CORPORATIONS

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CHAPTER 1: CHOOSING THE FORM OF BUSINESS VEHICLE

INTRODUCTION

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Consider the following when choosing a business vehicle:

1. Main factor is always who bears the risk of loss
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   - (ie. lawyers cannot achieve limited liability through incorporation as per s 133 of the *Legal Professions Act*)
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TYPES OF BUSINESS VEHICLES

1. Sole Proprietorship

Definition: when a person runs a business, all one thing, not a separate entity. No difference between the natural being and the business.

Main takeaway: simple and cheap for a small enterprise, man drawback is unlimited liability and some tax consequences.

All factors considered:

a. Creation:
   - Very easy and cheap to start- anyone in AB can start one.
   - Can be large or small, but usually small organizations use this vehicle.
   - Formalities:
     - Registration of business name

- **Section 110 of *Partnership Act* applies – if you're doing business in relation to trading, manufacturing, contracting or mining, you have to register the business name**
    - Unclear what "trading" and "contracting" mean:
        - Trading may be buying and selling goods
        - Contracting likely refers to someone whose business is that of a contractor
- Need to register to identify who the sole proprietor is, check credit before advancing goods on credit
- Consequences for failing to register as outlined in s 112 and 113:
    - $500 fine (S 112)
    - An action may be Stayed (s 112)
        - E.g. if you want to sue a customer and commence an action, the customer could bring an application to stay pending registration (this is not fatal to the action itself)
- Other formalities in naming:
    - Consider whether any municipal requirements apply (e.g. business license)
    - Check the proposed location of business for property zoning
    - May require a federal license (eg. trucking across provinces)
- Overall consider rules and regulations at play depending on what the business is and where it is being operated.

b. Risk of Loss:
    - Business is owned by one person who is responsible for ALL debts, personally liable (**unlimited personal liability)**
        - So sole proprietor can lose any personal assets to satisfy liability owed to others. Not just business assets.
        - Example: Mike LTD (the debtor) is late on paying loan to the Bank (creditor). So as per contract of guarantee, Mike, the individual, guarantees the debt of Mke Ltd.
            - So basically, a personal guarantee allows the creditor to go after the individual.
    - Individual responsible for all contracts
    - Vicarious liability:
        - Liability for tortious conduct is a risk hat the sole proprietor bears alone
        - Liability is vicarious when it is not based on any personal wrongdoing by the individual, but on the tortious conduct of someone else
    - IMPROTANT TO GET GOOD INSURANCE IF RUNNING A SOLE PROPRIETORSHIP.
c. Power of Control:
    - Entire management of the business rests with the sole proprietor
    - Sole proprietor has sole authority to set policies for the business, make personnel decisions, and decide what to do with profits
    - Not accountable to anyone, does not need permission for anything

d. Participation in Profits:
    - Sole proprietor has right to any profits and right to invest them in business
    - When the business winds up, the owner keeps anything left over after liabilities are paid
e. Dissolution:
    - Sole proprietor has the power to dissolve and decide when to bring the business to an end
    - As easy to dissolve as it is to start up
    - **Sec 111 of the *PA* if you've filed with the registrar because caught by s 110, you need to file a notice that you have CEASED to operate the business**
    - Death of the sole proprietor brings the business to an end
f. Other Considerations:
    - Income is directly taxed in the hands of the proprietor at the marginal rate of tax
        - Advantage: because individuals taxed on a progressive rate scale, this may be the most tax-effective method of conducting a small business undertaking
        - Losses from the business can be set against the income from other sources
            - Although this may be subject to the restricted farm loss rules in s 31 of the *TA*, the loss carryover rules in s 11 of the *ITA*, and the principle that in order for an enterprise to qualify as a business it must be carried on with a view to profit
    - If in the business of supplying services)e.g. lawyer)- do not need to file a declaration of a trade name
        - However, failure to file when required can result in a court action

2. Partnerships

a. Ordinary Partnership

Definition: S 1(g) of the *PA*- Partnership means the relationship that subsists between persons carrying on a business in common with a view to profit.

Factors:

i. Creation:
- Unlike LPs, no particular declaration or registration is required to create an ordinary partnership
    - BUT a partnership does have to file a declaration with the registrar in certain circumstances
        - S 106 and 115 of *PA*
- Few formalities

ii. Risk of Loss
- Partners face joint, several, or joint and several liability
    - Joint: A shared liability such that each defendant is liable to the full extent of the obligation in question
        - Sec 11(2): Each partner in a business is liable with other partners for debts and obligations of the firm

- Several: A separate or distinct liability based on apportionment according to fault or responsibility (such as insider trading as per s 130 of the *PA*)
- Joint and several: A form of liability such that the plaintiff can collect 100 on its judgement from any of the defendants, but facilitates apportionment as between defendants according to fault or responsibility
    - Specifically, s 15 states that partners have a joint and several liability for any loss, injury or penalty caused by a non-partner by the wrongful act or omission of a partner acting in the ordinary course of business of the firm or with the authority of his or her co-partners

iii. Power of Control
- Sec 28(e): Subject to agreement, each partner may take part in the management of the partnership business

iv. Participation in profits
- Default rule is equality under s 20 of the *PA*, absent an express or implied agreement to the contrary

v. Dissolution
- Unless the partnership provides otherwise expressly or y implication, a partnership automatically terminates on the death, bankruptcy, or withdrawal of a partner

vi. Other considerations:
- Partners owe each other fiduciary duty and must treat each other with utmost good faith
- Each partner is an agent of the firm and of his or her other partners for the purpose of the business of the partnership (*PA* s 6)
    - MORE ON AGENCY LAW BELOW.

How to determine if a partnership exists (also see *Volzke*):
- Look to the statutory definition in relation to the facts (s 1(g) of *PA*)
    - Relationship created with common purpose to gain profit?
- Then look to other rules provided in the *PA*:
    - S 4(a): joint tenancy, TIC, joint property, common property, or part property <u>DOES NOT in itself create a partnership</u>
    - S 4(b): the sharing of gross returns (all money received in connection with the business) <u>DOES NOT itself create a partnership</u>
    - S 4(c): the receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business
        - Sharing profit is the key indicia for the existence of a partnership.
            - **Sharing is different than just sharing gross returns – if a person is sharing profits, they would almost certainly be concerned about how the business is being managed.**

Volzke Construction Ltd v Westlock Foods Ltd

Facts:

- W owned 20% and B owned 80% of WSC.
- V, the appellant, is a contractor, undertook to build in two phases an addition to a mall but was not paid the final billing
- All of V's accounts were issued to B and pai from joint account, which only B had singig without to.
- Sued W, respondent company, alleging that the respondent was in partnership with B and was liable for the debt

Issue: Are the companies' partners or mere co-owners? **PARTNERS.**

Analysis:

- Control does not have anything to do with whether a partnership exists – a partnership exists when it fits the definition
- If the profits were shared, this is *prima facie* proof that the person is a partner.
- **Outlines approach to use in cases of alleged partnership:**
    - First, need to look at all relevant factors surrounding a course of dealing between business associated
    - Do not need to show control for a parentship because this is NOT in definition of the *PA*
    - Test for partnership is based on INTENT, and is functional- parties are partners based on what they do and how they act.

Holding:

- Evidence of partnership attributes may lead to a finding of partnership
- The fact that one partner has no real control over the business is irrelavnt
- Also, even if a partner says "this is not a partnership" but they still act as a partnership in accordance with the *PA* they are a partnership.

b. Limited Liability Partnership (LLP)

Purpose: professional businesses (such as law firms or accountants) that have so many employees everywhere in the world, it would be unfair to hold partners in Canada accountable for conduct of partners in Japan hat they have ever met or have control of.

- **Creation:**
    - Governed by part 3 of the *PA*
    - **S 5:** Must contain LLP in name of business
    - Not all professionals can create an LLP
        - As per s 81 of *PA*, it must be an eligible profession
            - This means a profession or discipline that is regulated by an Act of Alberta that specifically authorizes members of the profession or discipline to carry on business through a corporation that has the word OC as part of its name.
            - Example: Lawyers and Accountants can create LLPs, but not financial advisors.
- **Risk of Loss:**
    - Balance interest of claimants with interest of innocent professional partners

        - Unlimited personal liability as per s 12 of *PA*:
            - (1) Provides a partial shield for innocent, uninvolved partners. A partner is not individually liable for debts, obligations, or liabilities of the partnership or another partner that arise from the negligence, wrongful acts, or omissions, malpractice or misconduct that occur in the ordinary course of carrying practice in an eligible profession
            - (2) Does not operate to protect a partner from liability where the partner KNEW of the ACT and failed to take reasonable steps, or WAS DIRCETLY responsible by failing to take a supervisory role.

c. Limited Partnership (LP)

- **Creation:** Also governed by *PA,* but s 51 specifies steps that must be taken for them to exist.
    - S 51: An LP will consist of one or more persons who are limited partners
    - **Other formalities:**
        - S 54: Surname of a limited partner cannot appear in the firm name unless it is also the name of one of the general partners.
        - S 55(3): Only general partners may be shown on the title for any real property owned by the limited partnership
- **Risk of Loss:** General partner has UNLIMITED liability; limited partner has liability limited to the amount of its investment as per s 64 of the *PA*.
- **Power of Control:** Limited Partner is just there to give and get money, does not have a say in the structure or management of the business
- **Dissolution:**
    - **Ss 66 and 68:** A limited partner's interest is assignable and dissolves on death
    - **S 67:** The retirement, death or mental incompetence of a general partner dissolves the partnership unless the business is continued by the remaining general partners based on a right to do so set out in the certificate or with the consent of the remaining partners.

3. Corporations

Definition of a Corporation: an artificial or juristic entity created by or under the authority of laws of a state, province or nation, that is regarded in law as being a legal persons separate and distinct from the person(s) who comprise its membership. It may acquire rights and property in its own name, sue and be sued, and assume or be subject to legal obligations.

- Within this definition, "persons" has two meanings: an artificial person (corporation) and a natural person (an individual)

Types:

a. Business corporations under the *ABCA/CBCA*
b. Professional corporations under the *ABCA* and the *Legal Professions Act* (for example)
    - If professional corporation is negligent, this does not limit the liability.
    - S 133(2) states that liability of anyone carrying on law, does not change dependent on how it is being operated. Liability is the same,
c. Unlimited liability corporations under the *ABCA*

- Shareholders have unlimited liability
- Reverse of what a corporation really is and mainly done for tax reasons.
- Procedure for incorporation is not the same, must say ULC in name.

Factors:

a. Creation:
   - Corporations come into existence when a certificate of incorporation is issued by a government official as per the *Business Corporation Act*.
   - Cost of incorporation is relatively modest.
   - Registration requirements governed by s 5 of the BCA

b. Risk of Loss:
   - Limited Liability for shareholders as it is a separate entity.
     - Exceptions include:
       - When a shareholder signs a personal guarantee for the corporation's debts
       - A shareholder has contracted personal without giving adequate notice to a 3rd party that they were acting as agent
       - Loss occurs as a result of personal act or negligence
       - Shareholder has not fully paid for their shares, to the extent of the unpaid amount
       - Personal liability is provide for by statute
       - A shareholder has assumed the powers of a director under a unanimous shareholders agreement (s 46 of BCA)
       - Shareholder has recipe over-payments on liquidation (s 227 of BCA)
       - A court has "lifted the corporate veil" (more on this below)

c. Power of Control:

d. Participation in Profits:

e. Dissolution:

f. Other Considerations:

Pros and Cons of Corporation:

Pros	Cons
Limited liability: Because it is a separate legal entity, a corporation can assume its own liabilities. The shareholder stands to lose the amount he invested in the corporation, but no more.	**Higher costs:** Creating a corporation incurs filing fees and legal costs.
Flexibility: A corporation permits differing degrees of ownership and sharing in profits.	**Public disclosure:** When a corporation offers shares to the public, the corporation must comply with strict disclosure and reporting requirements.
Greater access to capital: Limited liability makes the corporation a very suitable vehicle through which to raise capital.	**Greater regulation:** Corporation statutes govern many decisions, limiting management options and requiring specific kinds of record keeping.
Continuous existence: The life span of a corporation is not tied to its shareholders.	**Dissolution:** Ending a corporation's life can be complicated.
Tax benefits: Though this is a fact-specific issue, a corporation can facilitate greater tax planning, for example, by permitting income splitting.	**Tax disadvantages:** A corporation may be subject to double taxation, depending on the circumstances. This is a fact-specific issue.
Transferability: Ownership in a corporation is more easily transferable through shares.	**Possible loss of control:** A corporation has diminished control because it issues shares with voting rights.
Potentially broad management base: A corporation is managed by directors and officers, who can provide a level of specialized expertise to the corporation.	**Potential bureaucracy:** The many levels of authority in a corporation may impede decision making.

Summary of Business Vehicles:

Characteristic	Sole Proprietorship	Partnership	Corporation
Creation	• at will of owner	• by agreement or conduct of the parties	• by incorporation documents
Duration	• limited by life of owner	• terminated by agreement, death	• perpetual unless dissolved
Liability of owners	• unlimited	• unlimited	• limited
Taxation	• net income taxed at personal rate	• net income taxed at personal rate	• income tax to the corporation; dividends and salary taxed to shareholders
Transferability	• only assets may be transferred	• transferable by agreement	• transferable unless incorporating documents restrict transferability
Management	• owner manages	• all partners manage equally unless otherwise specified in agreement	• shareholders elect a board to manage the affairs of the corporation; officers can also be hired

AGENCY

*Very important in partnerships as per s 6 of the *PA*.

Definition: Agency is the fiduciary relationship which exists between persons, one of whom expressly o impliedly consents that the other should act on his behalf as to affect his relations with the third parties (aka the outsider), and the other of whom similarly consents to act.

Parties: The one on whose behalf the acts are to be done is called THE PRINCPAL. The one on who is to act is called the AGENT. Any other person is referred to as the third party.

Authority:

1. **Actual Authority:** A legal relationship between a principal and agent created by a consensual agreement to which they alone are parties
    a. **Implied:** The agent actually has this, just that the authority itself is perhaps less clear or has not been explicitly recited. Extended by the "usual" or "customary" authority of an agent.
        - Every agents has an implied authority to do everything necessary for, and ordinarily incidental to carrying out his express authority according to the usual way in which such authority is executed.
        - Beyond this an agent's implied authority is further extended by what are terms usual of an agent in the trade in which the particular agent is employed, unless something was expressly said to contradict it.
    b. **Express:** Powers clearly or expressly given to the agent, as well as those powers that can be inferred as being in placed based on written or oral words.
2. **Ostensible/Apparent Authority:** This is the impression of authority that the principal has created. Comes into play where a person is held out as agent when that person is not ag agent, or being an agent is held out to possess an extent of authority greater than which has actually been conferred.
    a. **Ostensible:** Arises from a representation by the principal to a third party, as to the agent's authority.
    b. **Apparent:** The product of the principal's conduct, a representation that the person acting as the agent is authorized to act on his or her behalf
        i. An authority which apparently exists, but in fact it does not.

McDonic Estate v Hetherington

Facts:

- M attained W, a partner at a law firm who made various investments on her behalf
- M sued the law firm saying they breached fiduciary duty and were negligent when loans were made as some investments were unsecured
- W was the rogue partner and was not able to provide recovery to M (ie. broke, missing, in ail, etc.)

Issue: Are W's partners liable for W's actions based on actual or apparent authority? **YES.**

Reasons:

- Relevant statutory provisions from the AB *PA*:
  - **S 12:** If you are an innocent, uninvolved partner you will not be liable beyond firm assets
  - **S 13:** Liability of firm from wrongs- when by wrongful act or omission of a partner acting in the ordinary course of business loss or injury is caused to a person not being a partner, the firm is liable for it to the same extent as the partner (ACTUAL AUTHORITY)
  - **S 14:** Misapplication of money- the firm is liable to make good any loss when one partner acting within the scope of the partners' apparent authority receives the money or property of a third person and misapplies it (APPARENT AUTHORITY)
- Ostensible authority:
  - W was conducting business through the auspices of the firm, so he had ostensible authority to do what he did
  - A representation was found to have occurred.
- Actual authority:
  - Express: no express authority on the facts here
  - Implied: yes, if investing a client's money falls within the ordinary course of business

Legal Tests per *McDonic* re Authority:

1. **Express authority:** flows from the authorization of the other parties
2. **Implied authority:** flows from acts done in the ordinary course of business of the firm
   - So, is investing money part of the ordinary course of the law firm's business?
     - YES, because the money appeared in the books of the firm, and therefore, this is strong evidence, since they are using law firm's machinery to make the investment.
   - However, is investment advice out of the scope of a law firm's business?
     - Need to look specifically at what THIS law firm does, not what others do.
       - Since everyone in this firm was doing this type of work, it is ordinary.
3. **Apparent authority:** concerns whether a person dealing with the partner would reasonable regard the partner as acting on behalf of the partnership- this would be due to a *representation of authority* by the partner to the third parties- DID THE OTHER PARTNERS CLOTHE THE PERSON WITH THE APPARENT AUTHORITY TO DO WHAT THEY DID?

Holding: W acted under implied actual authority and the partners fell with him.

- **Note**: NATURE of the activity and not the manner in which it is performed that will determine if an activity falls under the ordinary course of business.
  - **People interact with the law firm under the expectation they will do work properly, so if only liable when work is done properly it would create a very small window of liability.**

- OB thinks even if the firm was an LLP the partners could not escape liability because investment advising cannot operate as an LLP, so no s 12 protection.

BUSINESS ARRANGEMENT VS BUSINESS VEHICLE

- **Business arrangement:** e.g. franchise- is a business commitment, best characterized as a type of contract
  - A contractual arrangement between a manufacturer or service provider and franchisee who buys the right to operate one or more units of the franchise system
  - Pays start up fee and royalties to the franchisor
- **Business vehicle:** for a franchise, any type of vehicle can be used such as a SP, partnership, or corporation.

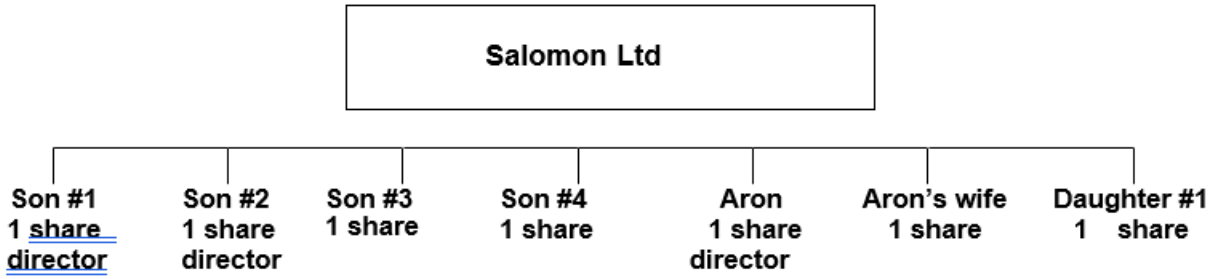
CHAPTER 2: BACKGROUND TO CORPORATIONS

INTRODUCTION

Salomon v Salomon & Co Ltd

Facts:

- Aron Salomon incorporated his sole proprietorship as follows:



- S Ltd purchased the sole proprietorship assets for $39,000. S Ltd paid this amounted owed to Aron by:
  - Issuing 20,000 shared with a pr value of $1 each
  - Issuing a debenture (a legal I.O.U>) in the amount of $10,000.
  - Providing a few other benefits
- As court summarizes the matter, it would seem that Aron received:
  - About $1000 cash
  - A $1000 debenture from S Ltd (making his a creditor for his own company)
  - About half the nominal capital in company
- Soon thereafter, S Ltd started to experience financial reversals due to a depression in the boot and shoe trade.
- To help S Ltd, A lent money to the company. He also had his debentures cancelled and reissued to Mr. B as security for a $5000 loan to A, the proceeds of which A gave to the company.
- When S Ltd failed to make a required interest payment to Mr. B, B had a receiver (liquidator) appointed to force the sale of corporate assets.
- In response to B;s claim, the liquidator brought a counter-claim to which A was also named a defendant.

- The business failed and the liquidator, B, claimed the corporation was acting as an agent for S, and as principal he should be personal liable for the debts.

Issue:

- Do corporations have a separate legal identity? **YES.**
- Can A be held liable for S's debts? **NO.** Shareholders cannot be held liable for a corporations debts.

Holdings:

- A corporation is a separate legal entity
- Shareholders are not liable for corporate obligations
- Corporations are not agents of the majority shareholder
- Shareholders can lend to and take security back from the corporation in which they hold shares
- S 16 of the *ABCA* functionally codifies this decision- a corporation had the capacity and subject to this Act the rights, powers, and privileges of a natural person.

GENERAL STRUCTORS OF A CORPORATIONS

Shareholders

- Equity claimants who invest for a return
- Claims or rights in terms of voting rights
- Dividend rights and rights on liquidation
- In large corporations they do not usually take on any direct managerial powers although they do elect the board of directors on the principle of majority rule
- In smaller corporations they also elect the board, but in addition they often take on responsibilities for the corporation's day to day operations

Corporation

- Separate personality
- Perpetual existence

Directors

- Appoint officers to manage the corporation
- Make major decision on corporate policy (could consist of just one director_
- Manage the business and affairs of the corporation
- Elected by the shareholders, duties and obligations are to the corporations (must act in corporations' best interest)
    - **The interest of the corporation and the interest of the shareholders often coincide, but where they do not the director's interest is to the corporation**
- Keep an eye on the CEO and make sure that they are doing their job well

Officers

- E.g. president, vice president, secretary, treasurer, CEO
- Manage the corporation- hire others to assist in management and carry on business of the corporation
- Supervise the corporate operations but are put in place by the board
- Head officer is often known as the CEO – appointed by the board, reports to the board

- CEO has the main direction of the company, responsible for everything related to corporate organizations

Internal groups are shareholders, directors, and officers. **External groups** include the government, public, and creditors.

THE CORPORATE CONSTITUTION

Every company has certain basic charter documents that constitute the fundamental terms of the corporation concerned. In exercising its power, carrying on its business and organizing its affairs, every company must stay within the boundaries traced out by that constitution. The nature of the documents comprising the corporate consecution depend upon the statute under which the company is incorporated.

- Corporate constitutions limit what a corporation can validly do
- Also helps identify rules the govern how a given conflict will play out between a director and shareholder.

1. **Special acts of incorporation:** used by the federal and provincial governments to create corporations for specific purposes – e.g. Crown corporations, banks, universities, etc. They only have the powers granted under the special act in question. This method is rare and not available to the average business person.
2. **General acts of incorporation:** ABCA or CBCA are the most common, generic in the sense that they are used to create corporations that engage in business of all kinds and descriptions – different from special acts of incorporation because they type of business is not usually a concern
    - All the general act company must do is abide by a global set of rules that the legislation imposes on it and every other corporation created through the act in question – virtually all business corporations are created this way.

Different models across Canada on how corporations come into existence what powers they possess:

- **Letters Patent Company**
    - This method of incorporation is direct descendant of the royal charter form, involves an application being made to the Crown's representative who has the power to issue an incorporating documents called the letters patent
    - The letters patent is the constitution of the new company – contains information like name of the company, business purpose, ownership
    - Rules governing the day to day operations are called bylaw, contained in a separate document
    - Only applies to business corps created in PEI
- **Memorandum of Association Company**
    - Aspects of this model are in NS, BC, and only used in AB for creating not-for-profit corporations
    - Incorporation achieved by registering a memorandum of association and articles of association with the registrar
    - It is a brief documents that sets out the constitution of the company, the articles set out the day to day operating rules, which are quite extensive

- **Articles of Incorporation Company**
  - The majority of the provinces (including AB) and the federal government use this system – articles of incorporation are filed with the appropriate government body, which issues a certificate of incorporation
  - The articles recite the corporations name, purpose, and capital structure
  - Day to day operations set out in bylaws – relate primarily to internal stakeholders and provide for routine matters

Comparison of the method above:

- All allow for the creation of an entity recognized as a legal person, owned by shareholders or members who have limited liability for the debts, and is managed by directors who owe a fiduciary duty
- Historically there was a big distinction but now the differences relate mainly to how the internal governance of the entity operates – corporations formed under different methods have different constitutions

In AB, the corporate constitution includes:

- Articles of incorporation
  - Contain only the most basic provisions concerning the corporation: name, structure of share capital, place of registered office, size of board of directors and any restriction on the business in which it may engage
- Bylaws
  - Rules adopted by a company for the regulation of its own actions and concerns, and of the rights and duties of members among themselves
- USAs
  - Unanimous shareholders agreement, see s 146 of *ABCA*
  - In *Duha*, SCC confirmed that USAs can indeed be consider part of the corporate constitution, along with articles and bylaws.

