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Unanimous Shareholder Agreements

Nicolas William Juzda

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UNANIMOUS SHAREHOLDER AGREEMENTS

NICOLAS JUZDA

**A DISSERTATION SUBMITTED TO
THE FACULTY OF GRADUATE STUDIES
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
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ABSTRACT

The unanimous shareholder agreement is a feature of most Canadian corporate statutes that allows the shareholders to, by creating an agreement meeting the necessary criteria, restrict the powers of the directors to manage the business and affairs of the corporation. One possible justification for this is the "nexus of contracts" theory that all corporations are notionally reducible to voluntary agreements. Three key areas of ambiguity surrounding unanimous shareholder agreements are examined in this dissertation, with specific reference to existing judgments. The requirements for their formation are reviewed, including the exact meaning and strictness of the unanimity criterion and the necessity and validity of possible restrictions upon the directors. Four competing approaches to their enforcement are identified and contrasted: the corporate constitutional approach that truly removes the board's powers, the contractual approach that treats unanimous shareholder agreements as contracts existing alongside the corporate power structure, and the directors' duties and oppression approaches that apply existing corporate law remedies to deal with violations. The transfer of duties and liabilities that accompanies unanimous shareholder agreements is considered in the context of unusual power structures and stakeholder theory, revealing unaddressed and possibly unsolvable problems in the legislation. It is concluded that, although the unanimous shareholder agreement may suggest a move toward a more contractual view of the corporation, it can also be understood as a specific tool within the statutory framework.

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In researching this dissertation, I consulted the libraries of Osgoode Hall Law School and York University, as well as the libraries of McGill University Faculty of Law, the University of Toronto Faculty of Law, and l'Université du Québec à Montréal. My thanks go to those institutions and their librarians. In addition, I used numerous online resources; I would like to thank all of them, and I would like to specifically thank Westlaw Canada and its staff.

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Chapter 1: Introduction

A Canadian corporation is, by default, a representative democracy.¹ Shareholders elect directors. Directors have ultimate authority over the company,² although much of that is delegated to officers and employees. While their exercise of this power is subject to certain legal duties,³ they are otherwise afforded a broad discretion by the law to govern the corporation as they see fit, and within that, they are generally not subject to direct shareholder control, only the threat of removal and replacement.⁴

The unanimous shareholder agreement⁵ is an addition to many of the Canadian corporate statutes,⁶

¹ It is a representative democracy in that the members of a constituency elect representatives to make decisions on their behalf; this does not necessarily imply that this process fully reflects any given set of "democratic values". In the present metaphor, the shareholders are equated with the voting citizens, or more precisely, the shares themselves are, given that votes are cast based upon the number of shares held. The assumption that such representation should be limited to them alone is questioned in Chapter Five's discussion of stakeholder theory.

² In order to avoid excessive repetition of the central terms in this dissertation, the following commonly used alternatives are sometimes substituted, even though they may not be technically precise or completely accurate synonyms. Throughout this work, unless context indicates otherwise, "company" means corporation, "investors" means shareholders, and "document" and "instrument" in reference to an agreement mean not just the physical object but also the legal arrangement it embodies.

³ Including duties of care and loyalty and a variety of other statutorily mandated responsibilities.

⁴ Although the law has provisions requiring approval for fundamental changes, and they are subject to some degree of control via the articles and by-laws. For example, in the *Canada Business Corporations Act*, RSC 1985, c. C-44 (hereinafter *C.B.C.A.*), see sections 6, 103, 173, 174, 190, and 247.

⁵ Alternative spellings include "unanimous shareholder agreement", "unanimous shareholders agreement", "unanimous shareholder's agreement", and "unanimous shareholders' agreement"; French variations include "convention unanime des actionnaires", "convention unanime d'actionnaire", and "convention unanime d'actionnaires". There is no legal difference between these terms. Except when providing direct quotations, I use "unanimous shareholder agreement", the spelling in the *C.B.C.A.*, regardless of what alternative(s) a given source employs. The common acronyms are forms of the self-evident "u.s.a." and "c.u.a.", and much more rarely "u.sh.a." "Unanimous shareholder declaration" (or some variant) has sometimes been used to describe a written declaration by a sole shareholder that is deemed to be a unanimous shareholder agreement; I avoid this phrase, since the slightly different rules governing formation under such circumstances do not appear to me to justify a bifurcation of terminology. For reasons discussed in Chapter Three, "shareholder agreement" (and variants) is a broader term that includes but is not limited to unanimous shareholder agreements; in order to maintain this distinction, I do not use it as a synonym for unanimous shareholder agreement, and where it appears in this dissertation (outside of quotations), it is either to refer to that wider class of documents or to refer to a specific example which either is not or may not be a unanimous shareholder agreement. Where a shortened term appears desirable for literary purposes, I prefer simply "agreement", also obviously a more inclusive one but less likely to inadvertently conflate two separate legal concepts.

⁶ *Alberta Business Corporations Act*, RSA 2000, c B-9 (hereinafter "*A.B.C.A.*"), s. 146; *Manitoba Corporations Act*, CCSM c C225(hereinafter "*M.C.A.*"), s. 140; *New Brunswick Business Corporations Act*, SNB 1981, c B-9.1 (hereinafter "*N.B.B.C.A.*"), s. 99; *Newfoundland and Labrador Corporations Act*,

including the *Canada Business Corporations Act*,⁷ that allows shareholders to restrict the powers of directors,⁸ and it can be used to transfer those abilities (along with the corresponding responsibilities) directly to the shareholders themselves in whole or in part.⁹ This opens up the potential not just to

RSNL 1990, c C-36 (hereinafter "*N.L.C.A.*"), s. 245; Northwest Territories *Business Corporations Act*, SNWT 1996, c 19 (hereinafter "*N.T.B.C.A.*"), s. 148; Nunavut *Business Corporations Act*, SNWT (Nu) 1996, c 19 (hereinafter "*N.B.C.A.*"), s. 148; Ontario *Business Corporations Act*, RSO 1990, c B.16 (hereinafter "*O.B.C.A.*"), s. 108; Quebec *Business Corporations Act*, CQLR c S-31.1 (hereinafter "*Q.B.C.A.*"), s. 213; Saskatchewan *Business Corporations Act*, RSS 1978, c B-10 (hereinafter "*S.B.C.A.*"), s. 140; Yukon *Business Corporations Act*, RSY 2002, c 20 (hereinafter "*Y.B.C.A.*"), s. 148. Throughout this dissertation, only the *C.B.C.A.* and the provincial and territorial statutes that authorize unanimous shareholder agreements will be cited when discussing general points of corporate law.

⁷ *C.B.C.A.* s. 146. In the former *Canada Business Corporations Act*, SC 1974-75, c. 29, (hereinafter "*C.B.C.A.* '74-'75") the unanimous shareholder agreement was set out at s. 140.

⁸ Depending upon the statute, certain other matters normally within the powers of the directors can be dealt with in the corporation's articles or by-laws. See e.g., *C.B.C.A.* s. 6(1), 103(1), 173(1). However, in the current *C.B.C.A.*, the scope of the unanimous shareholder agreement for this purpose is broader than that of the articles or by-laws, apparently encompassing any conceivable restriction upon the directors' power. This does not, however, have to be the case; see *C.B.C.A.* '74-'75, s. 6(2) and *N.B.B.C.A.* s. 4(2), which allow the articles to contain any provision found in a unanimous shareholder agreement. (See also, e.g., the British Columbia *Business Corporations Act*, SBC 2002, c 57 (which does not include the unanimous shareholder agreement), s. 137.) Even where the restriction in question is one that can be accomplished through these alternate means, doing so via a unanimous shareholder agreement may be more effective at creating a barrier against directors performing the restricted action (see Chapter Four), and a unanimous shareholder agreement is a better method for entrenching the limitations, especially if unanimity is legally required to amend it (see Chapter Three). Gerald McCarthy, "Shareholder Agreements", in *Meredith Memorial Lectures 1975* (Toronto: Richard De Boo Limited, 1975) 465, at pp. 469-470, drew a distinction between by-laws and unanimous shareholder agreements based upon the premise that the former can only restrict directors' powers but the latter can both do that and also restrict the board's "discretion" in how they use the powers they retain. Before even considering whether this characterization of either is correct, an initial objection is that this distinction is artificial. If a board's freedom as to how to use its power is restricted, then the power itself is restricted.

⁹ Throughout this dissertation, the term "unanimous shareholder agreement" refers to the type of instruments of that name created under Canadian federal, provincial, or territorial legislation. Several American states and Australia have developed tools that fill a similar niche, allowing shareholders of closely held corporations greater freedom to agree to alter the corporate structure and/or assume powers normally held by the directors. While the development of the Canadian unanimous shareholder agreement has thus not occurred in complete isolation, the law surrounding it has developed along its own path in this country, and an international comparison is beyond the scope of the current work. A summary of these foreign counterparts was provided in Industry Canada, *Canada Business Corporations Act*, Discussion Paper, *Unanimous Shareholder Agreements* (Ottawa: Industry Canada, 1996) (hereinafter "Industry Canada Discussion Paper"), at pp. 15-22. Robert M. Scavone, "The Unanimous Shareholder Agreement: Opting Out of Statutory Norms" in *The Future of Corporation Law: Issues and Perspectives: Papers Presented at the Queen's Annual Business Law Symposium 1997* (Scarborough: Carswell, 1999) 319, at pp. 360-373 provided a lengthy comparison of how the questions surrounding such an innovation in corporate law have been approached in Canada and the United States, contrasting provisions of the *C.B.C.A.* with the American *Revised Model Business Corporation Act*. Michael Disney, "The Unanimous Shareholder Agreement: A Promise Unfulfilled?" in Lazar Sarna, ed, *Corporate Structure, Finance and Operations*, volume 8 (Toronto: Carswell, 1995) 83 at p. 89 fn 6 noted that the Canadian legislation concerning unanimous shareholder agreements had apparently developed without express reference to the American counterparts, but at pp. 94-98 provided a contrast between the scope of the Canadian unanimous

completely relocate power from directors to investors, but also to split it between the two groups in numerous configurations, including division by subject matter and the creation of approval/veto powers.¹⁰ It has been described as shattering the traditional corporate structure that had stood unchallenged for more than a century¹¹ and embodying "a shareholder-chosen contractual model of corporate governance formerly absent from Canadian law".¹²

Is the unanimous shareholder agreement therefore a break from traditional corporate law principles in this country, a reconceptualization of the corporation at the most basic level? Or can it be understood as just one more tool within the established framework?¹³ The implications of these questions may extend far beyond the relatively small number of companies that are actually governed by these instruments.

It is unlikely, for obvious reasons, for a company with a very large number of shareholders to become the subject of a unanimous shareholder agreement, which may explain the relatively little attention the unanimous shareholder agreement has been given.¹⁴ But that is a practical limitation, not a legal one.¹⁵

shareholder agreement and the options in the American *Model Business Corporation Act*. Jean Turgeon, *Les Conventions D'Actionnaires d'une Petite Entreprise* (Montreal: Centre d'Edition Juridique, 1983), at p. 208 made the opposite claim, that "[i]ncontestablement, le principe de la substitution ou du transfert des pouvoirs des administrateurs vers les actionnaires origine de droit americain". (My translation: "incontestably, the principle of substituting or transferring the powers of the directors to the shareholders originates in American law".) However, the summary provided by Turgeon of the available instruments in the United States at pp. 208-212 illustrates only some similarities to the Canadian unanimous shareholder agreement, not any direct link between the two; he made occasional further references to the American counterparts throughout, establishing both commonalities with and differences from the unanimous shareholder agreement. Michael Dennis, "Corporations at the Crossroads" in *Meredith Memorial Lectures 1994/95* (Montreal: Faculty of Law, McGill University: 1995) 113 did not provide an in-depth comparison, but recommended that the *C.B.C.A.* provisions on unanimous shareholder agreements be amended in several ways to more closely resemble the American *Model Business Corporation Act* (at pp. 121, 124, 127). Trinidad and Tobago has adopted the unanimous shareholder agreement apparently based upon the Canadian model, although the exportation of this legal tool to that country is also not explored in this dissertation; see Daniel J. Fitzwilliam, "The Unanimous Shareholder Agreement: a Bane Or a Boon for Shareholders?" *Trinidad Tobago Law.Com* (website), online: <http://www.trinidadtobagolaw.com/commercial/baneboon.htm>, retrieved June 8th, 2008.

¹⁰ These arrangements are discussed in more detail in Chapter Five.

¹¹ Paul Martel, "La Convention Unanime Des Actionnaires En Droit Federal et Quebecois: Considerations Theoriques et Pratiques" (1983) 14 R.D.U.S. 1, at p. 4.

¹² Disney, *supra* note 9, at p. 118.

¹³ Turgeon, *supra* note 9, p. 242, took the position that because empowered shareholders assume the responsibilities that normally fall upon directors (see Chapter Five), this tool was created simply because "la loi accepte l'elimination des formalites tracassieres et inutiles et il ne s'agit que d'une innovation technique et non de la creation d'un nouveau concept juridique". (My translation: "the law accepts the elimination of awkward and useless formalities, and the unanimous shareholder agreement is only a technical innovation and not the creation of a new legal concept".)

¹⁴ The practical limit on the number of shareholders involved should not be mistaken for a limit on the size of the business. Corporations subject to unanimous shareholder agreements can have millions of dollars in assets.

¹⁵ Because unanimous shareholder agreements bind transferees, even the practical limitations are

These statutes do not even limit these instruments to non-publicly traded companies.¹⁶ In theory, according to the legislation, *any* corporation can have a unanimous shareholder agreement. A theoretical model of the corporation that includes room for them thus should not be limited to only some subsection of companies; it is part of how we must understand all corporations in those jurisdictions.

The statutory provisions provide little help in navigating either the practical or theoretical implications of the powerful and versatile tool they are authorizing. The legislation is, in all cases, almost shockingly vague, leaving even basic implementation issues ambiguous.¹⁷ If we are to comprehend the unanimous shareholder agreement as a component of corporate law, then, we must look to the case law and our own deductions.

An exploration of the unanimous shareholder agreement along those lines is thus in order, both to learn about the tool itself and about how it reshapes the law surrounding it. The aim of this dissertation is to accomplish that.¹⁸

weaker than they might first appear. A company with a few shareholders can become subject to an agreement, which continues in force even as the number of investors multiplies.

¹⁶ With the exception of the *Q.B.C.A.*, s. 219. Although the observation that the *C.B.C.A.* (and some provincial and territorial versions) would theoretically allow a public company to have a unanimous shareholder agreement has been made by other commentators- *e.g.* Normand Ratti, "La Convention Unanime des Actionnaires" [1986] C.P. du N. 93, at p. 97; Turgeon, *supra* note 9, p. 257; Disney, *supra* note 9, p. 115; Scavone, *supra* note 9, p. 339- the general consensus has been that it is for practical purposes irrelevant, since satisfying the criteria for the creation of a unanimous shareholder agreement is impossible in a public company. One possibility that is more rarely discussed is that arguably a unanimous shareholder agreement could be created during a period when a company is closely held (either its early days or after "going private") and then survive a public offering. This scenario was also spotted by Nathalie Beauguard and François Auger, "Les Conventions entre Actionnaires" Journées d'études fiscales (Canadian Tax Foundation, 2010), who acknowledged its theoretical validity but found it difficult to see any way that the advantages of maintaining a unanimous shareholder agreement in a public company would outweigh its costs and drawbacks. Assuming that the power structures discussed in Chapter Five are legally permissible uses of this tool, though, there do seem to be interesting (and low-cost) implications of restricting directors of public companies to increase profits, promote corporate social responsibility, or serve other goals. Paul Martel and Luc Martel, *Les Conventions entre Actionnaires*, Eleventh Edition (Montreal: Wilson & Lafleur, 2013), at p. 376 also identified this possibility in the *C.B.C.A.*, and thus recommended that a unanimous shareholder agreement contain a clause that it automatically terminates in the case of public offering; they considered the scenario inherently problematic, although the only example they provided of an actual downside was the right of shareholders to annul the purchase of shares subject to an undisclosed unanimous shareholder agreement. They warned that, absent such a term, a shareholder who refused to terminate the agreement could prevent a company from going public (since it was assumed that doing so with the instrument still in place was non-viable). The wording of the *C.B.C.A.* and other statutes aside, whether or not securities law or securities regulators would allow this is another question, one beyond the scope of the current discussion.

¹⁷ The *C.B.C.A.* version, for example, provides no explanation for how they can be amended or terminated.

¹⁸ This dissertation is not exhaustive of all the legal questions posed by unanimous shareholder agreements. Some issues that have sparked analysis by other commentators are, for space and thematic reasons, largely omitted here, *e.g.* what should be the default decision-making process for empowered shareholders (including whether it would be vote per-share or per-shareholder) or whether there are means

Before the analysis turns to these particular agreements, Chapter Two provides a further explanation and critique of the "nexus of contracts" theory that it has been alleged unanimous shareholder agreements incorporate (no pun intended) into Canadian law. While it would be extremely simplistic to reduce all the questions surrounding these agreements to whether or not they replace the statutorily-defined entity model of the corporation with a contractual one, many of the dilemmas posed by them arise in part out of the tension between the traditional corporate structure and the potential of these documents to alter it.

Over the course of Chapters Three through Five, that tension is illustrated through three key aspects of the unanimous shareholder agreement: their formation, their enforcement, and the transfer of responsibility that accompanies them.

In order for something to meet the statutory description of a unanimous shareholder agreement, it must be a written agreement amongst all the shareholders that restricts the power of the directors.¹⁹ This seemingly simple definition hides a web of subtle possibilities for controversy, as the examination of the case law in Chapter Three demonstrates. But judicial interpretations of these criteria can reveal more than precedents for handling various odd technicalities; they tell us whose consent is required to make such alterations to the corporate structure, and what alterations are permissible.

The question of what a unanimous shareholder agreement *is* and how it should be enforced are fundamentally intertwined. In Chapter Four, four separate approaches found in the case law will be considered: the "corporate constitutional" model whereby these documents literally remove powers from the directors, the "contractual" view that they can be treated as contracts with the directors regarding what decisions they will make, "directors' duties" analyses that treat the requirement that directors obey the restrictions upon them as akin to the obligations they already owe the company, and an "oppression remedy" based approach that considers unanimous shareholder agreements as part of the reasonable expectations which cannot be oppressed, unfairly disregarded, or unfairly prejudiced. Each of these four represents a different understanding of what a unanimous shareholder agreement is, what principles govern its enforcements, and what the appropriate remedy for a violation might be.

Just as unanimous shareholder agreements can transfer power from directors to shareholders, so too do they move the accompanying duties and liabilities.²⁰ Once again, a seemingly simple principle is far more technically complex in execution than it first appears, and Chapter Five examines some of its ramifications. As the various assignments of power that these agreements can create do not all suggest obvious divisions of responsibility, resolving them requires considering afresh the underlying justifications

of acquiring shares that escape the various wordings of the "transferee" provisions.

