# CORPORATIONS LAW

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# Corporations Law

## Chapter 1: Choosing the Form of Business Enterprise

Objectives:

- 3 primary vehicles: proprietorships, partnerships and corporations
- Key provisions: *Partnership Act* ss 1-4, 6-15, 28, 33-34, 38-39, 48-51, 53-54, 56-59, 64, 67, 81-82, 105-106, 108, 110-113, 115-116

**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 person separate and distinct from the person or persons 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

- "Person" has two meaning – an artificial person (corporation) and a natural person (an individual)
- Important topics:
  - Rights and liabilities of a corporation
  - Rights and liabilities of the individuals behind the corporation
  - Rights of those dealing with or being impacted by the corporation and/or those behind a corporation

**Factors to choose a business vehicle**

1. Creation and other formalities:
   a. How is it set up?
2. Risk of loss:
   a. Who runs the financial risk of the business failing?
3. Power of control:
   a. Who is the boss, who makes decisions?
4. Participation in profits and distribution of assets:
   a. How are the profits divided up? What happens to leftover assets when the business ceases to do business?
5. Dissolution:
   a. How is it dissolved, terminated, brought to an end?

**Consider the following when choosing:**

1. Main factor is always who bears the risk of loss
2. Nature of the business will have an effect on importance of limited liability (e.g. lawyers can't achieve limited liability through incorporation, s 133 of the *Legal Profession Act*)
3. Desired income tax treatment
4. Desirability of perpetual existence
5. Number of persons involved
6. Amount of control parties want
7. Borrowing requirements
8. Availability of gov't grants
9. Estate planning
10. Employee participation
11. Cost
12. Flexibility

### Sole Proprietorship

**Main takeaway:** simple and cheap for a small enterprise, main drawback is unlimited liability. Some tax consequences
**Factors:**

- <u>Creation:</u>
  - Very easy and cheap to start – anyone in AB can start one. Can be large or small but usually small organizations choose this
  - 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, and contracting likely refers to someone whose business is that of a contractor
            - Need to register to identify who the SP is, check credit before advancing goods on credit
            - Consequences for failing to register – s 112, 113
                - $500 fine
                - An action may be stopped – e.g. if you want to sue a customer and commence an action, the customer could bring an application to stay the action pending registration – although this is not fatal to the action itself
            - Other formalities:
                - Consider whether any municipal requirements apply – e.g. business license
                - Check the proposed location of business for proper zoning
                - May require a federal license – e.g. trucking across provinces
                - Overall: rules and regulations at play depending on what the business is and where it is being operated
- <u>Risk of loss:</u>
    - Business is owned by one person who is responsible for all its debts – if the SP incurs a debt, they are personally liable (**unlimited personal liability**)
    - Individually responsible for all contracts
    - Vicarious liability:
        - Liability for tortious conduct is a risk that the SP 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
- <u>Power of control:</u>
    - Entire management of the business rests with the SP
    - SP has sole authority to set policies for the firm, make personnel decisions and decide what to do with profits
    - Not accountable to anyone, does not need permission for anything
- <u>Participation in profits:</u>
    - SP has the right to any profits and the right to invest them in the business
    - When the business winds up the owner keeps anything left over after liabilities are paid
- <u>Dissolution:</u>
    - SP has the power to dissolve and decide when to bring the business to an end
    - Easy to dissolve
    - **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 SP brings the dissolution of the business
- <u>Other:</u>
    - Income is directly taxed in the hands of the proprietor at the marginal rate of tax
        - Advantage: b/c 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 *Income Tax Act*, the loss carryover rules in s 111 of the ITA, and the **principle that in order for an enterprise to quality as a "business" it must be carried on with a view to profit**
    - If in the business of supplying services (e.g. lawyer) - don't need to file a declaration of trade name
        - Failure to file can result in a court action

## Partnerships

1. Ordinary partnership:
    a. Unlimited personal liability per the *PA* – see *Volzke* and *McDonic*
2. Limited liability partnership (LLP):
    a. Unlimited personal liability subject to s 12 of the *PA* – many law firms operate as LLPs

3. Limited partnership (LP):
    a. The general partner has unlimited liability; the limited partner has liability limited to the amount of its investment – subject to s 64 of the *PA*

**Main Takeaway:**
**Factors:**

- Creation:
    - Unlike limited partnerships, 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 (see s 106 and 115 of the *PA*)
    - Few formalities
- Risk of loss:
    - Partners face joint or several liability
    - Sec 11(2): each partner in a firm is liable with other partners for debts and obligations of the firm
    - Sec 15: partners are joint and severally liable for wrongs
    - 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
- Power of control:
    - Sec 28(e): subject to agreement, each partner may take part in the management of the partnership business
- Participation in profits:
    - Default rule is equality under s 20 of the *PA*, absent an express or implied agreement to the contrary
- Dissolution:
    - Unless the partnership provides otherwise expressly or by implication, a partnership automatically terminates on the death, bankruptcy or withdrawal of a partner
- Other:
    - 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)

## Definitions

- **Agency:** the fiduciary relationship which exists between persons, one of whom expressly or impliedly consents that the other should act on his behalf so as to affect his relations with third parties, and the other of whom similarly consents so to act or so act (*Bowstead and Reynolds on Agency*)
    - The one on whose behalf the or acts are to be done is called the **principal**
    - The one who is to act is called the **agent**
    - Any person other than the principal and agent is the **third party, outsider or obligee**
- **Indemnification:** making something whole – in this context, indemnity refers to reimbursement. E.g. a plaintiff who pays out 100% can seek indemnity from other partners
- **Partnership:** s 1(g) of the *PA*, means the relationship that subsists between persons carrying on a business in common with a view to profit
    - Sec 6 of the *PA*, each partner is an agent of the firm and of the other partner's other partners for the purposes of the business of the partnership
- **Personal guarantee:** a contract of guarantee that means the individual agrees to satisfy the debt of another, if the individual fails to pay
- **Profit:** the gain that a business realizes over and above the expenditures
- **Joint liability:** joint and several sections 11, 13, 15 of the *PA*, a shared liability such that each defendant is liable to the full extent of the obligation in question (e.g. s 11(2) of the *PA*))
    - E.g. when the firm fails to pay back a loan, each partner is liable for what it owed, and the client who receives negligent legal advice can recover 100% from any partner because liability is shared
- **Several liability:** a separate or distinct liability based on apportionment according to fault or responsibility
    - E.g. is each defendant is held in several liability such that each is 20% responsible, the plaintiff can only recover 20% from each defendant and not more
    - E.g. insider trading in *Tongue v Vencap* - directors bought shares from plaintiffs based on insider trading, plaintiff sold shares for less than he otherwise would have to the directors. Plaintiff established liability against directors,

asked for a finding that they were jointly liable - b/c if joint, then can go after any defendant for 100% and not just the pro-rated share
    - **Sec 130 of the *PA* –** a person who practices insider trading is liable to compensate any person for direct loss suffered by that person as a result of the transaction
    - This section means that the defendants are not jointly liable to the plaintiffs, instead each defendant is severally liable – each defendant is required to compensate the plaintiffs for losses in an amount equal to the proportion of shares it wrongfully purchased from the plaintiffs
- **Joint and several liability:** a form of liability such that the plaintiff can collect 100% on its judgment from any of the defendants, but facilitates apportionment as between defendants according to fault or responsibility – s 15 of the *PA*

## How to determine if a partnership exists

(see *Volzke*)

1. Look to the statutory definition in relation to the facts – s 1(g) of the *PA*
2. Rules provided in the *PA*
    a. S 4(a): joint tenancy, TIC, joint property, common property or part property <u>does not in itself create a partnership</u> as to anything owned
    b. S 4(b): the sharing of gross returns (all money received in connection with the business) does not of itself create a partnership
    c. 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
        i. **Sharing a profit is the key indicia for the existence of a partnership**
        ii. 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

## Agency Law

**Key question:** is the principal bound due to agency law?

**Per *PA*, s 6:** Each partner is an agent of the firm and of the partner's other partners for the purposes of the business and of the partnership (which is why you have joint liability, all liable for each other)

**Agency:** Agency is the fiduciary relationship which exists between persons, one of whom expressly or impliedly consents that the other should act on his behalf so as to affect his relations with third parties, and the other of whom similarly consents so to act or so acts (per Bowstead and Reynolds)

- **Principal**: the one on whose behalf the acts are to be done
- **Agent**: the one who is to act
- **Third party:** any person other than the principal and the agent

## Kinds of Authority

(see *McDonic*)

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 hasn't been explicitly recited. *Extended by the "usual" or "customary" authority of an agent*
    b. **Express:** powers clearly or expressly given to the agent as well as those powers that can be inferred as being in place based on written or oral words

Note: every agent 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 termed the 'usual' and/or 'customary' authority of an agent** in the trade in which the particular agent is employed, unless something was expressly said by the principal to contradict it.

**Actual authority**

Express

Implied

2. **Ostensible or apparent authority:** this is the impression of authority that the principal has created
    a. **Ostensible authority:** arises from a representation by the principal to a third party, as to the agent's authority
    b. **Apparent authority:** 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 (an authority which apparently exists, but in fact it does not)
    c. This principle comes into play where a person is held out as agent when that person is not an agent, or being an agent is held out to possess an extent of authority greater than which has actually been conferred

**Takeaway:** the principal is bound when the agent has actual or ostensible authority. In a partnership, each partner is an agent of all other partners and therefore binds if the partner has actual or ostensible authority

### Legal Tests per *McDonic re Authority*

1. **Express authority:** flows from the authorization of the other partners
2. **Implied authority**: flows from acts done in the ordinary course of business of the firm
3. **Apparent authority:** concerns whether a person dealing with the partner would reasonably regard the partner as acting on behalf of the partnership – this would be due to a *representation of authority* by the partner(s) to the third parties – did the other partners clothe the person with the apparent authority to do what they did?

### *Volzke Construction Ltd v Westlock Foods Ltd*

<u>Facts:</u> Appellant is a contractor, undertook to build in two phases an addition to a mall but was not paid the final billing. Sued respondent company alleging that the respondent was in partnership with another limited company, and was liable for the debt
<u>Issue:</u> are the companies' partners or mere co-owners? Important because if partners, liability on the other party's bill
<u>Reasons:</u>

- Control doesn't 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
- <u>**CA outlines an approach to use in cases of alleged partnership**</u>
    - **Need to look at all relevant factors surrounding a course of dealing between businesses associated** (e.g. shared bank account, mortgage, sharing of profits, etc.)
    - **Do not need to show control for a partnership because this isn't in the definition in the *PA***
    - **Test for partnership based on intent, and is functional – parties are partners based on what they do and how they act**

### *McDonic Estate v Hetherington*

**Legal proposition:** you are your partner's keeper because you have joint liability for their negligence – tremendous responsibility for what they do, whether you know about it or not. <u>Lack of awareness is no defence</u>. Responsibility for partner goes beyond firm assets, the innocent partner's personal assets can also be seized and sold (if you share the benefits you should share the losses)

<u>Facts:</u> Partners had liability for their partner's malpractice because his poor investing advice were part of the ordinary course of business for this law firm. Two elderly sisters retained Watt, a partner in McDonic law firm, he made investments on their behalf, they received very poor financial advice. Watt did not inform them of the nature of the investments he was making or get their approval
<u>Issue:</u> Are Watt's partners liable for the sisters' loss based on actual or apparent authority?
<u>Reasons:</u>

- Relevant statutory provisions from AB *PA*:
    - **S 12:** if you are an innocent, uninvolved partner you will not be liable beyond firm assets <u>(legislative defence for the innocent)</u>
    - **S 13**, liability of firm for 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 (court says this is **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 parson and misapplies is (court says this is **apparent or ostensible authority**)
- Ostensible authority: Watts 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: s 13, <u>ordinary course of business can include a dishonest or improper purpose or else the scope would be too narrow</u>
  - Express: no express authority on the facts here
  - Implied: yes, if investing a client's money falls within the ordinary course of business

<u>Holding:</u> Watts acted under implied authorities and the partners fell with him

**Note: it is the <u>nature</u> 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**

### "Am I my Partner's Keeper?"

- ***Korz v St. Pierre***: "A partner is liable for the wrongful acts of another partner committed in the ordinary course of the partnership's business, even though he or she had no direct participation in the events giving rise to the lawsuit or was even aware of them
  - Firm should have policy about personal business dealings with clients.
- ***McDonic Estate*****:** Even where agent is acting outside of the scope of their authority, partners can be liable on basis of apparent authority in that case. Factors: lawyer was partner, worked at their office; corresponded on letterhead; received cheques from firm account, all records of investments kept by employees of the firm
- Page 17 casebook

## Limited Partnerships (LPs)

- **Sec 49-80.1 of the *PA***
- Created by statute - governed by *PA*, but need to take specific steps to create them
- An LP will consist of one or more persons who are limited partners (s 51 PA)
  - The **general partner has unlimited liability for the obligations of the partnership, while a limited partner is liable only to the extent of the amount of money or other property he or she contributes** or agrees to contribute to the limited partnership (*PA* ss 56 and 57)
- LP is a hybrid - offers investors limited liability similar to a corporation but also a flow through of losses and other tax consequences that are characteristic of partnerships
  - Essentially investment vehicles used where investors want the tax treatment afforded to partnerships but are willing to relinquish their right to control and manage

**General Rules**

- The **surname of a limited partner cannot appear in the firm name unless it is also the name of one of the general partners** - if it appears then the limited partner will be **liable to any creditor as a general partner**, unless the creditor had actual notice that the limited partner was not a gen partner (PS s 54)
- Gen partners are subject to all liability of a partner in an ordinary partnership
- Limited partners not liable for obligations, except in respect of the amount of property they contributed or agreed to contribute to the capital
- A limited partner's interest is assignable and dissolves on death (ss 66, 68)
- The retirement, death or mental incompetence of a gen partner dissolves the partnership unless the business is continued by the remaining gen partners based on a right to do so set out in the certificate or with the consent of the remaining partners (s 67)
- Only gen partners may be shown on the title for any real property owned by the limited partnership (s 55(3))

**When not to choose an LP**

- Where the limited partners want to participate in the control and management, b/c **s 64 of the PA eliminates a limited partner's liability if "he takes part in the control of the business"**
  - What constitutes "control" is still not clear - may be a question of fact, decided on a case by case basis

## Limited Liability Partnerships (LLPs)

- Basically an ordinary partnership in which partners enjoy a measure of limited liability in certain circumstances – if formal steps aren't taken then all you have is a partnership
- Rationale: idea that many modern firms have a large partner population with different branch operations, makes the concept of effective supervision of partners virtually impossible

**General Rules**

- Need to have "LLP" in the name (s 5)
- Partnership must advise all of its existing clients of its registration as an AB LLP and explain the potential changes in partner's liability as a result of registration
- Individual partners bear full liability for their own negligence or wrongful acts, for the acts of people under their supervision, and for failing to act when they know of an act
- Partners not involved in the act or responsible are not personally liable except to the extent of their interest in the partnership property
- Partners in AB LLPs not shielded from liability for the partnership's ordinary contractual obligations

### Section 12 Shield for Innocent Partners

- Sec 12 *PA* (casebook pg. 472)
- Liability of partner in LLP: **if the firm in question is an LLP, s 12 provides a partial shield to innocent, uninvolved partners.** Wrongdoing partner can't claim protection of s 12. S 12 shields the innocent from: personal liability from the malpractice, negligence, etc. of the partner in question or an employee who is acting in the ordinary course of carrying on business in an eligible profession.
    - The partner disputing liability must be innocent and uninvolved - includes the idea in the legislation under s 12(2) that the partner in question didn't know about the problem - if they did know and failed to take reasonable steps, the shield won't hold
    - If the problem arises because the partner in question had a duty to provide supervision and failed to do so, the shield won't hold
    - Where one of the LLP partners was negligent or misconducts herself, the **other partners are shielded from personal liability in excess of their share of the partnership assets**
    - The shield applies in the context of negligence or misconduct, all partners remain liable for the ordinary debts of the firm, e.g. in section 11 and on pg. 6 casebook
- **When the shield doesn't apply at all:**
    - Doesn't apply to all kinds of partnerships, b/c not all are allowed to operate as an LLP
    - Those that can include, e.g. law and accountancy - investment providers are not allowed

## Unlimited Liability Corporations (ULC)

- These are another exception to the principle that corporations afford limited liabilities to shareholders - Alberta amended the BCA in 2005 to allow them
- Incorporation procedure - identical to regular corps, **except that:**
    - The corporate name must end with the words "unlimited liability corporation" or the abbreviation "ULC"
    - The articles must state that "the liability of each of the shareholders of the ULC for any liability, act or default of the ULC is unlimited in extent and joint and several in nature" (BCA ss 15.3, 15.4)
    - ULC status must be prominently displayed on share certificates but failure to do so won't affect the unlimited liability of any shareholders (BCA s 15.9)
- ULCs can amalgamate and theoretically continue from one jurisdiction to another but some corporate authorities are reluctant to give consent (b/c AB shareholders have greater unlimited liability than NS)
- Because many provinces won't consent to the continuance of a LLC of that province to Alberta as a ULC, need to do this in two steps:
    1. Continuance to AB as a LLC, then
    2. Amendment of the articles to convert it to a ULC
- Primarily used by Americans as a tax effective vehicle to hold business interests in Canada - b/c they are taxed in Canada as corporations but treated as flow-through entities for tax purposes in the US

## Business Corporation

- Provincially created under ABCA, federally created under the Canada Business Corporations Act (CBCA) (roughly analogous, but some large differences)

## Professional Corporation

- If the individual professional who is practicing law through a professional corporation is negligent, the plaintiff is not limited to the assets of the professional corporation - client can still go after the assets of the lawyer due to provisions of the Legal Professions Act - sec 133(2)

### Difference between a business vehicle and business arrangement

- Business arrangement: e.g. a franchise - is a business commitment, best characterized as a type of contract (pg. 18)
  - 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, a corporation may be the business vehicle, or maybe a partnership

# Chapter 2: Background to Corporations

Key statutory provisions: *ABCA* ss 16, 46

#### *SalSalomon v Salomon & Co Ltd*

Facts: S transferred his business, initially run as a sole proprietorship, to a corporation incorporated with members of himself and his family. The price was paid by way of shares and debentures. When the business failed and went into liquidation, S's right to recovery against the debentures stood prior to the claims of the unsecured creditors. The liquidator alleged that the company was a sham, essentially an agent of S and therefore S was personally liable for the debt- sought to overlook the separate personality of S Ltd.
Issue: Whether, regardless of the separate legal identity of a company, a shareholder could be held liable for its debt over the capital contribution so as to expose the member to unlimited personal liability
Reasons:

- S was found to have properly incorporated the company, so his motives were irrelevant - this case firmly created the legal fiction of "corporate veil" between the company and its owners/controllers
- Any rights, obligations or liabilities of a company are discrete from those of its shareholders, where the latter are responsible only to the extent of their capital contributions (limited liability)

**Important takeaways from *Salomon***

- A corporation is a separate legal entity - separate corporate legal existence
- Shareholders are not liable for corporate obligations
- Corporations are not agents of the majority shareholder (at least without more)
- Shareholders can lend to and take security back from the corporation in which they hold shares
- Section 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 Structure of a Corporation

**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 decisions 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 shareholders often coincide, but where they don't coincide the director’s interest is to the corporation**

- Keep an eye on the CEO and make sure that they're doing their job well

**Officers:**
- E.g. president, vice president, secretary, treasurer
- Manage the corporation – hire others to assist in management and carry on business of the corporation
- Supervise 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 operations

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

## The Corporate Constitution

Importance: the corporation must stay within the confines of the document governing it. Whenever there is a conflict, it is crucial to know the foundation on which the conflict ought to be resolved.

