Shareholders Under The Draft Canada Business Corporations Act

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I. Introduction

Recently there has been a deluge of corporate legislation reform, as illustrated by the new statute of Ontario, the proposed corporation statute for British Columbia and the proposals for a Draft Canada Business Corporations Act.[1] The purpose of this article is to discuss generally the provisions of the Draft Act dealing with shareholders. The discussion will not cover all the shareholder provisions in the Draft Act, however, nor will it be exhaustive of those provisions which are selected for discussion.[2] Moreover, there are very important provisions dealing with security certificates, registers and transfers (Part 6.00 of the Draft Act), pro-

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[1] Ontario's statute is: *The Business Corporations Act*, S.O. 1970, c. 25, amended by S.O. 1971, c. 26 (hereinafter referred to as the "Ontario BCA"); see also: Bill 180, An Act to Amend The Business Corporations Act, 2nd Sess., 29th Legis., 21 Eliz. II, 1972 (1st reading, June 15, 1972). For comments on the BCA, see: Lavine, *The Business Corporations Act, 1970: An Analysis* (1971); *The Business Corporations Act 1970*, Special One-Day Programme of The Law Society of Upper Canada (1970); Getz, *Corporation Law*, (1971) 5 Ottawa L. Rev. 154; Iacobucci, *The Business Corporations Act, 1970: Creation and Financing of a Corporation*, (1971) 21 U. of Tor. L.J. 416, and *Management and Control of a Corporation*, (1971) 21 U. of Tor. L.J. 543; Salter, *The Business Corporations Act — One Year Later*, [1972] Special Lectures of The Law Society of Upper Canada 1 (hereinafter cited as "Special Lectures").

British Columbia's proposed statute is: Companies Act, Bill No. 66 (1972). See also the related Departmental Study Report of the Department of the Attorney-General of B.C. (Dec. 21, 1971).

The proposed Canadian legislation is in two volumes: *Proposals For a New Business Corporations Law for Canada* (1971), Commentary (vol. 1) and Draft Canada Business Corporations Act (vol. 2), (hereinafter referred to as "Commentary" and "Draft Act", respectively).

[2] See: Howard, *The Proposals for a New Business Corporations Act for Canada: Concepts and Policies*, in Special Lectures, *op. cit.*, at p. 17; Willis, *A New Canadian Business Corporations Law?*, (1971) 99 Canadian Chartered Accountant 442; Hornstein, *Perspectives in Corporation Law*, in 1971/72 Annual Survey of American Law 131.

spectus qualifications (Part 15.00) and take-over bids (Part 16.00) which affect shareholders directly but which will not be discussed.

The Draft Act has been selected for comment by the author simply because it represents the best Canadian attempt to deal realistically and sensibly not only with shareholders but also with the corporation itself.

II. Provisions Affecting Shareholders

A. *Financial Aspects*

(1) *Share Capital*

Many provisions of the Draft Act dealing with corporate finance and corporate securities generally are very innovative. The Draft Act has also introduced related rules dealing with security certificates, registers and transfers, and trustees and trust indentures which were initially enacted by the Ontario BCA.[3]

Under the Draft Act, there is no mandatory requirement for a corporation to have stated clearly in its articles of incorporation its authorized capital. Section 2.02(1)(c) prescribes simply that any maximum number of shares which the corporation is authorized to issue shall be set out in the articles of incorporation. Consequently the concept of authorized shares is optional, and most corporations will not provide for authorized capital, thereby avoiding extra legal fees and time in not having to file a charter amendment whenever a proposed share issuance would exceed their authorized shares.

An extremely welcome provision is section 5.01(1), which requires that shares be without par value since, as mentioned in the Commentary, the concept of par value is not only arbitrary but also quite misleading.[4] In my opinion the best reason for abolishing par value shares is that such terms as "paid-in" and "contributed surplus" will also disappear. These terms have caused considerable confusion and scope for abuse, since the surplus

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[3] Security certificates, registers and transfers are dealt with in Part 6.00 of the Draft Act; *compare* Ontario BCA, sections 63-97. Trustees under trust indentures are dealt with in Part 7.00 of the Draft Act; *compare* Ontario BCA, sections 57-62. Parts 6.00 and 7.00, like their Ontario counterparts, are based on U.S. legislation: Article 8 of the *Uniform Commercial Code*, and the *Trust Indenture Act* of 1939.

[4] "What matters to an investor is the proportionate size of his investment in a corporation, not the arbitrary monetary denomination attributed to that investment": Commentary, para. 98.

arising on the issuing of shares in excess of par value could be used for distribution as dividends. The effect of abolishing par value shares will be that all of the consideration received by the corporation will be allocated to the share capital account and thereby locked in, subject to the rules relating to return of capital.[5] The Draft Act also allows shares to be redeemed as long as the redemption price or the manner in which such price will be determined upon redemption is specified in the articles.[6]

The Draft Act also makes no formal distinction between types of shares, that is, common and preference (or special shares in the Ontario BCA). The Draft Act simply provides that if a corporation has more than one class of shares, the rights, privileges, restrictions, and conditions applying to the different classes are to be set forth in the articles. If there is one class of shares, then the shares must confer on the holders thereof the right to vote at all shareholders' meetings; if there is more than one class of shares, at least one class must be fully voting.[7] The draftsmen apparently feel there is not much to be gained from describing shares as "common" or "preferred" since such description assumes each type of share has a precise meaning, an assumption which the draftsmen argue is misleading. This may be true, but calling all types of shares by the same designation may prove to be more misleading than the present common-preferred distinction. Perhaps the statute should provide that where there is more than one class of shares the shares should be designated by some term which indicates the class difference, for example, voting or non-voting.

A useful mechanism is provided in section 5.04 of the Draft Act with respect to the issue of a series of shares of a class. Subsection (1) provides that the articles may authorize the issue of any class of shares in one or more series, and may authorize the directors to fix the number of shares in the series and the rights and conditions attaching thereto, subject to the articles. This means that, if the shareholders so desire, the directors may be given considerable

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[5] The abolition of par value shares will, of course, also eliminate the difficulty of not being able to issue shares at less than par value. See also section 5.03 of the Draft Act which requires a corporation to maintain a separate stated capital account for each class and series of shares issued; it also provides that the consideration received for shares is to be added to the stated capital account. The latter requirement is analogous to section 13(9) of the present *Canada Corporations Act*, R.S.C. 1970, c. C-32 (hereinafter referred to as "the present Act").

[6] Section 5.10. This is similar to section 35(1)(a) of the Ontario BCA.

[7] Section 5.01(2), (3), (4).

flexibility in issuing shares in series — useful in order to meet changing market conditions. The provision giving added discretion to the directors (who could, for example, issue preferred shares with different dividend or conversion rights) is basically fair since the shareholders must authorize such discretion by their approval of the articles.[8]

(2) *Purchase By a Company of Its Own Shares*

The Draft Act reverses the rule in *Trevor* v. *Whitworth*,[9] which prohibited a corporation from purchasing its own shares. The treatment of a company purchasing its own shares is distinguished from a redemption of redeemable shares. Anything beyond such a definition of a purchase or redemption is subject to the provisions dealing with a reduction in capital.

The basic section dealing with this subject is section 5.07(1), which expressly prohibits a company from purchasing its own shares, or shares in its holding body corporate, and renders such a purchase void;[10] but several exceptions are provided. The first two exceptions allow a corporation to hold its own shares as a legal representative, and as security for a transaction entered into by it in the ordinary course of business that includes the lending of money.[11]

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[8] The Commentary points out that some jurisdictions (for example, North Carolina) allow the directors to vary only certain terms, for example, the dividend rate, amounts payable on redemption or liquidation, sinking fund provisions, and conversion privileges. See section 55-41 of the North Carolina *Business Corporation Act*, which section also provides that each series must be designated to distinguish the shares thereof from the shares of all other series and classes.

[9] (1887), 12 App. Cas. 409 (H.L.). Not much is said in the Draft Act as to why a corporation *should* be able to acquire its own common shares. The Commentary mentions that the objections of impairment of capital to the detriment of creditors, consolidation of control by the directors, and market manipulation have been covered by the rules of the Draft Act. See: Commentary, paras. 123-26, 136. One may doubt whether the provisions of the Draft Act fully meet the above objections, however. For example, the Commentary says since shares acquired by the corporation are cancelled, this reduces the opportunity for directors to use the votes of those shares. But if the directors own a near majority of the shares, they could cause the corporation to purchase enough shares to give them control. This possibility does not seem specifically removed by the Draft Act. See the discussion of section 5.08, below.

[10] This is similar to section 19 of the present Act; for a recent case on this section, see *Schiowitz* v. *I.O.S. Ltd.*, [1972] 3 O.R. 262 (C.A.).

[11] Section 5.07(2), (3).