¹⁹ In some jurisdictions, including under the *C.B.C.A.*, it must be also be "lawful", although there is debate about whether that criterion has meaning. See the discussion in Chapter Three.

²⁰ Arguably they did not always transfer both, if there is a difference; although currently all statutes specify that shareholders incur and directors are relieved of duties and liabilities, this has not always been the case. *C.B.C.A.* '74-'75 s. 140(4) excused the directors of their duties and liabilities, but only explicitly

for directors' duties and liabilities. The obligations that directors owe to the corporation pose perhaps the most challenging dilemmas. It has sometimes been argued that the primary purpose of the directors' duties is to benefit shareholders, raising the question as to whether there is a point in imposing them upon those very investors. But the Supreme Court of Canada has endorsed the opposite view, holding that those obligations are to the company itself and may take into account other stakeholders, a position that seems at odds with the investors' ability to utilize a unanimous shareholder agreement to assume power directly in order to pursue their own interests.

These issues get at the heart of the unanimous shareholder agreement, exploring its very nature, to what extent and on what basis it can alter or affect corporations, and what some of the legal consequences of doing so may be.

As a consequence, they also tell us much about the corporation itself. The unanimous shareholder agreement can serve as a sort of "stress test" for the principles of corporate law. By pushing the corporation in unusual directions, they demonstrate aspects of its nature that might otherwise remain obscured. Assuming that the law is consistent,²¹ these agreements can teach us about not just the corporations that actually have one in place but also those that merely exist in a structural framework designed to include them, *i.e.* all corporations in the relevant jurisdictions.²²

The unanimous shareholder agreement can help us understand whether corporations are best conceived of as a "nexus of contracts" that can be rewritten by the parties or whether they are better viewed as statutory creations, largely static structures subject only to limited customization. The very existence of these agreements might suggest the former, but the specific requirements for their formation imply the latter; a careful review of those criteria can shed light on just how malleable this tool has rendered the corporation. The enforcement of unanimous shareholder agreements provides additional, conflicting information as to whether the corporate power structure can be truly and fundamentally reshaped by its shareholders or whether the default arrangement's entrenched status has proven resilient enough to absorb or externalize the instruments' effects. The transfer of directors' duties and liabilities that accompanies the restriction of their power further demonstrates that these existing legal mechanisms, which presumably serve policy goals, are designed to operate within the default structure, causing tensions when it is rearranged. Consideration of these issues reveals that, while the unanimous shareholder agreement by its very nature made the Canadian corporation more "contractual" in some ways, the creation of this legal tool has not in fact resulted in the re-conception of the statutorily-authorized entity as nothing more than a

stated that the duties were assumed by shareholders. See note 1680.

²¹ A debatable assumption in practice, but one which this dissertation will treat as a theoretical goal. It is acknowledged that some readers may disagree about the value of consistency even as necessarily desirable.

²² This includes public corporations, except in Quebec; the corporate law statutes do not exclude them from the unanimous shareholder agreement provisions, although practical factors and regulatory

"nexus of contracts".

In addition to such general questions about the nature of corporations, the unanimous shareholder agreement can shed light on specific aspects of them. Examining the appropriateness of bringing an oppression claim to enforce the terms of a unanimous shareholder agreement requires a reconsideration of what the general purpose of this remedy is and how it should coexist with other legal rights. Exploring the restructuring of the directors' duties when these instruments are in effect, particularly their duties to the corporation, requires us to re-evaluate the purpose and effect of those responsibilities, not just when imposed upon shareholders, but also when still owed by the directors themselves. Each interaction between the unanimous shareholder agreement and another aspect of corporate law can tell us something about both.

Because the law surrounding unanimous shareholder agreements is rife with unknowns, a useful place to begin their study is through a careful review of the case law, and so where possible, the analysis that follows is grounded in a review of actual judgments.²³ This pseudo-doctrinal methodology is not intended to "settle" all the questions left unresolved by the statute through the force of precedent- even if that were the purpose, between the relative rarity of reported cases on any given point and the frequent contradictions between them, it is unusual that there is undeniable judicial consensus on any of these issues,²⁴ although some trends can be identified and the data presented may be of benefit to readers seeking

bodies might.

²³ All of the cases cited in this dissertation can be found on either the Westlaw Canada, Quicklaw, or CanLII websites, as of the time of writing. Except for the reasons specified below, all of the judgments herein that are portrayed as dealing with unanimous shareholder agreements referred to the documents in question at least once as a "unanimous shareholder agreement" or one of the synonyms listed *supra* at note 5 (or specifically denied that they qualified as such). These terms were taken as invoking the specific statutory tool of that name, even if no judicial determination was performed confirming the document met all the relevant criteria. Many of the judgments discussed, despite specifically identifying the document in question as a unanimous shareholder agreement, also referred to it by the more general phrase at points, sometimes in a manner suggesting the two terms were synonymous, and for analytic convenience, I assumed that *in that context only* terms such as "shareholder agreement" were being used as an abbreviated form rather than a superset of "unanimous shareholder agreement" (similar to how this dissertation employs "agreement"). By contrast, cases that did not include one of those specific terms are generally not included in my analysis (unless they are being used to provide wider legal context); for example, a judgment that *only* used the wider term "shareholder agreement" (without the "unanimous") to refer to a document would not be treated as dealing with a unanimous shareholder agreement, even if my own reading of the facts suggests the document might have qualified. Exceptions were made in order to review the full judicial history of cases or where a judgment was later cited as precedent regarding unanimous shareholder agreements, even if it did not use the term itself. I acknowledged that this use of the specific terminology employed as a primary sorting mechanism is not without problems. As mentioned, judicial usage of the terms has not always precisely distinguished the two, and judges have doubtless occasionally carelessly employed the phrase "unanimous shareholder agreement" or failed to use it when it might have been appropriate to do so. To disregard the choice of terminology, however, would have muddied this attempt to understand the judicial view of unanimous shareholder agreements (the statutory tool) with their view of shareholder agreements generally.

²⁴ The closest that exists is the Supreme Court of Canada decision in *Duha Printers (Western) Ltd. v. R.*, [1998] 1 S.C.R. 795, 159 D.L.R. (4th) 457, 39 B.L.R. (2d) 1, [1998] 3 C.T.C. 303, 225 N.R. 241, 1998

specific precedents- but rather to shed light on the interaction between the unanimous shareholder agreement and the courts.

Both in consideration of individual judgments and for general prescriptive purposes, the critical perspective adopted emphasizes virtues internal to the law and legal system- logical rigour, consistency, clarity, certainty, predictability, ease of application, *et cetera*²⁵- but wider social policy goals and concerns are taken into account through consideration of how the unanimous shareholder agreement can and should interact with the existing legal principles that serve as their presumed proxies, including the oppression remedy, the directors' duties to the corporation (particularly in light of the inclusion of stakeholder theory into those obligations by the Supreme Court of Canada), and the general array of regulations affecting corporations and their directors; some of the possible economic implications are also touched upon in that same discussion. The scope of the following analysis does not extend, however, to an empirical study of whether unanimous shareholder agreements actually allow investors to better achieve their goals, whether those include greater profitability, minority shareholder protection, corporate social responsibility, or some idiosyncratic aim.

CarswellNat 750, 1998 CarswellNat 751, 98 D.T.C. 6334, [1998] S.C.J. No. 41 (S.C.C. May 28, 1998) (hereinafter "*Duha SCC*") and as explored in later chapters, subsequent decisions have both challenged and misapplied aspects of it.

²⁵ I acknowledge that these priorities are neither value-neutral, apolitical, nor necessarily unproblematic.

Chapter 2: Nexus of Contracts Theory

1. Introduction

The first question posed by the unanimous shareholder agreement is the reason for its inclusion in Canadian corporate law. The superficial explanation for it is that it has received legislative authorization and thus *is* part of Canadian corporate law. Such an approach is unsatisfactory in that it provides guidance neither for application, interpretation, nor reform in this area. Some further justification is therefore necessary on both theoretical and pragmatic grounds. Looking to the Dickerson Report, the initial reasoning behind this tool was to let corporations operate more like partnerships. "By expressly legitimating the device of a unanimous shareholder agreement in Part 11.00 we allow the closely-held corporation to avoid much of the formalism that is not appropriate to it, and to operate, in effect, as a partnership with limited liability."²⁶ That also simply begs the question. Why should a corporation be more like a partnership in this regard?

At least two general approaches to justifying the unanimous shareholder agreement suggest themselves. The first is to search for specific policy goals that might be furthered by the provision. Possible answers range from the ideological- *e.g.* shareholder empowerment is inherently good because it advances democratic principles, property rights, *et cetera*- to the practical- *e.g.* companies operated in this manner are more efficient, conscious of the public interest, *et cetera*.²⁷ Such arguments may have merit, and they will be revisited in the discussion of stakeholder theory in Chapter Five. For the present, however, a different justification will be examined, one allegedly grounded in corporate law itself.

This second approach develops from the premise that allowing unanimous shareholder agreements is consistent with the basic nature of the corporation. There is an academic tradition that views the corporation as a "nexus of contracts". This school of thought would hold that the "unanimous shareholder agreement" is not simply a tool of corporate organization created by specific sections of Canadian statutes, but rather was the definition of a corporation all along. The instrument set out in the legislation is a tool for amending this hypothetical pre-existing agreement.

Whether the "nexus of contracts" view of the corporation is convincing, and thus whether it and not more specific policy goals (if anything) justifies the unanimous shareholder agreement, is not a strictly

²⁶ R.W.V. Dickerson et al., *Proposals for a New Business Corporations Law for Canada*, Volume 1 (Ottawa: Information Canada, 1971) (hereinafter the "Dickerson Report"), p.11.

²⁷ These contentions are presented only as examples.

academic distinction. As will be discussed in Chapter Three, one of the debates concerning unanimous shareholder agreements is the degree to which their potential subject matter should be restricted. What justification the provision has would be a highly influential, if not determinative, factor in answering that question. Similarly, Chapter Four explores the enforcement of unanimous shareholder agreements, a topic that has become divided into approaches that either accept or reject the premise that these instruments fundamentally alter the corporate structure; the degree to which a "nexus of contracts" model of the corporation is accurate has relevance to that debate.

This chapter is divided into four sections. In the first, the history and basic elements of the "nexus of contracts" theory of the corporation are elaborated upon. The subsequent three sections deal with various criticisms of this approach as an explanation of the internal workings of the corporation, and specifically as an explanation of the relationship between shareholders and directors. The second section concerns challenges that the "nexus of contracts" is descriptively inaccurate. The third re-examines the alternative "concession" theory of the corporation. The fourth covers the debate over whether the "nexus of contracts" view of the corporation, when combined with total contractual freedom, adequately protects shareholders.

An additional objection to the "nexus of contracts" theory is that it inappropriately disregards the interests of stakeholders in the corporation other than shareholders and directors. Chapter Five will contain a general examination of the stakeholder debate and its relevance to unanimous shareholder agreements.

2. The "Nexus of Contracts Theory" of the Corporation

The "nexus of contracts" theory of the corporation, like all popular academic theories, has a number of variations. What all versions have in common is the view that the corporation has no separate existence as an entity unto itself. Instead, the "corporation" is nothing more than a descriptive term for the set of notional contracts among the individuals who comprise it.²⁸ Legal references to the corporation as a distinct entity would therefore be properly understood as convenient shorthand only, and it would be a mistake to give any further substance to the metaphor.²⁹

Though the current "nexus of contracts" school has its roots in the 1930s and developed in full during the latter decades of the last century, there is nothing novel about challenging the legal notion of the corporate person and emphasising that, in reality, the corporation exists only through human beings. Such

²⁸ Which individuals those might be is a matter of debate, as discussed later in this chapter.

²⁹ see *e.g.* Robert Hessen, "A New Concept of Corporations: A Contractual and Private Property Model" (1978-1979) 30 *Hastings L. J.* 1327, at p. 1335; Henry N. Butler and Larry E. Ribstein, "Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians" (1990) 65 *Wash. L. Rev.* 1, at p. 3 fn 1; Frank H. Easterbrook and Daniel R. Fischel, "The Corporate Contract" (1989) 89 *Colum. L. Rev.* 1416, at p. 1426.

arguments have been made periodically throughout history.³⁰

What distinguishes the "nexus of contracts" school from these earlier objections, if anything does, is that it was not originally based upon a preference for analysis in terms of real human beings over unreal legal entities. Instead, it grew out of attempts to explain corporate activity in economic terms, the result of which has been the erosion of the entity concept until only discrete contracts remained. Notwithstanding this differing origin, some advocates of the "nexus of contracts" approach, having arrived at the conclusion that the corporation is merely the sum of a set of contracts, have found advantages to this result when combined with a libertarian view of human freedom that might have proven more difficult to extend to non-human entities, a point that will be returned to.

2.(a) Historical Development in Economics

Three economic articles are generally viewed as having been influential in the development of the "nexus of contracts" theory.³¹ The first of these is Ronald Coase's "The Nature of the Firm".³² Prior to Coase, firms had been treated by economists as "black boxes" whose inner workings were not considered; they existed because some tasks required groups, and they simply produced or not in accordance with market conditions.³³ "The Nature of the Firm" addressed the question of why firms existed at all, rather than allowing market price mechanisms to arrange every level of economic activity.³⁴ In theory, if one party would require the same service to be performed repeatedly in the course of business,³⁵ they³⁶ could separately bargain for it each time: perhaps arriving at the same terms and perhaps not, perhaps with the same individual and perhaps not.

The conclusion reached was that firms existed because the market contained transaction costs.³⁷

³⁰ William W. Bratton Jr., "The New Economic Theory of the Firm: Critical Perspectives from History" (1988-1989) 41 Stan. L. Rev. 1471, at pp. 1471-1472 and generally.

³¹ Ian Ayres, "Making a Difference: The Contractual Contributions of Easterbrook and Fischel" (1992) 59 U. Chi. L. Rev. 1391, at p. 1395; Thomas S. Ulen, "The Coasean Firm in Law and Economics" (1992-1993) 18 J. Corp. L. 301 generally follows the development of the theory, but only used the first two; Melvin A. Eisenberg, "The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm" (1998-1999) 24 J. Corp. L. 819, at pp. 820-822; Bratton, *supra* note 30, p. 1477, although he placed the development of this line of analysis within a much larger historical context; William W. Bratton Jr., "The 'Nexus of Contracts' Corporation: A Critical Appraisal" (1988-1989) 74 Cornell L. Rev. 407, at pp. 415-416; Robert Flannigan, "The Economics of Fiduciary Accountability" (2007) 32 Del. J. Corp. L. 393, at pp. 401-406.

³² R. H. Coase, "The Nature of the Firm" (1937) 4 *Economica* New Series 386.

³³ Ulen, *supra* note 31, pp. 304-307; Bratton, *supra* note 30, p. 1496.

³⁴ Coase, *supra* note 32, p. 388.

³⁵ For example, a manufacturer of wooden tables might require someone to stain each one.

³⁶ In order to be inclusive regardless of gender, I adopt the use of the singular "they" in this dissertation to refer to a generic individual.

³⁷ Coase, *supra* note 32, p. 390.

When such costs were assumed to be zero, there was indeed no reason not to engage anew in a bargaining process each and every time one party required another to engage in some activity. But given the reality that time, effort, and incidental expenses were costs of bargaining, there came a point where this outweighed the advantages of pricing each transaction in the market. At that point, Coase reasoned, the firm would replace the market as the means of organizing affairs.³⁸ Within the firm, instead of costly bargaining, there was only (relatively) costless hierarchical ordering.³⁹ As the respective transaction costs of bargaining and inefficiencies of non-bargaining shifted, so too would firms expand and contract.

Coase's approach was challenged and developed upon by Armen Alchian and Harold Demsetz in "Production, Information Costs, and Economic Organization".⁴⁰ The firm, they argued, could not be said to be apart from the market, as transactions within the firm operated according to similar principles.⁴¹ A superior in the firm had no real authority over subordinates, because in the event that the subordinate did not agree to an order, they could refuse to follow it.⁴² That such refusal might entail a cost (loss of pay, termination, *et cetera*) did not undermine this observation because such costs were no different from the costs a party might pay in the market for refusing a potential contract.⁴³ In this sense, then, relationships within the firm were constantly being reaffirmed or not in accordance with the same market principles that governed relationships outside the firm. This approach has been subject to criticism on the basis that it fails to fully capture the real psychological and social conditioning that encourages conformity with firm hierarchies.⁴⁴ That criticism does not displace the model of corporate employees as contractual performers, however; it only negates the position that they are free of all (non-economic) influence in deciding whether to perform, and that therefore they are not economic abstractions.

The insights of Coase and Alchian and Demsetz are several degrees removed from what would later become the "nexus of contracts" theory of the legal nature of the firm, which is normally more concerned with using a contractual analysis to understand the relationship between investors and the corporation than with the relationship between employees and the firm. But they set the stage by opening up the corporation to internal examination. The economic "black box" had its counterpart in an irreducible legal entity; once one discipline pried into the internal workings to find the separate relationships within, the other would follow.

Meanwhile, the place of investors within the economic corporate contract theory was also being developed, with Michael C. Jensen and William H. Meckling's "Theory of the Firm: Managerial Behaviour,

³⁸ Ibid, pp. 394-395.

³⁹ Ibid, p. 392.

⁴⁰ Armen A. Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization" (1972) 62 Am. Econ. Rev. 777.

⁴¹ Ibid, p. 777.

⁴² Ibid, p. 777.

⁴³ Ibid, p. 777.

⁴⁴ Eisenberg, *supra* note 31, p. 827.

Agency Costs, and Ownership Structure".⁴⁵ It was in this article that the corporation was apparently first described as a "nexus for contracting relationships",⁴⁶ a phrase shortened to "nexus of contracts" by subsequent authors. It is worth addressing the exact meaning of the term as used here, since as discussed below, there are a number of different models operating under that banner.

Jensen and Meckling addressed the issue of why and how an entrepreneur (whom they call a "manager"⁴⁷) seeking funding might choose between debt and equity,⁴⁸ or more likely, how the ratio between debt and equity might be determined.⁴⁹ In order to do so, they broke down debt and equity into packages of economic rights; significantly, they removed voting rights from equity for the purpose of their analysis.⁵⁰ Thus considered, equity becomes merely a form of financial obligation, like debt but with different assumed terms, namely to "share proportionately in the profits of the firm".⁵¹ The relationship between the entrepreneur and the equity investors is therefore treated as contractual, and the "corporation" is termed a "nexus of contracts" because it is the sum of the entrepreneur's contracts with the investors.

While Jensen and Meckling's analysis may be highly insightful regarding the choice between debt and equity financing, caution must be taken when proceeding from there to a legal description of the corporation as nothing but a set of contractual relationships. The model presented was not intended for that purpose, and includes a number of assumptions that make that leap problematic.

