ANNUAL SURVEY OF CANADIAN LAW

CORPORATION LAW*

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I. INTRODUCTION

Since the last corporate commentary was published in this journal,[1] there have been some significant developments in the area. The Canada Business Corporations Act[2] has been proclaimed in force and proposed amendments were recently passed by the Senate.[3] Both Saskatchewan[4] and Manitoba[5] have adopted new corporate Acts which are based on the federal statute. British Columbia has passed amendments to the 1973 Companies Act[6] and at present there are further amendments to the Business Corporations Act before the Ontario Legislature.[7] Other provinces have either completed[8] or are in the midst of corporate reform.[9]

Aside from legislative developments, there have been other points of interest. Judicial interpretation of the new model statutes is beginning, particularly in British Columbia. Moreover, there have been a number of decisions in the more traditional areas of corporate law that warrant comment.

This survey will not attempt an exhaustive analysis of either legislative or judicial development; such an effort would require a book. Particularly in the case of Manitoba and Saskatchewan, the legislation is largely the same as the CBCA. With rare exceptions,[10] any variations are of an organizational nature. Accordingly, since readers should be familiar with the trend in legislative developments, it is intended to focus the article on judicial developments. Where legislation or proposed amendments are relevant and worthy of comment these will be dealt with.[11]

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[1] Berner, *Annual Survey of Canadian Law: Corporation Law*, 7 OTTAWA L. REV. 152 (1975).

[2] S.C. 1974-75-76 (1st sess.) c. 33 (proclaimed in force Dec. 15, 1975).

[3] Bill S-2, 30th Parl., 3d sess., 1977-78 (passed by the Senate Mar. 20, 1978) [hereinafter cited as Bill S-2].

[4] The Business Corporations Act, S.S. 1977-78, c. 59 [hereinafter cited as SBCA]. *See* Finley, Note, 42 SASK L. REV. 251 (1977).

[5] The Corporations Act, S.M. 1976 (3d sess.) c. 40 [hereinafter cited as MCA].

[6] *See most recently* the Companies Amendment Act, S.B.C. 1974 (1st sess.) c. 19.

[7] Bill 9, 31st Leg. Ont., 2d sess., 1978 (2d reading Apr. 6, 1978).

[8] DEPARTMENT OF JUSTICE, NEW BRUNSWICK REPORT ON COMPANY LAW (1975); OFFICE OF THE PROVINCIAL SECRETARY, DRAFT PRINCE EDWARD ISLAND BUSINESS CORPORATIONS ACT (1975).

[9] Alberta, Quebec and to a lesser extent, Nova Scotia.

[10] *See, e.g.*, the dissenting provisions in the SBCA, s. 184(2).

[11] Some introductory comments on the scope of the discussion might be appropriate. Due to the nature of this paper and the amount of new developments, only major

II. PRE-INCORPORATION TRANSACTIONS

The problems with respect to pre-incorporation contracts under the common law are well known.[12] Over the last eight years, many provinces have adopted new Acts which contain sections intended to remove most of the common law difficulties.[13] Common to all such statutes are joint liability provisions[14] similar to subsection 20(4) of the Business Corporations Act:

> (4) Whether or not a pre-incorporation contract is adopted by the corporation, the other party may apply to the court which may, notwithstanding subsections 2 and 3, make an order fixing or apportioning liability as between the contractor and the corporation in any manner the court considers just and equitable under the circumstances.[15]

In *Bank of Nova Scotia v. Williams*,[16] this provision arose for consideration for the first time in Canada. The pertinent facts involved a private corporation set up by Williams and Aikins. Aikins supplied the capital and Williams undertook to provide the corporate vehicle. The capital was supplied by Aikins' wife, who took a $15,000 mortgage on the family home, the proceeds of which were eventually delivered to the corporation and evidenced by a promissory note in favour of Mrs. Aikins. Eventually, Mrs. Aikins became liable under an earlier bankruptcy proceeding and, as part of the settlement, the plaintiff became subrogated to her rights under the promissory note. When the private corporation got into financial difficulties, the plaintiff commenced an action against Williams personally to recover the $18,000 due under the note. In part it was argued that Williams, as a promoter of the company, could be held liable under section 20(4). Van Camp J. refused to exercise her discretion under that provision:

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or novel cases will be discussed in the text. Otherwise extensive use will be made of footnotes. The discussion in the text will also tend to be brief except where the cases or legislation have Not been discussed elsewhere. Use will be made of other Commonwealth material which I feel is pertinent to Canadian developments. Finally, this paper will not deal with strict matters of corporate finance or securities legislation, except where they arise in a true corporate context, *e.g.* insider trading, amalgamations, and arrangements. Thus, there will be no discussion of such cases as Pacific Coast Coin Exchange of Canada Ltd. v. O.S.C., [1978] 2 S.C.R. 112, 2 B.L.R. 212 (1977) or Multiple Access Ltd. v. McCutcheon, 2 B.L.R. 129 (Ont. H.C. 1977). Nor will there be any discussion of winding up, "just and equitable" or otherwise.

[12] *See generally* Getz, *Pre-incorporation Contracts: Some Proposals*, U.B.C.L. REV. — C. DE D. 381 (1967); Nugan, *Pre-Incorporation Contracts*, in Vol. 1, STUDIES IN CANADIAN COMPANY LAW 197 (J. Ziegel ed. 1967); Gross, *Liability on Pre-incorporation Contracts: A Comparative Review*, 18 MCGILL L.J. 512 (1972).

[13] *See* Canada Business Corporations Act, S.C. 1975 (1st sess.) c. 33, s. 14 [hereinafter cited as CBCA]; The Business Corporations Act, R.S.O. 1970, c. 53, s. 20 [hereinafter cited as OBCA]; MCA, s. 14; SBCA, s. 14.

[14] Except that most contain provision for the exclusion of any personal liability by the promoter: *see, e.g.*, CBCA, s. 14(4).

[15] OBCA, s. 20(4).

[16] 12 O.R. (2d) 709, 70 D.L.R. (3d) 108 (H.C. 1976).

> I am asked to exercise a discretion thereunder to apportion liability for the debt between Harvey Williams and H. Williams Mechanical Contractors Ltd. The section recites that the other party to the contract may make such application. The submission is that since the debt has been assigned to the plaintiff that it may make the application. This section was introduced into the Act in 1970 and I have been referred to no authority as to the exercise of the discretion thereunder. My understanding is that section was introduced to clarify the doubt that existed as to whether a company could adopt a contract made on its behalf before incorporation and release the person who signed on its behalf from liability. I can understand that there may be times when the company and the one who contracted on its behalf should not be able to agree as to the assumption of liability to the detriment of the person with whom the contract was made. However, in the situation before me, Mrs. Aikins was not misled as to which party she was advancing the moneys to, nor did any action of Mr. Williams or the company mislead her as to who would be assuming responsibility for repayment. Consequently, I am not exercising any discretion under that section to apportion the liability of the company between it and Mr. Williams.[17]

One could not disagree with Van Camp J.'s decision on the facts. Williams was completely innocent and there was no cause to attach personal liability to him. One wonders, however, at the judge's assessment of the rationale for the joint liability provisions. It is difficult to conceive of situations where the promoter and the company are not able to agree on their respective liabilities and this is not the reason for the introduction of joint liability. The provisions were included to deal essentially with the situation where promoters attempt to defraud third parties by hiding behind an inadequately capitalized company. Thus, a promoter cannot avoid his obligations by getting the contract adopted by a shell corporation which cannot meet its obligations under the contract. This is the situation where the court should intervene and it is to be hoped that Van Camp J.'s decision will not restrict the effectiveness of such provisions.[18]

While many provinces have adopted the statutory pre-incorporation provisions, others still have to deal with the problems of the common law. There have been several Australasian cases[19] which are of general interest. In particular, the New Zealand Supreme Court decision in *Rita Joan Dairies Ltd. v. Thomson*[20] illustrates the detailed analysis required in construing a pre-incorporation agreement in order to attribute personal liability to the promoter when the contract is not formally adopted by the company. In Canada, a decision of the Supreme Court of British Columbia has evidenced a refreshing approach to the old

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[17] *Id.* at 712-13, 70 D.L.R. (3d) at 111-12.

[18] *See* INFORMATION CANADA, Vol. I, PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA para. 72 (1971).

[19] Miller Associates (Australia) Pty. v. Bennington Pty., 7 A.L.R. 144 (N.S.W.S.C. 1975); Rita Joan Dairies Ltd. v. Thomson, [1974] 1 N.Z.L.R. 285 (S.C. 1973); Hawke's Bay Milk Corp. v. Watson, [1974] 1 N.Z.L.R. 236 (S.C. 1973); Marblestone Industries Ltd. v. Fairchild, [1975] 1 N.Z.L.R. 529 (S.C. 1974).

[20] *Id.*

problem of *when* and *how* a company can adopt such an agreement at common law.

In *a.d.p. Computer Services Ltd. v. Franklin*,[21] prior to the incorporation of the corporate defendant, Northern Industrial Maintenance Ltd., the plaintiffs had discussed with the individual defendant, one Franklin, the question of their providing record keeping and accounting services for a company which the latter intended to incorporate. The corporate defendant was incorporated and these services were performed but in some cases the accounts were not paid. The question before the court was whether the individual or corporate defendant was liable for the amounts owing.

Murray J. found that the individual defendant was not liable. The parties' conduct and documentary evidence clearly indicated no personal liability was intended. His Lordship also found that performance of the terms of the pre-incorporation contract after incorporation amounted to a new contract between the plaintiffs and the corporate defendant.[22]

This conclusion is clearly in conflict with the traditional authorities on adoption of pre-incorporation contracts. In his article on pre-incorporation contracts, Getz outlined the difficulties of a company ratifying an agreement entered into by a promoter.[23] Mere performance by the company of the agreement has not amounted to adoption of a new contract.[24] Moreover, the courts have even been reluctant to hold that performance plus variation of the agreement can create a new contract through the doctrine of novation.[25] The rationale for this traditional approach is simply that the company is performing its obligations in a manner consistent with the old agreement rather than under the terms of a new contract.

Clearly, from a practical point of view this sort of analysis is quite unrealistic. It may be that there are technical difficulties, such as past consideration and ratification by non-existent principals, in adopting a more liberal approach. Nevertheless, in the business world the crucial issue is whether the company has indicated by its conduct that it is undertaking the contractual obligations under the pre-incorporation agreement. In that the *a.d.p. Computer Services* case recognizes this reality, it is to be welcomed as reflecting a genuine relaxation of

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[21] (B.S.S.C. Mar. 8, 1977).

[22] *Id.* One important piece of evidence was that the individual defendant had guaranteed the accounts of the corporate defendant to the plaintiff. This evidence does not answer, however, the question whether performance amounts to a new contract.

[23] *Supra* note 12, at 385-89. *See also* Repetti Ltd. v. Oliver-Lee Ltd., 52 O.L.R. 315, [1923] 3 D.L.R. 1100 (C.A. 1922).

[24] *In re* Northumberland Avenue Hotel Co., 33 Ch. D. 16 (C.A. 1886).

[25] *Id.* The cases in which a novation through variation of the original terms, or on any other basis, has been found are rare. *See* Howard v. Patent Ivory Mfg. Co., 38 Ch. D. 156 (1888); McLeod v. Cardiff Colliery Co., [1925] V.L.R. 1 (C.A. 1924); Mount Gambier Co-Operative Milling Society Ltd. v. Williams, [1921] S.A.S.R. 185 (S.C.). *See also Re* The Red Deer Milling and Elevator Co., 1 Alta. L.R. 237 (S.C. 1907).

out-dated nineteenth century contractual principles.[26] It may be that in the rare case, the policy considerations of protecting shareholders from the imposition of an inequitable contract will persuade the courts to find that performance does not amount to adoption. However, normally the

[26] For another discussion of novation in the context of a company successfully adopting the liability of a promoter, *see* Mettam and Apex Devs. Ltd. v. Stockall and Cadac Devs. Ltd., 22 N.S.R. (2d) 477 (S.C. 1976). Also, for a decision where the promoters continued to have standing to sue *after* the incorporation of a company and its performance of the contract, *see* Hellekson v. Canadian Pacific Ltd., 1 B.C.L.R. 321, [1977] 2 W.W.R. 216 (S.C. 1976). The latter decision was based on the fact that the defendant had continued to deal with the individual plaintiffs. Finally, a novel case involving ratification arose in Porky Packers Ltd. v. The Pas, [1974] 2 W.W.R. 673, 46 D.L.R. (3d) 83 (Man. C.A.), *rev'd* [1977] 1 S.C.R. 51. Here, an action was commenced by a corporation against defendants based on a supposedly negligent mis-statement made to the company's promoters. The Supreme Court of Canada dismissed the negligence action. The interesting question, however, is why the company was bringing the action. The explanation given by Matas J.A., which apparently was assumed to be correct by the Supreme Court, was:

> I have concluded that the principles relied on by counsel for the town, with respect to pre-incorporation contracts, have no application to the circumstances of this case, particularly in light of s. 142 of the *Companies Act*, 1964 (Man.) (2nd Sess.), c.3 (now R.S.M. 1970, c. C160, s.159), which reads:
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> > 159 *Subject to its ratification by the corporation*, every corporation is upon its incorporation vested with all the property, rights, assets, privileges and franchises theretofore held for it, and subject to the liabilities under any trust created with a view to its incorporation.
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> (The italics are mine.)
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> In the case at bar, the three individuals were not acting merely as agents for a company not yet incorporated, but were promoters and trustees for that company. See *Palmer's Company Law*, 21st ed. (1968), pp. 140-2, for a discussion of the fiduciary character of promoters, and 38 Hals. 3rd ed., p. 819, para. 1362, for circumstances in which an agent is trustee.
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> It has been suggested that statutory provisions similar to that of the Manitoba *Companies Act* are merely transitional, having only historical interest with reference to early joint stock companies and the advent of letters patent companies: see *Canadian Company Law*, *supra*, at p. 204. But there is a difference between the Manitoba statute and the type of provision which has been enacted in several other jurisdictions. For example: Canada *Corporations Act*, R.S.C. 1952, c. 53, s. 14(2) [as renamed, now R.S.C. 1970, c. C-32, s.16(2)], reads:
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> > 14(2) The company shall from the date of its letters patent become and be vested with all property and rights, real and personal, theretofore held for it under any trust created with a view to its incorporation.
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> It will be noted that the first clause of the relevant Manitoba provision (which I have italicized) provides for ratification by the company. If it were held by the Court, that it is not possible for a company, upon incorporation, to ratify contracts made for it, the first part of that clause would be meaningless. In order to give all the words of this section meaning (see *Craies on Statute Law*, 7th ed. (1971), pp. 103-7) there would have to be a power to ratify a trust created with a view to its incorporation.

Id. at 680, 46 D.L.R. (3d) at 90-91.

It is, of course, difficult to know the rationale for specific words in legislation. However, the Manitoba Companies Acts have contained transitional provisions for joint stock companies for some time (*e.g.* MCA, s. 20) and one suspects that s. 159 is simply a more sophisticated version of these. The words "subject to its ratification by the shareholders", in all likelihood were inserted to make sure that shareholders of the joint stock company agreed to the application for letters patent and, thus, had nothing to do with pre-incorporation contracts. However, the recognition of the trust argument is interesting (*see* McKenzie, *The Legal Status of the Unborn Company*, 5 N.Z.U.L.REV. 211 (1973)) and is now academic in Manitoba in light of the adoption of a new Act.

board of directors will be given the power to adopt any pre-incorporation agreement and performance authorized by that body should accordingly be sufficient to bind the corporation.[27]

III. Corporate Responsibility for the Acts of Agents

While some of the new corporate statutes contain provisions dealing with the corporation's liability for its agents' acts,[28] to a large extent such sections amount to a codification of the common law. Accordingly, cases determining the usual authority of agents and the limitation of the indoor management rule through actual and constructive notice are still very relevant to *all* common law provinces in Canada. Further, the position as to the criminal liability of the corporation under the "identification" theory is still unclear. Recent decisions in Canada,[29] while perhaps not clarifying the position, present useful illustrations of

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[27] Final reference should be made to the possible development of an action based on negligent mis-statement by the promoter. Where the company does not come into existence, there is no theoretical problem with an action in negligent mis-statement against the promoter on the basis of *Hedley Byrne*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.). Where the company was incorporated and adopted a new contract, however, any possibility of a negligent mis-statement action was subject to the *dictum* of Pigeon J. in J. Nunes Diamonds Ltd. v. Dominion Electric Protection Co., [1972] S.C.R. 769, at 777-78, 26 D.L.R. (3d) 699, at 727, *aff'g* [1971] 1 O.R. 218, 15 D.L.R. (3d) 26 (C.A.), *aff'g* [1969] 2 O.R. 473, 5 D.L.R. (3d) 679 (H.C.), where his Lordship stated that where there is a contract in existence, any remedy must be in contract, *i.e.* breach of warranty. To entertain a tortious action there must be an independent tort. This *dictum* must now, however, be read subject to the sanction of pre-contractual misrepresentation actions in Esso Petroleum Co. v. Mardon, [1976] Q.B. 801, [1976] 2 All E.R. 5 (C.A.) and Coleman v. Myers, [1977] 2 N.Z.L.R. 298 (C.A.). *See also* Sealand of the Pacific Ltd. v. Ocean Cement Ltd., [1973] 3 W.W.R. 60, 33 D.L.R. (3d) 625 (B.C.S.C.).

[28] CBCA, s.18; MCA, s.18; SBCA, s.18.

[29] Aside from those cases dealing directly with the indoor management rule, a number of other cases are of general interest. For example, in Canadian Market Place Ltd. v. Fallowfield, 13 O.R. (2d) 456, 71 D.L.R. (3d) 341 (H.C. 1976), the Ontario High Court established once again that application of the corporate seal is unnecessary to bind a corporation to a contract. *See* OBCA, s. 18(2). A similar conclusion was reached concerning the sale of a hotel by the Saskatchewan Court of Appeal in Roman Hotels Ltd. v. Desrochers Hotels Ltd., 69 D.L.R. (3d) 126 (Sask. C.A. 1976). In North Rock Explorations Ltd v. Zahavy Mines Ltd., 3 O.R. (2d) 163, 44 D.L.R. (3d) 683 (H.C. 1974), the scope of s. 5(2)(17) of the Ontario Act was discussed. This provision requires a special resolution to authorize directors "to sell, lease, exchange or otherwise dispose" of all or substantially all of the property of the corporation. The directors of a company, pursuant to a special by-law under s. 53(1)(c), pledged securities of the corporation to secure an outstanding debt. The court held that the specific wording of s. 53 overrode that of s. 15(2)(17) and that since a pledge was not an alienation of property it did not fit within the latter section. *See also* s. 183(1)(2) of the CBCA. Finally, reference might be made to Storhoaks v. Mobil Oil Canada Ltd., [1976] 2 S.C.R. 147, [1975] 4 W.W.R. 591, 55 D.L.R. (3d) 1, *aff'g* [1973] 6 W.W.R. 644, 39 D.L.R. (3d) 598 (Sask. C.A.), *rev'g* [1972] 5 W.W.R. 90, 29 D.L.R. (3d) 438 (Sask. Q.B.), where the Supreme Court of Canada discussed the problem of whether a corporation can recover money paid under a mistake of fact even though some other agent of the corporation is fully aware of the true facts. The Court held that it could and there is an interesting discussion of the scope of the doctrine of restitution in such circumstances.

the problems outsiders run into when dealing with a company through its agents.

In *Anderson Lumber Co. v. Canadian Conifer Ltd.*,[30] the Alberta Court of Appeal was presented with a classic example of insiders attempting to rely on the indoor management rule. The case involved the determination of the validity of a series of debentures issued by the defendant company to the corporate plaintiff. The defendant's articles of association gave authority to the directors to raise or borrow or secure the payment of money for the benefit of the company subject to the requirement that, if the money involved was greater than the nominal capital of the company, the sanction of a general meeting was necessary. The debentures were issued and the sanction was given. However, no notice of the shareholders' meeting was given, no proxies were sent out and one shareholder was not present at the meeting and did not consent to the issue of the debentures. The essential question before the court was whether the debentures were validly issued in light of the defect in the meeting.

The Trial Division[31] simply held that the improper meeting solved the problem. While cases like *Walton v. Bank of Nova Scotia*[32] made it clear that formalities in a meeting can be waived if all shareholders effectively agree to the business transacted, this approach cannot apply where there is not unanimous consent.[33] No one would argue with this conclusion; otherwise shareholders would have their theoretical right to representation at company meetings judicially removed. Unfortunately, Moore J. did not discuss the effect of the indoor management rule on internal corporate malfunctions.

The Appellate Division directed itself to this point. It agreed with the trial judge's conclusion as to the validity of the meeting and the application of the *Walton* case. It then found that *prima facie* this was a case for the application of the indoor management rule: a third party need not be concerned with internal procedural niceties. The court then found, however, that Anderson Lumber Ltd. was an insider, with knowledge of the defect, and could not rely on the rule.[34]

This conclusion is quite correct. The prime mover in the issuance of the debentures was William Anderson. He owned almost fifty per cent of Conifer Lumber Ltd. and was present at the meeting. He was also president, director and ninety-nine per cent shareholder in Anderson Lumber Ltd. Clearly, if the debentures had been issued to him

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[30] 4 A.R. 282, [1977] 5 W.W.R. 41, 77 D.L.R. (3d) 126 (C.A.), *aff'g* [1976] 3 W.W.R. 255, 66 D.L.R. (3d) 553 (Alta. S.C.).

[31] *Id.*

[32] [1965] S.C.R. 681, 52 D.L.R. (2d) 506, *aff'g* [1964] 1 O.R. 673, 43 D.L.R. (2d) 611 (C.A.), *aff'g* [1963] 1 O.R. 502, 37 D.L.R. (2d) 684 (H.C.).

[33] [1976] 3 W.W.R. at 262, 66 D.L.R. (3d) at 599.

[34] *Supra* note 30, at 301, [1977] 5 W.W.R. at 57, 77 D.L.R. (3d) at 139.

personally the court would simply have applied *Morris v. Kanssen*.[35] The only problem in the instant case was that it was the legal entity of Anderson Lumber Ltd. that received the debentures. The Appellate Division decided that since Anderson was the "directing mind and will" of the plaintiff, his knowledge could be imputed to the corporation. Accordingly, the corporate plaintiff knew that the debentures were invalidly issued and could not invoke the rule in *Turquand's Case*.[36]

The decision in *Cypress Disposal Ltd. v. Inland Kenworth Sales (Nanaimo) Ltd.*[37] is not quite so easy to accept. The plaintiff in this case was negotiating with a salesman of the defendant for the purchase of two trucks. He signed an order form which contained a late delivery clause and so notified the salesman. The latter then told the plaintiff that if he would agree to slight alterations, the contract would be approved. The plaintiff agreed, the salesman forged the company officer's signature and the contract was apparently complete. Unfortunately, the trucks were delivered late and the plaintiff sued under the penalty clause.

Berger J., in the Trial Division, held the defendant liable under the contract. It was responsible and bound by the fraud of its agent. On appeal, this decision was reversed by majority judgment. Farris C.J. held that the salesman had no power to accept contracts; he could only communicate acceptance. The company had made no representation that the salesman had any wider power. Indeed, the plaintiff had notice of this fact through the first order form which made it clear that the defendant's consent to the contract was necessary.[38] Any representation made by the agent that he had authority to accept came from the salesman himself and this could not impose liability on the defendant.[39]

With respect, this conclusion is doubtful. As Seaton J.A. points out, in an excellent dissenting judgment,[40] to say that the salesman had no apparent authority to accept the contract is to avoid the issue. The salesman did not purport to finally accept the contract or hold himself out as having the authority to do so.[41] He forged the officer's signature and was, therefore, saying that the company had accepted the con-

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[35] [1946] A.C. 459, [1946] 1 All E.R. 586 (H.L.). This case and the case at bar are quite distinct from the decision of the English High Court in Hely-Hutchinson v. Brayhead Ltd., [1968] 1 Q.B. 549, [1967] 2 All E.R. 14 (Ch.).

[36] British Royal Bank v. Turquand, 6 El. & Bl. 327, 119 E.R. 886 (Ex. 1856).

[37] [1975] 3 W.W.R. 289, 54 D.L.R. (3d) 598 (B.C.C.A.).

[38] *Id.* at 291, 54 D.L.R. (3d) at 599.

[39] *See* Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd., [1964] 2 Q.B. 480, [1964] 1 All E.R. 630 (C.A.); Attorney-General for Ceylon v. Silva, [1953] A.C. 461, [1953] 2 W.L.R. 1185 (P.C.).

[40] *Supra* note 37, at 293, 54 D.L.R. (3d) at 602.

[41] *Compare* Jenson v. South Trail Mobile Ltd., [1972] 5 W.W.R. 7, 28 D.L.R. (3d) 233 (Alta. C.A.), where in a very similar situation the agent did in fact sign the acceptance form *with his own name*.

tract. It was certainly within his apparent authority to communicate this fact to the plaintiff.

The question comes down, then, to the issue of whether the company can be held liable on a forged document, in this case the forgery of the acceptance signature. By implication, the majority said "No". Seaton J.A., however, clearly concluded that the decision in *Ruben v. Great Fingall Consolidated*[42] had been effectively overruled by the subsequent decision in *Lloyd v. Grace, Smith & Co.*[43] This view represents the recent trend of thought and reflects the provisions in recent statutes,[44] which provide that forgery is not a defence so long as the agent issuing the document has the ostensible authority to represent it as genuine. In the present case, the salesman clearly had the apparent authority to represent the document as genuine; he always delivered contracts to clients and the corporate defendant chose not to deliver the document itself.[45] Accordingly, the corporate defendant should have been bound by his actions.

The point is a difficult one. Nevertheless, in my view the majority judgment is incorrect. In the final analysis, the question comes down to which innocent party should bear the loss. The corporation has control over the hiring of its agents. Therefore, if it hires a dishonest employee, it should take responsibility for his wrongful acts.[46] There is little the third party can do to protect himself in such circumstances.[47]

Cases involving the question of corporate responsibility for the fraudulent acts of an agent rarely arise. Occasionally, however, a court must decide whether the corporation is responsible for an agent's tort because the latter was acting within the scope of his ostensible authority

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[42] [1906] A.C. 439, 95 L.T. 214 (H.L.).

[43] [1912] A.C. 716, [1911] 2 K.B. 489 (H.L.). *See also* Uxbridge Bldg Soc'y v. Pickard, [1939] 2 All E.R. 344, at 350 (C.A.). *See generally* L. GOWER, THE PRINCIPLES OF MODERN COMPANY LAW 166-68 (3d ed. 1969).

[44] CBCA, s. 18(2); MCA, s. 18(e); SBCA, s. 18(e).

[45] This raises the question as to whether delivery of a document amounts to "issuance" under the new statutes. It may well be that "issue" means the delivery of a document from the appropriate internal corporate organ: in this case, the accepting official. It makes more sense, in my view, to include within this term anyone who has the power to *represent* a document as genuine.

[46] *See* Seaton J.A., *supra* note 37, at 305-06, 54 D.L.R. (3d) at 612.

[47] Another British Columbia case worth noting is Arnold v. Brookmere Properties Ltd., (B.C.S.C. 1976). In this case the agent, who was vice-president and a director of the corporate defendant, entered into a contract with the plaintiff when he knew that the shareholders' meeting had the final say in such matters. Readers should also note Port Darlington Harbour Co. v. Drilling, 11 O.R. (2d) 307, 66 D.L.R. (3d) 49 (H.C. 1975) (reliance by defendant on internal irregularities in company not permitted); Hadikan Bros. Lumbering Ltd. v. Canadian Surety Co., 57 D.L.R. (3d) 632 (B.C.S.C. 1975) (ostensible authority of insurance adjuster); La Société centrale d'hypothèques et de logement v. Blainville, [1976] R.P. 97 (Que. C.S.) (ostensible authority of secretary-treasurer); and Broadlands Finance Ltd. v. Gisborne Aero Club Inc., [1975] 2 N.Z.L.R. 496 (C.A.) (apparent authority of committee members of an unincorporated society, constructive notice through registration of documents and facts which may put outsiders on inquiry). *See* Shapira, *Rule in Turquand's Case Revisited*, 7 N.Z.U.L. REV. 142 (1976).

or whether the corporation is absolved because the agent was acting outside his authority on a frolic of his own. Such a case came before the Ontario Court of Appeal in *Canadian Laboratory Supplies Ltd. v. Engelhard Industries of Canada Ltd.*[48] The plaintiff in this *Canlab* case had legitimately bought platinum from the defendant Engelhard over a period of years. In 1962 a clerk of Canlab began ordering platinum for a fictitious customer. Canlab paid for the platinum which was picked up by the clerk and supposedly delivered to the customer. In fact, the clerk was keeping the metal himself and selling it back to the defendant as used platinum. Accordingly, the plaintiff was paying for the platinum and the clerk was recovering the proceeds from the resale to Engelhard. Upon discovery of the fraud in 1969, the plaintiff commenced an action in conversion against the defendant for buying back the platinum which belonged to the plaintiff without its consent. The trial judge found that the clerk was not acting as an agent of Canlab in his escapades. Moreover, since the plaintiff had to ratify all his fraudulent acts to bring the action in conversion, it could not argue that the defendant had converted the platinum.[49]

The Court of Appeal admitted that the clerk had no actual authority to enter into the transactions in question. Even the initial purchase of platinum from Engelhard was probably beyond the clerk's actual authority since he was only employed in the "sales" department. The majority, however, concluded that at all times the clerk was acting within his apparent authority:

> I have no difficulty in finding that Canlab, in the words of Diplock, L.J., in the *Freeman & Lockyer* case, represented the apparent authority of Cook by its conduct in "permitting" him to act in the way he did "in the conduct of [its] business" with Engelhard. From the beginning, Cook was in a position where he could represent himself as an agent with authority to purchase platinum for Canlab, sell it to customers and arrange for its resale by them direct to Engelhard. Purchase orders, both in the case of genuine purchases and of the fraudulent ones, went to Engelhard signed by the proper person in the Canlab purchasing department. Invoices from Engelhard to Canlab were paid in the ordinary course of business. Cook personally picked up both legitimate purchases of platinum and the platinum purchased fraudulently. Someone at Canlab must have known that their "Mr. Platinum" was picking up the legitimate purchases. The continuation of this total transaction over a period of seven years can itself be taken as powerful evidence of the apparent authority of Cook to undertake it on behalf of Canlab.[50]

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[48] 2 B.L.R. 65, 78 D.L.R. (3d) 232 (Ont. C.A. 1977), *rev'g* 12 O.R. (2d) 113 (H.C. 1975).

[49] Perhaps the most surprising thing about this case is how the fraud went undetected. In his last successful year, the clerk persuaded Canlab to pay $578,000 for the fraudulent purchases, while the plaintiff's legitimate purchases amounted to only $33,000. In total, Canlab paid out $970,000 for fraudulent purchases and received nothing in return. Yet, the court found that Canlab was not negligent in having inadequate audit procedures. The clerk must have been very clever.

[50] *Supra* note 48, at 72, 78 D.L.R. (3d) at 242.

While these comments applied from 1962 to 1969, the case was undoubtedly made much stronger by the fact that in 1966 and 1968, when inquiries were made of senior officials in Canlab, the inquiries were directed to the clerk to answer.

The only problem as to apparent authority arose with the resale of the platinum back to Engelhard. This point particularly concerned Lacourcière J.A. in his dissenting judgment. He decided that at no time prior to 1966 did the company represent the clerk as having the power to arrange such a combination of transactions which included the resale of the platinum.[51] Moreover, the transaction was so unusual that Engelhard should have been put on inquiry and sought information from a higher official.[52] The majority simply found that since the defendants were dealing with an employee, and since they believed he was acting within his apparent authority, they could rely on his actions. In other words, Canlab put the clerk into a position where he could arrange the transactions and, accordingly, they must accept responsibility.

Finding a representation is theoretically difficult at the best of times. Certainly, the plaintiff had never affirmatively represented that the clerk had that power. However, by implication from the company's reaction during the 1966 enquiry, Canlab had always felt that it was within the clerk's scope of authority to so act. Lacourcière J.A.'s concern about the unusual nature of the transaction is well taken. However, in light of the response to the 1966 inquiry, one wonders whether the company would have denied the authority of the clerk. In my view, the decision is a good assessment of a difficult case. As an aside comment, one wonders whether the British Columbia Supreme Court would have reached the same conclusion in light of the *Cypress Disposal Ltd.* case.

The problem of the liability of the corporation for criminal acts of its agents has been unclear since the decision of the House of Lords in *Tesco Supermarkets Ltd. v. Nattrass.*[53] The case has been fully discussed:[54] suffice it to say that *Tesco Supermarkets* has led commentators to suggest that only the highest official's criminal acts can be attributed to the corporation. Criminal liability will only be attributed from those who are the "directing mind and will"[55] of the company. In Canada, two recent decisions leave unsettled the question of whether this fairly strict view of corporate liability will apply or whether a more liberal approach will be adopted.

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[51] *Id.* at 79, 78 D.L.R. (3d) at 235.

[52] *Id.* at 78, 78 D.L.R. (3d) at 234.

[53] [1972] A.C. 153, [1971] 2 All E.R. 127 (H.L.).

[54] *See* Muir, *Tesco Supermarkets, Corporate Liability and Fault*, 5 N.Z.U.L. REV. 357 (1973); Ewaschuk, *Corporate Criminal Liability and Related Matters*, 29 C.R.N.S. 44 (1975).

[55] *Supra* note 53, at 171, [1971] 2 All E.R. at 132 (*per* Lord Reid).

In *Regina v. Waterloo Mercury Sales Ltd.*,[56] an employee of the defendant corporation adopted the practice of turning back odometers on used cars prior to sale. An attempt was made to find the corporate employer liable under the Criminal Code for the employee's offences. Legg J., of the Alberta District Court, convicted the corporation.

There is no doubt in my mind that this decision represents an extension of the concept of corporate criminal liability. The employee was not a director or an officer of the company, but supervised the used car sales division. He was subject to the authority of the general sales manager. He had no cheque signing privileges. At the same time it is clear that he *effectively controlled* the used car sale division of the company and, in particular, had the authority to incur debts for the company.[57] However, giving effect to the "chain of command"[58] theory adopted in *Tesco Supermarkets*, it is doubtful if the House of Lords would have reached a similar conclusion, since the employee was in fact subject to supervision by a senior officer.

In *Regina* v. *Parker Car Wash Systems Ltd.*,[59] on the other hand, there was no question that the individual involved was the "directing mind and will" of the defendant corporation. The individual had evaded taxes; he was fifty per cent shareholder, vice-president and in charge of the day-to-day operations of the company. In these circumstances there was obviously little difficulty in imputing the acts of the individual to the corporate defendant. The *dictum* of Hughes J. is, however, extremely interesting:

> I find on reference to the *Waterloo Mercury Sales* case that Legg D.C.J. makes no reference to the English cases which he is credited with refusing to follow and on referring to them myself I found "the muddled dicta" of Lord Reid sensible and illuminating as usual.[60]

It is difficult to tell whether Hughes J. is rejecting the approach in *Waterloo Mercury Sales*. But if one accepts that the latter case *extends* the House of Lords' decision in *Tesco Supermarkets*,[61] then by implication Hughes J. cannot accept the Alberta decision. This would be unfortunate. One should not be concerned with the effect of a company's allocation of power and supervision under its constitution or with ascertaining who has the "real" control of a company. Perhaps the best approach would be to adopt a vicarious liability concept and hold

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[56] 27 C.R.N.S. 55, [1974] 4 W.W.R. 516, 49 D.L.R. (3d) 131 (Alta. Dist. C.).

[57] *Id.* at 61, [1974] 4 W.W.R. at 522, 49 D.L.R. (3d) at 136.

[58] *Supra* note 53, at 175, [1971] 2 All E.R. at 135 (*per* Lord Reid). Alternatively, one might use "ladder of responsibility", *supra* note 53, at 177, [1971] 2 All E.R. at 137 (*per* Lord Morris of Borth-y-Gest).

[59] 1 B.L.R. 213 (Ont. H.C. 1977).

[60] *Id.* at 220-21.

