Business Organizations – CAN Fall 2014

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# Nature of Corporate Personality

Corporations

* Corporations in BC – registration jurisdiction
* “ultra vires” for corporations abolished – Lawrence Commission

BCBCA – s. 30 – corporation has full rights as individual with capacity

#### Salomon v Salomon & Co

Principles:

* corporation is distinct legal person / entity, separate from its directors, s/h’s, employees and creditors
* company is not agent of only or majority s/h

**Share issuance** – subject to business judgment rule

* s. 62 – directors have power to issue shares
* s. 64 adequate consideration for shares – company must get consideration in the form of cash, property or past services

## Limited Liability and Creditor Protection

* s. 87(1) s/h not liable for obligations of the corporation

## Piercing the Corporate Veil

3 instances when court more likely to pierce corporate veil (modify consequences of being separate entity):

1. Court thinks company is agent of its principal or sole s/h
2. Primary issue, how relevant the fact that corp treated as separate legal person answers question – look at facts in holistic manner
3. Fraudulent purpose – s/h of corp trying to say they are not responsible for action of company
	1. If pre-existing legal obligation, can’t hide behind corp to breach obligation

### 1) Agency

#### Clarkson Co v Zhelka

Facts: S owned co, Industrial. He transferred property to sister Z, who mortgaged it. S went bankrupt.

Issue: Was I S’s agent? So creditors would be entitled to assets?

Outcome:

* I was not the agent of S
* No evidence of illegal, improper exchange
* No evidence that corp formed as deliberate ploy to defeat creditors – no pre-existing obligations to avoid

NOTE- No Canadian case where court finds corp to be agent of its s/h, but keeps saying it’s possible. (more likely in US w/ company w/ high predictability of tort – like taxi drivers in NYC)

#### Lee v Lee’s Air Farming Ltd. (New Zealand)

Facts: L died, he was sole s/h of his corp. Had entered into contract for worker’s compensation. Wife made claim after his death, claiming he was employee of company. As director, he had hired himself as employee of company he owned and controlled.

Outcome (PC):

* He was agent of corp as director, and in that capacity entered contract w/ himself as employee
* Not a sham, he worked and paid salary – legitimate contract
* Normally directors are not employees of company

### 2) Tax Liability (or other regulatory statute)

#### De Salaberry Realties v Minister of National Revenue

Facts: Bronfman family set up property investment group of companies. Cemps Investment --- Cemps Holding --- separate subsidiaries --- each only owned 1 property each. Used to acquire piece of land, hold it, then sell it.

Issue: Whether companies were separate businesses that bought business to generate income, or whether simply vehicles to buy/sell individual property for capital gains purposes.

Outcome:

* Court looked at group as whole, factors like:
	+ No horizontal dealings – only from parents
	+ No directors of subsidiaries were independents – all nominees from those who controlled holding co – look at whether holding co **controls** the subsidiary
	+ Shelf corporations – only used occasionally for transactions
	+ Low capitalization
* Courts look at policy – how affiliated corps carry on business, and who controls them
* Court never asks: “is this a case where we should lift the corporate veil”, it was just what the purpose was that this company acquired this property for.

### 3) Fraudulent Purpose

#### Gilford v Horne

Facts: G is employee of H. He leaves company, signs agmt that won’t set up car company. He incorporates company, and that company carries on business within radius.

Issue: is he protected by corporation?

Outcome:

* G had pre-existing legal obligation, and used corp as device to avoid obligation
* His corporation still recognized – but won’t override obligation

NOTE – this is distinguished from tort liability – NOT pre-existing (although it may be highly predictable, like in US jurisprudence)

# The Process of Incorporation

* Delaware phenomenon – no similar jurisdiction in Canada
* General practice to incorporate provincially in the province where the corp expects to carry on its business
* Or to incorporate federally if the corp expects to conduct business in several provinces

## Extra-Provincial Licensing and Filing Requirements

Terms:

Company: corporation incorporated un BCBCA – specific to BC

Foreign corporation – corporation that isn’t a company (incorporated elsewhere)

### Registration:

* Registration system for foreign entities the carry on business in the province (s. 375)
* Designed to require corp to have address in BC, for serving legal action
* S. 375(2) deemed to carry on business if:
	+ Name in tel directory, in ad
	+ If have agent, place of business, or warehouse in BC
* Also common law definition – carrying business in BC (Weight Watchers)
* Registration Requirements: (s. 376)
	+ Register within 2 mos
	+ Appoint attorney provide mailing addy
	+ Display name
	+ Directors/officers of EP company that doesn’t comply become personally liable for contractual obligation
		- Statutory lifting of the corp veil
		- S. 426(1)(b) onus on defendant – to prove not carrying on business.

#### Weight Watchers Int’l v Weight Watchers of Ontario

Facts: Parent company licensed WW franchisee in Ontario. For extraprovincial reg requirements, did this mean that parent company was carrying on business in Ontario?

Outcome:

* No – just a one off relationship, not enough to show cont’d presence (same as vendor/purchaser)
* Having an agent that goes to a province and enters into contracts w/ people there for principal is business – very fact specific

## Continuance Under the Law of Another Jurisdiction

Continuance involves two steps:

1. **Export step:** emigrating corporation must obtain consent of authorities in jurisdiction of incorp.
2. **Import step:** emigrating corporation must meet requirements of federal or provincial Act under which it seeks to be continued.
* ss. 302-311: corp is basically immigrating.
* If want to cease being a corporation under this province’s laws and instead be a corporation under Alberta’s laws. Used to dissolve in old province and incorporate in the new province.
* continuation means dissolution no longer needed: new province recognize this BC corporation as a corporation under their statute if at the same time BC deregisters/strikes it off their register.
* Must be continuation provisions in both provinces’ statutes. NEED matching provisions in other province
* Mergers / amalgamations
	+ Can’t apply if they are foreign corp – Alberta comp can merge if it discontinues and becomes BC comp through continuation provisions
	+ Then merge under BC merger rules

# Classification of Corporations

## Public Companies vs Privately Held Companies

BCBCA applies to public companies different for some provisions, such as:

* S. 120 – must have minimum 3 directors – insider trading
* Audit committee requirements – s. 223
* Financial statements must be independently audited – s. 210 – private companies can have s/h waive this requirement

“Public Company”

1. Is the company a reporting issuer within meaning of Securities Act?
2. Company whose securities are listed on the stock exchange
* Required to make disclosure on continuing basis
* Test: whether any or all disclosure requirements are disclosed to public
	+ Test: level of “need to know” of ppl who are offered securities
	+ Ex. Ralston Purina – distribution to employees – junior employees needed to know, so needed prospectus

### One person corporations

* Treated same as multi-s/h corps
* Meetings of directors can now e held w/ one person
* Unanimous resolutions in writing – agree that no need for AGM

### Constrained share corporations

* Companies can have in their articles power to refuse transfer of shares if employees think that registering new shares would violate foreign investment legislation
* Companies such as telecommunications (CBA)

### Professional Corporations

* Members of professions can incorporate themselves (usually tax purposes)
* BC Law – Legal Professions Act allows lawyers to incorporate but preserves liability in same way as described in Ontario statute

### Unlimited Liability Companies

* In NS, Alberta, BC
* Mostly to do w/ US tax laws
* Facilitates US investors getting max. tax breaks – deemed to be partners, but treated as corps in Canada

### Special Act Companies

* Some incorporate through own statute- Crown corps (BC Hydro, ICBC)
* Only s/h – Attorney General
* All provisions in BCBCA apply as long as not inconsistent w/ special act

## Corporate Names – s. 21-29

* Naming corp only place where run into problems (when registering)
* Monopoly of name – BC Registry won’t give to anyone else
* Not country wide – this may be advantage of federal incorporation
* Concerned w/ names that confuse/deceive customers (ex. Nordstroms in BC)
	+ Now IP law concerned w/ protecting name, and afford protection based on potential harm
* 3 remedies if objection:
1. tortious remedy of passing off
2. infringement of registered trademark
3. ask courts to review decision of Registrar
	1. s. 406 – challenge

