory policy tf the dissent defence is out
		- Good faith reliance?
			* Is the VP a professional under **s 123(5)**
				+ No 🡪 not subject to any regulation from a professional regulatory body
				+ To invoke GFR, directors must make sure that the person they are relying on is a member of a professional regulatory body and must carry valid insurance.
	+ What about the business judgment rule?
		- The decision must be made in a reasonable manner on an informed basis
			* No evidence here that the decision was unreasonable – the decision did solve an urgent business matter
		- Directors were protected by this rule
* **Causation of loss?**
	+ Is the Board’s decision a proximate cause of the company’s bankruptcy?
		- SCC noted that there were other factors contributing more directly and more importantly to the bankruptcy
			* Financial difficulties, Walmart (competition)
			* **S 237.1:** Defendants are only liable for the % of damages attributable to the defendant’s conduct
* **HELD:** No breach of the DoC
* This case answered two important questions:
	+ Are the requirements of CBCA 122(1)(a)(b) on an **objective or subjective standard?**
		- Objective with a contextual element – allows social and economic conditions/circumstances to be considered
		- Is a director has particular skill/knowledge – they have an obligation to investigate deeper if they become aware of an issue
			* It is possible that these directors will be held to a higher standard based on their expertise

 * + To **whom are the duties owed?**
		- Before this decision: answer was clear – directors owe the fiduciary duties to the company
		- DoL: to the corporation
		- DoC: statute does not specifically refer to an identifiable party as the beneficiary of the duty // SCC: owed to the corporation & its creditors
			* This part of the decision was likely a mistake according to the corporate bar
			* Traditional view:
			* Both DoL and DoC owed to the C
			* When duties are broken, C can litigate against the Directors
			* But, the directors run the C… so why sue themselves
			* Tf the shareholders have the derived right to sue the directors under the C
				+ Derivative action
			* So where’s the conflict with the decision in Peoples?
				+ In that case the Trustee (a creditor) was the one suing the C (not in a derivative action), they made a separate negligence claim in tort
				+ The SCC confused the DoC in tort and in corporate law
			* After this case, Ontario amended its legislation to specify that both duties are owed to the Corporation.
 |

## Duty of Care

* + Duty of care means that directors and officers have to make decision carefully when they act on the behalf of the corporation. When handling corporate affairs, directors and officers must behave with a level of care of a **reasonably prudent person** in similar circumstances (subjective standard)
	+ Must be an **informed decision** (*Smith v. Van Gorkom,* and *UPM-Kymmene)*
	+ If he cannot understand the certain levels of detail of the company, he probably does not have the capacity to act as a director or officer of the company.
	+ Careless directors are rarely held liable
* **Also a duty of care under tort law.**
	+ “Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another”
		- A breach of applicable rules of conduct [CBCA s.122(1)(b)]
		- Breach resulted in injuries / damages
		- Causation
		- 🡪 Comparable to negligence in tort: Duty of care; Breach of the duty; Damage; Causation
* **Directors need to carry insurance // degree of liability:**
	+ A professional person must be subject to the regulation of a professional association and must carry insurance for professional negligence [s.123]
	+ Directors are only liable for the percentage of damages attributable to the director’s position [s.237.3]

|  |
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| **Smith v Van Gorkam** 1985 Delaware🡪 characterizing what “an informed decision” is // need to make investigation into proper share price when selling  |
| * + Company = Trans Union // CEO = VG
	+ CEO concluded that the best option was to sell the company
	+ Sun Sept 13, 1980 – VG approaches Jay Pritzker about the sale of the company, VG proposed that the sale price would be $55/share
	+ On Sat, VG had meeting with Senior Managers and he encountered strong resistance, CFO said that his department had determined that the reasonable price per share was between 55-65 dollars
	+ After that meeting they had a board meeting
		- VG made an oral presentation about the deal
		- CFO made the same statement about that being a low price per share – but did not circulate any report
		- Legal counsel said the directors would be sued if they voted against it
		- Later the shareholders sued the director’s because they ended up approving the deal
 |
| * Did the directors breach the DoC? YES
 |
| **Reasons** | * HELD: Decision was not an informed decision – directors could not use the protection of the business judgment rule.
	+ Court **noted VG did not make any investigation into the proper share price**
	+ Board meeting making the decision to sell was only 2 hours – not proper consideration (especially because there was no sig. financial/time pressure on this decision)
	+ Court said that the market price of a share was not an appropriate benchmark for share price
		- Why? 🡪 selling control of a company is not equivalent to selling a share or any minority stake
	+ Directors argued they relied on legal counsel – even so, the court decided that they needed to investigate more – cannot rely on collective experience or legal advice
	+ Moral of the story – directors need to do their homework
 |

NOTE: companies can now exculpate their directors using their AOI under Delaware law (due to lobbying by directors after this case)

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| **UPM-Kymmene Corp** 2002 ONCA🡪 characterizing what “an informed decision” is // need to conduct sufficient analysis in determining exec compensation |
| * Chairman of the C sought to become a senior executive with the company
	+ Proposed agreement included generous compensation
	+ Proposal was considered at 2 board meetings
		- 1st: board did not approve it; directors resigned after this meeting
		- 2nd meeting was under the new board: new board approved the compensation package, but the board members had never met the Chairman – relied on the advice of the independent compensation consultant (but his research was insufficient); board did not know the previous board was strongly against it; board did not question the reasonableness of the agreement
 |
| * Did the directors breach the DoC? YES
 |
| **Reasons** | * HELD:
	+ Board breached DoC
	+ They did not conduct a sufficient analysis to determine reasonable compensation
* directors had breached duty of care because they did not question/discuss the reasonableness of compensation package
* Board approved agreement that gave someone they did not know a lengthy contract with high pay and benefits when company was in financial trouble
 |

## Directors’ Common Law Defence: Business Judgment Rule

* This is the rule whereby courts will defer to the directors’ business judgment so long as they brought an appropriate degree of prudence and diligence in reaching a reasonable business decision at the particular time it was made
	+ w/o fraud, self-dealing or bad faith
	+ court will not substitute its judgment under the business judgment rule
* **Standard = a reasonably prudent person in similar circumstances**
* Respects the fact that directors and officers often have business expertise that courts do not, gives **deference** to business decisions
* Encourages qualified business people to serve as directors
* Rationale:
	+ Judges are not business experts
	+ Business decisions are made w/o complete information – retrospectively some decisions can look ridiculous despite the fact they were reasonable at the time
	+ Encourages qualified people to become directors – common argument 🡪 directors need the protection or else they wouldn’t do it

## Directors’ Statutory Defences: Stat defences for directors to defend themselves when the breach the duty of care

* [s.123(5)] **Good Faith Reliance**
	+ relied in good faith on
		- financial statements of the C represented to the director by an officer of the C // or in a written report from the auditor
		- a report by a person whose profession lends credibility to a statement made by the pro
* [s.123(4)] **Good Diligence Reliance**
	+ director not liable if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
* [s.123(1)-(3)] **Dissent on Record**
	+ if the director is present a Board meeting, the director is deemed to have consented to all the resolutions made at that meeting unless they record their dissent. If the dissent is absent the director is still deemed to have consented unless w/in 7 days they take steps to record their dissent.