Canadian Jorex v 477749 Alberta Ltd (DIRECTORS POWERS)

Facts:

- A special meeting (different than an AGM) of shareholders is called, but a month before it was to occur, the Directors cancelled it.
- The companies claim the directors do not have power to cancel an already called meeting
- Directors claim s 102 of the *CBCA* applies, and gives them power to manage the business and the affairs of the corporation.

Issue: Do the directors of a federal corporation have the power to cancel a special meeting called by them in advance of its scheduled date? **YES.**

Analysis:

- Directors do have the power to cancel- s 101 of the ABCA includes the power to cancel a shareholders meeting – under our corporate model the residual power to manage is with the directors, given by statute, and not derived from a delegation of powers from shareholders to directors
- Sec 102 of the *CBCA* statutorily confers on the directors of a corporation all residual powers to manage a corporation's affairs – it is not true that the directors do not enjoy a power unless specifically granted to them and would render the s 102 "basket clause" redundant

- A rigid, no exceptions approach to cancellation can lead to unreasonable results
- This interpretation would not necessarily affect the shareholders' right to requisition a special meeting
- *The directors' residual power under s 102 would not extent to he unilateral cancellation of any meeting properly conveyed on the shareholders' request*
- Shareholders have other options, do not automatically lose the right to examine the auditors if the meeting is cancelled:
    - S 142 (meeting requisition)
        - Directors cannot cancel this meeting, not in their residual power because the general power to cancel is read in light of the statutory power limiting it
    - S 242 (oppression)
    - S 143 (meeting called by the court)
    - S 132 (AGMs and special meetings) / s 15 (annual financial statements)
    - S 109 (removal of Ds by ordinary res.)
    - S 146 (USAs)
    - S 102(5) (bylaw proposal)

Holding: Under the *CBCA*, the residual power to manage a corporation's affairs lie with the Directors. This power can be taken away by USAs or bylaws, but has not been done in this case.

CHAPTER 3: PROCESS OF INCORPROATION

OVERVIEW OF INCORPORATION

1. **Where to incorporate?**
    - General practice is to incorporate provincially where business is expected to be conducted, then if there are several jurisdiction incorporate federally – tied to clients' needs
    - Shopping for a specific jurisdiction in Canada has never been prevalent because treatment is similar
2. **Who does the incorporating?**
    - See s 5 *ABCA*- one or more persons may incorporate a person – means that the power to be an incorporator is not confined to an individual, it is also something a corporation can do
    - The word "person" includes a natural and artificial person
        - S 1(x) states that a person can include an individual, partnership, association, body corporate, trustee, executor, administrator, or legal representative.
    - Under *CBCA* s 5: At least one person must be 18 or older, not of unsound mind, and not bankrupt.
3. **How does one incorporate?**
    - S 7: recites documents an incorporator must send to the registrar to create a corporation
        - Articles of incorporation, documents required by s 12(3) (relating to corporate name), s 20 (notice of registered office, a street office), indication of a separate records office if any, including minute book and post office box, and documents required y s 106 (notice of directors)
    - S 6: Sets out what information has to be contained in the articles of incorporation provincially
    - S 8: On receipt of these documents in good order and with the fees, the registrar shall issue a certificate of incorporation

- S 9: A corporation comes into existence on the date shown in the certificate

Note: Articles providing for the right, if any, to restrict the transfer of shares

- Traditionally been two reasons for including these:
  - Small private corporations typically wish to impose restrictions on the transfer of shares because the remaining shareholders do not want to be forced into business with someone they have not vetted, need to have a say.
  - Presence of share transfer restrictions is important in modern private companies, the private issue – if you're the private issue you will not have as many obligations under securities legislation:
    - Issue of shares contrary to the *Securities Act* is illegal and potentially fraudulent – always need to consider this when determining the share structure.

Bylaws

- Regulate corporate conduct in the scope of the articles – it sets up regulatory guidelines for managerial actions – less specific than ordinary director's resolution (simply records the boards decision, versus here where regulation is broader)
- Comes from directors, but has to be approved by shareholders pursuant to s 102(1)
  - Directors may by resolution repeal a bylaw, or shall submit a bylaw to the directors, etc.
- S 131(3): Place of shareholders' meetings – a shareholder may participate in the meeting via electronic means… if the bylaws so provide, or subject to the bylaws all shareholders entitled to vote at the meeting.
- S 102(2)(4): Unless the articles, bylaws, or USA otherwise provide, the directors may amend or repeal any by-law that affects the corporate legislation. Directors have to submit this change to the shareholders, and then shareholders can agree or disagree with what is done.
  - If directors do not do this or it is rejected, the change seizes to be affective and the Director cannot make changes that make the same purpose without first bringing it to the shareholders.

Directors Organization Meeting

- S 104(1): After the issue of certificate of incorporation, a meeting of the directors of the corporation shall be held and can adopt security certificate and corporate records, authorize, and appoint officers, auditors, and make banking arrangements or transact any other business.
  - At this first meeting directors can also adopt a corporate seal, but this is not required as per s 25.

Other Matters

- Organizing the information of the corporation
- S 21: A corporation shall prepare and maintain… a copy f USA agreement, nay amendments, minutes of meetings and resolutions, copies of financial statements
- S 23: Who has access to these records
- Client must clearly understand the consequences of incorporation

Kinds of Corporations

- Law distinguishes in a rough way between large corporations with many shareholders from smaller ones with less – idea is that they're different creatures
    - Smaller (close) corporations are typically defined by: blending the roles of shareholder, officer and director, close personal relationships, and lack of a market for reselling the shares
- Distinguishing between companies with more or less shareholders- private vs public, offering vs non-offering, closely vs widely held.
    - All just different ways of describing the same thing
    - The more involved the corporation is in the public domain, the more accountability and disclosure is required – non-distributing corporation is under less scrutiny.
- *ABCA* has amended the way we refer to smaller corps, now refers to a reporting issues, and they are subject to much more stringency under the Act than a non-reporting issues.
    - S 162: Shareholders of a corporation shall, by ordinary resolution, at the first annual meeting of shareholders and at each succeeding annual meeting appoint an auditor to hold office until the close of the next annual meeting
    - S 163: The shareholders of a corporation other than a reporting issue may be special resolution resolve not to appoint an auditor, and (2) this special resolution is only valid until the following annual meeting of shareholders.

Comparison of public companies and closely held corporations

Public Company	Closely Held Corporation
Separation btw ownership and management	Ownership and management often substantially identical
Large # of SH with shares traded in the securities market	One or ltd number of SH's with no public trading shares
Unrestricted transferability of shares	Restrictions on transfer of shares
Most SH are passive investors	SH's often consider themselves partners
Profits retained or paid out as dividends	Profits distributed as salaries and dividends
Most investors have diversified portfolios	Most personal wealth invested in enterprise
No familial or personal relationships bw SH	Familial/other personal relationships bw SH
Financing through a mixture of debt and equity	Debt most common form of financing
Defined roles & high degree of formality in decision making	Loosely defined roles and informal decision making

Professional Ethics

- Possibility of conflicts happening- so before a lawyer acts for more than one client in the same matter, need to obtain consent and provide them with advantages and disadvantages, and ensure its in their best interest
- Not mandatory that disclosure or consent be in writing (lawyer has the onus of proving this)- but it is advised to document the communication between lawyer and client

Incorporation Procedures:

- The following signed documents must be presented for registration via mail, in-person or electronically:
  - Articles of incorporation
  - Notice of address
  - Notice of directors, and
  - NUANs search results
- **Practice-oriented discussion of the incorporation procedure:**
  - First, determine client's purpose for incorporating
    - This ensures proper legislation is being complied with
    - Also makes sure right business licenses are being attained
    - Possibility to transfer assets of the business to the corporation by way of a tax fee rollover under s 85 of *ITA*
  - Second, determine jurisdiction of incorporation
  - Third, attain the correct licensing and registration
    - Often, both municipal and provincial licenses will be required
    - Sometimes additional licensing under specific legislation dependent on the type of business.
  - Next, if the corporation is to have more than one shareholder, consider the use of a USA.
    - If this is the case, each shareholder is required to obtain independent legal advice
  - Fifth, the client must get insurance..
  - Next, outline consequences of incorporation to the client
  - Once all documents have been submitted and the corporation is incorporated, director resolutions must be passed, followed by the passage of appropriate shareholders' resolutions.
    - Possible resolutions that may be passed at director's organizations meeting:
      - Adoption of bylaws
      - Adoption of form of share certificate
      - Adoption of corporate seal
      - Designation of offices and appointment of officers
      - Issuance of shares
      - Banking
      - Auditors and accountants
      - Transact any other business
  - Once directors' organizational resolutions have been passed, shareholders'' organization resolutions are passed:
    - Confirmation of bylaws
    - Election of directors
    - Auditors
  - Finally, once all resolutions are established, a minute book should be made and then a report should be given to your client.

Code of Conduct

Joint Retainers:

As per ss 3.4-5: Before a lawyer acts for more than one client in the same matter, the lawyer must:

- (a) Obtain the consent of the clients following disclosure of the advantages and disadvantages of a joint retainer
- (b) Ensure the joint retainer is in the bets interests of EACH client
    - Consider:
        - The complexity of the matter
        - Whether there are terms yet to be negotiated and the complexity and contentiousness of those terms
        - Whether considerable extra cost, delay, hostility, or inconvenience would result from using more than one lawyer
        - The availability of another lawyer of comparable skill
        - The degree to which the lawyer is familiar with the parties affairs
        - The probability that the conflict or potential conflict will ripen into a dispute due to the respective positions or personalities of the parties, the history of their relationship, or other factors
        - The likely effect of a dispute on the parties
        - Whether it may be inferred from the relative positions or circumstances of the parties that the lawyer would be motivated to favour in interest of one party over another (like a long-standing relationship), and
        - The ability of the parties to make informed, independent decisions.
    - Lawyer must make independent evaluation of this, it is insufficient to rely on the clients' assessment in this regard.
- (c) Advise each client that no information received in connection with the matter from one client can be treated as confidential so far as any of the other are concerned, and
- (d) Advise each client that if a conflict develops that cannot be resolved, the lawyer cannot continue to act for any of the parties and may have to withdraw completely.

Ways to get sued by your client:

- Failing to check for conflicts of interest or resolving them once detected
- Sueing a former client for an unpaid fee will almost always generate a corresponding malpractice claim
- Accepting any client and any matter the comes along
- Becoming a client's business partner
- Practicing outside area of expertise
- Going overboard in opening branch offices and making lateral hires
- Representing yourself in a professional liability dispute
- Settling a matter without written authorization from a client
- Failing to communicate with clients

USAs

- A lawyer will create these after listening to clients needs.
- Described as a client enjoying the benefits of incorporating with the flexibility of a customized relationship.

    - Closer like as in a partnership
- S 146 of *ABCA*: A USA may provide for all of the following:
    - Rights and liabilities of shareholders
    - Elections of directors
    - Restrict powers of directors to manage
    - Rules regarding transfers o shares; right of first refusal
- S 146 of *CBCA*: refers to restricting in whole or in part the powers of management and directors (in comparison to the *ABCA* where this is just one of the things that can happen)
- S 248 of *ABCA*: Seek compliance order; a specialized document that the Act provides defence mechanisms to.
- Under the *ABCA*, a USA may affect:
        - The pre-emptive rights of exisiting shareholders to acquire shares from the treasury of the corporation (s 30(1))
        - The information to be given to shareholders concerning the acquisition by a corporation of its shared (s 34(2))
        - The ability of personal representatives of a shareholder to deal with the shares of that shareholder (s 50(2))
        - The management of the corporation by the directors (s 101(1)): the amendment of the bylaws by directors (s 102(1))
        - The borrowing of money, pledging of debt obligation, giving of guarantees, mortgage or creation of security interests in the propriety of the corporation (s 103)
        - Election or appointment of directors (s 106(9)) and extension of max. term of office to three years from one
        - Removal of directors by the shareholders (s 109(1))
        - The filling of vacancies on the BoD (s 111(4)
        - Ability of directors to sign written resolution in lieu of a meeting (s 177(1)
        - Disclosure of a material interests in the contracts of the corporation y officers or directors (s 120(1))
        - Designation of officers of the corporation, specification of duties, and delegation to those officers of the power to manage the business and the affairs of the corporation (s 121)
        - Remuneration of officers, directors, and employees of corporation (s 125(1))
        - Contents of financial statements (s 155(1)(c))
        - Rights of shareholders upon a takeover bid (s 195(3) and
        - Entitlement of shareholders to demand dissolution of the corporation (s 215(1))

Cicco v 609940 Ontario Inc

Facts:

- C and B are directors who each own 0 of shares in a company and entered into a USA which said that all decisions affecting the corporation need both their consent
- In breach of the USA, B adopted a director's resolution that the corporations makes an assignment in bankruptcy
- C moved for an annulment of the assignment. C claims that because the director's resolution enabling the assignment was in breach of the USA, it was unauthorized.

Issue: Should the assignment into bankruptcy be annulled due to it contravening the USA? **NO.**
Analysis:

- Bankruptcy assignment will not be annulled as a breach of the USA give C a right of action, but because the corporation was insoluble the assignment should hold.
- Test for annulment of assignment in bankruptcy:
  - Court must conclude that the assignment ought not to have been made or filed
    - This is a wide ranging and flexible test
- The resolution and assignment are regular at face value because the director was duly appointed and qualified to act. Therefore, assessed in terms of the bankruptcy context with policy considerations:
  - Effect of USA was to limit the authority of the director, but that is entirely an internal matter between the director and shareholders.
  - B may be accountable to shareholders for failure to comply with the agreement, but that does not render assignment void
  - Assignment is for the benefits of the creditors and function of the trustee is to protect their interest
  - Policy of the *BCA* that assets of an insolvent company be distributed to the creditors according to the scheme of priorities described.
- So the USA is binding on the parties within the USA< but does not dislodge proceedings such as an assignment in bankruptcy.

Holding: A USA may not operate to bind a third party dealing with the corporation who has no notice of the restrictive authority of its directors. C has a private action for beach of USA against B.

CORPORATE NAMES

Corporations can be incorporated under a numerical name designated by the registrar (as per *ABCA* s 11) or a word name (which requires a name reservation and NUANs report).

A NUANS reports lists similar existing corporate names and trademarks; they are used to determine the availability of a new proposed name. Ensuring that new corporate names do not create confusion with others is intended to protect Canadian businesses and consumers.

General criteria for name approval:

- *ABCA* s 10:
  - Last word must be "Limited, Limitee, Incorporated, Incopoee, or Corporation" or full abbreviations of one
  - Must have distinguishing and descriptive elements
- *ABCA* ss 12(1)(b) and (c):
  - Subject to regulations, a proposed name may not be used if it is identical to the name of another AB body corporate, an extra-provincial corporation registered in AB, or a federal corporation.
  - If similar, but not identical, it will be available so long as it is not confusing or misleading.
    - Has been interpreted to man if the name is likely to decive the public
    - Note: Even if the name has been approved by the registrar, it does not mean the company is untouchable (*Pet Paw Food*)
- **Three required components:**

- Distinctive: regulations prohibit names that are too general, something different,
- Descriptive: must briefly describe the business to be carried on.
- Legal Element= Limited or Corp, or something as per s 10(1).

Pet Paw Food and Accessories Ltd v Paws and Shop Inc

Facts:

- PPFA challenges PS name for being too similar and applied to the Registrar, asking him to order PS change its corporate name by dropping the word Paws
  - This is a power granted to Registrar as per s 13 of the *ABCA*
- Registrar refused
- Due to refusal, PPFA brought an application under s 247(1)(b) for court to order the registrar to do something

Issue: Should the application be granted on the basis that the respondent's corporate name is "confusing or misleading" which is contrary to s 12? **YES.**

Analysis:

- Both companies operated retail shops in Calgary and sold the same things
- PPFA spent lots of money heavily advertising, and evidence directly shows that customers were confused and misled by the companies names.
- Regardless of the approach, it is no defence to an action of passing off that the name was approved federally or provincially by the registrar

Holding: The fact that customers believed PSA was a second store of PPFA indicated it could mislead an confuse, which is a breach of s 12 for not being distinctive.

Stenner v ScotiaMcLeod (a passing off action)

Facts:

- St is a financial consultant and investment advisor at National Bank Financial.
- He had a three person team, including his daughter, and was highly successful
- St did marketing research, radio shows 2x a week, and published a client newsletter; daughter was responsible for providing advice and service to clients.
- St committed to sell his book of business to his daughter with a phased retirement plan.
- There was a falling out and St did not sell the book; seeing no viable alternative the team moved to a competitor, ScotiaMcLeod, without notice
- St argued that the daughter is passing off and misrepresenting that her services are associated with St, and this unfairly tapping into his goodwill.
- Daughter has been using her father's namesake in all her advertising, including the same radio show he once had.

Issue: Was there passing off? **YES.**

Analysis:

- The common law action for passing-off protects the goodwill associated with a trademark or name- a person operating a business has a proprietary right to an established name – the property is business or goodwill that would be adversely affected by the representations of another person using the name to gain the benefit of that goodwill
  - Goodwill: broad concept that means the benefit and advantage of the name, reputation, and connection of the business, the attractive force that brings in customers, includes the nature of future patronage

    - Tradename: Must be registered in some cases
    - Trademark: a word, symbol, design, or any combination, that distinguishes one person's products or services from another.
- The essence of passing off is the representation of the defendant's goods as those of the plaintiffs- even a person's name can be enjoined in an injunction on the grounds of passing off, if confusion results or is calculated to result from such use.
- **To win a passing off action, the plaintiff must prove: (*Apotex*)**
    - The existence of goodwill,
    - Deception of the public due to a misrepresentation, and
    - Actual or potential damage to the plaintiff

Holding: The application for an injunction restraining the defendants from using the word "Stenner" is too broad in scope, but there was a tort of passing off since the defendants represented in several ways directly and impliedly that there was a connection or association with the plainitff.

SHARE CAPITAL

Equity Financing

Dividends: the cash contributions that corporate shareholders may from time to time receive from the corporation

Corporate share: a common, dividend, participation interest in the corporation's business- an interest ultimately connected in some way to an investment of money that has been made in the corporation.

Even when a corporation is dissolved and its assets liquidated, shareholders do not have any right to receive a distribution of those specific assets – they are only entitled to receive a proportionate distribution of the *value* of those assets (after debts and liabilities are satisfied)

- *United Fuel Investments Ltd*: shareholders didn't want to receive cash from United Fuel upon sale of its principal asset, they wanted to receive shares
    - Court held that the minority shareholders had no right to call for the property of the corporation in which they held shares to be distributed to them- they have no title to the assets of the company, rather entitled on dissolution to receive a pro rata share of the proceeds (no proprietary interest in the corporate assets)

Classification of Shares

- Starting presumption is that all shares of the corporation are in all respects equal and shareholders are entitled to be treated alike.
- However, this presumption can be defeated by dividing shares into different classes or series.
    - Where a corporation has only one class of shares, the rights of the holders thereof are equal in all respects and include the right to vote at all meetings of the shareholders and to receive the remaining property of the corporation upon dissolution.
        - These full rights are typically known as common shares.
        - Other shares include deferred, non-voting, employee, etc.
    - Where a corporation has more than one class of share, each constitutes a distinct subdivision within the total share capital- may, but need not have rights, distinguishing them from other classes

- Where articles provide for more than one class of shares, the rights, privileges, restrictions and conditions attached to each class of shares must be set out in the articles
- Where there are two or more classes of shares, the right to vote at all meetings and to receive remaining property upon dissolution must be attached to at least one set of shares.

Common vs Preferential Shares

- Common shares: confers a full right of participation, and thus unrestricted rights to participate in dividend and distribution of property.
  - Because holders of common shares may only be paid dividends or repaid capital after the satisfaction of other claims, ordinary shares are more risky – but they do provide an unlimited right to share in the profits and growth of the company
- Preference shares: special shares to which a preferential right is attached, which causes the share to rank ahead of common shares
- Golden share: allows the holder of that single share some sort of special class right to veto specified types of corporate acts or change in its basic constitution.

PRE-INCOPROATION CONTRACTS

Pre-incorporation contract is one entered into before the corporation comes into existence- usually the situation is where the promoter purports to contract on behalf of the corporation and the third party sues, must be determined if the promoter is personally liable.

Used when the parties are unwilling or unable to wait for the corporation to come into existence, but the promoter wants to make sure they are not personally liable on the contract.

Problems:

- Third parties cannot contract with an entity that does not exist
- Cannot have a contract with a legal entity that does not exist at the time of contracting (cannot ratify an impossibility)
- When the company is incorporated and purports to adopt the contract in question, it is merely engaged in nullity – the principal (corporation) cannot ratify acts by the agent that are legal impossibilities.

Historically Important Examples:

Kelner v Baxter: Promoter has personal liability via agency law

- Should there be liability where a third-party plaintiff sued a promoter personally on a pre-incorporation contract?
  - The individual defendant promoter was liable- as the agent, they acted for a non-existent principal and agency law says he should have personal liability
  - Court here did not explore the question of whether the parties intended the promoter to have personal liability, simply applied the rule of agency and said intent is irrelevant
  - Hard decision but logical – basically saying that if a person contracted on behalf of a company which was non-existent, he himself would be personally liable on the contract

Black v Smallwood: Depends on parties' intentions whether or not the promoter is personally liable

- Did the promoter have liability under the contract?

- Court said it was a matter of intention- the promoter would be liable if it was intended that he would be
- Both parties though the corporation existed when the contract was entered into, therefore the intent was that only the corporation would be liable on the contract not the promoter.

There was conflict between these cases, so the legislature intervened…

Legislative Response:

1. CBCA Approach: the promoter is deemed party to the contract
    a. Pursuant to a CBCA type model of liability, the promoter is deemed to be the other party of the pre-incorporation contract. Once the corporation is created or if its fails to adopt the contract in a reasonable time, the promoter remains liable fr the non-performance of the contract
    b. If the corporation is not created or if it fails to adopt the contract in a reasonable time, the promoter remains liable for the non-performance of the contract.

See s 21(1) in *Westcom*: a person who enters into an oral or 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 the benefits thereof.

Judicial interpretation of the CBCA model- *Westcom, Sherwood Design,* and *Szecket*

Then new statutory amendment introduced (anti-*Westcom*)

2. ABCA approach: the promoter is a warrantor, not a deemed contracting party

See s 1(2) of the ABCA: if a person enters or purports to enter into a written contract in the name of or on behalf of a body corporate before it comes into existence:

(a) That person is deemed to warrant to the other party of the contract
    i. That the body corporate will come into existence in a reasonable time
    ii. That the contract will be adopted within a reasonable time after the body corporate comes into existence

Applies when the contract is **written-** so if oral, then not covered by the contract and the CL would apply, gong back to the *Kelner* and *Smallwood* debate

Applies when it is intended that the contemplated corporation exists or will exist under the *ABCA* (not other jurisdictions)

Assuming application, the promoter is deemed to give two warranties:

1. That the body corporate will come into existence within a reasonable time;
2. That the contract will be adopted by the corporation within a reasonable time.
    - If these two do not come to pass, the promoter is liable for breach of warranty
    - BUT, there is one 'escape hatch"- s 15(6), a person who purports to enter into a written contract in the name of a body corporate before it comes into existence is not liable for damages if the contract EXPRESSLY provides they are not liable.

Canadian Cases (*OBCA/CBCA* law)

Westcom Radio Group Ltd v MasIsaac

OBCA case, very literal and technical interpretation of the statute

Facts:

- W was a service provider who contracted with a corporation that did not exist
- M mistakenly thought she was a shareholder, director, and officer of this corporation that did not exist.

Issue: Is M personally bound and liable for the contract? **NO.**

Analysis:

- Prior to intervention, s 21(1) of the *ONCA* said "except as provided in this section, a person who enters into an oral or 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 the benefits thereof"
- Courts said there was no personal liability and did so by applying a two-step test:
    - Applied common law principles, based on *Smallwood*, and concluded that defendant was not liable- no contract at common law, only one party because the other does not exist
    - Considered whether the statute in question would change the outcome at common law
        - NO, because there needed to be a contract for the provision to apply.

Holding: Only if the parties had entered into an enforceable contract could the enforceable provision be triggered- a failed attempt to contract means the act is not triggered.