### Requirements of Registrar

* s. 22(5) substantive legal requirement Registrar must follow
* test: whether “good and valid reasons” for Registrar to disapprove
* Desirable name is
	+ Descriptive of co
	+ Not named after public figure
	+ Not named after gov’t agency (UN)
	+ Can be #’d co
* S. 27 – must display name at place of business
* S. 23 - Need some word for corporateness – Ltd, co, corp, inc
* S. 263 – change of name
	+ Must amend notice of articles
	+ Need special resolution – change to company’s constitution

# The Nature of the Company Constitution

## The Incorporation Documents

* Founders need to enter Incorporation Agreement – agreement to acquire shares

**Notice Of Articles** – power /capacity

* Started from doctrine of ultra vires – corps had no powers except in constitution
* Doctrine of constructive notice – everyone outside company deemed to know content of docs bc publicly filed
	+ Abolished in s. 421 (in the ‘70s)
	+ Not deemed to know
* Previously companies could use constructive notice to get out of obligations from creditors
* Contains – name, address, directors name/address, records office, s. 52 – authorized share structure

**Articles (by-laws)**

* **S. 12** – rules of conduct, restrictions / powers company may exercise
* Special rights and restrictions attached to each class of share
* Table 1 Articles
* Not filed w/ registrar, but are accessible
* Certificate of incorporation is like birth cert

## Legal Effect of Constating Documents

Part of law applicable to corp ---statute and regs --- common law --- constating docs ---shareholder agreement

**S. 19** **Legal effect of constating docs**

* Company bound by notice of articles and articles at time when company recognized
* As if signed by each s/h – and as if contained covenants not to breach constating docs - like contract
* Personal remedy – s/h can enforce contract – ask for injunction if company goes against articles (not damages)
* Can only enforce terms of corps constitution that give the s/h rights that s/h enjoys
	+ Ie: can’t serve b/c certain director wasn’t hired

## Power and Restrictions of the Corporation

**s. 30** – corporation has the rights, powers of a person w/ capacity

**s. 33** – (1) A company must not:

(a) carry on any business or exercise any power that it is restricted by its memorandum or articles from carrying on or exercising, or

(b) exercise any of its powers in a manner inconsistent with those restrictions in its memorandum or articles.

(2) No act of a company, including a transfer of property, rights or interests to or by the company, is invalid merely because the act contravenes subsection (1).

* Company can make change to company’s articles
* S. 259/60 – fundamental change, needs special resolution

### Restricted Acts

* **s. 33(2)** – restricted act w/ third party, not deemed to be invalid
* if s/h knows – remedy of Compliance/Restraining order – s. 228 (broader than s. 19)
	+ can stop company from entering deal – injunction
	+ 3rd party – allows compensation to 3rd party for losses arising out of interruption to deal it thought it had - s. 228(3)(c) – courts can make any order it thinks appropriate
	+ can also lift corporate veil
		- director personally liable (s. 154 + 157 (defences))
		- imposing statutory personal liability on directors (outside of fiduciary duty)
* ultra vires in Extra-provincial Companies
	+ s. 378(3) – if EP company does restricted act (in home jurisdiction, b/c they still have ultra vires), the act is valid – deemed valid in BC
* restricted acts could also allow for derivative action – breach on restriction are also breaches of fiduciary duty

# Pre-Incorporation Contracts

* law doesn’t recognize existence of corp until cert of incorporation issued by Registrar.
* Difficulties arise when facilitator/promoter enter into contracts w/ third parties on behalf of the proposed corporation
* Question of facilitator’s liability, and whether third party has any rights

Three common scenarios:

1. Promoter knows and third party knows company not yet incorporated
2. Promoter knows and third party doesn’t know company not yet incorporated
3. Promoter nor third party don’t know company not yet incorporated (mistaken belief)

## Common Law Position

### Scenario 1

#### Kelner v Baxter

Facts: Both parties knew that it wasn’t incorporated. A signed on behalf of the company when T purchased extra wine stock and sold to company. A passed resolution to reimburse T.

Outcome:

* Court said company not yet formed, so A personally liable
* Similar to principal/agent principle – no principal formed yet
* “we must assume that the parties contemplated that the persons signing it would be personally liable”

### Scenario 2

#### Wickberg v Shatsky & Shatsky

Facts: T got employment contract to be new GM. T though company incorporated. It didn’t exist, then went bankrupt.

Issue: is A liable?

Outcome:

* A not personally liable – no intention of the parties for A to be personally liable when signed contract
* Contract is just void
* Only remedy – to show breach of warranty (relied on representation)
* BUT – his loss resulted from the fact that the business wasn’t a success, not from the breach of warranty

### Scenario 3

#### Black v Smallwood

Facts: A and T both not aware that company hadn’t been incorporated – both mistakenly believed it was. Entered contract for sale of land. A was acting as duly authorized agent of existing principal. – T thought the same. T sued A, relying on K&B.

Outcome:

* Distinguished from K&B – where A intended to be personally bound
* Here, couldn’t have intended personal liability of A – both though liability from corp (although mistaken)
* Intention of parties still important
* So A not personally liable
* Contract is void

## Statutory Reform

* s. 30 (2) Subject to subsections (4) (b) and (8), if, before a company is incorporated, a person purports to enter into a contract in the name of or on behalf of the company,

(a) the person is deemed to warrant to the other parties to the purported contract that the company will

(i)   come into existence within a reasonable time, and

(ii)   adopt, under subsection (3), the purported contract within a reasonable time after the company comes into existence,

* SO… not saying A is personally liable, but A is issuing warranty that company will be incorporated, and adopt K after comes into existence
* If condition fails, T has remedy against A
	+ In breach of warranty, not in breach of K

NOTE – s. 20 is exhaustive, and replaces the common law

Remedy – s. 20(2)(c)

the measure of damages for that breach of warranty is the same as if

(i)   the company existed when the purported contract was entered into,

(ii)   the person who entered into the purported contract in the name of or on behalf of the company had no authority to do so, and

(iii)   the company refused to ratify the purported contract.

|  |
| --- |
| **What happens when a pre-incorporation contract is entered into** |
| **Subsection 20(2)** of the BCBCA provides that a promoter, in entering into a pre-incorporation contract with a third party “in the name of or on behalf of” a not-yet-incorporated company, is deemed to *warrant* to the other contracting party that (a) the company will be incorporated within a reasonable time, and (b) the newly incorporated company will adopt the pre-incorporation contract within a reasonable time. **Section 20 is exhaustive, and replaces the common law.** |
| **How can the promoter’s warranty “disappear”?** |
| There are two ways in which the promoter’s warranty can “disappear”:1. Subsection **20(8)** provides that, if the parties to a pre-incorporation contract have *expressly agreed* that there will be no warranty as provided for in s. 20(2), the warranty is **contracted out of** .
2. If the newly incorporated company adopts the pre-incorporation contract, as provided for in s. 20(3), within a reasonable time. The promoter’s warranty disappears, and the newly incorporated company assumes all of the obligations under the pre-incorporation contracts, pursuant to s. 20(4).
 |
| **Adoption of the pre-incorporation contract by the newly incorporated company** |
| **Subsection 20(3)** provides that the company, upon incorporation, can adopt the pre-incorporation contract (and assume the obligations under it) “by any act or conduct signifying its intention to be bound by it”. – can be express or by action |
| **Remedies for the party that contracts with the promoter**  |
| **Breach of Warranty, s. 20(2)***This remedy applies even if the company is not formed.*  | **Subsection 20(2)(b)** provides that the promoter is liable to the other parties to the pre-incorporation contract “for damages for any breach of that warranty” set out in s. 20(2)(a). Therefore, if a company does not come into existence within a reasonable time and/or does not adopt the pre-incorporation contract within a reasonable time after coming into existence, the third party can sue the promoter for breach of warranty. |
| **Restitution/*quantum meruit*, s. 20(5)***This remedy only applies if company has come into existence, but does not adopt the pre-incorporation contract!* | **Subsection 20(5)** provides that, if the company comes into existence *but does not adopt the pre-incorporation contract within a reasonable time following incorporation,* any party to the pre-incorporation contract (the promoter *or* the third party!) can apply to the court for an order directing that company “restore to the applicant any benefit received by the new company under the pre-incorporation contract”. E.g. if the third party has provided some services to the new company under the pre-incorporation contract, the third party could apply for a court order that the company pay the third party for its services; or, if the promoter is out of pocket as a result of the pre-incorporation contract, the promoter can apply for a court order that the company compensate the promoter.  |
| **Order from a court, rearranging obligations, s. 20(6)***This remedy only applies if company has come into existence.* | **Subsection 20(6)** provides that any of the parties (the company, the promoter, or the third party) can apply to the court for an order *rearranging obligations* under the pre-incorporation contract. A court can order that the obligations under the pre-incorporation contract be join or joint and several as between any of the parties (s. 20(6)(a)), or apportion liability between the new company and the promoter (s. 20(6)(b)). While courts tend to try to give effect to the obligations that the parties agreed to, s. 20(6) seems to invite courts to rewrite some pre-incorporation contracts.  |
| However, if the company is never actually incorporated under the BCBCA, the language in s. 20 suggests that s. 20 may not apply (s. 20(2): “…if, before a company is incorporated, a person purports to enter into a contract in the name of or on behalf of the company...”). If this is the case, a court would need to go back to the common law rules (*what did the parties know? and what did the parties intend?)*. |