[61] *See also* R. v. Andrews Weatherfoil Ltd., [1972] 1 W.L.R. 118, [1972] 1 All E.R. 65 (C.A. 1971); Nordik Industries Ltd. v. Regional Controller of Inland Revenue, [1976] 1 N.Z.L.R. 194 (S.C. 1975). Both of these cases adopted the approach of the House of Lords. *See also* R. v. Armstrong, [1974] 4 W.W.R. 510, at 515 (B.C.C.A.) (*per* McIntyre J.A.) (criminal liability and *ultra vires* argument).

the corporation liable for criminal acts committed by individuals in the course of their employment. After all, the company and its shareholders are the beneficiaries of undiscovered criminal activities for the most part. Accepting that this development is virtually impossible, the preferable approach is to attach liability to the company for criminal acts by individuals who have *effective control and discretion over their own activities*. In the absence of proper supervision, such individuals are the "directing mind and will" in their employment. The presence of some other officer to whom they are ultimately responsible for the corporate policy should be irrelevant. This is the position taken in *Waterloo Mercury Sales Ltd.* and one hopes that any implicit rejection of this approach in the *Parker Car Wash Systems Ltd.* decision is not followed.[62]

IV. SHAREHOLDERS' RIGHTS

Relatively little has been written in Canada concerning the procedural and substantive rights which shareholders may exercise in an attempt to control or place restraints on the board of directors.[63] In the last few years, the courts have had to deal with an increasing number of cases involving such problems. These cases involve such diverse matters as when a meeting is "held",[64] what constitutes an "accidental"

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[62] Reference should also be made to the line of recent cases establishing the continuance of criminal liability from a participating corporation in a merger or amalgamation to the resulting corporate entity. *See* R. v. Black and Decker Mfg. Co., [1975] 1 S.C.R. 411, 15 C.C.C. (2d) 193, 43 D.L.R. (3d) 393 (1973), *rev'g* [1973] 2 O.R. 460, 11 C.C.C. (2d) 470, 34 D.L.R. (3d) 308 (C.A.), *rev'g* 9 C.P.R. (2d) 129 (Ont. Prov. Ct. 1972); Witco Chemical Co., Canada, Ltd. v. Oakville, [1975] 1 S.C.R. 273, 1 N.R. 453, 43 D.L.R. (3d) 413 (1973), *rev'g* [1973] 2 O.R. 467, 34 D.L.R. (3d) 315 (C.A.), *aff'g* [1972] 3 O.R. 712 (Cty. Ct.); *Re* The Queen and Mercantile Distributing Ltd., [1975] 6 W.W.R. 187, 24 C.C.C. (2d) 533, 61 D.L.R. (3d) 481 (B.C.S.C.). *See now and compare* CBCA, s. 180(e); MCA, s. 180(e); SBCA, s. 180(e).

[63] *See* Getz, *The Structure of Shareholder Democracy*, in Vol. 2, STUDIES IN CANADIAN COMPANY LAW 239 (J. Ziegel ed. 1973), and Iacobucci, *Shareholders Under the Draft Canada Business Corporations Act*, 19 McGILL L.J. 247 (1973). In particular the novel features of the new statutes remain to be fully discussed. Take, for example, s. 131 of the federal, Saskatchewan and Manitoba Acts. Sub. (1) gives a shareholder the right to submit a "proposal" and to discuss at the meeting any matter "of which he would be entitled to submit a proposal". What does this last clause mean? Is the shareholder allowed to submit a proposal and discuss *any* matter? Or is that right subject to the exclusions in sub. (5)? Under the draft CBCA (para. 11.05) it seemed clear that it was intended that the political, racial and social exemptions, for example, would stop any discussion of such matters. Under the CBCA, however, all exemptions in sub. (5) relate only to the *inclusion* of a proposal in the proxy and the circulation by management of a supporting statement. The right to *discuss* any proposal appears to exist as an unintended but actual independent right.

[64] Guss v. Veenhuizen, 50 A.L.J.R. 638, 9 A.L.R. 461 (H.C. 1976). Here the High Court of Australia appeared to hold that a meeting is only "held" when it is called and completed. A meeting which is called in 1972 and adjourned until 1973 is therefore apparently not "held" in 1972. *See* The Companies Act, R.S.A. 1970, c. 60, s. 133 [hereinafter cited as ACA]. The CBCA and the Saskatchewan and Manitoba Acts only require the directors to "call" annual meetings. *Cf.* Companies Act, S.B.C. 1973 (1st sess.) c. 18, s. 162(1) [hereinafter cited as BCCA].

omission to send notice of meetings[65] and the role of trustees in a voting trust.[66] For textual purposes,[67] however, it is necessary to limit the discussion to recent developments in the areas of proxies, shareholders' agreements, court ordered meetings and the right of a shareholder to have an inspector appointed to audit the affairs of the company.

A. *Court Ordered Meetings*

When Professor Getz wrote his excellent article on court ordered company meetings nine years ago,[68] there was relatively little authority on which to base his analysis.[69] Since that time, there has been little

[65] *Re* Compaction Systems Pty., 2 A.C.L.R. 135 (N.S.W.S.C. 1976). Here, the Supreme Court held that where there is a deliberate act of abstention from giving notice of a meeting and that act is based on a mistake of fact or of mixed fact and law (*e.g.* whether a shareholder is registered and entitled to notice), there is *no* "accidental omission". This means effectively that at least as far as New South Wales is concerned, to fit within the "accidental omission" clause which is very common in by-laws and articles of association, one must *intend* to send the notice but make an error in the forwarding process.

[66] Munden Acres Ltd. v. Lincoln Trust and Savings Co., 10 O.R. (2d) 492, 63 D.L.R. (3d) 604 (H.C. 1975).

[67] For other cases involving issues of shareholder control, *see Re* Western Mines Ltd. and Shield Dev. Ltd., [1976] 2 W.W.R. 300, 65 D.L.R. (3d) 307 (B.C.S.C.) (discussion of whether shareholders could increase the number of directors and fill vacancies at the same time under the articles of association, and some discussion of the purposes for which the power to elect directors can be used, *i.e.* for legitimate corporate purposes or with the intention of gaining control); Pedley v. Inland Waterways Assoc. Ltd., [1977] 1 All E.R. 209, 120 Sol.J. 569 (Ch.) (reaffirmation of the fact that at common law shareholders have no right, in the absence of express provisions in articles or statute, to have matters raised for discussion at a shareholders' meeting). *See now* CBCA, s. 131 and note 63, *supra*; *Re* Medefield Pty., 2 A.C.L.R. 406 (N.S.W.S.C. 1977) (discussion of the role of chairman of shareholders' meeting in close corporations and the extent to which he may implicitly give up the right to vote which was given to him in the articles without the knowledge of shareholders). Reference should also be made to the rather bizarre decision in *Re* MacMillan Bloedel Ltd., [1976] 6 W.W.R. 475 (B.C.S.C.). Here, an applicant filed an affidavit stating that he wanted a shareholders' list pursuant to s. 190 of the BCCA. His affidavit stated in part, *id.* at 478:

> 2. I require the above mentioned list only for corporate purposes.
> 3. The above mentioned list and the information contained therein will be used only for the purposes connected with MacMillan Bloedel Ltd.

On these facts the judge held:

1. The fact that the client's name was not disclosed by the solicitor applicant did not stop one using s. 109 (*see* CBCA, s. 21(3)).
2. One did not have to list the specific corporate purpose for which the list was wanted but only that it would be used for "corporate purposes".
3. The application failed because:

a) He had filed an affidavit rather than a statutory declaration. This seems unduly procedural. *See, e.g.*, CBCA, s. 21(7).

b) The application used the phrase "for purposes connected with MacMillan Bloedel Ltd." rather than "corporate purposes". This seems simply an incorrect or at least restrictive reading of the affidavit.

If nothing else, the case re-emphasizes the need to comply with procedure and requirements to the letter. *See also* cls. 27 and 50 of Bill S-2, whereby the shareholder proposal right will be restricted to shareholders entitled to vote at an annual meeting.

[68] Getz, *Court Ordered Company Meetings*, 33 CONV. (N.S.) 399 (1969).

[69] *See generally In Re* El Sombrero Ltd., [1958] Ch. 900, [1958] 3 All E.R. 1; *Re* Zimmerman and Commonwealth Int'l Leverage Fund Ltd., 58 D.L.R. (2d) 160 (P.E.I.S.C. 1966); *Re* British Int'l Finance (Canada) Ltd., [1968] 2 O.R. 217, 68 D.L.R. (2d) 578 (C.A.), *rev'g* [1967] 2 O.R. 635, 64 D.L.R. (2d) 683 (H.C.) (*sub nom.* Charlebois v. Bienvenu).

judicial discussion of the concept[70] and legislative developments have hardly been radical.[71] In one recent decision, however, the Quebec Superior Court had to deal with an application for a court ordered meeting made in the midst of a genuine struggle for control in a public company.

In *Re Canadian Javelin Ltd. and Boon-Strachan Coal Co.*,[72] the court was faced with an almost leaderless corporation at the date of the shareholders' application. The company's board of directors was effectively split.[73] There were in practical terms two functioning boards, one of which had purported to elect an executive committee which had been given very broad powers. Moreover, the "controlling" board had refused to call immediately after the annual meeting a special general meeting requested by the petitioner. Pursuant to this split, extensive litigation was commenced to determine the validity of actions undertaken by the board of directors. In short, the company was not functioning. In these circumstances Colas J. ordered that a meeting of the company be held and run under the chairmanship of a court officer.[74]

The decision is particularly interesting in that there were a number of factors involved which might lead one to think the court would not exercise its discretion in favour of a meeting. First, the petitioner controlled eighteen per cent of the shares.[75] Thus, a meeting could have been requisitioned under section 103(1) of the Canada Corporations Act.[76] How, then, could it be "impracticable" within section 106?[77] Secondly, the battle was essentially over corporate policy and

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[70] *See* South Shore Dev. Ltd. v. Snow, 4 N.S.R. (2d) 601, 19 D.L.R. (3d) 601 (S.C. 1971), where the Nova Scotia Supreme Court, in the absence of a statutory provision authorizing court called meetings, decided that it had the inherent jurisdiction to do so.

[71] The only real advance in the new statutes is to give the courts power to call meetings not only where it is "impracticable" but also "if for any other reason a court thinks fit". *See* CBCA, s. 138; MCA, s. 138; SBCA, s. 138. For a discussion of the impact of the extended sections, *see* Getz, *supra* note 68, at 406-09, and Otto v. Klipvlei Diamond Areas Pty., [1958] 2 S.A.L.R. 437.

[72] 69 D.L.R. (3d) 439 (Que. C.S. 1976).

[73] Basically, one suspects, because the petitioner, Doyle, was subject to certain criminal and securities charges.

[74] *Supra* note 72, at 448-50.

[75] That is, both personally and through his 100% beneficial membership in Javelin Foundries Ltd. and Boon-Strachan Coal Co.

[76] R.S.C. 1970, c. C-32.

[77] There has recently been another example of a court ordered meeting in a situation where the petitioner owned more than 10% of the shares. In *Re* Clairborne Industries Ltd. (Alta. S.C. Chambers, 1977), the petitioner could have requisitioned a meeting pursuant to s. 134 of The Alberta Companies Act but chose to go before the court under s. 135(2). Although the decision is not available, it is believed that Quigley J. stated that the petitioner should normally use the requisition section but that in extraordinary circumstances the court would order a meeting to be held. Apparently, in this case the meeting could be achieved more quickly under s. 135(2) than pursuant to s. 134. The motion by Quigley J. was in fact appealed to the Appellate Division but in the meantime a meeting was held, new directors elected and the action discontinued. For requisitioned meetings, *see now* CBCA, s. 137(1).

the role of the petitioner in corporate affairs. There was no long term malfunction evident in the company.[78] Thirdly, at the time of the application under section 106 there were numerous court actions and proceedings which might ultimately have had the effect of determining the structure of control in the company. Should the court have anticipated the result of these decisions by calling a meeting which would elect new directors?

There is no real discussion of these points by the court. However, its answer is clearly that the battle for control was hurting both the company and its shareholders. The corporation, for example, was in dire financial straits; its lines of credit had effectively been cut off. Moreover, the directors were spending all their time on the battle for control and not using their best efforts to promote the interests of the company:

> Further to these events, the line of credit of the Company, which was open to $5,000,000 was cut by the Banque Nationale de Paris in Panama. It is in evidence that since then no bank loan has been secured by the Company. If the Company cannot obtain any bank loans in the near future, its financial situation will be quite precarious as it can only cover the next two payrolls. It is in evidence also that the time and energy of many of the directors and officers of the *mis-en-cause* are being directed to the various legal battles and tactics between them. It is the opinion of the Court that the situation of the Company will continue to be seriously prejudiced unless the uncertainty as to the control of its management will be resolved.[79]

The court continued:

> There is no doubt from the evidence that the situation is not only abnormal but detrimental to the best interests of the Company and of its shareholders. The role of directors is to act in a fiduciary capacity for the benefit of the Company. They must spend all their efforts and energy to study all the problems that are related with the good management and to take the most appropriate decisions that will safeguard the assets and promote the development of the Company. Directors should not try to take over the control of the Company for their own personal advantage and with the hope that they will consolidate their power by creating a climate of uncertainty that places the Company in a suspicious position.[80]

With respect to the feasibility of a requisitioned meeting under section 103, it is clear that the court felt that such a meeting would not perform any useful function.[81] With the board of directors effectively split, such a meeting would presumably degenerate into a battle over who was to control the proceedings. This concern obviously led the court to appoint an officer to handle the calling of the meeting, including proxy solicitation, and to ensure its proper functioning. The decision

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[78] *See Re* Morris Funeral Services Ltd., [1957] O.W.N. 161, 7 D.L.R. (2d) 642 (C.A.).

[79] *Supra* note 72, at 443.

[80] *Id.* at 445.

[81] *Id.* at 447.

illustrates, then, that in circumstances of corporate emergencies, the courts may be prepared to intervene and call a meeting where it is not "impracticable" in the sense of "unfeasible" to deal with the matter under the corporate constitution.

B. *Shareholders' Agreements*

In light of their commercial importance, it is rather surprising that there has been so little judicial and academic comment on shareholders' agreements.[82] Any present discussion largely revolves around the validity of shareholders' agreements and the public policy limitations on directors' agreements.[83] This is, of course, in stark contrast to the voluminous literature in the United States.[84] Recently, the Alberta Court of Appeal had to deal with the delicate matter of the interpretation of a shareholders' agreement. Unfortunately, the court's efforts leave much to be desired.

In *Field v. Bachynski*,[85] the company involved, QCTV Ltd., was an Edmonton-based cable television company. The company had obtained a license from the CRTC and now wished to increase its capital. To satisfy the requirements of the federal agency, the founding shareholders decided to issue forty-nine per cent of the company's shares to the public, leaving the founding shareholders with effective control. To secure that effective control, the shareholders entered into a shareholders' agreement. The relevant details of that agreement are worth setting out in full:

> NOW THEREFORE THIS AGREEMENT WITNESSETH that in consideration of the sum of $1.00 lawful currency of Canada now paid by each party to each of the other parties, to this agreement (receipt of which is hereby acknowledged) the parties collectively covenant and agree as follows:
>
> 1. The founding shareholders covenant and agree each with the other and each of them that they will vote, or cause to be voted, their shares in QCTV which they presently own, whether they are personally present, or by their duly appointed proxies or nominees, in the manner as hereinafter provided, as a single unit, and in the same manner as each of the other parties to this agreement, *so that effective control of the shares of QCTV is exercised by the founding shareholders in the best interest of each party hereto, and of QCTV.*

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[82] *See generally* Pickering, *Shareholders' Voting Rights and Company Control*, 81 L.Q. R. 248 (1965).

[83] *E.g.* Ringuet v. Bergeron, [1960] S.C.R. 672, 24 D.L.R. (2d) 449, *aff'g* [1958] Que. Q.B. 222 (C.A.); Motherwell v. Schoof, [1949] 2 W.W.R. 529, [1949] 4 D.L.R. 812 (Alta. S.C.); Atlas Dev. Co. v. Calof, 41 W.W.R. 575 (Man. Q.B. 1963). *See now* CBCA, s. 140(1). In Bill S-2, cl. 39(1) will add s. 140(2.1) which makes it clear that a single shareholder can enter into a unanimous shareholder agreement. It is believed that this practice is a trend being adopted by some American parents of wholly-owned subsidiaries. *See also* cl. 39(2), which makes it clear that a director from whom power is withdrawn is not liable under s. 114 of the CBCA.

[84] *See generally* W. PAINTER, CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS 109-20 (1971); F. O'NEAL, Vol. 1, CLOSE CORPORATIONS: LAW AND PRACTICE ch.5 (1971).

[85] 1 A.R. 491 (C.A. 1977).

2. In order to better fulfill the intent of paragraph 1 hereof, the founding shareholders covenant and agree each with the other, that they will, during the currency of this agreement as herein provided, vote all of the common shares without nominal par value of which they are the registered owners in QCTV, in the manner *and in accordance with the majority vote as hereinafter provided, of the founding shareholders*, and each founding shareholder covenants and agrees with the other founding shareholders, *that the decision of the majority as hereinafter provided* shall be binding upon his or its shares so as to ensure that the whole of the common shares of which the founding shareholders are the registered owners will be voted as a single unit; and the founding shareholders further covenant and agree that he or it will give his or its duly executed proxy, in the form attached hereto as Schedule "A", to a nominee who shall be selected from amongst the founding shareholders, and that the nominee so selected as hereinafter provided, *shall vote all of the shares of the founding shareholders in accordance with the written instructions of the majority decision of the founding shareholders*; PROVIDED ALWAYS, each of the founding shareholders covenants and agrees with the other founding shareholders that he or it will not attempt to vote his or its shares in QCTV at any general or special shareholders meetings of QCTV, after he or it has given his or its duly executed proxy in accordance with the provisions of this paragraph.
3. The founding shareholders further covenant and agree each with the other as follows:
   a) A meeting of the founding shareholders (hereinafter called "the Meeting") shall be held at least seven clear days before the date prescribed in any notice of annual or special general meeting of the shareholders of QCTV;
   b) The Secretary-Treasurer of QCTV shall serve a notice in writing upon each of the founding shareholders at his registered address as provided to QCTV, specifying a time, place, and date for the said meeting in accordance with paragraph a) above;
   c) *Such a meeting shall be convened and held in accordance with the Articles of Association of QCTV;*
   d) The founding shareholders shall vote upon each item of business as specifically set forth in the Notice of annual or special general meeting, *and the majority decision of the founding shareholders either personally present or represented by their duly appointed proxies shall be binding upon the minority* so that all of the common shares in QCTV presently owned by the founding shareholders shall be voted as a single unit;
   e) Any shareholder may propose any resolution which may properly come before an annual or special general meeting of QCTV, and *a vote on any such resolutions shall be in accordance with paragraph d) above;*
   f) The founding shareholders shall appoint one of their number as their nominee to be present at any annual or special general meeting of QCTV, and the said nominee shall be instructed in writing *as to the binding majority decision of the founding shareholders on each item* of business on the said Notice of annual or special general meeting, or as to the decision upon any resolution proposed by any of the founding shareholders, and the said nominee shall be given a proxy by the founding shareholders as hereinbefore provided in paragraph 2., to vote all the shares owned by the founding shareholders only in accordance with the written instructions received from the Chairman of the meeting.
   g) The President, or failing him, any other officer of the Company in

attendance and authorized at the said meeting, shall provide to the nominee a letter stating what person was appointed as nominee of the founding shareholders, *and setting forth the majority decisions of the founding shareholders as hereinbefore provided.*[86]

Clauses 4 and 5 of the agreement read as follows:

4. The founding shareholders further covenant and agree not to transfer, sell, dispose of, assign or otherwise deal with the shares in QCTV of which they are presently the owners except as hereinafter provided:
   a) Any founding shareholders receiving an offer to purchase his shares in QCTV, or wishing to sell his shares in QCTV, (hereinafter called 'the offeror') shall serve a notice in writing on the Secretary of QCTV, who shall in turn notify in writing the other founding shareholders and parties to this agreement (hereinafter called 'the offerees') advising of the intention of the offeror to sell his or its shares, and the terms and conditions contained in the Notice of Offer from the offeror;
   b) The remaining founding shareholders or such of them as shall desire to purchase all or any of the offeror's shares, shall have an irrevocable right of first refusal for a period of thirty (30) days from receipt of written notice from the Secretary of QCTV to purchase on a pro rata basis (as determined by the proportion of shares held by each of the founding shareholders desiring to purchase the offered shares to the total of all shares held by founding shareholders in the initial offer, and subsequent re-offerings as required until all of the offeror's shares are purchased), all of the offeror's shares in QCTV on the same terms and conditions as contained in the Notice of Offer from the Secretary of QCTV. The purchase price of the offeror's shares shall be payable upon acceptance by any offeree on the terms and conditions contained in the original Notice of Offer to the Secretary of QCTV.
   c) Should the offerees not agree to purchase the offeror's shares within the said period of thirty (30) days, the offeror's offer shall be deemed to have been refused.
   d) In the event that the offerees, or any one of them, refuse, or are deemed by the terms of this agreement to refuse the offeror's offer as above provided, the offeror may effect the sale of his or its shares in QCTV to any other person or persons or corporate entities, on the same terms and conditions as originally offered to the founding shareholders, PROVIDED ALWAYS, the offeror shall provide upon request of the purchaser a Statutory Declaration setting forth the price and terms and conditions in his original offer to the offerees, and as a further condition precedent to any such sale:
      (i) The proposed purchaser of the offeror's shares shall agree to take such shares subject to all of the covenants, warranties and conditions contained in this agreement as if the said proposed purchaser were one of the founding shareholders, and an original signatory to this agreement. . . .
5. The founding shareholders further covenant and agree that any of them may, upon the written approval or consent of the Canadian Radio-Television Commission, and without the prior written approval or consent of any other founding shareholders, transfer, sell, assign or otherwise dispose of their shares in QCTV to their personal corporation, and/or their spouse, and/or their spousal trusts, and/or their children; provided however, the transferee(s) of any founding shareholder or anyone purchasing from a founding shareholder such shares in QCTV agree to remain bound by the terms and conditions of this agreement by signing the same where indicated herein.[87]

[86] *Id.* at 494-97 (emphasis of McGillivray C.J.).
[87] *Id.* at 503-04, 505-06 (emphasis of McGillivray C.J.).

Once the public offering was made the company operated successfully. However, after a period of time relationships between the plaintiff and defendant shareholder groups began to sour. By September 1974, the defendants had decided that they wished to replace the general manager. To effect that aim, they entered into a second agreement whereby all agreed that they would vote their shares, which constituted a majority of those subject to the agreement, in favour of a named board of directors. They also agreed to certain restrictions on the transfer of their shares. At the November 6th, 1974 meeting of the founding shareholders, a poll vote was requested by the defendants and as a result of that vote, the shareholders were bound to vote all shares for the defendants' slate of directors. The meeting to elect the directors was never completed. The plaintiffs then instituted an action to strike down the shareholders' agreement and, in particular, the motion passed at the November 6th meeting.

For present purposes there were two main arguments: first, that voting under the shareholders' agreement was to be by hand, rather than by poll; secondly, that the second agreement by which the defendants undertook to vote their shares in a group within the founding shareholders' meeting was void as it was inconsistent with the original agreement. Laycraft J. disposed of both these questions at the Trial Division in favour of the defendants.[88] A majority in the Appellate Division reversed that decision.

The majority decision on voting procedure was given by McGillivray C.J. His Lordship accepted that clause 3(c) was an important factor in the question. He concluded, however, that the clause did not necessarily apply to voting procedures, but to the procedure for holding the meeting. The voting procedure was dealt with expressly in clauses 3(d) and (e).[89] In fact, the Chief Justice felt that the voting procedure, if it was to be governed by the articles of association, would be better dealt with under the procedure for directors' rather than shareholders' meetings since a meeting under the auspices of a shareholders' agreement was more analogous to the former.[90] In looking at the intention of the parties then, McGillivray C.J. concluded that each party should have one vote each, rather than have the votes computed by the number of shares.[91] It seemed unreasonable that the plaintiffs would want to give up their votes in the company by entering into an agreement whereby that voting power would be lost. However, by analogy to partnership law, members of the agreement had to act in good faith toward one another in deciding what was in the best interests of the company. Accordingly, it was not unreasonable to suppose that majority shareholders should give up the right to vote so as to ensure the fifty-one per cent

[88] (Alta. S.C. Jan. 27, 1976, No. 89739).
[89] *Supra* note 85, at 501.
[90] *Id.* at 502.
[91] *Id.* at 500.

holdings would be ruled as a block. Perhaps the appropriate answer is that it is even more unreasonable to suppose that shareholders who had a greater number of shares would be willing to put themselves in a position whereby they would lose any vote because they had a smaller head count!

It is submitted, with respect, that the Chief Justice's conclusion is incorrect. In the first place, the analogy of a shareholders' agreement to a board of directors seems quite inappropriate. There is no authority for the proposition that shareholders must subjugate their own interests to the interests of the company in the same way as directors. In fact the agreement contemplates not only the best interests of the company, but also of the *parties thereto*.[92] Secondly, in my view the wording of the agreement was quite clear. The procedure of the meeting was to be as outlined in the articles of association. These articles in clauses 45 and 46 specifically contemplated a poll vote. Clauses 3(d) and (e) of the shareholders' agreement in fact had nothing to do with the *procedure* of voting. In an excellent dissenting judgment, Moir J.A. outlined some other reasons for reaching this conclusion.[93] The parties had always proceeded on the basis that a poll vote would be permitted. One of the plaintiffs had attempted to buy shares from the defendants to decrease the size of their holdings. Moreover, to give effect to a shareholder intention of one vote per person would lead to ludicrous results. It would mean that the company could be controlled by five shareholders with 15.9 per cent of the shares. Also, it quite unfairly prejudiced the position of the defendants who owned 25.3 per cent of the company but had put their shares into a holding company, apparently to avoid any conflict with their position as well-known businessmen and lawyers. Could these people have intended that they were going to have only one vote?[94]

In my opinion then, the decision on this point is wrong. It subjugates the majority shareholders to the control of the minority. To accomplish this and effectively remove the majority's vote, one would need explicit language which was not present in this case.[95] The

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[92] *See* cl. 1.

[93] *Supra* note 85, at 520-23.

[94] The other possibility not discussed by Moir J. was that the whole voting pattern could be changed by the founding shareholders selling their shares to a number of friendly individuals or to members of their family or personal corporations. The Chief Justice's response to this was that cls. 4 and 5 of the agreement provided that a shareholder must sell *all* of his shares to one purchaser and that if the transfer was to a member or members of his family, all purchasers would have only one vote (*see id.* at 503-07). While McGillivray C.J.'s interpretation is feasible, the clauses certainly do not state this result expressly and the contrary view can be forceably argued.

[95] It is interesting to compare this case with the American decisions on whether a minority shareholder can be given votes pursuant to a shareholders' agreement which gives him a control factor much greater than his actual shareholding would justify. *See* Nickolopoulos v. Sarantis, 102 N.J. Eq. 585, 141 A. 792 (App. Div. 1928); Katcher v. Ohsman, 26 N.J. Super. 38, 97 A. 2d 180 (Sup. Ct. 1953). *See*, for a discussion of this point, O'NEAL, *supra* note 84, at para. 5.13.

decision is particularly unfortunate in that this issue was raised only after an adjournment of trial and the filing of an amended statement of claim. Perhaps the case will not have a very wide impact; most shareholders' agreements require unanimous agreement. The Chief Justice's comments concerning the obligations of parties to an agreement may, however, combine to have wide application. In the final analysis, the decision holds an important lesson for corporate lawyers: draft explicitly and do not leave matters up to the courts for interpretation.

The second point argued by the plaintiffs was that the agreement to elect directors entered into by the defendants was inconsistent with the original agreement. Chief Justice McGillivray did not rule on the matter, but Prowse J.A. concluded that such an agreement was in fact illegal. His Lordship, after discussing the duties owed by members of partnerships and the board, and concluding that parties to the agreement had a duty to act in good faith, stated:

> In my view the principle enunciated in those cases applies equally in the present circumstances. Under the voting trust agreement the parties had an obligation to act in good faith and make their decision at a meeting. The meeting contemplated by the agreement was one at which decisions would be made by persons whose ability to act was unfettered, who would put forward views, listen to the views of others and, acting in good faith, make a decision. The respondents in coming to a meeting bound by the terms of the second agreement made a mockery of the spirit and expressed intent of the terms of the voting trust agreement.[96]

With respect, this interpretation completely ignores the reality of twentieth century corporate life. Once again, his Lordship seems to suggest that shareholders under an agreement are subject to some implicit fiduciary duty. There is no authority for this approach and it is quite unrealistic. Shareholders are also supposed to be unfettered and to be able to put forward views at a general shareholders' meeting. Obviously, this does not usually happen. In the present case, the losing shareholders under the shareholders' agreement were *prohibited* from voting in an unfettered manner. Is there anything inherently different between a general meeting and a meeting of shareholders under an agreement?[97] Moreover, the second agreement was primarily limited to the election of directors. The shareholders had decided *what in their view was in the best interests of the company* — no subsequent meeting was going to change their minds. Finally, his Lordship seems obsessed by the fact of a signed paper. The plaintiffs had for some time been grouped together and it is obvious that they had agreed to vote together. Should their less formal agreement also be void? The trial

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[96] *Supra* note 85, at 510-11.

[97] Although as an aside comment, one must admit that the courts, as evidenced by the decisions in Clemens v. Clemens, [1976] 2 All E.R. 268 (Ch.), and Diligenti v. RWMD Operations Kelowna Ltd., 1 B.C.L.R. 36 (S.C. 1976), appear to be a little more willing recently to apply equitable principles to close corporations.

judgment of Mr. Justice Laycraft, in which he emphasized the real freedom that shareholders have in voting their shares even under a shareholder agreement is, it is submitted, much preferable.[98]

C. *Inspection of a Company's Affairs*

All provincial statutes[99] and the federal Act[100] contain provisions authorizing shareholders to apply to court for an order appointing an inspector to investigate the affairs of a company. These provisions vary widely in approach but they all have a common theme: they are designed to enable shareholders to obtain information about corporate activities, particularly financial material, when they feel that there has been some wrongdoing.[101] The sections are closely linked with other remedial provisions in the statutes and with the common law, since any information obtained may serve as the basis for more substantial actions against the company's directors or possibly a winding up or oppression application. Somewhat surprisingly, there has been little judicial discussion of the effect of such sections,[102] although there have been two recent decisions of interest.

In *Baker v. Paddock Inn Peterborough Ltd.*,[103] the applicants were minority shareholders of a company whose business was the operation of motels. Although generating a substantial revenue, the company was still operating at a loss. Disagreement arose over the management of the corporation and the applicant directors were disturbed that none of their advice was being accepted. Moreover, there was evidence that many procedural niceties of corporate law were not being followed. Accordingly, the applicants, two of whom were directors of the corporation, applied for a court ordered investigation under section 186 of the Ontario Business Corporations Act.

The court dismissed the application. Galligan J. felt that the main reason for section 186 was to force an audit when it was apparent that the books of the company were not being properly kept, although he

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[98] *Supra* note 88, at 16-18.

[99] *E.g.* ACA, ss. 160, 161; OBCA, s. 186; BCCA, s. 230.

[100] CBCA, ss. 222-30.

[101] *See* PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA, *supra* note 18, at 153ff.

[102] *See, e.g., Re* H. Flagal (Holdings) Ltd., [1966] 1 O.R. 33, 52 D.L.R. (2d) 385 (H.C. 1965) (investigation of a subsidiary); *see now, e.g.*, CBCA, s. 222 — "affiliated corporations"; R. v. Board of Trade, [1965] 1 Q.B. 603, [1964] 2 All E.R. 561; *Re* Automatic Phone Recorder Co., 15 W.W.R. 666 (B.C.S.C. 1955); *Re* Charles J. Wilson Ltd. and Nuform Investment Ltd. (Ont. H.C. 1974) (allegations against directors, not against the financial situation of company; rights could be enforced pursuant to a shareholders' agreement rather than necessitating an investigation pursuant to s. 186 of the Ontario Act). *See also Re* Presswood and Int'l Chemalloy Corp., 20 C.B.R. (N.S.) 275, 65 D.L.R. (3d) 228 (Ont. H.C. 1975) (discussion of the effect of solicitor-client privilege in the context of court ordered investigations in Ontario). See CBCA, s. 229 BCCA, s. 234.

[103] 16 O.R. (2d) 38, 2 B.L.R. 101 (H.C. 1977).

envisaged there may be other bases for court intervention. However, while his Lordship stated that the power to intervene was an extremely important one, it was one that had to be utilized with caution in the case of a private company. In the present case there was no evidence of bad faith or serious mismanagement, merely a difference over management of the corporation between majority and minority shareholders.[104]

No one would argue with these sentiments so long as the courts exercise their discretion to intervene in a responsible manner; the line between an intra-corporate policy dispute and serious mismanagement may be difficult to assess. Often the only means of obtaining sufficient information to commence a derivative action will be through an inspection.[105] One slight problem does, however, arise with another comment by Galligan J.:

> In my opinion, the power of the Court to intervene in the affairs of a private corporation is an important and vital one, but it is one that ought to be exercised with caution. The section provides that the application must be *prima facie* in the interests of the corporation or the holders of its securities. It is to be noted that the applicants Patrick Baker and Tom Brown are directors of the company. I see nothing in the material that suggests that they have been denied access to or production of any of the company's books or records. There is no evidence in the material to make me suspect that the company would prevent or interfere with any inspection of the books and records by an accountant chosen privately by the applicants if they wished to conduct any audit or inspection themselves. It does not seem to me that a Court should appoint someone to inspect and audit the books of a private corporation if the shareholders who wish that relief do not establish that they cannot get it privately.[106]

The point of concern is in his Lordship's reference to shareholders of a private company. Such people are not given access to the minutes of directors' meetings or the detailed accounting records.[107] It may be that Galligan J. was influenced in his decision by the fact that two of the applicants were directors who would, in the normal course of events,[108] have such access. It may also be that his Lordship was simply saying shareholders should *ask* to see the records. If the intention, however, was to suggest that shareholders make a formal effort to view such records, the *dictum* is incorrect. Such a step should not be a necessary prerequisite to an inspection order.

The second decision of note is that of the British Columbia Supreme Court in *Re Peterson and Kanata Investments Ltd.*[109] This case is

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[104] *Id.* at 40, 2 B.L.R. at 104-05.

[105] *But see Re* Automatic Phone Recorder Co., *supra* note 102. *Quaere* whether a contrary conclusion would be reached under the broader language of s. 22 of the CBCA or whether the court would order the claim to be made under the oppression and derivative action sections.

[106] *Supra* note 104, at 40, 2 B.L.R. at 104-05.

[107] *See* OBCA, s. 162; CBCA, ss. 20(1), 21(1); BCCA, ss. 186(1), 187(1) and (2).

[108] *See* Conway v. Petronius Cleaning Co., [1978] 1 W.L.R. 72 (Ch.).

[109] 60 D.L.R. (3d) 527 (B.C.S.C. 1975).

important, however, not so much for the British Columbia legislation but as an illustration of cases likely to arise under Part XVIII of the CBCA. The inspection and audit sections throughout the country generally fall into two categories. There are those, like section 186 in Ontario, which permit an investigation where the application is made in good faith and where it is in the best interests of the corporation, and section 160 of the Alberta Act where the shareholders (ten per cent) must show good reason. The CBCA and more recent statutes[110] adopt a different approach. Section 222 of the federal Act reads:

> 222(1) A shareholder or the Director may apply, *ex parte* or upon such notice as the court may require, to a court having jurisdiction in the place where the corporation has its registered office for an order directing an investigation to be made of the corporation and any of its affiliated corporations.
>
> (2) If, upon an application under subsection (1), it appears to the court that
>
> (a) the business of the corporation or any of its affiliates is or has been carried on with intent to defraud any person,
>
> (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder,
>
> (c) the corporation or any of its affiliates was formed for a fraudulent or unlawful purpose or is to be dissolved for a fraudulent or unlawful purpose, or
>
> (d) persons concerned with the formation, business or affairs of the corporation or any of its affiliates have in connection therewith acted fraudulently or dishonestly,
>
> the court may order an investigation to be made of the corporation and any of its affiliated corporations.

This section closely corresponds to the oppression remedy[111] and it has been somewhat unclear how the courts would exercise their discretion. The British Columbia case is relevant in that it gives some idea as to the scope of the federal section.