### Summary of the DoC

* Directors and officers must act carefully
* SoC: a reasonable person in similar circumstances
* Defendant directors’ defenses
	+ Business judgment rule (no fraud, no self dealing, no bad faith, no conflict of interest), good faith reliance, due diligence reliance, dissent on record
* V rare that careless directors are held liable
	+ Why? Court tend not to second guess business decisions

# Duty of Loyalty

* The directors and officers must put the corporations’ interest ahead of their personal interests (*Peoples v. Wise* and *BCE*)
	+ Best interest of the corporation means the maximization of the value of the corporation
	+ Directors’ fiduciary duty does not change when the corporation is on the brink of bankruptcy
* Typical situation when the duty of loyalty may arise?
	+ **Self-dealing transactions** 🡪 interest directed contracts
		- Ie. Director selling his own property to the corporation // two separate companies having the same director that make a contract between each other
	+ **Corporate opportunities**
		- Ie. Directors taking advantage of deals that would have gone to the corporation
	+ **Competition**
		- Ie. Two companies in direct competition have the same board member
	+ **Hostile takeovers**
		- Hostile bidder takes over a company through buying a sig number of shares, in face of this threat the directors take action to protect themselves – recommend that shareholders don’t accept the offer **or** they amend the company’s by-laws and insert a provision that says that anyone acquiring X number of shares – then every shareholder can purchase the companies shares at a huge discounted price
		- When the BoD takes defensive actions – whose interests are they representing?
* To whom is the duty owed?
	+ ***Peoples:*** duty is owed to the C and does not shift ever.

## Common Law:

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

## Statutory Safe Harbour:

* s.120 provides safe harbor for directors when engaging in self-dealing transactions, if requirements are et, K is not voidable simply because of a conflict
	+ Board’s approval process [s.120(7)]
		1. Written disclosure of conflict or in minutes (see below)
		2. Abstention from voting
			- s.120(5) Do not need to abstain from voting in cases of:
				* Remuneration

Each D has essentially the same compensation and insurance/indemnity contracts, so there is no need to abstain as these decisions are not delegable to officers (in practice its still a good idea to abstain)

* + - * + Indemnity or insurance
				+ Contracts with an affiliate
		1. Substantive fairness – good deal for the C
			- Little judicial guidance for fairness
			- Court can take other circumstantial factors into account when contract was entered
			- No bright line rule
	+ Shareholders’ confirmation process – if the Board’s approval requirements were not met, could still be saved by SH process [s.120(7.1)] need to meet the following elements:
		1. Disclosure of conflict (see below)
		2. Approved by special resolution
		3. Substantive fairness (see above)
	+ **Disclosure rules (apply to both)**
		- **(s 120(2))** Timing of disclosure for directors - **Directors should disclose at first meeting after director becomes interested**
		- **(s 120(3))** Timing of disclosure **for officers** - **Immediately after becoming interested in transaction**
		- **(s 120(4))** Even if in ordinary course of business and transaction is not required to be approved by shareholders**, must disclose immediately after becoming aware of interest**
		- **(s 120(6))** Director or officer **can give general notice/disclosure of conflict of interest with a long-term or frequent supplier and this will be sufficient**
		- **(S 120(6.1)** **gives shareholders access to portions of minutes from board meetings relating to disclosure of director’s conflict of interests in particular transactions**
			* Typically shareholders do not have access to minutes
* If safe harbor used, and steps from s.120 are followed, contract is neither void nor voidable
* Remedies if s.120 is not satisfied:
	+ The contract is NOT automatically void.
	+ Apply to court and the court has the discretion to set aside the contract [s.120(8)]

## Corporate Opportunities:

* Corporate expansion v. Manager entrepreneurialism
* What is a corporate opportunity?
	+ Directors should not usurp any “corporate opportunity” -- any business opportunity that comes to the director in his role as a director of the company *[Regal]*
* What does an opportunity cease to belong to the corporation?
	+ Obtained through personal capacity
	+ Corporate rejection
	+ Corporate impossibility (barred by AoI)
	+ Resignation before pursuing opp

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| **Regal (Hastings Ltd) v Gulliver** 1942 UK🡪 even where a C does not have the resources to pursue a corporate opp, the directors cannot take up the opp! // solicitor does not ow fiduciary duty to company (does not usurp CO) |
| * Regal owned movie theatre; Regal had 5 directors; set up a subsidiary to acquire a long term lease on two cinemas (subsidiary makes contract with LL for the 2 property leases); subsidiary had very little capital, so LL demanded the directors of Regal give personal guarantees for the lease payments; directors decided to purchase shares of the subsidiary (only Gulliver did not);
* Gulliver arranged for 3 outside investors and the company’s solicitor to purchase shares of the subsidiary; later the company and subsidiary were purchased and the new shareholders sued the directors for usurping a corporate opportunity (purchasing the shares)
 |
| * Did the solicitor usurp the corporate opportunity? NO
 |
| **Reasons** | * C: No, he was not a director/officer, he was just the solicitor—owes no fiduciary duty to the company
* Gulliver was not liable—did not purchase shares, so he did not usurp corporate opportunity
* Other 4 directors—only had the opportunity because they were directors—even though they acted in good faith, they still usurped the corporate opportunity and had to return profits they earned from purchasing the shares
* Regal did not have the capital/resources to secure the lease payments or finance the subsidiary
* Profits returned to the company went to the new shareholders, even though the old shareholders were the ones who were harmed by the directors usurping the opportunity
* Company could have been sold at a better price if the subsidiary was wholly owned by Regal, so the old shareholders missed out on income
* suggests if BOD decides not to invest, director deciding to invest using own money is still liable and must return profits (hypothetical question in this case)
* **Important Implication: Even when the company does not have the resources to pursue the corporate opportunity, the directors still cannot take up the opportunity (very strict standard)**
 |