# Management and Control of the Company

## Introduction

* Corporation bound by acts of its agents:
	1. Shareholders and general meeting (or special)
	2. Board of Directors
* Gowers in Modern Company Law – directors have more power than agent of company – directors have power vested, s/h’s have almost nothing

### Powers and functions of directors

* **S. 136** – directors must manage or supervise the business and affairs of the company
* Defined as almost anything the company is empowered to do
* Power vested in Board collectively – different than fiduciary duties (which is individual)
* **S. 138** – person who performs the functions of director, must also comply w/ provisions for directors as if they were director
* Day-to-day control of company

### Appointment of Directors

* **S. 1(3)** – appointment of directors
* **S. 135** – emergency situation when director not in place, personal representatives can step in
* **S. 143** – even if default in election of director – acts of person are nonetheless valid
* **S. 128(3)** impeachment provision – s/h’s can pass special resolution to remove director

#### Automatic Self-Cleansing Filter Syndicate v Cuninghame (1906)

Facts: S/H’s convened meeting, passed general resolution selling company’s assets. Ordered directors to carry out instructions, sell company’s assets. Board said s/h’s didn’t have power, so refused. Articles of company contained language vesting power in directors.

Outcome:

* Unless clause in article amended (which requires special resolution), directors not obliged to carry out instructions from s/h’s, even if unanimous
* Can only amend constitution or replace directors

### Types of Authority/Agency

**Actual authority** – power vested in an individual (ex. CEO)

**Usual/implied authority** – not expressly articulated, but vested by office held (ex. Lawyer)

**Apparent/ostensible authority –** no express/implied, but acting as though company’s agent

## Indoor Management Rule

**s. 146** - third parties can take for face value that: (a) a company’s Charter have been complied with, (b) the individuals registered as directors are *actually* directors, (c) a person who holds themselves out as a director, officer, or agent of a company is a director, officer, or agent of the company, (d) any record issued by a director, officer, or agent of a company is genuine and valid, and (e) any record kept by the company is accurate and complete. However,

* now that *ultra vires* and the doctrine of constructive notice have been abolished, the indoor management rule is less important.

**s. 421** – no constructive notice – not deemed to have knowledge b/c records are available

## Corporate Goals and Social Responsibility

* debate on role of corporation in modern society
* community interest (stakeholders other than s/h’s) vs status quo (focus on profit maximization for s/h benefit)

**Summary of law related to corporate goals:**

* primary goal of corporations is profit-making and
* directors owe the corporation a fiduciary duty to act in its best interests;
* in considering what is in the best interests of the corporation, directors *may* (but are not obliged to) consider the interests of other stakeholders like shareholders, creditors, employees, etc.

#### Dodge v Ford Motor Co

Facts: Ford Motor issued cash dividends regularly. HF announced no more dividends, would reinvest profit into company to expand, create more jobs. Dodge brothers looked to compel Ford to issue dividends.

Outcome:

* corporations primary purpose is for the profit of s/h
* ordered dividends paid – arbitrary of HF to hold back payments

#### Parke v Daily News

Facts: DN wanted to sell newspaper, use the money to benefit the staff and pensioners. S/h started action claiming the compensation was ultra vires.

Outcome:

* all actions taken by directors must, ultimately, be done for the benefit and to promote the prosperity of the company
* 3 part test (Re Lee, Behrens): (1) Is the transaction reasonably incidental to the carrying on of the company’s business? (2) Is it a *bona fide* transaction? (3) Is it done for the benefit and to promote the prosperity of the company?
* Although motivated by generosity, not authorized to benefit former employers = breach of fiduciary duty (needs to benefit company)

#### Re Peoples (SCC)

Facts: Wise and Peoples merged joint inventory procurement policy. Both went bankrupt. Action by the trustee in bankruptcy against directors for breach of fiduciary duty by prioritizing their own creditors’ interest over those creditors of the firm generally.

Outcome:

* Fiduciary duty owed by directors to the corporation (not group of stakeholders)
* What is in best interest of corporation? – act honestly and in good faith
* In acting in corporation’s best interest, directors can consider interests of other stakeholders – s/h’s, employees, suppliers, creditors, consumers, gov’ts and the environment
* Creditors can use duty of care and oppression remedy

#### RE BCE (SCC)

Facts: Buyout of BCE – debentures in Bell Canada. Debenture holders opposed arrangement – decrease in market price, so sought oppression remedy.

Outcome:

* Courts should give business judgment of directors appropriate deference
* Must lie within a range of reasonable alternatives (business judgment rule)
* Reasonable expectations of the debentureholders was that directors act in best interest of the corporation
* Directors establish sub-committee to investigate – seen as proactive by directors, which may protect against breach of duty

## The Audit Committee

* Public companies – must have AC – study/discuss/assess auditors
* **S. 223 – 226**
* Enhances the detection o fraud and improves financial soundness in corporation’s management
* Problems:
	+ Auditors may compromise objectivity b/c of loyalty to ppl who hired them
	+ Directors on AC might not ask great questions – may want to maintain independence
	+ Directors will recommend same AC – getting fee

### Requirements

**s. 224 –** directors must select “independent” audit committee, composed of at least 3 directors, majority of who are not officer/employees

**s. 225** – AC must review and report to directors on financial statements & auditor’s report – positive duty

**s. 224(6)** auditor can demand that AC meet if he wants and (5) must be given notice – can also be required to attend

## Sale of the Undertaking

**s. 301** (1) A company must not sell, lease or otherwise dispose of all or substantially all of its undertaking unless

(a) it does so in the ordinary course of its business, or

(b) it has been authorized to do so by a special resolution.

If directors wish to sell of most of company’s assets, s/h’s can prevent this by special resolution

“all or substantially all of its undertaking”

* all of the assets (net worth)
* quantitative and qualitative test
	+ Quantitative – more than 50%
	+ Qualitative – does the sale strike at the heart of the company’s business?
* Exceptions (6) – mortgages, lease less than 3 yrs, between affiliated corps (parents)

“unless in ordinary course of its business”

* Like it frequently sells off 95% of its assets

### Remedies for Shareholders

**s. 301(5)** Appraisal remedy

* s/h may dissent – deemed to be fundamental change, doesn’t have to prove merit/wrongdoing

**s. 301(3)** Remedy – Merit

* makes the contract of sale valid
* the innocent party, the buyer, is protected (similar to s. 33(2))

**s. 301(2)** Personal Remedy

* if directors contravene 301(a), creditors, directors and s/h’s have standing
* court can stop the sale, set it aside, or do anything else appropriate
* may be injunction to stop sale, then compensation

# Duties of Directors and Officers

**S. 142(1)**  - directors of a company owe 2 duties:

1. **Fiduciary duty** –s. 142(1)(a): “a director…must…act honestly and in good faith with a view to the best interests of the company”
2. **Duty of care** – s. 142(1)(b): “a director…must…exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances.”
* Duty of care and fiduciary duty – owed by *individual* directors (not collective)
* Duties owed to the *company* (not other stakeholders)

## Directors’ Duty of Care and Skill

### Common Law Duty of Care

#### Re City Equitable Fire Insurance

Elements of the common law duty of care:

1. A director is only obliged to exhibit the skill and care that can be reasonably expected from a person of his knowledge and expertise.
2. A director isn’t bound to give continuous attention to corporate affairs, and can justifiably act only intermittently.
3. A director can rely on delegated management and isn’t required to second-guess their recommendations or put out inquiry
* Very lax standard of care – courts unwilling to second-guess business decisions.

