Controlling the Power to Manage in Closely-Held Corporations under the Canada Business Corporations Act

Introduction

Notwithstanding the fact that they have little in common, both publicly-held and closely-held corporations are, with minor exceptions, subject to the same rules under the *Canada Corporations Act*.[1] The imposition of a single set of rigid legal principles has created numerous problems for participants in closely-held corporations, the most difficult of which relate to the control of management powers. Subsection 86(1) of the old Act, for example, provides that the affairs of a company shall be managed by a board of directors. The courts have further held that directors cannot validly contract as to how they shall vote at future board meetings.[2] The conclusion of this syllogism is that the management of corporate affairs cannot be controlled by contract. As a result, provisions in shareholder agreements which purport to regulate such matters as the appointment of officers and the granting of signing authority for banking purposes, are of doubtful validity.

The *Canada Business Corporations Act*[3] contains a number of provisions which significantly increase the freedom of shareholders to establish their own rules with respect to the control and allocation of management powers. The purpose of this article is to briefly review and comment upon some of the control techniques which are permissible under the new legislation.

1. The unanimous shareholder agreement

Subsection 140(2) of the new Act permits the restriction of the management powers of the directors by means of a written agreement among all of the shareholders.[4] While the unanimous share-

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1 R.S.C. 1970, c.C-32 (hereinafter referred to as "old Act").

2 L.C.B. Gower, *The Principles of Modern Company Law* 3d ed. (1969), 525. See also *Motherwell* v. *Schoof* [1949] 2 W.W.R. 529, (1949) 4 D.L.R. 812 and *Atlas Development Co. Ltd* v. *Calof & Gold* (1963) 41 W.W.R. 575. There is a growing debate as to whether this rule applies in the Province of Quebec. See D. Sohmer *Protecting the Minority Shareholder in Letters Patent Jurisdictions* (1971) 31 R.du B. 388, 392.

3 S.C. 1974-75, c.29 (hereinafter referred to as the "new Act").

4 It should be noted that the holders of shares which do not have voting rights must also agree.

holder agreement is a welcome innovation, there are certain aspects of the new Act relating to such agreements which unnecessarily diminish their utility.

It has been argued that the board of directors is superfluous for the closely-held corporation and ought to be dispensed with entirely where the participants desire to do so.[5] The new Act does not go this far. Subsection 140(2) only validates restricting the powers of the directors as opposed to the transfer of those powers. Thus, while a unanimous shareholder agreement may provide that directors cannot exercise management powers without the prior consent of the shareholders, it cannot provide that the shareholders may act to the exclusion of the directors. Several sections in the new Act reinforce this conclusion. Subsection 97(1) provides that management powers are vested in the directors "subject to any unanimous shareholder agreement" while other provisions vest certain powers in the directors "unless a unanimous shareholder agreement otherwise provide[s]".[6] The rules of statutory construction dictate that a different meaning be ascribed to these phrases. Furthermore, the new Act contains a number of provisions which grant certain powers specifically to the directors without expressly permitting any transfer or restriction of those powers by means of a unanimous shareholder agreement. Examples of these powers are the power to

[5] R. Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism* (1960) 27 U.Chi.L.Rev. 697.

[6] S.98(1) of the new Act for example provides that the directors may make by-laws "unless the articles, by-laws or a unanimous shareholder agreement otherwise provide". A number of provisions in the new Act are based upon provisions of the New York *Business Corporation Law* of 1963 and upon provisions of the *Model Business Corporations Act*. It is interesting to note that both clearly permit a transfer of management powers to the shareholders. S.620(b) of the New York statute validates a provision in the certificate of incorporation which "is otherwise prohibited by law because it improperly restricts the board in its management of the business of the corporation, or improperly transfers to one or more shareholders or to one or more persons or corporations ... all or any part of such management otherwise within the authority of the board ...". S.35 of the *Model Business Corporations Act* provides that "the business and affairs of a corporation shall be managed by a board of directors except as may be otherwise provided in the articles of incorporation". There is some indication that the relevant provisions in the new Act do not accurately represent the intentions of the draftsmen. Robert Dickerson, one of the architects of the new Act has stated that the provisions relating to unanimous shareholder agreements permit the shareholders "even to assume directly the functions and the responsibilities of the directors". R.W.V. Dickerson, *The Canada Business Corporation Act* (1975) C.A. Magazine 45, 51.