A major exception is found in section 5.08, which provides that, notwithstanding the basic prohibition mentioned above, but subject to a solvency test (mentioned below) and to any provisions in its articles, a corporation may *for any reason* purchase its own shares. Presumably under section 2.02 a corporation could include a provision in its articles prohibiting it from purchasing its own shares. It is interesting to speculate on the meaning of "for any reason". Literally it could mean a corporation could purchase shares to increase the voting strength of the directors and officers of the corporation through the cancellation of the shares so purchased. In other words, "for any reason" implies that a purchase can be made notwithstanding that it is not in the best interests of the corporation. Hopefully this would not in the end be the case, however, as the purchase would presumably be subject to the duty of directors prescribed by section 9.19 of the Draft Act.

This raises another point which remains obscure under the provisions: the Draft Act does not specify whether the directors of the corporation must authorize the purchase, and if so whether a separate resolution is required. Section 9.16(2)(a), which holds liable those directors who vote for or consent to a resolution in contravention of section 5.08, at least implies that the directors *may* pass a resolution authorizing such a purchase. But the procedure for a purchase of shares should be set out clearly in the enabling provision and not left to inference from the liability section, especially since many questions are unanswered; for example, can the directors buy from "friends", or is there any obligation to give all shareholders an equal chance to sell their shares.[12]

Under section 5.08(2) a corporation cannot purchase its own shares or shares of its parent "if there are reasonable grounds for believing that (a) the corporation is or would after the purchase or acquisition be unable to pay its liabilities as they become due, or (b) the value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes." Basically, then, a two-fold solvency test is applicable to a purchase of shares by a corporation, expressed in terms of the two usual

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[12] *Compare* Ontario BCA, section 39. I do not mean to suggest that the federal act's procedure should necessarily be as restrictive as that found in section 39, but it might be worthwhile to specify certain requirements. For example, the directors must authorize the purchase of a prescribed amount (not each specific purchase), and must do so in good faith for certain purposes connected with benefitting the corporation; and perhaps the directors should be required to disclose to the shareholders the specific purpose of the purchase. See: North Carolina *Business Corporation Act*, section 55-52.

definitions of solvency. Note that the corporation may purchase if there are *reasonable* grounds for believing the corporation is solvent. Presumably the directors have reasonable grounds for such belief if they rely in good faith on financial statements to determine that the company is solvent, since this defence for directors is expressly provided in section 9.16(9).[13]

Subsection (3) of section 5.08 provides that for the purposes of subsection (2), "... account may be taken of an unrealized increment in the value of any marketable asset, and no allowance is required to be made for depletion of a wasting asset." This subsection has been added because in the view of the draftsmen it is "absurdly conservative" to require the calculation of the value of assets based on historical cost.[14] Several questions come to mind, however. First, if one is concerned about protecting creditors from improper dissipation of capital, perhaps an abundance of caution is worthwhile, especially since some of the terms used in subsection (3) are not defined (for example, what is a marketable asset, or what is the unrealized increment at any given time[15]). This means a considerable reliance will be placed on the accountants by the directors. The Commentary mentions that the directors' potential personal liability under section 9.16 will ensure that the financial position of the corporation will receive close scrutiny in considering a purchase of its own shares. However, as already mentioned, the directors can successfully defend such an attack if they can show they have relied and acted in good faith on financial statements prepared by an officer or the auditor of the corporation.

Section 5.09 outlines some specific purposes for which a corporation may purchase its own shares:

(a) to settle or compromise a debt by or against the corporation or the holding body corporate;
(b) to eliminate fractional shares;
(c) to "fulfil terms of a non-assignable agreement under which the corporation or the holding body corporate has an option or is obliged to purchase shares owned by a director, officer or employee of the corporation or the holding body corporate";
(d) to satisfy the claim of a shareholder who dissents from certain transactions under section 14.17; or

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[13] By section 9.16(9), the financial statements may be relied upon if they are represented to be correct by an officer of the corporation or stated to be accurate in the written report of the auditor.

[14] See: Commentary, para. 128.

[15] On the question of ignoring depletion of wasting assets, see: Commentary, para. 129.

(e) to comply with a court order requiring the corporation to purchase an aggrieved shareholder's shares under section 19.04.

The solvency test contained in subsection (2) of section 5.09, which is applicable to the purchases contemplated in situations (a), (b) and (c), is somewhat more relaxed than that in section 5.08(2).[16]

Section 5.10 allows the redemption of shares, subject to a solvency test and to any provision in the articles; but the corporation cannot redeem at prices exceeding the redemption price stated in the articles or calculated *according to a formula* stated in the articles. Presumably the intent of the emphasized words is that if there is no redemption price specified, there must be a formula which determines a *fixed* price; it would not be a formula to state in the articles that the shares may be redeemed at whatever price the directors decide.[17]

In a rather complicated and inelegant fashion, section 5.11 deals with the effect on the stated capital of a purchase, redemption or other acquisition or conversion of shares, the intention being to reduce stated capital by the amount which was credited to the stated capital when the shares were originally issued. Subsection (6) of section 5.11 provides that shares purchased, redeemed or otherwise acquired by it shall be cancelled, or, if the articles include a concept of authorized shares, shall be restored to authorized but unissued shares. This makes abundant sense, since by this simple provision some very nasty problems are eliminated: accounting problems relating to the purchase, especially those dealing with presenting the "surplus" arising in the resale of such shares; problems regarding the dividend or voting rights of reacquired shares; and problems concerning voting and stock market manipulation.

In this connection, section 10.01(1)(b)(ii) of the Draft Act defines an "insider" to include a corporation which is purchasing or other-

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[16] Section 5.09(2) requires that the value of the corporation's assets after the purchase must not be less than the aggregate of its liabilities and the amounts required for payment on a redemption or in a liquidation of all shares which carry the right to be paid for prior to the shares purchased or acquired. The solvency test for situations (d) and (e) are covered in sections 14.17(26) and 19.04(6) respectively.

[17] Paragraph 131 of the Commentary suggests that the insolvency condition is really the only one that is necessary, inasmuch as there is "public notice" of the fact that the corporation is empowered to reduce its capital. Note, however, that section 3.04 of the Draft Act purports to abolish the doctrine of constructive notice of the documents filed by the Registrar, which would include the articles. *Compare* Ontario BCA, sections 27(2), 35(1)a. See: Salter, *op. cit.*, at p. 8.

wise acquiring its own shares, and therefore the corporation is subject to Part 10.00 of the Draft Act dealing with insider trading. Accordingly such purchases will become public knowledge, since it is contemplated that the Registrar will publicize insider information generally. However, it would be even more desirable for the corporation to disclose more directly to its shareholders the number and details concerning such purchases, including the reasons therefor, perhaps by disclosure in the information circular for the annual meeting or by balance sheet notation, or both.

Section 5.12 provides that agreements to purchase, redeem or otherwise acquire shares are specifically enforceable against the corporation, unless prevented by the provisions of the statute, with the corporation having the onus of proving that performance is so prevented.[18]

(3) *Dividends*

Section 5.14 attempts to simplify the muddled law relating to the payment of dividends.[19] Briefly, it prohibits the payment of a dividend if there are reasonable grounds for believing that the corporation is or would be insolvent, with solvency defined in the same way as for a purchase by a company of its own shares. Again, account may be taken of the unrealized increment in the value of any marketable asset, and no allowance is required to be made for depletion of wasting assets. Section 9.16(2)(c) imposes personal liability on directors who approve a resolution authorizing payment of a dividend contrary to section 5.14, but subsection (9) of section 9.16 provides a defence to directors who rely and act in good faith on the financial statements of the company.[20]

Two more aspects of a corporation's acquisition of its own shares should be mentioned. First, section 43 of the Ontario BCA gives an Ontario corporation the power to accept shares by way of gift without any payment of capital in respect thereof. This is not expressly provided for in the Draft Act. And second, the new income tax

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[18] It should be noted that section 5.12 refers to sections 5.09 and 5.10 but omits section 5.08.

[19] See: Bryden, "The Law of Dividends", in *Studies in Canadian Company Law*, Ziegel ed. (1967), at p. 270 (hereinafter cited as "Studies").

[20] Two more related sections of the Draft Act are section 5.15, which deals with stock dividends and dividends in kind, and section 5.16, which deals with loans to shareholders.

considerations relating to a purchase or redemption by a corporation of its shares must be kept in mind.[21]

B. *Shareholders' Rights*

(1) *Issuance of Shares and Pre-emptive Rights*

"Securities" of a corporation under the Draft Act may not be issued until fully paid, which occurs when "the corporation has received all the consideration therefor in money, or in property or past services that is the fair equivalent of the money that the corporation would have received if the security had been issued for money."[22] This provision will eliminate partly-paid shares and the procedures for calls thereon which have been anachronistic in the modern setting.

The Draft Act introduces a significant change with respect to pre-emptive rights. At common law, it is arguable that the issuance of shares, absent an express provision in the instrument of incorporation, is not qualified by a pre-emptive restriction requiring the issuance to be offered to existing shareholders *pro rata* on the basis of their existing shareholding.[23] But section 5.05(1) of the Draft Act provides for a pre-emptive right *unless* the articles of incorporation have expressly limited the right or excluded it. This is a rather curious formulation for this provision especially when one examines the reasons for its enactment.