First, it bears repeating that for ease of analysis, Jensen and Meckling excluded voting rights from the equity investment contract. It is possible to create an economic model that includes voting rights, and this has indeed been done.⁵² However, the presence of voting rights may be seen to create an ideological complication for the legal theorist. While voting rights in the corporation might be economic tools with no moral component, an alternative view is that any system with voting rights should bear more than a passing resemblance to a functioning democracy.⁵³

⁴⁵ Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305.

⁴⁶ *Ibid*, p. 311.

⁴⁷ I prefer the term "entrepreneur" in this context, as the phrase "manager" may suggest that managing is occurring on someone else's behalf, the very opposite of the scenario that is being described.

⁴⁸ "Equity" in this context refers to the form of investment described above. It should not be confused with the principles of equity that originated in the Chancery Courts.

⁴⁹ Jensen and Meckling, *supra* note 45, p. 306.

⁵⁰ *Ibid*, p. 314.

⁵¹ *Ibid*, p. 312.

⁵² *e.g.* Frank H. Easterbrook and Daniel R. Fischel, "Voting in Corporate Law" (1983) 26 *J. L. & Econ.* 395.

⁵³ *e.g.* Bratton, *supra* note 31, pp. 437-438. The concept of "shareholder democracy" has been subjected to critique; see Nicholas Wolfson, "A Critique of Corporate Law" (1979-1980) 34 *U. Miami L. Rev.* 959, at pp. 991-994; Ralph K. Winter, "State Law, Shareholder Protection, and the Theory of the Corporation" (1977) 6 *J. Legal Studies* 251, at p. 276; Daniel R. Fischel, "The Corporate Governance Movement" (1982) 35 *Vand. L.Rev.* 1259, at pp. 1274-1276; Easterbrook and Fischel, *supra* note 52, generally.

Second, Jensen and Meckling's assumption of a single entrepreneur, a "single manager... with ownership interest in the firm",⁵⁴ is descriptively inaccurate for a large number of corporations. Interestingly, it might also call into question their analysis of the firm as a nexus of contracts, because one might say that they *presuppose and equate* the firm with their hypothetical single manager. To avoid this, one must consider that it is not the manager seeking investment, but the firm. This eliminates the descriptive problem, as it expands the model's viability to firms not governed by single entrepreneurs, but instead it ends up begging the question of what the firm is, and if it has an essence that cannot be reduced to individual contracts.

Third, Jensen and Meckling assumed for the purposes of their analysis no legal framework protecting the parties other than their own contracts.⁵⁵ This is obviously descriptively inaccurate, but the more immediate caution is that it does not appear that Jensen and Meckling were making a normative suggestion that there should be no such framework or that their analysis demands such a conclusion.

Finally, it is interesting to note, in the context of the stakeholder debate that will be examined in Chapter Five, that Jensen and Meckling's analysis does not privilege the corporate contract(s) with shareholders, but instead explicitly places it on approximately the same footing as the corporate contract(s) with creditors; both are simply alternative "outside claims on the firm".⁵⁶ This is in marked contrast to much, though not all, of the "nexus of contracts" analysis that follows.⁵⁷

These articles, among others, transformed the economic view of the corporation as a "black box" into one where all the relationships within, be they between supervisors and employees or entrepreneurs and debt and equity investors, could be separately analyzed as contractual relationships subject to the same market forces as those outside the firm. It was upon this basis that legal theorists proceeded to develop the "nexus of contracts" approach to corporate law.

2.(b) Three "Nexus of Contracts" Models

Legal theory and practice have different requirements from economics. As a result, when the "nexus of contracts" approach to the corporation made the transition from one field to the other, certain refinements were necessary in order for it to suit legal purposes. It was not sufficient to say only that a set of contracts existed; it became necessary to provide descriptive and prescriptive analyses of what rights and duties those contracts entailed.

If the interior of a firm is comprised of nothing but a web of contractual relations, and at the

⁵⁴ Jensen and Meckling, *supra* note 45, p. 314.

⁵⁵ More accurately, no legal framework other than one that enforces contracts.

⁵⁶ Jensen and Meckling, *supra* note 45, p. 343.

⁵⁷ Eisenberg, *supra* note 31, p. 833 noted that the "nexus of contracts" theory is commonly thought

boundary of the firm are also contractual relations, then it is ambiguous precisely which contracts constitute the firm.⁵⁸ Further, since these alleged contracts must be inferred from characteristics of the metaphorical entity, it is left to the theorist to "discover" at least some of the terms. As a result, there appear to be at least three ways of characterising the "nexus of contracts" firm. I will refer to these as the entrepreneur-centric, shareholder-centric, and decentred models. The differences between the models is significant in part because the choice of characterization has influenced the normative arguments presented by various commentators regarding mandatory versus default legal rules of corporate governance. It may also be significant when other legal principles, such as liability rules, are applied to corporations.

The entrepreneur-centric "nexus of contracts" model is derived from Jensen and Meckling. In this version, the corporation is created and controlled by an entrepreneur or group of entrepreneurs who retain direct power, presumably becoming the corporate directors and management. These entrepreneurs may seek to obtain capital by contracting with investors and exchanging equity rights (or some approximation thereof) in return for funding. They may alternatively obtain funding through more traditional debt. Additionally, these entrepreneurs may be considered the principals who contract with employees to perform various tasks.⁵⁹

The entrepreneur-centric model might have conceptual appeal to those who do not object to- indeed, who support on efficiency grounds- widely dispersed shareholders exerting little actual control over large corporations.⁶⁰ This model also fits comfortably with corporate contracts that exclude traditional controls on directors, such as the duties of care and loyalty and even shareholder voting rights.⁶¹

The shareholder-centric model appears to be the dominant one in current legal "nexus of contracts" analysis.⁶² In this version, a group of shareholders enter into an agreement with each other that creates a corporation.⁶³ They then contract with managers to operate as agents on their behalf.⁶⁴ These

to support shareholder primacy, yet actually would suggest the opposite.

⁵⁸ See note 108.

⁵⁹ Wolfson, *supra* note 53, pp. 972-973, without explicitly adopting the entrepreneur-centric model, rejected shareholder-centric views and classified shareholders as a form of lender; Eisenberg, *supra* note 31, pp. 830-831 considered this approach.

⁶⁰ William A. Klein, "The Modern Business Organization: Bargaining Under Constraints" (1981-1982) 91 Yale L.J. 1521, at p. 1559, while not precisely subscribing to this approach, followed a similar logic.

⁶¹ Klein, *supra* note 60, p. 1560 discussed shareholders being completely uninterested in control; Robert C. Clark, "Contracts, Elites, and Traditions in the Making of Corporate Law" (1989) 89 Colum. L. Rev. 1703, at p. 1708 discussed the elimination or curtailment of voting rights.

⁶² This approach implicitly underlies any analysis in which the articles are considered equivalent to the corporate contract. Klein, *supra* note 60, p. 1527 considered this explicitly, although his actual model is not shareholder-centric. Manuel A. Utset, "Towards a Bargaining Theory of the Firm (1994-1995) 80 Cornell L. Rev. 540, at pp. 550-551 outlined this as the "Agency Theory".

⁶³ This is a theoretical understanding of the formation of a corporate "contract", and it should be understood as separate from the steps involved in incorporating under current law.

⁶⁴ The relationship between directors and shareholders is often described as one of agency. See e.g.

managers, in turn, may enter into contracts with other parties, including employees, but notionally they do so only as agents acting on behalf of the shareholders as principals. The shareholder-centric model often equates the articles of incorporation with the corporate "contract".⁶⁵ Any given shareholder may or may not have had input into the original articles of incorporation upon which the company was founded, but the acquisition of shares is presumed to include consent to the corporation's existing articles,⁶⁶ and they are, of course, subject to amendment by the shareholders. No other group need agree to changes to the articles, although for procedural reasons, it is essentially impossible to amend them without support of the directors.

The shareholder-centric model reconciles shareholder primacy with an opposition to government regulation designed to protect shareholders' interests. While one of the principal challenges to the contractual model comes from those who believe that it does not adequately protect shareholders, as discussed below, this does not imply that the defenders of the contractual corporation tend toward the entrepreneur-centric model. Instead, many of them automatically align themselves with the shareholder-centric model, and assert that whatever privileges managers enjoy are those that shareholders have rationally bargained away in order to further their own interests.⁶⁷

Finally, in the decentred "nexus of contracts" model, the corporation is truly a nexus through which contracts flow. All participants in the corporation, be they shareholders, creditors, managers, customers, *et cetera*, are entering into a multilateral relationship with all other parties.⁶⁸ The decentred model might be the only approach that truly transforms the corporation into a nexus of contracts, rather than identifying the essence of the corporation with a single group, be it the managers or the shareholders. However, it does not appear to be the version of "nexus of contract" theory used by most of its advocates, perhaps because it has implications at odds with their ideology. It makes the concept of renegotiating the corporate contract more difficult- it would, for example, suggest that a "unanimous *shareholder* agreement" would be inadequate due to a failure to include all relevant parties- and it leads rapidly to stakeholder theory.

2.(c) **Libertarianism**

Frank H. Easterbrook and Daniel R. Fischel, "Corporate Control Transactions" (1981-1982) 91 Yale L.J. 698, at p. 701; Roberta Romano, "Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws" (1989) 89 Colum. L. Rev. 1599, at p. 1602 fn 10.

⁶⁵ Much of the literature on opting out of directors' duties makes this equation; see Section 4.

⁶⁶ See the subsection "Initial Versus Amendments" later in this chapter.

⁶⁷ See Section 4 of this chapter.

⁶⁸ Stephen M. Bainbridge, "Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship" (1996-1997) 82 Cornell L. Rev. 856, at p. 859 presented a description that may qualify as this type; Margaret M. Blair and Lynn A. Stout, "A Team Production Theory of Corporate Law" (1999) 85 Va. L. Rev. 247, generally discussed a version of this model,

If the corporation is nothing more than a set of contracts amongst shareholders and/or between shareholders and directors, then government regulation of corporations is the regulation of those contracts. It is this observation that has fuelled much of the normative prescription in the "nexus of contracts" literature.

The contractual approach to the corporation often, though not always,⁶⁹ goes hand in hand with a libertarian approach to contract. This view holds that the parties to a contract should be free to make whatever deals they wish, without government interference, and should be trusted to look after their own interests adequately, or alternatively be left to suffer the consequences of their own poor judgment.⁷⁰ In short, it has no place for paternalism.⁷¹ An exception is sometimes made when the agreement might harm third parties, a phenomenon known as "externalities"; this is considered a special case when government intervention is appropriate.⁷²

It is because of this libertarian view of contracts that the "nexus of contracts" approach has such appeal to some commentators. If the corporation is a distinct entity- and in particular though not necessarily exclusively if that entity is created only by the state itself- then such an entity might legitimately be subject to regulation.⁷³ Or it might not, but that would require arguments from base principles to demonstrate, with perhaps also reference to a wide range of policy goals and empirical evidence of costs and benefits of regulation. If, however, contracts are assumed to "naturally" be free of government intervention, then once the corporation is equated to a contract, no further argument is necessary to demonstrate that it should be free of regulation. At the very least, these "nexus of contracts" advocates assume that the burden of proof has been shifted to the regulators.⁷⁴

described succinctly at pp. 278 and 320.

⁶⁹ Lucian Arye Bebchuk, "The Debate on Contractual Freedom in Corporate Law" (1989) 89 Colum. L. Rev. 1395, at p. 1409; Klein, *supra* note 60, p. 1526; Eisenberg, *supra* note 31, pp. 823-824; Robert B. Thompson, "The Law's Limits on Contracts in a Corporation" (1989-1990) 15 J. Corp. L. 377, at p. 379; John C. Coffee Jr., "No Exit?: Opting Out, the Contractual Theory of the Corporation, and Special Case of Remedies" (1987-1988) 53 Brook. L. Rev. 919, at p. 924.

⁷⁰ Bebchuk, *supra* note 69, p. 1397 presented this view without endorsement; Winter, *supra* note 53, p. 253; Ayres, *supra* note 31, p. 1396; Ulen, *supra* note 31, p. 322; Clark, *supra* note 61, p. 1714-1715 summarized this position; Flannigan, *supra* note 31, p. 406 noted this argument.

⁷¹ Clark, *supra* note 61, p. 1718 is one of the few places in this debate where it was suggested that paternalism may have merit even absent market failures such as imperfect information, rational apathy, *et cetera*; the expertise of outsiders may sometimes allow for better decision making than non-expert affected parties could make.

⁷² Romano, *supra* note 64, p. 1616; Bebchuk, *supra* note 69, p. 1405; Winter, *supra* note 53, p. 253; Ayres, *supra* note 31, p. 1396; Eisenberg, *supra* note 31, p. 824, though not advocating free contract generally, noted externalities as a concern; Clark, *supra* note 61, p. 1706 described this as part of the strong form of the theory.

⁷³ Hessen, *supra* note 29, p. 1328.

⁷⁴ Butler and Ribstein, *supra* note 29, p. 64 noted that there is no good theoretical reason to put the burden of proof on one side or the other, and then proceeded to assert on the basis of an alleged historical trend that the burden of proof is on regulators.

Not all advocates of the "nexus of contracts" approach take such a position; some note that, as contracts themselves are subject to regulation both in general and specifically according to type,⁷⁵ then so too might the contractual corporation.⁷⁶ But this appears to be a minority position, or at least a less vocal one.⁷⁷ Instead, the "nexus of contracts" theoretical model of the corporation has become heavily associated with advocacy for free corporate restructuring. To quote one commentator:

Unfortunately, it has proved easy to confuse the positive proposition that the corporation is a nexus of reciprocal arrangements with the normative proposition that the persons who constitute a corporation should be free to make whatever arrangements they choose, without the constraints of any mandatory legal rules.⁷⁸

Believers in a libertarian approach to contract on philosophical grounds would likely argue that the scale of the arrangements has no bearing on whether or not the government should interfere.⁷⁹ Those with at least some belief in the wisdom of government regulation of private arrangements, however, might find that large-scale enterprises invite such interference more than small ones, due to the number of parties potentially affected. Even ignoring immediate externalities upon outsiders, the ultimate social, economic, and moral costs of allowing widespread financial injury to large numbers of willing participants might be too great to ignore.⁸⁰ Even if corporations are contracts, the size of public corporations might invite regulation that an arrangement among a handful of parties would not.

Such concerns do not factor into the libertarian approach to "nexus of contracts" corporate theory. Instead, the choices of the parties should be determinative of the content of the corporate contract.⁸¹ This position becomes slightly trickier when the contract is not explicit (or reasonably implicit) about all subject matter, a result that is inevitable given the long-term existence of the corporation and the impossibility of foreseeing all eventualities, let alone the cost efficiency of contracting for them all.⁸² These gaps must be filled, and it is the law that fills them.⁸³

A criticism of this conceptual approach to judicial contract interpretation- that is, a criticism of

⁷⁵ *e.g.* consumer transactions.

⁷⁶ See notes 151 and 152.

⁷⁷ This observation is made somewhat informally, from my own review of the literature. It must be noted, however, that it can be difficult to separate a pro-regulation contractarian from an anti-contractarian.

⁷⁸ Eisenberg, *supra* note 31, p. 824. See also, *e.g.* John C. Coffee Jr., "The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role" (1989) 89 Colum. L. Rev. 1618, p. 1619.

⁷⁹ Hessen, *supra* note 29, p. 1328.

⁸⁰ Most market crashes, such as the one in late 2008, demonstrate this.

⁸¹ See the discussion of mandatory and default rules below.

⁸² *e.g.* Fred S. McChesney, "Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg" (1989) 89 Colum. L. Rev. 1530, p. 1536; Coffee, *supra* note 78, p. 1621; Butler and Ribstein, *supra* note 29, pp. 28-29.

⁸³ Explicit mandatory or default rules are not gap-fillers *per se* as they were known to be part of the agreement, *per* Flannigan, *supra* note 31, p. 418; however, judicial decisions may perform a genuine gap-filling function.

treating judicial contract interpretation as consistent with a contractual approach to *contracts themselves*- is that it is unnecessary and inaccurate to resort to this rhetoric. Judges may state that they are determining what the parties might be understood to have bargained for, but the truth is that they are attempting to balance the interests of the parties in a fair and welfare-enhancing manner.⁸⁴ Framing this as what they would have bargained for is unnecessary and arguably misleading; advocates of freedom of contract frame the ideal role of judicial interpretation this way solely to support their metaphor of the corporate contract. Without *actual* consent, there is no difference between the imposed "contract" and regulation.⁸⁵ This does not mean that corporations cannot be contracts, but it does remind us that even if they are, that does not mean that they are perfect instruments and expressions of the parties' wills subject to no other power. No contract is. Those who find contracts self-justifying on the basis that they are consensual instruments which further the parties' rational self-interest should bear this in mind.

2.(d) Rules Regimes

Statutes and established common law principles which govern the corporation can be divided into two categories: mandatory and default rules.⁸⁶ Mandatory rules are those from which parties cannot opt out. Default rules are those which operate in the absence of a contrary agreement by the parties. Most "nexus of contracts" advocates assume that default rules are preferable to mandatory ones.⁸⁷

⁸⁴ Anthony T. Kronman, "A Comment on Dean Clark" (1989) 89 Colum. L. Rev. 1748, at p. 1749; Ulen, *supra* note 31, p. 321 described this as the contract being inevitably "imperfect and in need of correction from outside the contracting process"; Lewis A. Kornhauser, "The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel" (1989) 89 Colum. L. Rev. 1449, at p. 1452 noted that parties operating under ideal conditions would not necessarily reach an agreement that maximized their wealth as judges might attempt to prescribe; Clark, *supra* note 61, p. 1712 contrasted "contract rule making" by the parties and "elite rule making" by judges; Coffee, *supra* note 78, p. 1623 suggested that the approach used by courts should not necessarily base decisions on what the parties would have chosen; Flannigan, *supra* note 31, p. 417 described judicial decisions as embodying a "social consensus" designed to guide behaviour rather than reflecting the parties' wishes.

⁸⁵ Kronman, *supra* note 84, p. 1750.

⁸⁶ Ian Ayres and Robert Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989-1990) 99 Yale L.J. 87, at p. 87; Bebchuk, *supra* note 69, p. 1396; Utset, *supra* note 62, pp. 607-608; Melvin Aron Eisenberg, "The Structure of Corporate Law" (1989) 89 Colum. L. Rev. 1461, at p. 1461; Coffee, *supra* note 69, p. 924; Coffee, *supra* note 78, p. 1618.