**Corporate constitution:** every company has certain basic charter documents that constitute the fundamental terms of the corporation concerned. In exercising its power, carrying on business and organizing its affairs, every company must stay within the boundaries traced out by that constitution (McGuinness)
- The nature of the documents comprising the corporate constitution depends on the statute under which the company is incorporated – may take the form of letters patent, a special Act, articles of incorporation or a memorandum of association

### How Corporations Come into Existence

1. **Special acts of incorporation:** used by the fed and prov 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 the type of business Is not usually a concern
    a. 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 corps are created this way

Different models across Canada on how corporations come into existence and what powers they possess:
1. **Letters Patent Company**
    a. This method of incorporation is a 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 document called the letters patent
    b. The letters patent is the constitution of the new company - contains info like name of the company, business purpose, ownership
    c. Rules governing the day to day operations are called bylaws, contained in a separate document
    d. Only applies to business corps created in PEI
2. **Memorandum of Association Company**
    a. Aspects of this model are in Nova Scotia and BC, Alberta uses it only for creating not for profit corporations
    b. Incorporation achieved by registering a memorandum of association and articles of association with the registrar
    c. It is a brief document that sets out the constitution of the company, the articles set out the day to day operating rules, which are quite extensive
3. **Articles of Incorporation Company**
    a. The majority of the provinces (including AB) and the fed government use this system - articles of incorporation are filed with the appropriate government body, which issues a certificate of incorporation
    b. The articles recite the corporations name, purpose and capital structure
    c. Day to day operations set out in bylaws - relate primarily to internal stakeholders and provide for routine matters

Comparison of methods:
- 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:**

1. 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
2. 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
3. USAs: unanimous shareholders agreement, see s 146 *ABCA*

### *Jorex Ltd 477749 Alberta Ltd*

Facts: Board called a special meeting of shareholders of Jorex - a few weeks prior to the meeting, the board of directors purported to cancel the meeting by notice. One of the shareholders applied for an order confirming that the cancellation was of no force and effect. Shareholders cared because they would lose the right to examine the shareholder in s 168 of the ABCA (actually was the CBCA but same provision)

Issue: Do the directors of a fed corporation have the power to cancel a special meeting called by them in advanced of the date?

Reasons:

- Directors do have the power to cancel – the ABCA provisions 101 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 (different than British model)
- 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 don't 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 wouldn't extend to the unilateral cancellation of any meeting property conveyed on the shareholder's request*
- **Shareholders have other options, don't automatically lose the right to examine the auditors if the meeting is cancelled:**
  - Oppression remedies (s 242 ABCA)
  - Shareholders can requisition the calling of a meeting (s 142 ABCA) – directors can't cancel this meeting, not in their residual power because the general power to cancel is read in light of the statutory provisions limiting it
  - Can apply to the court under s 144 for an order directing that a meeting proceed (s 132 ABCA)
  - Director's power to cancel is limited by the statutory requirement that an AGM be held no later than 15 months preceding the general meeting (s 155)
  - At the AGM the shareholders may remove the directors (s 109 ABCA)
  - Sec 132, AMGs and special meetings - power is limited by statute that AGM must be held every 15 months, or 18 months after creation – don't have the power to cancel an AGM that would contravene s 132
  - The shareholders retain the right to eliminate the directors' power to cancel meetings called by them by including a provision to this effect in the bylaws or a USA (s 102(5) ABCA)

**Takeaway:**

- Importance of understanding differences between methods of incorporation and how this impacts the relevancy of precedents
- Under our model directors have residual management powers, in the UK shareholders give the power to manage to the directors so they don't have residual management powers

# Chapter 3: Process of Incorporation

Key objectives:

- Corporations are creatures of statute and have to be incorporated in order to come into existence
- The *ABCA/CBCA* contain the rules governing creation
- Requirements: corporate name and corporate constitution
- Early common law didn't recognize pre-incorporation contracts and could hold the person who contracted on behalf of the corporation (the promoter) personally liable
- This common law approach has been altered by s 15 of the *ABCA*

Key statutory provisions:

- *ABCA* ss 1, 5-14, 15, 20, 146, 163, 246-248, 249
- *CBCA* s 14
- *Partnership Act* ss 110-115

## Overview of Incorporation

**Where**

- General practice is to incorporate provincially within the corporation where business is expected to be conducted, then if there are several jurisdictions incorporate federally – tied to clients' needs
- Shopping for a specific jurisdiction in Canada has never been prevalent because treatment is similar (although NS, BC and AB are the few which allow unlimited liability corps)

**Who**

- 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

**How**

- 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 by s 106 (notice of directors)
- S 6: sets out what info 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
- Also see s 12(3), s 20 and s 106

Note: <u>Articles providing for the right, if any, to restrict the transfer of shares</u>

- Traditionally been two reasons for including these:
    - Small private corporations typically wish to impose registrations on the transfer of shares because the remaining shareholders don't want to be forced into business with someone they haven't vetted, need to have a say
    - Presence of share transfer restrictions is important in modern private companies, the private issuer - if you're a private issuer you won't 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**

- See s 131(3), s 102(2)(4)
- 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) pg. 498
- Provide in house rules and respond to possibilities suggested by the ABCA
- **Sec 131(3) BCA**, 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 cote at the meeting
- Usually come from directors but still have 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.

    - Penalty if directors fail to do so - 102(4) - if a bylaw amendment, repeal, etc. is rejected by the shareholders or if the directors don't submit as required, the bylaw ceases to be effective

**Directors Organization Meeting**

- Sec 104, Organization Meeting: a meeting of the directors shall be held at which the directors may make bylaws, etc.
    - At this first meeting directors can also adopt a corporate seal (but under s 25 this isn't required)

**Other Matters**

- Organizing the info of the corporation
- Sec 21 - a corporation shall prepare and maintain … a copy of USA agreement, any amendments, minutes of meetings and resolution, copies of financial statements
- Sec 23 - who has access to these records
- Client must clearly understand the consequences of incorporation (see pg. 40 of casebook)

**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 relationship, and lack of a market for reselling the shares
- Distinguishing between companies with more or less shareholders - private vs public, Ontario has offering vs non-offering, etc. - different ways of describing
    - ABCA has the distributing corporation (defined as a reporting issuer, s 1(p)) and non-distributing corporation SEE PAGE 37
    - The more involved the corporation is in the public domain, the more accountability and disclosure is required - non-distributing corporation is under less scrutiny
- Takeaway: ABCA distinguishes in a broad way between distributing and non-distributing corporations - the latter is subject to less mandatory rules
    - E.g. under s 163, shareholders of a corp other than a distributing may resolve not to appoint an auditor

**Professional Conduct**

- 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 these) – but it is advised to document the communication between lawyer and client

**USAs (unanimous shareholders agreement)**

- Governed by s 146 ABCA
- Device in which closely held corporations can enjoy the benefits of incorporations with the flexibility of partnership because the relationship can be customized
- Deal with a number of matters, set contractual ground rules:
    - E.g. to restrict the power of the directors to manage the corporation - s 146(1)(c ), 102(1)
    - Used to limit transfer of shares
    - Establish a manner of dispute resolution
- CBCA approach - more narrow than the ABCA (must concern the power of the directors to manage)
    - ABCA approach - more flexible - includes any provision that goes to the internal affairs and organization of the corporation as listed in s 146
- Difference between a USA and ordinary shareholder's agreement: USA is governed by the Act and it ranks on par with the corporation's constitutional documents and articles and bylaws.
    - Can seek a compliance order under the legislation if the USA isn't respected (s 248) or enforce it via a conventional breach of contract claim
    - Sec 146(8) - very difficult to change a USA once it is in place
- Also see ss 146 (ABCA), s 102(1) and 109, s 146(CBCA), and *Cicco*

### *Cicco v 609940 Ontario Inc*

*Looks at the difference between USAs and the statutory regime in relation to bankruptcy and insolvency*

Facts: C and B entered into a USA, C resigns and leaves B as sole director. B, in breach of the USA, adopted a director's resolution that the company makes an assignment in bankruptcy. C moves for an annulment, claimed that because the director's resolution enabling the assignment was in breach of the USA, the assignment was unauthorized

Issue: should the assignment be annulled because the supporting director's resolution was in breach of the USA? What is the reach of the USA?

Reasons:

- In order to annul the bankruptcy, the court must conclude that the assignment ought not to have been made
  - What to consider in determining if the assignment ought not to have been made:
    - Under B&I Act, assignment was "proper" – the trustee has deposed that as of the date of assignment, the company was insolvent
- The resolution and assignment are regular at face value because the director was duly appointed and qualified to act.
  - **The effect of the USA is to limit his authority, but that is an entirely internal matter between the director and the shareholders**
  - **He may be accountable to them for failure to comply with the agreement and the statute but that doesn't render the assignment void or disentitle the trustee to rely on the assignment.**
  - **To hold otherwise would have the result that no trustee could safely act under a corporate assignment in bankruptcy without enquiring into the internal matters on the authority**

Holding: Court agreed the assignment in bankruptcy was contrary to the USA, and therefore contrary to the internal rules governing 5 Star Auto. C has an action for breach of USA against B (private action is permissible)

## Corporate Names

### Common Law and Statutory Requirements

Corporation can be incorporated under a numerical name designated by the registrar, or an alphabetic name – this requires a name reservation and a NUANS report (newly updated automated name search)

A NUANS corporate name search report is required by the federal and most provincial governments when granting new corporate names for use. The report 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.

**Section 12:** a corporation shall not have a name that is prohibited by the regulations, that is identical to the name of a body corporate, etc., or similar to the name of a body corporate… **if the use of that name is confusing or misleading on the basis of its similarity**

- Has been interpreted to mean if the name is likely to deceive the public
- Note: the tort of passing off – even though the name has been approved by the registrar, doesn't mean the company is untouchable
- In AB the registrar will only reject a name if it is *identical* to an existing name – if it is merely similar the name will be accepted but the risk is on the applicant

**Components required for the name:**

1. Distinctive: regulations prohibit names that are too general
2. Descriptive: must briefly describe the business to be carried on, not strictly necessary but helpful
3. Legal element: required by s 10(1)

### *Paws Pet Food and Accessories Ltd v Paws and Shop Inc*

*What happens when the registrar accepts the name but another corporation disputes it*

Facts: The applicant asked the court for an order requiring "Paws and Shop" to remove "paws" from its name. Both operated retail shops in Calgary, sold the same products. The first name company had advertised extensively under the name, and some members of the public wondered if the first company had opened a new shop.

Reasons:

- The fact that customers believed the respondent was a second store of the applicant demonstrated that some are misled and confused by the respondents name
- This evidence confirmed that the names were similar not only in fact but also pursuant to the regulations – found to be in breach of s 12 because it wasn't distinctive
- **Regardless of the approach, it is no defence to an action of passing off that the name has been approved federally or provincially by the registrar**
    - Time and expense are factors!

### *Stenner v ScotiaMcLeod*

*Passing off action*

Facts: The plaintiff, Mr. Stenner, argued that the defendants (ScotiaMcLeod and his daughter) passed themselves off as being part of the Mr. Stenner team after they terminated their own employment with National Bank Financial. He sought an injunction to restrain the defendants from use of the word "Stenner"

Reason:

- High potential for confusion in this case - father, son and daughter were all financial advisors operating independent businesses in a small geographical area, and they all use the same advertising media (radio show)
- The CL action for passing-off protects the goodwill associated with a trademark or trade 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 good name, reputation and connection of the business, the attractive force that brings in customers, includes the nature of future patronage
    - The essence of passing off is the representation of the defendant's goods as those of the plaintiff - 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 succeed in a passing off action, the plaintiff must prove (1) the existence of goodwill, (2) deception of the public due to a misrepresentation and (3) actual or potential damage to the plaintiff** (*Apotex*)
    - Here the grant of the trademark further provided proof that the plaintiff had a reputation and goodwill associated to his name
- Holding: The application for an injunction restraining each of the defendants from using the word "Stenner" is too broad in scope, but held for the plaintiff for the tort of passing off

## Share Capital

### Equity Financing

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

Corporate share: a common, divided, 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 - shares are in all respects equal and that the holders of shares are entitled to be treated alike

- Can defeat this presumption by dividing shares into different classes or series
- All shares in a corp are classified - must belong to one and only one class of shares

**One class of shares**
Where a corp only has one class of shares, the rights of holders are equal and include the right to vote at meetings and receive the remaining property upon dissolution, unless there is some provision that would suggest the contrary (basically the holder of a share is part owner entitled to full participation)

**More than one class of share**
When a corp has more than one class of share, each constitutes a distinct subdivision within the total share capital - may, but need not have rights, etc. distinguishing them from other classes

- May be further subdivided into series
- Where the articles provide for more than one class of shares, the rights, privileges, restrictions and conditions attaching 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 right to receive remaining property upon dissolution must be attached to at least one set of shares

**Common and preferential shares**

1. Common shares: shares that confer a full right of participation in the corporation that issues them, and thus unrestricted rights to participate in dividends and the distribution of remaining property (often called "equity" shares because they are entitled to the equity of the company, meaning the residue after payment of all profits after prior claims such as loan interest and preference dividends, and capital after repayment of all prior claims such as tax, creditors, etc.)
    a. B/c 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
2. Preference shares: special shares to which a preferential right is attached, which causes the share to rank ahead of common shares
    a. Although all preference shares are special shares, some can't properly be described as such because they lacked the preference or right over the common shares - e.g. a prior right to receive a dividend, priority in the repayment of capital upon winding up, a right of redemption or retraction, conversion rights, or poison pill rights which augment the rights attached in the event of a take-over bid
3. Golden share: allows the holder of that single share some sort of special class right to veto specified types of corporate act or change in its basic constitution

Sometimes a share will be subject to a limitation rather than a right - can't describe this as a preference share - e.g. deferred shares, non-voting shares, shares with limited voting rights, etc.

## Pre-Incorporation Contracts

*Note: CBCA approach differs from ABCA*

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 aren't personally liable on the contract.

**Problems**

- Third parties can't contract with an entity that doesn't exist
- Can't have a contract with a legal entity that doesn't exist at the time of contracting (can't ratify an impossibility)
- When the company is incorporated and purports to adopt the contract in question, it is merely engaged in a nullity – the principal (corporation) can't ratify acts by the agent (promoter) that are legal impossibilities (basically can't be the agent of a non-existent principal)

**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 didn't explore the question of whether the parties intended the promoter to have personal liability, simply applied the rule of agency law and said intent is irrelevant
- Harsh 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

<u>*Black v Smallwood*</u>: *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, the intent was that only the corporation would be liable on the contract, no intention that the promoter would be personally liable

There was conflict between the *Kelner* and *Smallwood* cases until the legislature intervened.

**Legislative Response**

1. <u>CBCA approach</u>: the promoter is a **deemed party/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 and adopts the contract the promoter is released
   b. If the corporation isn't 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 amendments introduced (anti-*Westcom*)

2. <u>ABCA approach</u>: the promoter is a **warrantor, not a deemed contracting party**

See s. 15(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 to the contract
   1. That the body corporate will come into existence in a reasonable time
   2. 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 – then go 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)

<u>Assuming application, the promoter is deemed to give two warranties:</u>

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 don't 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 isn't liable for damages if the contract expressly provides they are not liable.**

### *OBCA/CBCA Cases*

### *Westcom Radio Group Ltd v MacIsaac*

*OBCA case, very literal and technical interpretation of the statute*

Facts: Promoter M negotiated a series of contracts with respect to placing radio advertisements for a corporation, which everyone thought had been incorporated already but there was an error - defendant thought she was part of an incorporated hotel business but turns out it was never incorporated. There was no indication that the D was entering into these contracts in her personal capacity.