Sherwood Design Services Inc v 872935 Ontario Ltd

Whether the pre-incorporation contract has been adopted by the incorporation

Facts:

- Individual defendants entered into a $300,000 agreement of purchase and sale "in trust for a corporation to be incorporated" with Sherwood Design
- Defendants stated to the plaintiff that a corporation had been assigned to the transaction and used to complete the asset purchase (one of the firm's shelf companies), and draft organizational documents were sent
- The deal did not proceed, so the shelf company was returned to the shelf and then assigned to a subsequent client of the law firm.
- S is suing for deal to be completed.

Issue: Was the conduct by counsel for the defendant sufficient adoption of the contract under the Act such that the shelf company is bound?

Analysis:

- Act says all you need is any "act or conduct" signifying an intention to be bound, and the court interpreted this to cover a broad range of activity

Dissent:

- Said the *Westcom* decision was wrong- s 21 has a remedial nature in relation to the adoption provisions

Holding: Corporate contract was real and defendant is liable. However, the defendant company can sue the law firm for negligence.

Szecket v Huan

- Liability was ultimately determined pursuant to s 21 of the *OBCA*, instead of basing a finding of personal liability on a combination of common law principles and the application of s 21
  - Should not first look for a "contract" to which the section can attach because this undermines the legislature's effort to supplant the common law and eliminate uncertainty
- Court effectively overruled *Westcom*- did not do this expressly, but now represents this area of law.

So, current state of the law under *ONCA/CBCA…*

- **JUST NEED TO APPLY THE ACT-** liability of the promoter is determined on the basis of s 21 alone
- When provisions speak of a "contract" they do not mean there must be a contract in the traditional common law sense
  - They refer to a form of statutorily created contract that *immediately* creates rights and obligations between the promoter and the third party as parties to the contract, that *may* create rights between the third party and the corporation to be incorporated

Measure of Damages

Wickberg v Shatsky et al

How to measure damages for breach of warranty by a promoter

Facts:

- Company sold business machines and supplies
- Those behind it decided to incorporate a new company, but never actually did; carried on business under that name improperly
- Approached W to be the manager for new "company"
- Business itself was not successful, when W was refusing to work on straight commission he was fired, then sued for wrongful dismissal.
- Termination letter referred to the company that did exist, but not the one with which W contracted.

Issue: Should the court applies *Kellner* or *Smallwood? **SMALLWOOD.***

Analysis:

- Court applies *Smallwood* and concluded S made a warranty to W that the company existed and was in a contract with him
- The plaintiff's loss:
  - Not being able to recover for wrongful dismissal because the corporation did not exist
  - But the fact they did not incorporate the company did not cause the loss, the loss was from the business not being a success- **the breach of warranty did not cause the loss to the plaintiff**

Holding: Plaintiff only received $10 in nominal damages- **if the promoter stipulates for a corporation of substance, then the plaintiff could recover substantial damages. In the usual case, the third party is taking his chances that the corporation would operate well, no reason to give the person more than they bargained for.**

So, current state of the law for *ABCA*…

- In AB, the common law is replaced by legislation in relation to a written contract or purported written contract entered into before the company comes into existence.
- If the contract is oral, the common law applies and we get into the *Kelner* vs *Smallwood* approach.

CHAPTER 4: THE CORPORATION AS A LEGAL PERSON

NATURE OF CORPROATE PERSONALITY

Salomon v Salomon Ltd held that a corporation is a separate legal entity, and one primary purpose of it is to shield hose behind the corporation from unlimited liability. Creditors cannot complain afterwards if they take a business risk that did not work out – only in exceptional circumstances can those behind the corporation be sued.

GROUNDS FOR LIABILITY FOR THOSE BEHIND THE CORPORATION

Separate legal personality and limited liability are distinct concepts

- **Separate Legal Personality** means that the corporation is a person in law, distinct from its shareholders and anyone else, purporting to act for its shareholder or on behalf of the corporation.
  - Key economic purpose is to partition the assets owned by the business entity so they are not available to creditors.
- **Limited Liability** signifies that the liability of shareholders for debts and other obligations of the corporation is limited to the amount remaining unpaid on their shares.
  - Key economic purposes include lowering monitoring costs for shareholders, facilitating free transferability of shares, allowing for portfolio diversification, etc.

Lifting the Corporate Veil

- **Lifting the veil** means to disregard either the separate legal personality of corporations or the limited liability of shareholders for a variety of purposes, including the reallocation of liability or benefits as between shareholders and corporations.
- Technically speaking, lifting the corporate veil engages the separate personality aspect, not the limited liability aspect.
- Doing this is very rare in Canada to ensure the principle of *Salomon* is respected. Mot often occurs in family law cases.
- Courts are more willing to piece the veil to find a corporation liable for shareholders or sibling corporations, but less willing to the vice versa.

Factors that influence lifting rates:

- Jurisdiction of the court
  - Federal courts least often, AB and ON more often
- The number of shareholders
  - Most often in sole shareholder corporations
- The identity of the claimant and the substantive nature of the claim

    - Third party government claims have been the most successful, while attempts by the corporation itself or parties related to the corporation have been the least successful.
- Nature of the claim
    - More often in tortious cases than contract cases
    - Highest in family law (and sometimes tax)

Summary of Tests:

***Kosmopolous* test in AB:** Courts will only lift the corporate veil when not to do so would be flagrantly opposed to justice.

- This is an abstract test… things typically have to be "really bad " to lift the corporate veil, so what does that mean?
- More of a principle, must be recognized with *Salomon* principle.

The test for lifting the veil from *Transamerica* summarized in *Driving Force*:

The court will lift the corporate veil when:

1. It is completely dominated and controlled; and
2. It is being used as a shield for fraudulent or improper conduct.
   Examples of what counts under the second step:
    - *Big Bend*: using a corporation to hide a previous claims history
    - *Jin v Ren*: ordering a wrongful thing to be done by retaining plaintiff's money in one's capacity as Director and refusing to account for it.
    - *Aubin*: using corporation as a weapon.
    - *Domestic Construction*: treating self interchangeably with corporation; using to deflect money from proper usage; intermingling corporate affairs with its own;

Reverse corporate veil: More commonly argued in the family law context.

3 step *Arsenault* test: Plaintiff has to show that:

1. The individual exercises complete control over the company
2. The individual has used that control to commit a fraud or wrong that would unjustly deprive a claimant of his or her rights, and
3. Misconduct was the reason for the third parties' injury or loss.

This test was recognized in *Aubin*.

Summary of Corporate Veil Cases

Driving Force Inc v I Spy Eagle Eyes Safety Inc

Corporate veil NOT lifted

Facts:

- D leased 9 truck to I, as negotiated with J (the sole shareholder and director of I)
- I alleges these were leases to own, and gave them the option to purchase the truck for $4000 upon completely of the 36-month lease. So, they did not return the trucks at end of lease.
- D disagrees and is trying to sue J, the sole shareholder and director of I, for conversion on top of suing the company.

Issue: Should the corporate veil be lifted and J be held liable? **NO.**

Analysis:

- A highly relevant factor in determining whether the corporate veil should be lifted is whether the plaintiff voluntarily dealt with a limited liability corporation, knowing the consequences.
- Courts are typically reluctant for these types of cases to be successful.
- Recognizes that *Kosmopoloulos* is more of a principle than a test, and should be balanced against the *Solomons* principles.
- In addition to the *Transamerica* test, the Court says to also look at some older tests if it is obvious something is wrong at the outset:
    - Is the corporation a sham? Does it operate solely as a cloak to shield the individual?
        - Does not have to be original purpose of corporation, but can become this.
- In this case, yes J has full control of the company and meets part 1 of the *Transamerica* test, but not part 2.
    - D is voluntarily doing business with a Limited Corporation and was aware of the consequences.
    - Additionally, J was not misusing the corporate vehicle. Not party t any of the leases and did not sign a personal guarantee.

Holding: Court says to be very careful when deciding to lift corporate veil. It is easy to meet part 1 of the *Transamerica* test, so part 2 needs to be more strict.

Big Bend Hotel Ltd v Security Mutual Casualty Co.

Corporate veil IS lifted

Facts:

- K was the president and sole shareholder of B, with the sole asset being the Big Bend Hotel in Golden, BC
- K deals with R to place an insurance policy with S
- K's original hotel burnt down by fire, and relevant insurance covered this. Then K bought all shares in B, insurers kept cancelling coverages, so he went to R.
- When K was filling out insurance, he never disclosed that insurance kept cancelling on him and that he had dealt with a fire loss in the past. K was even asked f he had suffered any previous losses, and knew if he filled this in his insurance would be declined or at increased premiums.
- K would argue that he was asked about B's history, not his own personal losses.

Issue: Is this the proper case to lift the corporate veil given K's failure to disclose? **YES.**

Analysis:

- K is wearing a cloak of new corporation to hide past of old one.
- On insurance point, he failed to disclose everything he knew. This is operating without good faith.
- He did answer all questions on the form truthfully about B's history, but is using the corporate vehicle for an improper purposes.

Holding: Agrees that *Solomon* principle is important but does not apply when corporation is used for purpose of misconduct or fraud as per *Transamerica*.

Jin v Ren

Corporate veil IS lifted

Facts:

- J invested money in R's company in exchange for a controlling interest
- R would not provide him with proof of interest, so J asked him to return his money
- R then promised to return the investment only if J would not work in any hemp-related industries in China or Canada
- J sued R personally and the company

Issue: Should the court lift the corporate veil? **YES.**

Analysis:

- Court cited *Transamerica*: the judge was unable to conclude that the corporation was a mere shield or façade, but did say there was an improper purpose.
  - Expressly directing a wrongful act be done, meets the second step of the test.
- R was retaining money that did not belong to him and thus expressly directed a wrong to be done.
- R was controlling the mind of the company.
- Both parts of *Transmerica* test are met.

Holding: There is personal liability. R and the company are jointly liable and an unjust enrichment claim was not precluded.

Note: To establish an unjust enrichment claim, need:

(1) An enrichment, (2) corresponding deprivation, and (3) absence of a juristic reason for the enrichment.

Rockwell Developments Ltd v Newtonbrook Plaza Ltd

Corporate veil is NOT lifted

Facts:

- R (controlled by K) took the view that a real estate transaction could be closed with a reduction in purchase price
- N wanted to collect on its costs, but R only has a total of $30 in assets
- Planet Ltd held 23 shares, and K beneficially owns the shares here.
- It was K's practice to incorporate separate limited properties for each real estate transaction he was pursuing
- N brought an application for an order directing K to personally pay the costs.

Issue: Who is the real litigant? K or his company? **COMPANY.**

Analysis:

- Despite the factors suggesting K was real litigant, the Court said ultimately it was the corporation that contracted, not its directors or shareholders.
- There was no allegation against K of any misconduct, which is typically required for lifting the corporate veil. (actually usually requires SERIOUS MISCONDUCT)
- The company cannot be seen as a mere trustee or agent for K- it is true K stood to benefit from the deal with N, but still the contract was made between companies

Holding: K did not have to pay the costs personally – relies on *Solomon*

Aubin v Petrone

Corporate veil IS lifted – Family law context that contains the "reverse corporate veil"

Facts:

- P and A were marred and incorporated company, Q
- P essentially owns and operates the company. They bought a home through another company they owned
- TJ ordered P to pay A approx. $5.6 million for matrimonial litigation – P said he had no money on his own and could not get money out of the corporation
- Lower court ordered that the money judgement be secured against Q' assets, a building with A being the secured creditor.
    - This is a reverse lifting of the corporate veil.

Issue: Can this scenario occur? **YES.**

Analysis:

- This cases recognizes the *Solomon* and *Kasmopolous* principles.
- Used the 3-step *Arsenault* test ; was met here.
- Need to make sure that corporate arrangements do not work an injustice in family law- obligations imposed by family law are on fair footing with other obligations

Holding: The law should not shelter wrongdoers because the wrong is too "common place" in response to the fact that lifting the corporate veil is rare (this is not a requirement).

Note: Some clients will try and treat assets of their companies as cavalierly. Do not allow them to do this. Also, don't allow them to bill an account for personal matters to their company. These are breaches of code of conduct and you can be sued by guarantors or creditors, or CRA.

Liability Based on Thin Capitalization

Thin Capitalization is where shareholders have invested a very small amount of money in return for shares, usually in an amount inadequate to cover the reasonable foreseeable obligations of the corporation.

Even though there are **no statutory or common law obligations regarding how much capital a corporation must have,** thin capitalization has been argued as grounds for when a corporation's separate legal personality should be ignored, because they knew they could not own up to their corporation liabilities.

However, there has not be a successful case yet where thin capitalization alone has led to lifting the corporate veil – other factors have always been included.

Henry Browne v Smith

Consensual claimant. No sympathy from court.

Facts:

- H is a manufacturer of steering devices and enters a contract with O, they deliver the items and do not get paid.
- H discovered that O was thinly capitalized, and only had 2 pounds n capital, and therefore, tried to sue one of the two shareholders, S.

Issue: Does the fact of thin capitalization change the outcome in relation to tortious liability? **NO.**

Analysis:

- O purchased the equipment, invoice was made to P, and collection agency sent bill to O.
- Court follows *Salomon* case that shareholder is not responsible for the default of the corporation.
- Court also says nothing is fraudulent about running business through a corporate vehicle, so nothing breaching *Transamerica*.
- There were other things that H could have done to protect himself, such as asking S to be a party to the contract or a personal guarantee.

Holding: H is a consensual claimant and voluntarily entered into the contract with O. SO Court has little sympathy for him.

Waljovsky v Carlton

A non-consensual claimant.

Facts:

- W injured when run down by a cab in NY
- Cab was owned by Seon Corporation, which was owned by the individual defendant, C
- Every other corporation owned by him was set up in the same way – two cabs, $10,000 in auto liability, and him being the sole shareholder.
- W can go after cab driver, and Seon cab for vicarious liability, but he is now trying to sue C individual plus all other cab companies he owns.

Issue: Does C, the individual, have personal liability for W's injuries? What about the other 9 corporations? **NO AND NO.**

Analysis:

- W unsuccessfully argued that C's corporations were all operated as a single entity unit and thus all liable to the plaintiff as each other's agents
- Court said that the single entity argument only worked when the Court has been asked to lift the corporate veil, so the corporation is seen as part of a larger enterprise to assist W getting compensation, not to impose liability
- Court says no fraud here- and running businesses through multiple companies is allowed (*Solomon* principle)

Dissent:

- Would have found liability for thin capitulation; offended by C's conduct
- Intentionally undercapitalized to avoid responsibility, and it was inevitable that injury would occur one day → Fraud
  - All income, continually drained out of corporation to keep it undercapitalized.
- Basis for finding liability: a participating shareholder of corporation vested with a public interest, organized with capital insufficient to meet liabilities, which are certain to arise in ordinary course of business, may be held personally responsible for such liabilities.

Holding: Thin capitalization on its own is not independently actionable, although can be considered. Here, C had secured the statutory minimum insurance required, and therefore he did not do anything illegal.

Liability Based on Total Disregard of Formality

Total disregard of formality means to not follow the rules.

Wolfe v Moir

Holding oneself out… Court says penalty for total disregard is personal liability.

Facts:

- W was injured while roller-skating
- M was a recreation director for the city
- The roller-skating company was run by Chinook Sport Shop, but M was involved with it and was a manager, but not on the day in question
- The premises were commonly referred to as "Moir's Sport Land" and were advertised as such, although billing when to CSS.
- M was secretary of the company and his wife was the president

Issue: Is M personally liable? **YES.**

Analysis:

- Evidence showed that no mention was made of the company name either in the newspaper advertisements or the tickets- other than the evidence that the M/s were secretary and president, there was nothing to indicate that the usual corporate formalities were gone through
- The effect of s 10(8) of the ABCA is that if a person chooses to advertise and hold himself out to the public without identifying the name of the company with which he is associated, he runs the risk of being held personally liable.

Holding: For a person to rely upon protection from personal liability, it is incumbent on him to establish that the formalities in the statute are complied with

Note: It is likely in *Moir* that the plaintiff knowing the company was not owned by M himself was not a factor in his decision to skate there- but under the statute reliance is not required; if you do not identify your corporation clearly you get personal liability.

Vallis v Prairie Alternative Energy Solutions Ltd.

Facts:

- K and the parties entered into a contract for the installation of a geothermal heating system
- K failed to represent that his business was incorporated- not included in his email, on his truck, in any documents or cheques

Issue: Was K liable to P in his personal capacity? **YES.**

Analysis:

- Factual indica from *Iqaluit Enterprises* to determine whether an individual is personally liable rather than acting as agent for a corporation:
  - Naming of parties and any other indicators of their contracting status in relevant documentation, signage, or advertising that might have come to the plaintiff's attention
  - Defendant's non-compliance with applicable business corporations and/or trade names registration statuses
  - Any oral exchanges between the parties regarding the contracting party's identity or legal status
  - Whether the plaintiff asked the individual defendant for a guarantee
  - The relative degree of sophistication between the parties
  - The nature of the defendant's business

- K failed to comply with the provisions of the *BCA* due to the improper identification of the corporation under which he was conducting business

Holding:

- Even though the failure to identify was not dishonestly done, he is still personally liable to the plaintiff's (INTENT DOES NOT MATTER)
- If the individual does not make it clear that it is a corporation, you have personal liability.

Liability in Trust Law

Caja Paraguaya… ("Pension Fund") v Garcia

Facts:

- G and other insiders perpetrated a massive, multi-million dollar fraud against the PF
- At issue, is the liability of Ms. D, wife of Mr. D, who was G's former business associate.
- Mr. D "filtered" $3million through Catan Inc. as part of the frau.
- In simple terms, Mr. G, with the assistance of Mr. D, routed $3million of funds that had been invested with Union through a bank account of Catan.
- Mr. D was found guilty for knowing assistance in the breach of trust. Therefore, he was personally liable.
- Ms. D signed necessary documents to perpetrate the fraud without making due inquiry.

Issue: Is Ms. D liable for knowing assistance in Catan's breach of trust? **NO.**

Analysis:

- **Knowing Assistance in Breach of Trust vs Constructive Knowledge**
  - Knowing Assistance:
    - The doctrine of knowing assistance is a mechanism for imposing liability on strangers to a fiduciary relationship who participate in a breach of trust by the fiduciary.
      - Strangers to a fiduciary relationships who are made liable on this basis are held responsibly because of their "want of probity", which means "lack of honesty" (*Air Canada v M & L Travel*)
    - Test for knowing assistance (*Air Canada*):
      - (1) a fiduciary duty,
      - (2) a fraudulent and dishonest breach of the duty by the fiduciary,
      - (3) ACTUAL KNOWLEDGE by the stranger to the fiduciary relationship of both the relationship and the fraudulent conduct, AND
        - It is not enough for the stranger to know or suspect in some unspecified way that the fiduciary was up to no go
        - More expansive, and includes recklessness or wilful blinders as per *Air Canada*
          - Wilful blindness is deliberate ignorance and exists where the subject suspects the relevant facts, but deliberately chooses not to inquire because they do not want to know the truth
      - (4) Participation by or assistance of the stranger in the fiduciary's fraudulent and dishonest conduct.

        - In this case, Ms. D would be liable as a knowing assistor only if she had actual knowledge that Catan held funds as trustee, and that she was participating in assisting Catan fraudulently in relation to those funds.
    - Constructive Knowledge:
        - Carelessness does not normally amount to knowing assistance.
        - Constructive knowledge is assessing whether knowledge of the facts would put a reasonable person on notice.
    - **So, to prove guilt in breach of trust, must show Ms. D had actual knowledge of what was happening, not what a reasonable person would have known.**
- **Knowing Receipt of Trust Property**
    - The theory of liability of strangers to the trust for knowing receipt rests in the law of restitution.
        - Liability arises from the fact that the stranger has received trust property for its own benefit and in doing so, has been enriched at the beneficiary's expense.
            - The stranger is therefore conscience-bound to restore the property received.
    - Test as per *Citadel*:
        - (1) The stranger receives trust property (2) for their own benefit or in their own personal capacity
            - In addition to actual knowledge, including wilful blindness or recklessness, (3) can be met where the recipient , having knowledge of facts which would put a reasonable person on inquiry, actually fails to inquire as to the possible misapplication of the trust property.
                - So basically, constructive knowledge, may service as a basis for restitution liability.

Holding: A new trial relating to Ms.D's liability is ordered.

CHAPTER 5: TORTIOUS, CRIMINAL, REGULATORY AND CONTRACTUAL LIABILTIY OF THE CORPORATION

Corporate Liability (without agency)

1) Contract: n/a, corporate liability in contract is only established via agency law
2) Tort: corporation X commits a tort, and has primary liability established by the *directing mind* doctrine
3) Crime: corporation X commits a crime, and has primary liability established through the *directing mind* doctrines as augmented by amendments to the CC

Corporate Liability (with agency)

1) Contract: the corporation is bound if the agent has actual or ostensible authority
2) Tort: the corporation's employee commits a tort in the ordinary course of employment. The corporation's liability is non-consensual and vicarious
3) Crime: n/a

Attributing liability to a corporate body is done through the corporate identification doctrine, where acts may be attributed to a corporation for the particular purpose or defence at issue

TORTIOUS LIABILITY

The "Rhone" v The "Peter Ab Widener"

Facts:

- Collision occurred when a ship being towed by 4 tugboats struck another ship.
- TJ held that the cause of the collision was the negligence of the master of the lead tug. He also had managerial responsibilities in respect of the operation.

Issue: Is the tug master a directing mind of the corporation because he performed some non-navigational duties? **NO.**

Analysis:

- The *Shipping Act* states that the owner of a ship has the benefit of limited liability concerning acts or omissions n the navigation to the ships that occur without the owner's actual fault or privity.
- Having actual fault implies a mental fault of the corporation- need to determine at what point the fault of an individual in a company is treated as fault of the company itself
- **Directing mind theory:** the corporation is like a human body and has a brain, this is the brain of the directing mind.
    - Test for directing mind at common law is the same for criminal and tortious matters
    - **Test as per *Canadian Dredge*:**
        - The focus of the inquiry is whether the impugned individual has been delegated the governing executive authority of the company within her authority?
            - This means that one must determine whether the delegation amounts to authority to design and supervise the implementation of corporate policy, rather than simply to carry out the policy (about governing executive authority)
- When the employee who committed the tort is found to be the directing mind, the corporation is seen as committing the offence.

Holding: K is not directing mind- although he was described as a manager, he was subject to the supervision of a captain and did not hold relevant authority. Since he was not directing mind, fault cannot be attributed to the corporation.

Deloitte & Touche v Livent Inc

Facts:

- D was retained by L to conduct financial audits
- Years after, L found out D conducted these audits poorly, and two associates had been fraudulently manipulating L's financial records
- L became insolvent and sued D through its receivers, claiming that because of the negligent audit, L's shareholders were unaware of its financial state which left them unable to safeguard the corporation's interest.

Issue: Who is liable? **DELOITTE.**

Analysis:

- D's defence is of illegality:
    - Arguing that the plaintiff engaged in illegal or immoral conduct and therefore, should not recover.

    - Although director's committed an illegal activity, it is unrelated to the case, and D's job was to detect if any illegal activity was occurring.
        - If a professional undertakes to provide a service to detect wrongdoing, the existence of that wrongdoing will not normally weigh in favour of barring civil liability for negligence through the corporate identification doctrine.
- **Test for corporate identification doctrine (*Canadian Dredge*)**
    - To attribute the fraudulent acts of an employee to its corporate employer, two conditions need to be met:
        - The wrongdoer must be the directing mind of the corporation; and
        - The wrongful actions of the directing mind must have been done within the scope of his or her authority
    - Another articulation of the test is that the action taken by the directing mind (a) was within the field of operation assigned to him; (b) was not totally in fraud of the corporation; and (c) was by design or result partly for the benefit of the company.
- Caveat: the Court carves out some exceptions as to when the doctrine will apply – the individual through attribution is the directing mind *unless* there is some kind of break with the company (ie. the act is totally fraudulent)

Holding: Courts still retain discretion to apply the test- even when the test is met and an attribution would otherwise follow, if not in public interest might not be applied.

CORPORATE CRIMINAL LIABILITY

Historically, it was difficult to land a charge against a corporation. A large barrier was that the directing mind also had to be the person who committed the actus reus- prosecutors would decide it was not worthwhile to prosecute.