⁸⁷ Easterbrook and Fischel, *supra* note 29, p. 1418; Romano, *supra* note 64, p. 1616; Ayres and Gertner, *supra* note 86, p. 89; Butler and Ribstein, *supra* note 29, p. 53; Jeffrey N. Gordon, "The Mandatory Structure of Corporate Law" (1989) 89 Colum. L. Rev. 1549, at p. 1551 identified this as the common position, although he disagreed; Bebchuk, *supra* note 69, p. 1396 identified this position; Ulen, *supra* note 31, p. 322; David Millon, "Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) 50 Wash. & Lee L. Rev. 1373 at p. 1378; Kornhauser, *supra* note 84, p. 1457 identified this preference; Jonathan R. Macey, "Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies From a Theory of the Firm Perspective" (1998-1999) 84 Cornell L. Rev. 1266, at p. 1270; McChesney, *supra* note 82, pp. 1536-1537.

There is some variation in suggestions as to how such defaults should be selected. One view is that the defaults should represent the bargain the parties "would have" selected themselves, possibly using assumptions such as bargaining costs being zero and the parties being rationally self-interested and fully informed.⁸⁸ Some ambiguity exists as to whether these criteria are meant to be interpreted by a court generally or with regard to specific circumstances.⁸⁹ In other words, if *most* parties to a corporate contract would have selected Term X, should it apply to parties whose specific circumstances would have likely caused them to select Term Y? If yes, then the result cannot be premised upon (retroactive implicit) consent, as it is the imposition of a socially determined correct result, not the determination of the parties' self-interested rational bargain,⁹⁰ although as noted above, judicial determination of a contract's content is always different from contractual agreement.

At least three alternative guidelines to selecting defaults exist. Generally undesirable default terms may be used, in order to better induce the parties to specifically contract around them, and thus reveal their own intentions.⁹¹ This approach stems from the belief that terms to which the parties have explicitly contracted are inherently better than defaults to which their assent is less clear. Another potential principle in creating default rules is that they should be selected with a view to which parties are better situated to contract around defaults.⁹² For example, corporate managers might be in a superior position as compared to shareholders, so default rules should favour (non-controlling) shareholders.⁹³ While in a theoretical world of zero transaction costs and equal bargaining power, this would be irrelevant, in the real world, such considerations may have bearing. Finally, it has been suggested that where the parties may be faced with the option of selecting between a clear term and an ambiguous one (*e.g.* "good faith", "best efforts"), then the default rule should be the ambiguous one.⁹⁴ This is because case law expounding upon the ambiguous rule is more likely to develop consistently with a consistent ambiguous rule; if the parties contract to create an ambiguous rule of their own, then their specific wording may make whatever case law results inapplicable to any other ambiguous contract and *vice versa*.⁹⁵ Further, parties are relatively unlikely to

⁸⁸ Easterbrook and Fischel, *supra* note 64, p. 702; Ayres and Gertner, *supra* note 86, pp. 89-90; Gordon, *supra* note 87, pp. 1550-1551; Kronman, *supra* note 84, p. 1749; described by Ayres, *supra* note 31, pp. 1396-1397; Ulen, *supra* note 31, p. 322; Bainbridge, *supra* note 68, p. 865; Kornhauser, *supra* note 84, pp. 1453-1457 deconstructed these conditions; Coffee, *supra* note 69, p. 951; Easterbrook and Fischel, *supra* note 29, p. 1444.

⁸⁹ Ayres and Gertner, *supra* note 86, pp. 91-92; Ayres, *supra* note 31, pp. 1402-1403; Kornhauser, *supra* note 84, p. 1452.

⁹⁰ Flannigan, *supra* note 31, p. 417, although he took the view that the result is guided by the consensus of society as a whole, not a (constructed) consensus of similarly situated parties.

⁹¹ Ayres and Gertner, *supra* note 86, p. 91 and generally; Ayres, *supra* note 31, pp. 1397-1400; Coffee, *supra* note 78, p. 1623 employed a variation.

⁹² Bebchuk, *supra* note 69, p. 1412.

⁹³ *Ibid*, p. 1412.

⁹⁴ Ayres, *supra* note 31, pp. 1403-1408.

⁹⁵ *Ibid*, p. 1405.

contract into an ambiguous rule of their own making, due to the massive uncertainty involved, whereas the relative clarity of a standardized ambiguous rule may make it palatable.⁹⁶ For these reasons, making the default rule the ambiguous one may be the only way to make ambiguous rules a viable choice for the parties.

2.(e) Initial Versus Amendments

A distinction may be drawn between the amount of freedom that should be allowed in initially enacting corporate "contracts" and in later amending them.⁹⁷ As the supporting analysis concerns publicly traded companies and public shareholders, the point of differentiation is actually when the corporation went public, and not its original formation; amendments prior to going public would likely be considered equivalent to initial terms (although they may raise similar issues).⁹⁸

Shareholders who buy into a corporation when it goes public are *all* presumptively agreeing, according to the assumptions of "nexus of contracts" theory, to the corporate "contract" which precedes their purchase.⁹⁹ Their purchase of the shares indicates their consent. Therefore, whatever form the corporate "contract" has at the time it goes public is agreed to by the initial wave of purchasers and all subsequent purchasers or transferees. This provides it legitimacy.¹⁰⁰

However, subsequent amendments to the corporate "contract"- here envisioned as the articles- may be passed with less than unanimous support. In such a case, some portion of the shareholders will find themselves parties to a corporate contract to which they never agreed.¹⁰¹ Whether their legal and economic options in such a circumstance adequately protect their interests, a question returned to below, one interpretation is not that their rights have been compromised, but that the corporate contract no longer has validity under such a circumstance, lacking the unanimous consent of the relevant parties as normally expected by contract law and philosophically required by some views of contracts. Therefore, free

⁹⁶ Ibid, p. 1406.

⁹⁷ Gordon, *supra* note 87, pp. 1573-1585; Bebchuk, *supra* note 69, p. 1399; Lucian Arye Bebchuk, "Limiting Contractual Freedom in Corporate Law: the Desirable Constraints on Charter Amendments" (1988-1989) 102 Harv. L. Rev. 1820, at p. 1820 and generally; Kornhauser, *supra* note 84, p. 1458; Coffee, *supra* note 69, pp. 938-939; Coffee, *supra* note 78, pp. 1674-1676; Eisenberg, *supra* note 86, p. 1515; Butler and Ribstein, *supra* note 29, p. 52, reject this distinction; Easterbrook and Fischel, *supra* note 29, p. 1444.

⁹⁸ Eisenberg, *supra* note 86, p. 1515 drew the distinction in that manner.

⁹⁹ Interestingly, Turgeon, *supra* note 9, p. 256, was critical of the statutory provisions governing unanimous shareholder agreements for making this concept explicit, and giving potential transferees the choice between being deemed parties to the agreement or declining to become shareholders. He criticized this as an artificial way of maintaining supposed unanimity.

¹⁰⁰ Bebchuk, *supra* note 69, p. 1404, although he qualified this; similarly, Bebchuk, *supra* note 97, pp. 1825-1827.

¹⁰¹ Eisenberg, *supra* note 86, p. 1474.

amendments to the corporate "contract" might not be justifiable, even if total freedom is allowed at the formation stage.¹⁰²

Assuming that the only relevant parties to the corporate contract are shareholders, then the unanimous shareholder agreement, even if enacted after a corporation's initial formation, avoids this problem, as by definition all shareholders must consent.¹⁰³ However, as discussed in Chapter Three, in some jurisdictions it is possible that an existing unanimous shareholder agreement might be amended non-unanimously, which reintroduces the problem.

3. Descriptive Challenges

The first major objection to the "nexus of contracts" theory of the corporation is that it is descriptively inaccurate. Such challenges tend to take one of three general forms.

The first, and most trivial, is that the libertarian vision of the corporation as an unregulated strictly private arrangement is false. The corporation is currently subject to a wide variety of government regulation and thus is not solely a creature of contract.¹⁰⁴ To quote Eisenberg, "The characterization of corporate law as a standard-form contract whose terms each firm is generally free to vary is belied by the great number of mandatory rules of corporation law."¹⁰⁵ Proponents of the "nexus of contracts" school generally concede this, arguing that it misses the points that (a) they are describing the underlying justification for the corporation, and (b) they are making a prescriptive argument for less regulation.¹⁰⁶

The second and third forms have more depth. These are, respectively, that it is descriptively inaccurate to equate the corporation with the set of relationships within it and that it is descriptively inaccurate to equate the relationships involved in a corporation with legal contracts.

3.(a) More Than the Sum

It is difficult to argue with the position that corporations include contracts, and moreso to argue with the position that they include relationships at all. This does not, however, necessarily lead to the conclusion that the corporation is nothing more than the sum of those contractual relationships.

What is the definition of a firm? Take first the premise that the firm itself is nothing but a set of

¹⁰² Bebchuk, *supra* note 69, p. 1401; Bebchuk, *supra* note 97, p. 1820 and generally.

¹⁰³ I assume here no problems of undue influence, unconscionability, *et cetera*.

¹⁰⁴ Eisenberg, *supra* note 86, p. 486, Victor Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract" (1985) 85 Colum. L. Rev. 1403, at p. 1415 fn29.

¹⁰⁵ Eisenberg, *supra* note 86, p. 1486.

¹⁰⁶ Bainbridge, *supra* note 68, p. 860; McChesney, *supra* note 82, p. 1531; Butler and Ribstein, *supra*

contractual relationships. Then, at the boundary of the firm, one finds again contractual relationships between the firm and outside parties. But because the firm is allegedly the aggregate of parties and their contracts, those are instead the contracts between inside parties and outside parties. It then becomes questionable whether the boundaries¹⁰⁷ of the firm are determinable at all.¹⁰⁸ Given these premises, as Hart observed, "there is therefore little point in trying to distinguish between transactions within a firm and those between firms".¹⁰⁹

From the perspective of theoretical economics, this might be an acceptable result. But if the corporation is to operate within a larger legal framework, greater clarity is required. Insofar as we allow corporate personality to have legal status at all, its delineation may be important. The corporation can sustain legal liabilities, is subject to regulation, enters contracts and commits torts. Prevention of monopolies, determinations of vicarious liability, enforcement of citizenship requirements, *et cetera*, all would be rendered more complicated, if not impossible, if we could not identify what was and was not within the corporation. Defining the corporation as an *identifiable* set of contracts could allow for the relevant contracts and parties to be subject to the application of the law as needed; positing that the corporation might or might not exist at all as part of a mass of contracts each of which might or might not be a part of it does not.

Determining the boundaries of an enterprise is not a new dilemma, and in some cases, solutions exist. There have been a variety of proposed tests to determine the difference between an employee and an independent contractor, for example, but these presuppose the existence of an employer. Query, further, why a shareholder might be thought of as "within" the firm and a creditor "outside" of it.¹¹⁰ Alternatively, if a large debentureholder is brought "within" the conceptual firm, why not a supplier who extends trade credit or even deals with the firm on a regular basis? And so on. Taken to its extreme, this logic suggests either one all-encompassing firm or, alternatively, no firms at all, neither of which seems reasonable and neither of which is consistent with attempts to define the corporation in a legal sense.

It therefore follows that there is a way of distinguishing, at least intuitively, between contractual relationships that are within the firm from those that cross its boundary. The question then becomes whether that distinction is found within the contracts themselves, or if it operates independently of them. If

note 29, p. 12.

¹⁰⁷ The same boundaries do not have to apply for all purposes in order to be determinable for any given purpose.

¹⁰⁸ Oliver Hart, "An Economist's Perspective on the Theory of the Firm" (1989) 89 Colum. L. Rev. 1757, at p. 1764; Jensen and Meckling, *supra* note 45, p. 311; Ulen, *supra* note 31, p. 321; Eisenberg, *supra* note 31, p. 832.

¹⁰⁹ Hart, *supra* note 108, p. 1764.

¹¹⁰ This is the standard assumption of the shareholder-centric "nexus of contracts" model. Interestingly, the shareholder is generally thought of as outside the corporation for liability purposes.

the latter, then the firm has a pre-existing definition separate from the contracts.¹¹¹

Assuming a shareholder-centric "nexus of contracts" model, one might limit the corporation to the shareholders themselves, who are all notionally considered parties to the articles (and who are all parties or deemed parties to a unanimous shareholder agreement), making it less a "nexus of contracts" than a single contract. Anyone else, including the directors, managers, employees, creditors, *et cetera*, would therefore be outside the "corporation". This result allows for a consistent interpretation of the principles involved, although the logical inference that the shareholders are the "principals" for legal purposes may have undesirable consequences.

If that approach is unsatisfactory, an alternative exists that could be applied to either the entrepreneur-centric or shareholder-centric corporations.¹¹² In this version, the corporation would begin either with the entrepreneurs or the shareholders, and proceed from there to encompass all parties who are agents or employees (or some combination thereof) of the starting parties, but excluding anyone with any other sort of contractual relationship. Problems emerge nonetheless. A strict application would exclude, for example, a creditor who had bargained for substantial rights to have input into corporate business decisions. Conversely, it might have difficulty distinguishing between, for example, a corporate vice-president's executive assistant (normally considered part of the corporation) and the same individual's household servant (normally not), assuming both were personally hired by the vice-president; one cannot differentiate between the two on the basis that one was hired by the corporation and the other not, because that begs the question.¹¹³

A second argument that the firm is more than the sum of its parts, and a possible alternative solution to the delineation problem, is that companies have institutional cultures that bind them together, not just contracts.¹¹⁴

More than a network of contracts, corporations are seen by realists as collective entities that have identities apart from those of any of the individuals who temporarily fill roles within them. The history of such an institution, the 'culture' and values it comes to embody and the institutional goals it formally and informally moves toward affect in every sense (legal, social or economic) the relationships among those who participate in the corporate enterprise.¹¹⁵

If legal significance is attached to the institutional culture, then the "nexus of contracts" model becomes insufficient to define the corporation.

¹¹¹ Eisenberg, *supra* note 31, p. 830.

¹¹² Eisenberg, *supra* note 31, pp. 830-831 noted the continuing problem that starting with the manager of the firm (or, presumably, the equity investors) still presupposes the existence of the firm.

¹¹³ In other words, it fails to adequately explain how that determination can be made.

¹¹⁴ William T. Allen, "Contracts and Communities in Corporation Law" (1993) 50 Wash. & Lee L. Rev. 1395, at pp. 1401-1403; Eisenberg, *supra* note 31, pp. 829-830.

¹¹⁵ Allen, *supra* note 114, p. 1402.

3.(b) Not All Relationships Are Contracts

The second problem of descriptive inaccuracy in labelling the corporation a "nexus of contracts" rests upon the meaning of the word "contract". In the context of the "nexus of contracts" theory, the term "contract" has a meaning apparently derived from the field of economics. It seems to indicate that the parties are engaged in a relationship presumed to be mutually beneficial and into which they are taken to have entered voluntarily.¹¹⁶ Easterbrook and Fischel, for example, declared that "[t]o say that a complex relationship among many voluntary participants is adaptive is to say that it is contractual".¹¹⁷ Some difficulties arise when translating this notion of "contract" into the legal sphere, where the term carries with it the implication of an entire body of principles.¹¹⁸

If the corporation is reducible to *relationships* but not *contracts* in the legal sense, then it follows that the appropriate body of law to govern it would not be contract law, or at least not entirely. There is precedent for this: family law, for example, and many areas of fiduciary duty, which involve relationships subject to other bodies of law.¹¹⁹ Some of the areas where the corporate "contract" has been alleged to diverge from traditional contracts are discussed in this subsection.

A unanimous shareholder agreement is a contract.¹²⁰ To the extent that it becomes integral to the corporation, it therefore lends credibility to a contractual description once it is in place. But the formation of one of these agreements is not simply an amendment of the terms of a pre-existing contract. It is arguably a change in the nature of the corporation from an entity whose foundation lies outside of contract law to one defined in significant part by a contract; if so, this invites debate about the justification for making such a reconceptualization possible, especially given the legal and policy implications. The instrument also, in its current form, provides only an incomplete transformation in that regard; a unanimous shareholder agreement can only ever be one component of the corporation, not its entirety, existing as it does in the context of a larger legal structure and (depending upon one's interpretation of the boundaries of the corporation) relationships and contracts with non-shareholders.

¹¹⁶ Eisenberg, *supra* note 31, pp. 822-823; Bratton, *supra* note 31, p. 410.

¹¹⁷ Easterbrook and Fischel, *supra* note 29, p. 1428.

¹¹⁸ Gordon, *supra* note 87, p. 1549; Eisenberg, *supra* note 31, pp. 822-823; Bratton, *supra* note 31, pp. 410-411.

¹¹⁹ Flannigan, *supra* note 31, generally.

¹²⁰ The Supreme Court has indicated that a unanimous shareholder agreement must be a lawful and valid contract (see *Duha SCC*, *supra* note 24, par. 66). Nonetheless, the remark was *obiter* and did not specifically address possible qualifications upon that position; see the discussion of the "lawful" criterion in Chapter Three. Even if it were permissible for a non-contract to be a unanimous shareholder agreement, however, it would remain accurate to observe that a unanimous shareholder agreement is *typically* a contract and always at least very similar to one, with all that that implies for its integration into the corporate structure.

3.(b)(i) Bargaining

Only shareholders who co-found a company have a real ability to "bargain" over the terms of the corporate "contract", in the manner of a traditional contract negotiation. Purchasers of shares, either at an initial offering or secondary purchasers in the market, generally cannot negotiate for the rights or organizational structure they prefer nor offer concessions in exchange. They must take or leave the shares and the corporation itself as they are.¹²¹ This is less true of potential purchasers who will be obtaining a substantial interest in the company, who may be in a position to demand changes in order to induce them to invest, but that is an exception.

Such a situation is not particularly problematic for contract law. Conceptually, this is no different from a negotiation in which one party refuses to alter an initial position. There is no requirement that contracts emerge from a give-and-take. Indeed, many contracts are provided on a take-it-or-leave-it basis.¹²² So long as the standardized terms are neither hidden nor unduly onerous, the law will treat them as any other contract to which the parties consented.

The creation of a unanimous shareholder agreement does require bargaining in a traditional sense,¹²³ but once the document is in place, the situation parallels all other facets of the corporate "contract", a situation that the legislation explicitly creates by deeming subsequent transferees to be parties to the agreement.

3.(b)(ii) Certainty

In order for a contract to be completed, it must be determinable what the content of the contract *is*. While the relationships in the corporate context might be more complex, they are probably still certain enough to be acceptable.

More problematic is that the "nexus of contracts" approach to the corporation calls into question who the parties are contrasting *with*. If an employee of a corporation is not contracting with a corporate entity, then with whom? The decentred "nexus of contracts" model suggests that the employee is

¹²¹ Brudney, *supra* note 104, p. 1412; Eisenberg, *supra* note 86, p. 1471 noted the lack of bargaining in public corporations, in contrast to close ones; Coffee, *supra* note 69, p. 934 accepted that "[p]ricing is not the same as bargaining, but the consensualists have not adequately explained why" and proceeded to restate the problem as one of information and bonding mechanisms.

¹²² Bainbridge, *supra* note 68, p. 870; Butler and Ribstein, *supra* note 29, p. 13, who also emphasized that "leave it" is an actual option.