Issue: Is the defendant personally bound?

Reasons:

- Courts said there was no personal liability and did so by applying a two-step test:
  1. Applied CL principles, based on *Smallwood,* concluded that the defendant wasn't liable - no contract at CL, it only has one party, the other party doesn't exist
  2. Considered whether the statute in question (s 21(1) OBCA)) would change the outcome at CL
- If by application of the CL rules there is no contract, then the statutory provision can have no application, because the statute asks for an oral or written contract - on facts like this we don't have this
- **Only if the parties had entered into an enforceable contract could the enforceable provision be triggered - a failed attempt to contract means the act isn't triggered**

Note: the purpose of the statute was to address this very problem – although the wording in the statute could have been clearer, when read in context it should have applied to these facts.

### *Sherwood Design Services Inc v 872935 Ontario Ltd*

*Whether the pre-incorporation contract has been adopted by the incorporation – analysis of dissent is important step in getting back on track post-Westcom*

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 be used to complete the asset purchase (one of the firm’s shelf companies), and draft organizational documents were sent. The deal didn’t proceed; the shelf company was returned to the shelf and assigned to a subsequent client of the law firm. The plaintiff sued.

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

Reasons:

- The corporation had adopted the contract and the defendant was liable – 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 provision**

### *Szecket v Huang*

- Liability was ultimately determined pursuant to s 21 of the OBCA, instead of basing a finding of personal liability on a combination of CL principles and the application of s 21 - shouldn't first look for a "contract" to which the section can attach b/c this undermines the legislature's effort to supplant the CL laws and eliminate uncertainty
- Court effectively overruled *Westcom* - didn't do this expressly, but *Szecket* now represents law in this area

**Current State of the Law for *OBCA/CBCA***

Correct approach: **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 don’t mean there must be a contract in the traditional CL 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* (1969 DLR)

*How to measure damages for breach of warranty by 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 plaintiff to be the manager for the new "company". Business itself wasn't successful, when the plaintiff was refusing to work on straight commission he was fired, then sued for wrongful dismissal. Termination letter referred to the company which did exist, but not the one with which the plaintiff had contracted.

Reasons:

- Court applied *Smallwood* and concluded Shatsky made a warranty to the plaintiff 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 doesn't exist
  - But the fact that they didn't incorporate the company didn't cause the loss, the loss was from the business not being a success – **the breach of warranty didn't cause the loss to the plaintiff**
- 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.**

**Current State of the Law for *ABCA***

In AB, the CL 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 CL applies and we get into the *Kelner* approach vs the *Smallwood* approach.

## Chapter 4: The Corporation as a Legal Person

Key objectives:

- A corporation is treated in law as a legal person with a personality separate from those behind the corporation
- As a general rule, the corporation has the same rights and obligations as a natural person and the promoters or shareholders are not liable for the actions of the corporation
- In rare situations a court may choose to disregard the corporate veil and impose liability on those behind the corporation
- Directors and officers of the corporation may also be held personally liable for torts committed by them while they were ostensibly conducting business affairs in the name of the corporation

Key statutory provisions:

- *ABCA* ss 1, 5-9, 16, 46, 118-119, 252

Corporations are essentially a legal fiction and only exist because of the *ABCA*

**Nature of Corporate Personality:** *Salomon v Salomon* (chapter 2) held that a corporation is a separate legal entity, and one primary purpose of it is to shield those behind the corporation from unlimited liability. Creditors can't complain afterwards if they take a business risk that didn't 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 aren't 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 Veil:** doing this is very rare in Canada to ensure that the principle in *Salomon* is respected. The leading test is articulated in *Kosmopolous* (when it would yield a result too flagrantly opposed to justice), but there is still no clear and abiding principle for when to lift the veil – taking advantage of limited liability per se isn't barred.

Courts have been more willing to pierce the veil to find a corporation liable for shareholder or sibling corporations (highest veil piercing in the family law context and tax cases where the claimant was a third-party gov't entity), but less willing to do so where it would mean holding a shareholder liable for corporate obligations.

## Summary of Corporate Veil

Lifting the veil is rare, courts are reluctant to impose liability on those behind the corporation because of the *Salomon* principle that a corporation is a separate legal entity, and shareholders have limited liability.

***Kosmopolous* continues to state the law in AB** – courts will only lift the corporate veil when to not do so would be flagrantly opposed to justice.

**The test for lifting the veil from *Transamerica* summarized in *Chevron*** is highly influential and is followed in AB (two step test). Courts will lift the veil when:

1. It is completely dominated and controlled and
2. It is being used as a shield for fraudulent or improper conduct.

**Test outside the parent-subsidiary relationship** is highly similar, articulated in *Jin v Ren* – courts will disregard the separate legal entity of a corporation when it is completely dominated and controlled and being used as a shield for fraudulent and improper conduct.

- The test is met when, e.g. a director causing a wrongful act of misappropriation would result (*Jin*), or see *Dominic Construction* 2019 which gives examples of when to lift the veil - evidence that the shareholder treats itself and the corporation interchangeably, when the corporation is merely created to deflect money from its proper purpose, that the shareholders fail to recognize the corporations proper identity, etc.

*Rockwell* shows the usual outcome that the corporate veil isn't usually lifted – emphasized that there had been no evidence of misconduct, which is almost necessary to lift the corporate veil (also, one person companies have been recognized in the *Salomon* case).

**Reverse corporate veils:** more commonly argued in the family law context

- 3 step *Transamerica* test: plaintiff has to show that
  - The individual exercises complete control over the company
  - The individual has used that control to commit a fraud or wrong that would unjustly deprive a claimant of his or her rights and
  - Misconduct was the reason for the third parties' injury or loss.
- Court in *Aubin* saw the two tests from *Transamerica* are basically the same - but use two step in commercial scenario and 3 step in family law case to follow precedent

### *Kosmopoulos v Constitution Insurance Co of Canada* (1987 SCR)

- The law on when a court may disregard the principle of a corporation being a distinct legal entity by lifting the corporate veil and regarding the company as a mere agent of its controlling shareholder or parent corporation doesn't follow a consistent principle
- However - the "separate entities" principle **is not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of the revenue"**

### *Yaiguaje v Chevron Corporation* (2018 ONCA)

*Transamerica test used for when the court can lift the corporate veil*

<u>Facts</u>: the plaintiff sought to enforce a $9.5 US billion judgment that had been won in Ecuador against Chevron Corporation - a court in New York had previously refused to enforce it. They argued that Chevron US has an indirect beneficial interest in Chevron Canada because Chevron US is the sole owner of the share of Chevron Canada

Issue: are the shares and assets of Chevron Canada exigible and available for execution and seizure pursuant to s 18(1) of the Execution Act to satisfy the judgment?

Reasons:

- Chevron Canada's (CC) direct parent is subsidiary 6 of Chevron US – the judgment debtor doesn't own the shares of CC. CC is not the asset of its parent or any of its intermediaries, it owns itself, so the only way the appellant could win is to have the courts lift the corporate veil and ignore corporate separateness
- **The court can lift the corporate veil when the test from *Transamerica* is fulfilled: courts will disregard the separate legal personality of a corporate entity where (1) it is completely dominated and controlled; and (2) being used as a shield for fraudulent or improper conduct**
- The test is not that the veil can be listed simply because it is just and equitable to do so (not what *Kosmopolous* says)
- **Courts are rigorous in their application of the *Transamerica* test** because the rule is provided for in statute and stakeholders of a corporation have a right to believe in, absent extraordinary circumstances, they may have to deal with the corporation as a natural person
- The group enterprise theory of liability has been rejected in our courts: it states that when there are several corporations operate closely as part of the same "group" of corporations, they are in reality a single enterprise and should be responsible for each other's debts

### *Elbow River*

*Example of Transamerica test used in AB*

- Canadian courts will pierce the corporate veil only when a corporation has been completely dominated and controlled, and used as a shield for fraudulent or improper conduct

### *Transamerica* test in *Chevron* for Lifting the Corporate Veil

Three circumstances identified in *Chevron* where courts will lift the corporate veil – only the second is important, that a court will lift the corporate veil when **the court is satisfied that a company is a "mere façade" concealing the true facts.**

General principle: **the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct.** This involves two steps:

1. **Step one**: the court must be satisfied that there is complete control of the subsidiary, such that the subsidiary is the 'mere puppet' or the parent corporation; and

2. **Step two (going to fraud or improper conduct):** the court must be satisfied that the subsidiary was incorporated for a fraudulent or improper purpose or used by the parent as a shell for improper activity.

### *Jin v Ren* (2016 ABQB)

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

Issue: Should the court lift the corporate veil?

Reasons:

- 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. Ren was retaining money that didn't belong to him and thus expressly directed a wrong to be done, so it was a situation where the corporate veils should be lifted
- Ren was the controlling mind of the company and expressly directed a wrong to be done – on this basis we have personal liability, both Ren and the company are jointly liable and an unjust enrichment claim wasn't precluded

Note: unjust enrichment

- Need to establish (1) an enrichment; (2) corresponding deprivation; and (3) absence of a juristic reason for the enrichment.

### *Rockwell Developments Ltd v Newtonbrook Plaza Ltd*

*Shows the common outcome in a corporate veil argument – courts refuse to lift the corporate veil*

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

Issue: who is the real litigant? K or his company?

Reasons:

- Despite the factors suggesting K was the 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 found in lifting the corporate veil
- The company can't be seen as a mere trustee or agent for K - it is true K stood to benefit from the deal with Newtonbrook, but still the contract was made between the companies

Holding: K didn't have to pay the costs personally - relies on *Salomon* to do so

Note: this case gives a good indication of when courts will lift the corporate veil – there has to be **serious misconduct in the way we see in *Transamerica*** (need evidence the corporation was being used as a shield for fraudulent or improper conduct)

### *Aubin v Petrone* (2020 ABCA)

*Corporate veil lifted here – family law context that contains a "reverse corporate veil". Also recognizes different family law application of Transamerica.*

Facts: P and A were married and incorporated a company called Q. P essentially owns and operates the company. They bought a home through another company they owned. TJ ordered P to pay A about $5.6 million for matrimonial litigation - P said he had no money on his own but couldn't get money out of the corporation. Lower court ordered that the money judgement be secured against a Q asset, a building, with A being the secured creditor. This would require a reverse lifting of the corporate veil, because one of the assets is security

Reasons:

- This case recognizes the *Salomon* principle and the *Kosmopolous* principle – the **two step *Transamerica* test that is applied in a corporate and commercial sense was slightly altered for the family context**
- **3 step *Transamerica* test: plaintiff has to show**
    - The individual exercises complete control over the company
    - The individual has used that control to commit a fraud or wrong that would unjustly deprive a claimant of his or her rights
    - Misconduct was the reason for the third parties' injury or loss
- Need to make sure that corporate arrangements don't work an injustice in family law – obligations imposed by family law are on fair footing with other obligations – the 3 step test was met here
- **The law shouldn't shelter wrongdoers because the wrong is too "commonplace" in response to the fact that lifting the corporate veil is "rare"** – this isn't a requirement

Note: **reverse corporate veil**

- The ordinary corporate veil makes the individual responsible for a corporate liability – e.g. in *Jin* the individual defendant was jointly liable to return the investment money because he had directed the wrongful thing to be done
- In the family context, the court orders the corporation controlled by the individual to somehow have liability for the individual – basically **makes the corporation liable for an individual obligation/liability**

### "There is still a Corporate Veil"

- Some clients treat assets of their private companies cavalierly. They feel free to intercept or spend company funds. That can be breach of trust or theft even if the client owns all the shares. Even if no shareholder or director ever complains, guarantors or other creditors may complain. They may sue everyone who participated in the breach of trust or theft.
- **Don't treat your clients and their companies as the same thing**, even if they do. Get the authority of the directors before you pay funds to someone else other than the company
- Page 117 casebook

## 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 too small to recover the reasonably foreseeable obligations of the corporation's business.

Even though there are **no statutory or CL 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.

This may justify placing liability on those behind the corporation, the idea is that the failure of the shareholders to adequately capitalize their ventures means they're trying to take advantage of limited liability without the burden – equity will permit the court to find those shareholders liable on that basis (basically implicit wrongdoing).

But there has **not been a case yet where thin capitalization alone has led to ignoring the corporate legal personality** – other factors have always been included.

### *Henry Browne & Sons Ltd v Smith*

Facts: plaintiff was a manufacturer who contracted with Ocean Charters Ltd, the defendant, for a yacht steering device. The plaintiff discovered that Ocean Charters was thinly capitalized and only had 2 pounds in capital, and ended up suing one of the two shareholders, Mr. Smith

Issue: Who does the plaintiff have a contract with? Does the fact of thin capitalization change the outcome in relation to tortious liability?

Reasons:

- Court followed Salomon – the sellers brought an action against Smith but failed because the contract was with the corporation and not the Smiths. No tort committed so no liability
- Argument that the company was a mere sham or the company placed the order as an agent for Smith – these arguments were rejected in *Salomon*, nothing prohibited about running your business as a corporation

### *Walkovsky v Carlton* (1966 NY)

Facts: P injured when run down by a cab in New York. Cab owned by a corporation, which was owned by the individual defendant Carlton. Every other corporation owned by him was set up in the same way - each had two cabs, some auto liability, and he is the sole shareholder.

Issue: Does C the individual have personal liability for the P's injuries?

Reasons:

- P unsuccessfully argued that the defendant corporations were all operated as a single entity unit and were thus all liable to the plaintiff as each other's agents (similar to *Chevron*) – 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 the plaintiff getting compensation, not imposing liability*
- Court says there is no fraud here – running a business through multiple companies in this way is allowed (*Salomon* approach)
- **Thin capitalization on its own isn't independently actionable, although is considered** – although C should have secured better insurance as a business practice, he did have the statutory minimum

Dissent:

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

### *Bond Street Properties*

Lifting a corporate veil due to a corporation's alleged thin capitalization is an American concept, in Canada this does not happen. This case underscores a court's reluctance to lift the corporate veil.

## Total Disregard of Formality

### *Wolfe v Moir* (1969 Alta)

*Holding oneself out*

Facts: A was injured while roller-skating. M was a recreation director for the city. The roller skating company as 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 went to Chinook Sport Shop. Moir was the secretary of the company and his wife was the president

Issue: Is the defendant, M, personally liable? (Yes)

Reasons:

- 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
- **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**
- **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**

Note: reliance

- It is likely in *Moir* that the plaintiff knowing the company wasn't owned by Moir himself wasn't a factor in his decision to skate there – but under the statute **reliance isn't required** – if you don't identify your corporation clearly you get personal liability

### *Vallis v Prairie Alternative Energy* (2013 SKPC)

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 the P's in his personal capacity?

Reasons:

- Factual indicia 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 partiers
    - The nature of the defendant's business
- K failed to comply with the provisions of the *Business Corporations Act* due to the improper identification of the corporation under which he was conducting business
- **Even though the failure to identify wasn't dishonestly done, he is still personally liable to the plaintiffs (intent doesn't matter)**
- **If the individual doesn't make it clear that it is a corporation, you have personal liability**

## Liability in Trust Law

Individuals can find themselves personally liable pursuant to trust law – a stranger to the trust relationship can be liable to the beneficiary under certain circumstances.

Means we need to assess how a director or officer might have personal liability for **knowing assistance in breach of trust**, or for **knowing receipt of trust property**.

1. **<u>Knowing assistance in breach of trust</u>**
   *(Citadel)*

Involves furthering a fraud and is a fault-based form of liability. It requires **actual knowledge** of the breach of trust.

Actual knowledge includes recklessness or willful blindness. Recklessness is doing something without caring if it was wrong or not, going about it regardless if it was wrong, taking a risk you had no right to take.

**Constructive knowledge is *insufficient* to found liability**. Constructive notice is knowledge of facts that would put a reasonable person on notice.

See *M&L Travel Ltd*, where the directors were personally liable for knowing assistance.

2. **<u>Knowing receipt of trust property</u>**
   *(Citadel)*

Requires that strangers to the trust receive or apply trust property for their own use and benefit and involves receipt-based liability.

**Constructive knowledge** (a lower threshold) is therefore sufficient due to restitutionary concerns.

See *Citadel*, where the bank was liable for knowing receipt.