Pre-emptive rights are designed to prevent dilution of a shareholder's interest and strength by the directors exercising their power of issuance in some improper way, whether to benefit themselves

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[21] Especially important are the deemed dividend provisions of section 84 of the *Income Tax Act*, S.C. 1970-71, c. 63. The new *Income Tax Act* changes the order of payment made under the former act in that capital is returned first and any balance is taxable as a dividend, with complicated transitional provisions. See also section 181 which deals with open market purchases of common shares.

[22] Presumably "shares" should be substituted for "securities" in section 5.02(3). "Security" is defined in section 1.02(1)(u) to mean "a certificate evidencing a share of any class or series of shares or a debt obligation [in turn defined by section 1.02(1)(k)] of a corporation". Section 5.02(4) provides that, in determining whether property or past services is the fair equivalent of a money consideration, the directors may consider "reasonable charges and expenses of organization and re-organization and payments for property and past services reasonably expected to benefit the corporation".

[23] See: *Harris* v. *Sumner*, (1909) 39 N.B.R. 204 (C.A.). *Cf. Martin* v. *Gibson*, (1908) 15 O.L.R. 623 (H.C.); *Bonisteel* v. *Collis Leather Co. Ltd.*, (1919) 45 O.L.R. 195 (H.C.).

personally or to prevent some occurrence, such as a take-over bid, from happening.[24] Those who advocate the adoption of pre-emptive rights believe that the general equitable restraints on the directors in issuing shares — that is, that they act honestly and in good faith in the best interests of the corporation — are too imprecise and lead to costly and uncertain litigation.[25] But the logical extension of this view would be to require that pre-emptive rights are *mandatory* for all corporations, not what one can call "quasi-mandatory" as in the Draft Act. This approach smacks of a compromise which, like many compromises, may prove undesirable. With respect to new corporations incorporated under the Draft Act, it will mean that most articles will contain a provision denying pre-emptive rights because most incorporators will desire the added flexibility gained by not having such rights. Existing corporations will probably effect a charter amendment inserting a denial provision in order to gain the same wanted flexibility.[26] But note that in both these cases it will be necessary for the corporation's legal adviser to know of the pre-emptive rights choice in the statute; in practice it is possible that counsel could overlook the right to insert a clause in the articles denying pre-emptive rights,[27] an oversight which could lead to a number of problems thereafter.

In this connection, there is nothing in the Draft Act which describes expressly or precisely the consequence of failing to comply with the pre-emptive requirement, apart from general enforcement provisions.[28] If the consequence is that the issue of shares is thereby rendered void, this could work a very real injustice on shareholders

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[24] See: *Hogg* v. *Cramphorn Ltd.*, [1967] 1 Ch. 254; *Bamford* v. *Bamford*, [1969] 2 W.L.R. 1107 (C.A.).

[25] See paragraph 116 of the Commentary where it is also stated that if a shareholder is to abandon his right to protection against direct dilution of his voting power, this should be done by deliberate exclusion of that protection.

[26] Under section 20.15, existing federal corporations must apply within three years after the Draft Act comes into force for a certificate of continuance dealt with under section 14.14, which requires articles of continuance to be delivered to the Registrar. A corporation might wish to insert a provision in its articles of continuance to deny the pre-emptive rights, although the procedure for this is not clear. It should be noted that if such certificate is not applied for within the stipulated period, the corporation is deemed to be dissolved by section 20.15(4).

[27] Such oversight seems possible despite the reminder in section 2.02(1)(e) dealing with a specific pre-emptive provision in the articles of incorporation.

[28] Section 19.10, discussed below, provides that a restraining or compliance order of the court may be obtained to force compliance with, *inter alia*, the articles and the Draft Act.

who have given valuable consideration without knowledge of the improper issue. However, it may be that the provisions of Part 6.00 of the Draft Act adequately protect such shareholders since those provisions attempt to reduce the defences which can be used to invalidate a shareholder's claim to securities.[29]

Nevertheless, pre-emptive rights will make it more difficult for lawyers to give their customary opinion that the outstanding shares of a corporation have been, *inter alia*, validly issued. Such an opinion would require a very careful examination of the corporate records to ensure that the pre-emptive rule had been duly followed when the shares in question were originally issued.

(2) *Shareholders' Participation in Decisions*

(a) *Shareholders' Meetings*

There is a series of technical provisions in the Draft Act which clarify or change several ambiguous or undesirable common law rules relating to shareholders' meetings.[30] For example, sections 11.03 and 11.04 call for a fresh notice of an adjourned meeting if the adjournment is for 30 days or more. Section 11.09 codifies the common law allowing voting to take place by show of hands unless a ballot is demanded, and makes it clear that a proxyholder may demand a ballot at any time without a prior show of hands.[31] Section 11.10 introduces the unanimous shareholder resolution as a replacement for the holding of a meeting.[32]

One very important section affecting shareholders' rights with respect to meetings is section 11.05, which is based on section 108.8 of the present Act and on Rule 14a-8 promulgated by the Securities and Exchange Commission of the U.S. pursuant to the Securities Exchange Act of 1934. This section gives a shareholder the right to communicate with all shareholders by requiring corporate management to insert his proposal in the proxy circular.[33] However, to take

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[29] In this connection, see: section 6.09, 6.14, 6.15.

[30] For a description of these changes, see: Commentary, paras. 266-93.

[31] See: Commentary, paras. 285 and 286, and the authorities mentioned therein.

[32] See: Commentary, para. 287, which cites *Walton* v. *Bank of Nova Scotia*, [1965] S.C.R. 681, as authority for the rule that the informal consent of all shareholders is as effective as a formal resolution at a duly convened meeting. *Compare* section 9.15 of the Draft Act, which validates a written resolution signed by all the directors.

[33] As noted in the Commentary, at common law there is no obligation on the management of a corporation to refer to non-management documents or to include in the notice of meeting a proposal other than its own. If it were

advantage of this right, the shareholder must follow the prescribed procedures for advance notice.[34] More importantly, the right is subject to the basic condition that, since shareholders are not unrestricted in the decisions which they can make, any shareholder proposal must be limited to a matter which the shareholders in a duly constituted meeting could validly authorize; it is rather unfortunate that the Draft Act does not elucidate more specifically matters which *are* appropriate for shareholder action.[35] The statute also provides that the corporation need not send out a shareholder's proposal if

> ... it clearly appears that the proposal is submitted ... primarily for the purpose of enforcing a personal claim or redressing a personal grievance 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.[36]

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not for section 11.05, the only alternative open to a shareholder wanting to discuss his proposal would be to invoke the provision for requisition of a meeting under section 11.11 of the Draft Act (section 103 of the present Act). See: Commentary, paras. 274, 275. For a similar but less generous provision, see section 102 of the Ontario BCA, where the holders of shares representing 5% of the outstanding voting rights are given the right to have proposals circulated to the shareholders by the corporation.

[34] Section 11.05(5)(a) states that the proposal need not be dealt with if it is submitted to the corporation after a record date has been determined.

[35] Section 11.05(5)(b) puts it negatively by providing that the corporation need not send out the proposal where it is not a proper subject for shareholder action or if it relates to the ordinary business operations of the corporation. See: *Re British International Finance (Canada) Ltd.*, (1968) 68 D.L.R. (2d) 578 (Ont. C.A.). In this connection, compare section 101 of the Ontario BCA which gives shareholders the right to requisition a directors' meeting to pass any by-law or resolution that the directors could pass. Subsection (4) of section 11.05 allows a proposal to include a nomination for directors if such nomination is signed by the holders of shares representing not less than 5% of the voting shares. This requirement is arguably too restrictive in the light of the realities of shareholder dispersal of ownership in widely-held companies.

[36] Section 11.05(5)(c). The corporation also need not send out the proposal if it had been previously included in a circular within two years and the shareholder failed to present it at the meeting, or a similar proposal was sent out within two years, or the shareholder wants "needless publicity for defamatory matters": Section 11.05(5)(d), (e), (f). Also,, under subsection (9) the corporation may apply to the court for an order allowing the corporation to omit the proposal. If a corporation does choose to circulate a proposal, however, subsection (6) provides that no liability may be incurred by reason only of circulating a proposal. On the U.S. provisions, see Hornstein, *op. cit.*, at p. 148.

These general statements could be interpreted so widely that a shareholder could never avail himself of the right to submit a proposal. On the other hand, there is some protection given since the corporation must give reasons for refusing to circulate a proposal; and the shareholder can appeal this refusal to a court which can restrain the holding of the meeting and may make such further order it thinks fit.[37]

Fundamentally at issue here is the question of the paramountcy of the directors of a corporation, and the extent to which the shareholders may initiate action either *sua sponte* or to overrule a directors' decision. This question is not easy to answer since it involves defining the roles of the shareholders and directors in the decision-making processes of the corporation. It would be very helpful if the Draft Act were more specific as to its views on this controversial issue rather than leaving it to generalizations. This question will be dealt with further below.