¹²³ Or at least, it affords greater leverage for it, since a refusal to accept a pre-prepared unanimous shareholder agreement means it cannot come into effect.

contracting with an uncertain and ever-changing mass of individuals in a manner that has no parallel in conventional contract law. Alternatively, the entrepreneur-centric and shareholder-centric models provide a more conventional second party to the arrangement (represented through agents), but at present, there remains some ambiguity as to which, if either, would apply in a "nexus of contracts" approach. Additionally, solidly identifying either group as the principals would call into question why they do not face potential liability as a result.¹²⁴

If a unanimous shareholder agreement is treated as the primary (or even sole) component of a "nexus of contracts" understanding of the corporation, then the shareholder-centric model must be correct. The shareholders are the only required parties to the corporate contract, a position that would hold whether or not they had actually created such an instrument. The premise is not necessary, however; it is also possible to view a unanimous shareholder agreement as only one contract within the "nexus", not its entirety.

3.(b)(iii) Consent

A crucial element in a legal contract is the consent of all parties. It has been argued that the corporation fails this test, because the shareholders do not consent to the corporate contract; they are, in fact, likely to be unaware of its content.¹²⁵ Shareholders with diversified small investments will likely remain rationally ignorant of many of the details of the corporations in which they invest, even when such details are made public. The benefits of informing themselves are insufficient to justify the effort.¹²⁶ Despite this rational ignorance, shareholders likely hold general assumptions as to the rules governing corporations in which they invest, which would lead to them being unpleasantly shocked to learn, for example, that a company in which they had purchased shares was permitting its directors to take valuable corporate opportunities for themselves.¹²⁷

The counter-argument is that the market allegedly reflects all such value-reducing terms in the price of the shares,¹²⁸ and that therefore the shareholders got what they paid for and implicitly consented to the full package. Granting them greater rights is giving them more than they paid for, a windfall profit.¹²⁹ Whether price mechanisms are adequate to protect shareholders' interests is discussed below; for now, the question is whether such an implicit consent to unknown undesirable terms is exceptional in contract law.

It is not. Such situations arise all the time in a wide variety of transactions, where parties find

¹²⁴ See discussion below.

¹²⁵ *e.g.* Brudney, *supra* note 104, p. 1411.

¹²⁶ *e.g.* Butler and Ribstein, *supra* note 29, p. 42.

¹²⁷ Brudney, *supra* note 104, pp. 1416-1419; Eisenberg, *supra* note 86, p. 1521.

¹²⁸ See discussion below of the securities market as a means for controlling directors.

¹²⁹ Coffee, *supra* note 78, p. 1682 discussed windfall profits, but assumed informed parties.

themselves bound by "boilerplate" they did not read.¹³⁰ Such contracts are sometimes voidable if one party was not given the *opportunity* to read the terms prior to entering the contract,¹³¹ but if the opportunity existed, the onus is on the party to avail themselves of it. Their rational apathy is no excuse. Notwithstanding that, there may be a duty to draw attention to particularly unusual or onerous terms. Were the law of corporations substantially changed to allow, for example, for the elimination of the duty of loyalty, it might then be required for corporations to make some effort to draw attention to that fact.¹³²

The problem of consent is more complex with regard to changes to the alleged corporate "contract".¹³³ The standard principles of contract law do not generally allow for the terms of the contract to be varied without the consent of all of the parties and consideration for said variation. Assuming that the articles of a corporation are taken to be a "contract", then this contract is not subject to the rules that normally govern variation. A majority (or super-majority) of participants is all that is required to change the articles, and such a change would bind parties who have not consented.¹³⁴ The *C.B.C.A.* allows dissenters to some types of amendments (but not all) to have their shares repurchased, but the available remedy is to be bought out, not to block the change.¹³⁵ The consequences of this would be stronger in the world desired by some "nexus of contracts" advocates, where the articles would be allowed to set essentially any and all terms under which the corporation would operate, but even within its current limits, a possibility for variation exists. The lack of consideration is also problematic; one might answer that the "benefits" of any amendment are themselves consideration,¹³⁶ but this is difficult to prove objectively and presumably the dissenting shareholders would dispute this subjectively. Even shareholders who do not actively dissent, but merely fail to assent to a change, are not truly consenting to it.¹³⁷ Such problems do not arise, of course, with the creation of a unanimous shareholder agreement, which requires the consent of all shareholders, but they might be created by an amendment to one if changes were permitted to occur non-unanimously, as some jurisdictions do.

¹³⁰ Henry N. Butler and Larry E. Ribstein, "Free At Last? The Contractual Theory of the Corporation and the New Maryland Officer-Director Liability Provisions" (1988-1989) 18 U. Balt. L. Rev. 352, at p. 359; Bainbridge, *supra* note 68, p. 870.

¹³¹ *e.g.* a software license agreement contained within a shrink-wrapped package.

¹³² See Eisenberg, *supra* note 86, pp. 1519-1520.

¹³³ Dennis R. Honabach, "Consent, Exit, and the Contract Model of the Corporation- A Commentary on Maryland's New Director and Officer Liability Limiting and Indemnification Legislation" (1988-1989) 18 U. Balt. L. Rev. 310, at p. 338 discussed the problem of consent when the corporate arrangement is altered by a change in the law rather than a change by the parties.

¹³⁴ Bebchuk, *supra* note 97, pp. 1828-1829; Honabach, *supra* note 133, p. 339; Eisenberg, *supra* note 86, p. 1474; Butler and Ribstein, *supra* note 29, pp. 65-67 addressed this issue, attempting to justify non-unanimous amendments as permissible if allowed by "the governance rules of the corporation".

¹³⁵ *C.B.C.A.* s. 190 .

¹³⁶ Gordon, *supra* note 87, p. 1589.

¹³⁷ Eisenberg, *supra* note 86, p. 1474.

4. Concession Reconsidered

The "nexus of contracts" theory is often presented as a superior replacement for the "concession" approach.¹³⁸ The latter explanation presents the corporation as a creation of the state (or, in earlier versions, the sovereign), existing only by the state's authority, and therefore subject to whatever conditions the state might impose without further justification. In other words, if there is no inherent right to incorporate *at all*, then there is no right to incorporate free of any particular rule or regulation, no matter how arbitrary.

This is not to say that the regulation that the state imposes cannot (or should not) be justified on some ground other than the arbitrary whim of the appropriate government body. Indeed, the historical roots of the corporation tie its initial purpose (and therefore the justification of corporate regulation) to specific objectives of the state. One might therefore divide the concession theory into two branches, one simply asserting that the state's unique authority to create a corporation is an authority to create a corporation on whatever terms it wishes, and the other that the corporation is a tool of the state (and by extension, in a modern democratic state, a tool of society) and should thus be designed to achieve the state's desired ends in the most effective manner.

4.(a) History

The first corporations, in both Great Britain and the United States, were specifically chartered by the government for a stated purpose. Classic examples include the Hudson's Bay Company in the English context and the early American corporations chartered to complete large engineering projects, such as bridges.¹³⁹ In those early days, the view that all authority descended from the state was of political significance, and was encouraged by those in power for obvious reasons.¹⁴⁰

Over time, general incorporation statutes replaced specific charters as the primary method of incorporation. As these statutes generally did not grant government officials discretion to refuse incorporated status, it began to appear that incorporation was a right, not a privilege. That corporations as

¹³⁸ Brudney, *supra* note 104, p. 1409 is one of the few to refer to concession theory as anything but a strawman. Butler and Ribstein, *supra* note 130, p. 352; Butler and Ribstein, *supra* note 29, pp. 8-10; Hessen, *supra* note 29, p. 1327; Bratton, *supra* note 31, p. 432 rejected this contrast, but similarly declared concession outdated in favour of other justifications for regulation, and at p. 434 identified concession theory as essentially a strawman used by nexus of contracts advocates.

¹³⁹ D. Gordon Smith, "The Shareholder Primacy Norm" (1997-1998) 23 J. Corp. L. 277 at p. 291; he noted, however, that even in these early corporations, the public interest justification did not prevent a shareholder primacy norm from dominating analysis (p. 296); Hessen, *supra* note 29, p. 1338; Bratton, *supra* note 30, p. 1484.

¹⁴⁰ John Dewey, "The Historic Background of Corporate Legal Personality" (1925-1926) 35 Yale L.

recognized legal entities are *created* by the state's recognition of them as such became obscured or, if one prefers, no longer true; the process of officially incorporating began to appear more a *pro forma* government acknowledgement of the independent fact that a corporation had been created by the parties involved.¹⁴¹ As a consequence of this, the idea that corporations were authorized for the purpose of furthering the state's objectives faded, replaced by the view that incorporation was a right of self-interested individuals seeking the advantages the form offered for their own enterprises.

Robert Hessen has argued that the true antecedent of the general incorporation statutes was joint stock associations, not charter corporations.¹⁴² In his view, the state had no choice but to open up incorporation to the public generally; there was too much demand for it, and if the state did not grant it, then the same results would be achieved through other methods.¹⁴³ Whether this would actually have been possible is considered below.

The historical origins of a statute or a legal tool do not, of themselves, provide sufficient guidance to govern its current application. Some measure of theoretical or practical justification should be provided in support of a given conclusion. Still, we can find in the history of the corporation the idea that it exists to serve a purpose; incorporation is not an inherent right. The transition from specific to general statutes does not necessarily contradict that conclusion; it might instead suggest that the general statutes serve a generic purpose. Most obviously, such a purpose might be wealth creation or perhaps the encouragement of productive activity.¹⁴⁴ But if that is the case, then such a goal might legitimately be weighed against other goals until a balance is struck.

4.(b) Levels of Assumptions

Proponents of the "nexus of contracts" view of the corporation have been accused of viewing free contracting between individuals as "natural" and thus requiring no further analysis, while they consider regulation "unnatural" and in need of justification.¹⁴⁵ Within an economic analysis, it might be possible to

J. 655, at p. 666; Bratton, *supra* note 31, p. 434.

¹⁴¹ Hessen, *supra* note 29, pp. 1336-1337; Bratton, *supra* note 31, p. 435; Bratton, *supra* note 30, pp. 1485-1486.

¹⁴² Hessen, *supra* note 29, p. 1340. He described these entities as follows:

By contract, and without obtaining governmental permission, British businessmen created joint stock associations that offered investors the attraction of freely transferable shares. They did this merely by copying the structure of the joint stock companies that held royal or parliamentary charters of incorporation.

¹⁴³ Hessen, *supra* note 29, p. 1340.

¹⁴⁴ Smith, *supra* note 139, p. 295 alluded to this by referring to chartered general corporations serving the public interest by promoting business.

¹⁴⁵ Brudney, *supra* note 104, pp. 1408-1409; Butler and Ribstein, *supra* note 29, p. 64 responded

treat contracts as distinct from any artificial state-supported framework, but the legal theorist cannot help but be aware that contracts are enforced by the legal system.¹⁴⁶ Taken further, there are at least four levels of legal structure that have at various times contributed to "nexus of contracts" doctrine, in each case as if these structures were natural and not the creation of the state, in contrast to the allegedly artificial regulation of the corporation. The first two are inseparably contained within the basic premise that the corporation is a "nexus of contracts"; the third and fourth have been used by "nexus of contracts" advocates as they developed their position in response to critics.

Firstly, "nexus of contracts" theorists seem invariably to hold an unquestioning assumption of some form of property rights.¹⁴⁷ It is beyond the scope of the current analysis to consider this issue in depth, save to note that there have been theorists (and governments) who have advanced the alternative view that property rights are not inherently natural, but are instead the creation of governments and societies, and nor are they inherently neutral.¹⁴⁸

Secondly, most "nexus of contracts" theory rests upon the implicit assumption that agreements between parties are enforceable- either through enforced specific performance or some form of damage assessment and enforced payment.¹⁴⁹ It is possible for some other mechanism than the state to be relied upon for this, such as reputational costs,¹⁵⁰ but realistically, the assumption that the agreements being discussed are enforceable through resort to the legal system appears to underlie, at least implicitly, the arguments of most "nexus of contracts" advocates.

Thirdly, in response to accusations that the "nexus of contracts" theory might inadequately protect the parties to the corporation, some of its advocates have abandoned total freedom of contract in favour of the use of actual contract law principles.¹⁵¹ These might include undue influence, misrepresentation, unconscionability, *et cetera*. These, it is argued, would suffice to protect parties to the corporate contract, just as they protect parties to contracts outside it. Even Easterbrook and Fischel have argued that "[c]ontracts signed under threat of force displace voluntary arrangements and are unjust; force is therefore

simply by saying that the pro-regulators were making the same sort of argument, then proceeded to reiterate their position.

¹⁴⁶ Kronman, *supra* note 84, pp. 1748-1749.

¹⁴⁷ Wolfson, *supra* note 53, pp. 978-980 (a section discussing corporations "going private") and Easterbrook and Fischel, *supra* note 64, pp. 723-731 are interesting in this context, as they would apparently disregard the minority's property rights.

¹⁴⁸ Millon, *supra* note 87, p. 1384 touched upon this.

¹⁴⁹ Noted explicitly by Kronman, *supra* note 84, pp. 1748-1749; discussed by Bratton, *supra* note 31, pp. 438-439; Flannigan, *supra* note 31, p. 406; usually just implicit in the discussion of contracts.

¹⁵⁰ Utset, *supra* note 62, pp. 557-559 criticized the possibility that "self-enforcing" through the market is sufficient to enforce contracts with managers.

¹⁵¹ Kronman, *supra* note 84, p. 1749 assumed that the "background rules" of contracts would automatically follow from enforceability; Coffee, *supra* note 69, p. 924; Coffee, *supra* note 78, p. 1620 took a slightly different but related approach, that corporate law achieves similar ends to contract law; Easterbrook and Fischel, *supra* note 29, p. 1434.

illegal. Fraud will vitiate an agreement. Infants and others who do not know their own interest cannot contract."¹⁵² While each of these principles may be (and hopefully *is*) justified on theoretical bases, they also form a body of law and cannot exist separate from it. There is no natural undisputed definition of "others who do not know their own interests", of "fraud", or even of "threat of force"; the terms only have meaning in the context of legal interpretation and judicial consideration.¹⁵³

It is interesting, then, given that much of the advocacy for "nexus of contracts" theory seems to rest upon criticizing the imperfections of courts relative to markets as a means of determining how corporations should be structured, that the approach does not and cannot exclude courts from the process.¹⁵⁴ Even the simple enforcement of contracts requires judicial interpretation of what the contract is, both interpretation of its explicit provisions and filling any gaps that may result; the application of other legal doctrine to the contract compounds this problem.

Finally, as part of the argument that the existence of corporations need not rely upon a concession by the state, it has been suggested that something with all the features of a corporation could be constructed without resort to incorporation.¹⁵⁵ In pursuit of this goal, all other aspects of the law *except* the statutes governing corporations seem to have been taken as natural. In particular, features of the limited partnership¹⁵⁶ have been relied upon. While the trust, a creation of the courts of equity, might conceivably be argued to be a "natural" development- although this requires accepting that there is a pre-existing "natural" law that the courts are simply identifying, rather than determining, a premise that is certainly contestable- it would be extremely difficult to see how the limited partnership is. Virtually any argument that the corporation exists only by the leave of the state through the process of statutory authorization applies in equal force to the limited partnership.

4.(c) Features of the Corporation

Assuming that some portions of the law are *not* concessions of the state, but that the corporation *might be*, the question becomes what aspects of the corporation specifically are being alleged to be the product of this concession. Alternatively, the exercise for the "nexus of contracts" advocate becomes demonstrating that these aspects of the corporation are achievable without resort to corporate law. Four features that stand out in particular as emblematic of the corporation and thus subject to this test are the

¹⁵² Easterbrook and Fischel, *supra* note 29, p. 1434.

¹⁵³ Katherine Van Wezel Stone, "Policing Employment Contracts Within the Nexus-Of-Contracts Firm" (1993) 43 U. Toronto L. J. 353, at pp. 357-359 pointed out the impact of labour law, and specifically the choices inherent in any given labour law system, upon the contracts employees enter into within this alleged nexus.

¹⁵⁴ Unless it replaces them with some similar mechanism.

¹⁵⁵ Hessen, *supra* note 29, pp. 1331-1334.

corporation's status as a person for certain legal purposes, the eternal nature of the corporation, the ability to trade shares, and limited liability.¹⁵⁷

4.(c)(i) Person

The corporation's status as a person allows it, *inter alia*, to contract, to sue, and to exercise certain other rights granted to persons under whatever law is applicable.¹⁵⁸ (For example, in Canada, a corporation has some but not all of the rights granted by the *Charter of Rights and Freedoms*,¹⁵⁹ e.g. freedom of speech.) Conversely, the corporation as a person can also be sued and be subject to statutory liability including the criminal law; it has been argued that this is a drawback to incorporation balancing the advantages,¹⁶⁰ but this is not necessarily the case, since the corporate person may then be bearing these disadvantages partially or completely in place of individual participants. Even when being held liable, it is presumably often convenient to be able to organize a defence around one entity, rather than a myriad of separate defendants, just as it is admittedly simpler for the plaintiff to sue that single entity.

It is doubtless advantageous for shareholders and directors that the corporation can function without needing some or all of its participants to personally be named and involved in these matters. But ultimately, this is a procedural convenience only. Allowing for agency, it would be relatively simple for corporate participants to designate a common agent for most of these purposes. Even removing agency, it would still be possible for the appropriate corporate participants to contract, sue, and exercise other rights directly, rather than through the corporate entity. In the case of constitutional rights, this might actually be more powerful: all *Charter* rights would be available in that case. The corporate entity's status as a person for certain legal purposes might be a concession from the state, but it is a solely procedural convenience.¹⁶¹ Anything that can be achieved through the corporate person could be achieved without it, at least in theory, by the shareholders and/or directors, albeit with more cost and inconvenience. To tie that concession to a vast amount of regulation, while perhaps theoretically permissible, would create such a poor bargain that one might expect the corporation to vanish.

¹⁵⁶ Hessen, *supra* note 29, p. 1335 analogized the liability of shareholders to limited partners.

¹⁵⁷ Macey, *supra* note 87, p. 1270; Ulen, *supra* note 31, p. 320 identified "limited liability, indefinite life, and the free exchange of ownership claims"; Hessen, *supra* note 29, pp. 1330-1331 identified entity status, indefinite life, and limited liability; Bratton, *supra* note 31, p. 433 follows Hessen.

¹⁵⁸ Hessen, *supra* note 29, p. 1330.

¹⁵⁹ *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (UK), 1982, c 11.

¹⁶⁰ Hessen, *supra* note 29, p. 1331.

¹⁶¹ Hessen, *supra* note 29, p. 1331; Easterbrook and Fischel, *supra* note 29, p. 1426.