### *Air Canada v M&L Travel Ltd*

*Involves director involvement, knowing assistance, and trust law in a corporate context*
<u>Facts:</u> Facts: M and V operated M & L travel. V took out a personal loan from a bank and repaid it with money from the company every month. Air Canada was supposed to be paid money for their tickets, and the agreement stated that the money for them would be held in trust by M & L until it was paid. M then suspected L was misappropriating funds and the business was closed. Air Canada sued M & L and M and V personally for the money owed to it for ticket sales.
<u>Issue</u>: Should M and V be held personally liable?
<u>Reasons</u>:

- **Elements in knowing assistance:**
  - There is a relationship of trust
  - The trustee breaches the trust
  - The breach was dishonest and fraudulent
    - E.g. the taking of a risk by the trustee or fiduciary to the prejudice of the beneficiary where the risk is known to be one which there is no right to take
  - Defendants assisted the trustee in that breach with actual knowledge (includes recklessness and willful blindness)
- If the trust was imposed by statute, he or she will be deemed to have known of it. If it was contractually created, then whether the stranger knew of the trust will depend on his or her familiarity or involvement with the contract

### *Citadel General Assurance Co v Lloyds Bank Canada*

*SCC case about receipt of trust property, constructive notice*
<u>Facts:</u> Insurance company is the trustee; it deposits premiums belonging to Citadel Gen Assurance (beneficiary). Insurance agent takes premiums belonging to Citadel in its own bank account. Defendant bank knew it contained trust funds. Bank later accepted instructions that the money is paid to the parent company of the trustee (parent instructs the bank to deposit the money from the trustee into their bank account, to reduce the parent's overdraft at the bank).
<u>Reasons:</u>

- Knowing receipt of trust property by the bank: the bank functionally receives the money because it benefits from the transaction
- Mental state: in knowing receipt cases, relief flows from a legally recognized duty of inquiry – **relief will be granted where a stranger to the trust, having received trust property for his or her own benefit and having knowledge of facts that would put a reasonable person on notice, actually fails to inquire as to the possible misapplication of trust property**
- The bank had constructive notice because the emptying of the bank account was suspicious – a reasonable person would have been put on inquiry as to the reasonable misapplication of the trust funds

# Chapter 5: Tortious, Criminal, Regulatory & Contractual Liability of the Corporation

Objectives:

- A corporation, as a separate legal entity, can sue and be sued
- A corporation faces tortious, criminal, contractual and regulatory liability
- Through the principles of agency, a corporation can be bound to perform contracts entered into by its agents

Key statutory provisions:

- *ABCA* ss 6(1)(e), 16-19, 25, 103, 116-117, 179(2)

**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 doctrine 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"* (1993 SCR)

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 operations.
Issue: is the tug master a "directing mind" of the corporation because he performed some non-navigational duties?
Reasons:

- Having actual fault implies a mental fault of the corporation – need to determine at what point the fault of an individual in a company as treated as the 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 (this is British law, sets the stage)
- Look to *Canadian Dredge* **– TEST for directing mind at CL is the same for criminal and tortious matters:**
    - 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 (but not that the directing mind theory is modified in the CC amendments)

Holding: K is not the directing mind – although he was described as a manager, he was subject to the supervision of a captain and didn't hold the relevant authority. Because he wasn't the directing mind fault can't be attributed to the corporation

**Takeaway for torts:** get the mental element for tort from the directing mind theory, look for the mental element from the person who has governing executive authority

**Directing mind:** the person(s) who have governing executive authority to design and supervise implementation of corporate policy

### *Deloitte & Touche v Livent Inc* (2017 SCC)

*Uses corporate identification doctrine test from Canadian Dredge – flexible interpretation*

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

Issue: Deloitte claims that the lower courts erred in failing to find that Livent's action wasn't barred by the defence of illegality, and that Deloitte should only be liable for part of the injury because of Livent's contributory fault

Reasons:

- Defence of illegality:
  - Bars an otherwise valid action in tort on the basis that the plaintiff has engaged in illegal or immoral conduct and therefore shouldn't recover. It is only available in very limited circumstances, where it is necessary to preserve the "integrity of the justice system". Integrity will only be compromised where a "damage award in a civil suit would allow a person to profit from illegal or wrongful conduct, or would permit an evasion of a penalty in criminal law"
- Here the only illegal conduct was committed by the directors, so for Deloitte to rely on this defence it needs to attribute the conduct of the directors to the company itself
- **TEST for corporate identification doctrine - to attribute the fraudulent acts of an employee to its corporate employer, two conditions need to be met: (*Canadian Dredge* test)**
  - 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
- **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, e.g. when an act is totally fraudulent and not a result even partially for the corporation's benefit
- Courts still retain discretion to apply the test – even when the test is met and an attribution would otherwise follow, courts retain discretion when otherwise the result would not be in the **public interest**

Takeaway: shows a flexible interpretation of the doctrine

Etsey J summarizes the test for corporate identification doctrine in *Canadian Dredge:*

*"*Identification doctrine only operates where the Crown demonstrates that the action taken by the directing mind was within the field of operation assigned to him, was not totally in fraud of the corporation, an was by design a result for the benefit of the party."

**Note:**

1. Although the test emerged from criminal law, it is still the test for tortious liability
2. *DeJonge* (SCC 2019) affirms this approach in *Livent;* says even in a civil context, the person seeking to attribute the acts to the corporation must fulfill all three steps from *Canadian Dredgs*

## 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 wasn't worthwhile to prosecute

Fed government amended the CC in 2004 to convict a corporation after the Westray mining disaster – passed **Bill C-45, An Act to Amend the Criminal Code**

Two main changes the Bill implemented:

1. The *actus reus* and *mens rea* can now be located in two different people

2. *Mens rea* can be established if a senior officer has the required mental elements (lesser standard than directing mind)

The Bill also provides that:

1. 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

2. 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 organization's 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 further to Bill C-45 and shows how corporate criminal responsibility has expanded. Notable because the **Crown's burden of proof was collapsed into the conduct of one person** (site supervisor found to be a representative and a senior officer because he was responsible for managing an important aspect of the operation's activities
- Facts: charge of criminal negligence causing death, the defendant company contracted to restore concrete balconies on a high rise building, the swing stage fell and killed four people

**Notes: New Regime**

- Even where an organization exercises due diligence to ensure workplace safety, **there is a possibility of liability for criminal negligence based on the conduct of a single individual**, provided that he or she is responsible for manning an important aspect of the organization's activities
- A site supervisor wouldn't likely have been considered a directing mind at CL, but under the new CC regime the individual can be regarded as a senior officer (responsible for managing an important aspect of the activities)

**Deferred Prosecution Agreements (DPAs)**

- 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
- SNC Lavalin is an example where prosecutors decided against offering a DPA

## Regulatory Liability

Both corporations and officers and directors have exposure to considerable regulatory liability, particularly liability in relation to environmental offences.

Regulatory liability is not criminal in any real sense but can still be very serious and is prohibited in the public interest. Sometimes called statutory liability or public interest liability.

In *Canadian Dredge* the court invokes the system set out in *Sault Ste Marie:*

1. **Absolute liability:** liability instantly arises upon the breach of the statutory prohibition. No particular state of mind is a prerequisite to guilt. Corporations and individuals stand on the same footing – it is a case of automatic primary responsibility. Here, the corporation is treated as a natural person.

2. **Strict liability:** intent is not on an automatic breach of statute, but on the establishment of actus reus, subject to the defence of due diligence. Does not matter if the accused is a corporation because the liability arises according to the terms of the statute. Liability is primary, not vicarious (the individual or the corporation committed the offence)

3. **Mens Rea offences:** traditional criminal offences where the accused is convicted if they have the requisite mens rea

Regulatory offences usually are offences of strict liability – generally, liability is strict in that doing the prohibited act imports the offence, but the defendant can demonstrate due diligence as a way out (see *Bata*)

### *R v Bata Industries* (1992 OR)

*Leading case of due diligence and how directors are liable under environmental protection regulation, and how the corp can be liable*

Facts: Bata Industries and some of its key officers were charged with violation of two environmental acts (chemical waste stored in rusting containers that were leaking). Defence of due diligence failed because they couldn't establish that they took *all reasonable care* (at the heart of due diligence)

Issue: can the individual directors successfully raise the defence of due diligence?

Reasons:

- 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 circumstance. 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 relieved* 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 balance of probabilities
- Personal liability:
  - Although the legislature doesn't expect the board of directors or officers of the corporation to make all environmental decisions, it isn't 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?

**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 the 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 Synrcude Canada Ltd* (2010 ABPC)

Facts: Birds died in a Syncrude tailings pond, Syncrude tried to establish due diligence

Reasons:

- 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 balance of probabilities
  - Not up to the prosecution to prove negligence, rather open to the defendant to prove that all due care has been taken - burden on defendant because he is the only one who would generally have the means of proof
- Due diligence:
  - 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 and will of the corporation, whose acts were in law the acts of the corporation itself
    - To meet the onus - don't 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 on pg. 163 (differs on the facts) - may include the nature and gravity of the adverse effect, the foreseeability of the effect, alternative solutions, skill levels expected of the accused, complexities involved, etc.
- Alternative solutions:
    - To plead the defence of reasonable care the accused must establish on a balance of probabilities that there were no reasonable feasible alternatives that might have avoided or minimized injury - here alternatives were found
- Foreseeability:
    - Foreseeability is considered to determine if the accused has taken reasonable steps. It is only required to take steps that it can reasonably 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

## Corporate Liability in Contract

Question: how and on what basis do we say a corporation is bound by contract?

At CL, 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 of ultra vires: a corporation comes into existence with the limited capacity conferred upon it by its constituting documents. By virtue of this, a corporation can't act outside these boundaries because it doesn't exist outside these boundaries
        - Under the memorandum of association in place at the time, corporations would have to write "objects 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

    <u>Section 16:</u> a corporation has the capacity and rights, powers and privileges of a natural person

    <u>Section 17(3):</u> 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 step back from doctrine of 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 (see *Pickles*)

2. **The constructive notice doctrine (s 18 *ABCA*)**

    - Constructive notice is knowledge of a fact that is presumed or imputed by law. At CL, 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

    <u>Section 18:</u> 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 (doctrine of constructive notice is statutorily repealed in these circumstances)

3. **The indoor management rule (s 19 *ABCA*)**

    - Those dealing with the company aren't affected by the 'indoor management' of the company, meaning the indoor rules governing how things are to 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 can't 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

Section 19: A corporation can't assert against a person dealing with the corporation that the articles hasn't 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/ostensible. The principal is bound by the agent's conduct if the agent is acting with actual or apparent/ostensible authority
    - **Actual authority:** can be express or implied, and results when there is a manifestation of consent to act by the principal to the agent
        - Express actual: the authority that the principal has given orally or in writing
        - Implied actual: agent has to do what is necessarily or normally incidental to the activity expressly authorized. Can be extended by "usual" or "customary" activities (need authority from the principal or someone with authority to speak on behalf of the principal)
    - **Apparent/ostensible authority**: where the manifestation of assent to the agent's authority is made by the principal to a third party. The principal is cloaking the agent with authority and makes a representation to the third party to this effect, and is therefore bound

Main question: *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 can't 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 specific holding out).

## Agency Overview

*(Freeman, Canlab & Doiron)*

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

**Requirements to establish ostensible authority (*Freeman*):**

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(1) 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 wasn't deprives of the capacity to enter into a contract of that time (also make sure it isn't ultra vires)

**How to establish ostensible authority:**

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

## Doctrine of *Ultra Vires*

### *Jon Beauforte (London) Ltd Re* (1953 WLR)

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 the 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 didn't have knowledge of this and sought to be repaid

Reasons:

- Creditor argued that the business needed his supply for its legitimate business and he can't 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 - their claim was rejected

Holding: unfairness here – doctrine seen as inflexible

Note: remember that the CL in AB has changed this – s 16 and 17(3) *ABCA*

### *Communities Economic Development Fund v Canadian Pickles Corp* (1991 SCR)

*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. The 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 thus the loan was ultra vires

Issue: what is the applicability of the doctrine of ultra vires to a statutory corporation?

Reasons:

- **The general doctrine of ultra vires isn't 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 weren't 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 act for public purposes
    - This protects the public interest because a company created for a specific purpose by an act of a legislature shouldn't have the power to do things that won't further that purpose
    - **Here it is a special act corporation – ultra vires applies here because it protects the public purpose – a company created for a specific act by the legislature shouldn't be able to act outside of its purpose**
- Question becomes: was the appellant expressly or impliedly granted the power to act outside its statutory objects? – No

## Contracting with Agents of the Corporation – Actual and Apparent Authority

### *Panorama Developments Ltd v Fidelis Furnishing Fabrics* (1971 CA)

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

Facts: The company secretary fraudulently rented luxury cars 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, defrauding his company of large sums of money

Issue: was the company responsible, did the secretary have authority to do this?

Reasons:

- Need to look not just at the contracts that were signed, 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 by the secretary, so the contract was with the company and not with the secretary personally
- The role of a secretary had changed considerably, he was not just a clerk but regularly made representations on behalf of the company and enters into contracts on its behalf - the secretary had the ostensible authority to enter into the contracts for hire of the cars, so the company has to pay for them
- Need to be aware of who you employ - need to take the risk they 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 Fidelis to Panorama, the plaintiff regarding Bayne's (defrauder) authority
    - **Representation here is by the board of Fidelis appointing Bayne to the position of secretary – the board has clothed Bayne with this authority through the appointment of his job**

Holding: Fidelis 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* (1964 CA)

*Leading discussion of actual and ostensible authority – here found ostensible authority in a permissive manner b/c the corporation held K out through its conduct*

Facts: K was a property developer and entered into a contract to purchase an estate with assistance from H. They formed a limited liability company. 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 on behalf of the company architects and employers. The firm claims now seeks to claim their fees from the company

Issue: is the defendant company liable or is K?

Reasons:

- 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 rights and liabilities between the principal and the contractor
    - **Apparent or ostensible 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

**TEST that allows a contractor to enforce against a company (when an agent has ostensible authority)** Must be shown:

i. A representation was made to the plaintiff that the agent had authority
ii. Representation made by a person who had actual authority (directors authority to manage comes from s 101(1) of the Act)
iii. Third party (contractor) was induced by the representation to enter the contract
iv. Under its memorandum or articles of association the company wasn't deprived of the capacity to enter into a contract of that time (also make sure it isn't ultra vires)

- Remember:
    - The only "actual" authority which is relevant is that of the persons making the representation relied on

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 powers

**Key idea:** How does the corporation (principal) give a representation to a third party pursuant to ostensible authority?

- **Has to come from someone in the corporation who has the actual authority to do so – in *Freeman* we have a representation of the board by its conduct in permitting K to act in the management of the principal's business, which counts as a representation**
- K was held out as an agent who had the authority to enter into these kinds of contracts by someone with actual authority

### *Doiron v Manufacturers Life Insurance* (2002 ABQB)

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

Issue: What is the nature of D's relationship with Manulife? (Is there an agency relationship so that Manulife is implicated?

Reasons:

- D had no actual authority to make contracts on behalf of Manulife in his agreement with Manulife, he was not an agent - his relationship was also non-exclusive (he could sell investment products of other companies). Devon isn't a Manulife product. Other evidence - he paid for his secretarial staff, etc. - he is not an employee
- Test: whether the person performing is doing so as a person in business or on own account. Consider:
    - (1) level of employer control; (2) if the worker provides own equipment; (3) worker hires own employees; (4) degree of financial risk taken by worker; (5) degree of responsibility for investment and management by worker; (6) worker opportunity to profit
- Ostensible authority: court uses the test from *Freeman*
    - Who at Manulife had the actual authority to make representations regarding D's ostensible authority?
    - **On the strength of Manulife's marketing techniques, plaintiff's placed reliance and thought D was a Manulife agent - the reliance cause the loss, so they have met the requirements of the *Freeman* test on this analysis (Manulife held out D as its employee)**

Holding: Manulife held out D as its employee. The failure of D to inform them that they weren't investing with Manulife is a misrep

### *Canadian Laboratory Supplies Ltd v Englehard Industries of Canada Ltd* (1979 SCR)

Facts: C (plaintiff) bought platinum from E (the defendant) and would regularly sell the scrap back to E. Cook (the rogue) conducted E and said that a scientist named 'Giles' was conducting experiments and needed platinum for this experiment. E agreed to ship the platinum ordered by C directly from Giles and make payment for the scrap returns directly to Giles. Cook was discovered after 7 years and had stolen over a million dollars in platinum '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 instructions binding on C to do what it did? It is at this point that its liability in conversion ends, but until this point it is on the hook

Reasons:

- 1962: fraud begins - Cook asks Englehard to send scrap payment directly to Giles
    - Can't bind C at this point because no binding representation by C that Cook had any authority
    - The defendant is liable in conversion starting at this point
- 1966: defendant makes enquiry
    - At this point C is bound so E's liability in conversion ends – Snook was a purchasing agent so had actual authority to handle the matter. Court applies the *Freeman* test
- 1968: representations by C's VP operations
    - These representations would definitely bind

Dissent: says there isn't liability in 1966 because Snook had no managerial authority and thus no actual authority to make representations as to Cook's authority (O'Byrne thinks this is correct)

# Chapter 6: Corporate Governance

Objectives:

- Directors have the task of operating the business and affairs of the corporation by the *ABCA* and are elected by shareholders
- The *ABCA* imposes certain qualifications on directors before they are eligible to take office
- Directors owe a duty of care, skill and diligence and hold a fiduciary position with respect to the corporation
- Directors may be personally liable for a tort committed while conducting the affairs of the corporation
- Directors and officers may have the ability to claim indemnification

Key statutory provisions:

- *ABCA* ss 6(1)(d), 101, 105-109, 111-116, 120-124, 132, 144
- *CBCA* s 123, 237.3, 237.4

## Introduction to the Role of the Board of Directors

**Corporate governance** includes the process by which a corporation is directed and controlled by the 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 **section 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 requirements of the board include:

1. *Appointing and supervising the CEO and other officers* – appointing, setting terms of employment, supervising, compensating, evaluating, and removing corporate officers if necessary. Also approves major organizational changes and ensures that adequate plans are in place for management succession.