(b) *Shareholders' Agreements*

It has long been recognized that shareholders may enter into agreements specifying how they will vote on certain matters.[38] If the agreement were otherwise lawful, the shareholders could agree to vote as they stipulated; but they could not agree as directors to manage the affairs of the corporation in a certain way, since such an agreement would be construed as fettering the independent judgment of directors in carrying out their duties. Such an agreement was stated to be invalid even when all the shareholders of the corporation were party to it.[39]

The Draft Act has reduced this rigidity by sensibly providing in section 11.14 that a "unanimous shareholder agreement" is valid notwithstanding it restricts the discretion of the directors.[40] However, in that event, the shareholders are, to the extent that and so long as the restrictions on the directors' powers exist, deemed to assume the duties and liabilities imposed upon the directors by the statute and common law, and the directors are relieved from such duties

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[37] Section 11.05(7), (8).

[38] *Greenwell* v. *Porter*, [1902] 1 Ch. 530, 71 L.J. Ch. 243; *Puddephatt* v. *Leith*, [1916] 1 Ch. 200; *Motherwell* v. *Schoof*, [1949] 4 D.L.R. 812 (Alta. Sup. Ct.); *Ringuet* v. *Bergeron*, [1960] S.C.R. 672. See generally: Pickering, *Shareholders' Voting Rights and Company Control*, (1965) 81 L.Q.R. 248.

[39] *Atlas Development Co. Ltd.* v. *Calof and Gold*, (1963) 41 W.W.R. 575 (Man. Q.B.).

[40] Section 11.14(2). The agreement may have all shareholders plus a person not a shareholder as parties to the agreement, presumably to include a trustee or agent to supervise the terms of the agreement.

and liabilities.[41] Other subsections provide that: the unanimous shareholder agreement is void unless its existence is noted conspicuously on every share certificate issued by the corporation; a transferee of shares subject to such an agreement is deemed to be party thereto; and such an agreement is deemed to confer the pre-emptive right to purchase additional shares unless that right is expressly limited or excluded in the agreement.[42] It might be more accurate to require or deem the corporation to be a party to the unanimous shareholder agreement, since technically the corporation must act pursuant to the agreement and therefore should be a party thereto if for no other reason than to give it formal notice of the terms of the agreement.[43]

However, even more fundamental is the question whether the concept of a unanimous shareholder agreement is the best way to deal with closely-held corporations and their shareholders. More on this point will be discussed in the concluding remarks.

(c) *Voting Rights*

(i) *Cumulative voting.* Cumulative voting for directors has been strongly advocated by those who feel that the minority shareholders of a corporation should be represented on the board.[44] By this voting method, a shareholder is entitled to the number of votes determined by multiplying the number of shares he owns by the number of directors to be elected, and he may cast all his votes for one candidate or among several as he sees fit. Cumulative voting does not guarantee minority representation on the board, but it enhances the possibility of this result by preventing a majority shareholder from electing all the directors perforce.[45]

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41 Section 11.14(5).

42 Section 11.14(3), (4), (6).

43 For example, the pre-emptive right given by section 5.05 of the Draft Act is a right which may be exercised against the corporation. Moreover, section 19.10, discussed below, provides for an order for compliance which may be obtained in connection with a unanimous shareholder agreement and could involve requesting the corporation to act in a certain way.

44 See: Williams, *Cumulative Voting For Directors* (1951); *Should Cumulative Voting Be Mandatory? A Debate,* (1955-1956) 11 Bus. Lawyer 9. The Select Committee on Company Law of the Ontario Legislature did not recommend mandatory cumulative voting because of the "uncertainties" involved: *Interim Report of the Select Committee on Company Law* 73, (1967), 5th Sess., 27th Legis., 15-16 Eliz. II, 1967.

45 See paragraph 216 of the Commentary for the formula which can be used to calculate the number of votes required to elect a given number of directors. It is crucial in cumulative voting to know how many shares will be represented at the meeting and to cast one's votes accordingly.

Section 9.06 of the Draft Act requires cumulative voting in the quasi-mandatory fashion it requires pre-emptive rights to be given to shareholders: unless the articles expressly exclude cumulative voting, it applies. The criticism made above with respect to the undesirability of this compromise approach to a basic corporate rule also applies in this case: if one concludes, and one can argue quite forcefully to this effect, that cumulative voting is a meritorious reform, why not make the rule mandatory?[46] The draftsmen suggest that cumulative voting is somewhat controversial, and may be more appropriate to closely-held corporations where shareholder control is more important than to large widely-held corporations "... where stability and harmony in management are the dominant interest."[47] Hence the draftsmen chose not to make cumulative voting mandatory. But if the draftsmen felt this way, one wonders why cumulative voting was not simply made optional, as under the Ontario BCA.[48]

(ii) *Review of directors' elections.* Also related to the election of directors are the provisions in the Draft Act dealing with the right of a shareholder (or director) of the corporation to seek judicial review of a directors' election. Section 11.13 of the Draft Act is an attempt to provide the shareholder with quick and simple access to the courts for review without the legerdemain of the common law.[49] The section gives the court wide discretion to make such order as it deems fit.

(d) *Questions For Shareholder Approval and Dissenting Shareholders' Rights*

(i) *In general.* As mentioned above with regard to shareholders' meetings, one of the most difficult problems in corporation law reform is to define the role of shareholders *vis à vis* other corporate organs, notably the directors and officers, in the management of the business corporation. In general terms, the problem is reflected in the question as to the voice shareholders should have in the corporation's affairs. The question of such shareholder involvement has traditionally been dealt with by giving to the shareholders the right

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[46] Several prominent jurisdictions have done so, for example, California, Illinois, and North Carolina.

[47] Commentary, para. 206. The Commentary does not explain how cumulative voting necessarily *detracts* from stability and harmony in management.

[48] Section 127. The Draft Act sections on cumulative voting have several provisions aimed at preventing the dilution of the right. See: section 9.06(a), (c), (d), (f), (g), (h). See also: Commentary, paras. 207, 210.

[49] For a review of the rules in various jurisdictions, see: Commentary, paras. 294-96.

to elect directors, who in turn were the primary — or arguably the only — persons entrusted with the power to manage the affairs of the corporation.[50]

However, one other area was open to shareholder action under the common law: the corporate charter could be amended only by the unanimous consent of all the shareholders.[51] In time the corporation statutes reduced this rigidity to allow amendments of the corporate charter with a specified majority of shareholder approval. This latter approval has led to cases in which the courts were faced with situations involving a review of an amendment to the corporate charter approved by the required majority of shareholders but objected to by a very strenuous minority. There have been very few instances where the courts felt the majority action was assailable. Moreover, the courts enunciated tests which excluded judicial criticism except if fraud or bad faith — both nebulous concepts in this area of law — on the part of the majority shareholder were proved by the minority complainants.[52] The judicial reluctance to review the business decisions effected by majority rule may be explained on various grounds, but it is difficult to deny that such reluctance has led to injustice in many cases.[53]

Consequently, as a result of these judicial developments, or lack of same, corporate law reformers have advocated a legislative remedy which composes two lines of inquiry: for what matters should shareholder approval be required, and what alternative should be available to those minority shareholders who disagree with the position approved by the majority.

The first question would require a separate treatise to consider all the ramifications it raises, and no attempt will be made to cover it here. One should consider *inter alia* the nature of the shareholders' interests in the corporation, whether they are investors or proprie-

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[50] For a very illuminating discussion and analysis of the roles of shareholders and directors in the corporation, see: Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, (1969) 57 Calif. L. Rev. 1.

[51] Commentary, para. 344; see also: Gower, *The Principles of Modern Company Law*, 3rd ed. (1969), at pp. 301-02.

[52] See e.g.: *Allen* v. *Gold Reefs of West Africa Ltd.*, [1910] 1 Ch. 656 (C.A.).

[53] See, e.g.: *Greenhalgh* v. *Ardene Cinemas Ltd.*, [1951] Ch. 286 (C.A.), and the related cases involving *Greenhalgh* discussed in Gower, *op. cit.*, at pp. 571-74. The cases demonstrate the tip of the iceberg in that they represent only those conflicts which have gone to the courts. There have been undoubtedly many more disputes which have not surfaced because of an unwillingness or inability to litigate, perhaps because of procedural roadblocks in the way of the minority shareholders to bring an action.

tors or both; the nature of the roles of directors and officers and for whom they act; and the restrictions to which directors and officers should be subjected in carrying out their duties. Suffice it to say that corporation statutes traditionally have given directors and officers paramount control of corporate affairs, and have given shareholders rather limited rights: (1) to approve only certain prescribed transactions, (2) to elect other directors if they disagreed with the policies introduced by the existing directors, and (3) to have access to the courts for a review of the directors' and officers' action, although such access and review were rather sharply limited.