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| **Peso Silver Mines Lts** 1966 SRC🡪 if opp is expressly rejected by the Board in good faith then no ursurping/breach of DoL // contrasted with Regal b/c here the opp was not necessary for the corporation to survive |
| Peso had 3 directors (Cropper, Walker, and V); Peso owned mining claims in Yukon; 3rd party (Dickson) made offer to Peso to sell some claims that were near their existing claims; board considered the offer, but rejected it—did not have financial resources to buy additional claims; 6 weeks later, the 3 directors formed a company with Peso’s consulting geologist (Dr. Aho), in order to acquire the Dickson claims; Peso sold and the new board sued Cropper for usurping an opportunity (W & V had already returned the money to the company, but Cropper refused) |
| * Did Cropper breach the duty of loyalty? NO
 |
| **Reasons** | In this case, SCC ruled that Cropper was not liable for breaching duty of loyalty—**opportunity was expressly rejected by the board in good faith** (rejected not because they wanted to pursue opportunity personally; they believed it was in the best interest of the corporation not to pursue the deal)* Rejection decision was a conflict of interest decision
	+ Must be made in good faith, with view to corporation’s best interest
* Directors were free to take up the opportunity if the corporation had rejected the opportunity in good faith
	+ Corporation had first dibs
* How the opportunity came to the directors:
	+ After company rejected opportunity, the geologist approached cropper as a private person, rather than in his capacity as director
	+ Was no evidence that cropper used any confidential information derived from his role as Peso’s director
		- **Acquired opportunity in individual capacity**
	+ Opportunity arose 6 weeks after the original opportunity
* Value/Nature of the opportunity
	+ **Opportunity was not essential to operation of Peso**—they frequently get these types of opportunities/offers—cannot accept every offer—claims were very speculative and unproven—nature of opportunity was highly speculative and risky
		- Different from Regal—opportunities were essential to the business in regal
 |

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| **Canadian Aero Services v O’Malley** 1974 SCC🡪 list of factors (non-exhaustive) to consider when evaluating if there was a breach of the DoL // cannot usurp even after resignation if the resignation was influenced by the opp |
| related to aerial mapping in South America—corporation had sought out this opportunity; defendant directors left the corporation and sought the opportunity for themselves; directors were liable and had to account profits to the corporation |
| * Was there a breach of the DoL? YES
 |
| **Reasons** | * Officers owe fiduciary duties (does not matter if they are not appointed directors)
* Fiduciary duty of a director or officer does not terminate upon resignation and it cannot be renounced at will by the termination of employment ***(SCC citing American Case: Raines v Toney)***
* Was there a breach?
	+ No single stringent standard for determining if there is a breach—**is list of factors:**
		- *Position or office held*
			* Generally, ordinary employees do not have fiduciary duties
			* Also look at whether employee signed a non-compete agreement
				+ Breach of this agreement results in the company being able to recover compensation for lost profits (different from breach of fiduciary duty, where company is entitled to accounting of profits)
		- *Corporate opportunities*
			* Its nature, ripeness, specificness, director’s or officer’s relation to it
			* In this case, the opportunity was very ripe and the company had been actively pursuing it
			* Defendants became familiar with the opportunity because of their participation in the company’s project
		- *Knowledge*
			* Amount of knowledge possessed, circumstances in which it was obtained, whether special or private
				+ In this case, the defendants used the information gained from their position as officers to gain the opportunity
		- *Alleged breach after employment termination*
			* Time in continuation of fiduciary duty
			* Circumstances under which the employment was terminated (retirement, resignation, or discharge)
			* If the opportunity prompted the resignation, likely liable
* The factors outlined are helpful, but not exhaustive
 |

## Competition:

* Competition by former directors and officers (post-departure competition)
	+ General rule: free to compete after departure provided no covenant not to compete, no use of the former’s trade secrets and confidential information
	+ *Canaero:* higher standards for directors and officers
* Competition by current directors and officers
	+ Sitting on the boards of 2 competing companies
		- Is okay for a director to sit on board of two competing companies *(London and Mashonaland v New Mashonaland)*
		- but if there are other specific facts that raise concerns about the director’s ability to put the company’s best interest ahead of the interests of the competing company, director may be liable *(Scottish Co-op Wholesale Society v Meyer)*
	+ Operating a business that competes with the company
	+ Having a material interest in any entity that competes with the corporation

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| **London and Mashonaland Exploration Company** 1981 WN🡪 its OK to sit on the board of a rival company  |

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| **Scottish Coop Wholesale** 1959 UK- HoL🡪 Director cannot sit on the boards of two different companies when the interests of both companies diverge |
| Scottish Co-op created a subsidiary; subsidiary hired two experts (Meyer and Lucas)—they were appointed as directors and given 3900 shares; society held 4000 shares; society appointed 3 directors of the subsidiary, who were also directors of the parent company; became clear that the help provided by the experts became dispensable; wanted to get rid of the experts; Scottish Co-op offered to buy out the shares of the experts; Scottish Co-op set up its own unit to compete with the subsidiary—the 3 directors who were on both boards were now on the boards of two competing companies; |
| * Did the directors breach the DoL? YES failed to put interests ahead
 |
| **Reasons** | * these three directors breached the duty of loyalty—failed to put interest of subsidiary ahead of the parent company’s interest—should have protested the creation of the unit
	+ when the interests of both companies are consistent—no breach
	+ when the interests of both companies diverge—problematic
 |

# Hostile Takeovers

* **Hostile takeover** = a type of corporate acquisition or merger which is carried out against the wishes of the board (and usually management) of the target company.
* Instead of negotiating with board, bidder makes bid to shareholders and bypasses the board
* May make offer for shares 40-50% above market price for shares, will replace the mgmt. of the board if he believes he can do a better job
* Hostile to directors, not shareholders—SHs often welcome the offer for above market price
* Most M & As are not hostile—rather friendly
	+ Negotiate with each other to reach preliminary agreement
	+ Board of acquisition will submit the agreement to the SH and recommend the SH accept it (SH need to approve the deal)
	+ 2 companies, 2 boards. One approaches the other and two sides negotiate the deal. At the end, they will reach a merger agreement and the target board will submit the agreement to shareholders—because this is required here. Friendly i.e. supported by the target board.