2. *Directing and evaluating strategy* – strategic management is the integrated planning and implementation of the major changes needed to improve corporate performance. The board should oversee an action program based on the purpose, strategy, operations, results, etc. of the company. Supervision focuses on keeping management accountable for performance in implementing plans and more to merit continuing support of the shareholders and other stakeholders.

3. *Representing shareholders and maintaining shareholder relations* – includes reflecting shareholder concerns to management, reporting shareholders as legally required and otherwise communicating to them directly or indirectly

4. *Protecting and enhancing the company's assets* – when major issues arise in management, ownership, investments, etc., the board must be fully involved

5. *Fulfilling fiduciary and (other) legal requirements* – board is responsible for adherence to the laws, regulatory requirements and preparation of necessary minutes, documents, contracts and records

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: don't directly manage or have a direct role, but do exercise power through electing the board

**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 |

## 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*.

Eight principles of corporate governance listed - of note include the board approving corporate strategies that are intended to build sustainable long-term value and striving to build an *engaged and diverse board* whose composition is appropriate in light of the company's needs and strategy (see principles 1, 5, and 8). (pg. 192)

## Statutory Provisions Concerning Directors

- **Sec 101:** subject to any USA, the directors manage and supervise the management of the business and affairs of a corp

- **Sec 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)
    - Citizenship and residency requirement in 105(3) – at least ¼ of directors must be Canadian residents
- **Sec 106:** election and appointment, at the time of sending articles of incorporation, the incorporators must send a notice of directors to 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 not later than the close of the next annual meeting of shareholders following the election

### Diversity Reporting

**Bill C-85:** Board compensation from a diversity perspective is a recent phenomenon. New amendments to the *CBCA* require diversity – *shareholders must present information to their shareholders about these groups.*

Public CBCA corporations are required to disclose things like the number and percentage of women, visible minorities, aboriginal people and people with disabilities on the board of directors and in executive positions, whether there is a written policy in respect of diversity adopted, etc. The CBCA would not require that corporations amend their procedures, but disclosure would have to be made specifically in respect of the enumerated categories.

Rationale: diversity linked to competitive advantage, and social justice – corporations seen as owing social responsibilities in some way, so leaders have accountability on this front – but unclear how far this actually goes in practice.

### Cumulative Voting

**Section 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 shareholder 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 she sees fit.*

Rationale: provide a way for minority shareholders to possibly get a member on the board and have a voice, as opposed to in a simple majority voting procedure where if a shareholder has more votes, they can get all of their favorites elected.

### Removing a Director

1. **Sec 109(1):** subject to a USA, can remove a director by simple majority
2. **Sec 242(3)(f) and s 241:** if no majority power, can seek removal of a director subject to an oppression action or a derivative action

## Statutory Duties of Directors and Officers

### *Peoples Department Stores Inc. (Trustee of) v Wise*

<u>Facts:</u> Wise and Peoples were department stores. Wise expressed an interest in acquiring People from its British parent company. Under the agreement Wise 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 Peoples took on more debt for Wise than the other way around. Both ended up declaring bankruptcy. The trustee in bankruptcy brought an action claiming that the Wise brothers, as directors of People, had favoured the interests of Wise to the detriment of People's creditors in breach of duties of directors under s 122(1) of the CBCA
<u>Issue:</u> Did Wise Bros breach s 122? (No)
<u>Reasons:</u>

- *Sec 122(a)* – **fiduciary duty**
    - <u>**Court said the fiduciary duty isn't owed to creditors, rather owed to the corporation only under sub(a)**</u>, 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 doesn't create a fiduciary duty for creditors under any circumstances

    - Here there was no evidence of personal interest of improper use in the procurement policy by Wise Bros, they were trying to make both corps better so didn't breach their duties
    - Best interests of the corporation means maximization of the value of the corp – but courts have recognized that other factors may be relevant in what directors should consider in managing the interests of the corp
        - In determining if they are acting with a view to the best interests of the corp, **should consider the broader interests of shareholders, employees, suppliers, creditors, consumers, govt's and the environment**
- *Sec 122(b)* **- duty of care**
    - **<u>This duty can be owed beyond the corporation</u>** (extended to creditors, but some dispute on this)
    - 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 officers must make reasonable business decisions in light of all this info, including socioeconomic situations they were, or should have, been aware of
    - No breach found here – directors owe a duty of care, but didn't breach the duty of care associated with this duty – it was a reasonable business decision to rectify a serious and urgent business decision
- <u>*Business judgment rule:*</u>
    - Tribunals should refrain from finding directors liable for business decisions when **two 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 the light of all circumstances that the directors knew or ought to have known

<u>Holding:</u> no breach of the standard of care because of the business judgment rule, so the directors couldn't successfully be sued

Note: problem with this decision
- SCC says that the breach of section 122 duty of care is not *per se* actionable by creditors, meaning it *doesn't found a cause of action*
- See *Saskatchewan Wheat Pool* – **SCC says that the statute sets the standard of care, but the plaintiff still has to show according to ordinary CL principles that there is a duty of care owed and demonstrate how the standard of care has been breached**
- This is the approach used by AB in *Transportaction*

**Takeaway**: Directors could owe under s 122 a duty of care to third parties like creditors, but couldn't owe a fiduciary duty to third parties through this section because of the wording. Plaintiff has to establish that the director or officer in question owes them a duty of care via the test for negligence. Legislation then provides the standard of care.

**Defence for director: section 123(3)** – a director 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 or report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility
- BUT a title does <u>not</u> automatically mean the statement/person lends credibility

**Other causes of actions in *Peoples*:**
- Sec 240 derivative action: creditors seek to bring an action on behalf of *Peoples* for a wrong done to the corporation
- Sec 241 *CBCA*/ s 242 *ABCA* oppression action: creditors sue the Ds corp for conduct that is oppressive

### *Transportaction Lease Systems Inc v Weaver* (2007 AJ)

*Follow up from Peoples, Livent test for negligence*
- This case applied *BCE* and *Peoples*
- The alleged breach of the duty of care as contemplated by s 122(b) doesn't give the plaintiff a direct action under the ABCA, but may constitute the standard of conduct owed by directors and officers to creditors at CL in an action based on the tort of negligence if elements of that tort can be made out
    - Basically – we go to the CL to establish a duty of care

**<u>Test for negligence/negligent misstatement based on *Livent*:</u>**

Plaintiff must demonstrate that:
1) The defendant owed him or her a duty of care;
2) The defendant's behaviour breached the standard of care;
3) The plaintiff sustained damage; and

4) The damage was caused, in fact and in law, by the defendant's breach.

**Step 1: does the defendant owe the plaintiff a duty of care?**

- Stage 1: Is there a *prima facie* duty of care? This involves two questions:
    - **Reasonable foreseeability**: was an injury to the plaintiff a reasonably foreseeable consequence of the defendant's negligence? AND
    - **Proximity:** is there a relationship of sufficient proximity between the parties such that it would be "just and fair having regard to that relationship to impose a duty of care in law?"
    - If the answer to both is "yes", proceed to step 2

- Stage 2: are there residual policy considerations outside the relationship of the parties that may negate the imposition of a duty of care?
    - Four factors identified: (1) whether the law already provides a remedy; (2) whether recognition of the duty of care creates the spectre of unlimited liability to an unlimited class; (3) whether there are other reasons of broad policy that suggest that the duty of care should not be recognized
    - Overall: whether it would be better for reasons relating to legal or doctrinal order, or social concerns, to not recognize a duty of care in a given case

**Step 2: did the defendant breach the standard of care?**

- In the context of *Peoples*, the standard of care for directors and officers is supplied by s 122(b): *did the defendant fail to have the care, diligence and skill of the reasonably prudent person?*

**Step 3: did the plaintiff sustain damage?**

**Step 4: was the damages caused, in fact and in law, by the defendant's breach?**

- The legal test for in-fact causation is sometimes debated, but courts generally ask the following question: would the harm not have occurred *but for* the defendant's action?
- Cause in-law goes to remoteness: a court asks "even if there is an obligation to take reasonable care and it was breached, how far will the legal liability of the defendant stretch?"
    - *Livent* states that remoteness examines whether the actual harm was too unrelated to the wrongful conduct to hold the defendant fairly liable

### *BCE Inc v 1976 Debentureholders*

*Confirms and echoes Peoples for s 122. Affirms that Ds/Os only have a fiduciary duty to the corporation. If conflict between the corporation and other stakeholders exists, the duty is owed to the corporation*

Facts: Group of purchasers proposed a leveraged buy-out of all the shares of BCE. Bell Canada (subsidiary of BCE) is to guarantee the debt 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 brought an oppression action under s 241 and challenge the approval as not being fair and reasonable under s 192

Issue: have the debentureholders been treated unfairly?

Reasons:

- 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 judgment 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 directors aren't likely to sue themselves for breaching their own fiduciary duty, the statute provides remedies:
    1) **Proceed by way of a derivative action (s 240):** argues that directors have breached their s 122 obligations
    2) **Proceed by way of a civil action for breach of duty of care (s 122(1)(b)):** doesn't provide debentureholders for 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
    3) **Proceed by way of an oppression action (s 242):** debentureholders had a reasonable expectation that the directors would consider their position and choose a deal that would maintain the investment grade of their debentures
    4) **Additional "remedial" provision in s 192 provides for court approval in certain cases:**

a. 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
b. This review requires a court approving a plan of arrangement to be satisfied that:
    i. The statutory procedures have been met;
    ii. The application has been put forth in good faith;
    iii. The arrangement is fair and reasonable
c. If any element fails, approval is withheld

- Debentureholders 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 judgment
- No provision in the contract that the investment grade of the debentures would be maintained

**Takeaway:** the interests of the corporation shouldn't be equated with the interests of shareholders – but contrary to the traditional view, the interests of other stakeholders could be relevant

- Basically **broadens** the discretion of directors by widening the array of interests they are permitted to consider

## Peoples and BCE s 122 Summary

- ABCA s 122(1) provides that directors owe a fiduciary duty and a duty of care
    - Fiduciary duty is owed to the corp alone (*Peoples*)
    - The duty of care is owed to the corporation and outsiders/third parties like creditors (*Peoples*)
    - The duty of care provision does **not** create a cause of action – it still has to establish a duty of care with CL principles, test from *Livent* (*BCE* and *Peoples,* 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:

- **Best interests of the corporation:** when acting with a view to the best interests if the corporation, the D/Os of the corporation may consider but are not limited to the following factors:
    - The interests of: shareholders, employees, retirees and pensioners, creditors, consumers, and governments
    - The environment and
    - 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* (1985 Del)

*Section 122(1)(b) case – from the US, example of legal liability faced by directors even when their conduct doesn't 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 seek damages against the defendant board. Board of TU decided to consider the sale of the company. The CFO reported that a buyout of TU was possible at $50-60 a share. Van Gorkom (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 don't get a new interest). Dissenting shareholders say the cash out merger approved by the board was at too low a price, they should have held out for a better offer.

Issue: should the board have approved the offer of $55/share?

Reasons:

- Business judgment rule
    - Unlike in the US, the SCC doesn't 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 (balance of probabilities). Defendant can successfully invoke the business judgment 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
    - Didn't meet the standard for the business judgment 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
    - Shouldn't have relied on a 20 min 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 didn't cover everything

Dissent:
- Directors were very experienced so they wouldn't have needed the time that less experienced directors would have needed to make an informed decision, had already discussed a buyout on several occasions

## Breach of Fiduciary Duty

Statement of law: due to their fiduciary obligations, directors and officers must avoid a conflict between duty to the corporation, and self interest.

Examples:

1) **Taking corporate opportunity:** a director has a duty not to take advantage of opportunities that belong to the corporation - this is stealing from the corporation. Have to avoid a conflict between your duty to the corporation and your self interest (duty and interest)

2) **Self-dealing:** 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 CL, but there is a gradual loosening of the case law leading up to the legislative response

3) **Competing director:** directors are to some extent forbidden from competing with their own company (e.g. can't sit on the board of a competing corporation)

4) **Proper purpose:** as a fiduciary, a director can only use his or her power for a proper purpose

5) **Take-over bids:** when directors of a corporation that is the subject of a takeover feel conflicted because if it is successful they might lose their job - could create a conflict of interest (*Maple Leaf*)

### Taking Corporate Opportunity

The corporate opportunity doctrine arises out of the fundamental obligation of a fiduciary not to allow a conflict of his or her duty with his or her own interests.

### *Cook v Deeks* (1916 PC)

*How the directors went about resolving the matter was contrary to their fiduciary duty – decided to exclude the plaintiff from future business dealings*

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 saying that the company had no interest in the contract. Cook 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 Cook

Issue: have the directors appropriate a corporate opportunity?

Reasons:
- Fiduciary duty
    - The directors violated fiduciary duty by violating an opportunity that belonged to their company

    - Those who assume complete control over a company's business *must remember that they* ***can't just operate in their own personal interests*** **and divert in their own favour business that should belong to the corporation**
- Shareholder ratification
    - Shareholders **ratified** what happened here – doesn't matter because the majority is "making a present of something to themselves", thus oppressing the minority

Holding: had to turn over all of the benefits

### *Canadian Aero Service Ltd v O'Malley* (1974 SCR)

*The duty to avoid conflicts 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 – leading case*

Facts: Two officers at the center of the plaintiff corporation (Canaero). By the time contract was out for tender, they had resigned and created a new corporation, Terra, the purposes of which were to engage 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 duties to Canaero and take a corporate opportunity belonging to Canaero?

Reason:

- Rule
    - The corporate opportunity doctrine precludes a fiduciary from obtaining for himself any property or business advantage either belonging to the company or which has been negotiated
    - **Don't have to be appointed as director to find liability as such** – duties apply equally to any officials of the company authorized to act on it's behalf, in particular those acting in a managerial capacity
    - Here the SCC said that they were more than employees – members of senior management and thus had a fiduciary duty
- Timing – they argued that the opportunity wasn't a corporate opportunity, it was just "ripening"
    - Need to avoid a conflict of interest by not usurping or diverting a maturing opportunity –**doesn't matter if its ripening or mature**
- Resignation
    - The **fiduciary duty can survive past resignation depending on the circumstances**
- Difference – they argued the proposals were slightly different and Canaero wouldn't have been awarded the contract
    - Directors can't create their own "escape hatch" by creating the first proposal as different
    - Irrelevant if Canaero had obtained the contract or not because at the relevant time they had not abandoned hope that it would be awarded to them
- This area of the law is strict
    - But takes a big step back from *Regal Hastings* which is a very strict view
    - Need to ask: **in fairness, does the opportunity belong to the corporation or not? This drives the analysis**
    - Laskin gives a non-complete list of influencing **factors**, which include:
        - Position held
        - Ripeness and specificness
        - Directors or managerial officers 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: 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 been given the profit

Note: for exam, need to go through all factors according to the facts

### *Regal Hastings*

- Very strict and formulaic test – SCC didn't follow this in *Canaero*
- Court said directors shouldn't take a corporate opportunity even though the corporation itself didn't have the financial wherewithal to pursue the opportunity itself

### *Matic et al v Waldner et al* (2016 MBCA)

*Explains and amplifies Canaero - taking a corporate opportunity doesn't 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 hasn't expressed an active interest in the opportunity. No strict formula, everything depends on the facts*

- **Nature of a corporate opportunity:**
  - Need to determine if the opportunity *belonged* to the corporation - this requires a contextual analysis, different tests have been used in case law
  - 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
  - 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 factor
  - 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 *Aero*
  - The manner is not determinative, but it just another factor to be considered
- **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 liability
- Overall goal: to determine whether the opportunity fairly belonged to the corporation in the circumstances

## Self-Dealing Transactions

Where the director is on both sides of a transaction. Concern is that the self-dealer has an influence on the decision making of a corporation, and has some personal interest in the outcome.  Note that they are not necessarily unfair.

### *Abderdeen Railway Co v Blaikie Bros*

<u>Facts:</u> B was 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

<u>Issue</u>: is this a self-dealing contract, making it voidable at the option of the purchasing company (Aberdeen)?

<u>Reasons:</u>

- 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 - CL is guarding against the appearance of bias and the 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 of the contract - the concern is what creates the rule against self dealing

<u>Holding</u>: B shouldn't have been involved, the contract s set aside based on his involvement

**Evolution of Approach to Self-Dealing Contracts**

Where we are at this point (*Aberdeen*) in English CL:

- Absolute bar on self-dealing contracts - law doesn't merely prohibit wrongful conduct, but any dealings at all to prevent a conflict from arising. The contract can be avoided if they wish (*Blaikie*)

Stage 2:

- Law evolved, partial opening - if the articles (bylaws) included a provision that allowed the directors to enter into certain self dealing contracts, this was permissible
- Typically would have a requirement that the interest would need to be disclosed. If the deal wasn't 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*)

Note: **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

### *North-West Transportation Company Ltd v Beatty* (1998 AC)

*At this point self-dealing contracts were not completely forbidden – here they were ok if disclosed and ratified by shareholders on behalf of the corporation, provided there was no fraud on the minority*

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 (couldn't have won without this). Minority shareholders challenge the transaction

Issue: is the self-dealing contract voidable, or does the ratification insulate it?