Bill C-45: Changes to Statutory Regulations Applied in *Metron*

Federal government amended the *Criminal Code* in 2004 to convict a corporation after mining incident
Two main changes included:

- The *actus reus* and *mens rea* can now be located in two different people
- *Mens rea* can be established if a senior officer has the required mental elements (lesser standard than directing mind)

The Bill also provides that:

- Organizations including corporations can be criminally liable if one or more of the representatives is a party to an offence, and the senior officer responsible for the area departs markedly from the standard of care that could reasonably be expected to prevent the representative's unlawful acts or omissions from occurring
- Senior officer is broadly defined to include not only directors, CEOs and CFOS, but also anyone who is responsible for managing an important part of the organizations activities
    - This expands the attribution of corporate criminal liability to a class of actors comprised of policy and decision makers and those who manage or supervise operations

Metron Construction Corporation

Represents the first criminal conviction under Bill C-45 and shows how corporate criminal responsibility has expanded.

Facts:

- Charged with criminal negligence which resulted in death when a lift broke and 5 workers fell 14 stories; 4 of whom died.
- Negligent site supervisor (who died) was found to be a senior officer and his negligence was the company's negligence
- President of Metron pled guilty to additional charges that were against occupational health and safety guidelines.

Analysis:

- Court must consider the following that are specific to corporate defendants:
  - An advantage realized by the organization as a result of the offence
  - The degree of planning involved in carrying out the offence and the duration/complexity of the offence
  - Whether the organization has attempted to conceal its assets, or convert them, in order to show that it is not able to pay a fine or make restitution
  - The impact that the sentence would have on the economic viability of the organization and the continued employment of its employees
  - The cost to public authorities of the investigation and prosecution of the offence
  - Any regulatory penalty imposed on the organization or one of its representatives in respect of the conduct that formed the basis of the offence
  - Whether the organization was – or any of its representatives who were involved in the commission of the offence were- convicted of a similar offence or sanctioned by a regulatory body for similar conduct; and
  - Any measures that the organization has taken to reduce the likelihood of it committing a subsequent offence.

Deferred Prosecution Agreements

- Became possible due to amendments to the CC- it is an agreement entered into between a prosecutor and a company alleged to have engaged in economic crimes.
  - It suspends the outstanding prosecution while simultaneously establishing specified undertakings that the organization must fulfill in order to avoid facing potential criminal charges.
- Used to reduce corporate criminal behaviour by encouraging the voluntary disclosure of conduct by corporations for criminal activities that may otherwise remain unknown to regulators
- DPAs must be in the public interest; factors to consider here include:
  - (a) the circumstances in which the act or omission that forms the basis of the offence was brought to the attention of investigative authorities;
  - (b) the nature and gravity of the act or omission and its impact on any victim;
  - (c) the degree of involvement of senior officers of the organization in the act or omission;
  - (d) whether the organization has taken disciplinary action, including termination of employment, against any person who was involved in the act or omission;

- (e) whether the organization has made reparations or taken other measures to remedy the harm caused by the act or omission and to prevent the commission of similar acts or omissions;
- (f) whether the organization has identified or expressed a willingness to identify any person involved in wrongdoing related to the act or omission;
- (g) whether the organization — or any of its representatives — was convicted of an offence or sanctioned by a regulatory body, or whether it entered into a previous remediation agreement or other settlement, in Canada or elsewhere, for similar acts or omissions;
- (h) whether the organization — or any of its representatives — is alleged to have committed any other offences; and
- (i) any other factor that the prosecutor considers relevant

REGULATORY LIABILITY

In *Canadian Dredge* the court invokes the system set out in *Sault Ste Marie* outlining three types of offences:

1. Absolute Liability: arises simply upon the breach of the prohibition, no particular state of mind required.
2. Strict Liability: Intent is not required, but due diligence defence is allowable here. (primary liability here, not vicarious)
3. Mens rea offences: traditional criminal offences where the accused if convicted if they have the requisite mind set.

R v Bata Industries

What is due diligence and how do we prove it

Facts:

- B and some of its key officers (three individuals; Tb, DM, and KW) were charged with violation of two environmental acts as they stored chemical asters in rusting containers that were leaking.

Issue: Can the individual directors successfully raise the defence of due diligence? **NO.**

Analysis:

- Statute:
  - Under corporate law, directors have the duty to manage or supervise the management of the business and affairs of the corporation "in the best interests of the corporation."
    - They must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
    - Powers may be delegated to officers, and they must exercise due care in selecting competent officers.
  - Directors may be absolved from liability if, as part of managing the business of the corporation, they rely in good faith upon the reports of professionals.
- Actus Reus: **Burden of Proof**
  - Crown must prove the actus reus of regulatory offences BARD.
    - Once this is established, the Crown is presumptively relived of having to prove anything further.

        - Fault is presumed from the bringing about of the proscribed result, and the onus shifts to the defendant to establish reasonable care on a BOP.
- Personal Liability:
    - Although the legislature doesn't expect the board of directors or officers of the corporation to make all environmental decisions, it is not acceptable for them to insulate themselves from all responsibility for environmental violations by delegating all aspects of compliance to shareholders
    - Thomas Bata established due diligence through evidence of his awareness of his environmental responsibilities and acts he took to protect this. Merchant and Weston were found to have not discharged the burden of establishing due diligence because of their delay in clean up, and lack of thorough inspection.
- **Test used here:**
    - Did the board of directors establish a pollution indication system?
    - Did the director ensure the corporate officers had been instructed to set up a system sufficient in the terms and conditions of the industry to ensure compliance, to ensure the officers report back periodically and report any substantial non-compliance?

Holding: Defence of due diligence failed because they could not establish they took all reasonable care.

TEST: How a corporation can establish due diligence:

- Did the accused exercise all reasonable care by establishing a system to prevent commission of the events and take reasonable steps to ensure it was effective?
- The availability of the defence to a corporation will depend on whether such DD was taken by those who are directing mind and will of the corporation, whose acts are therefore in law, the acts of the corporation
- Do not have to meet a standard of perfection- just have to show a proper system and reasonable steps
- Assessed against the standard of a reasonable person in similar circumstances

R v Syncrude Canada Ltd

Facts:

- Birds died in S's tailing pond
- S tried to establish due diligence as they had a bunch of deterrents in place
- However, deterrents were not set up until a month after the hazard as in place.
- S had just made cuts to their environmental department, and the head of department was not educated in bird deterring.
- Also competitors had better deterrents that S did not have

Issue: Is S liable for violating environmental legislation? **YES.** Can S prove it took all reasonable care as a defence? **NO.**

Analysis:

- In strict liability cases the Crown still bears the onus of proving BARD that the accused committed the prohibited act. The defence must establish reasonable care on a BOP.
    - Not up to the prosecution to prove negligence, rather up to the defendant t prove that all due care was taken.

- Due Diligence:
    - Not a standard of perfection
    - Defence of due diligence will be available in a prosecution for strict liability if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent; or if it took all reasonable steps to avoid the particular event
    - The availability of the defence to a corporation will depend on whether due diligence was taken by those who are the directing mind
    - To meet the onus- do NOT have to prove that it took ALL POSSIBLE STEPS, rather need to show the existence of a "proper system" and "reasonable steps to ensure the effective operation of the system"
    - List of factors that may be considered included:
        - The nature and gravity of the adverse effect
        - Foreseeability of the effect
            - Foreseeability is considered to determine if the accused has taken reasonable steps.
                - Only required to take steps that it can reasonable foresee.
            - The test is not whether the accident was foreseeable, but whether a reasonable person would have foreseen the circumstances that led to the accident and created a hazard requiring remedial intervention.
        - Alternative solutions
            - To plead the defence of reasonable care the accused must establish on a BOP that there were no reasonable feasible alternatives that might have avoided or minimized the injury
                - In this case, alternatives were found.
        - Skill levels expected of the accused
        - Complexities involved
        - industry standards
        - legislative or regulatory compliance
        - Character of the neighbourhood
        - What efforts have been made to address the problem,
        - Promptness of response,
        - Matters beyond accused's control,
        - Preventative systems,
        - Economic considerations, and
        - Actions of officials
- S also argued de minimis, which is controversial because it says to the public "what we did is not that bad" which almost comes across as not caring.

Holding: S found guilty and had to pay over $3million in fines.

CONTRACTUAL LIABILITY

At common law, a corporation's contractual liability is tied to:

1. **The *ultra vires* rule (S 16 and 17(3) *ABCA*)**
    - Describes a class of acts of a body beyond its powers or jurisdiction

- Idea: a corporation comes into existence with the limited capacity conferred upon it by its constituting documents. By virtue of this, a corporation cannot act outside these boundaries because it does not exist outside these boundaries.
    - Under the memorandum of association in place at the time, corporations would have to write "object clauses" which would be strictly respected by the Court
    - Policy justification: to protect shareholders and creditors by barring the corporation from entering into unauthorized contracts
- **S 16:** A corporation has the capacity and rights, powers and privileges of a natural person
- **S 17(3):** No act of a corporation, including any transfer of property, is invalid by reason only that the transfer is contrary to its articles (taking a big stp back from *ultra vires*, it essentially has no operation under corporate legislation)
- **Application today:** Instead of having an objects clause, if the corporation is restricted from carrying on specific business, these restrictions are specified – but, the doctrine of ultra vires can still operate in specialized circumstances (*Pickles*)

Jon Beauforte (London) Ltd Re

Facts:

- A company was authorized by its memo of association to carry on business of costumiers, gown makers and related activities, but then decided to undertake te business of making veneered panels (which was ultra vires)
- The company later went into compulsory liquidation.
- Proofs of debt were rejected by the liquidator on the basis that the contracts to which they were related were ultra vires.
- Creditors did not have knowledge of this and sought to be repaid.

Issue: Do the creditors have a claim? **NO.**

Analysis:

- Creditor argues that the business needed his supply for its legitimate business and he cannot be prejudiced by its misapplication
- Court held that since they had constructive notice of the contents of the memo of association, they had notice the transaction was *ultra vires*
- Claim was rejected

Holding: Unfairness here- doctrine is inflexible.

- The CL in AB has changed this though due to s 16 and 17(3) of ABCA

Communities Economic Development Fund v Canadian Pickles Corp

Ultra vires is alive in certain circumstances (including special act corporations) but in other cases has been essentially repealed

Facts:

- The CEDF was a lending institution created by statute.
- CPC was approved for a $150,000 loan with a personal guarantee by the directors
- The CPC defaulted on the loan and the appellant sued the company and the guarantors for repayment
- The respondents argue that the CEDF could only get its power from the statute and this the loan was ultra vires

Issue: What is the applicability of the doctrine of *ultra vires* to a statutory corporation? **CAN STILL BE ALIVE.**

Analysis:

- **The general doctrine of ultra vires is not in accordance with sound policy anymore (CL essentially repealed here)-** it was created to protect creditors by ensuring that the company's funds that would pay the creditors were not used in unauthorized activities, and to protect investors by allowing them to know how their money was being used.
- However, limited aspects of the doctrine may be present with respect to corporations created by special acts for public purposes
    - This protects the public interest because a company created for a specific purpose by an act of a legislature should not have the power to do things that will not further that purpose
    - **Here, it is a special act corporation**
        - ***Ultra vires* applies because it protects the public purpose- a company created for a specific act by the legislature should not be able to cat outside of its purpose**

Holding: So, since CEDF was not expressly or impliedly granted this power to act outside its statutory object, ultra vires applies.

2. **The Constructive Notice doctrine (s 18 ABCA)**
    - Knowledge of a fact that is presumed or imputed by law.
    - At common law, a person who dealt with a corporate body was deemed to have notice of all contents of all documents that the corporation was required to file with a public office open to public inspection.
    - **S 18:** No person is affected by or is deemed to have notice of the contents of a document concerning a corporation only because the document is filed by the registrar or is available for inspection at a corporation
        - **THEREFORE, DOCTRINE OF CONSTRUCTIVE KNOWLEDGE HAS BEEN STATUTORILY REPEALED** in these circumstances

3. **The Indoor Management rule (s 19 ABCA)**
    - Those dealing with the company are not affected by the 'indoor management' of the company, meaning the indoor rules governing how things are o be done.
    - Outsiders are entitled to assume that the internal procedures of the company have been fulfilled, absent notice to the contrary.
        - Conversely, the company cannot rely on its own internal non-compliance as grounds for avoiding a contract (unless notice is provided)
    - Purpose is to provide some measure of protection for those who enter into contracts with a company from the consequences of the possibly complex internal organization of the company in question
    - **S 19:** A corporation cannot assert against a person dealing with the corporation that the articles have not been complied with… unless the person has knowledge of those facts at the relevant time.

4. **Agency Law**
    - Authority of an agent can be actual, or apparent. The principal is bound by the agent's conduct f the agent is acting with authority.
    - The main question here is: to what extent is a corporation (the principal) permitted to prejudice outsiders by citing a deficiency in the agent's authority? When do we say a corporation has held out as having specific authority?
    - The outsider cannot assume that authority was conferred when it was only *possible*- this can only be assumed when the apparent authority is traced to a representation by an authorized officer (either appointing him to a position with such authority or by specifically holding out)

Agency Overview

(*Freeman, Canlab, & Dorion*)

Freeman's requirements regarding ostensible/apparent authority have been approved by the SCC in *Canlab* and in AB in *Dorion.*

Requirements to establish ostensible authority:

1) A representation was made to the plaintiff that the agent had authority
2) Representation made by a person who had actual authority (directors authority to manage comes from s 101(!) of the Act)
3) Third party (contractor) was induced by the representation to enter the contract
4) Under its memorandum or articles of association, the company was not deprived of the capacity to enter into a contract of that time (also make sure it was not ultra vires)

How to establish ostensible authority:

1) **Route 1:** Representation by virtue of the office/apparently held by the agent (*Panorama/Freeman/Dorion*)
2) **Route 2:** Representation as to Agent's authority by a corporate representative with actual authority to make such a representation (*Canlab*)

Panorama Developments Ltd v Fidelis Furnishing Fabrics Ltd

Ostensible authority found to exist through appointment of an individual to a position of authority.

Facts:

- F's secretary fraudulently rented luxury cars from P under the guise that he was doing so for his company
- He used the company's forms to do so and signed his name as the secretary of the company
- This defrauded his company from large sums of money.

Issue: Was F responsible? Did the secretary have authority to do this? **YES.**

Analysis:

- Need to look not just at the contracts there were signified, but the circumstances as a whole
    - Here, the hiring agreements were the 'machinery' for carrying the correspondence into effect
        - They were stamped with the company name and signed for by the secretary, so the contract was with the company and not personally with the secretary
    - The role of the secretary had changed considerably, he was not just a clerk but regularly made representations on behalf of the company and enters into contracts

        - The secretary had the ostensible authority to enter into contracts for hire of the cars, so the company has to pay for them.
    - Need to be aware of who you employ
        - Take the risk that employee's will be honest in transactions
- **Argument for actual authority:**
    - Corporate secretary has extensive powers, could argue for liability based on actual authority because his job title confers actual authority to the world
    - This analysis would often work but courts usually jump to ostensible authority instead
- **Argument for ostensible authority:**
    - Need a representation by the defendant corporation F to P, regarding the secretary's authority
    - Representation here is by the board of F appoint him to his position- the board has clothed him with the authority through the appointment of his job

Holding: F has to pay the car tab even though it received no benefit because ostensible authority was found.

Freeman and Lockyer v Buckhurst Park Properties Ltd

Leading discussion of actual and ostensible authority- here found ostensible authority in a permissive manner because the corporation held K out through its conduct

Facts:

- K was a property developed and entered into a contract to purchase an estate with assistance from H.
- They formed a LLC
- K, to the knowledge of the board, acted as if he were the managing director to finding a purchaser for the estate
- Without express authority from the board, he employed architects and employees.
- The firm seeks to claim their fees from the company

Issue: Is the defendant (B) or K liable? **THE COMPANY, B, IS.**

Analysis:

- The articles (like bylaws) contain the power to appoint a managing director, none were appointed, but basically this is what K did and everyone agreed
- If there is a contract it is between B and the architects, not K.
- Actual and apparent authority are independent of one another- it is the apparent authority of the agent that the contractor normally relies on in the ordinary course of business when entering into contracts
    - **Actual authority:** legal relationship between the principal and agent created by a consensual agreement to which they alone are parties (contractor is a stranger). If the agent enters into a contract pursuant to actual authority, it creates contractual right and liabilities between the principal and the contractor.
    - **Apparent authority:** legal relationship between the principal and contractor created by representation, made by the principal to the contractor, intended to be and in fact acted on by the contractor that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the apparent authority, so as to render the principal liable to perform any obligations imposed on him by the contract

        - The representation acts as an estoppel, preventing the principal from asserting that he is not bound by the contract.
        - **Representation of agent's authority must come from someone in the company who has actual authority.**
- **Test that allows a contractor to enforce against a company (when an agent has apparent authority):**
    - A representation was made to the plaintiff that the agent had authority
    - Representation made by a person who had actual authority
    - Third party was induced by the representation to enter the contract
    - Under its memo or articles of association, the company was not deprived of the capacity to enter into a contract of that time.

Holding: Directors were found to have represented K, so the corporation is thus liable to pay under the contract by virtue of K's ostensible authority.

Dorion v Manufacturs Life Insurance

Facts:

- D had $60,000 in their bank because the deposit on their new house was not due for 2 months, so they decided to invest it
- They asked a Manulife Investment Advisor, for investment advice on no-risk ventures and ended up purchasing a product they did not know was not Manulife and turned out to be a fraud.

Issue: What is the nature of the investment advisor's relationship with M? **EMPLOYEE.**

Analysis:

- Advisor had no actual authority to make contracts on behalf of M in his agreement with M, he was not an agent
    - His relationship was also non-exclusive (he could sell investment products of other companies).
    - Devon is not a Manulife product. He also paid for his own staff, etc.
- **Test:** Whether the person performing is doing so as a person in business or on his own account, consider:
    - Level of employer control
    - If the worker provides own equipment
    - Worker hires own employees
    - degree of financial risk taken by the word
    - Degree of responsibility for investment and management by the worker
    - Worker opportunity to profit
- To test for ostensible authority, the court uses *Freeman*
    - On the strength of Manulife's marketing techniques, D's placed reliance and thought advisor was a Manulife agent
        - This reliance caused the loss, so they have met the test,

Holding: M held out the advisor as its employee. The failure of the advisor to inform them they were not investing with M is a misrepresentation.

Canadian Laboratory Supplies Ltd v Englehard Industries of Canada Ltd

Facts:

- C bought platinum from E and would regularly sell the scrap back to E
- Cook, the rogue, contacted E and said that a scientist named "G" was conducting top secret experiments and needed platinum.
- E agreed to ship platinum ordered by C and to accept scrap returns directly from "G" and make payment for the scrap returns directly to "G".
- Cook managed to run the scheme for almost 7 years at which point he was discovered and interrupted.
- By this time, Cook had stolen well over a million dollars via platinum scrap reimbursement payments.

Issue: Is E liable to C in conversion? If so, at what point does its liability end or is it liable for C's whole loss? When does E have proper instruction binding on C to do what it did?

Analysis:

- 1962: Fraud begins- Cook asks E to send scrap payments directly to G
  - Cannot bind C at this point because no binding representation by C that Cook had any authority
  - E is liable in conversion starting at this point
- 1966: E makes inquiry to S about G
  - At this point, C is bound so E's liability in conversion ends
    - S was a purchasing agent so had actual authority to handle the matter
- 1968: Representations by C's VP operations
  - These representations would definitely bind

Dissent:

- Says there is not liability in 1966 because S had no managerial authority and thus no actual authority t make representation as to Cook's authority.
- "The casualness with which E acted in respect of its transactions with the unknown G – indeed, the evidence does not disclose that E ever saw Cook- deserves the castigation which TJ heaped upon- C was swindled by the crafty manipulations of a dishonest employee. However, E should have been on-guard by the bizarre request"

Holding: Liable for conversion from 1962-1966.

CHAPTER 6: CORPORATE GOVERNANCE

INTRODUCTION

Corporate governance includes the process by which a corporation is directed and controlled by the board of directors.

Role of Board of Directors

Section 101(1) ABCA: directors shall manage and supervise the corporation

Directors have essentially the same responsibilities and liability whether the corporation is large or small (except for obligations imposed by securities law). Shareholders elect directors- their role is one of stewardship.

Directors also owe a fiduciary duty under s 122 – they must act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence, and skill that a reasonably prudent person would exercise in reasonably similar circumstances.

General requirement of the board include:

1. Appointing and supervising the CEO and other officers
2. Directing and evaluating strategy
3. Representing shareholders and maintaining shareholder relations
4. Protecting and enhancing the company's assets
5. Fulfilling fiduciary and other legal requirements

Officers: also bound by s 122, they are responsible for day-to-day operations of the business and typically enter into contracts for the business. Top officer is usually the CEO.

Shareholders: do not directly manage or have a direct role, but do exercise power through electing the board.

2019 Business Roundtable Statement on the Purpose of a Corporation

The purpose of the corporation is not just to make money for shareholders, but also to deliver value for all stakeholders. In this way, the corporation is to be governed with a broader perspective and broader goals (including customers, suppliers, communities, etc.). This is consistent with s 122 of the ABCA.

Principles of corporate governance:

1. Strategies are intended to build sustainable long-term value and management support this purpose
2. The audit committee of the board retains and manages the relationship with outside auditor
3. Corporate governance committees play a leadership role in shaping AN ENGAGED AND DIVERSE corporate government of a company
4. Compensation committee of the board develops an executive compensation philosophy
5. Board and management should engage with long-term shareholders
6. Board may consider the interests of all of the company's constituencies.

Statutory Provisions Concerning Directors

- **S 101:** subject to any USA, the directors manage and supervise the management of the business and affairs of a corporation
- **S 105:** qualifications of directors – certain people are excluded – no minors, no one with capacity issues, not an individual (note that a corporation can be a person but not an individual, need a high degree of accountability)
    - No longer any citizenship or residency requirements
- **S 106:** Election and appointment, at the time of sending articles of incorporation, the incorporators must send a notice of directors o the Registrar for them to file
    - Directors elected by ordinary resolution, s 106(3)- shareholders shall, by ordinary resolution, elect directors to hold office for a term expiring no later than the close of the next annual meeting of shareholders following the election

Cumulative Voting

- **S 107 of the ABCA** provides that if the articles provide for cumulative voting, the shareholder 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. The shareholder may cast all those votes in favour of one candidate, or distribute them among the candidates in any manner.
    - **This means that each shareholders is entitled to vote the number of shares she holds multiplied by the number of directors to be elected and can concentrate those votes how they see fit.**
- Rationale: provides a way for minority shareholders to possibly get a member on the board and have a voice, as opposed to in simple majority voting procedures where if a shareholder has more votes, they can get all their favourites elected.

Example: A holds 101 shares and B holds 400 shares. There are 4 directors to be elected.

- Following a simple majority procedure, A cast 101 votes on C, D, E, and F. But B casts 400 votes on completely different directors. Therefore, anyone B votes for wins.
- However, under cumulative voting, A has 404 votes and puts them all on C. B has 1600 votes and allocated 40 on G, H, and I, but only has 385 left to put on J. Therefore, A got 1 representative on the board.

Removing a Director

- **S 109(1):** Subject to a USA, Directors can be removed by a simple majority.
- **S 242(3)(f) and 241:** If no majority power, disgruntled shareholders can seek removal of a director subject to an oppression or derivation action.

Diversity Reporting

Bill C-85: Board compensation from a diversity perspective is a recent phenomenon. New amendments to the CBCA require diversity reporting from all distributing corporations.

- In terms of disclosure, if you are required to report diversity, it has to be done as per s 172.1
    - Every annual meeting will have a diversity report given to all shareholders and to Corporations Canada
    - 4 groups required to include in disclosure:
        - Aboriginal peoples
        - Persons with disabilities
        - Members of visible minorities, and
        - Women
    - Companies can elect to provide disclosure in respect of additional designated peoples identified in their information circulars.
- Rationale for this amendment: diversity is linked to competitive advantage and social justice
    - Corporations seen as owing special responsibilities in some way, so leaders have accountability on this front
        - But unclear how far this actually goes in practice.