change the address of the registered office,[7] and the power to determine to whom and for what consideration shares may be issued.[8] The shareholder must therefore continue to wear both a director's and a shareholder's hat, and the hat-changing ritual will have to await future amendments before it is finally relegated to history.

A related problem also results from the fact that subsection 140(2) permits the management powers of the directors only to be "restrict[ed]". The right to restrict clearly includes the right to veto. But it is not clear that the right to restrict includes the right to initiate corporate action. Thus a provision in a unanimous shareholder agreement stipulating that certain individuals shall have signing authority for banking purposes may be invalid, since this involves a positive act by the directors. The same purpose could perhaps be achieved by phrasing the provision in the negative so as to prohibit the directors from granting signing authority to anyone other than those individuals.[9] However, this is precisely the type of artificial procedure which the draftsmen intended to render unnecessary.[10]

The utility of a unanimous shareholder agreement is further diminished by the provisions of subsection 140(4) which impose upon a shareholder who is a party to such an agreement, the duties of the directors to the extent that the agreement restricts the discretion or powers of the directors to manage the business and

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[7] *Supra*, note 3, s.19(3).

[8] *Ibid.*, s.28(1).

[9] This is reminiscent of the type of drafting which was necessary in injunctive proceedings in the Province of Quebec before mandatory injunctions were introduced in 1966.

[10] S.101 of *The Ontario Business Corporations Act, 1970*, S.O. 1970, c.25, permits the holder of shares to which are attached at least 10% of the votes attaching to the issued and outstanding shares of a company, to requisition the directors to call a meeting of the directors for the purpose of passing any by-law or resolution, and if such by-law or resolution is not passed within 21 days of the deposit of the requisition, the shareholder may convene a shareholders' meeting for the purpose of passing it. A shareholder can thus ensure the passage of any by-law or resolution by means of a covenant in a shareholder agreement to vote in favour of specified by-laws or resolutions in the event that they are placed before them pursuant to the provisions of s.101. While the procedure is unnecessarily cumbersome, it still provides shareholders with an effective means of initiating corporate action. The reason why the new Act does not contain a similar provision may be that the draftsmen thought that the provisions relating to unanimous shareholder agreements are sufficient to vest this power in the shareholder. See *supra*, note 6.

affairs of the corporation. Subsection 117(1) states that a director must act with a view to the best interests of the corporation. The effect of a unanimous shareholder agreement may therefore be to prohibit a shareholder from acting in his own best interests when they do not coincide with those of the corporation, notwithstanding that such action may not constitute a "fraud on the minority".[11] This can give rise to serious difficulties, particularly with respect to contracts in which such a shareholder is interested and with respect to opportunites which interest the corporation but which are not taken up.

Subsection 115(7) provides that a material contract between a corporation and one of its directors is neither void nor voidable, if the director disclosed his interest and the contract was approved by the directors or the shareholders. Subsection 115(5) prohibits such a director from voting on any resolution to approve the contract. This may make director approval impossible to obtain where there is no quorum of directors in office who are not interested.[12] Furthermore, if the director's hat is permanently rooted to the shareholder's scalp by virtue of subsection 140(4), the interested shareholder may be unable to approve *qua* shareholder. The proposition that such a shareholder may be unable to avoid director characterization is supported by the provisions of subsection 2(1) which defines a director as "a person occupying the position of director by whatever name called". A disinterested minority shareholder may therefore have the power to prevent a corporation from entering into a contract with a majority shareholder, notwithstanding the fact that the contract will not result in his "oppression" or in his being "defrauded". If, as is often the case, all of the shareholders are interested in the contract, it may also be impossible to ratify the contract, thereby exposing the shareholders to an action by future shareholders.