In *Re Peterson and Kanata Investments Ltd.*, three applicants applied for an investigation of the company. They held 15,000 Class A voting shares. The alleged wrongdoer, a Mr. McBride, held 140,000 Class B voting shares with no par value which had been issued to him for one cent per share. These shares gave him effective control of the corporation. Kanata Investments Ltd.'s main investment was 33,907 Class A shares with a par value of $2 cash in Empire Acceptance Corp. Another company, beneficially owned by McBride, Monashee Financial Corp., held 350,001 Class B voting shares of Empire. These shares had been issued at seven cents per share. McBride also held the

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[110] *E.g.* SBCA, s. 222; MCA, s. 222.

[111] CBCA, s. 234. Note specifically that in s. 234(3)(m), the court has the power to order an investigation under Part XVIII.

position of general manager of Empire under a ten year contract at an annual salary of $22,000.

In 1974, a group headed by one Hughes attempted to gain control of Empire and McBride made every attempt to prevent the takeover by persuading shareholders of Empire not to sell their shares. However, in August 1974, McBride signed a contract with the Hughes group. That contract, entered into on behalf of McBride, Kanata, and Monashee provided basically as follows:

1. Monashee would sell its shares in Empire for $59,500;
2. Kanata would sell its shares in Empire for $67,814;
3. McBride would receive $100,000 as compensation for giving up his position as general manager of Empire.

These factors, plus an alleged failure to disclose the entire contents of the contract, led the applicants to commence the present application. As a consequence of the application, McBride stated it was his intention to wind up Kanata and at the same time called in $17,000 owing by Kanata to Monashee and McBride personally. With the $67,000 received on the sale of the Empire shares, this would result in most shareholders in Kanata receiving approximately fifty cents on the $1 they had invested in the company.

Toy J. of the British Columbia Supreme Court found that the applicants could not utilize the investigation remedy due to the technical wording of section 230(1).[112] What is of interest, however, is that his Lordship held that the oppression remedy in section 221(1) could be applied. He found that the facts outlined above amounted to a cause of conduct oppressive and unfairly prejudicial to the applicants.[113] He ordered the rescission of the sale of Class B voting shares to McBride, thus effectively removing the latter from his control position in Kanata. This would permit a new board of directors to be elected and would allow a meeting of the shareholders, uninfluenced by McBride, to vote on the sale of Kanata shares and the decision to wind up. Any proposed shareholders' meeting to consider the sale was enjoined until a new board of directors was elected. An order was made appointing a receiver-manager to run Kanata until the annual meeting and to have up-to-date financial statements prepared.

Thus, the oppression section appears to have provided an adequate remedy. It seems clear that in similar circumstances, a court under the CBCA would find a breach of section 222(2)(b) in that McBride had acted in a manner which was oppressive or unfairly prejudicial towards the security holders. Presumably, the court would not adopt the same

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[112] Due to the fact that the section required *one* shareholder owning not less than 20% of the shares to make apptication, and not several. This has now been amended (S.B.C. 1976 (1st sess.) c. 12, s. 48) and currently one or more shareholders holding 20% can make the application.

[113] *Supra* note 109, at 543.

remedies as in *Re Peterson and Kanata Investments Ltd.*; the application is for an investigation and it would be inconsistent with the application to order a rescission of shares. However, the court does have jurisdiction to enjoin any meeting of shareholders while the investigation is taking place and information flowing from the investigation might well provide the basis for a derivative action or an oppression application under sections 232 and 234 respectively. The unlimited jurisdiction of the court under the remedial sections would then come into play.[114]

D. *Proxies*

By now, most provincial corporate statutes and the federal Act[115] contain detailed provisions dealing with the solicitation of proxies, mandatory solicitation and information circulars. While these provisions remain largely uninterpreted by the courts, two recent decisions illustrate some of the problems one is likely to run into under the new legislation.

In *Western Mines Ltd. v. Sheridan*,[116] the defendant shareholder was upset with the management of the plaintiff company and wrote to the other shareholders, expressing his desire that certain of its directors be replaced at its next meeting. No official request was made to become proxy for such shareholders but the plaintiff felt that the letter itself constituted a solicitation of proxies within section 1 of the British Columbia Companies Act. That section reads:

> "solicit" and "solicitation" include
>
> (c) the sending or delivery of a form of proxy *or other communication* to a member *under circumstances reasonably calculated* to result in the procurement, withholding, or revocation of a proxy.(emphasis added)

McKenzie J. concluded that the defendant's letter did not constitute a solicitation:

> As I construe the authorities, a shareholder is free to communicate with his fellow shareholders, to be critical of the company's policy, to urge reform, and, generally speaking, to exercise his freedom of speech to the limit except insofar as that freedom is curtailed by the Statute. The freedom is at large subject to restriction with respect to certain kinds of communication. The kind of communication that is forbidden here is a specific one. It specifically forbids, under penalty of summary conviction, the sending of a communication which is reasonably calculated to result in the procurement of a proxy.
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> On the facts of this case, I cannot find that the Sheridan letter, reasonably construed, is within that definition. I use the word "definition" although it is

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[114] CBCA, ss. 233, 234(3).

[115] *See, e.g.*, CBCA, ss. 141-46 and S.O.R./75-682 (110 Can. Gazette, Pt. II, 3163); ACA, ss. 137-44; OBCA, ss. 115-21, and R.R.O. 1970, reg. 78. *See also* the various securities acts.

[116] (B.C.S.C. Oct. 10, 1975). An excellent succinct discussion of the case can be found in Getz, Comment, 1 CAN. BUS. L.J. 472 (1976).

> not really a definition. But unless it can be fitted in within the four corners of the language employed by the legislature in describing what the word "solicitation" includes, then I believe that the communication cannot and should not be forbidden.[117]

It is interesting to compare the judge's conclusion and literal approach with the general comments of Bloomenthal[118] on solicitation. The letter stated that it was the defendant's "intention to *solicit* your support in electing a Board of Directors of Western Mines Ltd. which will properly represent the interests of all the shareholders of the company" and "*it is our intention at this meeting to ask you to join with us* in electing a Board of Directors that will accomplish this end for the benefit of the shareholders".[119] Bloomenthal states that one solicits where in preliminary activities one makes an effort to influence how shareholders vote or where one attempts to condition shareholders for an ultimate request for a proxy. Both these situations are illustrations of what Judge Learned Hand called a continuous plan intended to end in solicitation and to prepare the way for success.[120] As Getz states,[121] in an excellent criticism of the case, there can be little doubt that the letter in *Western Mines* fitted within these sentiments and amounted to a solicitation within the definition.

If one accepts McKenzie J.'s analysis, what is there to prevent minority shareholders misrepresenting the position of the incumbent management or inciting shareholders against directors in preliminary letters? What is perhaps more important is that his Lordship's narrow interpretation and rejection of the American approach may set a trend in the judicial consideration of the proxy legislation. What if, for example, a minority shareholder wrote to other shareholders after management proxies had been sent out and told them not to revoke or withhold the proxy, but simply to vote against management on vital issues? Clearly this does not fit within the definition of solicitation in the British Columbia Act. Equally clearly, the definition is only exemplary and such a letter would fall within the spirit and intent of the legislation. McKenzie J.'s judgment in *Western Mines* suggests that his Lordship's response would be that such a letter did not amount to a proxy. That judgment is narrow, wrong and should not be followed.

The second decision of some interest is that of the Ontario High Court in *Goldhar v. D'Aragon Mines Ltd.*[122] The applicants requisitioned a shareholders' meeting for the purpose of removing the

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[117] *Id.*

[118] H. BLOOMENTHAL, SECURITIES & FEDERAL CORPORATE LAW 13:15(1) (Release No. 6, 1977).

[119] *Supra* note 116.

[120] Securities and Exchange Commission v. Okin, 132 F. 2d 784, at 786 (2d Cir. 1943).

[121] Getz, *supra* note 116.

[122] 15 O.R. (2d) 80, 1 B.L.R. 204, 75 D.L.R. (3d) 16 (H.C. 1977).

directors and substituting certain named individuals. On calling a general meeting, the incumbent directors issued a proxy form which gave the shareholder a choice of voting for or against the resolution to remove the existing directors but gave unfettered discretion to the nominee to vote to reinstate them. Indeed, if a management nominee was accepted and instructed to cast a vote *against* the incumbent board, then the terms of the proxy and the information circular clearly indicated that the nominee would vote the share in *favour* of re-electing the incumbent board.[123]

The response of Holland J. was:

> It appears to me that the form of proxy sent out by management is not only unfair but also does not provide to the shareholders the choice of either maintaining the existing board on the one hand or removing the directors and substituting those nominated by the applicants on the other. The proxy does not permit the shareholders to exercise their choice in connection with "the transaction of the business stated in the requisition" under section 109(3) at [*sic*] the Act.[124]

One can understand and sympathize with Holland J.'s conclusion. I have never really appreciated the rationale of section 120(b) of the Ontario Act, nor of provincial statutes[125] which provide for no choice on a proxy form in the election of directors. The usual response is that the voter may withold his proxy but the *Goldhar* case illustrates how this theory breaks down when more than one issue is raised in the proxy. At the same time, his Lordship's conclusion must be incorrect. The Act states that there need be no choice in a proxy form where the election of directors is involved. Section 109(3) does not override the proxy sections. Indeed, section 109(3) is really no more specific than section 108 which requires that the directors must state the general nature of any business specified in the notice. Would anyone suggest that there should be a choice in the election of directors at a general meeting?

E. *Auditors' Liability*

For many years academics have complained of the legal standards applied to auditors.[126] The decision in *Re Thomas Gerard & Son, Ltd.*[127] hardly improved the situation. The decision of the New South Wales Supreme Court in *Pacific Acceptance Corp. v. Forsyth*[128] has subsequently laid down standards, however, which will ensure a reason-

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[123] *Id.* at 82, 1 B.L.R. at 208, 75 D.L.R. (3d) at 18.
[124] *Id.* at 82-83, 1 B.L.R. at 208, 78 D.L.R. (3d) at 18-19.
[125] *E.g.* ACA, s. 142(b).
[126] Baxt, *The Modern Company Auditor — A Nineteenth Century Watchdog?*, 33 MODERN L. REV. 413 (1970).
[127] [1968] Ch. 455, [1967] 2 All E.R. 525.
[128] 92 W.N.(N.S.W.) 29 (S.C. 1970).

able standard by auditors in their dealings with the corporation. The one area left uncertain is the obligation of auditors to shareholders or other third parties who suffer detriment in relying on negligent misstatements by auditors. This problem is not so much one of determining the fact of whether an auditor has done his work properly, but whether he owes a duty to advise these parties to be careful.

In *Haig v. Bamford*,[129] the Supreme Court of Canada had to deal with this contentious issue for the first time. The facts were very straightforward. The plaintiff invested money in a private company, relying on a financial statement prepared by the defendants which treated as earned revenue a $28,000 advance in respect of completed contracts. The statement gave rise to the inference that it had been audited when, in fact, no audit had been done. The plaintiff had clearly relied on the financial statement, but while the defendants knew the financial statement would be used to induce investors they did not know the identity of the plaintiff. The company collapsed, but not until after the plaintiff had attempted to save it by putting in another $2,500 to meet a payroll. On these facts, the Saskatchewan Queen's Bench found the defendants liable. The Court of Appeal reversed on the basis that there was no specific person or group in mind as potential investors. The Supreme Court of Canada restored the trial decision.

There was no question of the accountants' error. The issue was simply whether or not a duty of care was owed to the plaintiff. Dickson J. began on a promising note; his Lordship's judgment clearly indicates an appreciation of the role accountants play in the modern business world:

> The increasing growth and changing role of corporations in modern society has been attended by a new perception of the societal role of the profession of accounting. The day when the accountant served only the owner-manager of a company and was answerable to him alone has passed. The complexities of modern industry combined with the effects of specialization, the impact of taxation, urbanization, the separation of ownership from management, the rise of professional corporate managers, and a host of other factors, have led to marked changes in the role and responsibilities of the accountant, and in the reliance which the public must place upon his work. The financial statements of the corporations upon which he reports can affect the economic interests of the general public as well as of shareholders and potential shareholders.
>
> With the added prestige and value of his services has come, as the leaders of the profession have recognized, a concomitant and commensurately increased responsibility to the public. It seems unrealistic to be oblivious to these developments. It does not necessarily follow that the doors must be thrown open and recovery permitted whenever someone's economic interest suffers as the result of a negligent act on the part of an accountant.[130]

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[129] [1977] 1 S.C.R. 466, [1976] 3 W.W.R. 331, 72 D.L.R. (3d) 68, *rev'g* [1974] 6 W.W.R. 236, 53 D.L.R. (3d) 85 (Sask. C.A.), *rev'g* [1972] 6 W.W.R. 557, 32 D.L.R. (3d) 66 (Sask. Q.B.).

[130] *Id.* at 475-76, [1976] 3 W.W.R. at 338, 72 D.L.R. (3d) at 74.

His Lordship then proceeded to discuss the three alternative tests that could be applied to invoke a duty of care. These were: (a) the basic foreseeability test and reliance on any financial statement; (b) actual knowledge of the limited class that will use and rely on the statement; (c) actual knowledge of the specific plaintiff who will use and rely on the statement. Dickson J. decided he did not have to decide point (a).

After discussing relevant American and Commonwealth authorities, Dickson J. held, not surprisingly, that alternative (b) was preferable. There was no importance in the fact the defendants did not know the plaintiff's name. There was no difference between an accountant directly giving a document to a plaintiff and an employer giving the information, with the knowledge of the accountants, to a member of a limited class of people in furtherance of a transaction the nature of which is known to the accountants. Accordingly, the defendants were liable.[131]

No one could complain about this decision. Public policy would prohibit a conclusion that a duty is owed only to individual plaintiffs. Yet the decision is disappointing. Liability to a limited class known to be interested in a specific transaction is hardly a revolutionary development. The disappointing issue is that Dickson J. refused to give any indication of where the courts' sympathies would lie when the foreseeability test arose in the case of a member of an unlimited class relying on inaccurate financial statements.

The only indication in Dickson J.'s judgment as to whether he would sanction an extension of liability lies in the following statement:

> It does not necessarily follow that the doors must be thrown open and recovery permitted whenever someone's economic interest suffers as the result of a negligent act on the part of an accountant. Compensation to the injured party is a relevant consideration but it may not be the only relevant consideration [132]

Similar statements were expressed by the Ontario High Court in *Toromont Industrial Holdings Ltd. v. Thorne, Gunn, Helliwell & Christenson*.[133] In discussing the question of duty of care, the court stated:

> One might think that a firm of auditors in certifying financial statements of a public company would expect that the statements and certification would be relied on by any number of companies or individuals, such as bankers, investors, lenders or suppliers. The Courts realized that to recognize such a duty might cause vast liability, which I suppose might be impossible to cover by insurance or increased fees.[134]

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[131] *Id.* at 483-84, [1976] 3 W.W.R. at 345, 72 D.L.R. (3d) at 80. *See* Paterson, Comment, 2 CAN. BUS. L.J. 68 (1977) for a very good discussion of the Supreme Court decision. *See also* Thorne, Gunn, Helliwell & Christenson v. Edrow Investments Ltd. (B.C.S.C. Oct. 18, 1974).

[132] *Id.* at 476, [1976] 3 W.W.R. at 338, 72 D.L.R. (3d) at 74.

[133] 10 O.R. (2d) 65, 62 D.L.R. (3d) 225 (H.C. 1975), *varied* 14 O.R. (2d) 87 (C.A. 1976).

[134] *Id.* at 86, 62 D.L.R. (3d) at 246 (*per* Holland J.).

Neither of these comments, however, provide any real indication of how Canadian courts would respond to the question.

In *Scott Group Ltd. v. McFarlane,*[135] the point was considered by the New Zealand Court of Appeal for the first time. The facts are set out succinctly in the headnote:

> The plaintiff had for some years contemplated the possibility of acquiring John Duthie Holdings Ltd, a public company. The latter was first approached by S for the plaintiff through D the managing director of JDH Ltd in 1968 but was not then ready to receive an offer, but the door to future negotiations was left open and thereafter the two companies exchanged annual accounts. The defendants were the auditors of JDH Ltd but were unaware of these negotiations. In 1971 an offer was made by the plaintiff and D consulted a member of the defendant's firm and acting upon his advice made a counter suggestion to the plaintiff. The plaintiff acting upon the counter suggestion acquired the whole of the shares in JDH Ltd and D remained as managing director of JDH Ltd. For some years prior to the takeover the directors and the auditors of JDH Ltd had been aware that there was a problem in the consolidated accounts, but nevertheless the defendant auditors had given an unqualified report each year. The balance date of JDH Ltd was 30 September and the balance dates of all its subsidiaries was 30 June. After the takeover the balance date of JDH Ltd was changed to 30 June and in so doing it was discovered that an error had been perpetuated through all the previous years and consequently the assets of JDH Ltd acquired by the plaintiff had been overvalued by $38,000.
>
> It was admitted that the defendants had been negligent. The plaintiff sued the defendants for damages on the basis of the principles enumerated in *Hedley Byrne & Co Ltd* v *Heller & Partners Ltd* [1964] AC 465; [1963] 2 All ER 575 as refined in *Mutual Life and Citizens' Assurance Co Ltd* v *Evatt* [1971] AC 793; [1971] 1 All ER 150.[136]

The Trial Division found that no duty was owed by the defendants to the plaintiff company. Despite the fact that the company's financial statements were on public file, the auditors only owed a duty to their clients or any third party to whom they showed the accounts or to whom they knew their clients were going to show the accounts.[137] The Court of Appeal reversed the decision so far as liability was concerned and, by a majority, found that the auditors owed a duty of care to the plaintiff. However, Cook J.A., while finding liability, concluded that no loss had been suffered. Accordingly, the appeal was dismissed.

The dissenting judgment was given by Richmond J. After an exhaustive but excellent review of common law jurisprudence, and adopting *Haig v. Bamford,*[138] his Lordship concluded that some limits must be set to liability for negligent mis-statement:

> As I have said, I believe it to be essential to the existence of a 'special relationship' that the maker of the statement was or should have been aware

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[135] (N.Z.C.A. Nov. 18, 1977, No. 875), *rev'g* [1975] 1 N.Z.L.R. 582 (S.C.).
[136] [1975] 1 N.Z.L.R. at 582.
[137] *Id.*
[138] *Supra* note 129.

> that his advice was required for use in a specific type of contemplated transaction. This requirement has not always required emphasis in the course of judicial discussion as to the nature of a special relationship. Probably this is because in most cases the purpose for which the information was required was, on the facts, quite obvious. . . . I would think that it must almost inevitably follow, once the maker of the statement is aware of a specific purpose for which his information will be used, that he will also have in direct contemplation a specific person or class of persons, even though unidentified by name.[139]

Although not abundantly clear, it appears that Richmond J. was heavily influenced by the inequity of holding an auditor liable to people he did not know would definitely use the information.

The majority judgments on liability were delivered by Woodhouse and Cooke JJ.A. The thrust of these judgments and the rationale for the extension of liability beyond what is currently the position in Canada and the United States is admirably illustrated in the following lengthy extract from the opinion of Woodhouse J.A.:

> Was there a relationship between the parties sufficient to give rise to a *prima facie* duty of care? In my opinion there are four broad reasons which require the Court to answer that question, Yes. They are:
>
> (1) The auditors were professionals. They were in the business of providing expert advice for reward. Their work was undertaken voluntarily and their advice was then given in a considered and deliberate way by certifying in effect that the accounts could safely be relied on. It would be a fruitless exercise if they did not intend that the audited accounts could and would be relied on. So their audit report gave an added quality to the accounts and that was its purpose. Certainly there was nothing casual about any aspect of their professional function: of *Mutual Life* v. *Evatt* (*supra*).
>
> (2) Although an audit is undertaken on behalf of the members of a public company it must be within the reasonable contemplation of any auditor that confidence in its ability to handle its commercial arrangements would depend upon the authenticity of its accounts — a confidence that would disappear if reliance could not be put upon the audit report. So I think that when auditors deliberately undertake to provide their formal report upon the accounts of a public company they must be taken to have accepted not merely a direct responsibility to the shareholders but a further duty to those persons whom they can reasonably foresee will need to use and rely upon them when dealing with the Company or its members in significant matters affecting the Company assets and business. An example, no doubt, would be the banker asked to make substantial advances on the security of the Company undertaking. On the other hand there would seem to be formidable difficulties for a plaintiff who attempted to prove that an auditor should have foreseen the plaintiff's likely reliance upon some newspaper or a stock exchange reference to a company's accounts. However, it is sufficient for present purposes to restrict consideration to a takeover offer related, as so frequently is the position, to the value of shareholders' funds. In such a situation the need to rely upon audited accounts is, I think, quite obvious. As a matter of commercial reality I think the auditor and offeror are in a relationship of close proximity.
>
> (3) There is no opportunity in the ordinary case for any intermediate examination of the underlying authenticity of a company's accounts. Nor would it

[139] *Supra* note 135, at 22-23.

> be practicable for numbers of persons to make independent examinations on an individual basis. All this an auditor must be taken to realise when he accepts his delegated function for the shareholders.
>
> (4) The auditors had no direct knowledge of Scott Group or that a takeover from any quarter was contemplated. That lack of knowledge distinguishes the case from *Hedley Byrne* for example. But they undertook the audit knowing that the accounts, together with their report, would become a matter of public record in the Companies Office by reason of s.133 of the Companies Act 1955. That fact cannot involve them in some statutory responsibility to members of the public but it does mean that anybody sufficiently concerned will have direct access to the authenticated accounts when making decisions concerning the Company. In my opinion that last matter is an important reason for the statutory requirement that the audited accounts should be filed annually with the registrar. It enables significant information to become available to those who need it and at the same time, I think, that process complements the administrative oversight of those who have regulation responsibility in terms of the Act.
>
> The second stage of the enquiry is to consider whether there are factors in the case which ought to negative or limit the scope of the duty of care. In my opinion there are not. For reasons touched on earlier I do not think that the imposition of responsibility for negligent advice would lead to an intolerable burden upon auditor defendants. There is the initial need to establish a duty of care situation in terms of the critical requirement of reasonable foresight; and then there is the need to provide evidence in terms of causation. I am satisfied that these matters alone would prevent any risk of an open-ended type of duty. In the area of foresight I have referred to the difficulties likely to face a plaintiff who attempted to show that it could fairly be anticipated that he would act upon some casual reference to a company's accounts. And in the area of causation there would be the further need to show that the plaintiff actually had relied on the information (whether obtaining informally or even in a formal way from the Companies Office or the Company itself) to the point that it had become a real and effective cause of the loss. At least in the present case it is clear that Scott Group obtained the accounts directly from Duthie Holdings.[140]

Both dissenting and majority judgments in *Scott Group v. McFarlane* are well reasoned and provocative. In my view, the judgment of Woodhouse J.A. is correct, if for no other reason than that in the area of tort law, any theory of loss distribution demands that auditors accept responsibility for their negligent acts. After all, it is not only corporations, who are capable of shifting the loss themselves, that may rely on careless documentation. Auditors hold themselves out as professionals and the community accepts their work accordingly. The fact that they know that the audited financial statements will be used for a specific transaction should not make any difference to their ultimate responsibility for the accuracy of their work. At present then, the responsibility of auditors has been substantially increased in New Zealand. It remains to be seen whether Canadian courts will take the same approach. It may be that the broadening of auditors' liability may result in an increase in fees to reflect that risk premium, but this is a cost

[140] *Id.* at 10-13.

which must be borne by the users. Moreover, there is, of course, the possibility of obtaining an exemption from the requirement that an auditor be appointed.

The other aspect of auditors' liability to third parties which has recently arisen is the question of damages flowing from the directors' negligence. The standard test applied is the difference between the price paid and the actual value of the shares received. However, this will not be the quantum in all cases. In particular, it is vital that the plaintiff lead detailed evidence as to the proper value of the shares. Thus, in *Diamond Manufacturing Co. v. Hamilton*,[141] the New Zealand Court of Appeal refused to award damages because the plaintiffs had failed to adduce any evidence of the true value of the shares they received.

A similar conclusion was reached by the Ontario High Court in the *Toromont Industrial Holdings Ltd.* case.[142] Here, the auditors had been found negligent in a relatively minor way and the certificate of the auditors was incorrect. The court held that the purchase of shares would probably have gone ahead even if the errors had been known and the plaintiffs had not proven any other loss:

> It may well be that Mr. McKinnon would have come to the conclusion that the auditors were negligent in the way in which they performed the audit, but the decision to purchase had already been made. The Toromont Board and executive committee were eager to complete the purchase. They made little investigation and were worried about another prospective purchaser lurking in the background. I really do not think that I can say that the purchase would not have been completed, or that the loss flowing from the negligence of the defendant is, in this case, the difference between the purchase price and the true value of the shares.[143]

In other words, the plaintiffs had failed to show that they would have paid any less for the shares even if the true facts had been known. The decision provides a very clear warning for litigation lawyers.

The second Canadian example of damages problems was in *West Coast Finance Ltd. v. Gunderson, Stokes, Walton & Co.*[144] The plaintiff purchased shares in West Coast Finance Ltd., relying on financial statements which had been negligently prepared. The Court of Appeal found that no loss had occurred. The shares had been bought for $1. On a book value basis of valuation, the court found that the shares were worth between $1 and $10 at the time of purchase and no loss had flowed from the negligence, despite the fact that at the time of purchase the plaintiff believed they had a value of $1.42.

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[141] [1969] N.Z.L.R. 609 (C.A.).

[142] *Supra* note 133.

[143] *Id.* at 94, 62 D.L.R. (3d) at 254.

[144] [1975] 4 W.W.R. 501, 56 D.L.R. (3d) 460 (B.C.C.A.), *rev'g* [1974] 2 W.W.R. 428, 44 D.L.R. (3d) 232 (B.C.S.C.).

This very problem of what constitutes a loss arose to be decided by the New Zealand Court of Appeal in *Scott Group Ltd. v. McFarlane*.[145] While the shares in that case would be decreased in value due to the overstatement of the profit by $38,000, the value of the shares received on the takeover bid still exceeded the price paid for them. Unfortunately, the two judges who dealt with the issue had different views.

Cooke J.A. found that on these facts no damage had been suffered by the plaintiff. Following the approach in *McConnell v. Wright*,[146] his Lordship concluded that the plaintiff had only made a smaller profit than might otherwise have been the case. While he agreed the plaintiff might have offered a lower price, this was irrelevant as the plaintiff had suffered no *damage* by the defendant's negligence. Woodhouse J.A., however, concluded that there was evidence that the plaintiff would have offered a lower price if it had known the true financial picture. Accordingly, he assessed damages at $24,500.

Despite the traditional test for damages in tort cases, in my view it is startling that one can conclude that no *loss* was suffered in this situation. While it may be true that the plaintiff did not lose money, at the same time the return on his investment was much smaller. If the approach of Cooke J. and the British Columbia Court of Appeal in the *Gunderson, Stokes* case continues to prevail, it will be extremely difficult to recover damages in any takeover situation except where the auditors' negligence has been of an extraordinarily gross nature. This matter remains to be settled in the area of auditors' liability.

V. DIRECTORS

A. *Board of Directors — Procedural Problems*

Normally procedural niceties involving the board of directors do not invite comment. The procedure of the board as a rule is governed by the articles of association or by-laws and any conflict will simply involve a matter of interpretation. Recently, however, the Saskatchewan Court of Appeal has handed down a decision which may be of long term interest.[147]

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[145] *Supra* note 135.

[146] [1903] 1 Ch. 546, 73 L.J. Ch. 347. *See also* Hepting v. Schaaf, [1964] S.C.R. 100, 46 W.W.R. 161, 43 D.L.R. (3d) 168 (1963), where the Supreme Court of Canada followed the English case in laying down the test for damages for deceit.

[147] The other recent decision of some interest is that of the English High Court in Conway v. Petronius Clothing Co., *supra* note 108. In this case, directors of a company sought the right to inspect the books of account of the company pursuant to s. 147 of the United Kingdom Act (*cf.* MCA, s.119(3)). The directors felt that the controller of the company had been misappropriating assets. The controlling shareholder argued that the directors had misconducted themselves and was calling a meeting in the near future to

remove them as directors. The High Court decided that the right of directors to inspect books given by the section was not a statutory right but only recognition of a common law right. Accordingly, the court had to exercise its discretion in deciding whether or not to order the availability of the books. It was decided that the books should not be made available to the directors, mainly on the basis that they were going to be removed, although it is implicit in the decision that there was accordingly some possibility that the directors might not use the books in the best interests of the company. Admittedly, the case is an extreme one but the court's general comments are very interesting:

> (4) The right not being a statutory right, the court is left with a residue of discretion as to whether or not to order inspection. However, in the case where there is no reason to suppose that the director is about to be removed from office, the discretion to withhold an order for inspection will be very sparingly exercised. Though a director will not in general be called upon to furnish his reasons before being allowed to exercise his right of inspection the court would in my judgment in such a case restrain him in the exercise of the right, if satisfied affirmatively that his intention was to abuse the confidence reposed in him as director and materially to injure the company. In my judgment, however, in the absence of clear proof to the contrary, the court would in such a case assume that he was exercising it for the benefit of his company. It will be seen that the proposition contained in this present paragraph is derived from the passage from Street J.'s judgment in *Edman* v. *Ross*, 22 S.R. (N.S.W.) 351 which has already been cited. The passage seems to me, if I may say so, consistent with both principle and common sense. If the position were otherwise, a director's rights of inspection could be rendered more or less nugatory, at least for many months, by specious allegations that he was exercising them with intent to injure the company or for other improper motives.
>
> (5) Principles rather different from those just stated in my judgment apply in a case, such as the present, where an interlocutory application for inspection is made to the court by a director who is alleged to have been misconducting himself as a director and, at the time when the application comes before the court, a general meeting of his company has been convened for the purpose of removing him from office. In such a case the court would, in my judgment, normally intervene to assist him on an interlocutory application for inspection, before the wishes of the company had been made known at the general meeting, only if it considered such intervention necessary for the protection of the company. The right of inspection is in my judgment one given to him to exercise for the benefit of the company. He can claim the right as a personal right only in the sense that he may invoke it so as to enable him to discharge his personal obligations to the company and his statutory obligations. If the evidence shows that at least some members of the company no longer have confidence in him as a director, because of alleged misconduct, and have indicated that lack of confidence by causing a general meeting to be convened for the purpose of his removal, the balance of convenience will, in my judgment, normally require postponement of consideration of his interlocutory application for inspection until the meeting has been held: compare *Harben* v. *Phillips* (1883), 23 Ch.D. 14 and *Bainbridge* v. *Smith* (1889), 41 Ch. D. 462. Each case, however, must depend on its special facts. In particular circumstances, the court may consider it essential for the protection of the company or indeed for the personal protection of the director that he be allowed to inspect the company's books even though a resolution for his removal as a director is shortly thereafter to be considered by the company's members.

Id. at 90-91.

The decision is rather surprising in that s. 147 of the U.K. Act says the book of accounts "shall" be open to inspection by the directors. At the same time, the decision does give effect to the overriding equitable doctrine of acting in the best interests of the company. It will be interesting to see how the case is handled if it goes on appeal.

The only other decision worthy of note is that of Harris v. S., 2 A.C.L.R. 51 (N.S.W.S.C. 1976). Here the court has a brief but interesting discussion of the meaning of the term "director" in s. 2(1) of the Alberta Act and the CBCA. The same definition is used in most statutes. The section reads:

> "director" means a person occupying the position of director by whatever name called.

In *Roman Hotels Ltd. v. Desrochers Hotels Ltd.*,[148] the plaintiffs entered into a contract with the defendants for the sale of a hotel. The defendants refused to complete the sale and the plaintiffs sought an order for specific performance. The defendants argued, *inter alia*, that the contract was void because there had been no formal resolution by the directors of the vendor corporation authorizing the sale of the company's whole undertaking as required by section 181(1)(b) of the Saskatchewan Companies Act.[149]

The Saskatchewan Court of Appeal found that it was not necessary to satisfy section 181(1)(b) before a valid sale could take place. The section required the filing of such a resolution if it was passed; the court presumed that parties to a contract would have the good sense to check that internal corporate requirements had been satisfied, but it could not be said "that such a presupposition creates the suggested duty the breach of which carries a penalty no less than one of complete vitiation of a contract of sale."[150] This conclusion is in line with other decisions on the mandatory/directory effect of statutory provisions.[151]

More interesting is the response of the court to the question of whether a meeting had to be held to authorize such a contract. Bayda J.A. found that such an extraordinary sale required the sanction of the shareholders or, if as in this case the power had been delegated, of the board of directors. The problem in the instant case was that the directors had not formally met. However, all directors had informally given their assent to the contract. Bayda J.A. stated:

> Ordinarily, directors exercise the powers they have by holding formal meetings and passing resolutions. Apart from any express provision in the company's articles or other rules of administration and procedure is it possible for a binding corporate decision on a matter which requires the decision of the

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The N.S.W. Supreme Court held that similar words in the N.S.W. Act were meant to collect those *governing* officers of the company who, for some reason or another, are not called directors but bear some other title such as governor or president. This decision is of relevance particularly in Alberta where there is no legislative *requirement* for directors and there has been some discussion of whether or not, by not delegating power to any directors but holding it back for the shareholders, one could eliminate any need to have *resident* directors.

[148] *Supra* note 29.

[149] R.S.S. 1965, c. 131. S. 181(1)(b) reads:

181(1) A company shall file with the registrar:

. . .

(b) a copy of every resolution, whether passed in general meeting or by the directors, with respect to a sale or disposition of the whole or substantially the whole of the undertaking of the company, or the amalgamation of the company with any other corporation, or the purchase or acquisition by the company of the whole or part of the undertaking of any other corporation.

[150] *Supra* note 29, at 133.

[151] *See* Thompson & Sutherland Ltd. v. Nova Scotia Trust Co., 4 N.S.R. (2d) 161, 19 D.L.R. (3d) 59 (S.C. 1971), and cases cited therein.

> directors, to come into existence without the holding of a formal meeting and the passing of a resolution? In considering the answer to this question, it is important to keep in mind that the existence of a corporate decision is a question of fact, and, further, that there is a distinction to be drawn between the actual existence of a corporate decision and evidence of its existence. A formal resolution, considered, passed and duly recorded at a formal meeting, properly constituted, is, generally speaking, the best evidence of the existence of the fact of a corporate decision. Although it may be the best evidence of that fact, it is not necessarily the *only* evidence. Where during the course of an informal consideration of the company's affairs there comes a point at which occurs a meeting of the minds of all those entitled to participate in a decision to do, on behalf of the company, a certain act which is *intra vires* followed by the actual doing of that act, then generally speaking and apart from a specific company rule or statutory provision to the contrary, it may be said that corporate decision came into existence when that meeting of the minds occurred, despite the lack of observance of formalities pertaining to meetings and passing of resolutions. Where, as here, the evidence establishes that the three persons who are the sale [*sic*] directors and sole officers of the company as well as the sole beneficiaries of the company's capital, engage in discussions, in person and on the telephone, over a period of time respecting the sale of the hotel undertaking and these discussions culminate in a telephone conversation in which all three participate and during which the three unanimously agree to make a sale of the hotel at a certain price and this agreement is then acted upon by the representatives of the company then it is my respectful view there is sufficient evidence of a corporate decision to sell having taken place despite the lack of formalities.[152]

It is difficult to be positive about the effect of Bayda J.A.'s comments. There is, for example, no requirement of a "directors' meeting" in section 181(1)(b), but it is clear that the thrust of his Lordship's comments is that even where a formal meeting is implicitly required, informal assent will be sufficient. Such being the case, it is of course impossible to reconcile Bayda J.A.'s validation of a telephone conversation with the contrary conclusion reached by the British Columbia Supreme Court in *Re Associated Color Laboratories Ltd.*[153]

It is also difficult to determine the effect of the *Roman Hotels Ltd.* case under the new corporate statutes. Section 112(1) of the CBCA states, for example, that:

> (1) A resolution in writing, signed by all the directors entitled to vote on that resolution at a meeting of directors or committee of directors, is as valid as if it had been passed at a meeting of directors or committee of directors.[154]

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[152] *Supra* note 29, at 133-34. It is difficult to assess the intent of these words, but it is suggested that they contemplate the case where the statute or by-laws *expressly* permit only formal meetings or listed alternatives.

[153] 73 W.W.R. 566, 12 D.L.R. (3d) 338 (B.C.S.C. 1970).

[154] The telephone conversation section in the CBCA is a little unclear. S. 109(9) states that directors may *participate in a meeting* by telephone. Does this mean there must be a meeting at common law in line with the *Re* Associated Color Laboratories Ltd. case, *id.* (*i.e.* 2 or more physically present) or that a telephone conversation constitutes a meeting? It is suggested that the latter interpretation is preferable and in line with the *Roman Hotels* case.