STATUTORY DUTIES OF DIRECTORS AND OFFICERS

Directors Fiduciary Duty, Duty of Care, and the Business Judgement Rule

S 122(1) of ABCA states: 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; and
(b) Exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances

Peoples Department Stores Inc (Trustee of) v Wise

Facts:

- W and P were department stores. W expressed an interest in acquiring P from its British parent company.
- Under the agreement, W had to pay the parent company the purchase price over 8 years before the merger.
- They adopted a joint inventory procurement policy that meant that P took on more debt for W than the other way around. Both ended up declaring bankruptcy.
- The trustee in bankruptcy brough an action claiming that the Wise Brothers, as directors of P, had favoured the interests of W to the detriment of P's creditors in breach of duties of directors under s 122(1) of the ABCA

Issue: Did W Bros breach s 122? **NO.**

Analysis:

- S 122(a) of CBCA- fiduciary duty:
  - Court said the fiduciary duty is not owed to creditors, rather owed to the corporation only under sub(a), so the creditors lose on this point
  - While directors may owe creditors a fiduciary duty based on other circumstances, it would not be because of sub(a) – this does not create a fiduciary duty for creditor under any circumstances
  - Here, there was no evidence of personal interest of improper use in the procurement policy by W, they were trying to make both corporations better so did not breach their duties
  - Best interests of the corporation means maximization of the value of the corporation
    - But courts have recognized that other factors may be relevant in what directors should consider in managing the interests of the corporation
      - In determining if they are acting with a view to the best interests of the corporation, should consider the broader interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment
- S 122(b) of CBCA- duty of care
  - This duty can be owed beyond the corporation
  - Directors and officers won't be held in breach of the duty of care under the statute if they act *prudently and on a reasonably informed basis*
  - Under the statute, the standard of care is objective

        - Directors and officer must make reasonable business decisions in light of all this information, including socioeconomic situations they were, or should have been, aware of
    - No breach found here – directors owe a duty of care, but did not breach this duty as it was a reasonable business decision to rectify a serious and urgent business decision
- S 122(1): Directors automatically owe a duty of care to the corporation, but the question is whether they owe this duty to creditors.
- **Business judgement rule:**
    - Tribunals should refrain from finding directors liable for business decisions when 2 steps are met:
        1) **Good decision-making process:** directors must act prudently and on a reasonably informed basis
        2) **Examination into the reasonableness of the decision made:** decisions must be reasonable in light of all circumstances that the directors knew or ought to have known
- Other cause of actions or alternatives:
    - S 240- Derivative Actions: creditors seeks to bring an action on behalf of Peoples for a wrong done to the corporation (not mentioned by the SCC)
    - S 241 CBCA/ 242 ABCA- Oppression: Creditors sue the directors/corporation for conduct that is oppressive, unfairly prejudicial, or unfairly disregards interests of creditors.
        - Argument is based on notion that creditors have a reasonable expectation that W and P would share debt exposure more equitably, as mentioned by the SCC

Holding: No breach of the standard of care because of the business judgment rule, so the creditors could not successfully sue the directors.

Defence for directors under s 123(3): A directors is not liable and has complied with their duties if they exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances including reliance in good faith on:

- Financial statements or
- An opinion of report of a professional or employee with expertise in that area
    - JUST because someone has a title does not mean the person lends credibility, and therefore, litigation will typically revolve around whether the person is an expert
        - This does not happen in cases of professionals, because if they have the title it means the must be a reliable source of information.

Transportaction Lease Systems Inc v Weaver

Follow up from *Peoples, Livent* test for negligence

Facts: Creditor sues a number of directors arguing they breached duty of care owed to them under ABCA.

Issue: Does the creditor have a good cause of action against the corporate directors VP of Finance under s 122 of the ABCA? **NO.**

Analysis:

- **Test for negligence:**
    - The defendant owed a duty of care
    - The defendant's behaviour breached the standard of care

    - The plaintiff sustained damage; and
    - The damage was caused, in fact and in law, by the defendant's breach.
- **So, what does *Peoples* mean in Alberta?**
    - In *Peoples,* the duty of care formed the basis of the plaintiff's action under the QB Civil Code. However, this does not detract from the clear statement made that a stakeholder, including a creditor, has no direct action under the CBCA and therefore, none under the ABCA.
    - Basically, s 122 is an anti-*Peoples* provision, basically saying that *Peoples* is no longer law in AB.
    - So, duty of care is now narrowed to exclude third parties unless they can show a

Holding: Directors may owe a duty of care to an outsider based on the common law of torts, but it is NOT because of s 122 itself.

BCE Inc v 1976 Debentureholders

Facts:

- Group of purchases (headed by ON Teachers Pension Plan) proposed a leveraged buy-out of all the shares of BCE (Canada's largest telecommunications corporation)
- Bell Canada (subsidiary of BCE) is to guarantee $30billion of the deb that BCE would incur to do so.
- Bell's debenture holders resisted because they contended that Bell's increased liability would result in the downgrading of the value of their debentures while conferring a benefit on the shareholders
- The buy-out had to be approved by the courts as "fair and reasonable" under s 192.
    - Debenture holders brough an oppression action under s 241 and challenged the approval.

Issue: Have the debenture holders been treated unfairly? **NO.**

Analysis:

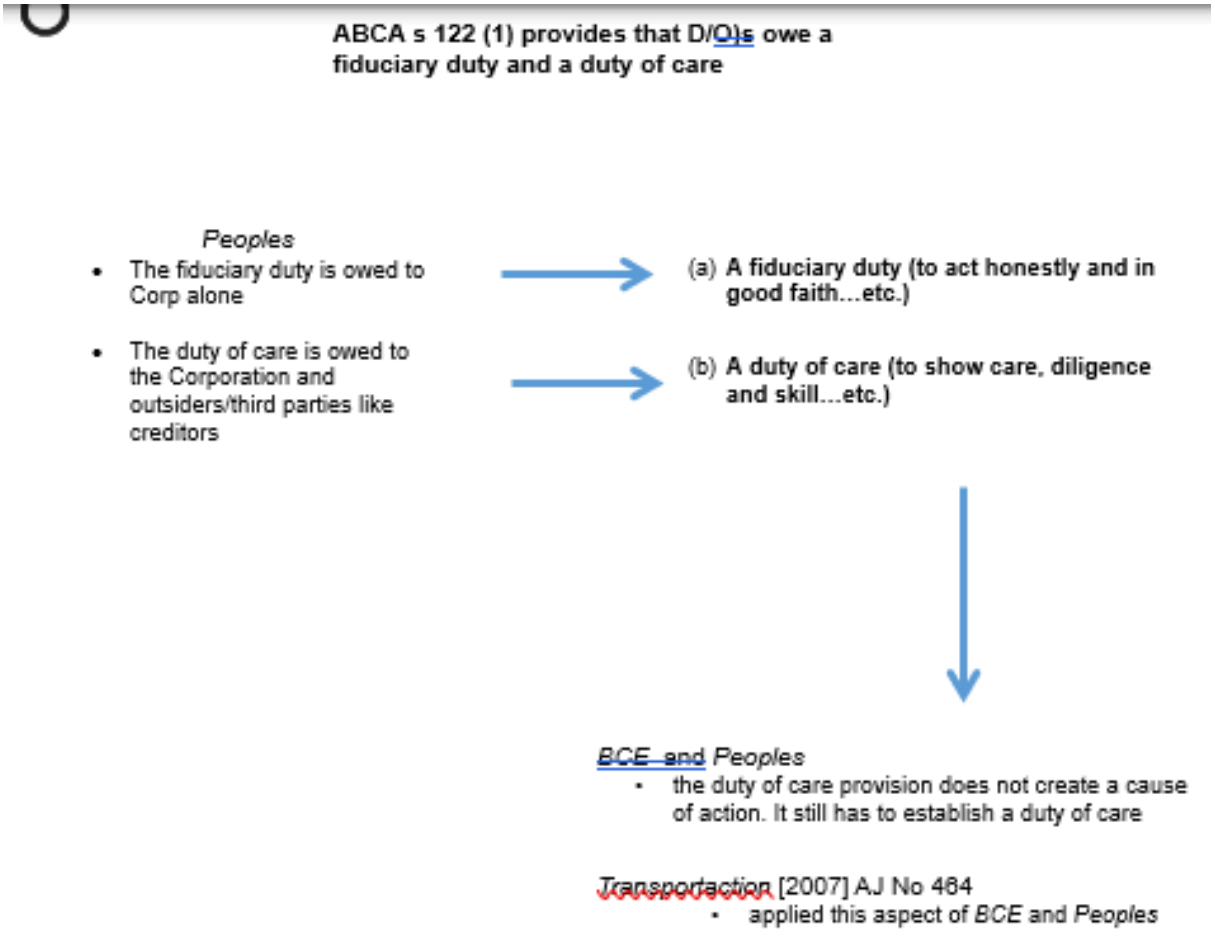
- Court emphasized that the directors are obligated to act in the best interests of the corporation, which involves looking out for a variety of stakeholders (must give deference to the business judgement of directors)
- Duty to act in the best interests of the corporation is a duty owed to the corporation, and would ordinarily fall to directors – but since director are not likely to sue themselves for breaching their own fiduciary duty, the statute provides remedies:
    - **Proceed by way of a derivative action (s 240):** argues that directors have breached their s 122 obligations
    - **Proceed by way of a civil action for breach of duty of care (s 122(1)(b)):** does not provide debenture holders with a statutory right of action against directors, only provides the standard of care. They still have to establish the factors of a negligence action with the legislation articulating the standard of care.
    - **Proceed by way of an oppression action (s 242):** debenture holders had a reasonable expectation that the directors would consider their position and choose a deal that would maintain the investment grade of their debentures
    - **Additional "remedial" provision in s 192 provides for court approval in certain cases:**

- Not a remedy per se, but has remedial like aspects – it is directed at the situation of corporations seeking to effect fundamental changes to the corporation that affects stakeholder rights- the Act provides that such arrangements require the approval of the court
- This review requires a court approving a plan of arrangement to be satisfied that:
    - The statutory procedures have been met;
    - The application has been put forth in good faith;
    - The arrangement is fair and reasonable
- If any element fails, approval is withheld.

- Debenture holders lost their oppression action – court said the deal could proceed because no matter what deal the board chose, they would not do well – provided deference to business judgement
- No provision in the contract that the investment grade of the debentures would be maintained

Holding: Confirms and echoes *Peoples* for s 122. Affirms that directors/officers only have a fiduciary duty to the corporation. If conflict between the corporation and other stakeholders exist, the duty is owed to the corporation.

Summary of *Peoples* and *BCE* s 122



- **ABCA s 122(1) provides that directors owe a fiduciary duty and a duty of care:**
  - Fiduciary duty is owed to the corporation alone (*Peoples*)
  - The duty of care is owed to the corporation and outsider/third parties like creditors (*Peoples*)
  - The duty of care provisions does NOT create a cause of action
    - Still has to establish a duty of care with common law principles and test from *Livent* (*BCE* and *Peoples*, as applied in *Transportaction*)

Amendments to the *CBCA* re s 122: Bill C-97

Bill C-97 amends s 122 of the *CBCA* to codify *BCE* as follows:

- S 122(1.1): Best Interest of the corporation- when acting with a view to the best interests of the corporation, the directors/officers of ther corporation may consider, but are not limited to the following factors:
  - (a) the interests of: shareholders, employees, retirees and pensioners, creditors, consumers, and governments
  - (b) the environment and
  - (c) the long term interests of the corporation

Overall, it codifies the court's decision in *BCE* affirming the broader stakeholder model and rejecting the shareholder primacy model.

Smith v Van Gorkom (Delaware case)

Section 122(1)(b) case- from the US, example of legal liability faced by directors even when their conduct does not seem to be that far off the case

Facts:

- A class action brought by shareholders of Trans Union against Trans Union for recission of a merger deal, and alternatively seeks damages against the defendant board.
- Board of TU decided to consider the sale of the company
- The CFO reported that a buy-out of TU was possible at $50-60 a share.
- VG, the CEO, indicated that he would accept $55.
- V approached a corporate takeover specialist – idea there would be a cash out merger of TU into New T (shareholders of TU are bought out, they do not get a new interest)
- Dissenting shareholders say the cash out merger approved by the board was at too low a price and they should have held out for a better offer.

Issue: Should the board have approved the offer of $55/share? **NO.**

Analysis:

- Business judgement rule:
  - Unlike n the US, the SCC does not refer to the rule as a presumption
    - Court only says that to rely on the rule, directors have to show that they followed a good process and made a reasonable decision. Once this is shown, the board can rely on the rule (deference to the business decision)
- Test in Canada
  - The plaintiff has to show negligence on BOP.
  - The defendant can successfully invoke the business judgement rule upon proving a good process and reasonable decision.

    - The rule will not protect those who have failed to inform themselves or have made an unintelligent decision.
- Application:
    - Did not meet the standard for the business judgement rule because they failed to properly inform themselves as to V's role enforcing the sale of the company, intrinsic value of the company
    - All they knew was there was a premium being offered above what the shares were traded at but never made an effort to establish if the premium was adequate
    - Should not have relied on a 20 minute presentation, failure to have adequate documents
    - Factors denoting competence can be outweighed by gross negligence

Holding: Board acted on valuation information inadequate to reach an informed business decision on the offer. All directors held jointly and severally for breach of duty of care for $23.5 million – board was personally liable because insurance did not cover everything.

Dissent:

- Argues the directors were very experienced so they did not need the time less experienced directors would have needed to make an informed decision.

BREACH OF FIDUCIARY DUTY

Statement of Law: Due to their fiduciary obligations, directors and officer must avoid a conflict between duty to the corporation, and self interest.

Examples:

- **Taking corporate opportunity:** cannot take a deal that belongs to the corporation, cannot put self-interest above corporation by stealing an opportunity from them.
- **Self-dealing:** where the director is on both sides of the transaction, director will be liable for benefitting from a transaction in which they have an interest. Traditionally prohibited by common law, but there is a gradual loosening of the case law leading up to the legislative response.
- **Competing director:** Directors are to some extent forbidden from competing with their own company. Have to avoid engaging in a competing enterprise.
- **Proper purpose:** ad a fiduciary, a director can only use their power for a proper purpose.
- **Take-over bids:** When directors of a corporation that is the subject of a takeover feel conflicted because if it is successful they may lose their job – can create a conflict of interest (*Maple Leaf*)

Taking Corporate Opportunity

Cook v Deeks

Facts:

- 3 directors of a company carrying on business of railway construction contractors obtained a contract in their own names to the exclusion of the company
- Because they held 3/4s of the issued shares they passed a resolution that the company had no interest in the contract

- C brought an action on behalf of the other shareholders and the company seeking a declaration that the benefit received by the defendants was held on trust for the benefit of the company – basically they worked to exclude C

Issue: Have the directors appropriated a corporate opportunity? **YES.**

Analysis:

- Fiduciary Duty:
  - The directors violated fiduciary duty by taking an opportunity that belonged to their company
  - Those who assume complete control over a company's business must remember that they cannot just operate in their own personal interests and divert in their own favour business that should belong to the corporation
- Shareholder ratification
  - Shareholder ratified what happened here – does not matter because the majority is making a present of something to themselves, thus oppressing the minority

Holding: Directors had to turn over all the benefits they received.

Canadian Aera Service Ltd v O'Malley

Facts:

- 2 officers at the centre of the plaintiff corporation (Canaero)
- By the time contract was out for tender, they had resigned and created a new corporation, Terre, the purposes of which were to engaged in the exact same business
- They then submitted a bid for the same contract that they worked on for their previous company

Issue: Did the individual defendants breach their fiduciary duty to C and take a corporate opportunity belonging to C? **YES.**

Analysis:

- Rule:
  - The corporate opportunity doctrine precludes a fiduciary from obtaining himself any property or business advantage either belong to the company or which has been negotiated
  - **Does not have to be appointed as director to find liability as such**
    - Duties apply equally to any officials of the company authorized to act on its behalf, in particular those acting in a managerial capacity
  - Here, the SCC said that they were more than employees, they were members of senior management and thus had a fiduciary duty
- Timing: Argued that the opportunity was not a corporate opportunity, just a ripening
  - Need to avoid a conflict of interest by not usurping or diverting a maturing opportunity – **does not matter if its ripening or mature**
- Resignation: **The fiduciary duty can survive past resignation depending on the circumstance**
- Difference: Argued the proposals were slightly different and C would not have been awarded the contract
  - Directors cannot create their own escape hatch by creating the first proposal as different

- Irrelevant if C had obtained the contract or not because at the relevant time, they had not abandoned hope that it would be awarded to the,

- This area of law is strict
  - But takes a big step back from *Regal Hastings* which was very strict
  - Need to ask: **In fairness, does the opportunity belong to the corporation or not?**
  - Laskin gives a non-complete list of influencing factors, which include:
    - Position heled
    - Ripeness and specificness
    - Directors or managerial officer's relationship to the opportunity
    - Amount of knowledge possessed and circumstances
    - Circumstances of obtaining the opportunity, including if it was special or private
    - Time and continuation of the fiduciary duty and the alleged breach
    - Circumstances of ending their relationship

Holding: The duty to avoid conflict of interest with the corporation includes not only the director's personal interest, but also those of any other corporation in which the director is interested.

- As a remedy, Canaero can disgorge the profits that Terra made from having been awarded the contract or proving what its loss of profit had been had it won.

Matic et al v Waldner et al

Explains and amplifies *Canaero*

Analysis:

Considerations for when something is considered taking a corporate opportunity:

- **Nature of a corporate opportunity:**
  - Need to determine if the opportunity belonged to the corporation
    - This requires a contextual analysis and is a fact intensive exercise
- **Mature business opportunity:**
  - Some divergence in case law as to whether and to what extent a business opportunity must be "mature" for its diversion to constitute a breach
    - Some decisions employ a strict or broad interpretation
  - But, the ethic imposed on fiduciaries applies to "potential" opportunities as well as maturing ones as per *Canadian Aero* and *Sports Vila*
  - A potential conflict must be a real, sensible possibility and more than a theoretical conflict
- **Active pursuit:**
  - A factor related to the maturity of the opportunity is the extent to which the corporation is actively pursuing the opportunity- some courts have questioned the importance of this
  - Main view is that a breach of the duty can occur when the diverted opportunity is one that the corporation is not actively pursuing
- **Circumstances in which opportunity obtained:**
  - This is included in the list of potential factors to consider in *Canadian Aero*
  - The manner is not determinative, but just another factor to consider
- **Limits on liability of directors and officers:**

    - Another way to analyze the extent of the duty of a director under the corporate opportunity doctrine is to examine whether any defences may be raised by them to limit their ability
- Overall goal: to determine whether the opportunity fairly belong to the corporation in the circumstances

Holding: taking a corporate opportunity does not just include taking a matured opportunity, but could on the right facts include taking potential opportunities. It can be taking a corporate opportunity even though the corporation in issue has not expressed an active interest in the opportunity.

Self-Dealing

Common Law

Aberdeen Railway Co v Blaikie Bros

Facts:

- B was a director of A
- A entered into a contract for the purchase and sale of chairs
- B said he could source the chairs from his partnership, B Bros

Issue: Is this a self-dealing contract, making it voidable at the option of the purchasing company, A? **YES.**

Analysis:

- A got the contract set aside on the basis of B being involved on both sides
- No evidence that B ripped anyone off or that the contract was unfair or improvident
    - common law is guarding against the appearance of bias and possibility that something might be unfair
- The court does not have to launch an inquiry to determine if the conflict of interest may have impacted the terms f the contract
    - The concern is what creates the rule against self-dealing.

Holding: B should not have been involved, the contract is set aside because of his involvement.

Evolution of Approach to Self-Dealing Contracts

Stage 1: English Common law has made an absolute bar on self-dealing contracts.

- NO requirement for wrongful conflict or benefits
- As per *Aberdeen*

Stage 2: Law evolved, partial opening

- If the articles/bylaws included a provision that allowed the directors to enter into certain self-dealing contract, it was permissible
- Typically would have a requirement that the interest would need to be disclosed. If the deal was not oppressive or a fraud, it was ok.

Stage 3: Self-dealing contracts are permissible if they are disclosed by the directors and ratified by shareholders at a general meeting

- This development comes from agency law
- Idea that a principal could ratify the unauthorized act of the agent, so the shareholders are ratifying what happened as the company
- As long as there is no fraud on the minority, the self-dealing director could vote his shares as a shareholder (*Northwest Transportation*)

- Fraud on the minority = appropriating for oneself money or other advantage that belongs to the corporation or in which all the shareholders should participate. It is a limit on majority rule, impugns conduct that is so outrageous the court will intervene.

Northwest Transportation Company Ltd v Beatty

Facts:

- One of the directors proposed to sell a steamship to a company. The directors all approved.
- Went to shareholders for ratification.
- It was ratified, but important to the win was Beatty's shares (could not have won without this)
- Minority shareholders challenge the transaction

Issue: Is the self-dealing contract voidable, or does ratification insulate it? **INSULATED IT.**

Analysis:

- Ratification insulated the transaction from attack – even though the interested directors votes as a shareholder and his votes made the difference in it passing, he is subject to vote as he sees fit (excluding fraud and oppression)
  - No fraud or oppression found here.

Holding: This was properly done, and the deal was fair, so ratification stands.

Legislative Approach to Self-Dealing Contracts (s 120 of the ABCA)

If you want to enter into an enforceable self-dealing contract, s 120 stipulated certain requirements that must be met for it to be valid. These requirements include:

- Disclosure in writing/minutes under s 120(1) and following
  - Also see s 120(7) disclosure via general notice will do if certain conditions are met
- Approval by the appropriate body
  - S 120(6): A director referred to in (1) shall not vote on any resolution to approve the contract/transaction unless the contract is within certain limits
  - S 120(5): If would not require approval by director or shareholders, then just shall disclose in writing to the corporation of the nature and extent of their interest.
- Proof that contract is fair and reasonable at the time it was approved
  - S 120(8): basically should have disclosed and followed the steps – but if there is a special resolution (2/3rd majority) and sufficient disclosure, and the contract is fair and reasonable at the time, you're ok
    - But if there is a failure to comply with this, the court has jurisdiction under s 120(9) to set aside on any terms that it thinks fit, or require an accounting or both
  - S 120(8.1): Known as the "Whoops" provision
    - Even if the condition of sub(8) are not met, a director or officer acting honestly and in good faith is not accountable to the corporation or to its shareholders for any profit realized from a material contract or material transaction for which disclosure is required under sub (1), and the material contract or material transaction is not void or voidable by reason only of the interest of the director or officer in the material contract or material transaction IF it was approved, if disclosure was made, and if it was reasonable

So, when a director has a material interest in the transaction and it is a self-dealing contract, there are two options:

1) Director discloses the material interest as per s 120:
    a. Sec 120(8) says that the contract is not void, and there is no liability for the director/officer
2) The director did not disclose the material interest before:
    a. The transaction can be subsequently approved and be valid under s 120(8.1)
    b. The contract can be set aside by the court on any terms if it sees fit as per s 120(9)

What kind of director involvement is caught by the requirements of s 120?

- **Direct:** Director is party to a material contract or transaction (*Beatty*) OR
- **Indirect:** Director has a material interest in any person who is party to the contract (s 120(1)(b)
    - What counts as material?
        - Financial = yes
        - Relationship/emotion-based = Maybe
    - No definition for material in Act.
        - *Dimo*… narrow view that material is a financial interest that is more than significant
            - An interest in which an individual could exercise discretion or control over sufficient shares so as to affect the financial outcome of the company – if you have this power, must disclose
        - *Zysko*… broad view that material interest incomes more than financial interests
            - If there is a possibility that the director is to benefit from the contract more than *de minimis,* then the transaction should be disclosed
    - Overall: If a corporation would undertake additional due diligence to determine whether the contract or any of its terms is truly in the best interest, or if it would assign another drector to handle the negotiation, then the interest is material and should be disclosed (*Zysko*)

Dimo Holdings Ltd v H Jager Developments

Facts:

- M was the director of J, and his wife was a director and shareholder of D
- D sent J $50,000 on an emergency basis to promote a failing concert
- The whole loan remains unpaid because the concert was a financial disaster
- D sues J and wants a summary judgement.
- J says M made no disclosure of his interest under s 120 so the contract should be set aside pursuant to s 120(9)

Issue: Is the contract caught by what is now s 120 of the ABCA (ie. was M required to disclose?)? **NO.**

Analysis:

- Material interest:
    - Court allows people to structure their own financial affairs

        - Here, there was no allegation of fraud, no evidence that this structure was created to defat J's rights
    - M is only required to disclose HIS material interest, not his wife's
    - On this basis, s 120 does not apply, M is not a director, officer, or shareholder in D.
- Disclosure under s 120(9)
    - If the contract is fair and reasonable to the corporation at the time it was approved, courts should be reluctant to set the contract side (no harm no foul)
    - Here, M dd not profit from the contract (except for a modest interest rate)
    - Court did not want to set the contract aside and forgive the debt – beyond this, the court confirms that even in the absence of an enforceable contract, J would be obliged to pay the debt subject to the principles of unjust enrichment.