Corporate law reform has recently seen some improvements with regard to the second and third points, resulting in a statutory right to remove directors prior to the expiration of their term, and an increased choice of shareholder rights to enforce the responsibilities of management imposed on directors.[54]

(ii) *Right of appraisal.* The Draft Act has gone further in protecting the dissentient shareholder by introducing to Canada a general shareholder right of appraisal, the main features of which have been adopted in most U.S. jurisdictions.[55] The shareholder who dissents from a "fundamental change" is entitled to leave the corporation by requiring it to pay a fair value for his shares. Such a right of appraisal is intended to avoid the common law difficulties of trying to restrict an abuse of power, detrimental to minority shareholders, by the directors or by majority shareholders where shareholder approval is required.

There has been considerable debate on whether the appraisal right is all that effective in modern-day circumstances.[56] It seems to me, however, that in addition to the traditional arguments made for appraisal rights, a cogent reason for having them is that such

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[54] Section 9.08 of the Draft Act gives the right to shareholders to remove directors before their term expires; the shareholder enforcement provisions will be discussed below.

[55] Apparently all the U.S. jurisdictions except West Virginia have adopted shareholder appraisal rights. See generally: Skoler, *Some Observations on the Scope of Appraisal Statutes*, (1957-1958) 13 Bus. Lawyer 240; Lattin, *Minority and Dissenting Shareholders' Rights in Fundamental Changes*, (1958) 23 Law and Contemp. Problems 307; Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, (1962) 72 Yale L.J. 223.

Section 100 of the Ontario BCA gives an appraisal right to shareholders of a corporation not offering its securities to the public where a resolution has been passed relating to the sale of the corporation's assets, the deletion from the articles of a provision restricting the transfer of shares, and the approval of an agreement for the amalgamation of the corporation with another.

[56] Manning, *op. cit.*, is quite critical of the right.

rights act as a check on the managerial decision being recommended by the directors.[57] If the directors know that an appraisal right exists, they will try to ensure a fair settlement of terms for all, since to do otherwise might occasion sufficient minority dissent to thwart the transaction because of the cash needed to buy the dissenting shareholders' shares.

Section 14.17 of the Draft Act sets forth a statutory code relating to the right of a shareholder to dissent and claim appraisal of his shares. The basic ingredients of this right are briefly as follows. First, the right to dissent is given to shareholders in five situations involving:

(i) an amendment to the articles dealing with a restriction on the right to transfer shares;[58]

(ii) a statutory amalgamation;[59]

(iii) continuance of the corporation under the laws of another jurisdiction;[60]

(iv) a sale, lease or exchange of all the corporation's property;[61] and

(v) an amendment to the articles derogating from the rights or conditions attaching to shares of a class or series having special rights or conditions.[62]

Second, the appraisal right is expressly made non-exclusive, meaning that the shareholder can exercise any other right conferred by statute or common law with respect to the transaction.[63] Third, the section sets forth a detailed procedure which must be followed in order for the appraisal right to be exercised.[64] Finally, the effect of the appraisal right is that the shareholder who complies with the section is entitled

> ...if and when the *action* approved by the resolution from which he dissents is *effective,* to be paid by the corporation the *fair value* of the

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[57] Eisenberg, *op. cit.,* at p. 86.

[58] Section 14.17(1)(a).

[59] Section 14.17(1)(b). Excluded is a "short-form" amalgamation under section 14.11, which involves a parent and its wholly-owned subsidiary.

[60] Section 14.17(1)(c). Continuance of a corporation under another jurisdiction's laws is dealt with in section 14.15.

[61] Section 14.17(1)(d). See section 14.16 for the requirements and procedures relating to the sale of corporate assets.

[62] Section 14.17(2). See also section 14.03(1) for the types of changes covered by section 14.17(2).

[63] Section 14.17(3). See generally: Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* (1964) 77 Harv. L. Rev. 1189.

[64] Section 14.17(5)-(27). The section is based on section 623 of the New York *Business Corporation Law.*

shares[65] held by him in respect of which he dissents, determined as of the day before the resolution was adopted by the shareholders of the corporation.[66] (Emphasis added.)

The fairly extensive right of appraisal in the Draft Act is a useful addition to the statute. One point that should be raised, however, is that although the Draft Act is quite generous in stipulating the situations which give rise to the appraisal right, perhaps a corporation should be free to insert a provision in its articles stipulating other circumstances in which the appraisal right may be utilized.[67]

The special provisions of sections 14.17(2) and 14.03 of the Draft Act, dealing with shareholders of a prescribed class, stem from the problem of how to give the holders of a prescribed class of shares having specific rights protection from unfair elimination or modification of such rights without at the same time throttling corporate decision-making by giving too loud a voice to the prescribed class. Section 14.03[68] is an attempt to compromise these conflicting goals by giving the holders of shares of a class (or shares of a series of a class if the holders thereof are "... prejudicially affected by an amendment in a manner different from other shares of the same class") a right to vote separately as a class or series on a proposed amendment that would effect any of certain prescribed changes in their rights. Notable about this section is that it encompasses the situation not only where some adverse change is proposed in a specific class of shares, but also where another class of shares is given increased rights or privileges which can accomplish the same result.[69]

(3) *Access to Information and Corporate Records*

Corporation statutes have not been too generous in giving shareholders a right to be informed about the management of the affairs

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[65] Section 14.17(4) provides that a dissenting shareholder must claim appraisal of not less than all of his shares of a given class.

[66] Section 14.17(3). The italicized words in the text will undoubtedly give rise to difficulty in interpretation. Subsections (15) and (16) allow a court application to fix the fair value of the shares; and subsection (21) gives the court the power to appoint appraisers to assist it in determining the fair value.

[67] This could be very useful in a closely-held corporation especially. Section 55-113 of the North Carolina *Business Corporation Act* covers certain additional transactions.

[68] Section 14.03 is based on section 55-102 of the North Carolina *Business Corporation Act.*

[69] See paragraph 358 of the Commentary which cites some of the U.K. cases on the point.

of the corporation. There appears to be adequate disclosure in the proxy machinery, prospectus qualification, and timely disclosure policies, but these are related to specific transactions and do not cover the case of the shareholder who wants information about the company's affairs when no specific transaction is contemplated. Should, for example, shareholders have the right to demand the identity of customers and suppliers and the volume of business, if they feel one particular ethnic or racial group is being privileged or discriminated against. It would seem that, apart from some few express statutory provisions, shareholders do not have an inherent right to know such detailed information.[70]

The Draft Act does recognize the rights of shareholders to obtain shareholder lists, to circularize shareholders with a particular proposal, and even to requisition a shareholders' meeting.[71] In addition, the Draft Act gives shareholders — and creditors — the right to examine basic corporate documents and records, and provides that shareholders are entitled upon request to a copy of the articles and by-laws without charge.[72] But these rights still do not provide all that much information; and, although obviously an unlimited right to ask for information cannot be provided, it is unfortunate that the Draft Act did not try to strengthen the rights of shareholders in obtaining more general information about the company's affairs. Quite apart from the interest of shareholders in obtaining information because they wish to know the policies of their company, shareholders should be entitled to have the information available so that they can effectively use their rights to have the directors and officers accountable for their actions.

(4) *Investigations*

Part 18.00 of the Draft Act, which deals with investigations of corporate affairs at the instance of the shareholders or the Registrar, has two objectives: first, to aid shareholders in bringing an action

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[70] On information generally available and shareholder access thereto, see: Harris, "Access to Corporate Information", in *Studies, op. cit.*, at p. 476. Section 107 of the Ontario BCA gives a shareholder the right to raise any matter relevant to the affairs and business of the corporation at the annual meeting. See: Lavine, *op. cit.*, at pp. 199-200.

[71] Section 11.06 deals with shareholders' lists, and section 4.03(3) allows any person to obtain a copy of such a list. Section 11.05, as discussed above, allows a shareholder to require the corporation to distribute his proposal with the management proxy circular. Section 11.11 gives the holders of not less than 5% of the voting shares to requisition the directors to call a shareholders' meeting.

[72] Section 4.03(1), (2).

for mismanagement, and second, to protect the public interest in ensuring the proper conduct of corporate affairs.[73] Both these objectives are laudable, but the actual wording of the recommended provisions is unduly narrow.

One or more shareholders holding not less than 5% of the issued shares or of the issued shares of a class, or the Registrar, may apply to the court *ex parte,* or upon such notice as the court may require, for an order directing an investigation of the corporation and any of its affiliated corporations. For the court to make such an order, under section 18.01(2) it must appear (a) that the business of the corporation or any of its affiliates "has been carried on with intent to defraud any person", (b) that the business of the corporation or any of its affiliates has been carried on or the powers of the directors have been exercised "in a manner oppressive or unfairly prejudicial to or in disregard of the interests of a security holder", (c) that the corporation or any of its affiliates was formed or is to be dissolved "for a fraudulent or unlawful purpose", *or* (d) that persons concerned with the corporation or any of its affiliates have acted "fraudulently or dishonestly".[74] The applicant need not give security for costs, and the court may order an investigation and make any other order it thinks fit.[75]

It is most unfortunate that the right to obtain an investigation is so severely circumscribed. The requirement that an applicant must be a shareholder or shareholders owning 5% or more of the issued shares has been justified on the ground that such a requirement recognizes the possibility of harassment of management. But harassment could happen with a 5% shareholder too. Giving *each* shareholder the right to apply for an investigation order, regardless of shareholding size, would seem preferable, especially since the grounds for obtaining the order are so serious, tantamount to fraud or unlawful dealing. If so serious a charge is involved — and *quaere* whether a *prima facie* case is to be made out or some other standard

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[73] Commentary, paras. 464-65.