### Statutory Reform – Duty of Care

**S. 142(1)(b)** – a director must “exercise the care, diligence and skill that reasonably prudent individual would exercise in comparable circumstances.”

**s. 142(2)** – statutory duty of care (and fiduciary duty) can be supplemented by common law, so not exhaustive. – can’t use statute to reduce accountability

**s. 142(3)** – a director can’t contract out of his duties of care or loyalty.

#### Re People Department Stores

Facts: Brothers combined Wise and People, created integrated inventory system. Relied on accountant’s report.

Outcome:

* Establishes gross negligence standard for breach of duty of care for directors - high threshold to meet
* Use objective standard – look at factual context, not motivation of director (SCC)
* Policy reason – improve quality conduct of directors, puts more pressure to put good governance into place (and business judgment rule applies)

### Directors’ Liability (extension of duty of care)

**S. 154(1)** – directors who votes for a resolution to violate various statutory provisions will be personally liable

* Ex. (a) restricted action that violates s. 33
* This applies if director there and doesn’t vote, or absent – deemed to have voted (s. 154(5), s. 154(8))

**S. 157** **(1)** – a director isn’t liable under s. 154 and hasn’t breached duty of care/loyalty under s. 142(1) if the director relied, in good faith, on any of the following:

1. Financial statements prepares by company’s auditors
2. Written report of lawyer, accountant, engineer, appraiser, or other profession that lends credibility to a statement made by that person
3. Statement of fact represented to the director by an officer to be correct
4. Any record, info or representation that the court consider provides reasonable grounds for the actions of the director, whether or not fraudulently made

**(2) –** director not liable if didn’t know that the act or resolution violates the law in the BCBCA (or reasonably should have known) – only for s. 154 (not s. 142)

#### Re Peoples Department Store

* Brothers tried to argue they had relied in good faith on info from Clement, their right-hand man – recommended inventory procurement policy
* Court of Appeal – said entitled to this defence
* SCC said no – he only had BA in Commerce, wasn’t chartered accountant, not member of professional org, no professional insurance

#### R v Bata Industries

Facts: Bata shoe factory, stored chemical waste – environmental damage. Directors argued it was reasonable to rely on internal corporate reports.

Outcome:

* Personally liable as directors to know what industry standards are for environment
* Directors should immediately act when know of violation
* Good example of contextual approach – trend toward informal due diligence obligation (if not, greatly increase liability)

### The Business Judgment Rule

* With statutory defences in s. 157 and business judgment rule, very difficult to bring claim against director for breach of duty of care
* SCC – “it reflects the reality that directors…are often better suited to determine what is in the best interests of the corporation”
* Business judgment rule fuses the duty of care and the duty of loyalty – presumes that directors acted both in good faith and on a reasonable basis
* Reasons:
	+ Judges lack skill to evaluate business decisions
	+ Risk of hindsight
	+ Too much liability on directors might dissuade them from taking positions
* In Canada no onus shift for plaintiff to rebut presumption of good faith (onus always on P, unlike US)

#### Pente Investment Management v Schneider Corp

Facts: Maple Leaf made takeover bid for Schneider. Directors thwarted w/ another bidder.

Issue: Should there be a formal shift of onus of proof in takeover bids? (like US?)

Outcome:

* No shift of onus of proof – onus is on plaintiff
* Question of whether directors of target company took steps to avoid conflict
* Business judgment rule – needs to lie within a range of reasonable alternatives
* Directors need to act on advice of a committee with no conflict of interest, acting independently – then business judgment rule applies

## Directors’ Fiduciary Duty

* Developed in common law, now set out in s. 142(1)(a) – director must “act honestly and in good faith with a view to the best interests of the company”
* SCC in Re BCE – fiduciary duty owed to the corporation – often interests of s/h’s and stakeholders are co-extensive w/ interests of the corp – if they conflict, directors’ duty is clear – to the corporation.

### Self-Dealing (Contracting with the Corporation)

* Contract of transaction between a director or officer and the corporation itself
* This is breach of director’s fiduciary duty

Common Law

#### Aberdeen Railway Co v Blaikie Bros

Facts: Director of railway company, enters into contract for railway chairs with partnership where he is a partner.

Outcome:

* Once facts of self-dealing proven, company A has option to rescind contract
* Potential harm from conflict of interest, not actual harm
* If company A doesn’t exercise right to rescind, then derivative action at CL would need to be brought

#### Gray v New Augarita Porcupine Mines

Facts: Gray, controlling s/h, made deal with mining company he owned. Company’s by-laws allowed director to avoid liability for a contract by disclosing the nature of the interest.

Outcome:

* He could contract out of fiduciary duty where harm is potential, not inevitable
* BUT resolution not effective b/c the disclosure of his interest was insufficient

#### North-west Transportation Company v Beatty

Facts: Directors asked company to ratify action. He was also s/h.

Issue: Whether the director (as s/h) could vote his shares as s/h to exonerate himself as fiduciary director from legal responsibilities.

Outcome:

* Directors are fiduciaries, different than rights as s/h’s
* In s/h capacity, can vote shares with view to own self interest (even if it involves exoneration of oneself as fiduciary
* Two different hats – s/h and director

Statute

**S. 153 – Disclosure obligation** (pre-emptive) – if director or senior officer holds any office or interest that could, directly or indirectly, create a duty/interest that materially conflicts with their position, he must disclose the nature and extent of the conflict – to the directors

* No clear remedy – could use s. 228

**s. 152 –** the self-dealing provisions are exhaustive

**s. 147 – defines disclosable interest** (1) Test: (a) is the contract/transaction material to the company, and (c) does the director have a material interest in that company?

(2) What doesn’t need to be disclosed:

(b)-(e) – where the interest is between affiliated organizations

* (4) insurance purposes, securities, etc.

**s. 148 obligation to account for profits** – (1) a director is accountable to the company for any profit from a transaction from which he has a disclosable interest

(2) not accountable If:

(2)(b) – if interest is disclosed to directors and Board approves

(2)(c) – approved by special resolution after disclosed to s/h’s

* + higher standard than CL – requires spec res
	+ can director as s/h vote? (likely yes, from Beatty)
* (2)(d) – contract entered into before director became director – not accountable

s. 149 (2) director w/ conflict of interest can’t vote to approve (unless, as per s. 149(3), all of the directors have disclosable interest)

**s. 150(1) Court order** – court can order that a director is able to keep profits if “fair and reasonable” (not a remedy)

(2) broad remedy provision – unless disclosable interest approved by 148(2), anyone can apply to court order (a) injunction to stop from entering contract (b) order director to pay profits (c) any other order that court considers appropriate

**s. 151** – contract not invalid merely b/c director/senior officer has interest in it, failed to disclose interest, or directors/s/h’s haven’t approved the contract.

Remedies: if breach of fiduciary duty, s/h can apply to sue derivatively on behalf of the company, or apply to court under s. 150(2) for order to set aside contract, or account for profits

Distinctions between statute and common law

* mandatory disclosure provision for director holding office/property
* previously only s/h could ratify allowing director to keep profit – now Board can
* new remedies for others outside company – s. 150(2) – court order
* Materiality test for disclosable interest (not just anything)
* S. 148(5) – allows s/h’s to inspect record/minutes of director meetings relating to self-dealing

### Corporate Opportunities

* Director or officer independently takes advantage of an opportunity that the company also has an interest it

#### Regal Hastings

Facts: Company didn’t have money to buy cinemas. Directors personally gave money and took shares in exchange for that cash. Company bought cinemas, directors sold shares for considerable profit.