Holding: On the basis of unjust enrichment, the money has to be paid

Note: financial vs emotional material interest

- Court in *Dimo* says material interest does not include anything that is not financial – but the statute does not specify, so maybe the intent was to keep flexibility
- Keep in mind the purpose of the legislation:
    - To identify transactions where the directors' ability to bargain fairly is compromised by an interest on the other side
- BUT couldn't we say that M's emotional interest in his wife might compromise his ability to bargain on behalf of J? Could argue that s 120 include *indirect financial interest*

Zysko v Thorarinson

Facts:

- EJSE wants to buy and develop land
- The land is owned by three individuals, who are later told to run the corporation through holding companies
- Notably, all documents are prepared by the husband and wife, but husband-wife's actions here expressly went against the USA

Issue: Is the mortgage and other security granted by the corporation valid? Does s 120 apply? **NO and YES.**

Analysis:

- The mortgage was a material contract under s 120(1)(a)
- **Any personal relationship or monetary interest that an individual may have in the other side that might be thought to be an inhibiting factor is a material interest**
    - Overall: material is more than financial
- Rule of thumb: there should be disclosure whenever the director or officer's involvement might be relevant to the corporation's decision-making process
    - This means that if the corporation would undertake additional due diligence to determine whether the contract or any of its terms are truly in the best interest, or if it would assign another director to handle the negotiation. Then the contract is material and must be disclosed
- *Welling*: problem of director or officer who has no monetary interest but has emotional interest (like close friend of family member on other side) ought to be suspect

- Material is a question of fact. Disclosure should be done when significant to decision-making process.

Holding: Any interest, including emotional or relationship, can be material.

Competing Director

Common law has been tolerant towards the issue of competing director. It is the idea that we have director of Company A that sits on the board of Company B, a competitor.

London and Mashonaland Exploration v New Mashonaland Exploration Company

Facts: Lord M was the director of a board company and agreed to sit on rival board company. An injunction was sought to stop this.

Analysis:

- No evidence he was about to disclose confidential information
- The Court had no problem with this and refused to issue an injunction
- OB thinks this is a bad case because it is very pro-director:
  - But regardless, if you were to sit as a competing director there will be litigation, cannot count on this case as protection
- The idea is that a competing director is oppressive in that joining the board of a second company is not giving regard to the best interests of the first

Sports Villas Resort Inc (Re)

Facts:

- Dobbin is director of SV and sole shareholder of a golf course
- SV owns the Terra Nova Par Lodge and Golf Course
- SV wants Dobbin off the SV board, stating that Dobbin is a competing director using property information from SV and taking a corporate opportunity.
- SV also wants to remove Dobbin's daughter from the board

Issue: Should Dobbin and/or his daughter be removed from the SV board due to Dobbin's share in the other golf course? **NEITHER SHOULD BE REMOVED.**

Analysis:

- Did Dobbin breach his fiduciary duty?
  - Remember the fiduciary duty does not preclude multiple memberships on the boards of different companies
    - To attempt to strike a balance between ensuring interest of the corporation and societal interests is not retraining corporate directors
  - Because the corporations are not in competing, the competing director issue is not at play (almost 300 kms apart)
- Is Dobbins a competing director?
  - First is to ask whether the corporations are in competition
    - Here they are not.
    - TJ relief on *Slate Ventures*- a director may in certain circumstances engage with a competing business, but fiduciary obligations require them to avoid actions that would conflict with the business interests (OB says do not eely on this)
    - If they were competitors, then virtually no way of not having a conflict of interest.

- Proprietary information: Did D take confidential information and use it or his own benefit?
    - If so, then that is a breach of fiduciary duty
    - However, court held that information here was not unique, it was generic
    - NO evidence that D had used any information from SV

Holding: No competition between corporations = no competing directors issue so long as he did not take any secret information to start the other business.

Take-Over Bids and Defensive Tactics by Management

A hostile take over is unsolicited in the sense that the Board did not seek the offer.

Conflict: During takeovers, a potential conflict arises because directors of a target company have a duty to act in the interests of the company, BUT they also have an interest in maintaining their employment – directors have an incentive to adopt defensive measures to disclosure the takeover.

One way to address this conflict: establish a special committee from the independent members of a board who do not have a conflict (*Maple Leaf*)

- The special committee will advise the directors and make a recommendation to the board
- This protects the interests of the minority shareholders and brings a measure of objectivity to the assessment of bids

Another way to address this is by establishing an auction to ensure the board of the target company acts in a neutral manner to obtain the best value; however, a market canvas may also suffice (*Maple Leaf*)

- The mandate of the directors is to manage the company according to their best judgement – must be informed and have a reasonable basis (business judgement rule)
    - Boards are entitled to consider other offers and other factors beyond finances (*Peoples* and *BCE* and *Maple Leaf*)

Maple Leaf Foods Inc et asl v Schneider Corporation et al

Facts:

- ML announces its intention to make a hostile take-over bid for S
- In response, the Board established a special committee to review the offer and consider other alternatives
- The Family (controlling shareholders of S) ultimately accepted an offer by Smithfield.
- ML says that the actions of the committee were not independent, and that the advice given by the committee to the Board was not in the best interest of S and its shareholders

Issue: Did the Board act in the best interests of S? **YES.**

Analysis:

- Did the directors act in the best interests of the corporation?
    - Boards dealing with a bid that will change control are in a difficult situation – have an ongoing fiduciary duty to act in the best interest, but know that it will likely result in them losing their job
    - If the board acted on the advice of a committee with no conflict of interest and that committee made an informed decision, the business judgment rule apples (deference accorded to the board's decision)

        - But if there are no reasonable grounds to support an assertion by the directors that they acted in the best interest of the company, a court will be justified in finding that the directors acted for an improper purpose (*Peoples*)
    - Board should get the benefit of the business judgement rule here because the decision was informed and reasonable
- Independence of the committee
    - Court held that the committee was independent
    - Even though Dodds, senior management, was permitted to negotiate with potential bidders and would have an interest in the outcome, this does not automatically taint the outcome of the committee
        - He did not sit on the committee and did not have a vote
    - Used S's resources to secure a competing bid?
        - NO- purpose of the special committee is to ensure the interests of those whom the oppression action protects is not disregarded
        - It was in the best interests of the company to get multiple offers
        - Provided bidders unfamiliar to the Canadian market some data
    - Board should have conducted an auction?
        - An auction is merely one way of preventing conflicts of interests
            - The director has to get the best price possible but an auction is not automatically available, dependent on circumstances
        - Board not required to institute a process of competitive bidding
        - Would have le to S's offer being withdraw because it had a no-shop condition attached
    - Not having an auction contract to the minority shareholders reasonable expectations?
        - No reasonable expectation that a public auction would be held – in public statements the company expressed they "might" be interests in selling – was always conditional
    - Board was wrong to waive the standstill provision?
        - Board permitted the Smithfield bid and waived the standstill agreement
        - Special committee exercise business judgement

Holding: Smithfield bid was the only one effectively available to the shareholders. It was in the best interests of all the shareholders.

OTHER SOURCES OF FIDUCIARY DUTY

Tongue v Vencap Equities Alberta Ltd.

Facts:

- T were minority shareholders in a company
- V was the intermediary that purchased T's shares at $0.60/share. It did not disclose that a named buyer was negotiation to buy all the company shares for more than $2 each.
- After T sold their share, V resold them for $2.16/share.
- T sued V claiming civil liability in damages for breach of the insider trading provisions in s 121 of the CBCA and breach of fiduciary duties

Issue: Do the directors owe a fiduciary duty to shareholders? **AS PER ABCA NO, BUT FIDUCIARY DUTY DOES ARISE.**

Analysis:

- **Directors do not owe a fiduciary duty to shareholder's, but there is more law outside the ABCA, in this context, a fiduciary duty can arise (s 122)**
    - Several circumstances where directors can owe a fiduciary duty:
        - When directors are acting outside the scope of their ordinary duties
            - In soliciting and arranging for the disposition of shares for the company, this causes a new role and the director is occupying it outside the scope of their duties
        - When directors are purchasing shares from the shareholders
        - Other grounds:
            - The category of fiduciary relationships is never closed
            - In this case if the court could not have fit the facts under the other two categories, they would have fit it here.
                - Directors used their position for personal advantage at the expense of shareholders.
- **Legal reality that insiders, such as directors, are entitled to buy shares in the company they direct, but not when acting on information hat has not been publicly disclosed (s 130)**
    - This section is a remedy – insider cannot make use of specific confidential information for their own benefit
    - Here the shareholders/directors were successfully sue
- **Releases: T signed releases purporting to disclose of any right of action and forbearing from pursuing new action… do these have effect?**
    - NO- court says they do not bar the action, they can only cover what the party had in contemplation
    - Here, causes of action arising out of fiduciary duty and s 130 were not contemplated
    - Legal advice does not alter this, because the advising lawyers did not have complete information
- **Nature of the defendant's liability: How should the court apportion liability?**
    - Plaintiff's seek joint and several liability – can then enforce a judgment against even one of the directors
    - Court looks at what kind of liability s 130 contemplates – liability is limited to direct loss sustained by the plaintiff
        - Each defendant is liable to compensate for an amount equal to the proportion of the shares purchased on his behalf by the agent V
        - Idea that a direct loss is a several liability
    - Fiduciary loss is joint and several – each defendant is responsible in full, can collect form one or more jointly, or all

Holding: Breached multiple fiduciary duties. This case shows there is a whole area of law outside the ABCA that can be germane to litigation – cannot get too wrapped up in the legation, need to think about other areas of law.

Shareholder ratification of breach of fiduciary duty

- The *ABCA* and *CBCA* have greatly reduced the liability of directors to approve fiduciary breaches – the only places it works is in s 120 self-dealing contract, and the pre-conditions are rigorous

Before *CBCA*: It was possible in most jurisdictions for shareholders to absolve fiduciaries of the consequences of a breach of fiduciary duty by voting to approve, or "ratify" it

- Only circumstances in which a breach could not be ratified were where the transaction was oppressive to the interests of the minority (not effective if it was obtained by some improper means)
- Rationale: that it was needed to balance the strict application of the common law rules as expressed in *Aberdeen*
    - If shareholders decided that a transaction was acceptable, they could approve it
    - Problematic because fiduciary duties flow to the corporation, not the shareholders, and because there was no prohibition against majority shareholders voting their shares to ratify breaches of fiduciary duty in which they were involved in personally

***CBCA*:** Greatly reduced the effect of shareholder approval of fiduciary breaches

- Except in accordance with the scheme for rendering self-dealing contracts enforceable under s 120, a shareholder resolution approving a breach of fiduciary duty does not cure a breach or relieve the fiduciary duty for the breach (s 122(3))
- Only effect of a resolution is that it must be considered by the court in deciding whether to grant a shareholder the right to bring a derivative action on behalf of the corporation for breach of fiduciary duty (s 242(1)), and in deterring whether any action of incorporation or the directors is oppressive
- Means that **shareholder ratification is a small legal effect – but can be helpful in the context of defending an oppression or derivative action under s 243**

Remember sec 122(3): Subject to section 146(7) (shareholders take on directors' duties), no provision in a contract, the articles, the bylaws, or a resolution, relieves a director from the duty to act in accordance with the CBCA or the regulations or relives the director for liability for a breach of that duty

Overall: ratification has a very small influence today in corporate law.

Sitting on your client's board

- Leads to waiver of client's confidentiality, conflicts of interest, etc.
    - Biggest thin is professional liability insurance might be lost
- Suggest not sit as a board members, but to just sit in on meetings to give LEGAL ADVICE
- *Allen v Aspen*: could strengthen relationship, raise profile and increase business but there are risks (could end up dragging firm into the litigation)

Dissenting Director

- Once you vote on something, cannot dissent it
- *CBCA* s 123:
    - (1) Scenario 1: Director is present at board meeting – request dissent or abstention be recorded

- (3) Scenario 2: Director is not present – deemed to have consented unless within 7 days of becoming aware of dissolution request to have dissent recorded either orally or in mail.

OTHER STATUTORY DIRCETORS

Such as environmental statutes (*Batta*) or *Income Tac Act* (*Minister of National Revenue*)

Zwieschke v Minister of National Revenue

Facts:

- Director did not maintain sufficient amounts of cash to pay taxes.
- Company became insolvent and now the state wants its share of taxes from the director

Issue: Is the director liable under the *ITA?* **YES.**

Analysis:

- The corporation was cash poor, and while it did make its source deductions, it failed to remit the money.
- The director is exposed to personal liability for this failure
- Only deference is under the *Income Tax Act* – not liable if you exercise the required degree of care and skill in this context
  - If yes, no personal lability for unremitted source deductions
- Here – cannot rely on this deference because he did not exercise any degree of care, diligence or skill. He managed the company and knew about its affairs.
  - Writing a cheque to the government and hoping it will clear does not count as due diligence.

Holding: Directors did not act responsibly and are liable.

DIRECTORS AND OFFICERS LIABILITY IN TORT TO THIRD PARTIES

Introduction

Canadian common law is fractured regarding whether Directors are personally liable for torts they commit in a corporate capacity. Complicating question is **whether the directing mind of a corporation is also a tortfeasor in a personal capacity, and therefore, should also be personally liable.**

ScotiaMcLeod v Peoples: broad protection

- **Directors will rarely be liable absent fraud, deceit, dishonesty, or want of authority**
  - Gives a broad shield of protection because liability is contingent on it being shown that the actions themselves are tortious or exhibit a separate identity or interest from that of the company, so as to make the act or conduct complained of their own
- Seems to foreclose liability for ordinary negligence because such conduct usually does not exhibit separateness
- Seems to mean that tortious conduct in the best interests of the corporation does not expose directors to personal liability

ADGA: narrow protection

- **Directors are virtually always responsible for their own torts even though the impugned conduct was directed in a bona fide manner to the best interests of the company**
  - Acting bona fide is only a deference for the tort of inducing breach of contract

- Directors are responsible for their tortious conduct, would generally be found liable based on this test
- Acknowledged the defence *Said*, where a director is absolved of liability for inducing breach of contract by the corporation, provided she is acting bona fide within the scope of her authority

Courts have essentially agreed that directors have liability for their intentional torts, subject to the defence of *Said* which applies only to the tort of inducing breach of contract. Less clarity in the area of negligence, where personal liability will either commonly be found (*ADGA*) or not (*ScotiaMcLeod*)

Absent a personal guarantee or other circumstances indicating that the director has assumed personal responsibility for her words, there is no duty to the plaintiff, and therefore, no liability for negligence causing pure economic loss.

- *McFadden*: not clear on economic loss, but directors liable for tort of inducing breach of contract unless they can establish defence of justification in *Said*

Directors can owe a duty of care to third parties 0 this is recognized for causing personal injury, death, and property loss – courts have said there is no policy argument in giving them a pass for causing such loss

Law in AB is *Hogarth*:

- Majority: no personal liability on director for negligent misstatement
  - Test of *ScotiaMcLeod* not met
- Concurring: There can be liability for simple negligence/negligent misstatement but only where there is a duty of care/special relationship (*Abt*)

Note: *Andersen* says in principle that a corporate officer or employee may have a personal duty of care and may be liable for acts that are in themselves tortious notwithstanding the involvement of a corporation.

Intentional Torts: Inducing Breach of Contract

McFadden v 481782 Ontario Ltd

Facts:

- M worked for PMAC, but PMAC's business was not succeeding
- The defendant's directors caused PMAC to pay them $32,000 – this was a fraudulent preference
  - Idea of dealing with the debtor's property in a way that prefers one creditor over another
- PMAC, acting through the directors, fired M without cause or notice or payment in lieu of notice.
- Wrongful dismissal, PMAC is liable for breach of contract to M

Issue: Are the defendant directors personally liable to the plaintiff for the amount awarded against the defendant company? **YES.**

Analysis:

- Tort of inducing breach of contract is committed when D, knowing of a contract between P and a third party and intending to procure a breach of that contract to injury of P, induces the third party without justification to break the contract

- Need to show the following (*Pocklington*):
    - Existence of a contract
    - Knowledge/awareness of the contract
    - Breach of the contract by the contracting party
    - That the defendant, by their conduct, induce that breach and intended to cause the breach
    - That the defendant acted without justification
        - Asks whether the defendants were acting bona fide within their scope of duties to the employer or not?
            - If acting within scope, they are justified. If not, they become liable to an action of tort
        - Sometime better to breach the contract then to not.
            - If it is in best interest of corporation, then they were likely acting for the interest of the corporation
        - Here, they were acting in their own interest and therefore, cannot rely on defence from *Said.*
    - Plaintiff suffered loss
- The directors intended to get the plaintiff fired by the corporation
- Specific defence for inducing breach of contract is in *Said*:
    - If an officer is relieved, it is because he acts under a compulsion of duty to the corporation and the act is justified. When he does not act bona fide and is no longer justified, he becomes liable.

Holding: Does not speak to economic loss, but shows that directors are liable for the tort of inducing breach of contract unless they can establish the defence in *Said*. Plaintiff was wrongfully dismissed and should be reimbursed accordingly.

Negligence

Montreal Trust Co of Canada v ScotiaMcLeod Inc

Facts:

- Peoples (defendant) had issued senior unsecured debentures.
    - Trust has purchased these debentures for $17 million but says the prospectus and other information only disclosed one contingent liability when in fact there were several.
- This makes Peoples a less attractive investment
- MT says Scotia failed to disclose all of Peoples liabilities, which constitutes a material negligent misrepresentation
- Scotia says that specific directors committed this tort

Issue: Should the third party claims be dismissed for not disclosing a reasonable cause of action? **YES.**

Analysis:

- Decided cases where officers have been found personally liable for actions carried out under the corporate name are fact specific.
    - In the absence of findings of fraud, dishonesty, or want of authority, on the party of the directors, liability is rare.

- Absent allegations that fall in these categories, protection is afforded from personal liability unless it can be shown that actions are tortious, or exhibit a separate identity or interest from the corporation
- To hold the director of People's liable, there must be some activity that taxes them out of the role of directing mind of the corporation
    - Idea is that if a director is acting bona fide within the scope of their authority, the director is indistinguishable from the corporation and does not have personal liability for the tort
        - If not acting bona fide in the scope of her authority, she will be seen as separate and distinct and be found personally liable.
    - For liability, need to make the tort their own – sperate and distinct versus best interest of the corporation

Holding: Overall, this case says three things:

1) The pleadings must be particular: musts et out the basis of the tort that the plaintiff is alleging
2) Directors must make the tort their own to the extent there is no longer any identify of interests between the director and the corporation
3) Absent fraud, dishonesty, or want of authority, liability is rare: pleadings must allege these kinds of matters, cannot just look at this as a pleading question, need to get them into the realm of one of these three things.

Policy reason for this decision is to somewhat protect directors, so directors want this job. If we make them to prone to liability, no one will want to be a director or they will be unduly cautious when making decisions.

London Drugs Ltd v Kuehne & Nagel International Ltd

Facts:

- LD left a transformer with KN.
- The employees of KN dropped the transformer
- LD is suing KN in contract and tort, and also suing the employee for damage in negligence.
- The contract between LD and KN contains limitation of liability clause stating "the responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law. Therefore, liability is limited to $40."

Issue: Can the employees shelter under this clause as a defence to LD's action against them? **YES.**

Analysis:

- SCC said the employees owe a duty of care, and they would be liable in tort in the ordinary sense
- But, it is an exception to privity that saves them because the court permitted them to shelter under the liability clause that limits liability – even though they were not parties to the contract
- Junior employees do not have a special immunity in negligence – they have liability as compared to *Scotia*, seems like directors have a special immunity unless they make the tort their own.

Holding: So, the employees are still negligent, but can shelter under the liability limitation. Without this, they would have been responsible for the whole loss.

ADGA Systems International Ltd v Valcom

Facts:

- ADGA suing individual directors of V personally, allegation that they raided the employees of ADGA
- V, through its director and senior employees, persuaded virtually all of A's employees to permit their named to stand in a bid package and join V should the bid be successful
- They won the bid and almost all of the employees defected to A
- A brought an actions against director and employees

Issue: Is the conduct by the individual V actionable even if genuinely directed to the best interests of V? **YES.**

Analysis:

- The defendant cannot use the defence of *Said*
  - They did not induce their own corporation V to breach its own contract as in *McFadden*, rather induced outsiders to breach their own employment contracts
- Could argue they are liable for inducing breach of contract
  - The directors here were genuinely acting in the interests of their employer, V, so based on *Scotia* how can we say that they had the necessary separateness'?
    - Based on *Scotia*, we could argue that a tort has been committed, but there is no personal liability because they were acting for the benefit of the corporation and did not make the tort their own.
- Court of Appeal:
  - This Court says there s a consistent line of authority that n all events, Directors are responsible for their tortious conduct even though it was in a bona fide manner (opposite of *Scotia*)
  - Employees can be liable for tortious conduct even when acting In the course of duty (also not what *Scotia* says, it says that you have to have good pleadings that show a separateness so that the directors are no longer the conducting mind)
  - Court says that *Solomon* is not related to directors having personal liability for their torts, only about corporation being a separate legal entity
    - BUT to the extent that directors have broad liability even when acting as directors of the corporation, this functionally undermines the *Solomon* principle. If directors are easily liable, protection is watered down.

Holding: Says opposite of *ScotiaMcleod*. Directors liability is common, there is only a small shield of protection, there would be liability for ordinary negligence provided that a duty of care is in place.

NBD Bank, Canada v Dafasco Inc

Facts:

- D, M and N were found a trial to be jointly and severally liable to NBD for $2million
- The appellant, M, negligently misled NBD as to Algoma's (the steel company) true financial state
- Relying on the misrepresentation, the bank lent $4million and two weeks later A was announced to be insolvent.

Issue: Is M liable for his negligent misstatement? **YES.**

Analysis:

- M's defence was that he was acting for the benefit of his employer, so no personal liability as per *ScotiaMcLeod*
    - CA says officers are liable for their own tortious acts subject to the exception in *Said* (court here applies *ADGA*)
        - Because of this he is not protected from liability, so now his only defence is to prove he did not commit a tort
- *Livent* is used to determine if a duty of care has been established:
    - (1) Is there a prima facie duty of care?
        - This exists when there is proximity and reasonable foreseeability of harm.
            - Proximity asks "whether the parties are in such a close and direct relationship that it would be just and fair having regard to the relationship to impose a duty of care in law."
                - In case of pure economic loss, two factors are determinative in the proximity analysis:
                    - (i) the defendant's undertaking, and
                    - (ii) the plaintiff's reliance
            - Reasonable foreseeability asks "whether an injury to the plaintiff was a reasonable foreseeable consequence of the defendant's negligence"
    - (2) Are there residual policy considerations outside the relationship of the parties that may negate the imposition of a duty of care?
        - Considerations may include:
            - Whether the law already provides a remedy
            - Whether the recognition of the duty creates the spectre of unlimited liability to an unlimited class
            - Whether there are other reasons of broad policy that suggest the duty of care should not be recognized
- **Application of *Livent*:**
    - (1) Parties were in a close and direct relationship because the individual defendant was the bank's main contact at A, he held himself out as being able to answer questions. It was also reasonably foreseeable that the bank would rely on what M would say.
    - (2) No limitations due to policy concerns.
        - No indeterminate liability here, M is aware of the identity of the plaintiff and his negligent statements were used for the purpose for which they were made
        - It is contrary to good policy to immunize officers from the consequences of their negligent statements, which might otherwise be made in anticipation of being forgiven

Holding: There is liability, M is held responsible.

Blacklaws v Morrow

- No duty of care to inject his own money into the company merely because there is foreseeable loss to one's neighbour
- Having a shareholding or other financial interest in the corporation does not translate into a separate interest for purpose of establishing personal liability in trust

- Where no separate duty of care is owed between director and the plaintiff, there will not be personal liability for director
- States that we follow *ScotiaMcleod* reasoning in AB

Hogarth v Rocky Mountain Slate Inc

Important case- shows law in AB

Facts:

- H invested in a limited partnership based on misrepresentation from the general partner and its director, Simonson.
- The investment failed

Issue: Can the plaintiff's successfully sue Simonson personally for negligent misrepresentation? **NO.**

Analysis:

- TJ said yes, because S provided the investors with documents and information to facilitate their investment decision.
  - A duty of care existed based on sufficient proximity and reasonable reliance.
- Court of Appeal reversed this decision.
  - CA says there is no personal liability on S based on *Morrow*, which applies *ScotiaMcLeod*- only where the director's actions are themselves tortious or exhibit separate identity or interest from that of the corporation so as to make the act or conduct their own, is personal liability found
    - Conduct of S was not tortious in itself, no separate identity – it is not sufficient to create a separate identity that S was an officer and investor in the corporation
    - *Morrow* said that having a shareholding or other financial interest in the corporation does not translate into a separate interest for the purpose of establishing liability
  - Slatter J's analysis (concurred in result, but offered additional analysis for the director's exposure to personal liability in the context of tort law)
    - Looking for a situation where S did something to invite reliance on his own words
      - E.g. personally guaranteeing his word, not just speaking for the corporation
      - If he would have done that, a duty of care would be found
    - He s taking the position that directors *can* owe a duty of care to third parties, will just be more difficult to establish
    - There can be liability for ordinary negligence – remember *Peoples*, said that a director can owe a duty of care to third parties like a creditor
    - Main issue: was it reasonable for the plaintiff to rely on the individual's personal involvement so as to create a personal duty of care in the director?
      - More specifically, was it reasonably for the plaintiff to rely on the individual defendant's connection to the representation as engaging a personal duty on the part of the defendant

        - ON these facts, this stage of asserted reliance was unreasonable and beyond the reasonable expectations of the party
    - Notes that in stage 2 of *Livent* an important residual policy concern is the importance of the limited liability corporation in the Canadian economic

Holding: There is no personal duty of care owed by S to the investors

Abt Estate v Cold Lake Industrial Park

Facts: Investors making a claim against officer's personally

Analysis: Confirms approach taken by Slatter in *Hogart*.