[74] Section 18.01(1), (2). Note that "corporation" is defined in section 1.02(1)(h) to mean a corporation incorporated or continued under the Draft Act. "Affiliate" is defined in sections 1.02(1)(a) and 1.02(2). Thus section 18.01 investigations may affect only corporations governed by the Draft Act. *Compare:* Ontario BCA, section 186.

[75] Sections 18.01(2), (4), 18.02. The court, *inter alia,* may appoint an inspector and authorize him to enter any premises, conduct hearings, and prepare a report. The court is required to send the Registrar a copy of the inspector's report, but the court has discretion whether or not to order the report to be published or sent to anyone. It is arguable that the shareholders should be given a copy of the inspector's report as of right.

of proof met — surely each shareholder should have the right to apply on his own, without gathering more shareholder support or asking the Registrar to seek an order. If left as presently drafted, it is doubtful whether the section would be often used.[76] It also might be worthwhile to allow the shareholders voluntarily, by a majority-approved resolution, to appoint an inspector as an alternative to a court-appointed one.[77]

Other sections in Part 18.00 deal with the power of an inspector, the hearings before an inspector, giving evidence and self-incrimination, and questions of privilege.[78] Another section re-enacts section 114.1 of the present Act which gives the Minister power to determine the true ownership and control of securities for purposes of the insider trading and take-over bid provisions.[79]

C. *Shareholders' Remedies*

(1) *In General*

It is fundamental that the corporation statute must not only provide shareholders' rights but also contain adequate procedures for the enforcement of such rights: *ubi ius, ibi remedium.* The Draft Act is impressive in the variety of remedies available for shareholders to enforce their rights.[80]

As already discussed, there are several provisions that give shareholders increased rights. Furthermore, there has been an upgrading of the duties and responsibilities of directors and officers in many provisions of the Draft Act. Particularly notable in this respect are the provisions clarifying the duties owed by directors and officers to the corporation, and the requirements of directors regarding contracts in which they are interested.[81] There is not space here to discuss these very important provisions; but suffice it to say that they may provide as much in the way of increased shareholder protection as the specific rights and remedies given to shareholders by the Draft Act.

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[76] Section 186 of the Ontario BCA gives the investigation right to *each* shareholder, who must show the court that the application is in good faith and that it is *prima facie* in the interests of the corporation or the holders of its securities to get an order.

[77] This is provided for in section 187 of the Ontario BCA.

[78] Sections 18.03-18.06.

[79] Under section 18.07 of the Draft Act the Registrar is given this power.

[80] It is difficult to divide provisions into exclusive categories of shareholders' rights and shareholders' remedies. For a good list of the shareholders' rights of the Draft Act, however, see: Howard, *op. cit.*, at pp. 46-47.

[81] Sections 9.16-9.20; Commentary, paras. 223-51. See: Howard, *op. cit.*, at pp. 43-45.

Although Part 19.00 of the Draft Act deals generally with remedies, offences and penalties, specific remedies are interspersed throughout the Draft Act as well. Some of the more important of these specific remedies are the following: (1) the restraining order which a court may issue under section 3.03 on the application of a shareholder or creditor with respect to a contravention by the corporation of any restrictions on its business activities outlined in its articles;[82] (2) the civil insider liability under section 10.04;[83] (3) the restraining order which a court may issue under section 12.08 on the application of an "interested person" with respect to non-compliance with the proxy provisions;[84] (4) the rescission and civil liability provisions outlined in Part 15.00 of the Draft Act dealing with prospectus qualification; and (5) the court restraining order relating to a breach of the take-over bid requirements specified in section 16.11.[85]

In Part 19.00 several remedies are given to various persons: a complainant's derivative action for a wrong done to the corporation (sections 19.02 and 19.03); a complainant's action for some wrong done to specified persons (section 19.04); a security holder's or aggrieved person's application for a court rectification order (section 19.06); an aggrieved person's application for a court order compelling the Registrar to reserve a decision (section 19.09); and a complainant's or creditor's application for a court order for compliance with prescribed requirements (section 19.10). Various procedures are set forth, and, finally, there is a general offence section (19.13) and a penalty section (19.14).

Of fundamental importance in this Part are the definitions of "action" and "complainant". In section 19.01, "action" is defined to mean an action brought under the Draft Act or any other law, and "complainant" includes:

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[82] Sections 3.01, 3.02, 3.03; Commentary, paras. 29-30, 74-83. The Draft Act reduces greatly the impact of the *ultra vires* doctrine, basically by endowing a corporation with unlimited capacity unless it is otherwise expressly restricted in its articles. *Compare* section 16 of the Ontario BCA, which unfortunately retains too much of the *ultra vires* doctrine.

[83] Some changes from the existing insider trading provisions are incorporated in the Draft Act. See: Commentary, paras. 253-65.

[84] For the proxy requirements, see: Part 12.00 of the Draft Act; Commentary, paras. 303-23.

[85] On take-over bids, see: Commentary, paras. 426-38. For a very useful summary of the remedial techniques used in the Draft Act, see: Commentary, para. 478. The techniques are categorized in terms of disclosure of information, structural techniques (such as pre-emptive rights), civil liability, administrative action by the Registrar, directors' liability, and penalties.

"(i) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security [defined in section 1.02(1)(u)] of a corporation or any of its affiliates [defined in section 1.02 (1)(a) and 1.02 (2)],

(ii) a director or officer of a corporation or of any of its affiliates,

(iii) the Registrar, and

(iv) any other person, who in the discretion of a court, is a proper person to make an application under this Part."[86]

These definitions are obviously extremely wide and deliberately so since the underlying rationale is that the statute should be " . . . self-enforcing by civil action initiated by the aggrieved party, not by severe penal sanctions or sweeping investigatory powers."[87]

A few comments may be made on these provisions. It is very realistic to subject affiliates to the actions contemplated, since this is sensibly treating the corporation and its affiliates as the same unit for purposes of redress. It is also worthwhile to give the Registrar the status of a complainant to bring an action, although this will no doubt be viewed as a controversial point. There may be some question as to whether a security holder other than a shareholder should be given the same remedies as shareholders. Perhaps creditors, for example, *should* be given similar rights, but at the very least it would have been interesting to see some meaningful discussion in the Commentary on why a special class of creditors[88] is to be treated the same as shareholders, especially when such creditors usually extract fairly wide remedial covenants in their private agreements with the corporation. To add even further breadth to the remedies, a *former* beneficial or registered holder of a security may be

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[86] Because there is this residual class of persons who may be complainants at the discretion of the court, the definition should probably be exhaustive by saying that complainant *means* certain persons, not *includes* such persons. It might also be useful to include specifically in the list of complainants the auditor of the corporation.

[87] Commentary, para. 479.

[88] Arguably, only creditors holding some certificate evidencing the debt obligation would be included within the term "complainant", in which case unsecured creditors would be omitted. Section 19.10 reinforces this interpretation since in that section a complainant *or* a creditor of the corporation may seek a restraining order. Paragraph 80 of the Commentary states that the term "complainant" was broadened on the basis of the recommendation of the Jenkins Report "paras. 119 to 212" (presumably meant to be paras. 199-212): *The Report of the Company Law Committee,* (1962) cmnd no. 1749 (hereinafter referred to as the "Jenkins Report"). But it is not exactly clear what recommendation of the Jenkins Report is relied upon to expand the definition of complainant as is done in the Draft Act.

a complainant; this appears to be unduly wide. One can see reasons for allowing a former shareholder to be a complainant, where, for example, he may have sold his shares at a price which may have been less than it should have been, owing to some breach of obligation to the corporation. But except where a former creditor may have accepted less than full payment for his debt, it is difficult to see how he retains any interest in the corporation for purposes of bringing an action since, as a *former* creditor, he will have been paid his debt *ex hypothesi.* On the other hand it *would* make sense for a former officer or director to be allowed specifically to be a complainant because such persons may have information which is not generally known and which affects a cause of action covered by Part 19.00.