4.(c)(ii) Eternal Existence

Unlike a classic partnership, a corporation is a hardy thing, able to survive the withdrawal or death of the founders, and theoretically continuing indefinitely. This feature has been identified as a possible "concession" by the state that distinguishes corporations.¹⁶² However, a partnership can be structured to avoid that problem by agreement.¹⁶³ Of the features of the corporation, this is the least compelling as an argument for the "concession" theory.

4.(c)(iii) Tradable Shares

A share in a corporation carries with it a number of rights, which usually include a claim to a proportionate share of the company's residual value, uncertain periodic payments at the discretion of the directors, the ability to vote for directors, and a number of statutory and common law rights and remedies that vary somewhat by jurisdiction, *e.g.* the oppression remedy. It is likely that it would be possible to create a similar arrangement from scratch using contract law, although of course that would require the latter group of additional rights to be specifically enumerated in the contract. Some care would need to be taken to ensure certainty of consideration; stripped down to just dividend rights at the directors' discretion, a problem might arise. The claim to residual value might also result in problems of uncertainty of consideration, were directors free to divert it for themselves prior to the shareholders' claim being exercised; the contract would therefore need to include something akin to the duty of loyalty.

That such a claim should be saleable is also compatible with contract law. However, the existence of a *regulated* market for such shares is not a "natural" phenomenon. If one presumes that securities regulation is desirable, then it must either be provided privately or by the state; in practice, both occur, but arguably either might suffice. It may prove difficult, though, to entirely divorce regulation of the sale of securities from any regulation of the corresponding corporations themselves.

Further, paralleling a point made earlier about entity size, it does not necessarily follow that because a single contract would be unregulated, therefore a large group of similar contracts should not be. Just as large enterprises might invite greater regulation by virtue of their potential to affect significant numbers of people, so too might securities markets composed of the sale of vast numbers of similar individual "contracts" be regulated where a single such contract would not be.

¹⁶² Hessen, *supra* note 29, p. 1332.

¹⁶³ *Ibid.*, p. 1332.

4.(c)(iv) Limited Liability

The primary attribute of the corporation which resists replication by contract is limited liability.¹⁶⁴ The potential liability of a corporate shareholder¹⁶⁵ for the corporation's debts (contractual, tort damages, statutory fines, *et cetera*) is limited to the amount they paid for the shares they bought.¹⁶⁶ That is to say, their shares may become worthless, but they have no potential for losses beyond that. Additionally, corporate directors and managers are largely shielded from liability as well; they are not liable for the corporation's contract debts, they are not personally liable for many of the statutory sanctions it might face, and their liability for torts committed by the company is a subject of some uncertainty.¹⁶⁷

Normally, the principals who control agents are responsible for meeting the obligations the agents incur in contracting on their behalf, and furthermore the principals have vicarious liability for torts (and similar harms¹⁶⁸) perpetrated by their agents. If the corporation is a shareholder-centric "nexus of contracts", then the directors, managers, and employees of the corporation are, in fact, all the agents of the shareholders; the shareholders should then have open liability for contract debts and other liabilities arising from the corporation's activities.¹⁶⁹

The entrepreneur-centric "nexus of contracts" would instead place this open liability upon the directors, as the highest authority in the corporate structure. However, determining vicarious liability in a strictly contractual setting is a fact-specific process, and the shareholders' voting rights might place them as the ultimate principals. A unanimous shareholder agreement that transferred power from directors to shareholders would eliminate any ambiguity; the shareholders would definitely be the principals.

It would be possible to replicate limits on contractual liability by contracting for them.¹⁷⁰ The lack of widespread guarantees of corporate debts might be taken as evidence that limiting liability to the corporate assets is "efficient" or at least acceptable to all creditors.¹⁷¹ This argument is not entirely convincing, as it ignores the real-world constraints and transaction costs that may make obtaining such guarantees difficult or impossible. A minor trade creditor would have difficulty obtaining the guarantee of

¹⁶⁴ Easterbrook and Fischel, *supra* note 29, p. 1425 described limited liability as an attribute of the investment rather than the corporation, but it is unclear what this distinction means- particularly in light of their own theory that the investment agreement *is* the corporation- or what utility it has.

¹⁶⁵ At least, *qua* shareholder.

¹⁶⁶ See *e.g.* Easterbrook and Fischel, *supra* note 29, p. 1425; Hessen *supra* note 29, p.1334.

¹⁶⁷ See generally Nicolas Juzda, *The Tort Liability of Directors to Parties Outside the Corporation* (LLM Thesis, York University, Osgoode Hall Law School, 2008) (Ottawa: Library and Archives Canada, 2009).

¹⁶⁸ Property offenses, *et cetera*, which might not strictly be classified as "torts".

¹⁶⁹ Hessen, *supra* note 29, pp. 1333-1334 argued that shareholders should not be subject to vicarious liability due to their lack of control. However, as the shareholders have the power to select and replace the directors, who in turn have more direct control, an argument can be made that shareholders do have control.

¹⁷⁰ Hessen, *supra* note 29, p. 1332.

¹⁷¹ Macey, *supra* note 87, p. 1270 suggested that where the parties require such guarantees, they

its customer's entire board of directors, let alone of all its shareholders. Contracting to obtain guarantees becomes yet more complex given that corporate participants may change over time. It does not follow that creditors would normally be willing to limit their potential source of recompense to an arbitrary subset of the debtors' assets, rather than all available assets.

Limits on tort liability are almost impossible to replicate by contract. If the likely tort victims could be identified beforehand, they might be induced to enter into contracts waiving or limiting liability, but it must be assumed that the ability to identify potential tort victims is always incomplete at best, and that conversely the number of individuals identified as likely victims but who are ultimately never harmed would be very high. The potential tort victims would almost certainly demand something in exchange,¹⁷² if they were willing to limit liability at all. And unlike voluntary creditors, who currently willingly contract with corporations whose shareholders are known to have limited liability by law and therefore might be presumed to be amenable to replicating that situation by contract, there is no reason whatsoever to assume that tort victims would ever accept such an arrangement.

The limits on liability supplied by the law, conversely, apply automatically to all involuntary creditors, and they have no direct cost¹⁷³ to the corporation to obtain. Similarly, voluntary creditors find the onus upon themselves to obtain guarantees, which might be costly, impractical, or impossible to obtain.

In short, limited liability cannot be replicated contractually.

This is a non-trivial conclusion. Limited liability is one of the fundamental elements of the corporation, not a mere procedural convenience, and the advantages that it grants are difficult to overstate. If the success of the corporation as an economic vehicle is that it allows for dispersed passive investment, then that success is dependent upon limited liability. It allows for investors to remain passive participants in the corporation, secure in the knowledge that their other assets are not potentially vulnerable should the corporation incur liabilities.

Daniel Fischel, one of the primary advocates of the "nexus of contracts" approach, has admitted:

Other typical provisions of corporate law... such as limited liability in tort cases, could not be negotiated by private contract. To this extent, corporations have attributes that would not exist absent state statutes. But this does not make corporations creatures of the state. Limited liability in tort cases is more accurately viewed as a subsidy to encourage a certain type of private conduct, forming corporations (particularly close corporations in which corporate governance is not an issue), than as a creation of the conduct itself.¹⁷⁴

If limited liability is a subsidy to encourage the formation of corporations, that opens up the question of *why* governments would do that. Despite Fischel's protest to the contrary, he invites the state

obtain them.

¹⁷² Contract law would actually *require* that they received consideration.

¹⁷³ Complex analysis of indirect dispersed social costs goes beyond the scope of this argument.

¹⁷⁴ Fischel, *supra* note 53, p. 1274.

into the corporation and suggests a basis for arguing that corporations are not simply the result of contracts among self-interested individuals; they are concessions of the state designed to promote some policy goal. So long as corporations allow their participants to enjoy limited liability, they cannot claim to be solely the creation of contract and may have to accept regulation as a trade-off.

5. Shareholder Protection

Much of the literature surrounding "nexus of contracts" theory concerns the question of whether or not that approach to corporations adequately protects shareholders from being taken advantage of by directors. Strictly speaking, this concern is separate from whether the corporation can be viewed as a contract; it might be addressed by the position that the corporation is a contract between parties of unequal power and therefore must be regulated, much as consumers are protected by specific regulation.¹⁷⁵ Nonetheless, as the "nexus of contracts" theorists generally, though not universally, tie their conception of the corporation as a contract to a largely normative view that it should be a *free* contract, the two issues have become linked.

The obvious question is why shareholders would *want* to alter the corporate contract to allow directors greater latitude to take advantage of them. As one commentator put it, "What sane shareholder would agree to license theft?"¹⁷⁶ They might be induced to allow arrangements that are simply unwise,¹⁷⁷ but several explanations have been proposed for how such changes might be in shareholders' best interests. First, qualified individuals might balk at becoming directors due to concerns about an overly high standard of behaviour and resultant possible liability.¹⁷⁸ Second, it would discourage other shareholders from launching frivolous suits against the directors, defence against which would waste corporate resources.¹⁷⁹ Third, a certain amount of allowed self-interest might be part of directors' agreed-to compensation package.¹⁸⁰

It has also been suggested that, if directors have greater room to take advantage of shareholders,

¹⁷⁵ Coffee, *supra* note 69, pp. 937-938 made such a comparison; Butler and Ribstein, *supra* note 29, pp. 48-49 criticized this analogy.

¹⁷⁶ Romano, *supra* note 64, p. 1601.

¹⁷⁷ Shareholders might allow such alterations because they are rationally apathetic to changes in the corporations in which they have invested given the relative costs and benefits of taking an interest, because the system is structured to favour the passage of changes proposed by directors, and because the changes may have been accompanied by "sweeteners". Such scenarios do not represent shareholders *wanting* the changes, however. See Gordon, *supra* note 87, pp. 1577-1580, Romano, *supra* note 64, pp. 1611-1612; Coffee, *supra* note 69, p. 949; Eisenberg, *supra* note 86, pp. 1474-1479.

¹⁷⁸ Honabach, *supra* note 133, pp. 320-321 addressed this; Butler and Ribstein, *supra* note 130, p. 356; Coffee, *supra* note 69, p. 927.

¹⁷⁹ Butler and Ribstein, *supra* note 130, p. 356; Fischel, *supra* note 53, p. 1291.

¹⁸⁰ Coffee, *supra* note 69, p. 952 put this slightly differently: it might be in exchange for concessions

this will be reflected in a lower share price.¹⁸¹ Shareholders who purchase at that lower cost are therefore inferred to have agreed to the factor that depressed the price, *i.e.* the possibility and/or reality of director disloyalty.¹⁸² The difficulty with this argument is that it substitutes price for consent; some portion of shareholders might not agree to the deal at all if they understood exactly what they were getting;¹⁸³ this problem was discussed above.

Where advocates of freeing directors from their traditional duties have allowed for the possibility that this will occur without the unanimous approval of shareholders, they have argued that the "Wall Street rule" applies: shareholders unhappy with developments can sell their shares.¹⁸⁴ One consequence of this-lower share prices- and the alleged incentives for directors to avoid this result, are discussed below. Despite that, presumably at least some of the time, director self-interest will still either occur or become likely. One problem with the "exit" solution is that shareholders who sell presumably do so at a depressed price.¹⁸⁵ Selling is therefore a way of cutting their losses, but it does not return them to the position they would have been in prior to the problem arising. Alternatively, they may still consider the investment financially wise, but not *as good*, in which case the exit solution is not desired.¹⁸⁶

The quintessential example¹⁸⁷ of a corporate contract rewritten in favour of directors is their being excused from the traditional duties of care and loyalty. Much of the debate has conflated the two duties, and has discarded the possibility that extra-contractual moral values or social norms may underlie them, in particular the duty of loyalty.¹⁸⁸ Instead, the two duties have been interpreted as terms of the corporate contract designed to maximize value.¹⁸⁹ Contractarians, having taken the position that, notwithstanding their current statutory status, the duties of care and loyalty were conceptually contractual in character- as is all of corporate law in their model- then proceeded to argue that if the two duties were excluded from the contract, there would still be mechanisms to replicate their affects. Primary among these mechanisms are

by the directors elsewhere; Easterbrook and Fischel, *supra* note 64, p. 734.

¹⁸¹ See the discussion below of the market for securities as a control on directors.

¹⁸² Flannigan, *supra* note 31, p. 406 argued that share prices reflect the *risk* of disloyalty, not actual disloyalty. However, assuming disloyalty was certain to occur or known to be ongoing, that would presumably also be reflected.

¹⁸³ See the section of this chapter on consent to contractual terms, and the footnotes therein.

¹⁸⁴ *e.g.* Fischel, *supra* note 53, pp. 1277-1278.

¹⁸⁵ Bebchuk, *supra* note 97, p. 1828.

¹⁸⁶ Bebchuk, *supra* note 97, p. 1854 fn 54 noted that even after a value-decreasing amendment, those who opposed it might still wish to hold stock in the company for "investment reasons".

¹⁸⁷ Other examples exist: corporations might cease making adequate disclosure of information to shareholders or put into place anti-takeover measures not in the shareholders' best interests. See *e.g.* Utset, *supra* note 62, p. 598.

¹⁸⁸ Allen, *supra* note 114, p. 1404; William W. Bratton, "Public Values and Corporate Fiduciary Law" (1991-1992) 44 Rutgers L. Rev. 675, at p. 680 and generally; Brian R. Cheffins, "Law, Economics and Morality: Contracting out of Corporate Law Fiduciary Duties" (1991) 19 Can. Bus. L.J. 28, at pp. 45-47; Flannigan, *supra* note 31, p. 394 and generally asserted that controlling the "mischief" of opportunism is a policy goal in its own right.

the market for securities and the market for managers.¹⁹⁰ Presumably, those who allege this genuinely believe it to be true, but it is unclear why they consider it supportive of or supported by a "nexus of contracts" theory. It would appear unnecessary in that regard; any contract may leave one or more parties disadvantaged and vulnerable if they did not insist upon adequate terms to protect their interests. The likely reason for this line of argument being advanced is a fear of paternalistic regulation designed to protect shareholders from "bad corporate contracts", rather than because it is necessary to prove that corporations are contractual at all.

The market for securities argument rests upon a belief that the capital market is efficient. This means that the market, through the sum of trades of shares by both informed and rationally apathetic parties, will price shares accurately (or more accurately than any other method) and that, by corollary, any change in the value of the company will be reflected in a corresponding change in the value of the shares.¹⁹¹ The logic then proceeds that directors will neither cause changes in the corporate "contract" (e.g. amendments to the articles) nor take any other actions that are value decreasing, even when such changes would favour themselves, because directors do not want the value of the shares to decrease. They would wish to avoid this for four reasons: firstly, they may be shareholders themselves;¹⁹² secondly, they may eventually want to raise more capital through additional share offerings;¹⁹³ thirdly, they wish to prevent a takeover that would occur if the shares were undervalued;¹⁹⁴ and finally, changes in share prices affect their worth in the market for managers.¹⁹⁵

There are some problems with this logic. Most obviously, the hypothesis of efficient capital markets is vulnerable to challenge. The contractarians, who believe that government officials cannot be trusted to accurately evaluate the wisdom of alternative corporate arrangements,¹⁹⁶ have a curious faith in the market's ability to do so. In order for this to be true, some subset of market participants must (a) be monitoring the firm for changes, (b) identify a value decreasing change, (c) price that change with a high

¹⁸⁹ see e.g. Easterbrook and Fischel, *supra* note 64, pp. 700-703.

¹⁹⁰ Critiqued by Utset, *supra* note 62, pp. 555-556; critiqued by Brudney, *supra* note 104, pp. 1421-1423; critiqued by Bebchuk, *supra* note 97, pp. 1841-1846; Thompson, *supra* note 69, p. 381; critiqued by Eisenberg, *supra* note 86, pp. 1495-1505; mentioned by Butler and Ribstein, *supra* note 29, p. 27; mentioned by Cheffins, *supra* note 188, p. 31.

¹⁹¹ Butler and Ribstein, *supra* note 130, p. 359.

¹⁹² Critiqued by Eisenberg, *supra* note 86, pp. 1493-1495; Wolfson, *supra* note 53, p. 967.

¹⁹³ Wolfson, *supra* note 53, p. 967; Winter, *supra* note 53, p. 256.

¹⁹⁴ Wolfson, *supra* note 53, p. 970; Winter, *supra* note 53, p. 256; Honabach, *supra* note 133, pp. 335-336 discussed this; Brudney, *supra* note 104, p. 1425; Millon, *supra* note 87, p. 1375; Butler and Ribstein, *supra* note 130, p. 355; Bebchuk, *supra* note 97, p. 1843-1844; Thompson, *supra* note 69, pp. 381-382; Eisenberg, *supra* note 86, pp. 1497-1499; Butler and Ribstein, *supra* note 29, pp. 23-25; Cheffins, *supra* note 188, p. 41.

¹⁹⁵ Wolfson, *supra* note 53, p. 972.

¹⁹⁶ Fischel, *supra* note 53, p. 1288; McChesney, *supra* note 82, p. 1544.

degree of accuracy, and (d) influence the market as a whole that their appraisals are correct.¹⁹⁷ Even if all of this occurs, the impact of the directors' behaviour is felt in the context of every other factor affecting price, which may constitute "noise" that will obscure the effects of the self-interest.¹⁹⁸ In a condition where the product market is proving kind to the corporation, share prices may be going *up* as the directors' self-interested behaviour is occurring, even assuming the increase is accurately being lessened.

This is not to disparage the market's substantial ability to price shares; it can obviously do so a significant amount of the time with a significant amount of accuracy. But it is trivial, and perhaps trite, to list the evidence from this past decade of companies which were incorrectly valued by the market for a substantial amount of time. As Melvin Eisenberg has observed, there is a difference between a system that will discipline a self-interested director *on average* and one that holds all directors separately accountable.¹⁹⁹

Assuming, however, that share prices do vary accurately in response to directors' self-interested behaviour, there is reason to question whether this serves to discipline them. Let us reconsider the four factors enumerated above.

First, the directors might be shareholders and so share in the loss they cause. But their share of the gain will usually be total (or divided up among a small group, *e.g.* the directors as a whole²⁰⁰) while their share of the loss will be proportional to their shareholding and thus presumably much smaller.²⁰¹ Except in the rare case where the gain is much smaller than the loss (*e.g.* a multi-million dollar deal lost because the director took an afternoon off to play golf) the "rational" director would disregard the corporation's interests.

Second, the corporation might later need to raise additional capital by a new share offering. Other than vague references to the directors' desire to empire-build,²⁰² it is unclear why this would motivate them.²⁰³ An inability to make a new share offering would hurt the corporation, not the directors. Unless the situation was so dire that the lack of new capital threatened bankruptcy, it is uncertain why the directors

¹⁹⁷ Easterbrook and Fischel, *supra* note 29, pp. 1430-1431 assumed this works; Butler and Ribstein, *supra* note 130, p. 359 assumed this works; Butler and Ribstein, *supra* note 29, p. 42 assumed this works; Coffee, *supra* note 69, pp. 941-942 suggested that this could work; Gordon, *supra* note 87, pp. 1556-1557, argued that these mechanisms do not function for I.P.O.s; Bebchuk, *supra* note 69, p. 1406 also argued that information problems operate during I.P.O.s; Eisenberg, *supra* note 86, pp. 1517-1518 described possible failures in these assumptions.