Reasons:

- 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 oppression or fraud on the minority found here

### Legislative Approach to Self-Dealing Contracts – s 120 *ABCA*

If you want to enter into an enforceable self-dealing contract, need to follow section 120 requirements under the ABCA. They include:

1) **Disclosure in writing/minutes under s 120(1) and following**
    a. Also see s 120(7) disclosure via general notice

2) **Approval by the appropriate body**
    a. Sec 120(6): director cannot vote if they are the self-dealing party (because they have a fiduciary duty)
        i. The self-interested shareholder isn't discussed in the legislation: if the shareholder is the self-interested party, they should be able to vote their shares as a shareholder as in *Beatty* (even though the Act doesn't say this)
        ii. Also oppression under s 202 is such that you can attack a self-interested shareholder in that way
    b. Sec 120(5): If approval is required by neither, this section says that the director or officer shall disclose in writing the extent and nature of their interest
        i. Sec 120(7) – a general notice to directors is a sufficient disclosure of interest

3) **Proof that the contract is fair and reasonable at the time it was approved**
    a. Sec 120(8): basically should have disclosed and followed the steps – but if there is a special resolution (2/3rds majority) and sufficient disclosure, and the contract is fair and reasonable at the time, you're ok
        i. 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
    b. Sec (8.1) the "whoops" provision: even if the conditions of subsection (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 subsection (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

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

1) Director discloses the material interest as per the subsection of s 120:
    a. Sec. 120(8) says that the contract/transaction 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/contract can be subsequently approved and be valid under s 120(8.1)
    b. Sec 120(9) allows the contract or transaction to be set aside by the court on any terms it sees fit

**<u>What kind of director involvement is caught by the requirements of s 120?</u>**

1) Direct: Director is ***party to a material contract*** or transaction (*Beatty*) OR
2) Indirect: Director has a ***material interest in any person who is a party*** to the contract (interest in the other party exists) (s 120(1)(b))
    a. What is "material"
        i. Financial – yes
        ii. Relationship/emotion-based – maybe

**<u>Material contract</u>**

- No definition in the *Act* – but "material" means important – main issue is whether emotional interest could also be caught
- Welling: says that **often the interest will be financial, but more could be caught by s 120 based on its purpose**
    - *The purpose is to identify those negotiations where a corporate manager's ability to bargain effectively on behalf of the corporation may be inhibited by an interest they have on the other side*
    - Basically – meaning that a personal interest in the corporation may mean that his corporation gets a bad deal – on this basis it could include a personal or emotional relationship
- **Narrow view (*Dimo*):** 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, need to disclose
- **Broad view (*Zysko*):** material interest includes more than financial interest (relationship or emotion based)
    - If there is a possibility that the director is to benefit from the contract more than *de minimis*, then the transaction should be disclosed
    - Basically – disclosure whenever the D/Os involvement might be relevant to the corporation's decision-making process
- **Overall:** if a corporation would undertake additional due diligence to determine whether the contract or any of its terms is truly in its best interest, or if it would assign another director or officer to handle the negotiations, then the interest is material and must be disclosed (*Zysko*)

### *Dimo Holdings Ltd v H Jager Developments* (1998 BLR)

*Traditional approach to s 120*

<u>Facts:</u> Moeller was the director of Jager, and his wife was a director and shareholder of Dimo Holdings. Dimo lent Jager $50 000 on an emergency basis to promote a failing concert. $30 000 remains unpaid because the concert was a financial disaster. Dimo, the plaintiff, sued Jager and wants summary judgment. Jager says that Moeller made no disclosure of his interest under s 120 so the contact should be set aside pursuant to s 120(9). Interest charged on the loan was 50%

<u>Issue:</u> is the contract caught by what is now s 120?

<u>Reasons:</u>

- **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 defeat Jager's rights
    - Moeller is only required to disclose *his* material interest, not his associate's (wife's)
    - On this basis s 120 doesn't apply – Moeller isn't a director, officer, or shareholder in Dimo
- **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 aside (no harm no foul)
    - Here, Moeller didn't profit from the contract (except for a modest interest rate)

    - Court didn't want to set the contract aside and forgive the debt – beyond this, the court confirms that even in the absence of an enforceable contract, Jager 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 doesn't include anything that isn't financial – but the statute doesn't 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 Moeller's emotional interest in his wife might compromise his ability to bargain on behalf of Jager?
    - Could argue that s 120 includes ***indirect financial interest*** – here, Moeller's finances are linked

### *Zysko v Thorarinson* (2003 ABQB)

*Second line of authority – goes against Dimo*

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?

Reasons:

- 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* (O'Byrne thinks this is the more persuasive view)

## Competing Director

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

### *London and Mashonaland Exploration v New Mashonaland Exploration Company* (1981 HCCD)

Facts: Lord Mayo was the director of a board company sitting on the board of a rival company. An injunction was brought to stop this

Holding:

- The court had no problem with this and refused to issue an injunction
- Bad case because its very pro director – but regardless, if you were to sit as a competing director will just end up in litigation, can't count on this case as protection
- The idea is that competing director is oppressive in that joining the board of a second company isn't giving regard to the best interests of the first

### *Sports Villas Resort Inc* (2000 NFCA)

Facts: Two directors of Sports Villas Resort applied to the court to disqualify another director, D, and his daughter from membership on Sports Villa's board of directors because of D's interest in another company that they alleged was in competition with their business, and of his alleged appropriation to his own benefit of corporate information and opportunity belonging to Sports Villas

Issue: D as a director has a fiduciary duty to act with a view to the best interests of Sports Villas – has D met that standard here?

Reasons:

- Depends in part on the **nature of the business – are they competing companies?** If they aren't D, can't be a competing director
    - Here they were quite different, located almost 300 kms away

    - TJ relied 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 (O'Byrne says don't rely on this)
    - If the companies are competitors, how can the director avoid a conflict of interest? Would be virtually impossible
- Competition:
    - Remember, the **fiduciary duty does not preclude multiple memberships on the boards of different companies** – it attempts to strike a balance between ensuring interests of the corporation and societal interests in not restraining corporate directors
    - Because the corporations are not in competition, the competing director issue isn't at play
- Proprietary info:
    - Did D take confidential info and use it for his own benefit in developing the second golf course? If so, breach of fiduciary duty
    - Court held the info here was not unique, it was genetic, no evidence that D has used any info from Sports Villas

## Takeover Bids and Defensive Tactics by Management

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 discourage the takeover

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

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

Another way to address is by establishing an **auction** to ensure the board of the target company acts in a neutral manner to obtain the best value

But you are **not required to establish an auction;** a market canvas may suffice (*Maple Leaf*)

- The mandate of the directors is to manage the company according to their best judgment – must be informed and have a reasonable basis (business judgment rule)

**It is in the interest of the company to assess alternatives to an unsolicited offer**

**When looking at one bid over another:** is it fair to consider other factors beyond finances – *Peoples* and *BCE* say that boards are entitled to consider other factors (*Maple Leaf*)

- Non-financial considerations have a role to play in determining the best transaction available in the circumstances
- Overall, it is in the best interests of the corporation to consider these things – but it shouldn't drive the whole decision process

### *Maple Leaf Foods Inc et al v Schneider Corporation et al* (1998 OR)

Facts: Maple Leaf announced its intention to make an unsolicited take-over bid for Schneider. In response the Board established a special committee to review the offer and consider other alternatives. The Family (controlling shareholders of Schneider) ultimately accepted an offer by Smithfield. Maple Leaf 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 interests of Schneider and its shareholders

Issue: did the board act in the best interests of Schneider? ML said the committee wasn't independent and the advice they gave wasn't in the best interests of the shareholders

Reasons:

- **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 applies – 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 interests of the company, a court will be justified in finding that the directors acted for an improper purpose (remember *Peoples*)
    - Board should get the benefit of the business judgment rule here because the decision was informed (committee knew the family wouldn't sell to ML) and it was reasonable, not actually a better offer
- **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 doesn't automatically taint the outcome of the committee**
        - He didn't sit on the committee, didn't have a vote
    - Used Schneider'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. Not one blueprint, depends on the circumstances
        - Board not required to institute a process of competitive bidding
        - Would have led to Smithfield offer being withdrawn because it had a no-shop condition attached
    - Not having an auction contrary to minority shareholders reasonable expectations?
        - No reasonable expectation that a public auction would be held - in public statements the company expressed they "might" be interested 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 and board exercised business judgment

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* (1994 AR)

*Shows there is a whole area of law outside the ABCA that can be germane to litigation – can't get too wrapped up in the legislation, need to think about other areas of law*

Facts: Plaintiffs were minority shareholders in a company. The corporate defendant Vencap was the intermediary that purchased the defendant's shares at $0.60/share. It did not disclose that a named buyer was negotiating to buy all to buy all the company shares for more than $2. After the plaintiffs sold their shares, Vencap resold them for $2. 16/share. Plaintiffs sued the defendants claiming civil liability in damages for breach of the insider trading provisions in s 131 of the CBCA and breach of fiduciary duty

Issue: do the directors owe a fiduciary duty to shareholders?

Reasons:

- **Director's don't owe a fiduciary duty to shareholders, 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:
        1. ***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 occupies a new role outside the scope of their duties to the corp – a fiduciary duty can arise
        2. ***When directors are purchasing shares from the shareholders***
        3. ***Other grounds:*** the category of fiduciary relationships is never closed – in this case if the court couldn't have fit the facts under the previous two categories, they would have fit it here (directors used their position for personal advantage at the expense of the plaintiffs)
- **Legal reality that insiders, such as directors, are entitled to buy shares in the company they direct, but not when acting on info that hasn't been publicly disclosed (s 130)**
    - This section is a remedy – insiders can't make use of specific confidential information for their own benefit
    - Here the shareholders/directors were successfully sued

- **Releases: plaintiff's signed releases purporting to disclose of any right of actin and forbearing from pursuing new actions – do they have effect?**
    - Court said they don't 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 weren't contemplated
    - Legal advice doesn't alter this, because the advising lawyer also didn't have complete information
- **Nature of the defendant's liability: how should the court apportion liability?**
    - Plaintiffs 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 Vencap
        - *Idea that direct loss is a several liability*
    - Fiduciary loss is joint and several – each defendant is responsible in full, can collect from one or more jointly, or all

**<u>Shareholder ratification of breach of fiduciary duty</u>**

- The *ABCA* and *CBCA* have greatly reduced the liability of directors to approve fiduciary breaches – the **only places it works is in sec 120 self-dealing contracts**, and the preconditions are rigorous (Van Duzer)

- Before *CBCA*: 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 couldn't 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 CL rules as expressed in *Aberdeen Railway v Blaikie* - 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 determining whether any action of incorporation or the directors is oppressive under s 241
    - 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 or officer from the duty to act in accordance with this Act or the regulations or relieves the director or officer from liability for a breach of that duty.

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

**<u>Sitting on your client's board</u>**

- Leads to waiver of client's confidentiality, conflicts of interest, etc. Biggest thing is professional liability insurance might be lost
- Suggests that they don't sit as a board members, but that they sit on meetings of the board
- *Allen v Aspen:* could strengthen relationship, raise profile and increase business, but there are risks – could end up dragging his firm into the litigation

**<u>Other statutory directors</u>**

- Environmental statutes (*Batta*)

- Income Tax Act (*Minister of National Revenue*)
    - Statutory duty to remit income tax source deductions in relation to employees of the company

### *Zwieschke v Minister of National Revenue* (1991 CTC)

Facts: Director didn't 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 Income Tax Act?
Reasons:

- 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 defence 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 liability for unremitted source deductions
- Here – can't rely on this defence because he didn't 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 doesn't count as due diligence

## Directors and Officers Liability in Tort to Third Parties

Canadian CL is fractured regarding whether D/Os 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 doesn't exhibit separateness
- Seems to mean that tortious conduct in the best interests of the corporation does not expose D/Os to personal liability

*ADGA:* ***narrow protection***

- **D/Os 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 defence 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 D/O 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 D/Os 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 D/Os liable for tort of inducing breach of contract unless they can establish the defence in *Said* (justification)

Directors can owe a duty of care to third parties – 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.

### Intentional Torts: Inducing Breach of Contract

### *McFadden v 481782 Ontario Ltd* (1984 OR)

*Doesn't speak to economic loss, but shows that D/Os are liable for the tort of inducing breach of contract unless they can establish the defence in Said (justification)*

Facts: M worked for PMAC, but PMAC's business wasn't succeeding. The defendant 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 the plaintiff

Issue: are the defendant directors personally liable to the plaintiff for the amount awarded against the defendant company? (yes)

Reasons:

- 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 the injury of P, induces the third party without justification to break that contract
- **Need to show the following (*Pocklington*):**
    - Existence of a contract
    - Knowledge or awareness of that contract
    - Breach of the contract by the contracting party
    - That the defendant, by their conduct induced that breach
    - That the defendant acted without justification
    - Plaintiff suffered loss
- The directors intended to get the plaintiff fired by the corporation
- Specific defence in the context of inducing breach of contract: *If an officer or director 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*
- Here the defence does not apply – the directors were acting without justification

## Negligence

### *Montreal Trust Co of Canada v ScotiaMcleod Inc*

*D/O's liability to third parties in tort is rare – broad shield of protection. Separate corporate personality as in Salomon would be too easily compromised*

Facts: Peoples (defendant) has issued senior unsecured debentures. Trust has purchased the debentures for $17 million, but say the prospectus and other info only disclosed one contingent liability, when in fact there were several. This makes Peoples a less attractive investment. Plaintiff says Scotia failed to disclose all of People's liabilities, which constitutes a material negligent misrep. Scotia says that specific directors committed this tort

Issue: should the third party claims be dismissed for not disclosing a reasonable cause of action?

Reason:

- Decided cases where officers have been found personally liable for actions carried out under the corporate name are **fact specific** (liability is rare absent fraud, dishonesty or want of authority)
- 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 takes them out of the role of directing mind of the corporation**
    - *Idea is that if a D/O is acting bona fide within the scope of her authority, the director is indistinguishable from the corporation and doesn't 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" – separate and distinct versus best interest of the corp*

Takeaway: overall this case says three things:

1) **The pleadings must be particular:** must set 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 identity of interest between the director and the corp:** have to show the Ds made the tort their own
3) **Absent fraud, dishonesty or want of authority, liability is rare:** pleadings must allege these kinds of matters, can't just look at this as a pleadings question, need to get them into the realm of one of these three things

### *London Drugs Ltd v Kuehne & Nagel International Ltd*

*Exemplifies that junior employees don't have a special immunity to negligence, seems like D/Os do unless they make the tort their own*

Facts: LD left a transformer with KN (warehouseman company). The employees dropped the transformer and they were negligent. LD sues KN in contract and in tort, then sues the employee in tort. There was a limitation of liability clause

Issue: can the employees shelter under the limitation clause as a defence to LD's action against them?

Reasons:

- 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 weren't parties to the contract
- **Junior employees don't have a special immunity to negligence – they have liability as compared to *Scotia*, seems like D/Os have a special immunity unless they make the tort their own**

### *ADGA systems International v Valcom* (1999 OR)

*Opposite of ScotiaMcleod – D/Os 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*

Facts: ADGA suing individual directors of Valcom personally, allegation that they raided the employees of ADGA. Defendant, Valcom, through its director and senior employees, persuaded virtually all of the plaintiff's technical employees to permit their names to stand in a bid package and join the defendant should the bid be successful. They won the bid and almost all the employees defected to ADGA. Plaintiff brought an action against director and employees

Issue: is the conduct by the individual defendants actionable even if genuinely directed to the best interests of Valcom?

Reasons:

- The defendants can't use the defence of *Said* (justification) – they didn't induce their own corporation Valcom 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, Valcom, 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 didn't make the tort their own
- Court of Appeal:
    - This court says there is a consistent line of authority that in all events, D/Os are responsible for their tortious conduct even though it was in a bona fide manner (this says the 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 directing mind)
    - Court says that *Salomon* isn't related to D/Os having personal liability for their torts, only about corp being a separate legal entity
        - BUT to the extent that directors have broad liability even when acting as Ds of the corp, this functionally undermines the *Salomon* principle. If directors are easily liable, protection is watered down

Takeaway: *Scotia* and *ADGA* don't say the same thing

### *NDB Bank, Canada v Dofasco Inc* (1999 OR)

*Fraud and other intentional torts fit more easily the tougher Scotia test that directors have to make the tort their own. This case discusses ordinary negligence – says that Ds are responsible for any tort their might commit, including ordinary negligence, provided that the pleadings are in order (& with the exception of Said)*

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

Issue: Is M liable for his own negligent misstatement?

Reasons:

- 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 isn't protected from liability, so not his only defence is to prove he didn't commit a tort
- *Livent* is used to determine if a duty of care has been established: (see page 35)
    - **(1): is there a *prima facie* duty of care? This exists when there is proximity and reasonable foreseeability of harm?**
    - **(2) are there residual policy considerations outside the relationship of the parties that may negate the imposition of a duty of care?**
- Parties were in a close and direct relationship because the individual defendant was the bank's main contact at Algoma, 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
- Limited by policy reasons?

- No – 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* (ABCA 2000)

- No duty of care to inject his own money into the company merely because there is foreseeable loss to one's neighbor
- 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
- Came out before Hogarth

### *Hogarth v Rocky Mountain Slate Inc* (2013 ABCA)

*Important case – law leading into Hogarth is mostly from Morrow – about negligent misrepresentation*

Facts: Plaintiffs invested in a limited partnership based on misrepresentations from the general partner and its director, Simonson. The investment failed.

Issue: can the plaintiff's successfully sue Simonson *personally* for negligent misrep?