Issue: Should the directors be accountable for the profit (even though it made the other s/h’s profitable?)

Outcome:

* No harm done to the company – made profit, as did directors (no bad faith)
* “conflict rule of accountability in corporate opportunity cases – refined from profit rule
* strict application of breach of fiduciary duty - only way to get out of breach was ratification vote – seen as taking fiduciary duty too far (like trust standard)
* court said they could have just passed a special res

**Ratio: if directors make a profit “by reason and only by reason of the fact that they were directors…and in the course of execution of that office,” those directors are liable to the company for those profits.**

Profit rule: if you are a fiduciary (director) and it is proved that you made a profit in connection with your role, you are accountable for that profit

Conflict rule: only when a director makes profit by reason and only by reasons that they were directors and in the course and execution of their office are they accountable for profits

* remoteness/proximity test – accountable if close to performing duties
* narrows the profit rule

#### Peso Silver Mines v Cropper

Facts: Private company that went public, and were offered mining claims. Decision made not to purchase the claims. Directors formed their own company, purchased claims themselves. New owners of Peso sued to recover profits made from mining deals.

Outcome:

* applied the dicta in Regal and exonerated the directors from being accountable b/c company had made a bona fide decision not to pursue the opportunity
* directors were in conflict – when conflict arose, they could only consider the company
* company had many opportunities to buy similar claims, and had limited funds
* after the directors made a bona fide decision not to buy the mining claims for the company, the conflict came to an end- directors free to purchase claims

**Ratio: if a corporation rejects an offer, one of its directors can, acting in his own capacity, accept the same offer and not be liable to the corporation to account for profits**

Note – policy reason for requiring onus shift to directors to prove company’s decision was BF – maybe have committee of experts to consider the opportunity

#### Canaero Aero Services Ltd v O’Malley

* new approach to way Cnd law states liability in corporate opportunity cases
* like a pre-cursor to BCE and Peoples

Facts: Directors sent to South America to do topographical mapping. Later, they resigned from company and set up own company to bid for the same contracts. They only became aware of the business opportunity while they were senior officers of Canaero.

Outcome:

* SSC (Laskin) upholds liability
* Reformulates law re: accountability for corporate opportunity and alleged breach of fiduciary duty:
	+ neither conflict/profit rule are exclusive in liability for breach of fid. duty in these cases – other ways to uphold liability
* List of critical factors to consider for whether there is breach of fid. duty:
	+ Position held in company (how high up)
	+ Nature of corporate opportunity (its ripeness, specificity, the relationship of the defendant to it)
		- Ex. More concrete opportunity vs. vague
	+ Amount of knowledge D possessed (special/private, how obtained)
	+ Relationship with the corporation (are they fiduciaries?)
	+ Time lapse between working on contracts w/ company and exploiting personally
* Dismisses conflicts rule – don’t want to be limited by rigid rules
	+ (what about *Peso*? Likely decided differently now)
	+ this is similar to contextual approach to corporate liability for duty of care in *Peoples*

**Ratio: where a director or senior officer takes advantage of a corporate opportunity that a company has an ongoing interest in, he is liable for breach of fiduciary duty and must account to the company for any profits made**

### Competition

* where director/officer has a potential conflict of interest – requires them to disclose the fact that they hold office/own any property that could cause conflict of interest
* competition arises in 3 situations:
	1. senior officer serving on Board of 2 competing companies
	2. director owning or operating business that is in competition w/ corp.
	3. having material interest that compete w/ entity (ie. owning share in another corp)

**S. 153(1)** – director must disclose the “nature and extend of the conflict” (2) disclosure must be made promptly, after individual becomes director, or after the conflict of interest arises (3) must be in consent resolution, minutes of meeting, or any other record

#### London and Mashonaland Exploration v New Mashonaland Exploration

Facts: Same person director of 2 competing businesses. Neither had provisions in constitutions that this was prohibited.

Outcome:

* director had not breached his fiduciary duty to the plaintiff company
* director may sit on the board of 2 competing companies without breaching his fiduciary duty, provided that the companies’ charters do not prohibit doing so
* also breach if the plaintiff co can show that the director disclosed info obtained confidentially by him as a director to the rival

BUT…rule against “fettering”

* directors must make sure they are doing best things for both corporations
* can’t agree to always vote one way, in that it breaches duty to consider matter of each company in its best interest

### To Whom the Fiduciary Duty is Owed

#### Re BCE Inc

Facts: Friendly merger with BCE - arrangement that required special resolution. Debenture holders went before court saying it was unfair – BCE required that Bell guarantee new debt for takeover. D-holders said the value of debentures would go down 20%

Outcome:

* Directors under fiduciary duty to treat all affected decisions in fair manner
* BCE respected contractual rights, didn’t violate terms of agmt
* BCE executed due diligence by setting up special committee – good enough
	+ Based on facts, creditors treated fairly
* Whenever potential conflict between shareholders and other stakeholders, s/h’s must prevail

### Hostile Take-overs and Defensive Tactics

* No discrete provision except s. 300 - right of appropriation to offeror when they receive 90% of voting shares in target company
* *Securities Act* – has disclosure requirements for takeover bids – attempt to get 20% or more – takeover bid circular - target company responds w/ directors’ circular

**Poison pill (shareholder rights plan)**

* Pre-emptive attempt to block outside control for public companies, and protect founding s/h’s
* 2 components – issuance of rights to s/h’s (option to buy more shares), and a flip-in event (like when any s/h obtains more than a stated % of shares)
* flip-in event triggers s/h’s rights, and acquirer is only s/h who can’t exercise right

Fiduciary duties of Directors in Target Company

* Previously “proper purpose doctrine” (*Hogg v Cramphorn)*– directors have no right to exercise power to issue shares, in order to defeat attempt to secure control of company (inherent conflict – interest in self-preservation of directors)
	+ Conflicts w/ business judgment rule (courts know better)
* Changed in *Teck v Millar* – now appears this is over

#### Bonisteel v Collis Leather

Facts: Directors exercised power of issuance of shares as defence of takeover bid

Outcome: although in good faith for best interests of the company, this was illegal, and issuance of shares void.

#### Teck Corp v Millar

Facts: Afton Mines needed money – M was CEO. Wanted takeover from Canex, so issued shares. Teck also wanted to takeover – paid higher price for shares. M negotiated revised deal w/ Canex that undermined Teck’s control in Afton. Teck claimed breach of fiduciary duty for issuance of shares – said improper purpose, to defeat TO bid.

Outcome:

* Not always improper purpose to issue shares to defeat takeover bid – may be in target company’s best interest (some bids justify)
* Must be reasonable grounds to think that directors not acting in company’s best interest – to show breach
* Said Millar’s purpose was to get best financing for company/best deal – not motivated by defence from Teck
* Doesn’t override improper purpose doctrine, but suggests alternative
* Doesn’t go as far as US cases to shift onus to directors

**Ratio (actually obiter) – director can issue shares to frustrate a takeover bid provided that they reasonably believed it was in the best interests of the company to do so (otherwise it’s breach of fiduciary duty)**

### Relief from Liability (sanction by S/H of fiduciary breach)

* Ratification is approval by s/h, by simple majority, of act by directors that constitutes breach of fiduciary duty

Common Law

#### Foss & Harbottle

Rule: the only body with the authority or standing to sue the directors under fiduciary duty is the corporation itself

* No common law derivative action (unless in exception)

Exception: “fraud on the minority” – ex. Appropriation of company assets

* As long as not brought about by unfair or improper means, not illegal or fraudulent or oppressive towards minority s/h’s

#### North-West Transportation v Beatty

Facts: Self-dealing – which could be ratified by the majority.