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[11] While the issue of which breaches of fiduciary duty are ratifiable is fraught with uncertainty, as a general rule it appears that a breach may be ratified unless it involves an appropriation of the company's assets by the majority at the expense of the minority. See S.M. Beck, "An Analysis of *Foss* v. *Harbottle*" in J. Ziegel (ed.), *Studies in Canadian Company Law* (1967), vol.1, 545, 572; "Corporate Opportunity Revisited", vol.2, 193, 233; *Northwest Transportation* v. *Beatty* (1887) 12 A.C. 589 (ratification permitted); *Cook* v. *Deeks* [1916] 1 A.C. 554 (ratification not permitted).

[12] S.98(4) of the old Act provides that a director of a private company can vote in respect of a contract in which he is interested where there is no quorum of directors in office who are not so interested. The new Act contains no similar provisions.

In Equity, a director is prohibited from appropriating "to himself property or opportunities, the chance for which came to him because of the position he occupied".[13] However, as a general rule, a breach of this fiduciary duty may be ratified by the shareholders.[14] As indicated above, subsection 140(4) may have the effect of making such approval impossible to obtain.

The new Act should have contained a provision which would make it clear that the imposition of the duties of a director on shareholders who are parties to a unanimous shareholder agreement, does not deprive them of any ratification rights which they would otherwise have had. The remedy against oppression provided by section 234 is sufficient to protect a minority shareholder against abuses of such rights.

It should be noted that agreements between shareholders of companies incorporated under the old Act may constitute unanimous shareholder agreements when such corporations are continued under the new Act. The shareholders would then be subject to the provisions of subsection 140(4).

Another criticism of the unanimous shareholder agreement provisions is that the unanimity requirement, which is intended to protect minority shareholders, can be circumvented. Subsection 6(2) provides that the articles may set out any provision permitted to be set out in a unanimous shareholder agreement, and paragraph 167(1) (n) permits the articles to be amended so as to set out such a provision by means of a special resolution. A special resolution however can be passed by a two-thirds majority of the votes cast by the shareholders who voted in respect of the resolution. The use of the articles instead of unanimous shareholder agreements for restricting the powers of the directors may also be encouraged by the fact that subsection 140(4) only imposes the duties and liabilities of directors on shareholders who are parties to unanimous shareholder agreements. If the articles are so used, the only danger to the shareholders would be that they may be characterized as directors under subsection 2(1), and therefore be subject to the duties and liabilities of directors *qua* directors.

Since an agreement requires two or more parties, the unanimous shareholder agreement provisions cannot apply to one-man corporations. Even if the new Act permitted the transfer of managerial powers to the shareholders by means of such agreements, a sole

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13 Beck, "Corporate Opportunity Revisited", *supra*, note 11, 206.

14 *Regal (Hastings) Ltd* v. *Gulliver* (1942) 1 All E.R. 378, 389, *per* Lord Russell of Killowen.

shareholder would be denied the right to do so by means of a unanimous shareholder agreement. The transfer of powers would have to be effected by means of a provision in the articles or by transferring a share to a "dummy" and entering into unanimous shareholder agreement with him. There is no reason why a sole shareholder acting alone should be denied the convenience of using a unanimous shareholder agreement for this purpose.

Although the unanimous shareholder agreement is not as flexible a device as many had hoped it would be, there are a number of provisions in the new Act which will permit it to play an important role in the control of management powers.

Subsection 6(3) sanctions high vote requirements for director and shareholder action in the articles or in a unanimous shareholder agreement. Such requirements can provide effective protection without depriving shareholder-directors of their ratification rights.[15]

Paragraph 149(1)(c) requires directors to place before the shareholders at every annual meeting any information respecting the financial position of the corporation and the results of its operations required by the articles, the by-laws or any unanimous shareholder agreement. Section 240 provides that this requirement may be enforced by means of a compliance order. Compulsory disclosure will often deter abuses in the exercise of management powers, particularly when such abuses may result in an application under sections 232 or 234 of the new Act.