Reasons:

- CA says there is no personal liability on Simonson 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 founded
  - Conduct of Simonson wasn't tortious in itself, no separate identity – it isn't sufficient to create a separate identity that Simonson was an officer and investor in the corp
  - ***Morrow* said that having a shareholding or other financial interest in the corp doesn't translate into a separate interest for the purpose of establishing liability**
- Slatter J's analysis:
  - Slatter is looking for a situation where **Simonson did something to invite reliance on his own words,** e.g. personally guaranteeing his words, not just speaking for the corporation – here a duty of care would be found
  - He is 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?**
- Note: test for negligent misstatement is now based on *Livent,* as discussed in *NBD*

### *Hall v Stewart* (2019 ABCA)

*Summarizes factors as to when D/Os would have personal liability for their own tort*

**Factors include:**

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 *(Rocky Mountain Slate*)
4. That the conduct was in the best 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 identified with corporate activity that they are not fairly categorized as "individual torts" (*London Drugs* & *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, Blacklaws*)
10. Whether the damage was physical or economic

### *Abt Estate v Cold Lake Industrial Park* (2019 ABCA)

- Says that circumstances where individual takes responsibility for accuracy for their 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 (a repackaging of SM)

### *Andersen v Canadian Western Trust Company* (2019 ABQB)

Facts/Issue: if the individual applicants who provided investment advice through an incorporated service provider had personal liability for the negligent misstatement alleged by the plaintiff

Reasons:

- A fiduciary obligation and a duty of care in tort can be imposed on an individual financial advisor notwithstanding that he provided his services through the intermediary of an incorporated provider
- In cases of pure economic loss arising from negligent performance of a service, two factors are determinative in the proximity analysis: (1) defendant's undertaking (2) plaintiff's reliance (*Deloitte*)
- In principle, a corporate officer or employee may have a personal duty and may be liable for acts that are in themselves tortious notwithstanding the involvement of a corporation
- Personal duties on individual professional advisors acting through a corporation is fact specific - consider the degree of proximity in the relationships, the expectations of the parties, nature of the relationship, degree and reasonableness of reliance on the individual defendant

Holding: application refused because the limited summary judgment didn't sufficiently address these matters

**In Alberta:**

***ScotiaMcleod* as understood in *ABT Estate* – D/Os can have personal liability for ordinary negligence causing pure economic loss. But the ABCA now reads *Scotia* differently; on its face it says that extreme conduct by the defendant director and nothing less will do to impose liability. Now we say that the net of liability is broader. If the D/O takes personal responsibility, this could be sufficient to create a separate identity from the corporation to make the act their own**

- In *Hogarth* the majority followed *ScotiaMcLeod.* They applied *Morrow,* in which no liability was found. The concurring decision here went into more detail. **This is important because**:
  1) Slatter J expressly held **that D/Os can be liable in negligence to third parties causing pure economic loss**
  2) View of liability has to be correct in light of the SCC's decision in *Peoples* – held that **D/Os can owe a duty of care to third parties like creditors**, simply falls to the plaintiff to prove the elements of duty of care
  3) Can and should be difficult for a plaintiff to show that a duty exists in the case of ordinary negligence – it is not enough to show that a duty of care exists simply because the D/O was negligent in relation to a third party in the course of acting for the corporation
     i. D/Os shouldn't be regarded as guarantors, etc. Rejects the idea of universal concurrent liability

- Factors Slatter J said will influence the negligence test:
  - Whether the plaintiff chose to deal with the corporation (less likely to find a duty of care) or had the relationship imposed (more likely)
  - Whether the tort was independent (more likely) or "closely related to corporate activity" (less likely)
  - Whether the loss was economic (less likely) or physical (more likely)

- Remember the second stage of the duty analysis: whether there are any residual policy considerations outside the relationship of the parties that may negate the imposition of a duty of care
    - Slatter J emphasized that compensation of plaintiffs is important, but it is also a legitimate desire of entrepreneurs to operate in a limited liability environment
    - Holding tortfeasors accountable doesn't automatically prevail over all other objectives

*Andersen:* in principle, 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 (cites *Hall v Stewart*)

## Indemnification

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 of reimbursing directors in certain circumstances.

Primary concern: without the possibility of such reimbursement, people won't want to serve as D/Os

### *Blair v Consolidated Enfield Ltd* (1993 OR)

Facts: Director, Blair, is seeking indemnification from the corporation. Corp is Enfield, at the time of the conflict it was controlled by Canadian Express. B was the CEO and chair of the meeting regarding election of directors. He doesn't count proxies in favour of Tim Price (nominated by Canadian Express) due to legal counsel's advice. B won his place back on the board because of this. Acted on a reasonably informed basis because he did so on legal advice. Canadian Express took the matter to court. B is looking for indemnity but Enfield doesn't want to provide

Issue: whether the company's decision not to indemnify can be successfully challenged

Reasons:

- Director has to have acted honestly and in good faith with a view to the best interests of the corporation
- Defence under 123(3) - B relied on the report of a lawyer in his decision not the count the proxies - doesn't relate directly to the indemnity provision, but does help inform the question of whether the director acted honestly and in good faith
- When Enfield wouldn't indemnify him, B sued under s 12(4) and Carruther J said:
    - B wasn't acting with a view to the best interests of the corp in defending the litigation, because it was based upon a ruling based on his favour absent evidence that B was the better director than P
        - CA reverses this - **best interests of the corp is not about who is the best director, it is about what the voting procedure should be and how can integrity be preserved**. Enfield's best interest relates 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 that 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 wasn't using his powers for an improper purpose**
    - *Taking legal advice doesn't automatically fulfill the requirements of good faith and best interests, but it is helpful*

Holding*:* Judgment against Enfield, 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 B hadn't acted in bad faith, etc. They have to show that B hasn't fulfilled his fiduciary duty* - here the corp failed to do so
    a. B not required to show his good faith - to a large extent about the corp 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*
    a. 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 D/Os
    a. Permitting B to be indemnified is consonant with the broad policy goals underlying indemnity provisions - allow for reimbursement, reasonable good faith behaviour

b. Indemnification should only be denied on male fides

### *R v Bata Industries* (1995 OR)

Facts: Batta convicted of causing the discharge of industrial waste at its shoe manufacturing facility - two directors were convicted of failing to take all reasonable care. A term of the probation order prohibited Bata from indemnifying the directors in respect of the fines

Issue: the TJ's jurisdiction to impose the non-indemnification provision of the probation order

Reasons:

- 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 Bata must, according to the *Provincial Offences Act*, function to prevent similar unlawful conduct or contribute to the rehabilitation of the defendant Bata Ltd - it follows that the purpose of the non-indemnification order must be about ***deterring and rehabilitating Bata, so the order is improper since the TJ's intention is to require the 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 corp may indemnify, must indemnify, or cannot indemnify
  - If Bata is to be prohibited from indemnifying the directors, it should be under the statutory provisions regarding indemnification
    - E.g. s 124(1): if you read s (a) and (b) in a certain way, arguably Bata could not indemnify the directors because these sections haven't been met
  - Indemnification prohibition was struck out, the court said the indemnification provisions should do their own work

***ABCA* indemnification by corporation**

**124(1):** Where the corp isn't the plaintiff - to secure indemnification need to show the D/O acted honestly and in good faith with a view to the best interests of the corporation, and in the case of crim or admin action that they had reasonable grounds for believing the D/O's conduct was reasonable

**124(2):** Where the corp is the plaintiff - to secure indemnification, directors have to show they acted honestly and in good faith, and in the context of a crim or admin proceedings, that they had reasonable grounds for believing their conduct was lawful

**124(3):** entitled to indemnity if the person seeking indemnity was substantially successful on the merits, fulfills the two prior requirements (honestly and in good faith, reasonable grounds), and is fairly and reasonably entitled to indemnity

# Chapter 7: Corporate Social Responsibility

Objectives: the debate as to whether or not corporations have social responsibilities

**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
  - Involves 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

**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, suppliers, creditors, consumers and the environment

**Statutory Law**

- Codified in recent amendments to s 122 of the *CBCA* – now expressly recites that in considering the best interests of the corporation, directors can consider other interests including shareholders, employees, retirees and pensioners, the government, environment, and long-term interests of the corporation (codification of *BCE* and *Peoples*)

Note: the idea of businesses owing responsibilities to stakeholders seen in chapter 6

- Corporations took a stand on what the purpose of a corporation is
- Identified a "modern standard for corporate responsibility" – the corporation **isn't just about making money and serving shareholders,** the idea is that the CEOs will need to balance the needs of shareholders with other stakeholders
- Other resources: excerpt from Gerry Ferguson, roundtable from chapter 6 and responses to the roundtable on twen

**Two main conceptions: (1) property conception and (2) social entity conception**

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 charities, 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. Freidman 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 Freidman is acceptable *as long as its not philanthropic* – can give money to make yourself 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 – can't 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 don't meet these expectations they will be met with resistance from the public
   b. In *Peoples* Major and Deschamps JJ say that the best interests of the corporation should not be read simply as the best interests of the shareholders – hint at 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: **CL 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* (1919)

*Reflects shareholder primacy view*

Facts: Ford Motors had a lot of cash - this is typically when dividends are declared so shareholders can benefit. However Mr. Ford didn't 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 employments, profits to be reinvested into the corporation instead. Two minority shareholders sought a court order for the corporation to declare a large dividend

Reasons:

- 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 Ford was being strategic as opposed to being philanthropic

Holding: Incidental humanitarian expenditures for the benefit of employees are allowed, but Ford can't run a charity and have specific profit-making duties to the shareholders too. Dividends ordered to be paid.

Note: O'Byrne says this case may be distinguished because Ford 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*

### *Talisman*

*Shows the power of public opinion, power of internet, new reality that corporations will be held to account (even though no laws were broken)*

- Was a multinational corporation out of Calgary in the oil and gas industry. Was accused of lacking CSR
- Subject to strong international criticism for its presence in Sudan, corporation was too focused on property conception and failed to take into account the overall social context of its operations
- International reaction it received because of the view it was propping up the regime in Sudan - its share price was discounted by the market - despite multiple efforts to address its reputation, it was condemned and eventually it decided to divest of its interest in Sudan

## 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 doesn't have to circulate a shareholder's proposal if it clearly appears that the proposal **does not relate in a significant way** to the business or affairs of the corporation

Overall:

- Management 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 case
- But **specific purposes/goals may avoid the legislation**

### *Re Varity Corp v Jesuit Fathers of Upper Canada et al* (1987)

*If shareholders meet the rules then a proposal is circulated by the company, but no obligation for circulation if the proposal is primarily for the purpose of a general, political or racial cause*

<u>Facts:</u> Varity seeking a court order permitting it not to include a shareholder proposal that the corp end its involvement in South Africa. The proposal does also make a business case for pulling out. Section 131(5)(b) of the Act says that a corporation isn't required to comply with a shareholders request if it clearly appears that the proposal is submitted primarily for the purpose of enforcing a personal claim against the corporation or its directors, officers or security holders, or primarily for the purpose of promoting general economic, political, racial religious social or similar causes

<u>Reasons</u>:

- Jesuit says that the business conditions are poor, can't take on a general cause but here are making a specific proposal - for Varity to exit South Africa. Although it relates to political reasons, its tied to specific business reasons
- Court held that the primary purpose of the proposal is abolishing apartheid in South Africa - O'Byrne said its concerning that this issue wasn't allowed to be discussed at the AGM
- Court looks to the language and supporting statements to make this decision

<u>Dissent</u>: the issue of apartheid can't be a "general" cause, it must be considered specific in the sense of being exact

Note:

- Varity not seeking costs - because if they did seek costs it would be bad optics
- ABCA uses the same wording as the old CBCA provision, so **the way *Varity* is interpreted is the way the law still works in AB** – unclear if they would still follow this though, especially in the context of *BCE*

# Chapter 8: Shareholder Rights and Remedies

Objectives:
- Illustrate that shareholders have numerous rights under the *ABCA* and CL
- *ABCA* provides potentially robust remedies for shareholders, including the oppression action
- An interested party may be able to bring an action in the name of the corporation in certain circumstances

Statutory provisions:
- ABCA, ss 23(1), 23(2), 26(3), 102, 106, 109, 122(4), 131, 132, 134, 136, 136(1)(b) , 139, 142, 145, 146 , 147, 155, 162, 163, 173(1), 176, 176(3), 183(3), 183(5), 189(3), 189(4), 190(6), 190(4), 191(1)(a), 191(1)(b), 191(1)(c), 191(1)(e), 191(1)(d).
- CBCA, ss 132, 135(1), 135(1.1), 137, 137(1)(b), 143, 146

## Intro 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 bought 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

<table>
<tr><th rowspan="2">Categories of Rights</th><th rowspan="2">Examples</th><th colspan="2">Sources</th></tr>
<tr><th>Statute</th><th>Case Law</th></tr>
<tr><td rowspan="3">Basic</td><td>Vote at any meeting of shareholders of corporation</td><td rowspan="3">ABCA ss 26(3), 139</td><td rowspan="3"></td></tr>
<tr><td>Participate in dividends</td></tr>
<tr><td>Participate in distribution of assets upon “winding up”</td></tr>
<tr><td rowspan="3">Ex. Of Control Over Directors/Officers</td><td>Election & Removal of Directors – default ordinary resolution</td><td>ABCA ss 106, 109, 122(4), 145, 147</td><td rowspan="3">** Cumulative voting can be allowed in Articles. This gives minority power to concentrate votes (s 107)</td></tr>
<tr><td>Participate in AGM (to review perf of offs and examine financial statements)</td><td>ABCA s 155</td></tr>
<tr><td>SH proposals</td><td>ABCA s 136; But limited by s 136(5) and<br>CBCA s 137</td></tr>
</table>

| | | | |
|---|---|---|---|
| **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** <br> - | 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*] <br> • 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*] <br> • 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) <br> - - - | 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) <br> *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* | |

| 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) |

## 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

- Examples 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: (1) right to vote one's voting share; (2) right to propose bylaws; (3) rights triggered upon a fundamental change; (4) right to sue directors for breach of fiduciary duty (*Tongue*); (5) right to sue directors in tort; and (6) **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:* e.g. breach of shareholder agreement, negligent misrep made by shareholders to other shareholders

*Derivative:* involves a shareholder or other claimant bringing an action in the name of the corporation to endorse/protect the corporation's rights
- Directors would normally advance the claim are not bringing it
- Process by which minority shareholders make applications most frequently
- It's the corporation that has the cause of action, but derivative action is the way of bringing it forward

## Oppression Actions

***ABCA* section 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 don't have to show that you have a right violated

### *Deluce Holdings Inc v Air Canada* (1992 OR)
*Example of how the oppression remedy ensures the minority is not victimized by the majority – good overview of the doctrine of reasonable expectations (don't need a legal right, just an interest with reasonable expectations)*
<u>Facts:</u> Deluce Co is the minority shareholder in Air Ontario. D is suing Air Canada, the majority shareholder. USA provides upon termination of the last Deluce, AC has the option to acquire D's indirect interest in Air Ontario. Begins with purchase by AC of a majority interest in Air Ontario. The smaller connector airline had been owned by members of D family. Relationship between majority and minority shareholders was governed by a USA, said that on termination of the last D AC had the option to acquire the interest. The D family members managed Air Ontario. In 1991, the employment of Bill D was terminated by the board of Air Ontario (controlled by AC). 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, that this was oppressive. Mr. D didn't perform poorly
<u>Issue:</u> is there oppression?
<u>Reasons:</u>
- 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 corp (can't 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 can't act in a way that is unfairly prejudicial or unfairly disregards the interests of the minority stakeholders**
- Shareholders aren't 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

<u>Holding:</u>

- Directors on the board could not let their decisions be what was in the best interests of the shareholders of Air Canada, had to act in the best interests of Air Canada – didn't look to see if terminating D was in the best interests of the corp
- 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 Inc v 1976 Debentureholders* (2008 SCC)

*Leading test for oppression – remedy is ABCA s 242*

<u>Facts:</u> Group of debentureholders were complaining of a leveraged buyout of shares in BCE. The way the deal is 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

<u>Issue</u>: have the debentureholders been oppressed?