Issue: could that majority include the very directors voting, against who the breach in fiduciary duty had been alleged?

Outcome: balance between directors as directors, and s/h – it’s ok for directors to vote

Statute

Common law has been replaced by statutory derivative action (ss. 232-233)

**s. 233(6)** – no application for leave, or trial on the merits, shall be stayed or dismissed, merely b/c breach of duty owed to company, has or might be approved/ratified by the company – BUT evidence might be taken into account in making order under s. 232

* Was the voting independent, or did majority include ppl against whom the breach was alleged?
* s/h’s can try to ratify breach, but it’s up to courts to decide to give effect to ratification
	+ possibly can apply in procedural/substantive part

### Justification and Excuse

**s. 142(3)** – **Waiver** – directors can’t contract out of fiduciary duty or duty of care

**s. 147 Limitations on Liability** – director isn’t liable under s. 154 and hasn’t breached fiduciary duty under s. 142(1) if director relied, in good faith on professional reports, experts, etc.

**s. 234 –Relief in legal proceedings –** if in legal proceedings against a director/officer, the court finds the person liable for breach of duty, negligence, or breach of trust, court must take into consideration all circumstances of the case, and may relieve of liability – if person has acted honestly and reasonably and reasonably and fairly ought to be excused

* strange and problematic b/c law already designed in way to take these factors into account (business judgment rule, s. 157, etc.) – like a second chance

# Shareholder’s Rights

Main rights:

* normally right to vote at meetings of s/h’s of company
* share of company’s profits – dividends
* entitled to proportionate share of assets on windup

Where are s/h rights?

1. Charter (articles) – voting rights, right to attend meetings
2. Statute – personal actions for s/h’s
3. Common Law – constitution like a contract between s/h’s and company
4. Other docs – like shareholder agreement

## Voting Rights

**s. 173 (1)** – every share in BC company carries one vote at meeting of s/h’s, unless varied by Charter or Act

* s/h usually vote by proxy – critical in takeover bid (proxy battle)
* able to vote for directors, and vote for transactions that constitute a fundamental change
* problem – rational s/h apathy
* nominations for directors tend to go unopposed

## Shareholders’ Meetings

2 types:

1. annual shareholder meeting – must include 3 items on agenda –a) election of directors, b) appointment of auditors, and 3) presentation of financial statements / auditor’s report
* process set out in articles and statute (s. 182)
* privately held co – can use consent resolutions instead of meeting
1. special shareholder meeting – if matter arises between annual meetings (like fundamental change that requires special resolution)
* subject to same rules as AGM (s. 181)
1. Court ordered meeting – court can, on application from the company or on its own, order a meeting held
* Private co – s/h’s die, court can order meeting of reps, create agenda
* Or minority s/h building case against director, to get more info
* Court can dispense w/ formalities, decide on the business

### Shareholders Proposals (only public companies) s. 187-91

s. 188 permits s/h’s to make proposals to be considered at s/h meetings, such as proposal that the Charter be amended, nomination for election of a director, etc.

For standing – 2 requirements:

1. Person must own (or with others) 1% or more of shares
2. Person must have owned for at least 2 yrs prior

**s. 187(1)**  - proposal is “written notice setting out a matter that the submitter wishes to have considered at the next annual general meeting of a company”

**s. 188** – formalities:

* Must give 3 months notice, file declaration of proposal, w/ 100 word statement
* Company must send out as part of proxy materials for AGM (and pay for it)
* Proponent can come talk about it at meeting

**s. 189 (5) Exceptions** – the company doesn’t need to process proposal if:

(d) the claim isn’t relate to the business affairs of the company

(e) the purpose of the proposal is to secure publicity or enforce a personal claim/grievance

(f) the proposal has already been substantially implemented, ETC

**S. 191(1)** – if company doesn’t circulate, must submit to submitter within 21 days, notice of decision and explanation of reasons

**(2)** after receiving notice, submitter can apply for court review – court can order company to circulate proposal, reimburse submitter, or that the company hold meeting at its own expense to consider proposal.

Effect of s/h proposal depends on type of s/h proposal:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Proposal to amend Charter** | **Nomination for election of directors** | **Other residual proposals** |
| **Requirements** | Shareholder must be a registered or beneficial owner, and must have at least 1% of shares, or at least 1% of a class of voting shares.  | Shareholder must be a registered or beneficial owner, and must have at least 5% of shares, or at least 5% of a class of voting shares.  | Shareholder must be a registered or beneficial owner, and must have at least 1% of shares, or at least 1% of a class of voting shares. |
| **Effect** | If proposal is adopted by shareholders at the meeting (special resolution), the proposal is binding.  | Nomination for the election of directors.  | Directors have the exclusive power to manage or supervise management of the corp so effect of proposal in residual category is circumstance-dependent. |

#### Varity Corp. v Jesuit Fathers of Upper Canada

Facts: Proposal sent that the company should cease doing business in Apartheid South Africa. Previously exception in CBCA – if it “promoted social causes.”

Outcome:

* Company didn’t have to include proposal in AGM – primary purpose of the proposal was the enhance the agenda that the Apartheid should be adandoned (ie: for a social cause)

Strange b/c actually about doing business in SA – also could argue stopping would be good for business

#### Greenpeace Foundation of Canada v Inco Ltd

Facts: Greenpeace has shares in company. Proposal submitted to limit sulphur dioxide emissions at factory.

Outcome:

* Court used res judicata exception – substantially same proposal was already submitted previously, and only received 1.6% of votes

#### Michaud v Banque Nationale du Canada

Facts: S/H of Bank submitted proposal re: corporate governance (capping salaries of bank executives). Bank refused to circulate, claiming it was for personal grievance, and economic/social cause.

Outcome:

* Court said he had standing – this was s/h’s only way of communicating w/ other s/h’s

Criticism of system

* Silent majority won’t support – most ppl just ignore these proposals
* Not binding – s/h at AGM doesn’t have power – directors don’t need to listen to s/h resolution
* Only way to do it is to change constitution so that s/h have that general power
* VERY difficult to do this w/o support of incumbent directors

Value of Proposals

* Intimidate and force companies to think about them
* Educative function, salutary effect of pressure, public debate

### Requisitioned Meetings

**s. 167** – s/h’s can requisition directors to call a meeting - must hold 5% or more of issued voting shares **(2)**

* Applies to all companies under the Act – private and public
* Less about s/h activism – more strategic, urgent – used in takeover bids

**s. 167(7) Exceptions**

 **(a)** directors already called general meeting and sent notice – must be reasonable chance that the business in the req will be addressed

 **(c)** – doesn’t relate to business or affairs of company

 **(d)** – primary purpose for (i) publicity, (ii) personal claim/grievance

 **(e)** – business already implemented

 **(f)** – business would cause company to commit offence

 **(g)** – matter beyond company’s power to implement

**s. 167(5)** after receiving req, directors must call general meeting within 4 months, and pay for it

**(a)** must send notice to each s/h director

**(b)** send the text of the req

**(6)** text must be sent in (a) notice of requisitioned meeting, or (b) in company’s information circular

**s. 167(8) Failure to respond** – if directors don’t hold meeting within 21 days, and hold 2.5% of s/h’s support, then s/h can hold it themselves

**(10)** If (8), company must pay costs

AND – exceptions don’t apply

**s. 168 No liability** – no company or person incurs any liability merely b/c the company complies with section 167(5)(b) or (6)

#### Airline Industry Revitalization Co v Air Canada

Facts: AirCo sought to takeover Air Canada. AirCo attempted to requisition meeting for AC s/h’s to amend articles, alter board, and approve takeover. AC argued 3 things: res judicata exception (AC had called meeting in Jan), can’t requisition meeting of s/h to put forward resolution to amend company’s articles, and court shouldn’t court order a meeting.

Outcome:

* Res jud exception didn’t apply – AC won’t necessarily let AirCo include the proposal at the meeting
* S/H’s can vote to amend articles
* Court order issue – reluctant to use this provision (merit based, discretionary)
	+ Requisition procedure has its own personal right, remedy – able to call meeting themselves
* Found Airco’s req valid, so directors obliged to call meeting

NOTE – If s/h’s vote on matter at requisitioned meeting, and it’s within managerial power of Board (s. 136), even if a resolution passes, it is not binding on the Board.