In the absence of anything to the contrary in the by-laws of a federally incorporated company, is an informal *unsigned* agreement a valid resolution of the board of directors? Or will the courts take the approach of the Alberta Appellate Division in *Gray & Farr Ltd. v. Carlile*[155] and say:

> Where the articles of a company authorize one method of procedure by directors besides the procedure of a regular directors' meeting, there is by implication a denial of any other method. Accordingly, where by the articles of association, it is provided if the adoption of any resolution is evinced by the signatures of all the directors without their meeting together, the resolution shall have the same effect as if adopted at a formal meeting of the directors, a resolution agreed to by two out of three directors and later by the third director but not passed at a directors' meeting and not signed by the directors is invalid.[156]

It is suggested that courts should not hold sections such as 112 to be exhaustive. They merely represent the codification of a common pre-existing practice, an attempt to provide a more informal basis for the functioning of directors. They do not purport to set limitations. An analogy can be drawn with the case of shareholders' meetings. Would anyone suggest that because of the enactment of section 136 that cases such as *Walton*[157] and *Albert Pearl (Management) Ltd.*[158] do not apply under the CBCA?[159] In the final analysis all that is important is that directors consider the matter and decide. The forum in which they do this should be irrelevant, although obviously it may be more difficult to establish proof of a valid resolution in the absence of a formal meeting or signed resolution. This is especially so in the case of large private or public companies. Thus, the *Re Associated Color Laboratories Ltd.* case should have simply been decided on the basis that there was a meeting of minds and a consensus.[160] It may be that the telephone conversations should have been struck down because of inadequate notice to one director in that case.[161] However, any question as to whether the technicalities of a "meeting" by physical presence had been satisfied should have been irrelevant. The *Roman Hotels Ltd.* decision is, accordingly, an extremely sensible and realistic decision.

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[155] [1932] 1 D.L.R. 391 (Alta. C.A.).

[156] *Id.* at 391.

[157] *Supra* note 32.

[158] J.D.F. Builders v. Albert Pearl (Management) Ltd., [1975] 2 S.C.R. 846, 3 N.R. 215, 49 D.L.R. (3d) 422, *aff'g* [1973] 1 O.R. 594, 31 D.L.R. (3d) 690 (C.A.), *rev'g* [1972] 1 O.R. 201, 22 D.L.R. (3d) 532 (H.C.).

[159] Admittedly these cases arise in a different context but they clearly contemplate the giving of authority without a formal shareholders' meeting. It is true that this approach has only been accepted where there has been 100% approval of the action (*see* Anderson Lumber Co. v. Canadian Conifer Ltd., *supra* note 30) but it is suggested that the cases would apply where *all* shareholders had informally discussed the matter but one disagrees. *See also* Hely-Hutchinson v. Brayhead Ltd., *supra* note 35 and the concept of implied actual authority.

[160] *See generally* Cheung, Note, 9 U.B.C.L. REV. 405 (1974).

[161] *Id.* at 408, 410-11.

B. *Duties of Directors*

In recent years, cases involving purported breaches of directors' duties have arisen with some regularity. Some of the decisions, for example *Teck Corporation v. Afton Mines Ltd.*,[162] *Canadian Aero Service Ltd. v. O'Malley*,[163] and *Green v. Charterhouse Group Canada Ltd.*,[164] have generated a great deal of interest and have had a major impact on Canadian corporate law. At the same time, the period is important for what was not decided. The case of *Farnham v. Fingold*[165] and the issue as to the legality of securing a premium on the sale of control would have been in many ways the most important Canadian case of the century and it is extremely unfortunate that the issue did not proceed to trial.[166] Other areas of interest have started to develop.[167] Potentially the most important of these is the problem of transfers of management.[168] While not strictly a problem of directors' duties, the question raises some fascinating questions of the general duty or *bona fides*. Two cases which will soon be before the Alberta Courts will hopefully clarify the law in this area.[169] Finally, there have been

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[162] [1973] 2 W.W.R. 385, 33 D.L.R. (3d) 288 (B.C.S.C. 1972). *See* Iacobucci, *The Exercise of Directors' Duties: The Battle of Afton Mines*, 11 O.H.L.J. 353 (1973) for an excellent analysis of the area. However, compare the decision of the Privy Council in Howard Smith Ltd. v. Ampol Petroleum Ltd., [1974] 1 All E.R. 1126, [1974] 2 W.L.R. 689 (P.C.), which in my view is a subtle but clear rejection of the broad approach taken in *Teck*. For those who favour the *Teck* approach, *see* Spooner v. Spooner Oils Ltd., [1936] 1 W.W.R. 561, [1936] 2 D.L.R. 634 (Alta. C.A.), *aff'g* [1936] 1 W.W.R. 1 (Alta. S.C. 1935).

[163] [1974] S.C.R. 592, 40 D.L.R. (3d) 371, *rev'g in part* [1972] 1 O.R. 592, 23 D.L.R. (3d) 632 (C.A.), *aff'g* 61 C.P.R. 1 (Ont. H.C. 1969).

[164] 12 O.R. (2d) 280, 68 D.L.R. (3d) 592 (C.A. 1976), *aff'g* [1973] 2 O.R. 677, 35 D.L.R. (3d) 161 (H.C.).

[165] [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (C.A.), *rev'g on other grounds* [1972] 3 O.R. 688, 29 D.L.R. (3d) 279 (H.C.).

[166] *See* Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. 578, 328 N.E. 2d 505 (Sup. Ct. 1975) for a recent and radical U.S.A. case on point.

[167] Note the recent cases in the area of corporate trusteeships. *See* Fales v. Canada Permanent Trust Co., [1976] 6 W.W.R. 10, 11 N.R. 487, 70 D.L.R. (3d) 257 (S.C.C.), *rev'g* [1975] 3 W.W.R. 400, 55 D.L.R. (3d) 239 (B.C.C.A. 1974), *varying* [1974] 3 W.W.R. 84, 44 D.L.R. (3d) 242 (B.C.S.C.); and Munden Acres Ltd. v. Lincoln Trust & Savings Co., 10 O.R. (2d) 492, 63 D.L.R. (3d) 604 (H.C. 1975). To what extent will similar duties be placed on trustees under a trust debenture? *Compare* CBCA, ss. 86-88. The question of directors' liability insurance and the scope of indemnification remains an interesting question, as does the issue of how law firms are to deal with requests from companies to act as resident directors. In the area of liability insurance and indemnity, note cl. 30 of Bill S-2. This would amend subs. 119(3) and (4) of the CBCA. Sub. 119(3) is being altered to make it clear that a guilty director who wins on a technicality cannot get indemnity. Sub. 119(4) is being changed so that a company can purchase insurance to protect a person acting as nominee director of another corporation.

[168] *See* Alberts Ltd. v. Mountjoy, 2 B.L.R. 178 (Ont. H.C. 1977); Mid-Western News Agency Ltd., v. Vanpinxteren, [1976] 1 W.W.R. 299, 62 D.L.R. (3d) 555 (Sask. Q.B. 1975); Guyer Oil Co. v. Fulton, [1973] 1 W.W.R. 97 (Sask. Q.B.); Creditel of Canada Ltd. v. Faultless, 2 B.L.R. 239 (Ont. H.C. 1977). *See also*, in generally associated areas, H.L. Weiss Forwarding Ltd. v. Omus, [1976] 1 S.C.R. 776, 20 C.P.R. (2d) 93, 63 D.L.R. (3d) 654, *varying* 5 C.P.R. (2d) 142 (Ont. H.C.) and Bendix Homes Systems Ltd. v Clayton, [1977] 5 W.W.R. 10 (B.C.S.C.).

[169] Mobile Oil v. Canadian Superior and Chevron Standard v. Home Oil

several decisions elsewhere in the Commonwealth of interest in Canada. The decision of the New Zealand Court of Appeal in *Coleman v. Myers*[170] and the Australian High Court in *Walker v. Wimborne*[171] will both be commented on briefly.[172]

1. *Duty of Bona Fides*

The decision of Berger J. in the *Teck Corporation*[173] case will have an impact on many areas of corporate law. One of the most fascinating aspects of his Lordship's judgment was a rejection of the line of English authority[174] which limited a director to taking into account the interests of the shareholders. Rather, Berger J. envisaged a role for the directors which would have them take into account the interests of employees, consumers and society as a whole. I have little doubt that the law will continue to develop in this manner, as in the United States,[175] and many would justifiably comment that it is a natural development having regard to the present position of the corporation in a modern society. Berger J.'s judgment was, however, largely permissive. To my knowledge, until the decision of the High Court of Australia in *Walker v. Wimborne,*[176] no court had said the directors *must* take the interests of outside parties into account.

In *Walker v. Wimborne* an action was brought by a liquidator against the former directors of Asiatic Electric Co. for misfeasance. The defendants were also the controlling shareholders and directors of, *inter alia*, Australian Sound and Communications Ltd. and Estovil Pty. The defendants had caused Asiatic to pay $10,000 to Australian Sound with no security and, it appears, without any express promise on the part of the recipient company to repay. At this stage Australian Sound was insolvent and there was no apparent advantage to be gained by Asiatic from the transaction. The defendants had also caused Asiatic to borrow $10,000 from Estovil and had secured this loan in a manner which gave Estovil effective priority over other creditors. Both these transactions were entered into on the same day and at this time Asiatic was insolvent.

The attitude of the Australian High Court was summed up in the following two passages from Mason J.'s judgment:

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[170] *Supra* note 27.

[171] 50 A.L.J.R. 446 (Aust. H.C. 1976).

[172] At the time of writing, the decision in the possibly momentous *Canadian Pacific* case has been argued but no decision had been handed down.

[173] *Supra* note 162.

[174] *See generally Re* Lee, Behrens & Co., [1932] 2 Ch. 46, [1932] All E.R. Rep. 889; and Parke v. Daily News Ltd., [1961] 1 W.L.R. 493 (Ch. D.); *cf.* Charterbridge Corp. v. Lloyds Bank Ltd., [1970] 1 Ch. 62, [1969] 2 All E.R. 1185 (1968).

[175] *See, e.g.*, Herald Co. v. Seawell, 742 F. 2d 1081 (10th Cir. 1972).

[176] *Supra* note 171.

> The transaction offered no prospect of advantage to Asiatic, it exposed Asiatic to the probable prospect of substantial loss, and thereby seriously prejudiced the unsecured creditors of Asiatic. It was more than an improvident transaction reflecting an error of judgment; it was undertaken in accordance with a policy adopted by the directors in total disregard of the interests of the company and its creditors.
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> . . .[T]he directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as them. The creditor of a company must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent.[177]

It is difficult to assess the potential impact of *Walker v. Wimborne*. As Barrett[178] says, Mason J.'s comments are not restricted to the situation where the company is insolvent. At the same time, his Lordship's comments, not unnaturally, do appear to envisage situations where the directors' acts put the company into insolvency.

One wonders how often such a fiduciary duty will need to arise under the new statutes in Canada. For example, by virtue of section 113 of the CBCA, directors are personally liable to the corporation for any amounts paid out as a dividend,[179] for redemption or purchase of shares[180] or as financial assistance[181] contrary to the insolvency tests in the Act. These tests are, of course, primarily for the protection of creditors. However, one can envisage situations — for example, transfers to subsidiaries at less than fair market value, foolhardy investments or large unsecured loans — which may place the company and, thus, the creditors' interests in jeopardy, and which are not specifically dealt with by statute. Is Mason J. saying that in such situations a creditor will have standing to commence an action in, for example, negligence? Will this right to commence an action arise out of section 117(1)(b) of the CBCA? The section is not limited in any way to protecting the interests of shareholders. Alternatively, does the creditor's right arise from an extension of the traditional concept of standing in corporate actions?

Many questions remain to be answered from the High Court decision. Amongst these is the fundamental issue as to whether the creditor has a separate interest or whether his interest is part of the corporate interest in the same way as that of shareholders. Until further cases arise the scope of Mason J.'s comments will remain unclear. It is, however, a decision that corporate practitioners should keep well in mind.

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[177] *Id.* at 449.
[178] Barrett, Note, 40 MODERN L. REV. 226, at 229 (1977).
[179] CBCA, s. 40.
[180] CBCA, ss. 32, 33.
[181] CBCA, s. 42.

2. *The Corporate Opportunity Doctrine*[182]

Questions relating to the corporate opportunity doctrine have begun to arise with more frequency in Canada than any other breach of directors' duty. This is not surprising. The leading decisions in *Regal (Hastings) Ltd. v. Gulliver*[183] and *Peso Silver Mines v. Cropper*[184] have both given rise to intense discussion.[185] Moreover, while the courts reached opposite conclusions as to liability, both decisions left unanswered many questions relating to the proper role of directors in a modern corporation.

The decision of Laskin C.J.C. in *Canadian Aero Service Ltd. v. O'Malley*[186] in 1973 (the *Canaero* case), was one of the most significant contributions to corporate law in this century. The long-term importance of the decision lies in the broad approach taken by Laskin C.J.C. in defining the scope of the doctrine, and his comments are worth repeating even five years later:[187]

> [T]he fiduciary relationship goes *at least* this far: a director or senior officer like O'Malley or Zarzycki is precluded from obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested upon full disclosure of the facts), any property or business advantage *either belonging to the company or for which it has been negotiating*; and especially is this so where the director or officer is a participant in the negotiations on behalf of the company.
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> . . .[The fiduciary relationship between a director and a company precludes] a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is *actively pursuing*.[188]

Laskin C.J.C. then proceeded to state the general factors that should be taken into account in determining whether the duty had been breached:

> The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of

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[182] The corporate opportunity doctrine is, of course, part of the general duty of *bona fides*. I use it here in the sense of any situation where a director or officer uses, to his own direct or indirect benefit, an opportunity "belonging" to the company.

[183] [1942] 1 All E.R. 378 (H.L.).

[184] [1966] S.C.R. 673, 56 W.W.R. 641, 58 D.L.R. (2d) 1, *aff'g* 54 W.W.R. 329, 56 D.L.R. (2d) 117 (B.C.C.A. 1965). *See also* Zwicker v. Stanbury, [1953] 2 S.C.R. 438, [1954] 1 D.L.R. 257, *rev'g* [1952] 4 D.L.R. 344 (N.S.C.A.), *varying* [1952] 3 D.L.R. 273 (N.S.S.C.); Canada Safeway Ltd. v. Thompson, [1951] 3 D.L.R. 295 (B.C.S.C. 1950); Boardman v. Phipps, [1967] 2 A.C. 46, [1966] 3 All E.R. 721 (H.L.).

[185] *See* Beck, *The Saga of Peso Mines: Corporate Opportunity Reconsidered*, 49 CAN B. REV. 80 (1971); Jones, *Unjust Enrichment and Fiduciary's Duty of Loyalty*, 84 L.Q.R. 472 (1968).

[186] *Supra* note 163.

[187] *See* Beck, *The Quickening of Fiduciary Obligation: Canadian Aero Services v. O'Malley*, 53 CAN. B. REV. 771 (1975); Prentice, Note, 37 MODERN L. REV. 464 (1974); Iancono, Comment, 21 McGILL L.J. 445 (1975).

[188] *Supra* note 163, at 606, 40 D.L.R. (3d) at 382 (emphasis added).

> position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private.[189]

The actual facts and the conclusion of the Supreme Court of Canada are not exceptional. The case involved a clear breach of duty. What is important is that Laskin C.J.C. does away with the confines of special knowledge and confidential information as prerequisites to liability. His Lordship does not feel bound by such questions as whether the knowledge was acquired by virtue of the office of director. Rather, he sets a broad standard which can be applied flexibly to any set of facts as they arise. This position is basically an acknowledgment that it is impossible to fit every corporate activity within special rules and that it will be the function of subsequent courts to decide if future cases fit within the broad parameters of the rule laid down in *Canaero*. In subsequent cases this has not proved difficult.[190] In *The Jiffy People Sales (1966) Ltd. v. Eliason*,[191] the defendant had initially been involved in the importing of certain pen products into Canada from Japan. This right was sold to the plaintiff company which later acquired the right from the same Japanese company to sell "stock stamps" throughout Canada. Subsequently, the shareholders of the plaintiff company and the defendant incorporated a second company, X-Stamper, which obtained the right to manufacture "custom stamps" in Canada. In 1973, X-Stamper defaulted under its agreement to manufacture "custom stamps". The company was, however, still vitally interested in renewing the contract. Unfortunately, at this time the defendant was attempting to negotiate his own deal with the Japanese company and in 1974 a contract was entered into by his own company, Canex, in which the sole right to deal in Canada in both "stock" and "custom" stamps was given to Canex.

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[189] *Id.* at 607, 40 D.L.R. (3d) at 391.

[190] The one major exception to this is the recent decision of the Nova Scotia Court of Appeal in H.L. Misener & Son v. Misener, 21 N.S.R. (2d) 92, 77 D.L.R. (3d) 428 (C.A. 1977). Here, the majority held that it could not be said that:

> [I]n any case where the evidence establishes that the principal has not suffered any actual, possible or probable loss and the fiduciary has not received any actual, expected or potential profit or benefit, . . . there has been an actionable breach of the fiduciary relationship.

Id. at 440, *per* MacDonald J.A.

In theory this cannot be correct. The Court of Appeal appears to be looking at the case at the time of trial. Surely, the appropriate time frame is when the alleged breach of duty took place, and at this stage the conflict theory would prevent any reference to profit or loss for purposes of liability. It may be that under the broad terms of *Canaero*, the present case is one where a breach should not be found, but if one looks at the case at the time of the alleged breach it will be impossible to determine the potential profit or loss. As McKeigan C.J. (dissenting) stated, the latter should be only relevant for purposes of damages. However, for practical purposes, aside from the possibility of an injunction, it is difficult to envisage a situation where one would commence an action where no actual or potential profit or loss was present.

[191] 21 C.P.R. (2d) 209, 58 D.L.R. (3d) 439 (B.C.S.C. 1975).

The British Columbia Supreme Court had no hesitation in finding liability. The defendant was a director of X-Stamper at the time of negotiating the deal in "custom stamps". Accordingly, since X-Stamper was still "actively pursuing" the contract, he had illegally diverted to his company a right which belonged to the plaintiff.[192] Indeed, at the time of the misappropriation, it appears that X-Stamper may still have had some rights under the earlier agreement.[193] The liability with respect to the "stock stamps" was a little more difficult since the defendant had resigned as director of the plaintiff company in 1971. However, in an interesting example of judicial inventiveness, the Supreme Court found that, at the time the defendant effectively sold his interest in the "stock stamp" business to Jiffy People Sales (1966) Ltd., there was an implied term that he would not subsequently divert the source of supply of such stamps to his own benefit.[194]

Of all the provinces, Alberta has given rise to the greatest number of interesting corporate opportunity cases in recent years.[195] The deci-

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[192] *Id.* at 218, 58 D.L.R. (3d) at 448.

[193] *Id.* at 219, 58 D.L.R. (3d) at 448.

[194] *Id.* at 222, 58 D.L.R. (3d) at 451-52. The case is possibly most noteworthy for the lengthy analysis of damages flowing from the breach, a fact which is relatively unusual in corporate cases. For another quasi-corporate opportunity case in British Columbia, *see* Bendix Homes Systems Ltd. v. Clayton, *supra* note 168.

[195] Two other Alberta cases raise points of some interest. *See* Hawrelak v. Edmonton, [1976] 1 S.C.R. 387, [1975] 4 W.W.R. 561, 54 D.L.R. (3d) 45, *rev'g* [1973] 1 W.W.R. 179, 31 D.L.R. (3d) 498 (Alta. C.A.), *aff'g* [1972] 2 W.W.R. 521, 24 D.L.R. (3d) 321 (Alta. S.C.) where the Supreme Court of Canada overruled the Alberta Appellate Division in holding that the defendant, a former mayor of Edmonton, was not liable to account for profits made on the sale of shares in a company. The profit arose because the City of Edmonton decided to develop land in the area where the company owned property. The mayor had also disclosed his interest at the time of his election. The majority held that the defendant had made no profit from his position as mayor since the development would have taken place anyway. Accordingly, no breach of fiduciary duty arose and it is extremely doubtful whether a fiduciary relationship existed in respect of that particular transaction.

In the more recent decision of the Alberta Appellate Division, Evans v. Anderson, 3 A.R. 361, [1977] 2 W.W.R. 385, 76 D.L.R. (3d) 482 (C.A.), the question arose once again as to whether a fiduciary duty existed. This case, too, did not involve a corporation but the analysis is interesting. The defendants were officers of a golf club owned by a construction company. They bought the club from the company and the members brought an action alleging the defendants owed a fiduciary duty to the general members not to purchase the club secretly for their own profit at the expense of the larger group. The majority found the defendants not liable. A fiduciary duty only exists in two situations: (a) the plaintiff must have a beneficial interest in the property in question which is worth protecting; and (b) there must be an interference with that interest by someone who should be protecting the same. In the present case, the general members had no such interest; they did not own any property but only had a license to play. Accordingly, the defendants' decision to buy the property was a business decision quite outside the ambit of normal club activities. It is interesting to compare the judgment of Sinclair J.A. (dissenting), at 397-99, [1977] 2 W.W.R. at 408, 76 D.L.R. (3d) at 501-02, with this analysis:

> Corporate directors and officers are fiduciaries—that is beyond dispute. True, officers of companies are usually paid, and so are directors. On the other hand, most officers of voluntary organizations provide their service freely out of a spirit of dedication to the organization, and a belief that its objectives are

sion in *Abbey Glen Property Corp. v. Stumborg*,[196] however, is by far the most important. It involved a classic corporate opportunity situation and raises many points of interest. The defendants were former directors and shareholders of the plaintiff company.[197] In 1958 they had formed a syndicate to finance the purchase of property known as the Ebbers land. Through a company called Green Acres Investments, the Stumborgs had a thirty per cent interest in the syndicate. In 1965, the land was sold to Green Glenn, a company in which the Stumborgs had a fifty per cent interest. The other fifty per cent was owned by a subsidiary of Traders Finance Ltd. This joint venture with Traders was

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worthwhile. That is the situation in the present case. But is that any reason why an officer or director of a charitable or recreational organization ought not to owe a duty of loyalty and of good faith to the objectives of the organization, and to those other interested members of the community who are members of it?

. . .

In my opinion the officers of the men's section owed a duty to be loyal and faithful to the club itself and, it follows, to all its members. It is unnecessary to determine the parameters of that loyalty, and indeed I think to attempt to do so would be unwise. Suffice it to say that in my opinion the duty encompassed a responsibility not to become deliberately involved in an activity that would, by destroying or changing the very nature of the club, operate to the detriment of its members in a fundamental way.

Regard should also be given to Northern and Central Gas Corp. v. Hillcrest Collieries, [1976] 1 W.W.R. 481, 59 D.L.R. (3d) 533 (Alta. S.C. 1975). This decision of the Alberta Trial Division is not a corporate opportunity case. However, one extract is worth reproducing as an indication of one court's response to directors who claim they can rely on outside reports in reaching their decisions:

When "outsider advice", such as the Sproule report, is obtained the directors of a company are entitled to rely on that advice if it is given by a person appearing to be qualified, but on receipt of such advice *the directors must themselves exercise their judgment*. (The italics are mine.) *Palmer's Company Law*, 21st ed. (1968), p. 582.

In *Re Brazilian Rubber Plantation and Estates, Ltd.*, [1911] 1 Ch. 425, Neville J., says at p. 437:

A director's duty has been laid down as requiring him to act with such care as is reasonably to be expected from him, having regard to his knowledge and experience. He is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance; while if he is acquainted with the rubber business he must give the company the advantage of his knowledge when transacting the company's business. He is not, I think, bound to take any definite part in the conduct of the company's business, but so far as he does undertake it he must use reasonable care in its despatch.

Id. at 550-51, 59 D.L.R. (3d) at 598.

Subsequently, Lieberman J. appears to mix up the duty to take reasonable care and the general duty of *bona fides*. Nevertheless, this statement does serve as a warning to directors who rely on reports without any analysis (the present case was, however, quite extreme and it is unclear how far Lieberman J. would take his approach). *Compare* CBCA, s. 118(4) where, in fact, the words "relies in good faith" are used. Does this mean that a director who negligently, but in good faith, so relies is quite safe from an action under s. 117(1)(b)?

[196] [1976] 2 W.W.R. 1, 65 D.L.R. (3d) 235 (Alta. S.C.).

[197] At the time of the transactions, the plaintiff company was called Terra Developers Ltd. and became Abbey Glenn Property Corp. after several reorganizations.

brought about by the attempts of the Stumborgs to draw some large capital into the real estate business in Alberta. During the negotiations with Traders, Jerome Stumborg had continually represented himself as president and general manager of Terra. At all times it appears that the defendants intended Terra to share the equity interest in any venture with Traders. Unfortunately, the latter refused to be so involved. Accordingly, the Stumborgs themselves entered into the deal with Traders.

It was not until after the execution of the agreement that the deal was disclosed to the full board of Terra. It is unclear what actual steps the board[198] took but it is clear that they implicitly ratified the Stumborgs' actions. Subsequently, the Stumborgs sold their interests in Green Glenn. When, after a series of corporate reorganizations, the Abbey Glen Company was formed with a new board of directors, the present action was commenced against the defendants, alleging that they had misappropriated to themselves an opportunity belonging to their company.

Two other transactions should be briefly mentioned. First, the Stumborgs also acquired for Green Glenn property called the British-Goebel-King lands. At the time of acquisition, Terra was not attempting to buy or negotiate for the lands. The Williams land was bought in similar circumstances. Secondly, through another jointly owned company, Greenway Homes Ltd., the Stumborgs purchased the Groot lands. Once again, Terra had no active interest in the property.

McDonald J., in a lengthy but extremely interesting judgment, found the Stumborgs liable to account for their profit on the Ebbers transaction.[199] Following the Supreme Court of Canada decision in *Canaero*,[200] his Lordship dismissed the earlier limitation of liability caused by the "requirement" that the director must make the profit "by reason of and in the course of his official status". He simply decided that there was a conflict between the Stumborgs' position as directors of Terra and their interests as shareholders of Green Glenn. Since Jerome Stumborg had until 1965 been negotiating with Traders as a representative of Terra and since he acquired information about Traders by reason of his position as president of the former company, he had taken for himself an opportunity which belonged to that company. His brother was similarly liable.[201]

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[198] *Supra* note 196, at 247-50.

[199] Although only for profits received since the acquisition of the land by Green Glenn. The syndicate had been formed before Terra was incorporated and thus no fiduciary duty was owed. This does not, with respect, answer the question of whether the Stumborgs were accountable because they did not sell the property to Terra when the company was interested in buying it. Should not this give rise to a breach (as McDonald J. held) and give rise to potential liability, although clearly damages would be difficult to compute.

[200] *Supra* note 163.

[201] *Supra* note 196, at 254, 259. *See id.* at 282 for a discussion of the basis of the brother's liability in constructive fraud. *See* Hamlyn v. John Houston & Co., [1903] 1

In reaching this conclusion, McDonald J. made some interesting comments. First, his Lordship established once again that the chances of the company making the same deal are irrelevant if the action is for an accounting for profits. Thus, he disregarded the fact that Traders would not deal with Terra.[202] Secondly, the defendants argued that Terra had not been interested in acquiring the Ebbers land or any long-term real estate venture because of low capitalization. McDonald J. rejected this contention. In the first place, the eventual deal required Traders to put up the capital so this would not have hindered Terra.[203] However, in an incisive passage, his Lordship went further and after an analysis of the financial status of the company, concluded it could have put up money: other property could have been sold or used as security for loans.[204] Thirdly, the defendants argued on the basis of *Bell v. Lever Bros.*[205] that a director cannot be made to account where he makes a profit from his own property in which the company has no interest. McDonald J.'s answer is a perceptive analysis of the true meaning of the directors' fiduciary duty:

> Counsel for the defendants also relied upon the judgment of Lord Blanesburgh in *Bell v. Lever Bros. Ltd.*, [1932] A.C. 161 at pp. 193-5, [1931] All E.R. Rep. 1 at pp. 16-17. There His Lordship drew a distinction between the duty owed by a director in respect of contracts with the company when the director has a personal interest in the contract, and that owed in respect of a director's own contracts in which the company has no financial interest at all. In the latter case, Lord Blanesburgh says "the company has no concern in his profit and cannot make him accountable for it unless it appears — this is the essential qualification — that in earning that profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company". However in my view Lord Blanesburgh cannot be taken as having treated exhaustively of the liability of directors. While it is true that a director can be made accountable where he has made a profit through use of the property of the company or of some confidential information which has come to him as a director of the company there is, as Roskill, J., observed "a third class of case where a director might be called on to account, namely where he had misused his position as a director of a company". In regard to this class of case, in *Boardman v. Phipps*, [1967] 2 A.C. 46 at p. 123-5, [1966] 3 All E.R. 721 at pp. 756-7, Lord Upjohn said that the "whole of the law is laid down in a fundamental principle exemplified in Lord Cranworth's statement", in *Aberdeen R. Co. v. Blaikie Bros.* (1854), 2 Eq. Rep. 1281 at p. 1286, [1843-60] All E.R. Rep. 249 at p. 252, where he said:
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> > ". . . and it is a rule of universal application that no one having such duties to this charge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect."[206]

K.B. 8, 72 L.J.K.B. 72 (C.A.); Canada Safeway Ltd. v. Thompson, *supra* note 184; and D'Amore v. McDonald, [1973] 1 O.R. 845, 32 D.L.R. (3d) 354 (H.C.), all cited by McDonald J.

[202] *Id.* at 256.

[203] *Id.* at 262.

[204] *Id.* at 265-66.

[205] [1932] A.C. 161, at 193-95, [1931] All E.R. Rep. 1, at 16-17 (H.L.).

[206] *Supra* note 196, at 36-37, 65 D.L.R. (3d) at 267-68.

Finally, in a not unexpected argument, the defendants claimed that the board of directors of the predecessor of Abbey Glen had effectively ratified their actions. McDonald J.'s response was short. The intention of the directors was not clear from the minutes; the latter referred only to dividends or earnings received by the Stumborgs and did not clearly contemplate the dealings with the Ebbers land. Moreover, his Lordship concluded that ratification, presumably *ex post facto*, must be by the shareholders and that the directors could not waive the right of the company to bring an action.[207]

McDonald J. found the defendants not liable in respect of the other transactions. His Lordship concluded:

> On the basis of the evidence which has been placed before me, I am not satisfied that the acquisition by the Stumborgs [of the other lands]. . . constitutes a usurpation for themselves. . . of a maturing business opportunity which Terra was actively pursuing or that the opportunity to purchase the Williams land constitutes a business advantage for which Terra had been negotiating, or that the Stumborgs obtained their interest in the Williams land by reason and only by reason of the fact that they were directors of Terra and in the course of execution of that office, or that the Stumborgs acquired their opportunity or knowledge from their fiduciary position.[208]

This response is disappointing. In the first place, it marks to some extent a return to the traditional guidelines of *Regal Hastings v. Gulliver*[209] which McDonald J. himself had earlier rejected. It is not at all clear from *Canaero*[210] that Laskin C.J.C. felt that the opportunity must be acquired from one's fiduciary position. The question is rather whether, even if one hears of the opportunity in a private capacity, the information must, in appropriate circumstances be passed on to the company. This has not yet been clearly decided in Canada but his Lordship's judgment must be taken as a rebuttal of that proposition. Secondly, McDonald J. seems content to use the words "actively pursuing" and "negotiating" utilized by Laskin C.J.C. in *Canaero*. But the Chief Justice in fact said the duty goes "at least" that far. It is unfortunate that McDonald J. did not take the opportunity to discuss Beck's[211] argument that a director must hand offers over to the company when it could reasonably be regarded as being in the company's general line of business. In this sense, the decision of McDonald J., without any assessment as to whether his conclusion was correct on the facts, may have imposed a stumbling block on the future development of the corporate opportunity doctrine in Alberta.

Two final points might be made on the judgment. First, in respect of one transaction, the defendants argued that since they owed a

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[207] *Id.* at 48-49, 65 D.L.R. (3d) at 280.
[208] *Id.* at 44, 65 D.L.R. (3d) at 275.
[209] *Supra* note 183.
[210] *Supra* note 186.
[211] *Supra* note 187.

fiduciary duty to another company, they could not have breached their duty to Terra. McDonald J. dealt with this claim viciously:

> I wish to refer briefly to another point pertinent to the claims respecting the Williams and Groot lands. Counsel for the defendants submits that the Stumborgs could be directors of rival companies, and were in fact directors of Clarepine as well as of Terra, and that it could not be said that there was a breach of their fiduciary duty to Terra if what they did was in honour of their obligation to Clarepine. This proposition is based upon the decision in *London & Mashonaland Exploration Co. Ltd. v. New Mashonaland Exploration Co. Ltd.*, [1891] W.N. 165, which was approved by Lord Blanesburgh in *Bell v. Lever Bros.*, [1932] A.C. 161 at p. 195. Gower, in his textbook on *Modern Company Law*, 3rd ed., p. 547, describes the *London & Mashonaland* decision as a"queer, if inadequately reported, decision to the effect that a director of one company cannot be restrained from acting as a director of a rival company". Gower continues that "this assumes, of course, that it cannot be shown 'that he was making to the second company any disclosure of any information obtained confidentially by him as a director of the first company', in the words of Lord Blanesburgh". Lord Blanesburgh also said: "What he could do for a rival company he could, of course, do for himself".
>
> . . .It is not necessary to decide the point here, but I do not hesitate to express my opinion that the sweeping proposition for which the *London & Mashonaland* case and Lord Blanesburgh's dicta are cited is not the law. Even where there is no question of a director using confidential information, there may well be cases in which a director breaches his fiduciary duty to company A merely by acting as a director of company B. This will particularly be possible when the companies are in the same line of business and where acting as a director of a company B will harm company A. Beyond that I need go no further than to say that the question whether a breach of a director's duty to company A must be determined upon the basis of the factors enumerated in *Canadian Aero Service Ltd. v. O'Malley* and *Regal (Hastings) Ltd. v. Gulliver*, and a negative answer will not necessarily be produced by the mere fact that the director is also a director of company B and owes it a like fiduciary duty.[212]

There is insufficient space to elaborate on McDonald J.'s judgment: suffice it to say that the opinion raises for future discussion the intriguing possibilities of the legitimacy and consequences of interlocking directorships.[213] It is to be hoped that a fuller judicial discussion will eventuate in the near future.

Secondly, his Lordship dealt with the saving provision in section 292 of the Alberta Act. Several provinces still have similar provisions which, *inter alia*, provide for relief where the court feels a director, while guilty of a breach of trust, has acted honestly and reasonably. McDonald J. said the section could not be used; the directors had breached their fiduciary duty but had not committed a breach of trust.[214] His Lordship may be technically correct in saying that direc-

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[212] *Supra* note 196, at 46-47, 65 D.L.R. (3d) at 277-78.

[213] For a short discussion, *see* Beck, *supra* note 187, at 788-92, where most of the Commonwealth authorities are discussed.

[214] *Supra* note 196, at 50, 65 D.L.R. (3d) at 277.

tors are not trustees.[215] This was not made clear until relatively recently, however, and one might be forgiven for asking why the words "breach of trust" were included if they were not intended to cover breaches of fiduciary duty.

3. *Insider Trading*

The days of bemoaning the inadequacies of the common law and *Percival v. Wright*[216] have largely passed in Canada.[217] Most provinces[218] and the federal jurisdiction[219] have enacted restrictions on insider trading by directors and officers and their close relatives. Indeed, the CBCA,[220] Manitoba[221] and Saskatchewan[222] Acts extend liability to non-related recipients of inside information. Accordingly, most interest has centred recently around the interpretation of the various corporate and securities provisions regulating the conduct of insiders.

Two cases in particular have aroused interest in recent years. In *Green v. Charterhouse Group Canada Ltd.*,[223] the Ontario Court of Appeal found the defendants had not made use of admittedly "specific confidential information"; accordingly, they were not liable. In the more recent decision of *Re Harold P. Connor*,[224] the Ontario Securities Commission similarly found that no use had been made of information possessed by the insiders. Both these cases make important contributions in aiding the interpretation of, and the procedure under, the insider trading provisions. One must not forget, however, that the Criminal Code fraud and restitution sections[225] still exist. As shown by the recent decision in *Regina v. Littler*,[226] these provisions may yet prove to be effective remedies and, as Johnston commented, "the fear of a fraud conviction with imprisonment . . . may serve as a more formidable deterrent to insiders than potential civil liability."[227]

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[215] *See, e.g., Re* City Equitable Fire Insurance Co., [1925] Ch. 407 (C.A. 1924).