Subparagraph 207(1)(b)(i) permits a court to order the liquidation and dissolution of a corporation if it is satisfied that a unanimous shareholder agreement entitles a complaining shareholder to demand dissolution of the corporation after the occurrence of a specified event and that event has occurred. Subsection 207(2) permits a court on application for dissolution to make an order under section 234. The specified event need not involve oppressive

[15] *Quaere*: Does a high vote requirement alone constitute a restriction of the powers of the directors? If it does not, then an agreement containing such a requirement may not be a "unanimous shareholder agreement". (See s.140(2) and the definition of "unanimous shareholder agreement" in s.2(1).) This would nullify the effect of a high vote requirement in a shareholder agreement. If shareholders wish to benefit from the unanimous shareholder agreement provisions without having to contend with the problems resulting from the imposition of directors' duties and liabilities, it is suggested that the agreement provide for a nominal restriction of the powers of the directors. A provision, for example, which prohibits the directors from borrowing more than $5,000,000 without the shareholders' consent should suffice.

nor unfairly prejudicial behaviour. The mere fact, for example, that the salary of one shareholder-employee has been increased without a corresponding increase in the salary of another shareholder-employee would entitle the latter to apply for a dissolution, if a unanimous shareholder agreement so provides. The application could also ask for an order under section 234 increasing the salary of the applicant as an alternative to dissolution.

2. Non-unanimous shareholder agreements

In many cases a minority shareholder may constitute the balance of power in a closely-held corporation. Where, for example, the percentage of total votes controlled by A, B, and C, is 45%, 45%, and 10%, respectively, an alliance of A and C or of B and C will effectively control the corporation. Both A and B will usually desire protection against attack by such an alliance, but they may not want to pay the price which C may exact as consideration for entering into a unanimous shareholder agreement. Since A and B are prohibited from fettering their discretion *qua* director in the absence of unanimity, they must protect their interests by controlling their powers *qua* shareholders.[16] A shareholder agreement between A and B can give each a veto power over director action by providing that each will exercise his right to vote so that one-half of the board consists of A's representatives and the other half of B's representatives. Where, however, the "controlling" group consists of more than two shareholders, this approach is not satisfactory, since the directors representing one can always be out-voted by the representatives of the others. The new Act contains a number of provisions which will assist shareholders in this predicament. These provisions increase the power of the shareholders and thereby expand the scope of non-unanimous shareholder agreements.

a) *The power to make by-laws*

Subsection 98(5) gives shareholders the power to make, amend or repeal by-laws.[17] By employing this new power, parties to a non-unanimous shareholder agreement can, provided that they control a majority of the votes, exercise significant control over the directors. They can, for example, pass by-laws restricting the power of the

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[16] See *supra*, note 11.

[17] Under the provisions of the old Act, only the directors can adopt or alter by-laws. See ss.94 and 95 of the old Act; *Kelly* v. *Electrical Construction Co.* (1908) 16 O.L.R. 232; and *Stephenson* v. *Vokes* (1896) 27 O.R. 691.

directors to borrow,[18] to appoint officers,[19] to fix the remuneration of directors, officers and employees[20] and even vest in the shareholders the exclusive power to make by-laws.[21] They can also pass a by-law increasing the number of directors required to constitute a quorum at any meeting of directors.[22] If a director's presence is necessary to constitute a quorum, he can make it difficult for the other directors to transact any business to which he objects.[23] The disclosure of desired financial information can be ensured by means of a by-law requiring such information to be placed before the shareholders at annual meetings.[24]

b) *The power to amend articles*

Section 167 provides that the articles of a corporation are amended by special resolution. Subsection 2(1) defines a special resolution as a resolution passed by a majority of not less than two-thirds of the shareholders who voted in favour of that resolution.[25] The power to amend the articles can accordingly be regulated by a non-unanimous shareholder agreement between shareholders controlling two-thirds or more of the votes attached to the issued shares. Subsection 6(3) permits the articles to provide for a high vote requirement for shareholders' and directors' meetings, thereby providing the parties with a veto power over corporate actions. Another important provision which can be included in the articles is a provision giving the shareholders pre-emptive rights. This will protect the parties to a non-unanimous shareholder agreement against dilution of their voting strength and equity, and is discussed in more detail below.