### Removal of Directors

* Way for s/h’s to shortcut the power of management
* At any time, members of Board can be dismissed if s/h’s pass special res
* Overrides company’s articles

**s. 128(3)** – s/h’s can remove director before expiration of his term by special resolution, or if Charter provides, less than special majority

**s. 131(a)** – vacancy among directors as a result of removal (s. 128(3)) can be filled by s/h’s at the s/h’s meeting where the director was removed, or otherwise

# Shareholders’ Remedies

## The Derivative Action

* Directors hold a fiduciary duty to the company, and are in control, but won’t sue themselves
* Derivative action gives a minority s/h action to bring an application to sue derivatively on behalf of the company for a breach of duty from a director/officer
* Statutory derivative action is exhaustive (*Farnham v Fingold)*
* Exceptions to the rule from *Foss v Harbottle* no longer apply

Five Questions:

1. Is the nature of the claim such that only the corporation has standing to bring it?
* Where s/h alleges breach of duty, where director owes to the corporation
1. Does the person have standing to bring a derivative action?
* Directors and shareholders – as a right
* “appropriate person” – with leave
	+ ex. Creditors (like in BCE) – secured creditors less likely than unsecured
1. Has person met the four grounds for bringing an application to sue derivatively?
* See below (reasonable effort, notice, good faith, best interests)
1. Have the majority s/h’s ratified the director/officer’s breach of duty?
* **S. 233(6)** court can, in deciding whether to allow application, take into account evidence of s/h’s approval of breach of duty
* Should be independent do be taken seriously (*North West*)
1. What happens if the application to sue derivatively is successful?
* Court will “lend” the company’s name to the applicant and trial will proceed on the merits
* Company gets to keep any money (not complainant)
* S. 233(3)-(5) deal with “control person”, legal fees, settlements, etc.

### Common Law – the Rule in *Foss v Harbottle*

**1) Only company can sue for wrongs done**

* if something no capable of ratification by s/h, then s/h’s can sue in company’s name
* exceptions – fraud on the minority (minority can bring a claim)
1. **Procedural aspect**
* Don’t want parallel causes of action from s/h and company – need to tell judge that attempted to request to sue, or that the wrongdoers are in charge and won’t sue
* Rights claiming on behalf of company no greater than rights company can claim
* Money belongs to company

### Statutory Derivative Action

**s. 232(1)** – complainant (4 types) who has standing to petition the court to sue derivatively: directors, s/h’s, beneficial owners of shares, appropriate persons:

* Maybe be creditors, employees, consumers, liquidators of company

**s. 233(1)** – court may grant leave if:

 **(a)** complainant made reasonable efforts to have company sue (NW/BM)

 **(b)** given notice of application for leave to the company (BM)

 **(c)** complainant acting in good faith (BM)

 **(d)** “best interests of company” for proceeding to go forward – merits (NW/BM)

#### Re North West Forest Products

Facts: Directors sold assets for WAY less than worth. Claim in negligence (142). Asked company to sue, failed. Tried to get fellow s/h’s, failed.

Outcome:

* Reasonable effort to sue doesn’t need much detail, if good faith
* Prima facie in best interests – assume allegations are true
* This is essentially toast – now independent judicial discretion to look at vote of majority, wrongdoing (vote must be truly independent of those doing wrongdoing)
	+ **If passing of vote turned on wrong doing directors, vote won’t be taken seriously**

#### Re Bellman and Western Approaches

Facts: Takeover struggle for control in company. Bellman claimed financing of takeover violated s. 195 – ppl lending money buying shares of that company. Directors set up litigation committee to consider whether it was in company’s best interests to bring action in the company’s name, before rejecting the minority s/h’s request.

Outcome:

* Notice of application to company – court said don’t need to specify every ground you may be seeking (more liberal approach to formalities)
* Good faith – seeking damages in derivative action, not in oppression – so not vexatious (also relief isn’t the same in both)
* Best interests of the company
	+ Focus on how the directors responded to petition
	+ Subcommittee flawed b/c
		- One wrongdoing director on committee (not independent)
		- Subcommittee didn’t deal w/ all issues raised by complainant
	+ Subcommittee report lacked in quality – flawed
	+ Court doesn’t need prima facie evidence – ask whether, assuming claims can be proven, would it be in company’s best interest to pursue them

US Cases :

*Obark v Bennett* – committee found independent, business judgment rule precludes court from interfering with decision

*Zaparta* – Board appoints subcommittee, ruling independent – court says business judgment rule shouldn’t override, court still has discretion

NOTE – undecided in Canada – does business judgment rule override court discretion?

* Look at statute- “if it appears to court it’s in the best interest”
* Finding of internal procedure of company may influence court’s discretion, but not conclusive – unusual application of business judgment rule

## The Personal Action

Personal Remedy – don’t need to ask permission of court to sue on behalf of company

#### Farnham v Fingold

3 Issues:

* + 1) Premiums belong to s/h?
	+ 2)Claims s/h’s could make if could identify infractions of Securities act
		- Could bring personal action to enforce disclosure obligations – b/c the purpose was for the benefit of s/h’s, investors
		- CL personal right of action - outside of statutes
	+ 3): - whether majority of s/h owed fiduciary duty to exercise control position in fair and reasonable way toward minority
		- NO acceptance of this proposition (unlike UK)

#### Goldex

* + Developed this theory in more detail
	+ If requirements in Securities Act, implicit that they must be complied with in good faith – can enforce compliance
	+ BUT…don’t say there is any implied remedy in damages
		- Only way is through tort – statutory compliance obligation (Wheat Board case) – outside of this course

#### Jones v HF Ahmamson & Co

* + Majority is not fiduciary

NOTE - All this made largely redundant due to oppression remedy

## The Oppression Remedy

* Statutory remedy (previously no CL remedy for minority s/h’s
* Looks at reasonable expectations of s/h’s – more relevant in private companies

**S. 227** – **(2)** – s/h can apply to the court for an order on the ground that:

 **(a)** the affairs of the company are being conducted, or powers of the directors being exercised, in manner oppressive to s/h

 **(b)** act done or threatened, or resolution passed or proposed, that is unfairly prejudicial to s/h

Standing

**s. 227(1)** – s/h has automatic right – also beneficial owner of share, and who court considers to be “appropriate person”

* Appropriate persons: May be creditors, directors, widow of a s/h, trustee in bankruptcy.
* Courts more willing to grant standing to unsecured creditors, rather than secured creditors (BCE)
* Lessor not an appropriate person (*First Edmonton Place*)

Substantive Grounds

BC – oppression or unfairly prejudicial

1) What are the claimant’s reasonable expectations?

* Easier to show in closely-held company
* Where an applicant is both a s/h and a director in a closely-held corp, the applicant has a reasonable expectation that he will always be both s/h and director
* Excluded : bad behaviour that the applicant contributed to, and economic future-looking expectations

2) Were the claimant’s reasonable expectations breached?

* Focus on unreasonable changes to s/h’s expectations

3) Was the breach of claimant’s expectations sufficiently serious to amount to either oppression or unfair prejudice?

* Oppression: “burdensome, harsh, wrongful” (*Meyer*) , ex. Misappropriating property, high fees, failure to pay tax, self dealing, failure to pay dividends
	+ Conduct objectively bad (like MR) – bad faith, malice/intent
* Unfair prejudice: usually series of events w/ a lack of bona fide (*Ferguson*)
	+ If conduct affects applicant in their capacity as either s/h or director where there is a high level of interrelationship between both roles (*Diligenti*)
	+ Look more at effect (interests not taken into account)

Relief/Remedy

**s. 227(3)** court can grant a variety of different remedies including:

* An order that the company stop its oppressive behaviour
* Appraisal remedy order (only in Diligenti-type situations, where s/h also director/involved in mgmt) **(g)**
* Setting aside a resolution **(k)**
* Varying/setting aside a contract, and ordering compensation to 3rd party **(j)**

#### Ebrahimi

Facts: 2 partners ran art gallery business, made a corp at 15 yrs. Added 3rd director, his son. Father and son removed other director. Application under OR to purchase shares or windup company.