## Defences to Hostile Takeovers:

* Revise the capital structure
	+ Repurchase shares
		- Eliminates the cash in hand and makes company less attractive
	+ **Poison Pill** = the target company attempts to make its stock less attractive to the acquirer
		- *Flip-over pill*
			* Triggered when the bidder acquires a certain % of shares (20%ish) in target company without the approval of the board
			* When target company is merged with acquiring company, the shareholders of the target company, are entitled to purchase shares in the acquiring company at a huge discount price
				+ Purpose is to dilute the shares held by the shareholders of the acquiring company
			* Discourages companies from acquiring the company
		- *Flip-in pill*
			* Triggered when acquiring company acquires a certain % of shares of target company (~20%) without approval of the board—shareholders of target company are entitled to purchase shares of target company at huge discount price—acquirer is excluded from this right
				+ Discourages a takeover, because the bidder’s share percentage is diluted
				+ Becomes more expensive to take-over the company
		- Provision inserted in the *bylaws* and is created by the board of directors (directors have discretion to do this)
		- Provision looks like:
			* If anyone acquires a certain % of the shares of a company, all the existing SH will be entitled to purchase the company’s share at a huge discount price (the person acquiring the % of shares cannot purchase more shares)
			* Total shares = 100
			* Poison pill says if anyone acquires 20% of company’s outstanding shares, then each SH except bidder is entitled to purchase 1 share at 50% discount
			* Ie: bidder acquires 20 shares
			* Other shareholders hold 80 shares, and can purchase ADDITIONAL shares at 505 discount
				+ Note: the board has authorized but unissued shares (normally there is a “bank” of these that the board holds so that the board doesn’t need to amend the articles in order to authorize more shares. The board can simply issue more shares for those SH owning the 80 shares)
			* If all SH exercise their right, the company will issue 80 new shares and sell them to SH for ½ price
			* Total number of shares after pill is triggered = 180 shares
			* Now, bidder only owns 20/180 shares = 11% (ownership stake is diluted)
* Revise the corporate governance structure
	+ **Shark Repellant**
		- Staggered Board
		- Supermajority vote
* Alter the shareholder mix
	+ Issue shares to investors friendly to management or to an employee stock ownership plan / pension plan
* Find a palatable buyer
	+ **White Knight** = an individual or company that acquires a corporation on the verge of being taken over by forces deemed undesirable by company officials
	+ **Yellow Knight** = A company that was once making a takeover attempt but ends up discussing a merger with the target company. The ‘yellow’ is for cowardice
	+ Management Leveraged Buyout (LBO)
* Buy new business or sell Crown Jewels
	+ Buy junk businesses that are undesirable and depreciate value of company
* Accelerate or increase management’s employment benefits
	+ **Golden Parachute** = Substantial benefits given to a top executive (or top executives) in the event that the company is taken over by another firm and the executive is terminated as a result of the takeover
* Buy out the bidder
	+ **Green Mail** = an antitakeover measure that arises when a large block of stock is held by an unfriendly company that is threatening a hostile takeover. Greenmail is a term that applies to mergers and acquisitions, and refers to the money that is paid by the target company to another company, known as a corporate raider, that has purchased a majority of the target company's stock. The greenmail payment is made in an attempt to stop the takeover bid. The target company is forced to repurchase the stock at a substantial premium (the greenmail payment) to prevent the takeover.
* Attack the bidder
	+ Argue there is misleading information in the bidder’s circular to discourage shareholders from selling
	+ Takeovers regulated by securities regulation--violation of regulations would impact takeover deal

## Pros and Cons of Hostile Takeovers

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

## Duty of Loyalty + Hostile Takeovers:

* Is the board’s use of a hostile takeover defence motived to protect the interests of the company or the personal interests of the directors?
* *Teck Corp v. Millar*
* *Pente Investment v. Schneider*

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| **Teck Corp v Millar** 1972 BCSC🡪 Ds can take actions to defend the C against bidders as long as the decision is in good faith and they have reasonable grounds for their action // when considering bids, Ds can consider non-price factors (reputation ect) |
| * 2 companies make competing offers to co-develop a project with company A—company A selects offer that pays less, because they liked the company better; company with higher offer sued for breach of duty of loyalty
 |
| * Did the directors breach the DoL by accepting the lower offer? NO
 |
| **Berger J.** | * Teck relied on the rule set out in *Hogg v Cramphorn*
	+ Rule was that directors have no right to issue shares for the purpose of defeating a hostile takeover, even if the directors believed it was in the best interest of the corp.
		- To maintain control is an improper purpose for issuing shares
	+ In this case, the court disagreed with the opinion in Hogg: as long as the decision is in the best interest of the corporation, they should be okay
		- Changed rule in Hogg

**New Rules**: 1. Directors are allowed to take actions to defend the corporation (take actions against bidders) as long as the directors act in good faith and have reasonable grounds fro their actions
2. When considering hostile bid, directors are allowed to consider non-price factors (reputation, experience of bidder)
 |

## Duty of Loyalty vs Duty of Care Differences

No need to prove proof of damages of behalf of the company

* But, for duty of care, the plaintiff needs to show damages sustained!

Much more likely to be held liable for breaching the duty of loyalty

As long as board made decision in reasonable and informed manner, the judge defers to boards decision

Duty of loyalty: court takes a more interventionist attitude

# Directors’ Personal Liabilities

* Breach of the Duty of Loyalty [s.122(1)(a)]
* Breach of the Duty of Care [s.122(1)(b)]
* Other liabilities in corporate statutes
	+ Various illegal payments [s.118]

**CBCA s. 118 - Improper Payments Authorized By Directors**

* Directors jointly and severally liable
	+ Illegal to issue shares for consideration other than money, unless the value of the property or past services is not less than the value of the money that would have been received
		- * Jointly and severally, or solidarily, liable if director votes for or consents to a resolution authorizing this
		- **S 118(2)**—other illegal payments where directors can be held as jointly and severally liable or solidarily liable
			* Major types:

– Unfair non-money consideration for shares

– Dividend payments or share repurchases when failing to meet the tests

capital impairment test and cash flow test

* + - **S 118(3)**—directors can sue other directors who also voted for or consented to the resolution on which the judgement was based to recover the money they paid out to satisfy a judgement
		- **S 118(4)**--Directors may apply to court to compel shareholders who illegally received dividend payments to return the money to the corporation
		- **S 118(6)**--If director can prove that he did not know, or could not have known that the share was issued for consideration less than the fair equivalent of the money that the corp would have received, director is not liable
		- **S 118(7)**--Complaint must be raised within 2 years of the date of the resolution authorizing the action complained of
	+ Debts owing to employees [s.119]