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[18] *Supra*, note 3, s.183(1).

[19] *Ibid.*, s.116.

[20] *Ibid.*, s.120.

[21] *Ibid.*, s.98(1).

[22] *Ibid.*, s.109(2).

[23] S.109(5) permits the by-laws to provide that a notice of a meeting of directors must specify the purpose of the business to be transacted at the meeting. By causing such a by-law to be passed, a director who opposes certain proposed director actions can use this notice to determine which meetings to avoid. In the absence of such a by-law, no purpose need be specified in notices of meetings of directors. M.L. Fraser and J.L. Stewart, *Company Law of Canada* 5th ed. (1962), 615.

[24] Para.149(1)(c).

[25] Under the old Act, supplementary letters patent are initiated by by-law, and since by-laws can only be made by the directors, the shareholders do not have the power to initiate amendments to letters patent.

c) *The power to remove directors*

Section 104 authorizes the shareholders to remove any director from office. A majority of the shareholders could provide in a non-unanimous shareholder agreement for the removal of any director who does not comply with the instructions of that majority. This threat may be sufficient to induce the directors to do the shareholders' bidding.

d) *Pre-emptive rights and share transfer restrictions*

Since a shareholder agreement is only binding on the parties to it,[26] the issue or transfer of shares to non-parties can undermine the protection which the agreement is intended to afford.

The parties to a unanimous shareholder agreement can prevent the issue of shares to non-parties by providing that no shares shall be issued by the directors without the unanimous consent of the parties to the agreement. The parties to a non-unanimous shareholder agreement can secure similar protection by providing for pre-emptive rights in the articles. Section 28 gives statutory sanction to the administrative practice of permitting the articles to provide that no shares shall be issued unless they have first been offered to existing shareholders in proportion to their holdings of the shares of the class being issued. The protection provided by a pre-emptive right however, is not as complete as that provided by the right to veto the issue of shares. Paragraph 28(2)(a) states that shareholders have no pre-emptive rights in respect of shares to be issued for a consideration other than money. As important as this statutory exception is, the fact is that a pre-emptive right is useless if a shareholder does not have the means or the liquidity to pay the price at which the shares are offered.[27] Parties to a non-unanimous shareholder agreement would accordingly be well advised to supplement pre-emptive right provisions with high vote requirements in the articles and perhaps with high quorum requirements in the by-laws. This would permit each party to veto any proposed share issue.

Subsection 140(3) provides that a transferee of shares subject to a unanimous shareholder agreement is deemed to be a party to

[26] This is subject to the exception provided by s.140(3), which makes a unanimous shareholder agreement binding on a transferee of shares subject to the agreement.

[27] Ss.13(15) and 44-46 of the old Act permit the issue of partly-paid shares, so that the pre-emptive right provisions in the letters patent can provide for liberal terms of payment. S.25(3) of the new Act provides that shares cannot be issued until they are fully paid.

the agreement, provided that the security certificate transferred to him contains a reference to the fact that the certificate is subject to such an agreement. Parties to a non-unanimous shareholder agreement must, however, rely on share transfer restrictions to prevent the erosion of the protection provided by the agreement through transfers of shares to non-parties. Paragraph 6(1)(d) requires such restrictions to be set out in the articles. If the original articles do not contain adequate restrictions, section 184 may deter any necessary amendment, since it permits a dissenting shareholder to compel the corporation to purchase his shares at their "fair value" in the event of such an amendment.