[216] [1902] 2 Ch. 421.

[217] *See generally* the KIMBER REPORT (Report of the Attorney-General's Committee on Securities Regulation, Toronto, 1965). This part will only deal with the liability aspect of insider trading and is not concerned with the reporting requirements.

[218] Ontario, Manitoba, Saskatchewan, Alberta and British Columbia. *See also* the Securities Acts in Ontario, Quebec, Manitoba, Saskatchewan, Alberta and British Columbia. *See* ACA, ss. 81-88.

[219] *See* CBCA, ss. 121-25. *See also* the proposed amendments in cls. 31 and 36, Bill S-2, which will significantly clarify the definition of "insider" in the CBCA.

[220] S. 125(1)(f).

[221] MCA, s. 125(1)(f).

[222] SBCA, s. 121(f).

[223] *Supra* note 164.

[224] [1976] O.S.C.B. 149.

[225] R.S.C. 1970, c. C-34, ss. 338(1), 653 (*as amended by* S.C. 1974-75-76, c. 93).

[226] 27 C.C.C. (2d) 216, 65 D.L.R. (3d) 443 (Que. C.A. 1974), *varying on other grounds* 13 C.C.C. (2d) 530, 41 D.L.R. (3d) 523 (Que. S.P. 1972).

[227] Johnston, Comment, 2 CAN. BUS. L.J. 234, at 235 (1977).

It is not intended to comment further on these cases; they have been exhaustively analyzed in recent years.[228] The only comment I would venture to add is that the conclusion of the Securities Commission in the *Connor* case is baffling, to say the least, on the facts.[229] Rather, this part will deal briefly with a recent New Zealand Court of Appeal decision which, if followed in Canada, may provide some teeth to those jurisdictions in Canada where the common law still applies.

The main plaintiffs in *Coleman v. Myers*[230] were minority shareholders in the company of Campbell and Ehrenfried Ltd., who as a result of the takeover bid were subject to compulsory acquisition under the 90/10 rule. Myers, the first defendant, was the managing director of C & E Ltd. He made a takeover offer for all the shares in the company. The plaintiffs were at all times opposed to the takeover offer. Though not yet registered as owners of the shares, they were the beneficial owners by reason of a concluded arrangement with their aunt. They believed that the offered price of $4.80 per share was too low. However, the great majority of the shares in the company were held by people who in fact accepted the offer. Accordingly, the plaintiffs reluctantly sold their shares at $4.80 after a compulsory acquisition notice had been sent. Over ninety per cent of the acquired shares were sold from trusts to another trust resident in New Zealand, called the K.B. Myers Trust, controlled by the father of the first defendant. The father was also an avid supporter of the scheme. The takeover offer was made to the K.B. Myers Trust as holders of the vast majority of shares in C & E Ltd. and the Trust transferred the shares to the holding company of the first defendant.

Thus, Myers became owner of all the shares in C & E Ltd. The total purchase had cost him $5,647,996 and he had borrowed most of this money. In order to repay his short-term creditors, Myers proceeded to sell the surplus assets of C & E Ltd. By reason of various factors operating at that particular time, he managed to obtain advantageous prices for those assets to the extent that C & E Ltd. was thereafter able to declare capital dividends totalling $6,725,971. In New Zealand these capital dividends were not taxable to the recipient. This was enough to

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[228] *See* the excellent discussions in Anisman, *Insider Trading Under the Canada Business Corporations Act*, in THE CANADA BUSINESS CORPORATIONS ACT 151 (1975); Johnston, Comment, 32 U. TORONTO FAC. L. REV. 175 (1974); Johnston, *supra* note 227; Buckley, *How to do Things With Inside Information*, 2 CAN. BUS. L.J. 234 (1978); Baillie & Albioni, *The National Sea Decision — Exploring the Parameters of Administrative Discretion*, 2 CAN. BUS. L.J. 454 (1978); Johnston, Comment, 15 WESTERN ONT. L. REV. 239 (1976).

[229] Although, to be fair, since much of the hearing was *in camera*, it is difficult to assess the facts. For other cases on insider trading, *see* Ryan v. Triguboff, [1976] 1 N.S.W.L.R. 588 (S.C.). *See also* Dunford & Elliott Ltd. v. Johnson and Firth Brown Ltd., [1977] 1 Lloyd's Rep. 505 (C.A.) (use of confidential information on takeover bid — court's remedies).

[230] [1977] 2 N.Z.L.R. 298 (C.A.).

reimburse Myers for the total costs of the takeover and to yield a profit in cash. In addition, C & E Ltd. still retained a valuable half-interest in a trading company and the value of this interest as at March 1973, being some months after the takeover, was estimated at $5,154,364.

The plaintiffs became aware of these figures. It appeared to them that Myers had spent $5 1/2 million to acquire, as sole shareholder, corporate assets worth almost $12 million. This represented a profit of approximately $6 million. Not surprisingly, the plaintiffs took a hostile attitude to this transaction. They believed that the shares had been acquired at a gross undervalue and that the other shareholders had all been deceived into accepting an inadequate price. Accordingly, they brought an action, asking for rescission of their own share transfers, or, in the alternative, for damages. A variety of causes of action were formulated, of which the leading elements were fraud, actionable non-disclosure, negligence, insider trading at common law, and financial assistance by the company in the purchase of shares.[231]

Both the Trial Division[232] and the Court of Appeal dealt extensively with the question of insider trading. As one might expect, the main obstacle in the way of the plaintiffs was the decision of the English court in *Percival v. Wright*.[233] Mr. Justice Mahon in the Trial Division was not, however, particularly troubled by this decision. He referred to the extension of legislative coverage and the developments in the United States evidenced by the Supreme Court decision in *Strong v. Repide*[234] and the development of the special facts doctrine, and concluded that the decision in *Percival v. Wright* was incorrect and should not be followed in New Zealand. In reaching this conclusion, the judge was heavily influenced by cases such as *Regal Hastings v. Gulliver*,[235] *Boardman v. Phipps*,[236] and *Erlanger v. New Sombrero Phosphate Co.*,[237] and the general message from these cases is that a fiduciary relationship between individuals will be held to exist in any situation where this is a relationship of trust and confidence.

His conclusion is clearly set out in the following passage:

> Within the situation which I have been contemplating, there is, in my opinion, by reason of the statutory disability of the shareholder to compel disclosure of the relevant facts, unnecessary confidence reposed in the director, by virtue of his status, in relation to his advantageous possession of material information

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[231] *See* the discussion of this case by the writer in the proceedings of the Advanced Corporate Law Conference (Legal Education Society of Alberta, Banff, 1977) for a brief analysis of the courts' response to the other alleged illegalities.

[232] [1977] 2 N.Z.L.R. 225 (S.C.). *See* Hetherington, *Financing an Insider-Takeover*, 4 BUS. L. REV. 220 (1976) for a discussion of the Trial Division decision. *See also* Rider, Note, 40 MODERN L. REV. 471 (1977) for a rather unsympathetic assessment of the case.

[233] *Supra* note 216.

[234] 213 U.S. 419, 29 S. Ct. 521 (1909).

[235] *Supra* note 183.

[236] *Supra* note 184.

[237] 3 App. Cas. 1218, 39 L.T. 269 (H.L. 1878).

> known to that director and not known to the shareholder. In the present case, which is the case of a private company with unlisted shares, it seems an untenable argument to suggest that the shareholders on an offer to buy their shares are not perforce constrained to repose a special confidence in the directors that they will not be persuaded into a disadvantageous contract by non-disclosure of material facts. In my opinion, therefore, there is inherent in the process of negotiation for sale a fiduciary duty owing by the director to disclose to the purchaser any fact, of which he knows the shareholder to be ignorant, which might reasonably and objectively control or influence the judgment of the shareholder in forming his decision in relation to the offer. The application of the rule so assumed to exist must necessarily be confined to private companies and to such transactions in public company shares, listed or otherwise, where the identity of the shareholder is known to the director at the time of the sale. The liability of the director cannot be enforced in the absence of proof that he was capable in the specified transaction of compliance with the duty of disclosure. Thus in the case of stock exchange purchases and sales the regulation of insider trading must be left to the legislature.[238]

Having found a basis in law for insider liability, however, Mahon J. concluded that there was no evidence that the duty had been breached.

In one of those rare occurrences in corporate law, the Court of Appeal reversed the trial judge on the facts, going so far as to find the defendants guilty of fraud. More specifically, both Woodhouse and Cooke JJ. accepted the fact of a fiduciary relationship between directors and shareholders and found that the duty arising from the relationship had been breached. However, both judges narrowed somewhat the approach of Mahon J. Their Lordships felt that it was too broad a proposition that the fiduciary relationship arose in every case relating to a private or close corporation and that each case must be decided on its own facts. Their attitude is clearly set out in the following passage from the opinion of Woodhouse J.:

> As I have indicated it is my opinion that the standard of conduct required from a director in relation to dealings with a shareholder will differ depending upon all the surrounding circumstances and the nature of the responsibility which in a real and practical sense the director has assumed towards the shareholder. In the one case there may be a need to provide an explicit warning and a great deal of information concerning the proposed transaction. In another there may be no need to speak at all. There will be intermediate situations. It is, however, an area of the law where the courts can and should find some practical means of giving effect to sensible and fair principles of commercial morality in the cases that come before them; and while it may not be possible to lay down any general test as to when the fiduciary duty will arise for a company director or to prescribe the exact conduct which will always discharge it when it does, there are nevertheless some factors that will usually have an influence upon a decision one way or the other. They include, I think, dependence upon information and advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it.[239]

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[238] *Supra* note 232, at 278.

[239] *Supra* note 230, at 324-25 (*per* Woodhouse J.).

Perhaps the appropriate comment is that these facts will be present in most, if not all, private companies. In practice, then, their Lordships' reservations on the scope of the fiduciary duty may not be of great importance.[240]

The importance of this decision for the common law provinces in Canada cannot be overemphasized.[241] To my knowledge, this is the first occasion in which a Commonwealth court has definitely decided that there is a general duty owed by directors to shareholders. Cases such as *Allen v. Hyatt*[242] were decided essentially on an agency basis and, while it may be argued that *Gadsden v. Bennetto*[243] gave effect to the American special facts doctrine, the case is not altogether clear and has gone largely unnoticed. The refusal to follow *Percival v. Wright* is long overdue; seldom has a lower court decision held such sway for so long. It is hoped that when the occasion arises the courts in Canada will adopt the same principles as the New Zealand Court of Appeal.

VI. SHAREHOLDERS' REMEDIES

For many years perhaps the most commented upon area of corporate law has been the power of the minority shareholder to remedy ostensible wrongs done either to him personally or to the corporation. Invariably these wrongs are perpetrated by the directors of his company. In recent years, largely one suspects as a result of some excellent writings in the area,[244] the legislatures across Canada have introduced statutory procedures to improve the minority shareholder's

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[240] Readers should see the judgment of Cooke J. for an analysis of why the duty was breached. Particular reference might be had to his Lordship's discussion of "materiality" of the information. He said that as a broad test of "materiality" one might speak of "those considerations which can reasonably be said, in the particular case, to be likely materially to effect the mind of a vendor or a purchaser". The following passage from the United States Supreme Court decision in T.S.C. Industries v. Northway Inc., 426 U.S. 438, at 439 (Sup. Ct. 1976) was cited with approval:

> [W]hat the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.

[241] Nova Scotia, Prince Edward Island and Newfoundland; also Alberta where private companies are concerned. *See* ACA, s. 81.

[242] 17 D.L.R. 7 (P.C. 1914), *aff'g* 3 O.W.N. 1401, 8 D.L.R. 79 (C.A. 1912), *aff'g* 3 O.W.N. 370 (Div'l Ct. 1911).

[243] 3 W.W.R. 1109, 9 D.L.R. 719 (Man. C.A. 1913), *rev'g* 2 W.W.R. 733, 5 D.L.R. 529 (Man. K.B. 1912). *See* Anisman, *supra* note 228, at 162-65.

[244] Particularly Wedderburn, *Shareholders' Rights and the Rule in Foss v. Harbottle*, [1957] CAMB. L.J. 194, *cont'd* [1958] CAMB. L.J. 93; Beck, *An Analysis of Foss v. Harbottle*, in Vol. 1, STUDIES IN CANADIAN COMPANY LAW, *supra* note 12, at 545. *See, more recently*, Smith, *Minority Shareholders and Corporate Irregularities*, 41 MODERN L. REV. 147 (1978).

position.[245] This has been done in the area of derivative actions, personal actions, and in what may perhaps result in the most important development for members of close corporations, the legislatures have revamped the oppression remedies in many Acts. At the same time, while these reforms are very welcome, they have given rise in some instances to their own problems.[246] This part will briefly review one or two important developments in the common law relating to shareholders' remedies. It will then survey the important cases which are now beginning to arise out of the legislative reform.

A. *The Derivative Action — Common Law*

In the last few years, no cases of importance at common law have arisen locally. In other Commonwealth jurisdictions, however, there have been several developments of interest to common law provinces in Canada. In *Daniels v. Daniels*,[247] the plaintiffs, minority shareholders of the company, alleged that the company, on the instructions of the majority shareholders (directors), sold land in 1970 to one of the directors for £4,250. In 1974, that land was sold for £120,000 and it was claimed that the property had been sold in the first instance at an undervalue. No fraud was alleged by the minority shareholders and the majority shareholders sought to strike out the derivative claim.

Templeman J. held a derivative action could be commenced:

> The authorities which deal with simple fraud on the one hand and gross negligence on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of a breach of duty which they owe to the company, and that breach of duty not only harms the company but benefits the directors. In that case it seems to me that different considerations apply. If minority shareholders can sue when there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous — particularly as fraud is so hard to plead and difficult to prove — if the confines of the exception to *Foss v. Harbottle*, 2 Hare 461, were drawn so narrowly that directors could make a profit out of their own negligence.[248]

His Lordship's approach is very welcome. For twenty years commentators and judges have been concerned with the decision in *Pavlides v. Jensen*[249] and there can be little doubt that the conclusion in *Daniels* is a rejection of that decision. It is simply unfortunate that Templeman J. did not see fit to come out and state this.

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[245] *See* the relevant provisions in the federal, Ontario, British Columbia, Saskatchewan and Manitoba Acts.

[246] *See generally* Beck, *The Shareholders' Derivative Action*, 52 CAN. B. REV. 159 (1974); Getz, *Annual Survey of Canadian Law: Corporation Law*, 5 OTTAWA L. REV. 154, at 167 (1971).

[247] [1978] 2 W.L.R. 73 (Ch. D.).

[248] *Id.* at 79-80.

[249] [1956] Ch. 565, [1956] 2 All E.R. 518.

Readers should not, however, overestimate the impact of this decision. This case, despite the fact that fraud was not alleged, involved an alleged *mala fides* act by the directors. As in *Pavlides v. Jensen*,[250] but even more directly so, the directors were making a clear profit at the expense of the company. In this sense it is similar to those cases where it is alleged that directors have *intentionally* directed a corporate opportunity to their own benefit.[251] One should not be misled by the use of the word "negligence". If the facts as alleged are true, this case was as close to fraud as is possible and its omission from the statement of claim is simply an indication of how difficult true fraud is to prove. *Daniels v. Daniels*, then, stands for the proposition that directors cannot sell to themselves or their own company at an undervalue; such circumstances will give rise to a minority action. Although welcome, there should be nothing surprising in that conclusion. The case does not, however, conclude that negligent acts in themselves will give rise to a derivative action.

It is now generally accepted that breaches of directors' duties which are ratifiable cannot give rise to a derivative action. Consequently, much time has been invested in deciding when such ratification is possible.[252] Perhaps the most heavily criticized case in recent years in this area was the decision of the English Court of Appeal in *Bamford v. Bamford*.[253] In this decision the court appeared to say that *mala fide* acts by the directors could be ratified. The case, however, is really only remarkable for its lack of clarity.[254] It is impossible to tell what the judges meant by *mala fide* in their decision. Did they mean fraud or *mala fide* in the sense of an improper but *bona fide* use of their powers? Certainly, I have always regarded the case as being useful only for academic purposes. Recently, the New South Wales Court of Appeal had occasion to discuss the concept of ratification in a case very similar to *Bamford v. Bamford*. *Winthrop Investments Ltd. v. Winns Ltd.*[255] is, in fact, an extremely important decision and one would hope

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[250] In which the property in question was sold to a related company.

[251] For problems of ratification in this area and the possibility of derivative actions, *see* Beck, *supra* note 185, at 114-19.

[252] *See* Beck, *supra* note 185. The latest discussion of ratification is contained in a very good article by Buckley, *Ratification and the Derivative Action Under the Ontario Business Corporations Act*, 22 McGILL L.J. 167 (1976). While this article is primarily concerned with the statutory procedures, it has a complete discussion of common law authority. *See also* Mason, *Ratification of the Directors' Acts: An Anglo-Australian Comparison*, 41 MODERN L. REV. 161 (1978).

[253] [1970] 1 Ch. 212, [1969] 1 All E.R. 969 (C.A.).

[254] *See* Beck, *Corporate Opportunity Revisited*, in Vol. 2, STUDIES IN CANADIAN COMPANY LAW, *supra* note 63, at 237. *More generally, see* Larson, Comment, 5 U.B.C.L. REV. 363 (1973) for a discussion of the case in another context.

[255] [1975] 2 N.S.W.R. 666 (C.A.). For a succinct but excellent comment *see* Baxt, Comment, 4 BUS. L. REV. 315(1976). *See also* Provident Int'l Corp. v. Int'l Leasing Corp., [1969] 1 N.S.W.R. 424, at 440 (S.C.), where Helsham J. stated:

> The reason why the rule in *Foss* v. *Harbottle* does not apply in a case of fraud on a power such as the present no doubt resides in the fiduciary nature of the

that it will give rise to extended commentaries.[256] For the present, some reference to the court's approach to the issue of ratification is all that is possible in the available space.

The issue in *Winthrop Investments Ltd.* was the now common question as to whether directors breach their duty when they use their power to issue shares to defeat a takeover bid. What makes the present case interesting is that the directors of Winns Ltd. had convened an extraordinary special meeting to sanction the proposed arrangement and allotment of shares to third parties which was designed to nullify the takeover bid. Resolutions were passed sanctioning the acts of the directors at the meeting. The real question before the Court of Appeal was, then, the effectiveness of the sanctioning resolutions.

The majority of the court held that the resolutions were ineffective on important, but for present purposes technical, grounds. Samuels J.A. was of the view that the shareholders could not generally approve actions of the directors in advance because to do so would be to usurp the powers of the directors under the articles. Thus, the resolution would on this assumption be ineffective.[257] Moreover, both Samuels and Mahoney JJ.A. considered that if the ratification was intended to sanction a breach of duty, the directors had not given them adequate information upon which to base their conclusion.[258] In particular, the information circular did not set out the nature of the directors' breach and the fact that the directors sought to be absolved.[259] One suspects this latter point will be difficult to satisfy in many cases because the directors will normally be insisting that their acts are legally correct. Presumably a statement to the effect that "we think we are correct but if we are wrong, would you please sanction the breach", will be sufficient.

The point is, however, that all judges managed to avoid directly commenting on whether all ratifications by the shareholders, regardless

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duty owed and the fact that it is owed to all the corporators of the company: a breach of duty owed to an individual shareholder as one of the corporators could not be ratified by a majority of shareholders, any attempt by a majority to ratify a breach of a fiduciary duty by directors would be no less a fraud *qua* that shareholder than was the case in the acts of the directors; it is possible that *all* the corporators might confirm the actions of the directors, but this is not the question here . . . [I]n a case such as the present there has been an abuse of power and I do not think that a general meeting can resolve that the directors should act in abuse of their powers, or that such an abuse can be ratified where it has resulted in a breach of duty of a fiduciary nature owed to some person not a party to the resolution to ratify. It is in this sense that I think Buckley J. looks at the matter in *Hogg* v. *Cramphorn Ltd.* [*supra*].

[256] Some of the issues are the role of the shareholders' meeting *vis-à-vis* the directors, the possibility of a personal action for breach of directors' duties, the sort of information that must be given to create an effective sanctioning of a breach and, of course, the issue of when ratification is possible. In short, the case is a goldmine.

[257] *Supra* note 255, at 683-84.

[258] *See particularly* Samuels J.A., *id.* at 685.

[259] *Id.* at 685 *per* Samuels J.A., and at 705-06 *per* Mahoney J.A.

of motivation, would validate the directors' actions. Some *dicta* are, nevertheless, interesting.

All three judges clearly accepted the basic thrust of *Bamford v. Bamford* that the shareholders in general meeting may ratify an exercise of power by the directors of a company which is a breach of their fiduciary duty to the company. The shareholders, provided they have full information as to all relevant facts, may ratify that breach after the occurrence or prospectively. Indeed, Glass J.A., by accepting in his dissenting opinion that since full disclosure had been made the ratification in the present case was valid, could be said to be accepting that a ratification will be effective in all circumstances.[260] Mahoney J.A., however, did appear to place some limitations on ratification. While he expressly reserved the point, it is reasonably clear that his Lordship would not allow ratification of a director's fraudulent act. Thus, if directors issued shares to themselves to retain power without consideration of the amorphous good of the company, any ratification would be ineffective. Mahoney J.A. also implies that if the shareholders, in ratifying a breach, had the same collateral purpose as the directors — for example, to retain power in their own group without an objective consideration of the company's benefit — then this ratification may also be defective. This would be in breach of their duty to act *bona fide* in the interests of the company.[261]

It is disappointing that the New South Wales court managed to side-step the main issue of the effectiveness of ratification. Nevertheless, the comments of Mahoney J.A. do set welcome limits on the arguably too broad language in *Bamford v. Bamford*. As Baxt says,[262] the unlimited power of ratification may be commercially realistic since it is difficult to conceive of many situations where shareholders could challenge the acts of directors. It will be difficult to attack the *bona fides* of the shareholders and it may well be that ratification can be successfully challenged only where the directors, by their own votes or those of nominees, sanction their own misdoings. Nevertheless, as Baxt states so succinctly, "it would be a sad day if that kind of argument would sway the Court in deciding that they would not hear an action on the part of the shareholder."[263]

The final case that should be referred to is the decision of the English Court of Appeal in *Wallersteiner v. Moir (No. 2)*.[264] For many jurisdictions in Canada[265] the questions relating to costs involved in a derivative action are now a matter of legislation. Security for costs has

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[260] *Id.* at 673.
[261] *Id.* at 702, 709.
[262] *Supra* note 255, at 317.
[263] *Id.* at 318.
[264] [1975] 1 All E.R. 849, [1975] 2 W.L.R. 389 (C.A.).
[265] *See supra* note 2 generally.

effectively been abolished,[266] the court has the power to order the corporation to pay the plaintiff's interim costs,[267] and it has a discretion as to the awarding of final costs.[268] One would hope that this discretion will be exercised with a view to the problems of the unlucky, but *bona fide,* minority shareholder. In those provinces governed by common law, however, the problems of financing a derivative action remain a hidden, but perhaps great, hurdle to be overcome in commencing a derivative action.

In *Wallersteiner v. Moir (No. 2),*[269] a minority shareholder, who was involved in a derivative action against a particularly disreputable controlling shareholder/director,[270] had essentially run out of money. The Court of Appeal found that, in appropriate circumstances and with certain limitations, the court could order the corporation to pay the cost incurred by the minority shareholder in the action.[271] As Buckley L.J. stated:

> [W]here a shareholder has in good faith and on reasonable grounds sued as plaintiff in a minority shareholder's action, the benefit of which, if successful, will accrue to the company and only indirectly to the plaintiff as a member of the company, and which it would have been reasonable for an independent board of directors to bring in the company's name, it would, I think, clearly be a proper exercise of judicial discretion to order the company to pay the plaintiff's costs.[272]

The procedure suggested by the court is simple and inexpensive. The request for costs would preferably come before the action went to trial, but it should not involve a full trial of the case at a preliminary stage. Costs may be awarded on a common fund basis[273] until the end of discovery or until the trial, depending on the reaction of the judge considering the request. Other interested parties may be joined if the judge thinks necessary.[274] The full implications of *Wallersteiner v. Moir* remain to be seen. The case has not been followed as yet in Canada but there appears no reason why a similar attitude should not be adopted. In Alberta, for example, the appropriate procedure would be for the minority shareholder to approach the judge in Chambers and make the appropriate request. Whatever limits are subsequently set on the decision, *Wallersteiner v. Moir* represents, in my

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[266] *E.g.* CBCA, s. 235(3).

[267] *E.g.* CBCA, s. 235(4).

[268] *E.g.* CBCA, s. 233(d).

[269] *Supra* note 264.

[270] *See* Wallersteiner v. Moir (No. 1), [1974] 3 All E.R. 217, [1974] 1 W.L.R. 991 (C.A.).

[271] *See* Boyle, *Indemnifying the Minority Shareholder,* [1976] J. Bus. L. 18 and Prentice, *Wallersteiner v. Moir: The Demise of the Rule in Foss v. Harbottle?,* 40 Conv (N.S.) 51 (1976).

[272] *Supra* note 264, at 868-69, [1975] 2 W.L.R. at 407.

[273] *See, however,* Buckley L.J., *id.* at 870, [1975] 2 W.L.R. at 409.

[274] *See* the procedure outlined by Denning L.J., *id.* at 858-59, [1975] 2 W.L.R. at 397.

opinion, the greatest undermining of the restraints of *Foss v. Harbottle*[275] in this century. It is unfortunate the courts did not turn their minds to the matter fifty years ago.

B. *Derivative and Personal Actions — Statutory Procedures*

Five jurisdictions[276] have adopted new corporation statutes which regulate the procedure for commencing a derivative action and provide a quick method for remedying personal wrongs.[277] Unfortunately, but perhaps not surprisingly, this spate of legislative reform has given rise to problems of interpretation. It has also generated an increasing amount of case law.[278] The basis of the legislative approach has been discussed on previous occasions[279] and most jurisdictions have followed a common approach.[280] Moreover, several recent articles have canvassed much of the available jurisprudence and the problems raised therein.[281] Accordingly, this part will merely highlight the recent developments in this area.

1. *The Exhaustive Nature of the Derivative Action Provision*

After some initial uncertainty,[282] it is now clear that the derivative action sections provide an exhaustive procedure. If minority shareholders wish to bring an action against the directors of a company for a wrong done to the company, they must utilize the procedures laid down in the Act. This position was taken by the Ontario Court of Appeal in *Farnham v. Fingold*[283] and *Goldex Mines Ltd. v. Revill.*[284] More

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[275] 2 Hare 461, 67 E.R. 189 (V.C.C. 1848).

[276] *See* CBCA; OBCA; BCCA; SBCA; MCA.

[277] *E.g.* CBCA, ss. 231-33, 235, 240; OBCA, ss. 99, 261. The one exception is in British Columbia where there is no express compliance clause. *But see* ss. 15, 221 of BCCA.

[278] *See*, in addition to those cases dealt with in the text, In the Matter of Langley Automotive Ltd., (B.C.S.C. 1976); Artback v. Goodman, (Ont. H.C. Aug. 19, 1974); Soloman v. Masfall Investments Ltd., (Ont. H.C. Aug. 20, 1975); MacCallum v. MacCallum, (Ont. H.C. Nov. 12, 1975); Fowlds v. O'Brien Ltd., (Ont. H.C. Dec. 9, 1975); Rainey v. Norman, (Ont. H.C. May 6, 1976); Winchell v. Del Zotto, (Ont. H.C. Oct. 4, 1976); Solomon v. Elkind, (Ont. H.C. Sept. 17, 1976).

[279] *See* Getz, *supra* note 241; Iacobucci, *Shareholders Under the Draft Canada Business Corporations Act*, 19 McGILL L.J. 246 (1973); Tetrault, *Remedies, Offences and Penalties Under the Business Corporations Act*, in THE CANADA BUSINESS CORPORATIONS ACT, *supra* note 228.

[280] The major exception would be in s. 99 of the OBCA, where the ratification question is not as clear as in the other statutes. For a thorough discussion of the federal, Ontario and British Columbia Acts, *see* F. IACOBUCCI, M. PILKINGTON & R. PRICHARD, CANADIAN BUSINESS CORPORATIONS 191-208, 217-19 (1977).

[281] Beck, *The Shareholders' Derivative Action*, *supra* note 246, at 159; Campbell, *Summary Enforcement of Directors' Duties: Re Goldhar and Quebec Manitou Mines Ltd.*, 2 CAN. BUS. L.J. 92 (1977); Buckley, *supra* note 252.

[282] *See* the Trial Division decision of Haines J. in Goldex Mines Ltd. v. Revill, [1973] 3 O.R. 869, 38 D.L.R. (3d) 513 (H.C.).

[283] [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (C.A.), *rev'g on other grounds* [1972] 3 O.R. 688, 29 D.L.R. (3d) 279 (H.C.).

[284] 7 O.R. (2d) 216, 54 D.L.R. (3d) 672 (C.A. 1974), *aff'g* [1973] 3 O.R. 869, 38 D.L.R. (3d) 513) (Div'l Ct.).

recently, the Manitoba Court of Appeal has adopted a similar view[285] and there seems no reason why the other jurisdictions should adopt a contrary approach.

The courts' conclusions are quite correct. While the statutory procedures may turn out to be more expensive and time consuming,[286] and while there may be problems in obtaining quick injunctive relief,[287] as a general rule shareholders will obviously be better off under such legislation. Thus, the intention of the legislature was to establish a procedure which improved the common law and overcame some of the hurdles of *Foss v. Harbottle*.[288] The sections are a clear rejection of the common law procedures. They provide a *right* to a derivative action subject only to the judicial interpretation of *legislative* conditions. Moreover, as Beck concludes,[289] to allow both common law and statutory derivative actions would lead to total confusion. One set of restraints is sufficient.

2. *Derivative and Personal Actions*

Unfortunately, the decision that the derivative sections are exhaustive has led to problems. The basic thrust of all such provisions is that one must obtain leave of the court to commence such an action by convincing them of such requirements as the complainant's *bona fides* and that the action is in the best interests of the corporation.[290] In several cases, however, the plaintiffs have not obtained the leave of the court and have been forced to argue that their action was personal, not derivative in nature. This stance has placed the courts in a difficult position. For many years it had not been vital to distinguish between personal and derivative actions. Now, however, since derivative actions must comply with the statutory procedures, it has become extremely important on occasion for the courts to decide the true nature of the complaint. Normally, of course, this will arise where leave of the court has not been sought; there is no reason, however, why parties, uncertain of their position, may not commence a personal action under, for example, section 232 of the federal Act and pose the same problem.

The first important case to centre on this problem was *Farnham v. Fingold*.[291] The plaintiffs commenced a personal class action claiming that the premium received by the majority shareholders of Slater Steel

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[285] Churchill Pulpmill Ltd. v. Manitoba, [1977] 6 W.W.R. 109 (Man. C.A.), *aff'g on other grounds* [1977] 3 W.W.R. 581 (Man. Q.B.).

[286] *See* Buckley, *supra* note 252.

[287] *See Re* Goldhar and Quebec Manitou Mines Ltd., 9 O.R. (2d) 740, 61 D.L.R. (3d) 612 (H.C. 1975).

[288] *Supra* note 275.

[289] Beck, *supra* note 246, at 207.

[290] *E.g.* CBCA, s. 283(2).

[291] *Supra* note 283.

on the sale of their shares should be shared with the minority. The defendants argued, *inter alia*, that this action was derivative in nature and should be struck down because the court's leave had not been sought under section 99 of the Ontario Act. Morand J. surveyed the law, decided the merits of the action were arguable and referred the matter to a trial judge. Clearly, his Lordship felt that if the majority shareholders did owe a duty to the minority group then the action was personal in nature.[292] The Ontario Court of Appeal[293] did not really deal with the issue of whether the action was personal or derivative. Having found section 99 to be exhaustive, the plaintiff's action was struck down since the statement of claim contained alleged breaches of duty that were clearly derivative in nature. Since leave had not been obtained, the plaintiffs had no status.[294]

The plaintiff's cause of action in *Farnham v. Fingold* really faltered, therefore, on an issue of drafting. Having regard to the novel nature of their claim in Canada, the plaintiffs, in all likelihood, were unsure themselves whether their complaint was derivative or personal in nature.[295] A similar issue again came before the Ontario Court of Appeal in *Goldex Mines Ltd. v. Revill.*[296] The issue involved was the validity of allegedly misleading proxy solicitations distributed in connection with an annual meeting called by the defendant Probe Ltd. No leave to commence a derivative action was obtained and the plaintiffs argued that the action was personal. Once again, the Court of Appeal dismissed the action on the basis that the statement of claim contained allegations which were derivative in nature.[297] The alleged grounds for the action intermingled both personal and derivative claims and the court did not feel it was its job to suggest a redraft.[298]

On this occasion however, the court did enunciate on the difference between personal and derivative actions. Not surprisingly, it overruled the Divisional Court and concluded that the shareholders were entitled to full and accurate information under the Ontario Business Corporations Act and failure to deliver such information was a wrong to each shareholder personally:

> With the legislative trend obviously towards greater protection of shareholders by seeing that they receive certain information, truthfully and fairly presented, we see no difficulty in holding that shareholders are injured if they do not receive it, apart altogether from any breach of duty owed to the company itself. Where information is sent to shareholders that is untrue or misleading,

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[292] [1972] 3 O.R. at 690-91, 29 D.L.R. (3d) at 281-82.

[293] *Supra* note 283.

[294] *Id.* at 134-35, 138, 33 D.L.R. (3d) at 158, 162.

[295] *See* Beck, *supra* note 246, at 181, n. 104 for a brief discussion of such actions. *See also* Donahue v. Rodd Electrotype Co. of New England, Inc., *supra* note 166.

[296] *Supra* note 284.

[297] *Id.* at 224, 54 D.L.R. (3d) at 680.

[298] *Id.* at 226, 54 D.L.R. (3d) at 682.

> the duty to shareholders is breached, whether the senders were required by statute to send out that class of information, or whether they simply chose to do so.[299]

Thus, the delivery of invalid proxy material could give rise to a personal action.[300] One might add that the court also appeared to accept that delivery of false or misleading information would also be a wrong to the company.

Of greater impact, however, is the implication in the court's opinion that it would entertain hopes for an even wider concept of personal wrongs. Relying, one suspects, on Beck's excellent article in 1974,[301] the court stated:

> It would not be difficult to reach the conclusion that a shareholder's action is personal where one group of shareholders, by their own non-representative activities (*i.e.*, not as directors) acts in such a way as to deprive another group of shareholders of their rights, where those rights are derived from the letters patent (or articles of incorporation), the company's by-laws, or from statutory provisions enacted for the protection of shareholders as such. *The more difficult case arises where the directors, whose shareholdings are controlling or merely substantial, for a collateral purpose of their own, cause the company to act in a manner that deprives a group of shareholders of their rights* (Beck, *op. cit.*, at p. 174). *To cause the company to act to serve personal objectives of the directors would clearly be a breach of the directors' fiduciary duty to the company. Beck suggests that it is also a breach of the directors' fiduciary duty to shareholders as a whole — the duty "to act with an even hand and in good faith": he also asserts that this principle has been indicated (if not always clearly expressed) in the decided cases.*
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> The line of demarcation between a derivative action and a personal action was discussed by Traynor, C.J. in *Jones v. H.F. Ahmanson & Co. et al.* (1969), 460 Pac. Rep. 2d 464 at p. 470 *et seq.*, 81 Cal. Rptr. 592. The argument that the directors, officers and controlling shareholders owe a duty only to the corporation was rejected. The plaintiff was held entitled to bring her action without complying with s.7616 of the California Financial Code, requiring a prior determination by a commissioner that a proposed derivative action complied with certain statutory prerequisites.
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> One phrase used in the judgment of Traynor, C.J. requires comment. At pp. 470-1, referring to *Shaw v. Empire Savings & Loan Ass'n*, 186 Cal. App. 2d 401 at p. 407, he said:
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> > . . . the court [in *Shaw*] noted the "well established general rule that a stockholder of a corporation has no personal or individual right of action against third persons, including the corporation's officers and directors, for a wrong or injury to the corporation which results in the destruction or depreciation of the value of his stock, since the wrong thus suffered by the stockholder is merely incidental to the wrong suffered by the corporation and affects all stockholders alike." From this the court reasoned that a minority shareholder could not maintain an individual action unless he could demonstrate the injury to him was somehow different from that suffered by other *minority* shareholders. In so concluding the court erred. The individual wrong necessary to support a

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[299] *Id.* at 224, 54 D.L.R. (3d) at 680.
[300] *Id.* at 223, 54 D.L.R. (3d) at 679.
[301] *Supra* note 281.

> suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If the injury is not incidental to an injury to the corporation, an individual cause of action exists.
>
> What limitation on the general principle is intended by the words in the last sentence: ". . . not incidental to an injury to the corporation"?
>
> In the context of the whole judgment, we believe Traynor, C.J., meant by this phrase: ". . . not arising simply because the corporation itself has been damaged, and as a consequence of the damage to it, its shareholders have been injured".[302]

Is this passage an acceptance of Beck's thesis that many cases, thought to be derivative actions, were really personal in nature, and will the courts commence to look at who is primarily harmed in categorizing the wrong? Does it mean in particular that abuses of power given to directors in the statute or articles of association will give rise to a personal action? Certainly it is the losing shareholders who suffer in cases where the directors issue shares to thwart a takeover; the company in many cases is only indirectly harmed, if at all.[303] We shall have to await further developments to see the full impact of the *Goldex Mines Ltd.* decision but one can infer from the lengthy reference to *Jones v. Ahmanson*[304] that the Court of Appeal was giving the grounds for personal actions a broader scope than the failure to send out correct information.

It is unfortunate that both these cases were struck down on technicalities. *Farnham v. Fingold,* in particular, could have made a significant contribution to Canadian corporate law had it gone to trial. At the same time, the cases illustrate the vital importance of proper drafting. Despite the fact that the plaintiffs may have been unaware of their ground, they could have split their statement of claim, asked the court for leave on the derivative aspects, and then joined the personal and derivative components after leave had been obtained.[305] While the court did not grant leave *nunc pro tunc*, the plaintiffs were permitted to apply for leave in the future.[306] However, this is a time consuming process and as a general rule, if there is any doubt about an action being derivative in nature, leave of the court should be

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[302] *Supra* note 284, at 221-23, 54 D.L.R. (3d) at 677-79 (emphasis added).

[303] *See* Beck, *supra* note 246, at 169 for an excellent commentary in this area. Another approach apart from the damage theory is to argue that powers under the articles in a registration company are given to directors to use in accordance with their intended purpose. If they utilize their powers for an *ultra vires* purpose then that constitutes a breach of the articles. *But see* Winthrop Investments Ltd. v. Winns Ltd., *supra* note 255, *per* Mahoney J.A.; *see also* Prentice, Note, 40 MODERN L. REV. 587 (1977).

[304] 1 Cal. 3d 93, 460 P. 2d 464 (Sup. Ct. 1969).

[305] *See* Goldex Mines Ltd. v. Revill, *supra* note 284. Subject always, of course, to the relevant rules of court.

[306] *See* Churchill Pulpmill Ltd. v. Manitoba, *supra* note 285, at 120, where the Manitoba Court of Appeal indicated that the plaintiff probably had the right to seek leave for a new action without the permission of the court.

sought. It is hoped that when procedures under the new statutory provisions become settled, such cases as *Farnham v. Fingold* and *Goldex Mines v. Revill* will disappear.[307]

3. *Procedure for a Derivative Action*

All the new corporate statutes contain conditions precedent to the bringing of a derivative action. Thus, the CBCA in section 232(2) requires that the complainant satisfy the court that he has given reasonable notice to the directors of the corporation of his intention, that he was acting in good faith and that his action would be in the best interests of the corporation. Section 235 also leaves the question of ratification as a matter of court discretion. These conditions are clearly necessary to give the corporation an opportunity to commence the action and to guard against strike suits or vexatious litigation. It is not clear at the moment how the courts will interpret these requirements. Two recent cases indicate, however, that the courts will adopt a liberal approach in favour of the minority shareholder.

In *Re Marc-Jay Investments Inc. and Levy*,[308] the Ontario High Court made it perfectly clear that, in considering a leave application under section 99 of the Ontario Act, it was not going to try the action. Its sole job was to decide whether there was a *prima facie* case. O'Leary J.'s general comments on the court's role are refreshingly broad:

> It is obvious that a Judge hearing an application for leave to commence an action, cannot try the action. I believe it is my function to deny the application if it appears that the intended action is frivolous or vexatious or is bound to be unsuccessful. Where the applicant is acting in good faith and otherwise has the status to commence the action, and where the intended action does not appear frivolous or vexatious and could reasonably succeed; and where such action is in the interest of the shareholders, then leave to bring the action should be given.[309]

One might be forgiven for commenting that even the shareholder in *Pavlides v. Jensen*[310] would fit these criteria.

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[307] Later cases appear to have been more willing to entertain the notion that an action is personal in nature. *See, e.g.*, Solomon v. Masfall Investments Ltd., *supra* note 278 (oppressive action by directors and majority shareholders — personal action); MacCallum v. MacCallum, *supra* note 278 (notice problems and incorrect recording of minutes — personal action). *See also* Winchell v. Del Zotto, *supra* note 278. Note also should be made of Feld v. Glick, 8 O.R. (2d) 7, 56 D.L.R. (3d) 649 (H.C. 1975), where Morden J. could not decide whether an action must be brought with leave of the court under s. 99 of the Ontario Act where the only other shareholder is the defendant. I do not have any such doubt; the relevant language of s. 99 is, in my view, only descriptive.

[308] 5 O.R. (2d) 235, 50 D.L.R. (3d) 45 (H.C. 1974).

[309] *Id.* at 237, 50 D.L.R. (3d) at 47. Note also the conclusion of the judge that a beneficial owner of a share, although not registered, has status to bring an action. This makes absolute sense.

[310] *Supra* note 249. And one would hope that ratification would not destroy the case.

More recently, the British Columbia Supreme Court has fully considered similar conditions in section 222 of that province's Act. While some of the wording in section 222 is slightly different from other provinces' equivalents, the general thrust of the court's decision is generally applicable. In *Re Northwest Forest Products Ltd.*,[311] the directors of that company caused a subsidiary company to sell its entire undertaking to a corporation controlled by the directors. The sale price was $199,813.99 and on the same day the purchaser pledged the assets as security for a loan of $290,500. The plaintiffs, minority shareholders, alleged lack of *bona fides* or alternatively negligence on the part of the directors and sought leave to commence a derivative action.

The court granted leave to proceed. Cashman J. found the plaintiffs had status as shareholders and were acting *bona fide*. His Lordship also found that reasonable notice had been given to the directors. It was made quite clear by Cashman J., however, that to satisfy these criteria it will be necessary to give the directors full information as to the specific course of action contemplated.[312] The main difficulty encountered by the court was the meaning of "prima facie in the interests of the company" in section 222(3)(c). After referring to dictionary and judicial meanings, Cashman J. essentially adopted the same approach as was taken in *Re Marc-Jay Investments Inc.*:

> It will be seen that that [judicial] definition is not particularly helpful because such a criterion must be for proof upon trial. This application decides nothing more than whether the applicant has adduced sufficient evidence which on the face of that evidence discloses that it is, so far as can be judged from the first disclosure, in the interests of the company to pursue the action.[313]

This liberal interpretation of the conditions precedent to derivative action is welcome. The legislature placed a heavy responsibility on the courts in giving them broad discretion and power under the new Acts and they are living up to it. Applying a flexible standard at this stage will not open the floodgates of litigation, and one suspects that appropriate use of the discretion to award costs will cause shareholders who consider it easy to get past the preliminary stage to hesitate.

One further aspect of *Re Northwest Forest Products Ltd.* deserves comment. For some years, commentators have been concerned as to the importance the courts would attach to ratification of alleged breaches of duty. This was a particular concern under the Ontario Business Corporations Act but has also been a problem under the other new statutes. Section 222(7) of the British Columbia Act is similar to section 235(1) of the CBCA. It reads:

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[311] [1975] 4 W.W.R. 724 (B.C.S.C.).
[312] *Id.* at 733-34.
[313] *Id.* at 736.

> (7) No application made or an action brought or defended under this section shall be stayed or dismissed by reason only that it is shown that an alleged breach of a right, duty, or obligation, owed to the company, has been or might be approved by the members of that company: but evidence of that approval or possible approval *may* be taken into account by the Court in making an order under this section.(emphasis added)

In the present case the directors' conduct had in effect been approved by the shareholders in general meeting. The court refused to take this fact into account:

> However, here it should be noted that the company had issued 4,125 shares. J.A. Wood and Norman Wood between them owned 1,570 shares which were less than 50 per cent of the issued shares. The other three directors owned no shares in the company. On the other hand no minutes have been produced to indicate how many shareholders or how many shares were represented at that meeting. In this connection it should be borne in mind that Vancouver Island Utilities Ltd. owns 1,090 shares. There is no evidence as to who voted those shares or indeed whether any shares were voted by proxy.
>
> For these reasons I do not take into account the apparent approval of the members of the company.[314]

The court is thus saying that in the absence of evidence of voting pattern, the ratification or approval must be ignored. Moreover, there is a clear concern that shares voted in favour of the directors must be independently cast. It is quite possible that if this approach continues we may see the end of *North-West Transportation v. Beatty*[315] and its apparent sanction of self-approval.[316]

4. *Personal Actions and the Compliance Provision*

There can be little doubt that the compliance provisions in the new Acts[317] will provide a speedy method of rectifying clear breaches of the Act or of corporate constitutional documents. The procedure is summary; the court relies on affidavits and oral arguments and there is no full trial of the issue. Thus, shareholders with complaints about compliance with notice requirements, proxy solicitations or the holdings of meetings at required times can obtain immediate satisfaction.

In *Re Goldhar and Quebec Manitou Mines Ltd.*,[318] the plaintiff sought to extend the natural scope of section 261 of the Ontario Act. The case involved a very complex issue of multiple directorships and a purported breach of section 144 of that Act:

> The directors of Quebec Manitou Mines Ltd. (Quebec) had "working control" of Manitou-Barvue Mines Ltd. (Barvue) through Quebec's share ownership in

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[314] *Id.* at 733.

[315] 12 App. Cas. 589, 57 L.T. 426 (P.C. 1886).

[316] I say "apparent" because I am not yet convinced that the Privy Council would have reacted the same way had the case clearly involved an abuse of the directors' powers.

[317] *E.g.* CBCA, s. 240.

[318] *Supra* note 287.

> Barvue. The applicants' complaint was that the directors of Quebec had used Quebec's corporate control of Barvue to their personal advantage and that, through the use of this power, the directors had "stultified" the votes of other Quebec shareholders. The applicants requested three specific orders: an order declaring that a resolution by Quebec delegating to three of its directors the right to vote its shares in Barvue was void; an order declaring that the proxy of Quebec exercised by a director of Quebec at a shareholders' meeting of Barvue was void; and finally, a direction that the votes cast at the Barvue shareholders' meeting be recounted without including the shares represented by the proxy of Quebec.[319]

The court refused to grant the order. Reid J. held that section 144 gave rise to derivative actions and since the Ontario Court of Appeal had decided that section 99 was exhaustive, this left no room for section 261 in this area; section 261 was concerned with non-derivative matters.[320] Moreover, the court held that a summary application was not appropriate to deal with technical and sophisticated matters. Section 261 was designed to deal with mechanical issues:

> With that proposition we are inclined to agree. The difficulty of passing judgment on the honesty and good faith of directors in respect of decisions made sometimes of necessity hurriedly in sophisticated and complicated factual settings, or upon the credibility of witnesses when the directors as well as the witnesses are revealed only through affidavits and transcripts, needs no illustration. Suffice to say that these questions may be difficult enough to weigh fairly even after a full trial where the appearance and demeanour of witnesses has been experienced and the testimony of directors tested against pre-trial discovery.[321]

One can sympathize with the court's reaction. If the compliance provision were utilized to resolve difficult issues the whole procedure would become unworkable. It is, moreover, certainly difficult to rationalize any claim for jurisdiction under section 261 in a derivative action with the decision in *Farnham v. Fingold.*

At the same time, the case does raise some interesting questions. What does one do under section 99 if the minority shareholder wishes to obtain an injunction; will the court grant leave *nunc pro tunc* and abridge the seven day waiting period?[322] Is Campbell[323] correct in her claim that a temporary injunction should be available under section 261 until the leave application has been heard under section 99? Moreover, is the court correct in its statement that section 144 gives rise only to derivative actions? Certainly, there are suggestions in *Goldex Mines Ltd. v. Revill*[324] that failure to exercise directors' powers may give rise

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[319] Campbell, *supra* note 281, at 93.

[320] *Supra* note 287, at 744-45, 61 D.L.R. (3d) at 616-17.

[321] *Id.* at 743, 61 D.L.R. (3d) at 615.

[322] *See* OBCA, s. 99(2). S. 232 of the CBCA does not provide an explicit time limit but the conditions precedent will still mean a delay of several days. For a discussion of the possibility of an order granted *nunc pro tunc, see Goldhar, supra* note 287, at 746, 61 D.L.R. (3d) at 618.

[323] Campbell, *supra* note 281, at 99-100.

[324] *Supra* note 284.

to a personal action. If, for example, a director pays himself a salary grossly in excess of what is deserved in order to avoid paying dividends to a minority shareholder, this may well give rise to a personal action because the minority shareholder has directly suffered damage. It may also be a breach of section 144. May such a personal action be commenced under section 261 or must one proceed to court with a statement of claim? What if the director is about to declare a dividend; might not a temporary injunction be awarded under the section?

In fact, the court's general conception of section 261 as a clearing house provision for mechanical matters may mean that numerous complex personal rights issues could not be dealt with summarily on an interim basis. This view may be a realistic assessment of the capabilities of the summary procedure but it will remove much of the potential of section 261.

C. *Personal Rights*

At common law, the enforcement of personal rights generally arose in two situations: first, where shareholders attempt to enforce rights granted to them under articles, by-laws or the statute; secondly, in those cases of genuine shareholder oppression where the majority shareholders attempt to alter, for example, the articles of association in a manner which effectively removes rights of the minority group. It is with this latter class of cases that the present comment is concerned.

Traditionally, it has been extremely difficult to prove that an amendment of the articles constitutes a fraud on minority shareholders. Applying the basic test that a shareholders' resolution need only be passed "*bona fide* for the benefit of the company as a whole",[325] the courts have been reluctant to interfere in even the greatest cases of abuse.[326] Relying on authority, one is almost justified in concluding that the only time the courts will intervene is where majority shareholders of one class of shares actively discriminate against minority shareholders of the same class.[327] The recent decision in *Clemens v. Clemens Bros.*[328] may mark an abrupt change in this philosophy.

In *Clemens v. Clemens Bros.*, the plaintiff held forty-five per cent and her aunt fifty-five per cent of the issued share capital of the family

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[325] *See* Greenhalgh v. Arderne Cinemas, Ld., [1951] 1 Ch. 286, [1950] 2 All E.R. 1120 (C.A.) and Allen v. Gold Reefs of West Africa, Ltd., [1900] 1 Ch. 656, [1900-1903] All E.R. Rep. 746 (C.A.).

[326] *See* Sidebottom v. Kershaw, Leese & Co., [1920] 1 Ch. 154 (C.A. 1919); White v. Bristol Aeroplane Co., [1953] 1 Ch. 65, [1953] 1 All E.R. 40 (C.A. 1952); *Re* John Smith's Tadcaster Brewery Co., [1953] 1 Ch. 308, [1952] 2 All E.R. 751 (C.A.); Rights & Issues Investment Trust Ltd. v. Stylo Shoes Ltd., [1965] 1 Ch. 250, [1964] 3 All E.R. 628.

[327] *See* Brown v. British Abrasive Wheel Co., [1919] 1 Ch. 290, [1918-1919] All E.R. Rep. 308; Dafen Tinplate Co. v. Llanelly Steel Co., [1920] 2 Ch. 124; Australian Fixed Trusts Pty. v. Clyde Industries Ltd., [1959] S.R.(N.S.W.) 33 (S.C. 1958).

[328] *Supra* note 97. *See* Joffe, Note, 40 MODERN L. REV. 71 (1978).

company. For some time, the two shareholders had been at odds and, in fact, the plaintiff had resigned from the board of directors. The board of directors, one suspects on the initiative of the aunt, decided that the time had come to increase the capital of the company. The four directors were to be issued 200 shares each and a trust for employees was to be set up, to which would be issued 850 shares. The shares for the employee trust were to be fully paid by means of a loan from the company out of their current value of £19.50. The directors' shares were only to be paid up to the extent of £1.00. All shares were to have full voting rights and it appears clear that the trustees of the employee trust would vote with the board of directors. After some discussion, this resolution reorganizing the company's capital was passed at a shareholders' meeting. The plaintiff alleged that it was oppressive for four main reasons: (a) instead of receiving four-ninths of the dividends on the ordinary shares she would now receive less than two-ninths; (b) she would suffer a capital loss on her investment of approximately £14,000 due to the issue price of the shares; (c) it effectively reduced her shareholding from forty-five to 24.65 per cent and, accordingly, she had lost the right to veto special resolutions and fundamental corporate changes; (d) her right under the articles to purchase her aunt's shares had been infringed — other members now had that right as well and she had thus been permanently put in the position of a minority shareholder.

Foster J. found that the increase of capital was void. Equity would protect the rights of the plaintiff:

> I think that one thing which emerges from the cases to which I have referred is that in such a case as the present Miss Clemens is not entitled to exercise her majority vote in whatever way she pleases. The difficulty is in finding a principle, and obviously expressions such as 'bona fide for the benefit of the company as a whole', 'fraud on a minority' and 'oppressive' do not assist in formulating a principle.
>
> I have come to the conclusion that it would be unwise to try to produce a principle, since the circumstances of each case are infinitely varied. It would not, I think, assist to say more than that in my judgment Miss Clemens is not entitled as of right to exercise her votes as an ordinary shareholder in any way she pleases. To use the phrase of Lord Wilberforce, that right is 'subject. . . to equitable considerations. . . which may make it unjust. . . to exercise [it] in a particular way'.[329]

His Lordship then proceeded to hold that while the aunt honestly felt that she would like to give the directors shares and set up an employee trust, that in setting up the scheme she had been motivated by a desire to effectively remove the plaintiff's negative control position by reducing her shareholding to less than twenty-five per cent and to reduce her rights to purchase the aunt's shares. In these circumstances

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[329] *Id.* at 282.

a court of equity would intervene to stop the aunt using her votes to pass the resolution.[330]

It is difficult to assess the future impact of this decision. If Foster J.'s assessment is that the scheme was a subtle attempt to "squeeze out" the minority shareholder then his decision is defensible. It is simply a conclusion that the resolution was not passed *bona fide* in the best interests of the corporation, although quite clearly the court is adopting a much more sympathetic approach than had hitherto been the case.[331] The manner in which that conclusion is reached raises, however, one basic problem with the *bona fides* test. In the words of Evershed M.R., this phrase:

> does not. . . mean the company as a commercial entity distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.[332]

This approach is fine in the case of relatively disinterested shareholders. But when all shareholders will either benefit or be directly harmed, the test breaks down. So Foster J. asks, did the aunt honestly believe that the scheme would be for the benefit of the plaintiff?[333] As Joffe says, "applied literally across all sorts of companies, this test would prevent shareholders voting in their own interest if the vote meant that a minority shareholder was being harmed."[334] As a general rule this is quite contrary to comments in earlier cases and seems to give the court the role of ascertaining the nature of the majority shareholder.[335] The question then becomes, has the hitherto strong judicial sanction of majority interests given way to minority restraint?

Perhaps this is making too much of Foster J.'s decision. The case is relatively extreme. It is clear that his Lordship was primarily concerned with the destruction of the plaintiff's voting rights.[336] If the shares issued to the employee trust (and perhaps those of the directors) had been non-voting, one suspects a contrary conclusion would have been reached on the facts. In other words, it was not the scheme but the *manner* of implementation that concerned the court. Moreover, the court did place the onus squarely on the plaintiff to prove the invalidity of the shareholders' resolution.[337] Yet, when compared to the decision

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[330] *Id.*

[331] *See* the cases cited in notes 326 and 327, *supra*.

[332] Greenhalgh v. Arderne Cinemas, Ld., *supra* note 325, at 291, [1950] 2 All E.R. at 1126.

[333] *Supra* note 97, at 281.

[334] *Supra* note 328, at 73.

[335] *See, inter alia*, Shuttleworth v. Cox Bros., [1927] 2 K.B. 9, [1926] All E.R Rep. 498 (C.A.); North-West Transportation Ltd. v. Beatty, *supra* note 315.

[336] *Supra* note 328, at 278-79.

[337] *Id.* at 277.

of the English Court of Appeal in *Greenhalgh*,[338] the case exhibits a laudable perception of the importance of minority rights. Perhaps then, the decision in *Clemens v. Clemens Bros.* indicates, if not a radical departure from established jurisprudence, at least a greater role for the courts in evaluating minority concerns in the quasi-partnership corporation.

The other case worthy of brief note is the decision of the Ontario High Court in *Kippen v. Bongard, Leslie & Co.*[339] The plaintiff shareholders were holders of junior subordinated debentures. The conditions attaching to their debt obligation contained a negative covenant to the effect that the company would not issue any "other debentures, bonds, notes or other evidence of indebtedness". Subsequently, the company sought to create and issue senior preference shares and a resolution to approve the application for articles of amendment was approved by the shareholders. One of the conditions of these preference shares was an obligation on the company to redeem all the shares by 1987 or at any time before that date. The plaintiffs sought an injunction on the basis that the creation of the redeemable preference shares was an attempt to alter the priority held by the subordinated junior debentures.

This case only indirectly involves the personal rights of shareholders. The plaintiffs commenced the action in their capacity as debenture holders and O'Driscoll J. simply held that there was no *prima facie* case that the negative covenant had been breached.[340] Clearly, this conclusion was based on the premise that the convenant only covered debt obligations, and that the preference shares represented equity; unfortunately, there is little discussion of this matter. Yet the case raises some interesting questions.

First, for some time the courts have recognized that there is little difference in substance between certain debt obligations and standard preferred shares.[341] They have not as yet, however, treated the preferred share as representing debt capital. In an excellent editorial note to *Kippen*, some of the possible similarities are outlined:

> One might question whether it is correct to state that this "fundamental legal concept . . . obviously cannot be qualified". Given the very broad provisions of such modern corporate statutes as the Canada Business Corporations Act, 1974-75 (Can.), c. 33, and the Business Corporations Act, R.S.O. 1970, c. 53, as amended, it is possible to create a class of shares which has virtually the same conditions and restrictions, as are contained in a debenture with the only differences being, perhaps, (i) that a shareholder of such class would be entitled to dividends only in the discretion of the directors, while a debenture holder

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[338] *Supra* note 325.

[339] 1 B.L.R. 57 (Ont. H.C. 1976).

[340] *Id.* at 62.

[341] *See, e.g.*, the comments of Evershed M.R. in *Re* Isle of Thanet Electricity Supply Co., [1950] Ch. 161, at 175, [1949] 2 All E.R. 1060, at 1066 (C.A. 1949).

> would be entitled to interest as of right, and (ii) that a shareholder would rank after all debt on any liquidation.
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> As regards the first difference, if the share provisions state that the shares will be redeemable at the option of the holder in the event that dividends are not paid on a dividend payment date and that the redemption price is to include all accrued and unpaid dividends, except upon an insolvency, a shareholder could, in effect, almost compel payment of dividends.
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> As regards the second difference, the fact that a shareholder ranks behind all debt may merely mean that he views himself as being in the same position as the holder of a debenture that is subordinated to all other debt. His assessment of the credit risk in acquiring shares would be identical to his assessment of the credit risk in acquiring subordinated debentures and would be reflected in the rate of return.
>
> In an appropriate situation, where the parties to a contract agree to limit or restrict a corporation's right to create indebtedness and there is found an intention to circumscribe generally the ability of the corporation to create money payment obligations one could certainly conceive of a Court refusing to distinguish between debt and equity.[342]

Perhaps the appropriate answer is that the protection of creditors is dependent on the parties' ability to properly negotiate the negative covenants attached to the debt obligation. If debenture holders are concerned about the creation of redeemable preferred shares, the company should be restricted from issuing such equity. If the possibility is not covered, should the courts step in to remedy potential abuse which is really only the result of inadequate drafting? At the same time, any difference between the two forms of investment is only one of emphasis, and it will be interesting to watch future developments in the area.

Secondly, readers should consider the possibility of creditors using the oppression remedy in the CBCA in situations arising as in *Kippen*. Section 234(2) expressly gives the holders of debt obligations standing to commence an action. If the plaintiff can establish an informal agreement that the debt holders were to have absolute priority as to principal, but have failed to comprehensively protect themselves in writing, would the courts regard the issuance of preference shares redeemable at the option of the holder as an act unfairly prejudicial to the creditor? It is difficult to know the scope of section 234(2). It may be that it was intended only to provide protection to minority shareholders, who in this case, are also creditors or directors of the company and harmed in that capacity. Those who are only creditors have their rights governed under contract and it is questionable whether the courts would alter those contractual rights. At the present time, however, the limits of section 234 are yet to be set.

In order to avoid the inadequacies of the common law in the area of personal rights, the new corporate statutes provide extensive protection against the alteration of articles or other acts which might interfere with the rights of minority shareholders. In the CBCA, for example, the

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[342] *Supra* note 339, at 58.

corporation is given the right to amend its articles by special resolution in section 167. Section 170, however, prescribes that in certain situations, the holders of a class of shares, or in some situations a series of shares, are entitled to vote separately as a class or series upon a proposal to amend the articles; even shares not normally carrying a vote are given this right.[343] There will be no amendment of the articles until the members of a class or series entitled to vote separately have approved the proposal by a special resolution.[344] Any dissenting shareholders in a successful amendment are entitled to use the buy-out privileges in section 184.[345]

The scope of section 170 is very broad. At present it covers amendments which will add, change or remove the rights, privileges, restrictions or conditions attached to a class of shares.[346] It also deals with what is commonly called "upstream conversion"; namely, the creation of classes of shares with rights equal or superior to existing classes,[347] increasing the number of shares in a class with rights equal or superior to an existing class[348] and improving the status of an inferior class.[349] Accordingly, through class votes and dissenting rights, the protection by the CBCA is very effective.

Interestingly, the Department of Consumer and Corporate Affairs has found section 170 to be too all-encompassing. In Bill S-2, currently before the House of Commons, it is intended to restrict voting rights in specific situations. The new section 170(1), if enacted, will read:

> (1) The holders of shares of a class or, subject to subsection (2), of a series are, *unless the articles otherwise provide* in the case of an amendment referred to in paragraphs (a), (b) and (e), entitled to vote separately as a class or series upon a proposal to amend the articles. . . .[350]

These changes are clearly going to remove some basic rights from shareholders. However, the Department felt strongly that absolute shareholder protection must give way to practicalities.

The departmental view was put succinctly by John Howard:

> This has been one of the very sensitive issues in the Canada Business Corporations Act. In the statute we generally took the view that we did not need structural controls on corporations; that if management or majority shareholders were guilty of any particular misconduct, then the minority shareholders, or even the director of the corporation's branch, could attack the corporation under the derivative action provision in section 232 or the oppression remedy provision set out in section 234. There is, however, in section

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[343] CBCA, s. 170(3).
[344] CBCA, s. 170(4).
[345] CBCA, s. 184(3).
[346] CBCA, s. 170(1)(c).
[347] CBCA, s. 170(1)(e).
[348] CBCA, s. 170(1)(a).
[349] CBCA, s. 170(1)(f).
[350] Bill S-2, cl. 51 (emphasis added).

> 170 of the act a very strict limitation on dealings with classes of shares. Here we require, in respect of a number of changes not only within a class but among classes, a class vote. In addition, where there is a change within a class or among classes, even non-voting shares have a right to vote. These are very good from the point of view of shareholder protection. They do, however, create a very serious problem for corporations, and particularly very large corporations, that are constantly going into the market with classes and series of shares. They may be redeemable preferred, voting preferred or non-voting preferred. It does not matter. The effect of the section is, as I say, to give the shareholders the vote, even if they would not otherwise have it, and to require a class vote and, in addition, by implication, the section also confers on a dissenting shareholder the right to tender his share to the corporation and demand payment of the fair price for the share. This has created serious problems particularly in respect of the large corporations that go to the public frequently with classes and series of shares, where they are adjusting the rights attached to these shares in order to meet current market conditions. We felt we had solved most of the problems. However, there are three paragraphs in section 170, paragraphs (a), (b) and (c), which have raised a number of very practical problems.
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> This morning I received a call from counsel for an underwriter who suggested that we also except paragraph (e), pointing out to me that he has had to advise two or three of his clients not to continue under the Canada Business Corporations Act because it would create very practical financing difficulties for them.[351]

Presumably the Department feels that where the company does remove the right to vote in its articles, shareholders will have to rely on the derivative action,[352] the oppression remedy[353] and perhaps the common law to protect themselves against any abuse. The Department is, however, on record as stating that if they find abuses of the proposed section, they will come back to Parliament to ask for an amendment.[354]

Several other changes are proposed in Bill S-2 relating to the dissenting right under section 184. First, the dissenting right is extended in appropriate circumstances to shareholders subject to the proposed arrangement provision.[355] Secondly, section 184(3) is being amended to bring the present section into line with the British Columbia equivalent.[356] At present, section 184(3) provides that in ascertaining the fair value of a dissenter's shares, "any change in value reasonably attributable to the anticipated adoption of the resolution shall be excluded". Section 228(5) of the British Columbia Act, as illustrated by the decision in *Re Wall & Redekop Corp.*,[357] expressly provides that "any appreciation or depreciation in anticipation of the vote upon the resolution" shall be taken into account. The proposed amendment will

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[351] SENATE COMMITTEE,BANKING TRADE AND COMMERCE, Doc. No. 6, paras. 6.24-25 (30th Parl., 2d sess., 1977).

[352] CBCA, s. 232.

[353] CBCA, s. 234.

[354] *Supra* note 351, at 625.

[355] Bill S-2, cl. 56(1).

[356] Bill S-2, cl. 56(2).

[357] [1975] 1 W.W.R. 621, at 628, 50 D.L.R. (3d) 733, at 739 (B.C.S.C. 1974).

simply bring the CBCA into line with British Columbia. Finally, it is proposed to amend section 184(11) to clarify the status of a dissenting shareholder and enumerate the situations in which his rights as a shareholder are reinstated.[358]

The new Acts in Manitoba and Saskatchewan provide for slight variations in the dissenting rights provisions. Section 184(2) of the Manitoba Corporations Act[359] follows basically the thrust of the proposed amendments in Bill S-2. It provides that a holder of a class of shares entitled to vote under section 170 may dissent except with respect to transactions under section 170(1)(a).[360] Section 184(2.1), however, provides that a corporation may provide in its articles that a holder of a class of shares entitled to vote under section 170(1)(a) may dissent. The Act, then, retains the right to vote as a class with respect to all amendments dealt with in section 170, but effectively limits the right to dissent in some circumstances.[361]

The variations in the Saskatchewan Business Corporations Act[362] are more substantial. Once again, the differences revolve around the right to dissent under amendments pursuant to section 170. Classes of shares are given the right to vote separately under that section but the rights of shareholders to dissent are severely restricted. First, any right to dissent arising out of a section 170 amendment is restricted to "non-distributing corporations". Here, the draftsmen have followed the Ontario model,[363] presumably on the basis that a ready market is available for shares of distributing companies. Secondly, even shareholders in private companies have no absolute right to dissent. Section 184(2) states that:

> The articles of a corporation may provide that a holder of any class or series of shares of a corporation, except a holder of shares of a distributing corporation, who is entitled to vote under section 170 may dissent if the corporation resolves to amend its articles in a manner described in that section.

It is difficult to fathom the reason for this variation. The whole purpose of sections 170 and 184 of the CBCA was to protect minority shareholders in the absence of a realistic response by the common law. Some latitude is acceptable because of corporate practicalities but it is questionable whether the whole issue should be left to be dealt with by the corporation articles. At the very least, a *statutory inclusion* subject to a right to *exclude* in the articles would have been preferable.

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[358] Bill S-2, cl. 56(3).

[359] MCA.

[360] These provisions are identical to the similarly numbered sections in the CBCA.

[361] It is interesting to note that in the CBCA, the articles will have to exclude the right to vote, whereas under the Manitoba Act the right must be granted in the articles.

[362] SBCA.

[363] OBCA, s. 100(1).

Finally, note should be made of the first case to interpret the new provisions regulating class rights. In *Re Trend Management Ltd.*,[364] the articles provided that the Class A common shares were entitled to elect one director to a board of three, the other two being elected by the holders of Class B common shares. A further article provided that any expenditure in excess of $100,000 for a single item had to be approved unanimously by the directors. On an expenditure which required unanimous consent, the director elected by the Class A shareholders objected, whereupon the remaining directors called an extraordinary meeting of the shareholders to amend the articles by deleting the requirement for unanimous consent. The Class A shareholders contended that this was an abrogation of a right attached to their shares, and, accordingly, asked for an order compelling the respondents to purchase their shares.

The relevant sections of the British Columbia Act read:[365]

> 247(1) No right or special right attached to any issued share shall be prejudiced or interfered with under any provision of this Act or of the memorandum or articles unless members holding shares of each class whose right or special right is prejudiced or interfered with consent thereto by separate resolution requiring a majority of three-fourths of the issued shares of the class.
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> 248(1) The holders of
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> . . . .
>
> (b) not less than ten per cent of the shares of a class of shares of the company, whose rights are affected by a special resolution abrogating or altering special rights or restrictions attaching to any class of shares of the company, or approving of any arrangement, who did not, in person or by proxy, vote in favour of the resolution referred to in section 247;
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> other than as a proxy for a person whose proxy required an affirmative vote may, not more than fourteen days after the passing of the last resolution, apply to the Court to set aside the special resolution.
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> . . . .
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> (4) Upon an application under subsection (1), the Court may
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> . . . .
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> (c) affirm the special resolution and require the company, subject to subsection (1) of section 257, or any other person, to purchase the shares of any member at a price and upon the terms to be determined by the Court,
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> and, in any case, the Court may make such consequential orders, including any order as to costs, and give such directions as it considers appropriate.

The applicants argued that the only way they could restrict management's spending of funds was by having the right to elect a director and require an unanimous vote on some transactions. Accordingly, the conditions were fundamental rights attached to their shares. The re-

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[364] 3 B.C.L.R. 186 (S.C. 1977).

[365] BCCA. S. 248 is soon to be amended.

spondents replied basically that the unanimous vote provision was not a right attached to the shares. It was an article regulating the functioning of the board. The rights attached to Class A shares were the right to dividends and the right to elect a director, and these remained unaffected.

Andrews J. accepted the argument of the respondents:

> I am persuaded by respondents' argument that it cannot be said in the circumstances at hand any "right" or "special right" attached to the Class A shares has been affected by this resolution. It seems to me it might be argued that the "enjoyment" of the right has been affected to the extent that the director elected by the Class A shareholders no longer enjoys a veto but that, I repeat, is at most an abrogation of an "enjoyment", as opposed to the "right".
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> I, like counsel, have been unable to find Canadian authority, but support is found in English authority for the proposition there is a difference between varying or abrogating a right attached to the share and taking some action which affects the enjoyment of that right: see *Greenhalgh v. Arderne Cinemas Ltd.*, [1946] 1 All E.R. 512 where the affect of a proposed subdivision of shares was to deprive the plaintiff of voting control and where Lord Greene M.R. drew a distinction between rights being "affected as a matter of business" and "varied as a matter of law" [p. 518]. See also *Re Mackenzie & Co. Ltd.*, [1916] 2 Ch. 450, and *White* v. *Bristol Aeroplane Co.*, [1953] Ch. 65, [1953] 1 All E.R. 40.
>
> In my view, the most the applicants can complain of is the enjoyment of their right being affected as a matter of business, but this does not bring into operation the protective provisions of s. 248 of the Act.[366]

The case is a difficult one. The requirement of "unanimous consent" looks like a "right". However, on balance I believe the court's conclusion is probably correct. This requirement related to the functioning of the board. There was no guarantee that their elected director would always vote the way the Class A shareholders desired. Indeed, while the point is quite unrealistic, in theory such a right might well be void as fettering the discretion of a director if it is viewed as guaranteeing ultimate control by the shareholders.

The problem with Andrews J.'s judgment is his Lordship's return to the old common law cases. The case could have been simply disposed of on the basis that no *right* attached to the shares was being abrogated or removed. Andrews J.'s acceptance of the distinction between rights being "affected as a matter of business" and "varied as a matter of law" makes it clear that he considers the old distinction as still relevant in British Columbia. This may be correct under the wording of section 248 but we can do without judicial sanction of the fact.[367]

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[366] *Supra* note 364, at 192.