- Says that circumstances where individual takes responsibility for accuracy for their own words may be sufficient to identify separate identity to make that conduct complained of their own.
- Taking personal responsibility for words makes it consistent with *ScotiaMcLeod* now for establishing "separateness" needed for director
- If director invites personal reliance on their words, they fit the test for separateness in SM.

Hall v Stewart

Court goes through a number of factors that the case law reveals as to when directors would have liability in relation to their own tort:

1) Whether the negligent act was committed while engaged in the business of the corporation, and whether the negligence of the employee was contemporaneous with that of the corporation (*London Drugs* and *ADGA*)

2) Whether the individual was pursuing any personal interest beyond the corporate interest (*ADGA*)

3) Whether the director owed a separate and distinct duty of care towards the injured party (*Hoggart*)

4) That the conduct was in the bets interests of the company

5) Whether the plaintiff voluntarily dealt with the limited liability corporation, or had the corporate relationship "imposed" on it (*London Drugs* and *ADGA*)

6) The expectations of the parties (*Cooper v Hobart*)

- **a.** Was it reasonable for the plaintiff to think that the individuals involved would be personally responsible for any damage that resulted?
- **b.** In the area of negligent misrepresentation, this factor takes on particular importance – was it reasonable for the plaintiff to rely on the representation coming from the individual, rather than the corporation? (*Hercules*)

7) Whether the tort was independent

- **a.** Cases sometimes say that the employee or individual is liable for her "independent" torts, implying that there are some torts so closely identifies with corporate activity that they are not fairly categorized as "individual torts" (*London Drugs* and *ScotiaMcLeod*)
- **b.** However, in *Peracomo Inc* it was held that the intentional tort was essentially individual, and the issue was more correctly whether the corporation was responsible for the individual tort

8) Case law recognizes the exception in *Said v Butt*, specifically respecting claims of inducing breach of contract, without identifying whether it is a narrow or wide exception or the principles on which it is based
9) The nature of the tort, particularly if it was an intentional tort (*Hercules, ADGA, Morrow*)
10) Whether the damage was physical or economic

INDEMNIFICATION

Indemnify means to secure someone against legal liability for their actions.

Under what circumstances can directors be indemnified by the corporation in relation to the various costs and liabilities insured? Corporate statutes such as the *ABCA* provide a method or reimbursing directors in certain circumstances.

Primary concern: without the possibility of such reimbursement, people will not want to serve as directors

S 124:

(1) Where a corporation is not a plaintiff, they may indemnify a director against all costs, charges, and expenses including an amount paid to settle an action or satisfy a judgement, reasonably incurred in any civil, administrative, investigative, or other action.
(2) May with approval of court indemnify a person in respect to any action by or on behalf of the corporation in s 1(a) and (b) are met
(3) A person referred to in (1) is entitled, if the person seeking indemnity was not judged by a court or competent authority to have committed any fault or omitted to do anything that the person ought to have done and fulfils 1(a) and (b).

Blair v Consolidated Enfield Ltd

Facts:

- Director, B, is seeking indemnification from the corporation, E (which was controlled by Canadian Express at time of the conflict)
- B was the CEO and chair of the meeting regarding election of directors. He did not count proxies in favour of Tim Price (nominated by CE) due to legal counsel's advice.
- B won his place back on the board because of this
- CE took the matter to court, B is look for indemnity but E does not want to provide.
- B is argued he acted reasonably and on an informed basis because he did so on legal advice.

Issue: Is B entitled to indemnity? **YES.**

Analysis:

- Director has to have acted honestly and in good faith with a view to the best interests of the corporation
  - Defence under s 123(3)- B relied on the report of a lawyer in his decision not to count proxies – does not relate directly to the indemnity provision, but does help inform he question of whether he acted in good faith
- When E would not indemnify him, B sued under s 12(4) and Carruther J said:

    - B was not acting with a view to the best interests of the corporation in defending the litigation, because it was based upon a ruling based on his favour absent evidence that B was the better director
        - CA reverse this:
            - Best interests of the corporation is not about who is the best director, it is about what the voting procedure should be and how can integrity be preserved.
            - E's best interests related to only counting proxies that should be counted
- B relying on legal advice:
    - Asked about what to do from nominations from the floor – he got advice and acted on it
    - Did he bring himself within s 136 such that he acted honestly and in good faith?
        - Yes – he was using his powers at the meeting for a proper purpose
            - Although the result favoured him, the purpose was that the board have a legally elected board of directors – he was not using his powers for an improper purpose
    - Taking legal advice does not automatically fulfil the requirements of god faith and best interest, but it is helpful
- Policy concerns:
    - Permitting B to be indemnified is consonant with the board policy goals underlying indemnity provision
        - These allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection

Holding: Judgement against E, required to indemnify B.

Three takeaways from this case being heard at the SCC:

1) Clear that the corporation carries the burden to show that V had not acted in bad faith, etc. They have to show that B has not fulfilled his fiduciary duty.
    - Here the corporation failed to do so
    - B not required to show his good faith – to a large extent about the corporation proving what B did that was against its best interests
2) Relying on legal advice is not a guarantee that a director will succeed in securing indemnification, but it is helpful provided the reliance is reasonable and in good faith
    - SCC emphasized that B was facing a difficult legal question and sought good advice
3) Indemnification is a balancing act between too little and too much – want to limit indemnification to encourage good behaviour, but also want to encourage to get a good pool of people who want to serve as directors
    - Permitting B to be indemnified is consonant with the broad policy goals underlying indemnity provisions

R v Bata Industries

Facts:

- B convicted of causing the discharge of industrial waste as it shows manufacturing facility

- Two directors were convicted of failing to take all reasonable care
- A term of the probation order prohibited B from indemnifying directors in respect of the fine

Issue: Did the TJ have jurisdiction to impose the non-indemnification provision in the probation order?
NO.
Analysis:

- CA observed that the TJ's concern that if the company paid the director's fine there would be little point in fining the directors to begin with
    - But the terms of probation imposed on B must, according to the *Provincial Offences Act*, function to prevent similar unlawful conduct or contribute to the rehabilitation of B
        - It follows that the purpose of the non-indemnification order must be about deterring and rehabilitating B
            - Therefore, the order is improper since the TJ's intention is to require directors to pay their own fine for a collateral purpose.
- Any prohibition in the probation order would only work for the duration of the order – could wait for it to expire, and then seek indemnification
- Question of indemnification is governed by the indemnification of the ABCA – the sections are a code which establishes when a corporation may indemnify, must indemnify, or cannot indemnify
    - If B is to be prohibited from indemnifying the directors, it should be under the statutory provisions regarding indemnification (s 124)

Holding: Indemnification prohibition was struck out, the Court said the indemnification provisions should do their own work.

CHAPTER 7: CORPORATE SOCIAL RESPONSIBILITY

WHAT IS CSR?

- Broad and evolving concept
- Content is shaped by shifting societal expectations dependent in part on the industrial context in which it operates and the people who are impacted
- It is a concept that arises from the growing expectation that businesses should embrace social accountability
    - Foundation is the notion that corporations have responsibilities to stakeholders other than just their shareholders
- Industry Canada definition: the way a company achieves a balance or integration of economic, environmental and social imperatives while at the same time addressing shareholder and stakeholder expectations
- **Includes the following characteristics:**
    - Obligations apart from the formal requirements of law, is instead a reflection of normative standards
    - Involved companies demonstrating varying degrees of commitment to concepts such as corporate citizenship, sustainable development, and environmental sustainability
    - Governments, citizens, and investors now generally expect companies to adopt some form of internal CSR business strategy

- **Current CSR policies and initiatives:**
    - International organization for standardization, global reporting initiatives, transparency international's business principles for countering bribery

Note: The idea of business owing responsibilities to stakeholders in chapter 6

- Corporations took a stand on what the purpose of a corporation is
- Identified a "modern standard for corporate responsibility"
    - The corporation is not just about making money and serving shareholders, the idea is that the CEOs will need to balance the needs of shareholders with other stakeholders
        - Taking such stakeholders into account will enhance profits.
- Other resources: excerpt from Gerry Ferguson, roundtable from ch 6 and responses to the roundtable
    - When corporations do not align with social views, it can cause chaos. People will boycott or protest the company,

Case Law

- *BCE*: directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a **good corporate citizen**
- *Peoples*: In determining if they are acting with a view to the best interests of the corporation, need to consider the interests of shareholders, employees, supplies, creditors, consumers and the environment

Statutory Law

- Codified in recent amendment to s 122 of the *CBCA*
    - S 122(1.1) – When acting with a view to the best interests of the corporation under s 1(a), the directors and officers of the corporation may consider, but are not limited to, the following factors:
        - Shareholders
        - Employees
        - Retirees and pensioners
        - Creditors
        - Consumers, and
        - Government
        - The environment, and
        - The long-term interests of the corporation

Conceptions

Two main conceptions:

1) Property conception: the "shareholder" primacy model
    a. Milton Freidman: the corporation is the property of the shareholders and the job of the board of directors is to maximize shareholder returns – basically the social responsibility of the corporation is to make money

i. Idea that the CEO is charged with maximizing profit – they could have personal and social responsibilities (could give money to charity, etc.) but the point is that these are individual responsibilities, not corporate responsibilities

b. What if the CEO wants the corporation to exceed the minimum environmental standards and use corporate money to do so.?
    i. Friedman would say this is out of bounds – CEO is essentially levying a tax on the corporation

c. What about the corporation voluntarily donating?
    i. Corporate philanthropy according to Friedman is acceptable as long as its not philanthropic – can give money to make ourself look good, but if its not for this purpose then its stealing from shareholders

d. Criticisms:
    i. Ideas are old fashioned, people expect more from corporations today
    ii. Corporations, especially large ones, have tremendous power so there should be a level of accountability

2) Social entity conception: a corporation is not just about money and shareholders – corporations have a "public purpose"
    a. William Allen: corporations are created by statute, are quasi-public, and therefore tinged with a public purpose
        i. A corporation is a social entity and must have a purpose other than making money, such as contributing to public life – cannot be created without government, not purely private
        ii. View that there are many important stakeholders to consider in corporate decision-making which leads to a long term perspective – ensure a good corporate reputation, investing in communities – can be a good way to build value
        iii. CSR obligations regarded as very mainstream today – if corporations do not meet these expectations they will be met with resistance from the public
    b. In *Peoples*, majority say that the best interests of the corporation should not be read simply as the best interests of the shareholders, but as a social entity conception
    c. Criticisms:
        i. Seemingly breaks away from the shareholder primacy view
        ii. Undercuts notions of managerial accountability to shareholders, illegal to the extent it undermines the company's bottom line

Overall: Common law seems largely driven by the shareholder primacy/property view, but is subject to *BCE's* comment about corporate citizens and the amendments in section 122

Dodge v Ford Motors

Reflects shareholder primacy view

Facts:

- FM had a lot of cash – this is typically when dividends are declared so shareholders can benefit.

- However, F did not want to give more dividends at this time, he wanted to devote some of these profits to the company to lower the price of cars and increase employment, profits to be reinvested into the corporation instead
- Two minority shareholders, the Dodge brothers, sought a court order for the corporation to declare a large dividend

Analysis:

- Difference between an incidental humanitarian expenditure of corporate funds and a general purpose and plan to benefit mankind is obvious – a business corporation is organized and carried on for shareholders, the powers of directors should be employed at this end.
- In refusing to declare the special dividends, maybe F was being strategic (for not wanting to give the Dodge brothers access to cash to better their competitive company) as opposed to being philanthropic.

Holding: Incidental humanitarian expenditures for the benefits of employees are allowed, but F cannot run a charity and have a specific profit0making duty to the shareholders too. Dividends ordered to be paid.

- OB says this case may be distinguished because F did not have a good business reason not to declare dividends and to instead use the money for general human benefit – but this approach may be later softened because of *BCE*.

SHAREHOLDER PROPOSALS

ABCA section 136: one route for making management accountable for shareholder concerns

- Basically, a shareholder can submit to the corporation notice of any matter they propose to raise at the meeting, and the shareholder can request for the corporation to include the proposal in a circular
- BUT the corporation is not required to comply with this (s 2 and 3):
  - If it clearly appears that the proposal has been submitted by the shareholder primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the corporation, its directors, officers, or security holders or primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes.

CBCA s 137(5)(b.1): a corporation does not have to circulate a shareholder's proposal if it clearly appear that the proposal does not relate in a significant way to the business or affairs of the corporation

- Even if we used this amending wording in *Varity,* it is likely the outcome would be the same

Overall:

- Management is not required to circulate proposals if it appears that it is for enforcing a personal claim or grievance, or promoting a general economic/social/political/racial/religious cause (under old wording)
- BUT specific purposes/goals may avoid the legislation

Re Varity Corp and Jesuit Fathers of Upper Canada et al

Facts:

- V is seeking a court order permitting it not to include a shareholder proposal that the corporation ends its involvement in South Africa

    - The proposal does make a business case for pulling out
- V is arguing they do not have to circulate the proposal due to s 131(5)(b) and that this is a personal claim for promoting a racial cause. (anti-apartheid)

Issue: Does V have a case for not circulating the proposal? **YES.**

Analysis:

- J says that the business conditions are poor, cannot take on a general cause but here are making a specific proposal for V to exit South Africa.
    - Although it rates to political reasons, there are also specific business reasons.
- Court held that the primary purpose of the proposal is abolishing apartheid in SA – OB said its concerning that this issue was not allowed to be discussed at the AGM
- Court looks to the language and supporting statements to make this decision

Dissent: The issue of apartheid cannot be a general cause, it must be considered specific in the sense of being exact

Holding: Agree that V had a specific purpose, but the general overall goal is the abolition of apartheid in SA. IN other words, the company cannot be compelling to distribute the proposal.

Policy rationale for this provision:

- Trying to avoid minority shareholders abusing the procedure
- However, sometime activities result in a failure to the corporation by trying to get them to partake in high level conduct
- Amendments have been made in s 135.

CHAPTER 8: SHAREHOLDER RIGHTS AND REMEDIES

INTRODUCTION TO SHAREHOLDER RIGHTS

1. Basic Shareholders rights: vote at any meeting of shareholders, participate in profits of the corporation, participate in distribution of assets upon winding up (*ABCA* ss 26(3), 139)
2. Shareholder control over directors and officers: elect and remove directors, participate in AGM, shareholder proposals
3. Control over the corporation: access to corporate records, power to appoint an auditor, shareholder initiatives including (1) proposals for corporate bylaws, (2) USAs, and (3) requisition a meeting
4. Control over majority shareholders: notice and conduct of meetings, rights of discussion
5. Special rights in the event of fundamental change:
    a. Includes continuance, alteration in the corporate constitution, amalgamation, extraordinary sale/lease/exchange
    b. Special resolution (2//3rds majority), all shares vote (even a non-voting shareholder gets a say, right to dissent and be brought out to exit the corporation, class vote)
    c. Idea that some changes to the corporate organization are so foundational that special rights are in place to protect the minority shareholder

4 Kinds of Fundamental Changes	Special Resolution (2/3 Majority)	All Shares Vote	Right to Dissent and to be Bought Out
Continuance	S.198(4)	S.189(3)	S.191(1)(d)
Amending Articles	S.173(1)	S.176(3)	S.191(1)(a)(b)
Amalgamation	S.183(5)	S.183(3)	S.191(1)(c)
Extraordinary Sale, Lease, or Exchange	S.190(6)	S.190(4)	S.191(1)(e)

Categories of Rights	Examples	Sources	
		Statute	Case Law
Basic	Vote at any meeting of shareholders of corporation	*ABCA* ss 26(3), 139	
	Participate in dividends		
	Participate in distribution of assets upon "winding up"		
Ex. Of Control Over Directors/Officers	Election & Removal of Directors – default ordinary resolution	*ABCA* ss 106, 109, 122(4), 145, 147	** Cumulative voting can be allowed in Articles. This gives minority power to concentrate votes (s 107)
	Participate in AGM (to review perf of offs and examine financial statements)	*ABCA* s 155	
	SH proposals	*ABCA* s 136; But limited by s 136(5) and *CBCA* s 137	
Ex. of Control Over the Corporation	Access to corporate records	*ABCA* ss 23(1), 23(2)	
	Power to appoint an auditor	*ABCA* ss 162, 163	
	Shareholder Initiatives		
	(i) Proposals for corp bylaws	*ABCA* ss 102, 142	
	(ii) Unanimous Shareholder Agreements (USAs)	*ABCA* s 146 *CBCA* s 146	
	(iii) Requisition a meeting	*ABCA* s 142 *CBCA* s 143	
Control Over Minority Shareholders -	Notice and conduct of meetings	*ABCA* ss 131, 132, 134(1) *CBCA* ss 132, 135(1),(1.1)	• Even an unintentional failure to comply w statutory reqs is unacceptable *[Re Upper Canada Resources Ltd; Minister of Consumer and Commercial Relations]* • Entitled to "full, fair, and plain disclosure," SH's must be able to base their decisions on the most recent financial & other imp info about the corp. *[Imperial Trust Co v Canbra Foods Ltd]* • Whether SH votes w the majority or minority, an individual SH has the right to have his vote recorded. *[Pender v Lushington]*
	Rights of discussion	*ABCA* s 136(1)(b) *CBCA* s 137(1)(b)	The chairman of the meeting cannot end the meeting as his own will/pleasure. *[National Dwellings Society v Sykes]*
Special Rights in Event of Fundamental Changes (Continuance; Alteration in Corp CON; Amalgamation; Extraordinary Sale/Lease/Exchange) …	Special resolution (i.e. 2/3 majority)	*ABCA* ss 189(4), 173(1), 183(5), 190(6)	Fundamental changes: continuance (s. 189), alteration to constitution, amalgamation, extraordinary sale, lease or change (s. 190) *All show extra protection for SH when there is a fundamental change
	All shares vote → even non-voting shares	*ABCA* ss 189(3), 176(3), 183(3), 190(4)	
	Appraisal Right: Rt to dissent and to be bought out to exit corp	*ABCA* ss 191(1)(d)-dissent; 191(3)- right to be bought out	
	Class vote	*ABCA* s 176	
Dissolution	Dissolution in different Circumstances	*ABC s 211-215;*	
	Failing to file annual return- face being disolved	*ABCA s 268*	

SHAREHOLDER REMEDIES

Standing

- If a shareholder is bringing a cause of action it belongs to them. The default rule where the wrong is done to the corporation is that the corporation has a cause of action.

Example of personal rights:

- Some personal rights arise
  - out of legislation (e.g. right to propose bylaws, rights on fundamental change)
  - some out of the corporation's articles (e.g. right to cumulative voting), and
  - some arise by virtue of common law (e.g. right to sue in tort)
- Others include:
  - Right to vote one's voting share
  - Right to propose bylaws
  - Rights triggered upon a fundamental change
  - Right to sue directors for breach of fiduciary duty (*Tongue*)
  - Right to sue director in tort
  - Right to sue for oppression

- Where the corporation is injured: can bring a derivative action (a vehicle to bring another specific cause of action)

Oppression vs Derivative Actions

Oppression: Claim involves wrongs done to the stakeholder (usually done by corporation or directing minds)

- The shareholder has the right to their reasonable expectations being respected
- E.g. breach of shareholder agreement, negligent misrepresentation made by shareholders to other shareholders

Derivative: The claim is about a wrongdoing done to the corporation

- Involves a shareholder or other claimant bringing the action in the name of the corporation to endorse or protect the corporation's right
  - Because directors who would normally advance the claim are not bringing it
  - Process by which minority shareholders make applications most frequently

OPPRESSION

Judicial Interpretation

- *ABCA* s 242: A personal action that shareholders have against directors or others if the shareholder has been oppressed by their actions. Protects the reasonable expectations of shareholders – broadest remedy because you do not have to show that your right have been violated.

Deluce Holdings Inc v Air Canada

Facts:

- D is the minority shareholder in Air Ontario, and is suing majority shareholder, AC

- USA provides upon termination of the last D, AC has the option to acquire D's indirect interest in AO
- In 1991, the employment of Bill D was terminated by the board of AO.
- D alleged that AC improperly exercised its majority control of the board to terminate Mr. D's employment for the sole purpose of enabling it to buy out the shares of D, and that this was oppressive
- AC argues they fired Bill because he did not perform properly.

Issue: Is there oppression? **YES.**

Analysis:

- Can the Ac board of directors exercise discretion to fire someone for a proper purpose, or can they for any reason?
  - Court says the USA means that termination can only occur if it is in the best interests of Air Ontario – must be exercised in good faith and with a proper purpose, not for a collateral purpose
  - AC directors have to exercise their powers for good or else will be in breach of fiduciary duty to the corporation (cannot oppress the minority)
- Oppression:
  - The word oppression refers to conduct that is burdensome, harsh and wrongful – this is actionable, but something less will also do
  - Overall, directors cannot act in a way that is unfairly prejudicial or unfairly disregards the interests of the minority stakeholders
- Shareholders are not just entitled to have just their strict legal rights protected under the oppression action, but also their interests
  - In enacting s 241, Parliament intended that strict attention should be paid to the interests of shareholders as well
  - Thwarted shareholder expectations is what this remedy is all about

Holding:

- Directors on the board could not let their decision be what was in the best interests of the shareholders of AC, had to act in the best interests of AC – did not look to see if termination D was in best interests of the corporation
- Court found that the alleged oppression destroyed the underpinning of the arbitration
- Overall: AC could only arrange for the firing of D if his performance was deficient, but not for the collateral purpose of triggering their right to acquire his shares

BCE v 1976 Debentureholders

Facts:

- Group of debentureholders were complaining of a leveraged buyout of shares in BCE
- The way the deal s structured is that they would suffer a downgrade in the value of their debentures
- Shareholders of BCE would receive a benefit in the way of a premium on their shares

Issue: Have the debenture holders been oppressed? **NO.**

Analysis:

- Principles underlying remedy of oppression: FAIRNESS
- **Preliminary Observations:**
  - Oppression is an equitable remedy – it seeks to ensure fairness

        - It gives the court broad jurisdiction to enforce not just what is legal but what is fair
        - It also looks to commercial realities
        - There are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure
    - Oppression is fact specific
        - What is just and equitable is judged by the reasonable expectations of the stakeholders in context and in regard to the relationships at play
        - The oppression remedy recognizes that a corporation is an entity that affects many different stakeholders whose interests may conflict
        - All stakeholders are entitled to "fair treatment" – which means what they can "reasonably expect"
- **First step to an oppression action:**
    - Establish that an individual has standing as a claimant to bring an oppressive action, under s 239(b) of the ABCA
        - 239(b): Lists persons who have standing including registered holders, directors, creditors, debenture holders, etc.)
- **NEXT: Have to bring themselves under the two prong test for oppression**
    - (1) Does the evidence support the reasonable expectation asserted by the complainant?
        - The words "just and equitable" are a recognition of the fact that a limited company is more than a mere legal entity with a personality of its own – there is room in the law for recognition of that fact that behind it are individuals with rights, obligations, and expectations that are not necessarily submerged in the company culture
            - The power of the oppression remedy is very broad – do not have to show something that is independently actionable
                - Also protects reasonable expectations
        - Often it is alleged against the corporation – but the complainant can also complain that directors and officers have been acting oppressively (which is the complaint here)
            - Conduct of other actors such as shareholders can also support an action (see *Deluce*, sued majority shareholder)
        - Factors that are useful in determining whether a reasonable expectation exists include:
            - General commercial practice
            - The nature of the corporation
            - The relationship between parties
            - Past practice
            - Steps the claimant would have taken to protect itself
            - Representations and agreements
            - The fair resolution of conflicting interests between corporate stakeholders

        - Court emphasizes that what we're focusing on is concepts of fairness and equity – just because there is a failure to meet a reasonable expectation does not mean that oppression will be made out
    - (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms of oppression, unfair conduct, or unfair disregard of their interest?
        - Each word here seeks to capture different conduct
            - Oppression is most egregious (harsh, burdensome and wrongful).
            - However, something less will do, such as:
                - Unfair prejudice which is generally seen as conduct less offensive
                    - Examples include:
                        - squeezing out a minority shareholder
                        - failing to disclose related party transaction
                        - changing corporate structure to drastically alter debt ratios
                        - adopting a "poison pill" to prevent a takeover bid
                        - paying dividends without a formal declaration
                        - preferring some shareholders with management fee
                        - paying directors' fees higher than the industry norm (also a derivate action)
                - Unfair disregard is viewed as the least serious.
                    - Examples include:
                        - Favoring a director by failing to properly prosecute claims
                        - Improperly reducing a shareholder's dividends
                        - Failing to deliver property belonging to the claimant.
        - A derivative action must be pursued where the corporation suffers direct injuries and the indirect injury to the shareholder is only in the form of reduced share value
            - On behalf of the corporation who has suffered an injury versus an oppression action, where the shareholders' expectations have been hurt
                - The law does not permit the shareholder to pursue an action in oppression that actually belongs to the corporation
        - To the extent the complainant, like a minority shareholder, has only suffered an indirect loss when the corporation has been hurt, the law says that the shareholder does not have an oppression action, only action on the table is that which can be taken by the corporation or through a derivative action

- Indirect harm to shareholder in the form of share value and it's the corporation who has been harmed, then matter must proceed by corporation or through derivative action
- Including where the corporation suffers a direct injury and the only form suffered by the shareholder is reduced share value
- Paying director fees higher than industry norms sounds in oppression (but OB thinks this sounds more derivative)
    - But if the intention of the higher fees is to make them sell the shares, then it could be both
        - Breach of fiduciary duty and oppression
- Preferring some shareholders with management fees
    - Breach of fiduciary duty, would sounds as a derivative action, but on the right facts could be treated as oppression because there is a difference between groups of shareholders who get the fees, and those who do not
- Where a differential impact can be shown so that one group is preferred over another, could likely sound in oppression

▪ Decision from BCCA (*Canex*): although excessive management fees harm the company, the complainant suffered a unique and distinct harm (ability to recover from the company was reduced)

- **Application:**
    - The debentureholders did not establish that they had a reasonable expectation that the directors would protect their economic interest by putting forth a plan that would hold their value steady
    - All three bids would require BCE to take on some debt liability
        - No evidence that bidders were prepared to accept less
        - No deal on the table that was great for debentureholder
    - Board acted reasonable to create a competitive bidding process
        - Business judgement rule: had created a good process and good outcome
    - Directors did consider the interests of the debenture holders so no oppression found
    - Debentureholders could have taken steps to protect themselves; failed to negotiation protection

Holding: No oppression found.