 **CBCA s. 119 - Unpaid Wages And Vacations Pay**

* + - **S 119(1)**--Directors jointly or severally liable, to employees of corporation for all debts not exceeding 6 months wages for services performed for the corporation
			* Can be severance pay, vacation pay, benefits etc.
			* Only liable for debts accrued while the person was a director
		- **S 119(2)**—further exemptions:
			* Must sue for debt within 6 months after it has become due
			* Corporation has commenced liquidation and dissolution proceedings
			* Corporation has made an assignment or a bankruptcy order has been made against it
		- Employees must collect debts from corporation (directors not primarily liable)
			* **S 119(5)**—if director pays the debt, can recover from the company in bankruptcy with the same claim as the employee would have had
			* **S 119(6)**—can sue other directors who were also liable after satisfying the debt
* Other statutory liabilities
	+ i.e. tax law
	+ i.e. environmental law
* Tort Liability
	+ *ADGA Systems International v. Valcom Ltd.*
	+ A tortfeasor is a tortfeasor

## Relief from Liability:

* **Shareholder ratification** [s.120(7.1)] 🡪 note: applicable only to self-dealing (does not cover other things like breaching a duty of care)
	+ Breach involving an interest-directed contract (covered by CBCA s.120).
	+ Requires approval by shareholders through special resolution.
	+ SEE ABOVE FOR FULL DISCUSSION OF REQUIREMENTS (in Statutory Safe Harbour Section)
	+ Must be fair and reasonable to the corporation. Conflict of interest must be disclosed to shareholders.
	+ *Beatty*
* **If director usurps corporate opportunity** (breaches duty of loyalty), and this was approved by majority of shareholders, shareholders who opposed the resolution can still sue the directors
	+ - Court must take into account the fact that shareholders ratified the breach in determining whether directors are liable (s 242(1))
* **Exculpation clause** [s.122(3)]
	+ CBCA does not allow these sort of clauses
	+ You can’t have “blanket relief”
		- This is different than Delaware corporate law, which allows this! (as a result of corporate lobbying)
* **Statutory defences (only available to directors not officers)** [s.123]
	+ 1. Dissent on record [s.123(1)]
		- must be on record and in writing in the minutes of a board meeting
		- can’t assume that you don’t have personal liability
	+ 2. Due diligence defence [s.123(4)]
		- s.118 improper issuance of shares and payment
		- s.119 unpaid employee wages, vacation pay, reimbursement
		- s.122(2) compliance with the Act, the articles, bylaws, or USA
	+ 3. Good faith reliance defence [s.123(5)]
	+ Defences only available for **directors**, NOT available for officers
* **Indemnification and insurance** [s.124]
	+ Indemnification rights continue even after directors cease to be directors
	+ A statutory right – does not have to be stated in the articles of incorporation
	+ Both mandatory and permissive indemnification have to satisfy the requirements of s.124(3):
		- Directors must act honestly with a view to the best interest of the corporation
		- Reasonable grounds to believe that his act was lawful
	+ Indemnification = company’s promise to reimburse for litigation expenses and personal liability if the person is sued for being a director
		- Indemnification right persists even after someone ceases to be director
	+ 2 kinds of indemnification:
		- **Mandatory (s 124(5))—for successful defence**
			* If director successfully defends himself, has right to be reimbursed by corporation
			* Director must be found to not have committed any fault or not to have omitted to do anything that the individual ought to have done
			* Depends on finding at end of proceeding—must wait to be reimbursed
			* does not need to be in by-laws/articles—is a statutory right
			* **s 124(3)**—must act in good faith with view to best interests of corporation to be indemnified
		- **Permissive—for unsuccessful defence**
			* **S 124(2)**—do not have to wait to be reimbursed
				+ Can advance money to director for cost of proceedings
				+ Must pay back the money if director found to not be acting in good faith with view to best interest of corporation
			* **s 124(3)**—must act in good faith with view to best interests to be indemnified
			* must be specifically included in by-laws or articles
				+ in practice, many companies make permissive indemnification mandatory in the bylaws
		- **Third-Party Suit (s 124(1))**
			* may indemnify if action brought by a third party (not corporation or person on behalf of corporation; can reimburse against all costs, charges, and expenses, including settlement amounts or amount to satisfy a judgement
		- **Suit by Corporation or Person on Behalf of Corporation--S 124(4)**
			* Indemnity is permitted only with court approval
			* Limited to litigation expenses, not judgement amount or settlement amount
				+ Would make litigation meaningless if judgement amounts were covered
			* **S 124(2)**—do not have to wait to be reimbursed
				+ Can advance money to director for cost of proceedings
				+ Must pay back the money if director found to not be acting in good faith with view to best interest of corporation
	+ **Insurance**
* CBCA does not impose any limitations as to when insurance should be available
* CBCA drafter believe that insurance companies will make a sensible decision
* Some jurisdictions do not take the risk, and so in Ontario, insurance is not available (this limitation does not exist in BC)



* In practice, over 90% of companies offer D&O insurance

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| **North-West Transport Co v Beatty** 1887🡪 Interested share holders are allowed to vote when the SHs are voting to approve or confirm a self dealing contract |
| * transport company had director (Beatty) who sold a steamboat to the company. This is a self-dealing transaction. Later in a SH meeting, SH (including Beatty) pass resolution for approving the sale from Beatty to company of the steamboat by a simple majority vote
	+ one SH was trying to set aside the transaction
 |
| * Could Beatty vote on the ratification of the sale? NO
 |
| **Reasons**  | * Held: SCC:
* Privy Council: The vote of the majority must prevail, unless it was unfair or improper means
	+ - the only possible unfairness was that Beatty had voting control
		- BUT initially, B wasn’t controlling SH. BUT prior to SH meeting, he acquired a bunch of shares to make him a majority SH
		- So here, Beatty was allowed to vote in the conflict of interest transaction
* Ratio: Rule: interested SH are allowed to vote. This is adopted by CBCA
	+ S. 120 (7.1)
 |

## D&O Insurance:

* Companies may buy D&O insurance to protect their directors and officer
* CBCA has NO requirements to impose limitation as to when D&O insurance should be available
* 90% of TSX companies hold D&O insurance
* 2 types of insurance – depends on whether indemnification is available:
	+ NOT eligible for indemnification
		- Directors and officers are insured
		- Personal assets are at risk
		- D&O insurance Covers non indemnifiable liability of directors and officers
	+ YES eligible for indemnification
		- The company is insured
		- Company assets are at risk
		- D&O insurance covers company’s reimbursement of directors’ costs