Section 19.05 provides some important supplementary rules relating to Part 19.00 actions. Subsection (1) states that shareholder ratification of an alleged breach of right, duty or obligation owed to the corporation is no bar to the action but is only evidence which the court may consider in making its order. This reduces the troublesome issue of shareholder ratification of a breach of duty to saying basically that its effectiveness as a cure for a breach of duty will depend on the facts of each case and not according to some attempt to extrapolate a principle from a maze of cases which basically are difficult to reconcile.[89]

Subsection (2) of section 19.05 provides that any action under Part 19.00 "... shall not be stayed, discontinued, settled or dismissed for want of prosecution without the approval of the court given upon such terms as the court thinks fit". This is a copy of U.S. provisions aimed at preventing "strike suits", which attempt to obtain a financial settlement from the corporation.[90] Subsection (3) provides that a complainant will not be required to give security for costs, and subsection (4) allows the complainant to apply to the court for interim costs for which the complainant may be accountable on final disposition of the action.

Finally, by way of general comment on Part 19.00, section 19.11 provides that an application made under that Part may be made summarily, subject to any order for costs or notice or other order

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[89] See: Gower, *op. cit.*, at pp. 566-67; Beck, *The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered,* (1971) 49 Can. Bar Rev. 80, at pp. 114-19.

[90] See also: Ontario BCA, section 99(6). The basis for sections 99(6) and 19.05(2) is section 626 of the New York *Business Corporation Law,* which in turn is modelled after Rule 23.1 of the U.S. Federal Rules of Civil Procedure. See: Commentary, para. 488.

the court thinks fit;[91] and section 19.12 states that an appeal lies to the court of appeal from any order made by a court under the Draft Act.

(2) *Part 19.00 Remedies*

(a) *The Derivative Action*

Sections 19.02 and 19.03 deal with the shareholder's (in the Draft Act, the complainant's) derivative action — "derivative" because the wrong complained of is to the corporation. The sections obviate the procedural and substantive roadblocks surrounding the rule in *Foss* v. *Harbottle*,[92] and for the most part are very sound and beneficial.

Under section 19.02, a complainant may apply to the court for consent to bring an action in the name and on behalf of the corporation or any of its subsidiaries, or *intervene* in any action to which any such body corporate is a party for the purpose of prosecuting, defending or discontinuing the action.[93] Consent of the court is conditional on the complainant showing: (a) he made reasonable efforts to cause the directors to take the desired action; (b) he is acting in good faith; and (c) it is *prima facie* in the interests of the corporation or its subsidiary that the action be brought, maintained or discontinued. Although these conditions could be difficult to fulfil, the provisions represent a good attempt to give a useful derivative right to complainants, yet at the same time retain some control over the exercise of such right through judicial supervision. This approach is fair and appears to be inevitable in settling disputes of corporations. Whether or not the provision is effective will depend on how the courts respond to the conditions, which are capable of a very restrictive interpretation. Two other provisions might be useful: to require notice to the corporation of a derivative action, and to give the right to join the corporation as defendant.

Section 19.03 enumerates the powers of the court in derivative actions, which are extremely broad and reflect the intention of the draftsmen to give as much flexibility to the court as possible.

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[91] Section 19.11 arguably contradicts section 19.05(3) relating to costs, and should be expressed subject to that section and to section 19.05(4).

[92] (1843) 2 Hare 461. See generally: Beck, "An Analysis of Foss v. Harbottle", in *Studies, op. cit.*, at p. 545.

[93] The right to intervene is a substantial improvement over the corresponding provisions in section 99 of the Ontario BCA and section 226 of the proposed British Columbia statute.

The court may make "any order it thinks fit" including an order (a) that costs or legal fees of the complainant are to be paid by the corporation or subsidiary, (b) restraining a breach of duty owed to the corporation, (c) authorizing the complainant to control the conduct of the action, (d) giving directions for such conduct, (e) directing that any amount payable by a defendant in the action shall be paid to former and present security holders of the corporation or its subsidiary instead of to the corporation or its subsidiary,[94] and (f) requiring the corporation or its subsidiary to pay the complainant's legal fees.

(b) *Relief From Oppression*

Section 19.04 is the Draft Act's equivalent to section 210 of the U.K. *Companies Act*, a section which was rejected by those primarily responsible for the Ontario BCA.[95] Section 19.04 deals with an injury to "any security holder, creditor, director or officer" — not to the corporation. Here it does make sense to give the protection of the section to a broad category of persons, including all types of creditors, since they may be subject to abusive treatment for which the normal common law remedies may be inadequate or inappropriate.[96] As stated in the Commentary, section 19.04 is based to a large extent on recommendations for amendments to the U.K. section 210, made by the Jenkins Report

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[94] The power of the court to direct that any amount payable by a defendant should be paid to former and present security holders is intended to deal with situations where, for example, a corporation has been dissolved, and also to permit the amount recovered to go directly to the shareholders to prevent the wrongdoers from obtaining any part of the recovery. *Compare* the decision in *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] 1 All E. R. 378 (H.L.); see also: Gower, *op. cit.*, at pp. 535-37.

[95] The Select Committee on Company Law of Ontario said that section 210, *inter alia*, abdicated far too much to the courts to deal with on an *ad hoc* basis: *Interim Report, op. cit.*, at p. 60. For a criticism of the Select Committee's view, see Prentice, (1968) 46 Can. Bar Rev. 163, at pp. 169-70. For the failure of the Ontario BCA to include a provision similar to section 210, see: Beck, *op. cit.*, at pp. 599-600. The British Columbia Companies Act has a provision similar to the English model: S.B.C. 1960, c. 8, s. 15. See also: section 226 of the proposed B.C. statute.

[96] There is a slight inconsistency in the section in that section 19.04(1) says that a «complainant» (defined in section 19.01 as discussed above) may apply to the court for an order. Section 19.04(2) then speaks in terms of the interests of, *inter alia*, a *creditor*, although unsecured creditors would not be included in the definition of complainant. There should clearly be a consistent use of terms for purposes of those who have standing to bring an action and those who have been unfairly treated.

in order to make the rights under the section more accessible.[97] As presently drafted, section 19.04 allows the court to make an order where some oppression has already taken place; one wonders whether the section should also be preventive by stipulating that where one can show that oppressive conduct will result an order may be obtained.[98]

Once again there is a very wide range of discretionary powers given to the court, some of which are extraordinary but probably necessary.[99] Some may balk at the section because it gives too much power to the court in solving corporate disputes; but if one looks at the jurisprudence, the courts have been so reluctant to intervene in such disputes that aggrieved persons have received little assistance. Undoubtedly section 19.04 will be used more often for solving disputes in small or closely-held corporations, but this does not deny its application to all corporations regardless of size or shareholder composition. Critics of provisions like section 19.04, and indeed the derivative action sections, overlook the fact that such provisions may act as deterrents to corporate managers and controllers and therefore may promote fairer and more harmonious corporate dealings — surely a beneficial result. Hopefully other jurisdictions, notably Ontario, will soon follow suit.

(c) *Rectification Order*

Section 19.06, which is based on section 210 of the present statute and section 116 of the U.K. statute, allows the corporation

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[97] Commentary, para. 485, citing Jenkins Report, *op. cit.*, para. 212. See also: Gower, *op. cit.*, at pp. 598-604.

[98] *Compare* section 225(1)(b) of the proposed B.C. statute, which includes as the basis for a court order an act that the company is *threatening* to do, or some *proposed* shareholder resolution, that is unfairly prejudicial.

[99] Under subsection (3) the court may make an order, *inter alia*, restraining the conduct complained of, amending the articles or by-laws or *creating* or amending a unanimous shareholder agreement, directing an issue, exchange, or purchase of securities, varying a transaction or contract, and compensating an aggrieved person. Subsection (4) provides that where the court orders an amendment of the articles or by-laws, no further amendment may be made without the court's consent until a court otherwise orders; and subsection (5) provides that a shareholder cannot dissent under section 14.17 (appraisal rights) if an amendment to the articles is ordered under section 19.04. Subsection (6) provides that moneys cannot be paid to a shareholder if there are reasonable grounds for believing that the corporation is or would thereby be insolvent. Subsection (8) provides that an applicant may in the alternative apply for a liquidation and dissolution order under section 17.07 (discussed below).

or a security holder or "aggrieved person" to apply for a court order to rectify the records of the corporation. As noted in the Commentary, one of the purposes of such a provision was to allow a person to have his name taken from the list of shareholders where the shares were assessable,[100] a situation which will not arise under the Draft Act since section 5.02(2) specifies that shares issued under the Act are non-assessable. But section 19.06 may prove useful in solving problems arising, for example, from the security transfer provisions in Part 6.00 of the Draft Act.

(d) *Orders For Compliance*

Under section 19.10, a complainant *or creditor* through an application for a court order may compel a director, officer, employee, agent, or auditor of a corporation, or the corporation itself, to comply with the Draft Act, regulations, articles, by-laws or a unanimous shareholder agreement, or may restrain such persons from acting in breach of the provisions contained therein. To some extent this section answers rather neatly the question of whether the by-laws are enforceable between a shareholder and his corporation, a question which surprisingly has caused considerable confusion at common law.[101] The section should, however, add a shareholder to the list of persons against whom an order may be obtained since, for example, he is obviously a party to a unanimous shareholders' agreement.