Re Ferguson and Imax Systems Co

Facts:

- A alleged that I, in attempting a special resolution to amend its articles to recognize its capital, is acting in an oppressive manner because the effect of the resolutions would be the redemption of her class B non-redeemable shares, and this would put her out of the company
- She alleged this was an intentional act by her ex-husband, one of the promoters of the company, because she was the only class B holder
- She had worked to start the company alongside him and others

Analysis:

- The principle that the majority governs is fundamental, but its corollary is that the majority must act fairly and honestly
- The company did not act bona fide in exercising its powers to amend – she is the only one affect in this way – idea that when we apply the rules going to fundamental change there is a differential impact on her, that she is out of the company but she won't participate in the growth of the company anymore just when its about to do well
- Mrs. F had a reasonable expectation to participate in the future growth of the company. Mr F took actionable steps to thwart this, which is actionable.

Holding:

- Company is prohibited from implementing the resolution to amend
- Different kinds of oppression: failure to declare dividends, firing of Ms. F, amendment to articles
- Court emphasizes fairness, good faith, nature of parties' relationship – not just looking at strict legal rights but differential impacts, willing to look below the surface

Shevsky v California Gold Mining Inc

Recent example of *ABCA* assessing oppression in light of *BCE*

Facts:

- Fights for control of the CGM public corporation involved in mineral exploration
- S and his solely owned holding company allege that respondents breached his reasonable expectations that he would control CGMI if he raised at least $5 million in investments
- S asserts that CGMI engaged in oppressive conduct, including a secret placement of shares that diluted his voting power and refusing to allow him to appoint a third member to the board when his initial nominee refused to accept the position

Analysis:

- ABCA acknowledges *BCE* and its test as the leading decision
- Reiterates that what constitutes oppression is fact-specific
- Notes that oppression remedies are not intended to be a substitute for an action in contract, tort or misrepresentations
    - If you have a specific cause of action, plead it and prove it (do not throw everything into oppression)
    - But specific torts can be advanced as showing oppression and this is proper
- Remedies under oppression are very flexible
- ABCA's assessment that the business judgement rule apples to the oppression action means that the director's decision is entitled to deference if there has been a good process and a reasonable decision
- Relies on the *Rae* decision
    - Shows the court determining that derivative actions should not be permitted to masquerade as oppression actions
    - Idea that it relies on the rule in *Foss v Harbottle* that says individual shareholders have no cause of action for wrongs done to the corporation because it is a separate legal entity and should therefore pursue its own claims
        - Cannot, through oppression, pursue something that is essential derivative
            - This is a more traditional view that there is a line between them

- Harm must impact the complainant personally, giving rise to a personal interest, and not the collectivity of shareholders as a whole

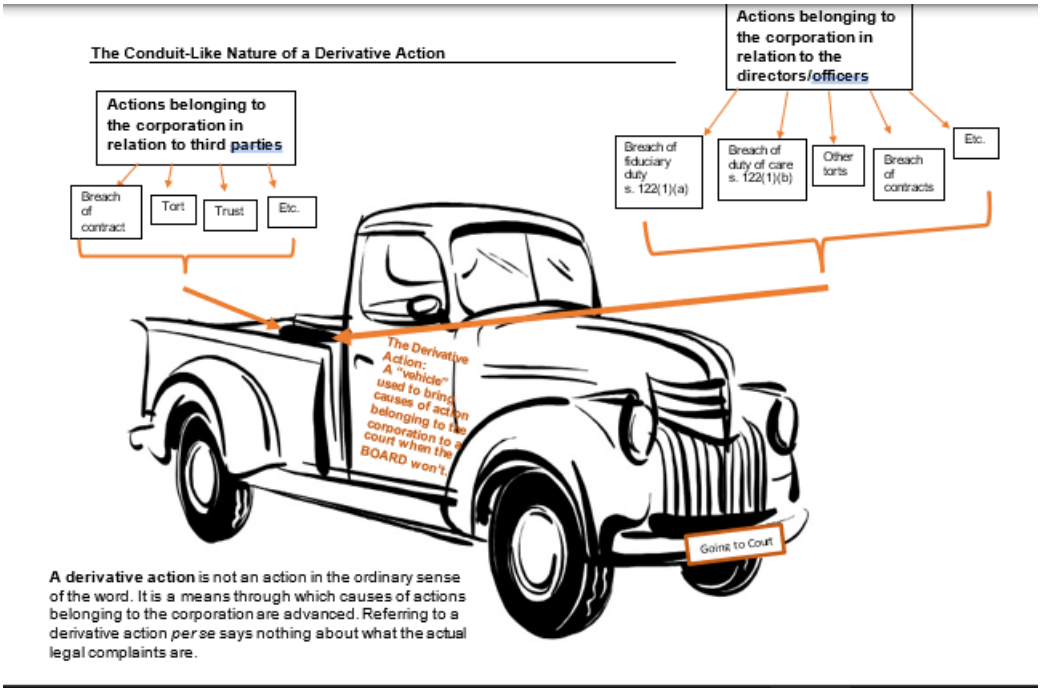
Holding:

- Oppressive versus derivative is distinct, and the line must be drawn between them as such
- Anytime your complaint is about the value of shares, you're looking at a derivative action
- Claims for the loss of value of shares belong to the corporation
- It is not sufficient to allege that shareholders generally have an expectation that directors generally will not act oppressively

DERIVATIVE ACTIONS

Leave to Commence a Derivative Action

- *ABCA* s 240(1):
  - Involves a shareholder or other complainant seeking to bring an action in the name of the corporation to protect and enforce the corporation's rights (e.g. because the director has breached fiduciary duty)
    - To do so, have to seek leave first
    - Complainant applies to bring an action in the name of and on behalf of a corporation
  - Need to show the following:
    - Reasonable notice
    - Acting in good faith
    - In the interest of the corporation that the matter is brough
- The court may make any order it thinks fit (s 241): Derivative action is like a vehicle – think of it as a way in which specific claims are brought to court



Pathak v Moloo

- Requirements for a successful application for leave to commence a derivative action per *ABCA* as outlined in s 240(1):
    - The complainant has given reasonable notice to the directors of the corporation or its subsidiary of the complainant's intention to apply to the Court under (1) if the directors of the corporation or its subsidiary do not bring, diligently prosecute, defend, or discontinue the action
        - Met here because the letter was "clear and specific, with no indication that this is a fishing expedition:
    - Act in good faith
        - The good faith needed is good faith with respect to commencing the derivation action, not good faith generally in all past conduct of the claimant
    - It appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecute, defended, or discontinued
        - Appears to be "in the interest" not that it appears to be the "best interest"

Hercules Managements Ltd v Ernst & Young

Facts:

- Shareholders brought the litigation, including H and two other corps, against a firm of accountants alleging that the auditors performed a negligent audit
- Relying on these audit, H invested more in the companies
- Shareholders say if they knew the true fact they would not have made any further investments
- Also claim for loss of value in their existing shares, because if they knew the truth they would have watched the directors and officers more closely
- Suing in breach of contract and tort

Analysis:

- Corporations are on the receiving end of a bad audit and would have a cause of action for breach of contract and negligent misrepresentation because the corporations hired the auditors (contract) and they committed the tort of negligent misstatement
- Generally speaking, how these matters would proceed is:
    - Directors would sue auditors on behalf of the corporation – if they refused, shareholder could apply for leave to commence derivative action (*Patak v Moloo*)
- Companies involved are in receivership, it may be that the negligence caused no loss – they might have failed regardless – but if the corporations wanted to sue, an action in tort, breach of contract, or both, would proceed.
    - But that is not what is happening here, the shareholders as plaints are suing the auditors in contract and tort.
- Shareholders' claims:
    - Contract:
        - The shareholders say they have a contract with the auditors – courts say no, no contract here.

- Tort:
    - Problem with there being a duty of care owed to them is that they did not actually use the audit for its intended purpose
        - The audit is prepared so shareholders can assess the performance of management, was not for them to make personal investment decisions
            - Pursuant to *Livent*: the reliance was not reasonably foreseeable, and the reliance on the audit was not reasonable when being relied upon in these circumstances
    - NO duty of care owed
- Regarding the existing investment, would have done more to keep any eye on management if they knew the truth:
    - NO duty of care owed by the auditors to the shareholders at this point
    - Purpose of auditors report was a collective one – was not aimed at protecting individual shareholders, but allowing them as a group to safeguard the interests of the corporation
        - Not for them to make individual decisions, rather for a collective purpose
- Shareholders say they lost the value of their shares
    - This is a red flag that the action is actually derivative
    - Reflects an indirect harm – does not create a personal action in the hands of the shareholders, otherwise not respecting the corporation as a sperate legal entity
    - But if the shareholder is impacted in a unique and different way, they might have a cause of action

- ***Foss v Horbottle***
    - The only cause of action for the bad audit lies in the hands of the corporation because of the rule in this case
        - This rule provides that **individual shareholders have no cause of action in law for any wrongs done to the corporation, and that if an action is to be brought in respect of such losses, it mut be brought either by the corporation itself (through management) or by way of derivative action**
    - Rationale: corporation is a separate legal entity. The company is liable for its contracts and torts, the shareholder has no such liability. The company acquires causes of action for breach of contract and torts which damage the company, no such cause of action vests in the shareholder

Holding: Cause of action against the auditors belongs to the corporation, shareholders do not have a cause of action

Takeaways:

- When in doubt, would be prudent to sue in both so that you are protecting the limitation period
    - This matters because if the shareholder brings an oppression action when its actually derivative, they're doing something they're not entitled to and could be struck out by the court.
    - If the limitation period has expired for filing new pleadings, then the lawyer has caused harm to the client

- Classic situation for oppression involves a disgruntled minority shareholder in a closely held corporation who alleges conduct that is unfair for being contrary to their reasonable expectations
    - In contrast, the derivative action is a statutory means by which a claim belonging to the corporation is advanced on their behalf by a minority shareholder

Brunette v Legault Joly Tiffault

Facts:

- Shareholders purported to sue a group of lawyers and accountants for giving bad tax advice, in which they held shares
- The bad advice allegedly caused the demise of the corporation
- The lawyers brought an action to strike the statement of claims as showing no cause of action, and were successful before the QBCA, affirmed by the SCC

Analysis:

- Shareholders may institute proceedings if they can demonstrate
    - (1) A breach of a distinct obligation, and
    - (2) a direct injury that is distinct from that suffered by the corporation in question
- Have to show these two steps to found an action of this kind – here the shareholders cannot sue for a wrong done only to the corporation
- But the shareholders are not without recourse – may not have a personal cause of action, but can pursue a derivative action

Rea v Wildeboer

Facts:

- Large corporation (usually oppression claim for small, closely held corporations)
- D undertook transactions that breached their fiduciary duty.
- Complaint: misappropriation of funds by insider directors.
- Rea, co-founder and vice chair, has a reasonable expectation that directors would conduct themselves with probity
- Two allegations:
    - Company sold used equipment at prices well over market price and on unfair terms to M and D received kickback
    - Company controlled by D purchased parcel of land from M without appropriate sales process and on unfair terms to M

Analysis:

- One set of facts could give rise to both the derivative action and the oppression action (they are not mutually exclusive)
    - Legislatures brought in these two actions to combat the harshness f the common law – but they still have safeguards
    - Leave requirement prevents strike suits, prevents meritless suits, and avoids a multiplicity of proceedings
- CA pushes back against *Matalta* -that case involved a closely-held corporation, and the plaintiff that was permitted to proceed by way of oppression was not just a shareholder, but also a creditor

    - Plaintiff was alleging misappropriation of corporate property as a shareholder and a creditor – could argue that this created a differential impact permitting te matter to proceed by way of oppression
    - If the defendants misappropriate corporate property, this is simply an injury to the corporation and the shareholders are all affected equally. But where one is a creditor – they are less likely to be paid back
    - On the facts of *Malata*, a shareholder who is also a creditor can bring an oppression action
- Bottom line: the respondent directors in *Rae* say there can be an overlap between oppression and derivative action, but there is distinction to maintain
    - Here, on the facts, there is no overlap between the two remedies
        - The appellants are not asserting that their personal interests as shareholders have been adversely affected in a way different from other shareholders. And Mr. R does not plead that the transactions impacted his interests as a director

Holding: Matter cannot proceed as an oppression action because the wrongs pled are all done to the corporation

Shefsky

- In *Rea*, the distinction between a generalized expectation and a personal claim that potentially attracts the oppression remedy is clearly set out
- The harm must impact the complainant personally, giving rise to a personal action, and not simply the complainants interests as part of the collectively of shareholders as a whole
- CA here followed *Rea* while recognizing that on certain facts, both causes of action could arrive

SUMMARY OF DERIVATIVE VS OPPRESSIVE

- **Oppression =** personal action, concerns a wrong done to the complainant
- **Derivative =** wrong done to the corporation, but brought by someone else on their behalf
    - A derivative action is a vehicle that carries causes of action when board will not bring the action
    - Actions belonging to the corporation in relation to 3rd parties (breach of contract, tort, trust)
    - Actions belonging to the corporation in relation to the directors/officers (breach of fiduciary duty s 122(1)(a), breach f duty of care s 122(1)(b), torts, breach of contract)

Two views:

- **Traditional Approach:** A complainant cannot run a derivative action as though it were an oppression action. The complainant needs a distinct claim beyond loss in share value.
    - ***Hercules, Brunette, Rea, Shefsky***
      ***CSA Buidling*: "**the claimant in an oppression action must show particular prejudice or damage beyond the diminishing in value of their shares as a result of the allegedly oppressive conduct:
    - Even the traditional approach acknowledges that there can be overlap, but there are clear distinctions

- **Looser Approach:** A complainant has considerable flexibility in how to proceed and it can be OK to avoid the derivative action.
    - **VERY RARE.**
    - *Malata*: In the context of a closely-held corporation, court essentially makes this claim. Note however, the complaint actually had an oppression claim in the traditional sense. When the defendant's misappropriated corporate property, that was an injury to the corporation but also to the complainant because along with being a shareholder, they were also a creditor
        - Clearly oppression on the facts
    - Aspects of *BCE*

Should always seek leave and proceed both ways so that your limitations period does not expire.

SCOPE OF RELIEF AVAILABLE

Section 243(3) lays out a broad kind of orders that the court may make (although not limited to)

- Remember, oppression is rooted in equity (fairness) and therefore, relief must be equitable to all parties

The discretionary power within the oppression remedy has two limitations:

1) It should not seek to punish but to apply a measure of corrective justice (rectify oppressive conduct), and

2) It should only protect the person's interest as a shareholder, director, or officer as such

Example of relief available:

- Court can order that a shareholder resolution not be implemented (*Ferguson*)
- Court can order other shareholders to buy out a shareholders shares at fair market value (*Naneff*)

Wilson v Alharayeri

Facts:

- W treated A unfairly
    - Played a key role in convincing the board not to convert his shares into common shares, diluted the value of A's shares

Issue: Should there be an order/remedy against W? **YES.**

Analysis:

- Judge ruled that W had to personally pay damages for his conduct to the respondent, including because W had personally benefited from the oppression
- Nature of the oppression remedy is well recognized – s 241 creates a equitable remedy that seeks to ensure fairness, what is just and equitable (*BCE*). It gives a curt a broad, equitable jurisdiction to enforce not just what is legal, but also what it fair.
    - Courts considering claims for oppression are therefore instructed to engage in fact-specific, contextual inquires looking at "business realities", not merely narrow legalities
- There is no universal formulation as to when a director/officer will be personally liable in oppression. The SCC endorses *Budd* which offers a 2-prong test:
    - (1) The oppressive conduct must be "properly attributable to the director because they are implicated in the oppression"

- (2) The imposition of personal liability must be fit in all circumstances
  - 4 general principles:
    - (i) The oppression remedy request must in itself be a fair way of dealing with the situation
      - Five factors where personal orders might be appropriate as providing some indica of fairness:
        - (1) D's obtaining a personal benefit
        - (2) increasing control over the corporation
        - (3) breaching a personal duty
        - (4) misusing a corporate power
        - (5) where a remedy against the corporation would prejudice the other security holders
      - Note this is not a closed list of factors.
      - Personal benefit and bad faith remain hallmarks of conduct not properly attracting personal liability, but are not exclusive.
    - (ii) Any order should go no further than necessary to rectify the oppression
    - (iii) Any order should service "only to vindicate the reasonable expectations" of the complainant(s)
    - (iv) A court should consider the general corporate law context in exercising its remedial discretion
      - Director liability should not be ordered where other forms of relief may be more fitting in the circumstances

- **Application:**
  - Under 1st prong: the oppressive conduct was properly attributed to W because he played a lead role in the board discussion
  - Under 2nd prong: W personally benefited, affirmed the personal order against W

Holding: Overall principles:

1) Where it is appropriate to impose personal liability, this does not necessarily lead to a binary choice between the directors and the corporation:
   - "surgery with a scalpel, not a battle axe"
   - When there is a personal benefit but no finding of bad faith, fairness may require an order to be fashioned by consider the amount of personal benefit
     - May not be appropriate to allocate responsibility partially to the corporation and partially to directors personally
2) Any order made under s 241(3) should go no further than necessary to rectify the oppression (*Naneff*)
3) Any order made under this section may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders (*Naneff*)
   - Cannot vindicate expectations arising merely by virtue of a familial or other personal relationship, and cannot serve a purely tactical purpose
   - Cannot allow them to "jump the creditors'" queue by seeking relief against a director personally

- This section still must remain rooted in and informed by the reasonable expectations of the corporate stakeholder

4) Court should consider the general corporate law context in exercising it remedial discretion under s 241(3)
    - Statutory oppression can be a help, but it cannot be the total law with everything else placed secondary
    - This means that director liability cannot be a surrogate for other forms of statutory or common law relief, particularly where such other relief may be more fitting in the circumstances

Naneff v Con-crete Holdings Ltd

Facts:

- Rainbow was founded and built by N and was very successful.
- His sons, B and A, have each been 50% owners of the equity in the company, they were looking forward to getting complete control after their father passed away.
- A's parents did not like his wife, so gave him an ultimatum that he would be put out of the company unless he divorced her.
- He was dismissed from the company on this basis.

Issue: Is there an oppression claim? **YES.**

Analysis:

- In normal circumstances, a claim for wrongful dismissible is not, in itself, a proper claim to be asserted by way of the oppression remedy
    - Where the dismissal is part of an overall pattern of oppression, and where the complainant's position of employment is closely connected with their rights as a shareholder, officer or director, the dismissal may properly be considered as part of that pattern of conduct.
- What are all the options for relief?
    - Put A and B in charge, remove N from his position of control
        - Court rejects this as it treats N unfairly.
        - Note, that A only worked for the company for 8 years, but N founded it.
    - Rainbow group be put up for sale, so anyone could bid (gives A and B chance to bid)
        - TJ picks this, but it is reversed on appeal
    - Other family members would acquire A's shares at fair market value
        - He would sell his majority position without a diminution in price reflecting a share purchase price of the minority shareholder
        - Unfair – then giving the oppressors what they wanted all along
- Court of Appeal:
    - A could never have reasonably been expected to be the owner on his father's death, he could have only expected this if he stayed in his father's favour
        - A remedy that rectifies cannot be a remedy that gives a shareholder something that even he could not have reasonably expected
    - Articulated a test for how to apply remedies in this scenario:
        - discretionary powers in this section must be exercised within two limitations:
            - They must only rectify oppressive conduct

        - They may protect only the person's interest as a shareholder, director, or officer as such
    - Second error – it attempts to protect A's interests in the business as a son and family member as well as a shareholder
        - Lower court's approach did more than rectify and protect A as a shareholder

Holding: New remedy: N and B are to acquire A's share at a fair market value without a minority discount

BRIEF SUMMARY OF COURSE

Basis propositions

1. The corporation is a **legal entity** distinct from its shareholders. See **Part 3** of the ABCA (*Capacity and Powers*). See **Chapter 4** (*The Corporation as a Legal Person*) of the CB.

2. The corporation has to be **created**. See **Part 2** of the ABCA (*Incorporation*). This part includes rules governing the very common occurrence of a person attempting to contract with a corporation prior to its incorporation. See **Chapter 3** (*The Process of Incorporation)* of the CB.

3. Statutes creating corporations follow **different models**, a basic knowledge of which is necessary in order to interpret the case law. See **Chapter 2** (*A Backgrounder to Corporations*).

4. Corporations may be subject to expectations regarding corporate social responsibility. See **Chapter 7** (*Corporate Social Responsibilities*).

5. Corporations sue, are sued, do business, keep records, etc. See **Section 4** of the ABCA (*Registered Office, Records and Seal*).

6. Corporations commit crimes, torts and regulatory offenses. They can also enter into contracts. See **Chapter 5** (*Tortious, Criminal, Regulatory and Contractual Liability of the Corporation*).

7. Corporations have to be **managed**. See **Part 9** of the ABCA (*Directors and Officers*) on the source of the Ds. power to manage, their qualifications, how they are paid, as well as their legal obligations. See **Chapter 6** (*Corporate Governance*).

8. Corporations have **shareholders.** See **Part 11** of the ABCA (*Shareholders*), Part 12 (*Proxies*), Part 14 (*Fundamental Changes*). See **Chapter 8** (*Shareholder Rights*) and **Chapter 8** (*Shareholder Remedies*) of the CB. See **Part 19** (*Remedies, Offences, and Penalties*) of the ABCA.

9. Corporations have rights. See **Part 19** (*Remedies, Offences, and Penalties*) of the ABCA and **Chapter 8** of the CB

10. Corporations need capital. See **Part 5** (*Corporate Finance).* See **Chapter 3** (*Process of Incorporation, Part C Share Capital*).