3. High vote and high quorum requirements

As indicated above, the new Act authorizes high vote and high quorum requirements for meetings of directors and shareholders.[28] Such requirements can provide protection for the shareholders of a closely-held corporation which is as effective as that provided by a

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[28] *Supra,* note 3, ss.6(3), 109(2) and 133(1). There appears to be no Anglo-Canadian jurisprudence with respect to high vote provisions in the articles or by-laws of a corporation. It has been argued that by-laws in letters patent jurisdiction are legislative in nature, so that the common law prohibition against a director fettering his discretion does not extend to a fettering of discretion by by-law as opposed to contract. See Sohmer, *Protecting the Minority Shareholder in Letters Patent Jurisdictions, supra,* note 2, 407. There is American jurisprudence to the effect that such by-laws are invalid in the absence of statutory authority. In the case of *Benintendi* v. *Kenton Hotel,* 294 N.Y. 112, 60 N.E. 2d 829 (1945), the New York Court of Appeals held invalid by-laws requiring unanimity for shareholders' resolutions, unanimity for the election of directors and unanimity for directors' resolutions.

It would be more difficult to characterize a high quorum provision as an illegal fettering of discretion. The jurisprudence indicates, however, that quorum provisions will be disregarded where it can be established that the failure to attend a meeting or the leaving of a meeting, had, as its object, the prevention of the formation of a quorum or the loss of a quorum. See *In re Copal Varnish Co., Ltd* (1917) 2 Ch.349; *Re Hartley Baird Ltd* (1955) 1 Ch. 143; *Hofer et al.* v. *Hofer et al.* (1968) 65 D.L.R. (2d) 607; *T. J. Winram Estate* v. *M.N.R.* [1972] C.T.C. 193; *Gearing* v. *Kelly,* 11 N.Y. 2d 201, 182 N.E. 2d 391 (1962); *cf. Fairgreen Investments Ltd* v. *M.N.R.* [1972] C.T.C. 2446. The consistent refusal of a director to attend meetings would probably constitute a breach of duty, and it may be that such a breach could be restrained by an injunction. The Quebec Court of Appeal has upheld contempt of court convictions against two municipal counsellors who disobeyed an injunction to refrain from acting together with a view to preventing a municipal council meeting from being held for want of a quorum; see *Bourque and Farineau* v. *Chartier et al.,* Quebec Court of Appeal, District of Montreal, no.14,646, September 10, 1973 (unreported). High quorum provisions are nevertheless an effective first line of unanimous shareholder agreement. As appears to be the case with the unanimous shareholder agreement, a high vote requirement cannot provide a shareholder-director with the power to initiate corporate action. It also appears that the shareholder-director is prohibited by the provisions of section 117 from exercising his veto power at directors' meetings when his own interests are in conflict with the interests of the corporation.

In order to deprive the directors of the power to appoint a third party to fill a vacancy which results from the death or incapacity of one of the shareholder-directors on the board, thereby removing the protection provided by a high vote requirement, either a high quorum requirement for directors' meetings should be required or the articles should stipulate that vacancies can only be filled by the shareholders.[29]

4. Cumulative voting

The shareholders of a closely-held corporation may want to grant a minority shareholder the right to be represented on the Board of Directors without giving him a veto power. The usual techniques for accomplishing this are provisions in shareholder agreements whereby the shareholders covenant to elect to the board a representative of the minority and the creation of a special class of shares, the holders of which have the right to elect a specified number or percentage of directors. Departmental practice[30] permits the use of a third technique, cumulative voting, and section 102 sanctions this practice. Cumulative voting is a more cumbersome technique than the others, and it is not anticipated that provision for it will be made in the articles of many closely-held corporations.

5. Non-voting shares

Subsection 13(17), and sections 104 and 105 of the old Act were interpreted by the Department as requiring that preferred shareholders must have some right to vote. The policy was that, at the very least, such shareholders had to be entitled to vote in the event that no dividends were paid for two consecutive years. Many closely-held corporations do not pay dividends regularly to preferred share-

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defense since an obstructionist purpose must be proved and such proof may be difficult to make unless there are repeated acts of absenteeism.

[29] *Supra*, note 3, ss.106(2) and (4).