## Advice for Directors:

* Review the corporation’s bylaws
	+ All corporate statutes in Canada permit indemnification
* Obtain an indemnification agreement
* Obtain D&O insurance (included in most well-drafted indemnification agreements, places obligation on the corporation)
* Collect sufficient information when making decisions (to get the protection of the Business Judgment Rule: reasonable manner, informed basis, without fraud or self-conflict)
* Having a good faith reliance on expert reports (to get the Good Faith reliance and due diligence defences under CBCA)
* Make sure dissent is properly recorded in Board meeting minutes or a written statement (to get the dissent defence under CBCA)
* Unanimous shareholder agreement
* If all else fails, then resign! (No limitation on a director’s freedom to resign under CBCA. Not a full protection, only helps protect from any future liability, does not protect from any liability arising from the time during which he served as a director)

# Derivative Actions

* Important for good corporate governance
* Directors owe the duty of care and the duty of loyalty to the corporation
* If they breach their fiduciary duties, harm comes to the corporation, so the corporation has the right to bring a claim through its human agents
* Under corporate law, shareholders, or other persons, are given the **right to sue on behalf of the corporation**
* The breach causes harm to the corporation – any award of derivative action belongs to the corporation, not the shareholder
* Shareholders typically do not have the incentive to sue
* Courts recognize the **benefits** of derivative actions:
	+ Provides compensation to an injured company – indirect benefit to the shareholder based on their proportion of ownership
	+ Creates fear of liability to deter future breaches
* To encourage derivative actions, courts have the power to award attorney fees to successful plaintiffs - this mechanism has profound impact on the frequency and efficacy of derivative actions – encourages shareholders to sue, sometimes bringing unmeritous claims **(“strike suits”)**

## Derivative Actions at CL

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| **Foss v Hartbottle// not good law anymore****Laid out two important rules:**Only the corporation has standing to sue (proper plaintiff rule)The court will not interfere if the alleged wrong may be ratified by a majority of shareholders (majority rule) BUT…S 242(1) *–* courts shall not dismiss a derivative action just because the alleged breach may be ratified by a majority of SHs // Intended to abrogate the majority rule in *Foss* |

## Derivative Actions – CBCA

* In Canada, statutory derivative actions in Canada have failed to make any substantial impact:
	+ Plaintiffs usually prefer oppression remedy over derivative action.
	+ Company has to be involved (notice to Board) + leave requirement to the Court.
	+ Neither of these is required under oppression remedy.
	+ Oppression remedy and derivative action are not mutually exclusive! Can happen simultaneously!
		- Depends on the plaintiff’s pleading choice.
	+ Typically, when 2 remedies are available, plaintiffs tend to prefer oppression remedy because there is no leave requirement and compensation will go to the plaintiff personally.

### Who can commence a derivative action?

s.238 definition of a “**complainant**” - who has standing to bring suit? 🡪 a current/former registered holder or beneficial owner of a security of a corporation or any of its affiliates

* Not all formers owners can bring derivative actions – must be some connection to the timing of the alleged wrong and the complainants status as an owner // complainant must have interest at the time of the wrongdoing
* Registered vs beneficial owner:
	+ Registered: SH whose name appears on the company’s securities register
	+ Beneficial: real owner of a security but that person’s name is not recorded on the company’s books (ie. Shares purchased through a securities broker)
* Two types of securities:
	+ Equity – Shareholders have shares
	+ Debt – means that the corporation raised money by issuing debt securities 🡪 borrows from large number of public investors (ie. Corporate bonds)
* What is an affiliate?
	+ Defn under s 2:
		- parent and subsidiary relationship as well as affiliated between the subsidiaries

### What steps to take:

s.239 steps to take:

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| (1) Subject to subsection (2), a complainant may apply to a court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate. (2) No action may be brought and no intervention in an action may be made under subsection (1) unless the court is satisfied that (a) the complainant has given notice to the directors of the corporation or its subsidiary of the complainant’s intention to apply to the court under subsection (1) not less than fourteen days before bringing the application, or as otherwise ordered by the court, if the directors of the corporation or its subsidiary do not bring, diligently prosecute or defend or discontinue the action; (b) the complainant is acting in good faith; and (c) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.  |

Similar provisions interpreted in (*Re Northwest Forest Products Ltd.* and *Re Bellman and Western Approaches)*

* + Apply to court for leave (s.242(2))
	+ Give notice to the Board of Directors of the corporation (at least **14 days** before the application made to the court)
		- Can notice be waived?
			* Think about the rationale – BoD has better knowledge about the operation of the company – are better able to determine if it is in the corporations best interest to pursue the action
	+ Complainant must act in good faith + appear to be in the best interests of the corporation

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| **Re Northwest Forest Products Ltd** 1975 BCSC🡪 reasonable notice in bringing a derivative action claim  |
| * Had Mr. Ross made reasonable efforts to cause the director of the corporation to commence the action?
	+ Yes, there was reasonable efforts—**both his letter and the resolution contained language mentioning fraud (cause of action) and both the letter and resolution had very similar language**
		- This was reasonable notice
* Was it prima facie in the interest of the company that an action be brought?
	+ Court was satisfied that action was prima facie consistent with interests of company—directors appeared to have failed to look for other bids and to find out the current market price of the shares
 |

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| **Re Bellman and Western Approaches** BCCA 1981🡪 to what extent should the court defer the Board’s decision not to pursue a derivative action // CL requirements to bring derivative action |
| * Bellman group sued under derivative action
 |
| * Did the group meet the requirements for a derivative action? YES
 |
| **Reasons**  | * + **Notice given was reasonable**—not required to specify each and every cause of action in the letter
	+ **Good faith?**
		- in this case, complainant made two actions (derivative and direct(oppression remedy))
		- damage sought in derivative action and oppression remedy were not the same, so it did not raise an issue about the good faith of complainant
		- requirement met
	+ **appears to be in best interests?**
		- Did board make decision not to pursue action independently?
			* Independent committee with outside experts had concluded that it was not—but should the court defer to this?
				+ BUT court said 4 directors were not independent—were nominees of controlling group
				+ Retained outside experts, but the reports prepared were very limited—did not address/consider potential breach of fiduciary duties
			* Decision not made in impartial way
		- Appeared to be in interest of corporation to pursue the action
* To what extent should court defer to decision of board not to pursue an action?
	+ Should this be protected by business judgement rule?
	+ Discussed in note 1 on page 715-716
		- In US, companies set up special litigation committees of independent directors—if decision is challenged, court investigates whether committee is independent and reasonableness of decision
			* If committee is found independent, court will defer to board’s decision
			* This case bears similarity to US jurisprudence, as court investigated independence and way decision was made
	+ Independence is context specific
 |