Outcome (HOL):

* Just and equitable to insist on legal rights – look behind strict legal parameters to what ppl expect when enter company
* Examples – association built on trust, relationship, partnership

#### Diligenti

Facts: 4 ppl have joint venture of restaurant franchise, all had equal shares. 3 directors gang up on one, pass resolutions to remove him from operations, as director, bought out land interest, set fees for themselves.

Issue: What is meant by unfairly prejudiced?

Outcome:

* Found there are rights, expectations, obligations, of managing/directing a company – includes rights to participate in company’s affairs
* Unfair and inequitable for his partners to remove him, in his capacity as s/h

**Ratio: Where there is a strong interrelationship between owning shares and being a manager, a director/s/h will be unfairly prejudiced by conduct that affects them in either role**

#### Ferguson v Imax Systems Corp

Facts: 3 couples owned IMAX. Wives had Class B shares. Ex-husband pressured other s/h’s to refuse to declare dividends. Then converted to non-voting shares. Applicant was involved in company, had a significant role.

Outcome:

* All directors share intimate involvement in company’s operations, and other directors’ attempts to get rid of her amounted to oppression and unfair prejudice

#### Re BCE Inc

Facts: see previous

Outcome:

* 2 part test – 1) Was there a breach of reasonable expectations?

 2) Whether conduct amounts to oppressive conduct, unfair prejudice, or unfairly disregards

* look at business realities, not narrow legalities
* oppression if fact specific
* Factors to look at:
	+ General commercial practice
	+ Nature of the corporation
	+ Relationship between parties
	+ Past practice of the organization
	+ Steps company could take to protect
	+ Fair resolution/mechanism between conflicting corporate stakeholders

## Compliance and Restraining Orders

**s. 19 -** Charter like a contract – binds s/h’s to each other, and the company

* S/h’s have standing, as a right, to apply to the court to have terms of Charter observed (specific performance, injunction – no damages)
* Personal remedy – creates privity of contract (all s/h deemed to sign)

**s. 228 Compliance/restraining order** – **(1)** any complainant (s/h or person the court thinks appropriate) – ex. Creditors, trustees in bankruptcy, employees

**(2)** if director, officer, s/h, employee, agent, auditor, receiver, contravenes or will contravene Act or Charter, can apply to court to stop this

**(3)** court can make an order appropriate, including:

 **(a)** person refrain from contravening provision

 **(b)** stop a transaction

 **(c)** for contracts against s. 33(1), compensation be paid to the company or any other party owed by the contract

### Issues:

1. Can’t use s. 228 to complain that director is guilty of breach of fiduciary duty under s. 242 (w/o having to sue derivatively) (*Goldhar*)
2. Can’t use s. 228 to bypass more detailed provisions for relief available in another section (like restricted acts – ss. 30, 33)
* More specific provision override general, exclude seeking relief under s. 228

### Remedying Corporate Mistakes

**s. 229** –**(1)** interested person have standing to correct omission, defect form breach of provision in Act or Charter, meeting of s/h, meeting of director, etc.

**(2)**  court can order to correct, modify the consequences in law, etc. – can excuse the breach

**(3)** court must consider effects – significance of alleged breach, inconvenience of setting aside and forcing redo

**(4)** third party still have rights of contract (if consideration, no notice)

**s. 143** **Validity of Acts of Directors** – if meeting improper, and person elected as director, and performed as director, can’t deny valid appointment merely due to non-compliance w/ requirements

## The Appraisal Remedy (Dissent Proceedings)

* Substantive remedy that s/h’s are entitled to as a right, triggered w/ fundamental change (don’t need proof of unfairness/harm)
* If s/h dissents to fundamental change, have right to make company buy their shares
* Especially important for minority s/h’s in closely-held companies (b/c no market for their shares)
* Also available as remedy under oppression (s. 227) but there must prove oppression – no guarantee of this remedy)
* Available to private and public companies, but most relevant to private

**S. 238(1)** s/h (whether or not able to vote) is entitled to dissent:

 **(a)** alternation to the company’s articles (under s. 260)

 **(b)(c)(d)** amalgamations / arrangement

 **(e)** sale of the undertaking (under s. 301(5))

 **(f)** continuation unto jurisdiction other than BC

### Procedures to demand purchase of shares:

**Special Resolution** – 21 days notice to s/h’s

**s. 240** – Notice of resolution (fundamental change) of right to dissent (all shares enfranchised) – sent to all s/h’s

**s. 238(2) + 242** – S/h files Notice of Dissent (all shares) (at least 2 days before res)

**s. 243** – Company gives Notice of Intent to Proceed,

* then dissenter must send in formal notice of intent to sell enclosing share certs (s. 244) within one month

**s. 244(6)** s/h who dissented, sent in notice, may not vote (also suggests not entitled to other remedies, like oppression)

**s. 239 Waiver** – can’t waive the right to dissent (can’t contract out, but CAN for specific resolution)

**s. 246(g)** if tell company intend to dissent, but actually vote in favour – estopped

**s. 245 “Payout value”** **(1)** company and dissenter can agree, or **(2)** can apply to the court to determine

**“Payout value” s. 237** (definition) = fair value of share immediately prior to passing of resolution

#### Domglas v Jarislowsky

Three ways to value a company’s shares:

1. Market value (hard in private co)
2. Asset value (add up assets, divide by shares – don’t usually reflect true value)
3. Earnings approach – estimated anticipated future value of company, discounted to present day value – divide by # of shares
* Issue of compensation for “squeeze out” premium
* For amalgamations – think there is value in majority getting rid of minority s/h’s
* Should court grant premium?
* Courts split – no answer
* Applied in *Domglas* (but maybe reversed)

## Winding Up

**s. 324** **(1)**- company, s/h, director (as a right) creditor, or other appropriate person, may apply for court order for company to be liquidated and dissolved if **(b)** it’s just and equitable to do so

* Harder remedy than oppression remedy – courts reluctant to use this terminal remedy (may be overkill)
* Can’t be customized to applicant

### Reasons for being just and equitable to wind up:

1. Justifiable loss of confidence (mgmt not trusted to run company)
2. Conduct of directors shows lack of probity and good faith
* Can’t use if disappointed w/ economic outcome of company, or voted down
* Needs to be about reasonable expectations
* Must show that come to remedy w/ “clean hands”
	+ Like contributory negligence

**s. 227** – winding up can be done under oppression remedy

#### Ebrahimi

Facts: see above

Outcome:

* Analogy between partnerships and closely-held corporations
* Expectations that they would all continue to be involved in running company
* Once he was removed, expectations undermined – so just and equitable that company be dissolved

## Shareholder Agreements

* Stand-alone common law agreement (like a pre-nuptial)
* Can detach from company w/ minimal adverse consequences
* More insulated than Articles as a contract (articles can be amended by less than unanimity)
* Can have buy-sell agmt – like contractual appraisal remedy – can have life insurance policy (is s/h dies and company can’t afford to buy out shares)
	+ Better to have this b/c If have s/h agmt, may not be able to dissent, so can’t claim appraisal remedy

**s. 175 Pooling agreements** – s/h’s may agree (written) that when exercising voting rights in relation to shares, they will vote those shares in accordance w/ terms of the agreement

#### Ringuet v Bergeron

Facts: 7 s/h’s w/ agreement to vote as directors. 1 s/h wouldn’t vote – in defence said agmt was void b/c referenced director meetings (and they aren’t allowed) – contrary to public policy. Said invalid.

Outcome:

* Clause didn’t refer to Board, so not void
* Looked at contractual intent of s/h’s, interpreted agmt that way
* s/h can agree as to how they will decide to vote in the future, but directors can’t
	+ directors must give company best interests

**Ratio: as long as s/h agmt makes it clear that obligations are only on them in their capacity as s/h’s it will be valid at common law**