¹⁹⁸ Brudney, *supra* note 104, p. 1424; Butler and Ribstein, *supra* note 29, p. 35.

¹⁹⁹ Eisenberg, *supra* note 86, p. 1492.

²⁰⁰ In theory, a director's portion of the shareholdings could exceed their own portion of the self-interested gain, but this would be exceptional.

²⁰¹ Jensen and Meckling, *supra* note 45, p. 312; Bebchuk, *supra* note 97, p. 1842; Eisenberg, *supra* note 86, pp. 1493-1495.

²⁰² Bebchuk, *supra* note 97, p. 1844.

²⁰³ Curiously, commentators appear to assume that directors have a direct stake in the corporation's attempts to raise capital, at least when the corporation is actually attempting to do so.

would care if it were impossible.²⁰⁴ More likely, the corporation would remain solvent but obtain less capital, with no particularly strong drawbacks for the directors. It has been suggested that, alternatively, the new share offering might be *larger*, obtaining the same amount of capital while diluting the interests of the older shareholders relative to a smaller offering.²⁰⁵ This is indeed possible, assuming the market for the shares exists, and again has no strong downside for the directors.

Third, there is the market for corporate control.²⁰⁶ A company whose value would be higher but for poor management is vulnerable to having its control purchased at the depressed price by a buyer who intends to replace the management and thereby attain the corporation's theoretical true worth. Because directors wish to keep their jobs, they are motivated to avoid this. Even setting aside the various impediments that directors may place in the way of a take-over, the so-called market for corporate control cannot function perfectly. The costs of a takeover attempt,²⁰⁷ plus the uncertainty that there really is gain to be had with new management, create a window where a company may be performing sub-optimally but the divide is not large enough for a takeover to be judged worthwhile. Within that window, directors may pursue self-interest without fear.²⁰⁸

Finally, there is the effect that share prices may have on managers' subsequent career options. If the share price goes up, the managers may be presumed to be competent and be in high demand at other corporations. Conversely, if the share prices tank, the managers may find they have few options.²⁰⁹ Again, there is the problem of "noise"; share prices may go up or down according to a wide variety of factors. Increases in the share price due to market success may hide self-interest; decreases in the share price may be blamed on market conditions.²¹⁰

This leads to a wider discussion of the market for managers as a control on director self-interest. Free contract advocates argue that managers will behave in a manner designed to encourage the company's success, in order to position themselves to obtain further and better employment as managers.²¹¹ Even aside from the indirect evidence of the managers' worthiness that a company's success or failure provides, their directly observable behaviour may affect their prospects for subsequent employment. For example, a manager known to engage in nepotism might find it difficult to obtain further employment opportunities,

²⁰⁴ Eisenberg, *supra* note 86, pp. 1500, 1504 raised the possibility of bankruptcy, although considered it unlikely; Thompson, *supra* note 69, p. 408 made the point slightly less strongly, that companies making adequate profit from the product market do not need to raise additional capital.

²⁰⁵ Bebchuk, *supra* note 97, p. 1845.

²⁰⁶ See note 194.

²⁰⁷ Winter, *supra* note 53, pp. 267-270 focused attention on costs due to regulation, but acknowledged that there are transaction costs no matter what.

²⁰⁸ Wolfson, *supra* note 53, pp. 970-971; Winter, *supra* note 53, pp. 267-268; Eisenberg, *supra* note 86, p. 1498; Bebchuk, *supra* note 97, p. 1844 suggested that directors are taking gains with only a marginal increase in fear rather than none whatsoever.

²⁰⁹ Ulen, *supra* note 31, p. 326.

²¹⁰ Utset, *supra* note 62, p. 555 fn 59.

even if the company was generally highly successful.

Whether or not managers do actually seek subsequent employment is crucial to determining whether the market for managers works at *all*, let alone efficiently. It must be assumed that some subset of managers do not intend to seek subsequent employment, even if others do. As the position of corporate director does not lead inevitably to sudden premature death,²¹² it follows that some notable portion are near to retirement.²¹³ Advocates of the market for managers as a primary means of controlling self-interested behaviour do not seem to have fully considered this, that directors do not play the game indefinitely. Assuming that there are no legal (or social/moral²¹⁴) constraints upon directors to prevent self-interest, only market forces, then these directors have no reason not to behave disloyally. On the contrary, if they were truly self-interested rational individuals in the economic mould, doing so is practically mandated. One can go a step further and, in the mode of the law and economics scholar, define the exact conditions under which this is the case.²¹⁵ For any directors who intend their careers to be finite, there will always come a point where this equation favours disloyalty, although as noted, it may be in the twilight of their careers.

A consequence of the above is that shareholders would have a motive to favour young directors over ones closer to retirement, and to terminate the latter suddenly in favour of the former. This could set off a chain reaction, as a lack of market for near-retirement directors would lead to a revised retirement horizon for slightly less old ones, creating a vicious circle. Some form of strong prohibition on disloyalty might actually be necessary to keep the market for managers from so collapsing.

The possibility that directors may not seek subsequent employment is not the only flaw in the position that the market for managers should discipline director behaviour. Consider that new directors are generally selected by existing ones, and shareholders only provide their approval in elections where rational apathy and free-rider problems exist. Some level of self-interest may be overlooked by the hiring directors

²¹¹ Critiqued by Utset, *supra* note 62, pp. 555-556.

²¹² This observation is anecdotal.

²¹³ Bebchuk, *supra* note 97, p. 1843 noted that many directors plan to stay with their current company until retirement, limiting the effects of the market for corporate control; Eisenberg, *supra* note 86, p. 1495 noted that while lower management may seek later careers, chief executive officers are usually in their final position; Utset, *supra* note 62, p. 586 noted that managers close to retirement have different time preferences.

²¹⁴ Eisenberg, *supra* note 31, p. 835; Coffee, *supra* note 69, p. 945.

²¹⁵ Assuming that there is a 100% chance that self-interested behaviour will be discovered and result in total exclusion from the field (and that no other form of employment is possible) but that there are no other negative consequences, then a director should behave disloyally when the value of doing so exceeds the value of the highest future opportunity to behave disloyally added to the compensation for acting loyally in the interim less the leisure value of the interim time; the highest future opportunity may be discounted for the uncertainty of it actually arising as foreseen, as might the interim compensation and leisure cost due to the possibility of unexpected termination, but the present opportunity is certain. If the (estimated) chance of detection is less than 100%, then the value of the current disloyalty would include the value of not being detected (equivalent to the value of not being disloyal, as described above) discounted by the probability of that occurring. If the severity of punishment is lessened, the incentive to behave

as part of a reciprocal understanding in the field.²¹⁶

Finally, it bears noting that the correlation between manager salary and corporate performance (including, one presumes, whatever negative adjustment to corporate performance is due to self-interested behaviour), has been empirically shown to be extant but tiny.²¹⁷ This casts into doubt the efficiency of the salary aspect of the market for managers, and therefore of its ability to affect their behaviour.

6. Summary

The "nexus of contracts" theory of the corporation contains useful elements. Many of the relationships within the corporation can be meaningfully compared to contracts; criticisms of the theory that rest upon differences such as a lack of bargaining or informed consent assume a too-narrow view of what a contract is. Taken to its natural conclusion, however, the "nexus of contracts" approach renders the boundaries of the firm unclear. This presents problems for certain types of legal analysis, in particular determinations of liability. A possible solution to such problems is to take seriously the suggestion that there is no corporate entity, only individual contracting humans, and accordingly determine that those humans are the true principals involved. Depending on the premises preferred, those humans would be either the shareholders (who notionally hire directors and managers as their agents) or the controlling entrepreneurs (who presumably are also the directors and managers).

Finding controlling entrepreneurs, let alone shareholders, liable for "corporate" acts might be seen as an undesirable consequence.²¹⁸ Therefore, limited liability must be integrated into the model.²¹⁹ Attempts to suggest that it could be replicated contractually are unconvincing; it must be granted by the state. The discredited concession model thus returns to relevance. The concession model is also bolstered by the insight that there is no delineation between contract law as a "natural" phenomenon and corporate law as an "unnatural" one. Even simple "interpretation" of a contract involves judicial determinations that substitute an outsider's views of what the parties *should have* done for their own consensual choices; the addition of other contract law principles only increases the divide. At that point, it is unclear what is

disloyally further increases.

²¹⁶ Brudney, *supra* note 104, p. 1421.

²¹⁷ Bebchuk, *supra* note 97, p. 1842; Coffee, *supra* note 69, pp. 943-944; Eisenberg, *supra* note 86, pp. 1489-1490.

²¹⁸ Or possibly as a desirable one, but for now, the operating assumption is that current principles of corporate law should be maintained.

²¹⁹ "Limited liability" only protects investors. Extending similar protection to active participants in the corporation, such as directors, requires a separate doctrine. (See Juzda, *supra* note 167, generally, for a consideration of possible justification for it and the various forms it might take.) Nonetheless, the implications in this context are identical.

problematic about adding specifically *corporate* law principles.²²⁰

Additionally, while not strictly relevant to the question of whether a corporation is a set of contracts, arguments as to whether directors' duties of care and loyalty should be default rather than mandatory rules have become intimately connected with the "nexus of contracts" debate. Mechanisms such as the markets for managers and securities may help curb self-interested behaviour, but it is easy to overstate their utility; in practice, they operate imperfectly at best. While mandatory rules would not operate perfectly either- if nothing else, detection problems always exist- there is certainly room to argue that they might usefully supplement market mechanisms as a means of controlling director self-interest. They may also function to maintain social norms. In short, even if the corporation is a "contract" in some sense, it might be desirable to have it be a *specially regulated type of contract*, much as consumer transactions often are.²²¹ This argument is given additional support when the interests of outside parties are factored in.

Clearly, then, the corporation is not and should not be a "nexus of contracts" if such is taken to refer to completely free agreements between self-interested parties whose own consensual choices are solely determinative of the agreement's content and who are ideally free from any state involvement whatsoever. A legal framework inevitably surrounds these agreements, enforcing and supplementing their content. A special privilege (limited liability) is granted by the state to some participants in this arrangement. Finally, and debatably, paternalistic involvement in the form of mandatory features to protect the parties is not only a conceded fact but may be a justifiable supplement to imperfect market mechanisms.

Granting all of these indicia of state involvement, then the corporation remains a "nexus of contracts" in the sense that its participants enter it voluntarily, exchanging their contribution for an expected benefit. It would be as inappropriate to ignore this motivation, or to fail to grant significant respect to the parties' *actual* ability to set their own preferences as to how to achieve their goals, as it would be to disregard the role that the state and its institutions play. To do so would result in the demise of the corporation as a useful economic vehicle.

7. "Nexus of Contracts" Theory and Unanimous Shareholder Agreements

The "nexus of contracts" theory, for all its flaws, may help to shed light on the origins of the unanimous shareholder agreement. The Dickerson report, from which this tool sprung, took it as axiomatic that shareholders should be free to alter the directors' powers unless some reason to forbid doing so could be advanced, and it found none.²²² The Alberta Report,²²³ which successfully recommended that that

²²⁰ Assuming, of course, that these corporate law principles are rationally connected to policy goals.

²²¹ Consumer protection limiting freedom of contract might also be objectionable to some.

²²² Dickerson Report, *supra* note 26, p. 70: "There seems no reason in principle or policy why

province adopt the unanimous shareholder agreement, was even clearer in framing corporate law as a set of statutory default rules that shareholders should be able to freely renegotiate:

The *CBCA* does, and we think the proposed *ABCA* should, lay down many rules about the conduct of the affairs of a business corporation and about the relationship among the shareholders, directors and officers. However, the shareholders of a corporation may want a different rule or an additional rule, and if they all agree, and if the change would not prejudice outsiders, we see no reason why they should not have it; the shareholders are able to decide what rules will best protect their interests and promote business efficiency, and there is no apparent inequality in bargaining position which might require the law to protect shareholders who have addressed their minds to the subject and come to an agreement.²²⁴

The Industry Canada report was more cautious, noting that there was both a "contractarian" and a "statutory division of powers" model of the corporation, and that each had benefits and drawbacks.²²⁵ But it determined that "philosophically, permitting shareholders to contract out of the corporate governance rules is more consistent with the 'contractarian' type of corporate law than with the 'statutory division of powers' type of corporate law".²²⁶ Even when the respective merits of both schools of thought were acknowledged, it was assumed that the unanimous shareholder agreement was aligned with the contractual understanding of the corporation.

There is an obvious compatibility between the "nexus of contracts" theory and unanimous shareholder agreements. These instruments fit well into this analytic model, indeed better than many of the other elements that are by default part of it; they are closer to classic contracts than the more abstract "contracts" usually discussed in the "nexus of contract" theory, more likely to be the product of real bargaining and informed consent. But "nexus of contracts" theory and the unanimous shareholder agreement are not synonymous. The former is a model for understanding the corporation not as an entity but as a group of (mostly hypothetical) "contracts", and the latter is a single²²⁷ actual document that affects the internal arrangement of the corporation. The inclusion of these agreements in Canadian law, notwithstanding the original justification, neither requires nor necessarily provides support for the "nexus of contracts" theory; it is also possible to incorporate these documents into a model of the corporation as a statutory entity.²²⁸

shareholders should not be free to agree to a different structure of management either by a provision in the articles, in the by-laws, or in a unanimous shareholder agreement."

²²³ Institute of Law Research and Reform, *Proposals for a New Alberta Business Corporations Act*, 2 vols. (Edmonton, 1980) (hereinafter "Alberta Report").

²²⁴ Ibid, pp. 21-22.

²²⁵ Industry Canada Discussion Paper, *supra* note 9, p. 6.

²²⁶ Ibid, p. 6.

²²⁷ It is possible to have more than one unanimous shareholder agreement, but each one is a single agreement.

²²⁸ Martel, *supra* note 11, p. 6, described the corporation as a legal fiction whose nature is determined

This chapter has examined and ultimately rejected the idea that the corporation could be entirely reduced to a "nexus of contracts"; limited liability proved an insurmountable barrier to the task, and some element of concession theory was necessary to entirely explain the defining features of the corporation. But while this allows one to reject the more extreme claims some "nexus of contracts" proponents have put forth, it does not mean that there is no merit whatsoever to this viewpoint.

Many of the issues discussed in the following chapters can, in part, be explained in terms of the tension between the view that a unanimous shareholder agreement is simply one more means of customizing a largely pre-determined entity in specific and perhaps superficial ways versus the view that the unanimous shareholder agreement allows (or should allow) shareholders to radically and fundamentally alter the corporation away from its default form.

One of the criteria for the formation of a unanimous shareholder agreement is that it restricts the directors. If these instruments are conceived of as a specific statutory tool, this requirement needs no justification; they must restrict directors because that is their *point*. It is, if anything, more curious that the documents can also include clauses which serve other purposes. Conversely, proceeding from the premise that a corporation is at heart a voluntary arrangement amongst shareholders designed to further their interests, then the unanimous shareholder agreement could be a convenient tool to better achieve that, and there would be no reason to limit it to placing restrictions upon the directors, nor to require a term of that sort as a precondition for the document's statutory validity. Even within the context of restricting directors, there are disagreement about what limitations are permissible; again, assumptions similar to those underlying the "nexus of contracts" theory would indicate that any restriction the shareholders can agree upon should be allowed, while perspectives more entrenched in the traditional corporate structure might seek to distinguish between acceptable and unacceptable deviations from the board's default authority. These controversies are explored in Chapter Three.

The enforcement of unanimous shareholder agreements, a topic covered in Chapter Four, is also informed by the debate as to whether the corporation is truly a "nexus of contracts", albeit in a more complex fashion. One approach to enforcement holds that the instrument has truly reshaped the corporation, a position that a "nexus of contracts" understanding would also suggest, in order to remove some or all of the directors' powers. The other three models are more compatible with an understanding of the corporation as a statutorily determined entity; either the agreement is one element to be considered

by the legislation, adding that before the creation of the unanimous shareholder agreement, the separation of powers between shareholders and directors was an integral part of that fiction, but now the lawmakers have allowed investors greater freedom to modify the nature of that fiction themselves, almost to the point of treating it as an unincorporated partnership. Martel thus sums up one of the paradoxes here: the unanimous shareholder agreement allows for greater freedom to alter the corporate structure, but only within the context of a legislative framework authorizing it and still subject to limits. James Smith, *La Partie 1A de la Loi sur Les Compagnies*, Volume 3: Les commentaires (Montreal: Centre d'Édition Juridique, 1981), at p. 305 and fn 17 made a similar point.

when performing evaluations pursuant to standard corporate principles such as the directors' duties and the oppression remedy, or it exists outside the entity entirely as a contract. But the connection between the "nexus of contracts" theory and the various enforcement models is not a strictly one-to-one association. Bearing in mind the discussion earlier that a "nexus of contracts" should still be subject to contract law, applying that same body of legal principles to enforcing a unanimous shareholder agreement implies similar assumptions.²²⁹ The other three methods of enforcement suggest instead that unanimous shareholder agreements- and, by extension, all matters of corporate governance- are not simply arrangements amongst private parties to be adjudicated according to contract law, but instead subject to principles that are uniquely those of corporate law.

Other issues raised by the "nexus of contracts" theory have significance to unanimous shareholder agreements as well. The earlier discussion about who the parties are to the corporate "contract" is relevant in light of the criterion that a unanimous shareholder agreement must be acceded to by all of the shareholders. This seemingly simple requirement is explored in Chapter Three, and the dilemmas over the definition of unanimity raised by unusual situations can be understood as manifestations of this same question.

Finally, the examination of directors' duties, in particular their duties of care and loyalty, in Chapter Five derives much from the debate as to whether protecting shareholders justifies or requires government interference in a "nexus of contracts".

Even if one rejects it as a fully workable model of the corporation, the "nexus of contracts" theory remains an intriguing viewpoint that contains some insights, and debates that have played out within its context have wider relevance. As the following chapters examine the unsettled areas of law surrounding unanimous shareholder agreements, a recurrent theme is the conflict between the view of the corporation as a largely pre-determined, statutorily-defined entity and the view of it as a fundamentally malleable arrangement.

²²⁹ But the limits on the "nexus of contracts" theory suggest similar limits on unanimous shareholder agreements; the state is always a party to a unanimous shareholder agreement. As a result, even if these documents are considered as contracts and subject to contract law for their enforcement, other policy goals than contractual freedom (and the prevention of externalities) should be considered in setting the possible scope allowed to unanimous shareholder agreements.