## Remedies:

* s.240(1) – anything the court sees fit!
* s.242(2) – settlement agreements must be subject to court approval 🡪 prevents agreements that are not in the best interests of the company
* s.242(3) – costs (*Turner v. Mailhot*) // to encourage derivative actions the CBCA provides that the complainant is not required to provide security for costs
* s. 242(4) – allows a complainant to seek indemnity but the complainant may still be liable for the costs of the final disposition

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| **Turner v Mailhot** BCCA 1981🡪 factors to consider when granting costs |
| * Filed derivative action and filed for interim costs
	+ After derivative action is filed, there is a prima facie presumption of indemnity
		- Factors:
			* **Financial ability of complainant to carry on lawsuit**
				+ In this case, no issue as to financial ability
				+ If financial ability changes, can seek more comprehensive indemnity later
			* **Is the benefit sought more for the corporation or the complainant**
				+ Minority shareholder entitled to indemnity to half of the future fees and costs—in this case, it was more about a dispute between minority and majority, and less about the corporation
 |

# Personal Actions vs Derivative Actions

* Personal Actions:
	+ Enforcing rights as shareholder
	+ Recovery goes to shareholders
	+ No leave requirements
* Derivative Actions:
	+ Enforcing rights on behalf of the corporation
	+ Recovery goes to the corporations
	+ Apply to court for leave
* *Goldex Mines* [misleading proxy solicitation was sent, P did not make it clear whether they were seeking a personal action or derivative action]
	+ “where a legal wrong is done to SHs by a director or to other SHs, the injured SHA suffer a personal wrong and may seek redress for it in a personal action
	+ “a derivative action on the other hand in which the wrong is done to the company”
	+ **Key question: look to where the wrong was aimed to determine personal vs derivative action – who suffers?**
		- if the injury is not incidental to the corporation, an individual cause of action exists
			* “not arising incidental to” means “not arising simply because the corporation itself has been damaged, and as a consequence of the damage to it, its SHs have been injured
	+ here sending a misleading proxy caused both kinds of harm
		- individual (violation of the P’s information right) and derivative (breach of fiduciary duty)
		- it’s necessary to distinguish each cause of action in the statement of claim

## Examples of Personal Actions:

* Compel payment of dividends declared but not distributed
* Compel inspection of shareholders list, or corporate books and records
* Require the holding of a shareholder meeting
* Challenge corporate restrictions on share transferability
* Challenge fraud on shareholders in connection their voting, sale, or purchase of securities
* Challenge the sale of the corporation in a merger where directors structure a transaction hat was unfair
* Challenge the denial/dilution of voting rights, ie when substantially all the corporation’s assets are sold without SH approval
* Compel dissolution of the corporation, such as for deadlock or oppression of minority of shareholders

Oppression Remedy

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

Who can initiate an oppression action?

s.238:

* Complainant =
	+ **Present Registered holder or beneficial owner**, former registered holder or beneficial owner, **of a security** of a corporation or any of its affiliates
		- Registered holder (name appears on books); beneficial owner (actual owner)
	+ **Former registered holder or beneficial owner**
		- Timing of alleged wrongdoing and holding of shares must coincide—if wrongdoing occurred before you sold, you can sue
	+ Corporation and affiliates
		- Affiliates = companies owned/controlled by the corporation
	+ Director or an officer or former director or officer of corporation or any of its affiliates
	+ CBCA director
	+ Any other “proper person”, at the discretion of the court
		- What about employees or creditors?
		- Most **creditors** can bring lawsuit on contract with the company or sue under tort law, so why do they have an incentive to sue under oppression remedy?
			* Court has unlimited flexibility in deciding a remedy under oppression remedy, not constrained like in contract or tort
			* Commonly try for oppression remedy when assets of company are transferred to personal assets of directors to defeat creditors
				+ Will look at whether there has been fraud perpetrated against creditor
		- **Employees:** CBCA s 241(2)
			* Seems to say that employees cannot bring an oppression remedy: does not mention employees, only protecting interests of security holder, creditor, director, or officer
				+ Wrongful dismissal claim cannot be brought under oppression remedy unless dismissal is part of a pattern of oppressive acts

E.g. employee is terminated and employee sues corporation and wins, but corporation transfers assets to avoid paying

*The original intention of the OR is to protect the minority SH. Minority SH are often directors, officers, and the purpose of the OR is to protect them*

* *Practical implication in courts: they have bene hesitant to grant OR to non-SH 🡪 The interest includes legal rights but ALSO reasonable expectations (s.241 slide)*

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| **First Edmonton Place Ltd** Alberta🡪 test for standing in an oppression remedy suit  |
| landlord corporation and tenant corporation. TC controlled by 3 lawyers. Lawyers were directors and SH of the company. LC tried to induce lawyers to enter into a contract for a 10-year lease for an office space. LC provided incentives to TC (1) offered 18 month rent free (2) offered a lease-hold improvement allowance – for renovations (3) offered a cash payment * lawyers stayed in space for 21 months without signing a contract, and then they left
* LC sued TC under oppression remedy
 |
| was LC eligible to sue under oppression remedy? |
| **Reasons**  | * Do they have standing as a landlord/creditor to bring oppression remedy?
* **2 kinds of creditors:**
	+ **Holders of debt securities (bond-holders; debenture-holders)**
		- **Fall under s 238(a) as security holders—have standing to bring oppression remedy**
	+ **Trade Creditors: Employees, suppliers, landlords etc.**
		- **Fall under s 238(d)—are they proper persons? Subject to approval of the court to bring oppression remedy**
		- **2 circumstances to grant standing for Trade Creditors:**
			* **If conduct of directors/management constitutes using corporation to commit fraud against the applicant creditor**
			* **If there was a breach of reasonable expectation arising from the circumstances in which the creditors’ relationship with the company arose**
 |

What constitutes oppressive conduct?