[367] There are two interesting questions arising out of this case and the relevant sections. First, what is the inter-relationship of the phrase "abrogating and altering" in s. 248 and "interfered or prejudiced" in s. 247? Presumably the latter is wider, but how will it be interpreted by the courts? *See also* ACA, s. 38(1)(a). Secondly, if the latter is wider, why did the applicants not simply proceed to court and ask for the resolution to be struck down as not being in compliance with s. 247, since it appeared there was not a separate class vote as required? This comment is premised on the fact that a "right" had been interfered with.

As an aside, it is suggested the conclusion would have been the same under the CBCA. While section 170(1) is clearly broader than sections 247 and 248 of the British Columbia Act, it is still worded in subsection (c) in terms of "add, change or remove the rights, privileges, restrictions or conditions" attached to shares. In my opinion, the requirement of unanimous consent among the directors does not fall within these words either.

D. *The Oppression Remedy*

It has long been the feeling of draftsmen that derivative and personal actions, either at common law or under the more recent statutory procedures, might not provide a completely satisfactory remedy in all circumstances.[368] Consequently some corporate statutes[369] have included oppression provisions based on section 210 of the United Kingdom Act.[370] The defects of the earlier provisions have been well documented;[371] suffice it to say that to a large extent they were judicially imposed. The oppression provisions which have arisen out of the recent era of corporate reform[372] were accordingly designed to remove some of the more blatant of the remedy's restrictions and in so doing to provide some modicum of protection for minority shareholders in private companies who were being "squeezed out" by the majority. Two recent British Columbia decisions provide some indication as to how the new provisions will be interpreted.[373]

In *Diligenti v. RWMD Operations Kelowna Ltd.*,[374] the applicant and three individual respondents had incorporated two companies to operate restaurants. The applicant and the respondents each held twenty-five per cent of the issued shares of the company. Each individual also held a twenty-five per cent interest in the land on which the restaurants were situated and which was leased to the companies. At the outset, each individual was a director of the corporations. Initially, relationships between the individuals were satisfactory and the applicant spent a great deal of his time setting up the businesses and supervising the operation. Eventually, however, differences arose between the

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[368] *See* PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA, *supra* note 18, at 163-65; JENKENS COMMITTEE, REPORT OF THE COMPANY LAW COMMITTEE, U.K., paras. 200-12 (1962).

[369] *See, e.g.*, Companies Act, R.S.B.C. 1960, c. 67, s. 185; Companies Act, N.Z. 1955, s. 209.

[370] Companies Act 1948, 11 & 12 Geo. 6, c. 38, s. 210.

[371] *Supra* note 1. *See also* GOWER, *supra* note 43, at 598-604; Mackinnon, *The Protection of Dissenting Shareholders*, in Vol. 1, STUDIES IN CANADIAN COMPANY LAW, *supra* note 12, at 512-13.

[372] BCCA, s. 221; CBCA, s. 234; MCA, s. 234; SBCA, s. 234.

[373] *See also Re* World Wide Salvage Co., (B.C.S.C. Oct. 26, 1976); *Re* Tarquin Investments Ltd., (B.C.S.C. Sept. 12, 1975).

[374] *Supra* note 97.

parties and the three individual respondents began to exclude the applicant from the affairs of the corporations. In particular, (a) he was removed as a director of both companies, (b) he was ousted from any right to participate in the day-to-day affairs and management of the companies, and (c) the respondents set up a management corporation to provide services to the restaurants and fees were paid to this entity. In these circumstances, the applicant applied for relief under section 221 of the British Columbia Companies Act.

Section 221[375] is not drafted as broadly as the equivalent section in the CBCA, or the Saskatchewan and Manitoba Acts. It provides a remedy where the affairs of the company are being conducted in a manner that is oppressive, or where some act has been done that is unfairly prejudicial to one or more of the members of a company. Thus, on its face, the section is restricted to situations where the member has been harmed in his capacity as a member and not, for example, as a director.[376]

The court dealt initially with the removal of the applicant from his position as director. Fulton J. accepted that section 221(1)(a) could not apply. Case law indicated that removal as a *director* was not conduct *oppressive* to an applicant in his capacity as a *member*.[377] His Lordship proceeded, however, to conclude that the act was *unfairly prejudicial* to the applicant as a member. Relying on the House of Lords decision in *Ebrahimi* v. *Westbourne Galleries Ltd.*,[378] he concluded that the words covered the situation where, in a quasi-partnership situation, it was clear that it had been agreed that all shareholders would share equally in the continuing management and direction of the affairs of the company. In these circumstances, the applicant's removal from his position as director had unfairly prejudiced him as a member:

> Adopting, as I respectfully do, this reasoning in its entirety three things appear to me to emerge quite clearly. First, in circumstances such as exist here there are "rights, expectations and obligations inter se" which are not submerged in the company structure, and these rights are enjoyed by a member as part of his status as a shareholder in the company which has been formed to carry on the

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[375] S. 221(1) of the BCCA reads:

221(1) A member of a company or an inspector under section 230 may apply to the Court for an order on the ground

(a) that the affairs of the company are being conducted, or the powers of the directors are being exercised, in a manner oppressive to one or more of the members, including himself; or

(b) that some act of the company has been done, or is threatened, or that some resolution of the members or any class of members has been passed or is proposed, that is unfairly prejudicial to one or more of the members, including himself.

[376] *See* note 381, *infra*.

[377] *See Re* 5 Minute Car Wash Service Ltd., [1966] 1 All E.R. 242, [1966] 1 W.L.R. 745 (Ch.); *Re* Bellador Silk Ltd., [1965] 1 All E.R. 667 (Ch.); *Re* B.C. Aircraft Propeller & Engine Co., 63 W.W.R. 80, 66 D.L.R. (2d) 628 (B.C.S.C. 1968).

[378] [1973] A.C. 360, [1972] 2 All E.R. 492 (H.L.).

> enterprise: amongst these rights are the rights to continue to participate in the direction of that company's affairs. Second, although his fellow members may be entitled as a matter of strict law to remove him as a director, for them to do so in fact is unjust and inequitable, and is a breach of equitable rights which he in fact possesses as a member. And third, although such breach may not "oppress" him in respect of his proprietary rights as a shareholder, such unjust and inequitable denial of his rights and expectation is undoubtedly "unfairly prejudicial" to him in his status as member.[379]

Few would complain of the tenor of Fulton J.'s comments. His Lordship was giving the section its proper effect. Yet one must query whether his decision is correct in light of previous jurisprudence and in light of the rationale for including "unfairly prejudicial" in the reformed statutes. These words do not appear to have been included to solve the problem of whether a *member* has been harmed. Rather, they were intended to make it perfectly clear, although arguably unnecessarily, that conduct did not have to be unlawful to fall within the oppression provision.[380] The problem of capacity should have been dealt with by the draftsmen in the same manner as in the CBCA, *i.e.* by making the section expressly applicable to conduct oppressing any security holder, creditor, director or officer.[381] By concluding that removal as director may *unfairly prejudice* a member, but maintaining that it cannot *oppress* a member, Fulton J. is treading on very dangerous ground and it is to be hoped that the British Columbia Act will be amended appropriately. Yet the decision makes admirable sense; inevitably in a private corporation with share management undertakings, removal from a management position may unfairly prejudice or for that matter oppress the individual in his capacity as member; one of the reasons for his shareholding in the company has been removed. This conclusion by Fulton J. is, therefore, very welcome but in terms of precedent perhaps doubtful.

The remainder of his Lordship's decision is less eventful. Fulton J. stated that the applicant had no inherent right to management fees or to continue in the position as a paid manager; an outside person could be appointed to manage the company.[382] As a general statement this may be inconsistent with his Lordship's earlier comments concerning private corporations. If there is an implicit agreement on incorporation that *X* shall handle the management of the company one would suspect that an act relieving him of this responsibility might be unfairly prejudicial to him. Nevertheless, Fulton J. went on to add that in the circumstances of this case, his removal from management was indeed unfairly prejudicial or oppressive. The individual respondents had not shared the

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[379] *Supra* note 97, at 51.

[380] *See supra* note 368.

[381] CBCA, s. 234(2). *See also* similar sections in the Manitoba and Saskatchewan Acts.

[382] *Supra* note 97, at 52.

management fees between all shareholders but had siphoned off the fees to a corporation wholly owned by themselves. Thus, the exclusion of the applicant from any enjoyment of management and its remuneration was at least *prima facie* evidence of conduct within section 221.[383] This, it is submitted, is a relatively straightforward and accurate application of the oppression remedy. There were no problems as to the capacity in which the applicant was being oppressed and the transfer of management fees is a simple example of the "squeezing out" which the section was designed to prevent.[384]

The second decision was also given by Fulton J. and is particularly interesting from a remedial point of view. In *Jackman v. Jackets Enterprises Ltd.*,[385] the applicant was the holder of shares which had been given to her employee/spouse for nominal consideration. There was never any intention that she should share in the management of the company. The majority shareholder, Etsekson, ignored virtually all the procedural requirements of the Companies Act. For three years the minority shareholder had received no financial statements or information relating to the company and no annual meetings had been held. In addition, the debt structure of the company had been radically altered. Previously, a trust company had made a loan of $210,000 to the company at ten per cent. This had been replaced with a loan of $450,000 at twelve per cent payable in whole in late 1978; $214,000 of this amount had been lent to another company, Ben's Truck Parts of Canada Ltd., of which Etsekson was the sole shareholder. This company had guaranteed the mortgage.

Fulton J. held that both grounds constituted conduct which was prohibited by section 221. The applicant was entitled to receive information as a shareholder and had the right to attend meetings annually.[386] As to the debt financing, his Lordship held that the equity of Jackets Enterprises Ltd. had been encumbered by the additional mortgage and had received no benefit. Any benefits had gone to Ben's Canada and indirectly to Etsekson as sole shareholder of that company. This was particularly burdensome as it appeared that there was no way that the said company could satisfy its obligations under the guarantee or even repay the money it had borrowed:

> [I]n my view, to channel moneys in this way at the instance of Mr. Etsekson into a company of which he is sole shareholder is conduct oppressive of or unfairly prejudicial to the Plaintiff as minority shareholder. Her equity is diminished or prejudiced proportionately by that extra borrowing from which she gained no benefit. So is that of Mr. Etsekson, but he benefits through his shareholding in Ben's Canada.

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[383] *Id.* at 53.

[384] There was no determination of remedies in this case, as it only involved a preliminary motion to dismiss.

[385] 4 B.C.L.R. 358 (S.C. 1977).

[386] *Id.* at 360.

> Jackets' liabilities, and thus its chance of earnings, are also affected by the extra interest charged on its previous borrowing, which extra interest charge was incurred in the course of the new borrowing which was made in order to raise the new funds which went to Ben's Canada.[387]

Neither of these conclusions is surprising. In providing a remedy, however, Fulton J. was quite inventive. Proceeding on the basis that this was not a quasi-partnership as *Diligenti* and that it was never intended that the applicant would play a part in management, his Lordship refused to order the purchase of the applicant's shares. As to the procedural matters, he accordingly made an order under section 221(2)(b) requiring the company's affairs to be conducted in accordance with the provisions of the Companies Act.[388] With respect to the debt financing, Fulton J. concluded that the remedy should secure the indebtedness from Ben's Canada to Jackets and compensate Jackets for the extra interest payment it had incurred. Since Ben's Canada was not a party to the proceedings, his Lordship used his wide remedial authority to require Etsekson to personally guarantee the loan from Jackets to Ben's Canada, the guarantee to become enforceable whenever steps were taken by Yorkshire Trust to realize on the mortgage. In addition, the order required Etsekson to pay or cause to be paid to Jackets the extra interest charges incurred by the new borrowing.[389]

This case is an excellent example of the use of the wide remedial power given to the courts under the oppression sections. By shaping the remedies as he did, Fulton J. effectively placed the applicant and Jackets in the same position as they had been prior to the financing. All that could feasibly happen was that Etsekson would not be able to pay when the guarantee became due, and presumably the court was satisfied on this count. The decision also illustrates that the sections may provide an extremely good remedy in cases which do not involve quasi-partnerships and where it is quite feasible for a derivative action to have been commenced. Indeed, while the court is given broad remedial powers in both types of action,[390] one suspects that in many cases a more equitable result may occur through use of the oppression, rather than the derivative, cause of action.

VII. Corporate Reorganizations and Reconstructions

Corporate reorganizations are the heart of the specialized corporate lawyer's practice. They are also among the most difficult and complex matters to deal with.[391] The range of corporate transactions in this area

[387] *Id.* at 361.
[388] *Id.* at 362.
[389] *Id.*
[390] *Compare* CBCA, ss. 234(3) and 233.
[391] For a general discussion of the multifarious factors which go into a corporate reorganization, *see* D. Morin & W. Chippindale, Acquisitions and Mergers in Canada (2d ed. 1977); Iacobucci, Pilkington & Prichard, *supra* note 280, at 418 ff.

is almost limitless, limited only by the ingenuity of the planner. At the most basic level they include the takeover with or without the compulsory acquisition option; amalgamations with or without a freeze-out of minority shareholders; arrangements which may also involve the squeeze-out of a minority and the sale, lease or disposition of all or substantially all of the corporation's undertaking.

Reorganizations have, of course, been taking place for decades. However, relatively little detailed jurisprudence has developed in the area outside of the takeover compulsory acquisition sections. With the passing of the new corporate statutes, the procedures for many of these transactions have changed.[392] Thus, restrictions on the sale of a substantial portion of a corporation's assets are now common.[393] In particular, the new statutes all provide for dissenting rights in many of these transactions for the minority who object and vote against the proposed action.[394] As in other areas of corporate law, the number of cases in the reorganization area appears to be increasing.[395] This part will briefly review the major judicial developments and attempt some assessment of what the future holds.

A. *Dissenting Rights*

Prior to the era of corporate reform, few corporate statutes provided expressly for the compulsory acquisition of minority dissenting interests.[396] If the statutory procedures were not complied with or the reorganization was inequitable in the view of the court, the proposed transaction would be nullified. However, in many situations, the transaction would go ahead and the dissenting shareholder remain in the company, a result which was often unacceptable to both majority and minority shareholders. On other occasions, the minority shareholder would be squeezed out; he could attempt to have the transaction nullified but had no set means of forcing the company to pay him the "fair value" of his shares if he felt mistreated. The dissenting rights and appraisal provisions in the new Acts were essentially brought in to

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[392] Particularly with respect to the disclosure requirements, a fact which seemed to escape the learned judge in Neonex Int'l Ltd. v. Kolasa, *infra* note 407. *See, e.g.*, the regulations on takeovers, S.O.R./75-682 (110 Can. Gazette, Pt. II, 3163).

[393] *E.g.* CBCA, s. 183(2); OBCA, s. 100(1)(a); BCCA, s. 221. *Cf.* ACA, s. 20(1)(12).

[394] *E.g.* CBCA, s. 184; OBCA, s. 100 (although far less clear than the other); BCCA, s. 228.

[395] Two interesting cases arising out of reorganizations but which are not essentially corporate in nature are O'Grady v. Insurance Corp. of British Columbia, 63 D.L.R. (3d) 370 (B.C.S.C. 1975) (wrongful dismissal and mitigation of loss) and Falconer v. Hill, 62 D.L.R. (3d) 745 (Alta. S.C. 1975) (libel and slander by a minority shareholder in the context of a takeover).

[396] *See* s. 155(2) of the ACA, dealing with "arrangements". Does this section contemplate a court having jurisdiction to order the purchase of a dissenting shareholder's shares? *See also* s. 34(5) of that Act (alteration of objects) and s. 249 (sale of assets followed by a voluntary winding up) which gives a limited right of appraisal.

deal with these problems. However, as with the statutory procedures for derivative actions, these new provisions have caused their own troubles. Not the least of these is what price the court should set on the shares if an application is made. In most cases, this will lead to the question of what is the "fair value".[397]

The leading case in Canada is still *Re Wall and Redekop Corp.*[398] In this case it will be remembered that McFarlane J. referred the question of valuation of shares to an appraiser.[399] Before doing this, however, his Lordship made a valuable survey of methods of valuation. McFarlane J. suggested three alternatives: (a) market value by reference to the stock exchange, (b) net asset or liquidation determination, or (c) the investment value of the shares based on a capitalization of the earnings of the company.[400] His Lordship did not state a preference, favouring a case by case analysis. However, many problems remained to be settled and are still not clear: to what extent should the fact that a minority interest is being acquired be taken into account; should the court have regard to the fact that the company may have a special value to particular shareholders; and what should happen if acquisition of a dissenting minority might lead to another shareholder gaining effective control?[401]

Two cases in particular should be noted since *Wall and Redekop*. In *Re Ripley International Ltd.*,[402] a public company went through an arrangement of its share capital in order to qualify as a private corporation. This was done by a consolidation on the basis of 1:5000; 99.5 per cent of the shareholders agreed and received transactional shares but these were bought out at the price of $5.00 per unconsolidated share. Two dissenting shareholders argued, *inter alia*, that the price was unfair. This decision, of course, did not involve a dissenting rights application.[403] Nevertheless, Southey J.'s comments on valuation are worth mentioning.

His Lordship essentially held that since tax advantages might flow from the transformation of Ripley to a private company, such advantages should be reflected in the purchase price of the shares:

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[397] *See*, in addition to the cases cited in the text, Bexley v. Dunning, [1976] 4 W.W.R. 446 (B.C.S.C.); *Re* Fontainebleu Plaza Ltd., (Ont. H.C. Feb. 16, 1976); Queensland Co-Operative Milling Ass'n Ltd. v. Hulchison, [1976] 2 A.C.L.R. 188 (Q.S.C.). For an excellent discussion of valuation problems, *see* I. CAMPBELL, THE PRINCIPLES AND PRACTICE OF BUSINESS VALUATION (1975).

[398] *Supra* note 357.

[399] *Id.* at 628, 50 D.L.R. (3d) at 739.

[400] *Id.* at 625, 50 D.L.R. (3d) at 737.

[401] This will not normally happen in the case of a reorganization but could happen if a court ordered valuation in an oppression context under CBCA, s. 234(3)(f). *See* the *Queensland Co-Operative* case, *supra* note 397.

[402] 1 B.L.R. 269 (Ont. H.C. 1977).

[403] The corporation applied for sanction of an arrangement under s. 194 of the OBCA.

> I am quite satisfied from the foregoing that the price of $5 per share proposed in the arrangement would be a fair, indeed generous, price to pay for shares of the applicant at the present time, if the applicant were going to continue as a public corporation. Whether $5 per share would be a fair price to pay for the shares of small shareholders who need to be gotten out of the way to permit the applicant to become a private corporation depends, in my view, on the extent of the tax savings anticipated from the change in status of the applicant and the resultant estimated increase in the value of the shares of the continuing shareholders. There is nothing in the material on these two points.
>
> The small shareholders, who would not be permitted to continue under the proposed arrangement, were invited originally to invest in a public corporation. If their shareholdings are now to be eliminated, against their wishes, in order to permit the applicant — and that means the few continuing shareholders of the applicant — to enjoy tax savings as a private corporation, then the price to be paid for their shareholdings would not be fair and reasonable, in my judgment, unless it reflected a pro rata participation in the anticipated tax savings. In other words, their shareholdings should be valued as if they would have been able to remain as shareholders in the newly constituted private corporation.[404]

Southey J. accordingly dismissed the application for approval of the arrangement although without prejudice to the applicant if it should present additional information in the future.[405] The case is particularly interesting in that his Lordship, in the absence of statutory authorization, opts for the British Columbia dissenting and appraisal provisions rather than the CBCA. Section 228(5) of the British Columbia Act provides that, in establishing "fair value", any appreciation or depreciation in anticipation of the vote on the relevant resolution should be taken into account. Section 184(3) of the CBCA provides the contrary; any change in value in the shares which is reasonably attributable to the anticipated adoption of the resolution shall be excluded. As will be seen, this choice by Southey J. has obviously had a profound effect on federal administrators.[406]

The federal dissenting provisions arose for consideration in the recent decision of the British Columbia Supreme Court in *Neonex International Ltd.* v. *Kolasa*.[407] The case arose out of an amalgamation between Neonex International Ltd. and Jim Pattison (British Columbia) Ltd. All CBCA, Security Exchange Commission and Securities Act requirements were complied with, and as a result of the amalgamation a new Neonex International Ltd. emerged. The amalgamated company was effectively controlled by Jim Pattison, most of the former shareholders having been bought out at $3.00 per share pursuant to the amalgamation agreement. The respondents objected to the amalgama-

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[404] *Supra* note 402, at 273-74.

[405] *Id.* at 274.

[406] Although, even after Bill S-2 becomes law, the compulsory buy-out under s. 199 of the CBCA will remain silent. Corporate practitioners should be concerned if *Re* Ripley Int'l Ltd. is applied in this context because it will be very difficult in many cases to gauge the cost of a takeover.

[407] 3 B.L.R. 1 (B.C.S.C. 1978).

tion and dissented under section 184. Neonex International Ltd. responded by offering the respondents what it felt was the "fair value" of the shares, namely $2.50. Finally, it appears that Neonex asked the court to establish "fair value". The respondents requested the appointment of an appraiser pursuant to section 184(21).

It would be an understatement to say that Bouck J. had little sympathy for Neonex. His Lordship criticized the amalgamating companies which were largely owned by Pattison;[408] he implicitly criticized the size of the companies,[409] and accused the companies of providing insufficient information at the time of the amalgamation.[410] His Lordship then proceeded to the more substantive questions. First, it is clear Bouck J. did not agree with the dissenting provisions in section 184:

> If Pattison had been compelled to follow the normal forcing-out provisions enunciated in s. 199 a variety of protective mechanisms would have been available to the minority which are not available on amalgamation. In particular there is no definition of fair value in the s.199 procedure. It is at least arguable the fair value should reflect any benefit the majority might receive by reason of the takeover. However, where a court is called upon to assess the fair value of a dissenter's shares on an amalgamation such as this, the calculation must be determined at the close of business on the day before the amalgamation resolution was adopted (s.184(3)). Any change in value reasonably attributable to the anticipated adoption of the resolution must be excluded. This seems to mean that any benefits Pattison gained by the amalgamation cannot be taken into consideration when valuing the dissenter's shares.
>
> Such a result is in direct contradiction to the earlier legislation because where two companies amalgamated under that statute the minority shared any benefits given the majority in the amalgamated company. It was a pro rata distribution of shares amongst all the shareholders and not a confiscation of their shares at a fixed price.
>
> If a shareholder wants to acquire all the other shares in the company by using the amalgamation sections rather than the forcing-out provisions then the law will be particularly concerned over the rights of the dissenters. Their property is being expropriated. It has always been the policy of the common law to protect the rights of the minority as against the abuse of an unreasonable majority. This is more so where an individual's property is being taken by the majority and it is claimed there has not been adequate compensation.
>
> If Parliament intended to deprive the minority of these common law rights then the law demands that the statute say so in the most clear and unequivocal language. *Otherwise, the common law will blossom through the cracks and crevices of the legislation and try to ensure that justice is done.*[411]

As a result of the supposed inadequacies of the legislation, Bouck J. held that a heavy burden rested on the corporation to show that a fair value had been offered for the shares.[412] He held this onus had not

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[408] *Id.* at 7-8.
[409] *Id.* at 8.
[410] *Id.* at 13.
[411] *Id.* at 12-13 (emphasis added).
[412] *Id.* at 13. This is an extremely interesting conclusion, and possibly a doubtful one, when one compares the attitude of the courts under the compulsory acquisition procedures in, for example, s. 153 of the Alberta Act. In such cases, the burden was on the shareholder to prove the corporate price incorrect.

been satisfied. Moreover, his Lordship did not decide the question of fair value himself, with or without the assistance of an appraiser. It was ruled that an appraiser was only appropriate where the value of one easily appraised piece of property was at issue; it was inappropriate to appoint an appraiser in a complex transaction because it was a time-consuming process and the question of costs was unclear.[413] Finally, his Lordship ordered a *trial* of the action to determine the fair value.[414]

Frankly, this decision is an abomination. It appears that the judge was mistaken in his assessment of the facts;[415] in particular, one suspects that the Securities Exchange Commission, Canadian Securities Commissions and the administrators of the CBCA would be delighted to know that their disclosure requirements are totally insufficient. Moreover, one must question his Lordship's analysis of section 184. Prior to the enactment of this section, a shareholder had *no* right to be bought out if he dissented to a fundamental change. He might be forced out and could possibly challenge the fairness of any purchase price, but the chances of winning were remote. Under section 184, a shareholder has the *express right* to challenge the "fair value" of any purchase price. The draftsmen made a deliberate choice of excluding the benefit of the transaction from "fair value" and, whether they were right or wrong, this is not a factor which should be taken into account in construing the legislation. In fact, in my view, section 184 is basically very clear. Finally, Bouck J.'s comments on the relationship between sections 199 and 184 are interesting. For a judge who is concerned about the expropriation of property, it is surprising that he does not deal at length with the fact that section 199 is a *compulsory* buy out[416] at an *ambiguous* fair value.[417] Under section 184, the shareholder at least has the right, admittedly seldom valuable, not to be bought out.

Two other points should be made. First, one would have thought that the more complex the valuation problem, the more valuable an appraiser's assistance would be. Moreover, one may be surprised at the court's concern over costs. It was the practice under the compulsory acquisition procedures under, for example, section 153 of the Alberta Act, to award costs against the company even if the shareholder lost,[418] provided, of course, that the shareholder was acting *bona*

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[413] *Id.* at 14.

[414] *Id.*

[415] *E.g.* in the Notice of Appeal (Feb. 9, 1978: S.C. No. C77663), it is stated that the Management Proxy Circular says that the amalgamation would go ahead only if it was approved by 50% of the shareholders other than Pattison. In fact almost 65% of the independent shareholders approved the amalgamation.

[416] CBCA, s. 199(2).

[417] For some reason, his Lordship seems to think that ambiguity is a blessing. *See Neonex*, *supra* note 407, at 12.

[418] There has been some subsequent judicial discussion of the correctness of this point, *but see generally In Re* Hoare Ltd., [1933] All E.R. Rep. 105, 150 L.T. 374 (Ch.).

fide. This approach was based partially on the "deep pocket" concept but also on the basis that no shareholders would object if they thought they would have to bear the ultimate cost of dissenting. Why should the same approach not be adopted under section 184?[419] Finally, while it is not clear, the judge seems to construe the role of the appraiser as one of witness or inquirer rather than one of independent expert.[420]

Secondly, it is submitted the judge's order for a new trial is completely outside his jurisdiction. Section 184(20) instructs the court to fix a fair value. By referring the matter to trial, Bouck J. has not exercised his responsibility and has, as an incidental result, increased the time and cost of a section 184 application. The case is currently on appeal and one hopes that the dissenting provisions will receive a better treatment at the hands of the Court of Appeal.

In any event, it appears that Bouck J.'s qualms concerning section 184 will soon be satisfied. Clause 56(2) of Bill S-2 provides that section 184(3) will be amended to read:

> (3) In addition to any other right he may have, but subject to subsection (26), a shareholder who complies with this section is entitled, when the action approved by the resolution from which he dissents *or an order made under subsection 185.1(4)* becomes effective, to be paid by the corporation the fair value of the shares held by him in respect of which he dissents, determined as of the close of business on the day before the resolution was adopted *or the order was made*. (emphasis added)

This amendment was proposed to give effect to the decisions in *Wall and Redekop* and *Re Ripley International* by permitting the effect of the transaction to be taken into account where appropriate.[421] The wording could have been clearer, but the amendment should succeed in achieving this aim. One wonders, however, whether the change should have been made. By electing to sell their shares in the company, the dissenting shareholders are surely indicating that they do not wish to participate in any future benefits. However, when minority shareholders are effectively being forced to dissent, for example, by being given eight per cent non-voting preference shares in return for common shares, and the remaining shareholders will reap the benefit of, for example, a going-private transaction, it may be that the former shareholders should share in that benefit to some extent.[422]

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[419] This is certainly in line with the discretion given to the court under CBCA, s. 233(d). Also note s. 184(22), which says the final order will always be *against* the corporation, but this appears to be purely procedural in nature.

[420] For an excellent discussion of this point, see the annotation to the case at 3 B.L.R. 1, at 3-5 (1978).

[421] *Supra* note 351.

[422] Readers should note that the fair value provision in s. 199(14) of the CBCA remains unamended at this stage.

B. *Arrangements*

Sections providing for the reorganization of the capital structures of companies are common in most corporate statutes.[423] Often, such changes can be made by the relatively straightforward sections dealing with alteration of the capital clause in the memorandum.[424] Recently, however, a practice has developed of using the "arrangement" provisions of the Acts to deal with major capital reconstructions.[425] These provisions vary considerably. For example, sections 154 and 155 of the Alberta Companies Act give very broad power to the courts to deal with the incidents of major arrangements, *i.e.* transfers of property and dissolution of a company. Accordingly, it is possible to use the arrangement section in major transactions involving amalgamations and the consequential transfers of property, issuance of shares and terminations of corporate existence. Section 134 of the Canada Corporations Act,[426] on the other hand, is more restrictive in its wording and does not appear to give the courts the broad jurisdiction found in the Alberta Act.

There is no clear reason for the increasing use of the arrangement sections. In some cases, this procedure is chosen because it involves court approval. Many practitioners are concerned about the possible impact of the *Re Hellenic*[427] case in Canada and feel that court approval of the scheme should be obtained. In other cases, the interference with existing shareholders' rights is so substantial as to persuade lawyers that it is safer to proceed by way of the arrangement provisions and put the scheme before the courts.

The most noticeable use of "arrangements" in recent years has been in the "squeeze-out" situation. In many cases, the object is to get rid of minority shareholders whom it is impossible to contact through death or change of address and who play no part in the company's activities. The most publicized squeeze-outs have, however, been in the context of "going-private" transactions. These occur when small public companies, who wish to reduce their filing and disclosure requirements, obtain superior tax treatment or simply get rid of troublesome minority groups, attempt to obtain the status of a private com-

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[423] *See generally* Mackinnon, *supra* note 371, at 522; Pekarsky, Arrangements for the Acquisition of Shares Under the Alberta Companies Act, Advanced Corporate Law Conference, *supra* note 231.

[424] *See, e.g.*, CBCA, ss. 167, 170; ACA, ss. 37, 38.

[425] *See, e.g.*, OBCA, s. 194; ACA, ss. 154, 155.

[426] R.S.C. 1970, c. C-32.

[427] In the decision in *Re* Hellenic and General Trust Ltd, [1975] 3 All E.R. 382, [1976] 1 W.L.R. 620 (Ch. D.), the court decided that despite the classical class structure, separate class meetings should have been held of the majority shareholder and the minority groups because the majority holder had a close relationship with the offeror and thus a vested interest in the proceedings. *See* Hornby, Note, 39 MODERN L. REV. 207 (1976) and Prentice, *Corporate Arrangements — Protecting Minority Shareholders*, 92 L.Q.R. 13 (1976). Also, for a brief discussion of whether the case should be followed in Canada, see the annotation to *Re* Ripley Int'l Ltd., *supra* note 402, at 269-70.

pany.[428] This can be done very simply, for example, through a stock consolidation and the issuance of fractional shares or cash in lieu of the latter or through any other capital reorganization which has the effect of cancelling the rights of an existing minority.[429]

This procedure was sanctioned in 1974 by the Ontario High Court in *Re P.L. Robertson Manufacturing Co.*[430] This decision was followed more recently in *Re Ripley International Ltd.*[431] The dissenting shareholders argued that the compulsory acquisition of fractional shares was invalid. Southey J. rejected this argument but in following the *P.L. Robertson* decision did restrict some potentially dangerous *obiter dicta* from the earlier case:

> As to the first point, the applicant relies on the case of *Re P.L. Robertson Mfg. Co.*(1974), 7 O.R. (2d) 98, 54 D.L.R. (3d) 354. In that case, Houlden J., as he then was, approved an arrangement which he believed to be fair and reasonable and in the best interests of both the applicant and a dissident shareholder, notwithstanding that it provided for the compulsory acquisition by the corporation of fractional share interests created by the consolidation involved in the arrangement. I consider myself bound by this decision to decide the first point against the dissidents, although I question the statement made in obiter in the *Robertson* case that ss. 193 and 194 are wide enough to permit the Court to approve an arrangement even if it is contrary to some provision of The Business Corporations Act. Such statement is at variance with the conclusion drawn by Morand J. as to the English law in *Re West Humber Apartments Ltd.*, [1969] 1 O.R. 229 at 232-233, 2 D.L.R. (3d) 110, that the arrangement must not be contrary to any of the sections of the company law or contrary to the general law.[432]

Perhaps the most interesting point to the "going-private" transaction is that it demonstrates several inadequacies in the existing law. Does the majority of the company owe any duty to the minority? What are the disclosure requirements? What role will the various securities commissions play in such transactions?

To some extent the law has begun to respond. The *Re Hellenic*[433] case may lead to the adoption of separate class voting with the minority being entitled to vote as a separate class.[434] In Delaware, the Supreme Court held in *Singer v. Magnavox*,[435] a particularly blatant case, that a going-private merger, undertaken for the sole purpose of "freezing out" a minority group, is an abuse of a fiduciary duty owed to that minority

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[428] *See* Iacobucci and Hansen, *Acquisition of Minority Shares Under the CBCA (forthcoming in the* CAN. BUS. L.J.).

[429] *E.g.* by amalgamation (although there may be problems fitting such transactions within s. 87 of the Income Tax Act, R.S.C. 1970, c 1-5, *as amended*) or by "issuer-bids"; *see* CBCA, s. 187 (the definition of takeover bid) and S.O.R./75-682 (110 Can. Gazette, Pt. 11, 3163).

[430] 7 O.R. (2d) 98, 54 D.L.R. (3d) 354 (H.C. 1974).

[431] *Supra* note 402.

[432] *Id.* at 271-72.

[433] *Supra* note 427.

[434] *See Re* Cablecasting Ltd., *infra* note 436.

[435] 380 A. 2d 969 (Del. Sup. Ct. 1977).

and also an abuse of the corporate process. Finally, the Ontario Securities Commission has also voiced its opinion on the subject. In *Re Cablecasting Ltd.*,[436] the effective controllers of the company owned all the common shares. A significant number of independent shareholders owned non-voting Class A shares, which carried no voting rights but otherwise participated equally with the common shares. As a result of a corporate reorganization, all shares owned by independent shareholders would be redeemed. Certain shareholders objected to this reorganization and asked the Securities Commission to exercise its jurisdiction under section 144 of the Securities Act and make a cease trading order.

After a thoughtful analysis of its jurisdiction under section 144, the Securities Commission decided not to issue a cease trading order.[437] For present purposes, however, what is interesting is the Commission's general comments on "going-private" transactions:

> Mr. Atkinson was prepared to commit on behalf of his clients that the reorganization would not be effected unless approved by more than 50% of the votes cast by shareholders other than the Management Group. The Commission concurred that this was an appropriate commitment to request, particularly since there are precedents for it in other transactions recently carried out in Ontario. However, the Commission was reluctant to require that the transaction not be implemented unless supported by the higher percentage suggested by Mr. Salter. Such a requirement would involve the problems implicit in an on-the-spot formulation of policies; further, the Commission was reluctant to assume the responsibility of preventing implementation of the reorganization if approved by more than a majority but less than two-thirds of the minority shareholders, when the consequence might well be to preclude for the minority the opportunity to obtain a favourable price for their shares.
>
> In its approach to the proposed transaction, the Commission was also influenced by the fact noted earlier in these Reasons, that in a number of other situations OBCA corporations have implemented "squeeze out" transactions without being successfully attacked. While the technique being used here is, so far as the Commission is aware, entirely novel, the result is the same as in other cases where the amalgamation technique, the share consolidation technique, and other procedures have been used. The lack of legislative or other action against these techniques adds to the reluctance of the Commission to create an instant policy to meet the present case, particularly since the Commission is not responsible for the administration of the OBCA.
>
> For all these reasons, the Commission rejected Mr. Cameron's contentions on this aspect of the matter but indicated that it would review Policy 3-37 and its other policy statements in light of the submissions made by Mr. Cameron and by Mr. Salter. That review will take into account recent developments in the United States, including the *Singer* v. *Magnavox* decision, and these therefore do not require detailed discussion here. It is, however, appropriate to note that, on the facts, *Singer* v. *Magnavox* involved a more serious situation than *Cablecasting*, even if all of the arguments advanced by Mr. Cameron were to be accepted.[438]

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[436] [1978] O.S.C.B. 37.