[30] Department of Consumer and Corporate Affairs, Corporations Branch (Canada).

holders. The occasional controlling shareholder suddenly found himself being outvoted because the preferred share voting rights had been triggered as a result of non-payment of dividends. Subsection 24(4) of the new Act removes this trap by permitting the creation of non-voting shares.[31]

6. One-man corporations

Subsection 97(2) reduces the minimum number of directors to one for corporations the securities of which are not or were not part of a distribution to the public. Since nominee directors are no longer necessary, problems relating to the control of their powers will no longer be encountered.

7. Arbitration

The new Act contains several provisions which will facilitate the use of arbitration as a technique for resolving disputes as to the exercise of management powers. A unanimous shareholder agreement can provide that a veto of director action by a party to the agreement can be overridden by the decision of a third party arbitrator. Subsection 140(4) necessarily implies that the arbitrator would not be subject to the duties and liabilities of the directors. Paragraph 6(1)(e) permits the articles to set out a minimum and maximum number of directors. A shareholder agreement, even a non-unanimous one, can accordingly provide that in the event of a dispute between the parties as to director action, a third party arbitrator shall be elected as an additional director until the dispute has been resolved.[32] In this case, the arbitrator would of course be subject to the duties and liabilities of directors, a fact which may make it difficult to induce a person to accept the role of arbitrator.

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[31] S.125(1) of the *Income Tax Act*, S.C. 1970-71-72, c.63, grants a small business deduction to Canadian-controlled private corporations. S.125(3) of the *Income Tax Act* provides that members of an associated group of corporations may share the small business deduction but that the full deduction may not be claimed by each of them. Under s.256 of the *Income Tax Act*, "control" is the test for determining "association". In the case of *Lou's Service (Sault) Ltd* v. M.N.R. [1967] C.T.C. 315, several corporations were held to be associated on the ground that control can be imputed to the holders of redeemable preferred shares, which, because of non-payment of dividends, carried the right to vote. This trap will also be removed by s.24(4) of the new Act.

[32] The third party need no longer be a shareholder to be a director, *ibid.*, s.100(2).

8. Buy-sell and stock-retirement agreements

Most shareholder agreements contain buy-sell provisions for use in the event of the death of a shareholder or in the event of irreconcilable disputes as to the exercise of management powers. These provisions contemplate the purchase of one shareholder's shares by one or more of his fellow shareholders. The use of stock-retirement arrangements whereby shares are purchased by the corporation is prohibited under the old Act as a result of the decision in *Trevor* v. *Whitworth*.[33] Sections 32 and 33 of the new Act remove this obstacle, and section 38 contains a number of specific provisions relating to such arrangements.

Section 184 may deter an amendment which may in many cases be necessary to give effect to the "buy-sell" provisions which most shareholder agreements contain. The customary charter share transfer restriction provides that no shares may be transferred without the prior approval of the directors. Any covenant by the directors to approve a transfer in accordance with the "buy-sell" provisions may constitute an illegal fettering of discretion. Since shareholders are free to fetter their discretion, the difficulty can be avoided by amending the articles so as to require shareholder approval instead of director approval. Section 184 however, provides a right to dissent not only where restrictions are added or removed, but also where they are changed.

Conclusion

The draftsmen of the new Act were sensitive to the fact that a large proportion of federally incorporated companies are closely-held. Among their objectives were the abolition of useless formalities, the provision of new and expanded remedies for the resolution of disputes, and an increase in management flexibility.

The provisions which seek to implement this last objective significantly expand the freedom of the participants in closely-held corporations to tailor the power structure in accordance with their desires. The new Act, however, does not permit as much flexibility as it should. The shareholder-director dichotomy is meaningless in the context of most closely-held corporations and the unanimous shareholder agreement provisions should have permitted the directors to be dispensed with entirely. At the very least, the new Act should have been drafted so as to clearly permit a transfer of management powers to the shareholders.

David H. Sohmer*

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33 (1887) 12 A.C. 409.

* B.C.L. (McGill), LL.B. (Dalhousie), of the Montreal Bar.