(3) *Liquidation and Dissolution: Part 17.00*

The ultimate remedy of a shareholder is to ask for the liquidation and dissolution of the corporation. The obviously drastic nature of this remedy requires that clear and fair procedures are provided conditional to its exercise. Part 17.00 of the Draft Act does much to simplify the law relating to liquidation and dissolution, and the changes made are very constructive. Under section 17.07 there are increased grounds given to a sole shareholder to invoke dissolution such that this right should be more meaningful to shareholders than it is at present.[102]

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[100] Commentary, para. 490.

[101] For a discussion of some of the authorities, see: Beck, *op. cit.*, at pp. 587-89. There has been even more confusion in interpreting section 20 of the U.K. statute dealing with the effect of the articles of association. See: Gower, *op. cit.*, at pp. 261-65. Section 19.10 of the Draft Act is based on section 261 of the Ontario BCA.

[102] Subsection (1)(a) of section 17.07 sets forth grounds similar to those for obtaining an order under section 19.04. Subsection (1)(b) allows a shareholder

III. Concluding Remarks

The Draft Act has undoubtedly made considerable advances in the treatment of shareholders. Nevertheless, as with most statutory reform, there is room for improvement.

In terms of shareholder treatment, the Draft Act has taken a traditional approach to the corporation. There is no overall reform of the corporation itself; in fact, the draftsmen have obviously decided there need not be such fundamental reform. But the Draft Act and the Commentary could have reflected far more in the way of a carefully thought out conclusion as to the nature of a shareholder of the modern corporation. Admittedly it is facile and misguided merely to assert the popular shibboleth that the corporation statute should reflect more "corporate democracy" by giving shareholders more voice in the administration and management of the corporation. On the other hand, it is also unsatisfactory to reject rather summarily, as is done in the Commentary, the above assertion about corporate democracy without presenting more fully one's views about the shareholder of a modern corporation.[103]

The draftsmen acknowledge that structuring techniques designed to make the corporation an ideal democratic polity are desirable, but point out that they are not a complete answer to resolving corporate disputes.[104] It is also stated that such techniques as pre-emptive rights and cumulative voting are encouraged; but then the surprising statement is made that to require such techniques would over-emphasize their most useful function, which is as close corporation planning tools. Surely, as stated previously, that attitude would dictate making these techniques simply optional, not quasi-mandatory. On the other hand, a good case can be made for making such techniques mandatory in every case, as ways to increase minority shareholders' rights.

It might also be desirable to give shareholders directly the right — indeed, perhaps the paramount right — to pass by-laws, rather than to prescribe a somewhat exceptional procedure for the exercise of such a right.[105] Power to pass by-laws initially may appear to be

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to apply for a liquidation or dissolution pursuant to a unanimous shareholder agreement, or where it is just and equitable that the corporation should be liquidated and dissolved. Subsection (2) allows an alternative application to be made under section 19.04.

[103] See the rather brief discussion rejecting the slogan of corporate democracy in paragraph 10 of the Commentary. For an excellent analysis, see: Eisenberg, *op. cit.*

[104] Commentary, para. 475.

[105] Through sections 9.02 and 11.05.

insignificant, but there could be cases in which such power would be of great importance; moreover, the principle of greater shareholder involvement and control is at issue.

In short, the preoccupation of the Draft Act is with shareholder remedies, and many useful and effective remedies have been provided by the draftsmen. This is unquestionably important, especially since Canadian courts have not been as creative or progressive in prescribing shareholder remedies as have U.S. courts. But it would seem that the development of remedies should be concurrent with finding better and more effective ways to give shareholders a greater voice in the corporation consistent with allowing the directors to manage on their behalf. Whatever one's view, the importance of the question warrants further elaboration than that given by the draftsmen of the Draft Act.

Shareholder liability is given little treatment in the Draft Act. It is well known from *Salomon* v. *Salomon & Co.*[106] that a corporation is an entity in law separate and distinct from its shareholders, and as such they are not liable for the obligations of their corporation. The limited liability principle remains the hallmark of company law[107] notwithstanding the claims of many that the principle has shown signs of age. Apparently the draftsmen of the Draft Act have treated the matter as primarily involving a question of insolvency to be dealt with in the bankruptcy statute. The recent bankruptcy report makes some recommendations in this regard, but these would involve orders in a bankruptcy proceeding only.[108] It would seem that the corporate veil should be lifted by the courts in cases not only of fraud or crime but also where there is some injustice as determined by the courts. This rule has been judicially fashioned in the U.S., but the prospects for such a development in Canada are dim.

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[106] [1897] A.C. 22 (H.L.). See generally: Felthan, *Lifting the Corporate Veil*, in [1968] Special Lectures of The Law Society of Upper Canada 305.

[107] Section 5.17(1) of the Draft Act provides that shareholders as such are not liable for any act or default of the corporation.

[108] *Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970) at pp. 108-09. One of the recommendations of the Report is that the corporate veil should be disregarded to hold the controlling shareholder liable where he has mingled his own property with that of the corporation, or has dealt with the property of the corporation as if it were his own. For a recent example of this type of situation, but where the court applied the *Salomon* principle, see *Clarkson Co. Ltd.* v. *Zhelka*, (1967) 64 D.L.R. (2d) 457 (Ont. H. C.). If the recommendations of the bankruptcy report are adopted, presumably section 5.17(1) of the Draft Act should be qualified by an express reference to the bankruptcy statute.

A discussion of the role of shareholders raises the question of the type of corporation involved. The Draft Act abolishes the private-public company distinction and substitutes a functional definition of the corporation which changes depending on the matter concerned. Considerable flexibility is afforded through the provisions allowing a unanimous shareholder agreement and the insertion of provisions in the articles and by-laws aimed at creating a closely-held corporation tantamount to an incorporated partnership. However, a better approach might have been to emphasize even more the differences between a closely-held corporation and a widely-held corporation by retaining the old definition with added provisions similar to several U.S. corporation statutes where the close corporation is given special recognition.[109]

There is also not much discussion in the Draft Act about the treatment of non-shareholders: creditors, consumers, employees and, to a lesser extent, government officials; it is another popular suggestion nowadays that corporation laws should be concerned with the interests of such people. The Commentary points out the difficulty of recognizing such interests through, for example, representation on the board of directors, because of the practical problems in establishing the electorate.[110] However, solutions to such problems could probably be found; for example, the corporation statute as enabling legislation could expressly provide that such non-shareholder interests could be represented on the board of directors of the corporation if desired, provided certain prescribed rules were met, for example, that a majority of directors represented shareholders. The actual method for determining such representation then could be left to each corporation to work out.[111] In this connec-

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[109] For a discussion of these statutes and the topic of the close corporation generally, see: O'Neal, *Close Corporations Law and Practice,* (1971) vols. 1 and 2. It is interesting to note that section 342 of the Delaware *General Corporation Law* has a definition of a close corporation similar to the definition of private company in Canadian statutes, viz., a limitation on the number of shareholders, a restriction on the transfer of stock, and a prohibition against the corporation's making a public offering of its stock within the meaning of the U.S. *Securities Act of 1933.*

[110] Commentary, para. 32.

[111] In the Commentary it is mentioned that the Draft Act does not *prevent* a corporation from making arrangements with its creditors, employees or others under which directors could be elected to represent these groups, provided they could exercise the necessary influence upon the shareholders, who are the sole persons who can vote. It is also stated that employees could perhaps bargain for directorate representation in a provision in the collective agreement, which provision shareholders would in all likelihood honour since

tion the Draft Act is to some extent inconsistent. In Part 19.00, as already mentioned, some creditors are given, with no explanation, the same fairly broad enforcement rights that are given to shareholders. If creditors are given such enforcement rights, perhaps they should also be given a right to participate in the control of the corporation whenever it is deemed desirable.[112]

In summary, in the area of shareholder treatment the Draft Act is basically a traditional statute but with some modern features from the United States and United Kingdom, our principal benefactors of corporate legislation. I do not mean the label of "traditional" to be an indictment of the Draft Act, however, since if it is enacted with basically no change, it will clearly become the best corporation statute in Canada.

"otherwise, the collective agreement would be broken". Commentary, paras. 33, 34. Some of the European corporation statutes, notably that of West Germany, allow employee representation on the supervisory (as distinct from the managerial) board of directors. See: Vagts, *Reforming the "Modern" Corporation: Perspectives From the German*, (1966) 80 Harv. L. Rev. 23, at pp. 50-53. Professor Vagts concludes that such an approach may not be suitable for the U.S. because, *inter alia*, the U.S. has a different scheme of industrial relations in which trade unions have a considerable voice: *Ibid.*, at pp. 76-78.

[112] I am not arguing in this discussion in favour of non-shareholder interests to be represented on the board as a matter of statutory *requirement*, since this may be unrealistic and could lead to quite serious problems. See: Eisenberg, *op. cit.*, at pp. 16-21. However, I would suggest that it might be worthwhile investigating allowing a corporation to bestow on non-shareholder groups the right to representation on the board of directors as a matter of *choice*. This may be done under the Draft Act, but it is certainly not stated that clearly in the Commentary.