[437] Particularly interesting in this respect is the question of the inter-relationship of s. 144 and other remedies. *See id.* at 41-42.

[438] *Id.* at 47-48.

At the time of writing, the review of Policy Statement 3-37 is not available. It is clear, however, that the Securities Commission is concerned about the increase in "going-private" transactions and may introduce a more all-encompassing system of disclosure to deal with such situations.[439] Their concern is justifiable. As the Commissioner of the Wisconsin Securities Commission recently stated:

> Going private — a process of eliminating public shareholders in a corporation — is so markedly fraught with the potential for investor abuse, and so clearly destructive of public investor confidence in the securities markets, it seems odd there has been no ground swell in this country for more adequate regulation of these transactions.[440]

The comment applies with equal force to Canada and it is hoped that there will be further discussion of the topic in the next few months.

At present, the CBCA does not contain an arrangement provision. The draftsmen felt that the amalgamation and capital reorganization provisions of the Act would be sufficient. It has come to the attention of the Department, however, that several transactions have not been able to fit within existing provisions of the Act.[441] Accordingly, section 57 of Bill S-2 will introduce a new arrangement provision as section 185.1. This amendment has been discussed elsewhere[442] and it will suffice in this survey to make two comments. First, the section will only be available where it is *impractical* to use other provisions in the Act;[443] accordingly, its use should be limited. Secondly, there is no concept of automatic shareholder consideration of the arrangement. The corporation may apply for court approval of any proposed arrangement and the court is given the discretion, *inter alia*, to order meetings of shareholders or appointment of counsel, at the expense of the corporation, to represent the interests of the shareholders.[444] The Department's rationale for this approach is twofold: first, that any "arrangements" under the CBCA will be of a technical nature; secondly, that it is easy to bury information in proxies and information circulars and this sort of practice should not be encouraged.[445] Neither of these reasons convince one that a fundamental change should potentially be permitted without the consent of shareholders. If the Department feels so strongly about the practice adopted in drafting information circulars, then the answer is to amend the appropriate provisions of the Act.

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[439] *See supra* note 410 for approaches already taken by the Commission.

[440] WISCONSIN SECURITIES BULLETIN, Dec. 1977. *See also* the disclosure requirements for going private introduced by the Commission, discussed in that BULLETIN.

[441] *See* SENATE COMMITTEE, BANKING, TRADE AND COMMERCE, *supra* note 351, at para. 6.31.

[442] Iacobucci and Hansen, *supra* note 428.

[443] Bill S-2, cl. 57, s. 185.1(3).

[444] Bill S-2, cl. 57, s. 185(1)(4)(2.1).

[445] *See* the SENATE COMMITTEE proceedings, *supra* note 351, at para. 6.32.

C. *Amalgamations*

Problems arise relatively infrequently in realtion to amalgamations. Such matters are commonly dealt with by experienced corporate practitioners and the problems simply do not get to court.[446] Occasionally, however, problems do arise as to the sufficiency of the disclosure made by the companies to the shareholders in order to gain their approval of the amalgamation agreement. Such a case arose in *Re Ardiem Holdings Ltd.*[447] The decision itself is not important but the approach of the British Columbia Court of Appeal is a timely indication of the attitude which will be taken by the courts in reviewing the sufficiency of information.

The British Columbia Companies Act provides that the substance of matters to be acted upon at a meeting of members of a company must be briefly described "in sufficient detail to permit shareholders to form a reasoned judgment concerning the matter".[448] In the instant case, the trial judge[449] refused to approve the amalgamation. His reasons were: (a) that the consolidated financial statements only gave the value of corporate assets on the basis of cost less accumulated depreciation and no information was given as to the current value of the assets — the latter was necessary to compute the fairness of the share-exchange ratios; and (b) that no information was given as to how management reached the share-exchange ratios.[450]

The Court of Appeal[451] allowed the company's appeal. It held that in the present case, what was important in determining share-exchange ratios was the performance of the various corporations with respect to earnings and dividends and these were in the consolidated financial statements.[452] The current value of the assets was not material. Moreover, the court concluded that since the dissenters had sufficient information to suggest alternative share-exchange ratios to those suggested by management, they must have had sufficient information to reach a conclusion on the fairness of the original offer.[453]

What is, however, particularly interesting about the case is that the Court of Appeal indicates that where the recipients of the information are already shareholders of the company (or companies), the directors

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[446] For a discussion of the effect of the amalgamation certificate, *see* Norcan Oils Ltd. v. Fogler, [1965] S.C.R. 36, 46 D.L.R. (2d) 630 (1964), *rev'g* 47 W.W.R. 257, 43 D.L.R. (2d) 508 (Alta. C.A. 1964); *Re* Gibbex Mines Ltd. (N.P.L.) and Int'l Video Cassettes Ltd., [1972] 2 W.W.R. 10, 49 D.L.R. (3d) 731 (B.C.S.C.).

[447] 67 D.L.R. (3d) 253 (B.C.C.A. 1976), *rev'g* 61 D.L.R. (3d) 725 (B.C.S.C. 1975).

[448] BCCA, s. 370(2); B.C. Reg. 318/73, Form 23, Item 11. *Also* ss. 269, 270.

[449] 61 D.L.R. (3d) 725 (B.C.S.C. 1975).

[450] *See* the Court of Appeal decision, *supra* note 447, at 262.

[451] *Id.*

[452] *Id.* at 262-63.

[453] *Id.* at 263-64.

need not be as meticulous in sending detailed information to them as they would if issuing a prospectus:

> I think it is important to recognize that the information circular was sent to persons who were already shareholders in A-1 Vancouver and who must have had some familiarity with its affairs. In that important respect the case differs from the case of a company proposing to issue its securities which circulates a prospectus to provide members of the public with information about the company in order that they may decide whether to purchase the securities being offered for sale.[454]

It may be remarked that many shareholders obviously do not take the same sort of interest in a company's affairs as the Court of Appeal is suggesting.

The courts' role in supervising major corporate changes is an unenviable one. In Alberta, for example, the basic requirement is that a shareholder must have knowledge of all the facts which a prudent man disposing of one stock and acquiring another would need to consider before coming to a conclusion.[455] Under the CBCA, the material features of any amalgamation agreement, including the reasons for it and its general effect on the rights of existing shareholders must be included in the management proxy circular.[456] Given these guidelines, it will be impossible to accurately forecast any court's response, but the decision in *Re Ardiem Holdings Ltd.*[457] suggests that so long as the information provided is "fair", in a broad sense, the courts will be reluctant to intervene.

D. *Takeovers — The 90/10 Compulsory Acquisition*

Most corporate statutes contain a section providing for the compulsory acquisition of a reluctant group of shareholders left after a takeover.[458] So long as that group holds less than ten per cent of the shares subject to the takeover bid, the company, within the constraints of the applicable legislation, may acquire those shares on the terms offered to the accepting shareholders.[459] The problems with the traditional provisions such as section 153 of the Alberta Companies Act have

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[454] *Id.* at 261.

[455] Fogler v. Norcan Oils Ltd., *supra* note 446 (*per* Porter J.A.); *also* Bayshore Investments Ltd. v. Endako Mines Ltd., [1971] 2 W.W.R. 622 (B.C.S.C.).

[456] S.O.R/75-682 (110 Can. Gazette, Pt. II, 3163). One interesting problem with the CBCA amalgamation provisions in ss. 175-77 is the inter-relationship of these provisions with the Income Tax Act. To obtain the rollover benefits of s. 87 of the latter Act, all shareholders immediately prior to the amalgamation must receive shares of the new company. What happens if a shareholder dissents under s. 184 of the CBCA?

[457] *Supra* note 447, at 253.

[458] The noticeable exception is the OBCA.

[459] *See, e.g.*, ACA, s. 153; Canada Corporations Act, R.S.C. 1970, c. C-32, s. 136.

been well documented.[460] Recently, however, two cases have provided some clarification of the scope of such provisions.

In *Re Sayvette Ltd.*,[461] Loblaws made a takeover bid for the shares in Sayvette. Loblaws owned, before the offer, 1,072,860 shares of the target company and its subsidiary owned 1,224,293; the remaining shares were held by independents. By the expiration of the offer, Loblaws had obtained 93.5 per cent of the shares not owned by itself or its subsidiary. Accordingly, it sought to use section 130(1) of the Canada Corporations Act to acquire shares held by the dissenters. The latter objected.

The dissenters' main argument was that since Loblaws and its subsidiary owned more than two-thirds of the shares before the offer, the scheme amounted to an expropriation of the minority. The court rejected this argument and held that since more than ninety per cent of the independents had accepted the offer, section 136(1) could be utilized to acquire the remaining shares.[462]

The decision in *Sayvette* is not well reasoned. Presumably the court proceeded on the basis of the words "shares affected" in section 136(1), but this is not clear. Nevertheless, one must question the correctness of the decision. I would agree that the decision in *Esso Standard*[463] can be distinguished where the offer is made only for shares independently held; these then are the "shares affected" and provided that ninety per cent acceptance is obtained no one should have any objection.[464] However, it appears that in the *Sayvette* case, the offer was made for *all* non-Loblaws shares, including the shares of the subsidiary. This is very similar to the facts in *Esso Standard* and there, it will be remembered, the court stated that the ninety per cent acceptance by independents must be disregarded because it may have

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[460] Flisfeder, *Compulsory Acquisition of the Interest of a Dissenting Shareholder*, 11 ALTA. L. REV. 87 (1973); MacNamara, Note, 10 WESTERN ONT. L. REV. 141 (1971); Hampton, Note, 4 N.Z.U.L.J. 168 (1970); Rajak, *Minority Rights and the Takeover Bid*, 87 S.A.L.J. 12 (1970); Beuthin, *Takeovers: Section 103ter*, 87 S.A.L.J. 276 (1970); Paterson, *Takeover Bids and the Companies Act*, 5 V.U.W.L. REV. 447 (1970); Prentice, Note, 35 MODERN L. REV. 73 (1972); Rowley, Comment, 6 ALTA. L. REV. 117 (1968); McCartney, Comment, 22 U. TORONTO FAC. L. REV. 167 (1964); Wedderburn, Note, 23 MODERN L. REV. 663 (1960); Getz, *Unfair Takeover Scheme*, 78 S.A.L.J. 438 (1961); Allen, *Mergers and Amalgamations*, 3 ALTA. L. REV. 463 (1964); Bird, *Corporate Mergers and Acquisitions in Canada*, 18 U.N.B.L.J. 16 (1968); Baxt, *The Unprotected Shareholder and the Compulsory Acquisition of Shares*, [1970] J. BUS. L. 86; Hansen, Compulsory 90/10 Acquisitions Under the Alberta Companies Act, Advanced Corporate Law Conference, *supra* note 231.

[461] 11 O.R. (2d) 268, 65 D.L.R. (3d) 596 (H.C. 1975).

[462] *Id.* at 271, 65 D.L.R. (3d) at 599.

[463] Esso Standard (Inter-America) Inc. v. J.W. Enterprises Inc., [1963] S.C.R. 144, 37 D.L.R. (2d) 598, *aff'g* [1962] O.R. 705, 33 D.L.R. (2d) 658 (C.A.) (*sub nom. Re* Int'l Petroleum Co.).

[464] Although where more than one class of shares is affected, consider whether s. 136 of the Canada Companies Act, R.S.C. 1970, c. C-32 will permit this argument to be used. This is not a problem under CBCA, s. 199.

been precipitated and tainted by the acceptance of the offer by the offeror's parent company who owned shares in the target company.[465] Amazingly, there is no reference in *Sayvette* to the *Esso Standard* case. Accordingly, the correctness of the decision must be doubted.

The second case is the decision of the Quebec Superior Court in *Re Quegroup Ltd.*[466] Here, the court struck down the attempted acquisition under section 136(1) on the basis that the four month period had not been complied with. In particular, the court appeared to be of the opinion that an extension of an otherwise too short offer would not validate the original bid. In my view, this is quite correct. Equally important, is that *Re Quegroup Ltd.* is one of the few cases where the offer has been termed "unfair" by the court. In fact, the court stated that "the morality of the offer is shocking".[467] While this was an extreme case, this reaction does at least indicate that the courts will not permit compulsory acquisition in cases of clear abuse.[468]

The new corporate statutes which contain compulsory acquisition procedures have been amended to resolve some of the problems of the old Acts.[469] In particular, in both the CBCA and the British Columbia Corporations Act, an attempt has been made to avoid the four month period established in *Rathie v. Montreal Trust Co.*[470] In *Re Canadian Allied Property Investments Ltd.*,[471] section 276 of the British Columbia Act arose for its first consideration. In this case, the offer was made on May 28, 1975 and required acceptance by July 3, 1975. The offer was, thus, open for a little over one month. Accordingly, when an attempt was made to utilize the compulsory acquisition procedures, the dissenters argued, *inter alia,* that the offer was illegal because it was not open for four months. Hutcheon J. held that since section 276 does not contain any postponement of the right to proceed by notice until four months have expired, the *Rathie* case did not apply to the new legislation.[472]

While the wording of section 276 is a little ambiguous, the decision is justifiable. The *Rathie* case, while correct on its facts, has caused substantial problems, not the least being the difficulties of rationalizing the four month period with the temporal requirements of the Securities

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[465] *Supra* note 463, at 151, 37 D.L.R. (2d) at 604.

[466] [1976] C.S. 1458 (summary: main decision unreported).

[467] *Id.*

[468] The only other case I am aware of where the court stated the offer was "unfair" is *Re* John Labatt and Lucky Lager Breweries, 29 W.W.R. 323, 20 D.L.R. (2d) 159 (B.C.S.C. 1959).

[469] *See* CBCA, s. 199 and BCCA, s. 276.

[470] [1953] 2 S.C.R. 204, [1953] 4 D.L.R. 289, *rev'g* 6 W.W.R. 652, [1952] 4 D.L.R. 448 (B.C.C.A.), *aff'g* 5 W.W.R. 675, [1952] 3 D.L.R. 61 (B.C.S.C.).

[471] 3 B.C.L.R. 366, 78 D.L.R. (3d) 132 (S.C. 1977).

[472] *Id.* at 370, 78 D.L.R. (3d) at 135-36. The case also contains an interesting analysis of the burden of proof involved in an accusation that the offered price is unfair.

Acts.[473] It is clear that the draftsmen wished to avoid that decision and Hutcheon J.'s decision simply gives effect to that intention. Similarly, while section 199 of the CBCA is also somewhat ambiguous, and is worded differently from the British Columbia section, it is almost certain that when the matter arises for consideration it will receive the same construction.[474]

E. *Sale of the Company's Undertaking*

The traditional corporate statutes normally contained no restriction on the ability of the directors to sell the undertaking of the company. Such an act was part of their power to manage its business and affairs.[475] As a matter of practice, however, it was normal in such circumstances to obtain the consent of the shareholders.[476] In the newer statutes, however, sale of the undertaking or a substantial part thereof is regarded as a fundamental change, requiring appropriate shareholders' consent and giving rise to dissenting rights and appraisals. It is still somewhat unclear what "substantially the whole of the undertaking of the company" means. Recently, the British Columbia Supreme Court in *Re Vanalta Resources Ltd.*[477] reviewed this question carefully.

The transaction at issue involved the sale of property with a book value of $244,314; the sale price was $655,000. The entire holdings of Vanalta had a present value in the vicinity of $4,000,000. Legg J. concluded that the sale of the property was not a sale of substantially the whole of the company's undertaking.[478] His Lordship's analysis of these words is, however, extremely valuable.

Legg J. considered that the issue should be approached on two bases. First, one must look at the sale on a *quantitative* basis.[479] This will essentially come down to a dollar calculation. Unfortunately, no indication is given as to what "substantially" means. Does it mean ninety per cent or sixty per cent of the company's undertak-

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[473] *See generally* D. JOHNSTON, CANADIAN SECURITIES LEGISLATION 332-33 (1977).

[474] *See generally* Iacobucci and Hansen, *supra* note 428.

[475] Before the era of corporate reform, there were four exceptions. *See* the acts in Manitoba, Ontario, Prince Edward Island and Nova Scotia. In McGregor v. St. Croix Lumber Co., 12 E.L.R. 199, 8 D.L.R. 876 (N.S.S.C. 1912), it was held that failure to obtain a special resolution on sale of the undertaking within s. 5 of the Companies Act, S.N.S. 1912, c. 47 (*now* R.S.N.S. 1967, c. 42) made the transaction *ultra vires*. It is doubtful whether this would be followed today. *See* Thompson & Sutherland Ltd. v. Nova Scotia Trust Co., 4 N.S.R. (2d) 161, 19 D.L.R. (3d) 59 (S.C. 1971), and the court's construction of s. 88 of the same Act.

[476] *See* Alberta Corporation Manual, Release No. 75, 3517 (E. Hughes, R. Love eds. 1978).

[477] (B.C.S.C. Dec. 17, 1976).

[478] *Id.*

[479] *Id.*

ing?[480] Secondly, following *Gimbel v. The Signal Oil Companies*,[481] his Lordship concluded that one must look at the transaction *qualitatively, i.e.* whether the transaction was unusual or one made in the regular course of business.[482] This would be an extremely broad test and could conceivably include the sale of one large piece of property where the company had for years been purely an investment company. However, Legg J. subsequently seemed to require that the transaction be one that strikes "at the heart of the corporate existence and purpose" of the company.[483]

One cannot argue with this approach. The object of the new Acts was to provide for shareholder approval where the transaction was such that it fundamentally changed the nature of the corporation. A dollar calculation may not answer this question in all cases and regard should be had to the *nature* of the property being sold. Assume, for example, that a company was incorporated to run a ferry business. It owned one boat worth $100,000. The business was run very successfully and the company accumulated retained earnings of $1,000,000 which were invested in real estate. If the company sold the ship, in my view that would be the sale of substantially the whole of the company's undertaking. While it only represents less than ten per cent of the value of the assets, it was and is the heart of the company's existence. For those shareholders who bought shares at an early stage in the company's existence, the nature of the company is being changed. Accordingly, their approval should be obtained.

VIII. MISCELLANEOUS

As with any area of law, there have been a number of cases which do not fit clearly within any category. Generally speaking, these discussions could be classified as procedural in nature. Few of these warrant any detailed discussion.[484] Cases have occasionally arisen involving the

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[480] For a general discussion of the American authority on this point *see* Elliott, Comment, 43 N. CAROLINA L. REV. 957 (1965).

[481] 316 A. 2d 599 (Del. Ch. 1974), *aff'd* 316 A. 2d 619 (Del. Sup. Ct. 1974).

[482] *Supra* note 477.

[483] *Id.*

[484] *See particularly* Manley Inc. v. Fallis, 2 B.L.R. 277 (Ont. C.A. 1978), *aff'g* 22 C.P.R. (2d) 237 (Ont. H.C. 1975). *See* at 279, where Lacourcière J.A. states:

> This is a case where the Court is not precluded from lifting the corporate veil and, in effect, regarding the closely related respondent companies as essentially one trading enterprise, in the interests of the affiliated companies, in a circumstance where the refusal to do so would allow the appellant to escape the consequences of his breach of a fiduciary trust.

See also Didrikson Trucking Ltd. v. Traders Group Ltd., 66 D.L.R. (3d) 354 (Alta. C.A. 1977), where under the Seizures Act, R.S.A. 1970, c. 338, s. 26(1), requiring the name of the debtor to be included in a notice of seizure, the plaintiff named the principal shareholder rather than the corporation — even in the special circumstances of that case, the court did not lift the corporate veil; and Olympia & York Developers Ltd. v. Price,

lifting of the corporate veil. There has been a series of decisions, particularly in British Columbia, involving questions relating to the status of extraprovincial corporations and the effect of non-registration.[485] Other cases have discussed such matters as procedure on discovery[486] and the right of corporations to appear in court without counsel.[487] This part will briefly note some developments in two areas, the effect of the incorporation certificate and corporate names.

A. *The Effect of the Incorporation Certificate*

In *C.P.W. Valve & Instrument Ltd. v. Scott*,[488] the defendant distributor agreed to purchase 5,000 pressure gauges from the manufacturer on or before June 15th. The purchase was to be made by a newly incorporated company. On June 15th, the distributor gave to the Registrar an application for incorporation of the company and on the same day placed the order. The manufacturer rejected the order as a sham and the distributor accepted this rejection as a repudiation of the contract, whereupon the manufacturer sued for breach of contract.

[1976] 5 W.W.R. 347 (B.C. Cty. Ct.) (action by plaintiff against shareholder whose company had been struck off the register). *Also* the numerous tax cases where the courts have lifted the corporate veil. *See*, *inter alia*, De Salaberry Realties Ltd. v. M.N.R., [1974] C.T.C. 295, 46 D.L.R. (3d) 100 (F.C. Trial D.), *aff'd* [1976] C.T.C. 656, 70 D.L.R. (3d) 706 (F.C. App. D.); Dominion Bridge Co. v. The Queen, [1975] C.T.C. 263 (F.C. Trial D.), *aff'd* [1977] C.T.C. 554 (F.C. App. D.); M.N.R. v. Leon, [1976] C.T.C. 532 (F.C. App. D.), *varying* [1974] 2 F.C. 708, [1974] C.T.C. 588 (Trial D.). For an interesting case illustrating the reverse situation, where the corporation is attempting to be classified as the *alter ego* of directors/shareholders, *see* Sigurdson v. Fidelity Ins. Co., [1977] 4 W.W.R. 231, 2 B.L.R. 1 (B.C.S.C.) and the annotation thereto, 2 B.L.R. at 2.

[485] *See* I.A.C. Ltd. v. Donald E. Hirtle Transport Ltd., 78 D.L.R. (3d) 90 (N.S.S.C. 1977); Canadian Stock Breeders Service Ltd. v. Reimer, [1976] 3 W.W.R. 448 (B.C.S.C.), *rev'd on other grounds* [1976] 5 W.W.R. 405 (B.C.C.A.); General Merchandising Corp. v. Vangolen, (B.C.S.C. May 27, 1977); *cf.* D-B Service (Western) Ltd. v. Madrid Services Ltd., 60 D.L.R. (3d) 299 (B.C.S.C. 1975); Anvil Jewellery Ltd. v. Persian House of Jewels Ltd., (B.C.S.C. July 8, 1975).

[486] Mobil Oil Corp. v. Project 2000 Investments Ltd., [1974] 4 W.W.R. 663, 59 D.L.R. (3d) 759 (B.C.S.C.).

[487] Northern Homes Ltd. v. Steel-Space Industries Ltd., [1975] 5 W.W.R. 115, 57 D.L.R. (3d) 309 (N.W.T.S.C.); *Re* Canron Ltd. and Canadian Workers Union, 12 O.R. (2d) 765, 70 D.L.R. (3d) 198 (H.C. 1976). For other general problems, see the decision of the Supreme Court of Canada in Edmonton Country Club Ltd. v. Chase, [1974] 4 W.W.R. 626, 44 D.L.R. (3d) 554 (S.C.C.), *aff'g* [1973] 3 W.W.R. 14, 30 D.L.R. (3d) 211 (Alta. C.A.) (a quite important case dealing with the question of the importance of limited liability as it applies to a shareholder's contribution beyond his initial investment and restrictions on the transfer of shares in public companies); Rizzie v. J.H. Lilley and Assoc. Ltd., [1976] 2 W.W.R. 97, 63 D.L.R. (3d) 187 (Alta. Dist. C. 1975) (question of whether a corporation not in good standing under the Act could be involved in litigation. The Alberta District Court said yes, because there was nothing in the Act equivalent to s. 179 of the ACA which dealt with the status of non-registered extra-provincial companies). *Also* Berroy Holdings Ltd. v. Stuart Cowan (Alta. Dist. C. 1977) (discussion of the effect of striking a company off the register and subsequent reinstatement under s. 189 of the Alberta Act. The court held the company was restored to full rights and could now commence an action with status; the action was not destroyed by being struck off, only the right to proceed).

[488] 8 A.R. 451 (C.A. 1978), *aff'g* 8 A.R. 470 (S.C. 1976).

At trial,[489] the manufacturer attempted to adduce evidence that the company was not incorporated on June 15th. Moshansky J. ruled such evidence inadmissible. Section 27 of the Alberta Companies Act reads as follows:

> A certificate of incorporation given by the Registrar in respect of a company is conclusive proof that all the requirements of this Act in respect of registration and of matters precedent and incidental to incorporation have been complied with, and that the company is a company authorized to be registered and duly registered under this Act.

Moreover, section 28 provides:

> From the date of incorporation mentioned in the certificate of incorporation the subscribers... are a body corporate... capable of exercising all the functions of an incorporated company....

His Lordship simply gave effect to these words and held that section 27 provided conclusive proof that the company was incorporated.[490] He made no attempt to deal with the correctness of the earlier Supreme Court of Canada decision in *Letain v. Conwest Exploration Co.*[491] but distinguished it on rather doubtful constitutional grounds and on the basis that the Dominion Companies Act[492] contained different wording from section 27.[493]

Very recently, the Appellate Division in a majority decision has overruled the Trial Division.[494] Clement J.A. accepted the fact that section 28 was conclusive proof that the company was incorporated on June 15th. However, he then referred at some length to the earlier decision in *Letain*. In that case it will be remembered that an option was exercisable "by causing to be incorporated on or before the first day of October, 1958. . . a mining company".[495] The letters patent of the company were dated September 25th but in fact they were not

> be conclusively taken as having the status of a company incorporated on the 25th of September, but rather whether or not the respondent caused it to be "incorporated on or before the 1st day of October, 1958" within the meaning of those words as they are used in para. 7 of the agreement pursuant to which this action is brought.
>
> I am of the opinion that the fact that the letters patent of Kutcho Creek Asbestos Company Limited bear the date the 25th of September and that company has status as from that date for the purposes of the Dominion *Companies Act* in no way precludes the appellant from adducing evidence to prove whether or not this option was exercised by the respondent in accordance with the terms of the contract now sued upon, and I would accordingly dispose of this appeal as proposed by the Chief Justice.[496]

Clement J.A. followed *Letain*. He held that if it could be demonstrated that the Registrar did not, in fact, perform his duties until June 16th, the company could not have ordered the goods on June 15th:

> It follows that the purchase order purportedly given by S. & V. Fluid Gauge Ltd. on that day had no legal validity at any moment of the critical period prior to 16 June, and cannot be relied on by Scott as performance of his obligation under the distributorship agreement. It existed only as a concept for which legal validity could only be secured by a statutory fiction reaching backwards to give legal substance and life to the concept. Section 28 may well have such effect for the purposes of the Act, particularly those mentioned in the section, but I would think it would take very clear words to enable a court to say that the creation of status for a corporation can operate to negate a breach of contract that had already existed. . . I would remit the action to the learned trial judge. . . .[497]

With respect, both this decision and that in *Letain* are, in my view, incorrect. In the first place, the conclusion is quite contrary to the words of the section which states that from the date of incorporation the company has corporate capacity. How, then, can evidence be adduced to demonstrate it had no capacity? McDermid J.A. stated in dissent that the company had status by statute on June 15th when it placed the order. Even if it was not put on the Register until June 16th, it should have been bound by its order.[498] As far as *Letain* is concerned, if the Act says the company is incorporated conclusively on date x, how can one be permitted to adduce evidence to show incorporation took place three days later? In my opinion, in attempting to rationalize the sections, both courts are playing a word game. Secondly, one would have thought the policy of sections like sections 27 and 28 was to avoid disputes in court as to when incorporation took place. It is essentially an administrative aid and it is unfortunate that neither the Supreme Court of Canada nor the Alberta Appellate Division paid heed to this policy. If, as is apparently the case, the practice of the Registrar is to backdate the certificate of incorporation to the date on which the

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[496] *Id.* at 107, 33 W.W.R. at 643-44, 26 D.L.R. (2d) at 274.
[497] *Supra* note 488, at 462.
[498] *Id.* at 469.

incorporation documents were received, it is clear that many Alberta corporations may, in fact, have been acting without capacity for the first few days of their existence.

B. *Corporate Names*

Lawyers are still facing difficulties in this area, aside from the practical problems of obtaining a name within a reasonable period of time. The number of cases which have arisen dealing with similar names since the decision of the Supreme Court of Canada in *Canadian Motorways Ltd. v. Laidlaw Motorways Ltd.*[499] is astounding and the area must be the most litigated in corporate law.[500] This section will only deal briefly with three cases to illustrate the nature of the difficulties involved.

In *Re Cantrade Sales and Import Co.*,[501] the Ontario High Court was faced with a battle between an Ontario and a federal company. Cantrade Sales and Import Co. Ltd. (Sales) was incorporated on April 25, 1972. Cantrade Industries Ltd. was incorporated in 1925 under the name Hoyt Metal Company of Canada Ltd., but on March 13, 1972 obtained its present name (Industries). Sales was an extremely active corporation while Industries had been largely inactive for forty years.

Through inadvertence, when Sales applied for incorporation the name of Industries was not on the register. Accordingly, the former obtained the requested name. Subsequently, the Minister on learning of the existence of the federal company, ordered Sales to change its name.

On appeal to the High Court, Sales was successful. The court held that the Minister had automatically considered the company's name to be cancelled and had not exercised the discretion he had under section 8(2) of the Business Corporations Act.[502] What is more interesting, however, is Robins J.'s analysis of whether, if exercised, the discretion had been utilized properly:

> In this case unlike those cited to us — *Re C C Chemicals Ltd.*, [1967] 2 O.R. 248, 63 D.L.R. (2d) 203, 52 C.P.R. 97, 36 Fox Pat. C. 152; *Re Laidlaw Motorways Ltd. and Canadian Motorways Ltd. et al.*, [1972] 1 O.R. 266, 22 D.L.R. (3d) 654, 3 C.P.R. (2d) 36; reversed [1974] S.C.R. 675, 40 D.L.R.

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[499] [1974] S.C.R. 675, 40 D.L.R. (3d) 52, *rev'g* [1972] 1 O.R. 266, 22 D.L.R. (3d) 654 (C.A. 1971).

[500] *See* Fordprint Ltd. v. Minister of Consumer and Commercial Affairs, 11 O.R. (2d) 434, 28 C.P.R. 262 (H.C. 1976); *Re* Prime Locations Ltd. and Prime Real Estate Ltd., 30 C.P.R. (2d) 38 (Ont. H.C. 1976); Browning-Ferris Industries Inc. v. Browning-Ferris Industries Inc., [1976] 3 W.W.R. 759, 25 C.P.R. (2d) 284 (B.C.S.C.); Executone Ltd. v. Executive Communications Ltd., (Ont. H.C. May 16, 1977); *Re* Ebsco Investments Ltd. and Ebsco Subscription Services Ltd., 11 O.R. (2d) 305, 66 D.L.R. (3d) 47 (C.A. 1975), *aff'g on other grounds* 7 O.R. (2d) 741, 56 D.L.R. (3d) 501 (H.C. 1975).

[501] 1 B.L.R. 179, 76 D.L.R. (3d) 227 (Ont. H.C. 1977).

[502] *Id.* at 185, 76 D.L.R. (3d) at 232-33.

(3d) 52, 11 C.P.R. (2d) 1; *Re Ebsco Investments Ltd. and Ebsco Subscription Services Ltd.* (1975), 7 O.R. (2d) 741, 56 D.L.R. (3d) 501, 19 C.P.R. (2d) 5 — the objecting company is not itself an operating company whose use of the corporate name has stamped it with a particular identity. I would not have thought, considering the history and operations of Industries, that it could assert a likelihood of deception in the use by Sales of the name "Cantrade". Nor in the circumstances of this case could there, in my opinion, be any probability that the use of the name is "likely to deceive" the public within the meaning of s. 8(1)(*a*) although, perhaps, there is the possibility, I think remote, that, if Industries were in future to engage in business, it might be thought the two companies were associated with one another.

The question then is whether in all the circumstances Sales should be required to change its name. In my view it should not. The Minister erred, in my opinion, in issuing the order appealed from on the material before him even though the name may have been originally granted contrary to s. 8(1); he should in the exercise of his discretion have allowed Sales to retain the name.

As I view this matter, looking at it in its total context, there are a number of facts which must be recognized and which were indeed acknowledged by the Minister in the factum filed on his behalf and were not disputed by Industries. The two corporations are engaged in totally dissimilar businesses; Sales is an active company, Industries a dormant one; there is no evidence of actual deception of the public or any segment of it arising out of Sales' use of the name "Cantrade"; those from whom Sales buys and to whom it sells are themselves engaged in specialized and sophisticated businesses unrelated to any anticipated business of Industries or the business of any suppliers of customers of Industries. Sales has since 1972 conducted a very active company with sales running into millions of dollars; Industries on the other hand has not been an operating company for 40 years and whether it will actively participate in business in the future can only be a matter of conjecture. That conjecture does not in my opinion warrant compelling Sales to change its name at this stage. As between the companies the equities clearly favour Sales and in the circumstances there is little if any likelihood of any confusion to the public or any part of it as a result of Sales' continued use of the name.[503]

In two recent Alberta cases,[504] the plaintiff companies also emerged as victors. In *Action Plumbing Ltd. v. Registrar of Companies*,[505] the defendant had refused the plaintiff company's request to order Action Auger Drain Cleaning Co. to change its name. The rationale for the Registrar's position was that the only common word in the names was "Action" which was in the public domain and merely descriptive of the quality of service given by both companies.

The appeal was dismissed by the Trial Division,[506] but reversed by the Appellate Division. Morrow J.A. reviewed the leading decisions in *Re C.C. Chemicals Ltd.*[507] and *Canadian Motorways Ltd.*[508] and concluded that the test was whether the words in question were merely descriptive of the company's business. His Lordship held that in the

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[503] *Id.* at 184, 186, 76 D.L.R. (3d) at 231, 233.
[504] *See* ACA, ss. 11,12.
[505] 1 A.R. 296, [1977] 1 W.W.R. 123 (C.A.).
[506] [1976] W.W.D. 86 (B.C.S.C.).
[507] [1967] 2 O.R. 248, 63 D.L.R. (2d) 203 (C.A.).
[508] *Supra* note 499.

instant case, "Action" was not descriptive of a line of business but merely an indication of speedy service, and the names of the two companies were otherwise similar. This point was emphasized by the fact that the companies' advertising would expose them to the whole population of Calgary. Indeed, the evidence clearly demonstrated that there had been substantial confusion among the public. Accordingly, a change in name was ordered.[509]

This decision was followed in *Bumpers, The Beef House (Banff) Ltd. v. Bumpers Discotheque (Calgary) Ltd.*[510] The appellant operated a restaurant in Banff while the respondent owned a discotheque in Calgary. Once again, the Registrar refused to order the respondent to change its name.

On appeal, Laycraft J. upheld the plaintiff's contention. Although the plaintiff company operated a restaurant, the premises were also used for dancing. Moreover, the company intended to move into Calgary and already, despite geographical distances, there was evidence of confusion. Laycraft J. stated:

> This is not, of course, a passing-off action; the issue is solely whether the Registrar was correct in saying that the use of the name Bumper's Discotheque (Calgary) Ltd. by that Company "would be likely to deceive" having regard to the name and the activities of Bumper's, The Beef House (Banff) Ltd. As in the *Action* case, if one examines the two names in full, side by side, the differences are obvious. If, however, one refers to the Company names in a form shortened to merely the descriptive word used in each case, confusion may arise. . . .
>
> The segment of the general public which both Companies will serve is generally similar and the geographical locations, even without expansion by the Banff Company are generally similar. The Banff Company has adopted the word "Bumper's" as part of its corporate name. It is a term not descriptive of its business, and following the *Action* case I find that its use of the term deserves protection against its use by a Company competing in a similar business in the same area.
>
> I therefore allow the appeal and direct the Registrar to withdraw his refusal and to act to require the change of name requested. The applicant is entitled to the costs of this application.[511]

There is no real lesson to be gained from these decisions. In both cases, there was some confusion between the corporate names and the companies were in roughly the same nature of business. If they illustrate anything, it is possibly that the courts, after *Re Canadian Motorways Ltd.*, appear to be granting greater protection to existing corporate names than has hitherto been the case.

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[509] *Supra* note 505, at 318, [1977] 1 W.W.R. at 140. (Clement J.A. dissenting). Motion for leave to appeal to the Supreme Court of Canada dismissed 4 A.R. 357 (S.C.C. 1977).

[510] 4 A.L.R. (2d) 68 (S.C. 1977).

[511] *Id.* at 71-72.