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| **Ferguson v Imax** 🡪 consider social relationship in determining whether conduct is oppressive |
| * Imax owned by 3 couples (Fergusons, Kroiters, Kerrs)
* Were 2 classes of shares (common and preferred)
	+ Preferred shares
		- Had dividend priority over common shares (5% per year)
		- Non-redeemable (no right to force sell back to company)
		- Non-voting, but (see case for exclusion)
* Each of the husbands held 700 common shares
* Each of the wives held 700 preferred shares
* All husbands participated in management of company
* Fergusons divorced
* Mrs. Alleged Mr. cooperated with other shareholders to try and force her out of company
	+ Argued that she got fired by company (used to be an employee)
	+ During divorce negotiation, Mr. tried to get Mrs. to sell the shares to him
	+ Mr. stopped all dividend declarations and blocked dividend payments, because he did not want Mrs. to get any money
* Shareholders passed a resolution to make the preferred shares redeemable and to freeze the value of the preferred shares
 |
| Did Mr. Ferguson’s actions constitute oppressive conduct? YES |
| **Reasons**  | **Held**: yes. Mrs. F was oppressed by her husband as a minority. BUT, what about the other preferred SH? NO, the others were not oppressed. * Preferred SH received no dividend and had to sell shares back to company. These two actions were oppressive to MRs F but not to other SH because the other SH could still enjoy the financial benefits of the company because their spouse was still a SH
 |

*General Trends about the oppression remedy:*

1. Typically happens in closely held corporations
2. A lot of oppression cases involve fundamental family disputes

Exceptions to this! = BCE - It does not involve a breakdown of family relations, and it involves a public company

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

Facts:* Company BCE has subsidiary called Bell Canada
* Bell had a group of debenture holders
* In April 2007, a group of investors led by Teachers’ Private Capital started to acquire shares of BCE on open market
	+ Indicated that they intended to take over BCE
* BCE’s board decided to conduct an auction to attract competing bidders
	+ Attracted 2 other bidders and TPC
* All 3 bidders offered LBOs
	+ TPC won the auction b/c they offered the highest price
	+ But, TPC required Bell Canada to provide guarantees of $30 billion to support the loan to acquire BCE
		- These guarantees would downgrade the debenture holders and the value of the debentures decreased by 20%
			* More risky, because there was a creditor who had priority over them in the event of insolvency
* Shareholders of BCE approved the transaction (~98% in favour)
* Debenture holders brought oppression remedy against directors of BCE
	+ Were the actions of the directors oppressive to the debenture holders?
 |
| Were the debenture holders oppressed? NO |
| **Reasons**  | * **Test for determining whether actions are oppressive:**
	+ **Did the claimant have a reasonable expectation that his interests would be protected?**
		- **Reasonableness is fact-specific/context-specific**
		- *Reasonableness Factors:*
			* **Consider general commercial practice**
				+ **Is this common practice?**
			* **Consider nature of corporation (public or private)**
			* **Relationship between the parties?**
				+ **Not only legal relationships, but also social relationships**
			* **Past practice**
				+ **How did the company handle issues like this in the past?**
			* **Self-protection measures**
				+ **Did the claimant take any steps to protect themselves?**
			* **Representation & agreements**
				+ **Consider statements made by company and contract governing their relationship**
			* **Fair resolution of conflicting interests between stakeholders**
		- **Is there a violation of this reasonable expectation that resulted in unfair/prejudicial consequences for the complainant?**
* Did the claimant have a reasonable expectation that his interests would be protected?
	+ Debenture holders did not have reasonable expectation
		- LBO’s are quite a common practice—are not unforeseeable
			* Debenture holders could have foreseen possibility of LBO
		- Representations—company made some statements suggesting a commitment to maintain investment grade, but all statements were accompanied by warnings
		- Contractual terms of debenture holders were met and not further commitment could be made
		- Debenture holders could have protected themselves by acquiring better terms in the contract for investment grade and trading price
		- Past practice—in the past, the investment grade was maintained
			* Past practice can be reasonably changed by changing market conditions
		- Is a public company—common for public companies to have leverage buyouts
		- Fair resolution? There were conflicts of interests between stakeholders, but directors have fiduciary duties to the corporation and they may consider the various interests of stakeholders, but no particular group’s interests should be favoured at the expense of other stakeholders
			* As long as decision is within range of reasonable choices for best interests of the company, the courts should defer to board’s decision, unless alternative transaction that is more beneficial to company was available
* Court reaffirmed position in People’s
	+ Duty of loyalty owed to the corporation only—have discretion to consider interests of various stakeholders
		- Shareholder wealth maximization is not the only corporate purpose
 |

What remedies are available to the complainant?

 241(3)

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

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| **Naneff v Concrete Holdings** 1995 ONCA🡪  |
| Son ousted from management of family business because father didn’t like his GF |
| Was this act oppressive? YES |
| **Reasons**  | **Trial Court Held**: finds that the father, as controlling SH and dominant director, his act was oppressive to A. Trial Court ordered a public sale of the company, and A was allowed to participate in the sale and acquire shares of the company. **CA Held**: varied the remedy! Oppression remedy is to correct oppression, nothing more. The trials court’s remedy was BEYOND ratifying oppression. A had no reasonable expectation that he would get control of the company during his fathers lifetime. Father also didn’t have a reasonable expectation that he would lose control of the company over this lifetime. The proper remedy is to give proper compensation to A for wrongful dismissal and also for the lost dividends  |

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| **Rea v Wildeboer** 2015 ONCA🡪 no claim to OR where the complainant does not suffer unique harm |
| public company. Former director sued current director and alleged the current directors misappropriated company’s money. Sought relief under oppression remedy, but didn’t seek any recovery for himself, he sough recover for the company (he didn’t argue that he suffered any person harm) |
| Can he bring the OR, even though he didn’t suffer harm and he isn’t claiming remedy for himself* complainant argued that harm to corporation usually also harms SH
* complainant can chose to sue through derivative action or oppression remedy:
 |
| **Reasons**  | **Held**: yes, these two things can arise simultaneously, and the typical situation that gives rise to both at once is in a closely held corporation, the majority SH misappropriates the company’s assets/property. In that case, the company is hurt AND so is the minority SH in a unique way (so minority SH has personal harm) * how does this arise: example:
* majority holds 70%, Minority holds 30%
* only assets are $100 and no liabilities
* if majority SH misappropriates $100 (they transfer the 100 to their own pockets. This hurts the company because then the company has nothing. Also hurts the minority SH and NOT the majority SH because the value of the minority SH shares are now worth nothing, and the majority’s shares are worth nothing, BUT the majority has the $100 in their pocket already!

Held: the **complainant did not have a claim to bring the oppression remedy, because in this case, the complainant didn’t suffer any unique harm**, and therefore needs to bring a personal claim (he doesn’t have the option of bringing BOTH claims, as was shown in the example – it is rare for this example to occur, and likely will not happen in a public company such as it was in this case  |

**Major Comparisons:**

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

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

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