<u>Reasons:</u>

- Principals underlying remedy of oppression: **<u>"Fairness"</u>**
- **Preliminary Observations:**
    - (1) Oppression is an equitable remedy – It seeks to ensure fairness (not just legal but what is fair!)
        - 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.
    - (2) Oppression is fact specific
        - What is just and equitable is judged by the reasonable expectations of the stakeholders in context & 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"
- **<u>First Step to an Oppression Action:</u>**
    - 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 to bring an oppressive action (e.g. registered holder, director, creditor, etc.)
        - Debentureholders are included within the persons listed (as registered holders)
- **<u>NEXT: have to bring themselves under the test for oppression (two prongs)</u>**
    - **(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 the fact that behind it are individuals with rights, obligations and expectations that aren't necessarily submerged in the company culture
            - The power of the oppression remedy is **very broad** - don't 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 (that 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; and 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 doesn't 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 the most egregious (harsh, burdensome and wrongful) - but something less will do
      - 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 *corp* who has suffered an injury – versus an oppression action, where the shareholders' expectation have been hurt - ***the law doesn't 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 corp who has been harmed - matter must proceed by corp or through a derivative action***
        - Including where the corp suffers a direct injury and the only form suffered by the shareholder is reduced share value
        - <u>Paying director fees higher than industry norm sounds in oppression</u> (but O'Byrne 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 to corp as well as oppression action
        - <u>Preferring some shareholders with management fees</u> - breach of fiduciary duty, would sound as a derivative action, but on the right facts could be treated as an oppression action because there is a difference between groups of shareholder who get the fees, and those who don't
        - <u>Where a differential impact can be shown so that one group is preferred over another</u>, could likely sound in oppression
      - Decision from BC CA (*Canex*) - although excessive management fees harm the company, the complainant suffered a unique and distinct harm (ability to recover from the company were reduced)
- Application:
    - The debentureholders didn't 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 liabilities - no evidence that bidders were prepared to accept less (no deal on the table that was great for debentureholders)
    - Board acted reasonably to create a competitive bidding process - business judgment rule - had created a good process and outcome
    - Directors did consider the interests of the debentureholders - no oppression found
    - Debentureholders could have taken steps to protect themselves - commercial practice - failed to negotiate protection

**Note: levels to the oppression remedy**

1. **Oppression** – Conduct that is coercive, abusive, & suggests bad faith
    a. Burdensome, harsh, wrongful conduct, visible departure from standards of fair dealing, abuse of power
        i. Squeezing out a minority shareholder, paying directors' fees higher than the industry standard (cause of action -> Breach of fiduciary duty by overpaying themselves)
2. **Unfair Prejudice** – "generally seen as involving conduct less offensive than 'oppression'.
    a. Less culpable state of mind that has unfair consequences
    b. Examples: Squeezing out a minority shareholder, Failing to disclose related party transactions, Changing corporate structure to drastically alter debt ratios, Adopting a "poison pill" to prevent a takeover bid, Paying dividends without formal declaration, Preferring some shareholders with management fees, Paying directors' fees higher

than the industry standard (But this is really a breach of fiduciary duty – a derivative action: because the impact on shareholders is only indirect)

3. **Unfair Disregard** – "least serious of the three injuries, or wrongs, mentioned in s.241
   a. Ignoring interests as being of no importance; viewed as the least serious conduct
   b. Examples: favouring a director by failing to properly prosecute claims, improperly reducing a shareholder's dividend, failing to deliver property belonging to the claimant

### *Re Ferguson and Imax Systems Co* (1983 OR)

*Shows the reach of the oppression action, example of how the remedy works and how it can focus on context and fairness rather than technicality (even when where what the directors have done is technically legal)*

<u>Facts:</u> Appellant alleged that Imax Corporation, in attempting a special resolution to amend its articles to reorganize its capital, is acting in an oppressive manner because the effect of the resolution 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

<u>Reasons:</u>

- The principle that the majority governs is fundamental, but its corollary is that **the majority *must act fairly and honestly***
- The company didn't act bona fides in exercising its powers to amend - she is the only one affected 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 very 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

<u>Holding:</u>

- 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

### *Downtown Eatery (1993) Ltd v Ontario* (2001 OR)

*Question going to the rights of the employee, shows the reach of the oppression action. Bad faith in intention not a requirement for oppression*

<u>Facts:</u> A was dismissed by his employer Best Ltd, then sues for wrongful dismissal. Several years after the action was commenced, Grad and Grosman reorganized their companies such that Best Ltd ceased to do business. They transferred its assets to other companies in the group, leaving Best with no assets to pay any liabilities. Wrongful dismissal action goes to court and A is successful, seeks to realize on his judgment, but G and G claim you can only execute against Best Ltd, which no longer exists, so nothing he can do. A alleges oppression against G and G for undertaking a corporate reorganization in face of his claims

<u>Reasons:</u>

- **Oppression action:**
  - Need to establish the person seeking it fits the definition of a complaint within the meaning of the Act - A fits under this
    - Sec 239 - creditors can becomes complainants under an oppression action, but only if the court agrees they are a proper person
  - Assess question of oppression:
    - What are A's reasonable expectations?
      a. That the defendants would conduct the company's affairs with a view to protecting his interests by retaining a contingency fund to satisfy the judgment in case he was successful
    - Have they been disappointed in a way that is oppressive, etc.?
      a. TJ said no - the corporate reorganization that eliminated Best wasn't undertaken with the purpose of depriving the plaintiff of recovery - it is legally permissible
      b. CA reverses - ***TJ's error was to assume that the oppression action requires conduct to be intention with the intention of harming the complainant (not required)***. Q is whether the reorganization effected a result that amounts to oppression (see pg. 392)
    - Bottom line: **in causing a profitable company to go out of business and transferring its assets to other companies, the defendants effected a result that was unfairly prejudicial or unfairly disregarded the interests of the judgment**, because he stood to win a judgment. They should have created a contingency
- Should there be a remedy awarded against the defendants personally?

    - Yes - the plaintiff had a reasonable expectation that G and G would retain a contingency fund. In failing to do so, they benefitted by diverting the accumulated profits to other profits they owned. Were able to insulate these funds
    - Courts can and do make orders directly against directors if that is the appropriate remedy
    - See *Wilson* for more on this

### *Shevsky California Gold Mining Inc* (2016 ABCA)

*Traditional, strict distinction between oppression and derivative action – recent example of ABCA assessing oppression in light of BCE*

Facts: Fights for control of the CGM public corporation involved in mineral exploration. Shefsky and his solely owned holding co allege that respondents breached his reasonable expectations that he would control CGMI if he raised at least $5M in investments. Appellants assert that respondents engaged in oppressive conduct, including a secret placement of shares that diluted S's voting power and refusing to allow S to appoint a third member to the board when his initial nominee refused to accept the position.

Reasons:

- ABCA acknowledges BCE as the leading decision, including the test
- Reiterates that what constitutes oppression is **fact specific**
- Notes that oppression remedies aren't intended to be a substitute for an action in contract, tort or misrepresentation
    - If you have a specific cause of action, plead it and prove it - don't 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 judgment rule applies to the oppression action - means that the directors 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 shouldn't 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
    - **Can't, through oppression, pursue something that is essentially 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

**Takeaway:**

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

## Derivative Action

***ABCA* section 240**

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 corp

Need to show the following things:

1. Reasonable notice
2. Acting in good faith
3. In the interest of the corp that the matter is brought

The court may make any order it thinks fit (section 241)

Derivative action is like a **vehicle** – think of it as a way in which specific claims are brought to court

- Actions belonging to the corporation in relation to third parties (e.g. breach of contract, tort, etc.)
- Actions belonging to the corporation in relation to directors/officers (e.g. breach of fiduciary duty, breach of duty of care)

Need to advance those actions through the derivative claim - a derivative action is a "vehicle" used to bring causes of action belonging to the corporation to a court when the *board* won't

Not an action in the ordinary sense of the word - it is a means through which causes of actions belonging to the corporation are advanced

- Referring to a derivative action *per se* says nothing about what the actual legal complaints are

### *Hercules Management Ltd v Ernst & Young* (1997 SCC)

*SCC insists on the difference between a personal action (oppression or tort) and a derivative action (Foss v Harbottle rule)*

Facts: Shareholders brought the litigation, including Hercules and two corporations (NGH and NGA), against a firm of accountants, alleging that the auditors performed a negligent audit. Relying on these audits, the plaintiffs invested more in the companies. Shareholder says if they knew the true facts they wouldn't 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 D/Os more closely. Sue in breach of contract and tort

Reasons:

- Corporations are on the receiving end of a bad audit and would have a cause of action for breach of contract and negligent misrep because the corps hired the auditors (contract) and they committed the tort of negligent misstatement (action in tort).
- Generally speaking, how these matters would proceed is:
  - Ds would sue auditors on behalf of the corp - if they refused, shareholder could apply for leave to commence a derivative action (see *Pathak v Moloo*)
- Companies involved are in receivership, it may be that the negligence caused no loss - they might have failed regardless - but if the corps wanted to sue, an action in tort, breach of contract or both would proceed. But that's not what's happening here - the *shareholders as plaintiffs* 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 claim:
    - Problem with there being a duty of care owed to them is that they didn't actually use the audit for its intended purpose - the audit is prepared so shareholders can assess the performance of management - wasn't for them to make personal investment decisions
    - Pursuant to *Livent:* the reliance wasn't reasonably foreseeable, and the reliance on the audit wasn't reasonable when it was being relied upon for the purpose of investment decisions
    - No duty of care owed
  - Regarding the existing investment, would have done more to keep an 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 - wasn't 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 - doesn't create a personal action in the hands of the shareholders, otherwise not respecting the corp as a separate legal entity
    - But if the shareholder is impacted in a unique and different way, they might have a cause of action
- *Foss v Harbottle*
  - The only cause of action for the bad audit lies in the hands of the corporation because of the rule in *Foss v Harbottle*
  - 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 must be brought either by the corporation itself (through management) or by way of a derivative action**
  - Rationale: corporation is a separate legal entity. The company is liable for its contract 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 don't 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 corp is advanced on their behalf by a minority shareholder

### *Brunette v Legault Joly Thiffault* (2018 SCC)

*Follows the rule in Foss v Harbottle - remains the law in Canada - shareholders can enforce a claim that belongs to the corporation and can only be enforced in a derivative action*

<u>Facts</u>: shareholders purported to sue a group of lawyers and accountants for giving bad tax advice, in which they held shares. The bad advice allegedly cause the demise of the corporations. The lawyers brought an action to strike the statement of claim as showing no cause of action, were successful before Quebec Court of Appeal - affirmed by the SCC

<u>Reasons</u>:

- **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 can't sue for a wrong done only to the corporation
- But the shareholders are not without recourse - may not have a person cause of action, but the court says they can pursue a derivative action in the corporation's name

### *Pathak v Moloo*

*Leave to commence requirements*

- **To succeed on application, need to show the requirements:**
    1. Applicant must be a complainant under s 239
    2. Reasonable notice: complainant must give reasonable notice to the directors of the corporation of the complainant's intention to apply to the court
        a. Was met here because the letter was "clear and specific"
    3. Good faith: good faith with respect to *commencing* the action, not with respect to all previous actions of the complainant
        a. Evidence here that the person was angry, but doesn't matter because only about *commencing*
    4. Interests of the corp: show a prima facie case (it "appears to be in the interest" of the corporation, <u>not</u> that it is in the *best* interest of the corp)
- For a question: apply the facts to these four steps
- Concern that without a derivative action protection people who are trying to bring a nuisance claim can easily do so – need to show you have a good claim with these steps, if you can't you're stopped at this preliminary point

### *Rea v Wildeboer* (2015 ONCA)

*Important case because its an example of the court of appeal analyzing this area in a thorough way - our court in Shefsky has used this, it is the law in AB – takes a strict view*

<u>Facts:</u> Important Factor: Large corporation (usually oppression claim for small, closely held corp). D undertook transactions that breached their fiduciary duty. Complaint: misappropriation of Martinrea funds (corp) by inside directors. Rea (P, co-founder, director, vice chair) has a reasonable expectation that directors would conduct themselves with probity.

- Two allegations: 1) Sold used equipment at prices well over market price and on unfair terms to Martinrea and D received kickbacks; 2) Company controlled by D purchased parcel of land from Martinrea without appropriate sales process and on unfair terms to Martinrea

<u>Reasons:</u>

- **One set of facts could give rise to both the derivative action and the oppression action (they aren't mutually exclusive)** - still need to ask if there is an oppression action on these facts
    - Legislatures brought in these two actions to combat the harshness of the CL - but they still have safeguards (must make the leave application)
    - **Leave requirement prevents strike suits, prevent meritless suits and avoids a multiplicity of proceedings**
- CA pushes back against *Malata* - that case involved a closely-held corporation, and the plaintiff that was permitted to proceed by way of oppression wasn't 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 the 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 a distinction to maintain**
    - **Claims must be pursued by way of a derivative action after obtaining leave where: (1)** the claim asserted seeks to recover solely for wrongs done to a public corporation**; (2)** the thrust of relief sought is solely for the benefit of that corporation, and; **(3)** there is no allegation that the complainant's individualized personal interests have been affected by the wrongful conduct
    - 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. Rea doesn't plead that the transactions impacted his interests *qua* director
    - Remember: the oppression remedy is not available simply because the complainant asserts a "reasonable expectation" - the conduct must fall within the terms "oppression" "unfair prejudicial" to or "unfairly disregard" the interests of the complainant

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

### *1043325 Ontario Ltd v CSA Building Sciences Western Ltd* (2016 BCCA)

*CA here also applies Rea, provides a good summary of the themes we've been dealing with - key question is whether a shareholder who has a complaint against a company for any wrong entitled to invoke the oppression remedy*

Facts: oppression claim by Skene Co, minority shareholder in CSA Ltd. CA agreed there was oppression by the majority shareholder and sole director, Jeck. For example, excess management fees were paid to Jeck, which can be seen as an injury to the shareholder and to the corporation. Court here references Malata's approach as "softening the particular loss" requirement, but then references Rea as taking a more rigorous view

Reasons:

- The claimant in an oppression action **must show particular prejudice of damage beyond the diminution of value of his or her shares as a result of the allegedly oppression conduct**
- Skene Co has shown particular prejudice or damage, personal to itself, and should not be required to sue derivatively
    - The prejudice was suffered solely by Skene Co
    - Even what's complained of could be pursued derivatively, there is a distinct personal claim here
- Bottom line: **if a majority is systematically blocking the minority from sharing in profits in a fair way, this is recognized as oppression**

### *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 collectivity of shareholders as a whole**
- **CA here followed *Rea* - while recognizing that on certain facts, both causes of action could arise**

**Oppression Versus Derivative**

- **Oppression=** personal action, concerns a wrong done to the complainant
- **Derivative=** wrong to the corp,
    - A derivative action is a vehicle that carries causes of action when board won't bring the action
    - Actions belonging to the corp in relation to 3rd parties (breach of contract, tort, trust)
    - Actions belonging to the corp in relation to the directors/officers (breach of fiduciary duty s.122(1)(a), breach of DOC s.122(1)(b), other torts, breach of contracts)
- **Two views:**
    - **Traditional**: 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, Rea, Shefsky, CSA Building, Brunette*
        - Even the traditional approach acknowledges that there can be overlap but there are also clear distinctions
    - **Looser view:** Complainant has considerable flexibility in how to proceed and it can be okay to avoid the derivative action
        - *Malata*: in the context of a closely held corp, court essentially makes this claim. Note however, the complainant actually had an oppression claim in the traditional sense. When the Defendant's misappropriated corporate property, that was an injury to the corp but also to the complainant b/c along with being a SH, they were also a creditor (so clearly oppression on the facts)
        - Aspects of *BCE*
- Should always seek leave and proceed both ways so that your limitations period doesn't expire

## Scope of Relief Available

Section 242(3) lays out a broad kind of orders that the court may make (although it is not limited to that list)

- **Remember:** Oppression is rooted in equity (ensures fairness) – therefore, 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

**Examples 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* (2017 SCC)

*Scope of relief available to an applicant*

Facts: defendant Wilson treated the plaintiff unfairly - played a key role in convincing the board not to convert his shares into common shares, diluted the value of the plaintiff's shares

Issue: should there be an order/remedy against the individual defendant?

Reasons:

- Judge ruled that Wilson had to personally pay damages for his conduct to the respondent, including because Wilson had personally benefitted from the oppression
- Nature of the oppression remedy is well recognized - s 241 creates an equitable remedy that seeks to ensure fairness, what is just and equitable *(BCE).* It gives a court a broad, equitable jurisdiction to enforce not just what is legal, but also what is fair.
  - Courts considering claims for oppression are therefore instructed to engage in fact-specific, contextual inquiries looking at "business realities", not merely narrow legalities
- There is no universal formulation as to when a D/O will be personally liable in oppression. The SCC endorses *Budd* which offers a **two prong test:**
  - **The oppressive conduct must be "properly attributable to the director because he or she is implicated in the oppression**
  - **The imposition of personal liability must be fit in all circumstances**
    - Four general principles:
      - 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 indicia of fairness: (1) D's obtaining a personal benefit; (2) increasing control over the corp; (3) breaching a personal duty; (4) misusing a corporate power; (5) where a remedy against the corp would prejudice the other security holders (note that this is not a closed list of factors or set of criteria to be "slavishly" applied)
        - Personal benefit and bad faith remain hallmarks of conduct not properly attracting personal liability, but are not exclusive
      - Any order should go no further than necessary to rectify the oppression
      - Any order should serve "only to vindicate the reasonable expectations" of the complainant(s)
      - A court should consider the general corporate law context is exercising its remedial discretion
        - Director liability should not be ordered where other forms of relief may be more fitting in the circumstances
- Under 1st prong: the oppressive conduct was properly attributed to W because he played a lead role in board discussion
- 2nd prong: W personally benefitted, affirmed the personal order against W

**Note: 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"**

- **Where there is a personal benefit but no finding of bad faith, fairness may require an order to be fashioned by considering the amount of personal benefit - may be most 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*) - remedial purpose

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**
    - **Can't 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 its remedial discretion under s 241(3):*
    - **Statutory oppression can be a help, but it can't 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* (1993 ONCA)

*Oppression remedy must not go beyond rectifying; cannot give something that would not be reasonably expected*

Facts: Rainbow was founded and built by Nick Naneff. Company 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 don't like his wife, 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?

Reasons:

- **A claim for wrongful dismissal 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 her rights as a shareholder, officer and officer of the company, the dismissal may properly be considered as part of that pattern of conduct
- What are all the options?
    - Put A and B in charge, remove Naneff from his position of control
        - Rejects this - treats Naneff unfairly, who is the founder of the company, and continues to have decision-making power
        - Note that A has only worked for the company for about 9 years
    - Rainbow Group be put up for sale, so anyone could bid (picks this option - reversed on appeal)
        - Gives A and B a chance to bid
    - Other family members would acquire A's share 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
    - Bottom line: business is to be sold in its entirety, any member can bid on it (reversed on appeal)
- CA: 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 can't be a remedy that gives a shareholder something that even he couldn't 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: Naneff and B are to acquire A's share at fair market value without a minority discount