Chapter 3: Basic Criteria and Formation

1. Introduction

The obvious starting point for understanding unanimous shareholder agreements is determining what constitutes a valid one.²³⁰ In order to know what these agreements *are* and how they function, to comprehend them as a specific facet of the law, one must first distinguish what is a (valid) unanimous shareholder agreement from what is not. And if the central dilemma the unanimous shareholder agreement introduces into Canadian corporate law is the potential conflict between a relatively static statutorily-determined organization and an expanded contractual freedom to reorganize that structure, then the scope of permissible restructuring and the formalities required to accomplish it are key questions.

While the legislation addresses these points, there is sufficient ambiguity to allow for interpretation, particularly if judges are inclined towards either maintaining the standard corporate form or allowing for greater freedom to deviate from it. It is difficult to say that the existing case law has "settled" the technical issues the statute does not explicitly cover, with the exception of certain specific ones addressed in the judgment of the Supreme Court of Canada in *Duha Printers (Western) Ltd. v. R.*²³¹ Other than that obviously compelling authority, the decisions are too scattered to truly form a body of accepted rules. Nonetheless, they constitute precedents, albeit perhaps weak ones, and more importantly, taken together they can give general insight into the levels of judicial understanding and acceptance of unanimous shareholder agreements. This ultimately yields two general observations.

Instead of analyzing these agreements in isolation through the development and use of abstract principles, the courts may consider them in light of the entire fact situation, the behaviour of the parties, equitable concerns, *et cetera*. This is obviously not unique to unanimous shareholder agreements, but there could be a vicious circle between the lack of well-developed and consistently applied legal doctrine surrounding the formation of these instruments and the tendency of courts to deal with them in this manner. While such contextual elements complicate attempts to derive general principles from the case law, unique

²³⁰ An "invalid" unanimous shareholder agreement is legally not a unanimous shareholder agreement (although it may have some other legal effect, *e.g.* as a binding contract). The phrase "valid unanimous shareholder agreement" is therefore technically redundant. Such terminology is in common usage, however, including in reasons for judgment, and it is often the clearest way to discuss the difference between a purported unanimous shareholder agreement that meets the statutory criteria and one that does not.

²³¹ *Duha SCC*, *supra* note 24.

equitable factors may also help explain away anomalous decisions.

A general result more specific to this topic is the overall judicial tendency, in situations where it is ambiguous whether the criteria for creation were met, toward resisting the existence of a contested agreement, with the result of instead maintaining the default corporate structure. This is by no means universal, but many of the judgments where an agreement *was* found to exist in spite of reasons to think otherwise can be explained on the aforementioned equitable grounds. Although the logic employed in these analyses may be compatible with a contractual understanding of the corporation- the unanimity requirement, in particular, derives more from that model than from the rest of corporate law- the effect is to prioritize the statutorily defined default power structure over shareholder attempts to rearrange it by agreement, the familiar over the novel. If the unanimous shareholder agreement represents a push in Canadian law toward a more contractual understanding of the corporation, then the cases dealing with the requirements for one's formation suggest that the reception this is receiving in the courts is, at best, mixed.

2. When Is It A Unanimous Shareholder Agreement?

The first question that must be answered when dealing with a unanimous shareholder agreement is whether it is, in fact, a unanimous shareholder agreement. There is a difference between a unanimous shareholder agreement in the statutory sense and an agreement among all of the shareholders.²³² The effects of this distinction include that only the former may limit the power of directors, is binding upon subsequent shareholders who were not party to it originally, affects *de jure* and not merely *de facto* corporate control,²³³ and is either equal to or superior to the articles in its authority over the corporation.²³⁴ An agreement of all the shareholders which is not a unanimous shareholder agreement possesses none of those features.

How then are the two distinguished? The unanimous shareholder agreement is a creation of statute, and it is in the relevant legislation that one may find the criteria for such instruments. The *C.B.C.A.* provides a representative example:

146. (1) An otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and one or more persons who are not

²³² There is obviously also a difference between a unanimous shareholder agreement and an agreement of only *some* of the shareholders, but this is less easily confused. One might further differentiate a unanimous shareholder agreement from an agreement between some (or all) of the shareholders and the corporation.

²³³ *Duha SCC*, *supra* note 24.

²³⁴ *Piikani Investment Corp. v. Piikani First Nation*, 2008 ABQB 775, 2008 CarswellAlta 2070, 173 A.C.W.S. (3d) 1087, [2009] A.W.L.D. 2490, [2009] A.W.L.D. 2491, [2009] A.W.L.D. 2492, [2009] A.W.L.D. 2493, [2009] A.W.L.D. 2494, [2009] A.W.L.D. 2520, [2008] A.J. No. 1470 (Alta. Q.B. Dec 17, 2008) (hereinafter "*Piikani*"); see discussion later in this chapter.

shareholders, that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation is valid.

(2) If a person who is the beneficial owner of all the issued shares of a corporation makes a written declaration that restricts in whole or in part the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation, the declaration is deemed to be a unanimous shareholder agreement.

A certain awkwardness of drafting is visible here, as section 146(1) only classifies a type of agreement as valid without stating that it is also a "unanimous shareholder agreement", but this is clarified in section 2(1).²³⁵

In cases where more than one shareholder exists,²³⁶ the unanimous shareholder agreement appears to have four criteria under the *C.B.C.A.*

1. It is otherwise lawful.
2. It is written.
3. All the shareholders of a corporation are party to it.
4. It restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the corporation.

Unless one reads in additional criteria not present in the wording of the statute, any instrument that meets these criteria would be considered a unanimous shareholder agreement. Conversely, any arrangement that does not meet these criteria is not a unanimous shareholder agreement.²³⁷

Manitoba,²³⁸ New Brunswick,²³⁹ Ontario,²⁴⁰ Quebec,²⁴¹ and Saskatchewan²⁴² all have statutory requirements very similar to the *C.B.C.A.*, although Ontario and Quebec do not include the "otherwise lawful" criterion, and Quebec allows for the agreement "to restrict the powers of the board of directors to manage, or supervise the management of, the business and affairs of the corporation, or to withdraw all

²³⁵ Where the definition of a unanimous shareholder agreement is "unanimous shareholder agreement" means an agreement described in subsection 146(1) or a declaration of a shareholder described in subsection 146(2)".

²³⁶ And the agreement was not created by an order of the Court. *C.B.C.A.*s. 241(3)(c).

²³⁷ At least, not unless the Court uses its powers to make it one. *C.B.C.A.* s. 241(3)(c).

²³⁸ *M.C.A.*, s. 140(2).

²³⁹ *N.B.B.C.A.*, s. 99(2). *N.B.B.C.A.*, s. 99(6), however, also deems close corporation by-law pursuant to s. 78 of the *Companies Act*, RSNB 1973, c C-13, to be unanimous shareholder agreements. By-laws under that section must be unanimously confirmed by the shareholders, but they also must be passed by the directors, and they deal with restrictions upon share transfers rather than upon the powers of the directors (s. 78(1)).

²⁴⁰ *O.B.C.A.*, s. 108(2).

²⁴¹ *Q.B.C.A.*, s. 213. Although this wording is not explicit that the restrictions may be "in whole or in part", there is no reason to interpret the section otherwise, and the case law appears consistent with that view.

²⁴² *S.B.C.A.*, s. 140(2).

such powers from the board".²⁴³

This model is not strictly followed by all provincial and territorial equivalents. Alberta's version does not include the "otherwise lawful" criteria and, in place of the requirement that the agreement restrict the directors, allows as follows:

146(1) A unanimous shareholder agreement may provide for any or all of the following:
(a) the regulation of the rights and liabilities of the shareholders, as shareholders, among themselves or between themselves and any other party to the agreement;
(b) the regulation of the election of directors;
(c) the management of the business and affairs of the corporation, including the restriction or abrogation, in whole or in part, of the powers of the directors;
(d) any other matter that may be contained in a unanimous shareholder agreement pursuant to any other provision of this Act.

Newfoundland and Labrador's,²⁴⁴ the Northwest Territories',²⁴⁵ Nunavut's,²⁴⁶ and the Yukon's²⁴⁷ statutes contain the same selection (with some slight variations in the wording).²⁴⁸ While these jurisdictions' departure from the federal standard are occasionally specifically referred to below, in the following discussion, the *C.B.C.A.* criteria are assumed as the default definition of a unanimous shareholder agreement unless otherwise noted.

The remainder of this chapter reviews each of the four *C.B.C.A.* requirements in turn, as well as the additional criterion of "intent" that some judgments have suggested. A few cases have considered whether, quite apart from the specific statutory requirements of the unanimous shareholder agreement, an agreement actually existed between the parties at all;²⁴⁹ while arguably these go toward the "otherwise

²⁴³ *Q.B.C.A.*, s. 213.

²⁴⁴ *N.L.C.A.*, s. 245(1).

²⁴⁵ *N.T.B.C.A.*, s. 148(1).

²⁴⁶ *N.B.C.A.*, s. 148(1).

²⁴⁷ *Y.B.C.A.*, s. 148(1).

²⁴⁸ Four of these statutes also allow documents to opt out of statutory unanimous shareholder agreement status. *A.B.C.A.* s. 146(9), *N.L.C.A.* s. 245(10), *N.T.B.C.A.* s. 148(9), and *N.B.C.A.* s. 148(9) all provide; "A unanimous shareholder agreement may exclude the application to the agreement of all but not part of this section." (The *Y.B.C.A.* does not contain an equivalent, nor do the *C.B.C.A.*, *M.C.A.*, *N.B.B.C.A.*, *O.B.C.A.*, *Q.B.C.A.*, or *S.B.C.A.*) It is presumably not coincidental that these four are among those that expand the list of topics sufficient to meet the statutory criteria to include subjects that might also be dealt with through a regular contract (*e.g.* the rights and liabilities of shareholders as amongst themselves), and this subsection insures that that remains possible. It is unclear, however, what the effect of excluding the application of the section would be for a document containing terms that could *only* be found in a unanimous shareholder agreement: restrictions upon the directors. Either the exclusion or the restrictions (or the entire agreement) would have to be ineffective.

²⁴⁹ In *Brewer v. Bishop*, 2009 NBQB 330, 351 N.B.R. (2d) 202, 2009 CarswellNB 573, 904 A.P.R. 202, 183 A.C.W.S. (3d) 529 (N.B. Q.B. Dec 14, 2009), an issue was raised (but not decided) regarding whether a unanimous shareholder agreement was binding because it had allegedly been rescinded by parties who had already signed it before the remaining shareholder did (pars. 11-15). The issue of the validity of the agreement was specifically not decided because this was a motion hearing and the issue was

lawful" criterion, they do not raise issues particular to the unanimous shareholder agreement and are not considered in depth.

3. "Otherwise Lawful"

Welling, in his textbook on corporate law, suggested that the "otherwise lawful" criterion is redundant, merely an example of legislative caution.²⁵⁰ The case law would largely seem to bear that view out. Judges apply pre-existing legal principles to determine the validity of unanimous shareholder agreements without reference to this criterion, apparently considering their relevance and applicability self-evident. Attempting to justify those decisions as *implicitly* based upon the "otherwise lawful" requirement is a strained argument at best. Nonetheless, on the strict wording of the statute, it may have been necessary. The provision specifically *affirms the validity* of agreements that meet its stated qualifications; to omit reference to wider principles might inadvertently lead to the result that any agreement, no matter how legally problematic it might otherwise have been, was deemed valid by the statute so long as it was unanimous, written, and restricted the directors.²⁵¹

The "otherwise lawful" criterion has received almost no judicial attention, presumably because of this perceived redundancy, and yet it potentially has some significance to the question of whether unanimous shareholder agreements represent a displacement of corporate law principles by contract law. "Otherwise lawful" is not a term defined in the legislation, and without some point of reference, such a phrase must be either meaningless or tautological. The most obvious framework to draw upon is that which governs most other agreements, that is to say contract law. Concepts such as unconscionability,

best left for trial (par. 19) and because the motion itself could be determined on the bases that it was an attempt to re-litigate a motion that had already been decided and that the agreement could have been raised during the earlier hearing (par. 26). In *Iampen v. Royal Bank*, 79 A.R. 305, 1987 CarswellAlta 318, 66 C.B.R. (N.S.) 47 (Alta. Master Jun 01, 1987), the plaintiff's failure to produce any copies of an alleged unanimous shareholder agreement led Master Funduk to make an adverse inference as to either the *existence* of the agreement or, if it did exist, its terms (pars. 56-57, 59-60). In *Sheer v. Lee*, 263 A.R. 305, 2000 CarswellAlta 248, [2000] A.J. No. 299 (Alta. Q.B. Mar 13, 2000), a preliminary agreement to later form a unanimous shareholder agreement was found to be insufficient to create one, and an arbitration clause in the preliminary agreement was not sufficiently broad to allow an arbitrator to create the unanimous shareholder agreement, only to determine if one's terms were in accordance with the preliminary agreement (pars. 36-43).

²⁵⁰ Bruce Welling, *Corporate Law in Canada: The Governing Principles* (Toronto: Butterworths, 1984) (hereinafter "Welling 1st ed."), at p. 452.

²⁵¹ Martel, *supra* note 11, p. 9-10, provided a similar explanation, but with the wider concern that this declared validity of unanimous shareholder agreements could otherwise circumvent not just contract law, but any legal restriction, *e.g.* by making an illegal dividend into a "valid" one. McCarthy, *supra* note 8, p. 468, similarly stated that the purpose of the "otherwise lawful" element was to indicate that the only legal rule that the provision waived was the normal inability of shareholders to restrict directors, but that other laws still applied, *e.g.* those governing restraint of trade.

misrepresentation, and legal capacity would therefore be relevant to determining whether a unanimous shareholder agreement is "otherwise lawful" and thus valid, and while those might not be particularly contentious, other aspects of contract law could be more controversial.²⁵²

An agreement is generally unenforceable if lacking in consideration; it is arguable that this could be applied to unanimous shareholder agreements.²⁵³ That would allow parties to take the position that none of the restrictions placed upon the directors were for their benefit (nor were any other terms) and thus they had received no consideration. Given that the *C.B.C.A.* allows for power to be transferred to some (rather than all) shareholders,²⁵⁴ a use of this tool that presents obvious consideration problems,²⁵⁵ there is a question raised as to whether the formation of a unanimous shareholder agreement should be subject to *all* the principles of contract law.²⁵⁶ Even without all the standard requirements, these documents could still be

²⁵² These concepts listed are taken from the common law. In Quebec, civil law would be relevant.

²⁵³ In *Renfrew Insurance Ltd. v. Cortese*, 2014 ABQB 157, 2014 CarswellAlta 450, 238 A.C.W.S. (3d) 953, [2014] A.W.L.D. 2229, [2014] A.W.L.D. 2289, [2014] A.W.L.D. 2290 (Alta. Q.B. Mar 17, 2014), the defendants argued that there had been no consideration for a non-compete clause in a unanimous shareholder agreement; Hawco J. found that the consideration was that they had been allowed to become shareholders, but also noted that it was in each shareholder's interests that the others agreed to this term (par. 19). The Court of Appeal, in *Renfrew Insurance Ltd. v. Cortese*, 2014 ABCA 203, 2014 CarswellAlta 958, 241 A.C.W.S. (3d) 442, [2014] A.W.L.D. 2938, [2014] A.W.L.D. 2960, [2014] A.W.L.D. 2961 (Alta. C.A. Jun 18, 2014), briefly indicated agreement with this conclusion (par. 12).

²⁵⁴ *C.B.C.A.* s. 146(6). See also *Q.B.C.A.* s. 214,

²⁵⁵ "Pre-made decisions", a type of restriction discussed in Chapter Five, might also raise problems of consideration, depending upon the facts.

²⁵⁶ Another such question arises if a unanimous shareholder agreement, as a contract, would be subject to the laws of a foreign jurisdiction. Must the agreement be "otherwise lawful" according to that foreign jurisdiction's contract law? Is the result different under the statutes that do not specify that a unanimous shareholder agreement must be "otherwise lawful"? Even within Canada, the same problem might arise inter-provincially. Bruce Welling, *Corporate Law in Canada: The Governing Principles*, Third Edition (London, Ontario: Scribblers Publishing, 2006) (hereinafter "Welling 3rd ed."), at p. 468 argued that "a unanimous shareholder agreement may or may not be a contract", with the answer dependent upon conflict of laws rules and the contract law of the applicable jurisdiction, but with the document remaining effective as a unanimous shareholder agreement regardless; he did not address the relevant passage of *Duha SCC*, *supra* note 24.

If the Supreme Court's comment that a unanimous shareholder agreement "must take the form of a written contract" is interpreted literally, then the result would be that the agreement would have to constitute a contract under the laws of whatever jurisdiction conflict of laws rules dictated. However, Iacobucci J. contrasted "tak[ing] the form of a written contract" with the apparently more stringent standard of "accord[ing] with the other, general requirements for a lawful and valid contract", implying that the former did not necessarily include the latter. If the key point the Supreme Court was making was not that the agreement must *be* a contract *per se*, but rather that it must take the form of one (without implying validity) and that it must also "accord with the other, general requirements for a lawful and valid contract", then it is possible that those could be the requirements for a contract in its jurisdiction of incorporation. (Query, however, what that would mean for a corporation under the *C.B.C.A.*)

That perhaps strained reading of *Duha* aside, the Supreme Court of Canada has indicated that a unanimous shareholder agreement must be a contract. I have already suggested that that *obiter* remark might require

deemed to be valid contracts, if that result is considered desirable for other purposes, such as enforcement.²⁵⁷

Although contract law is generally a suitable component in the determination of whether a unanimous shareholder agreement has been created, it might not be appropriate in all circumstances. The Supreme Court of Canada has stated that a unanimous shareholder agreement must be a lawful and valid contract (at least under some of the statutes), but the remark was *obiter* and the Court was not being asked to consider the more problematic implications of that position. The law may therefore not be fully settled as to whether the formation of a unanimous shareholder agreement always has to satisfy all the requirements for the creation of a contract.²⁵⁸ Nonetheless, the Supreme Court has indicated that, at least in jurisdictions that include the "otherwise lawful" criterion, it must. In *Duha*, Iacobucci J. wrote:

[T]he USA is a corporate law hybrid, part contractual and part constitutional in nature. The contractual element is immediately apparent from a reading of s. 140(2): to be valid, a USA must be an "otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and a person who is not a shareholder". It seems to me that this indicates not only that the USA must take the form of a written contract, but also that it must accord with the other, general requirements for a lawful and valid contract.²⁵⁹

some qualification regarding the need for consideration under the common law. Given that even the requirements of Canadian contract law may be inappropriate for unanimous shareholder agreements, there seems to be even less reason to subject the creation of a statutorily-authorized tool for governing a Canadian corporation to the contract law of a foreign country (or even of a province or territory other than the one where it was incorporated, if not under the *C.B.C.A.*). Whatever policy goals prompted the inclusion of the "otherwise lawful" criterion (or can be assumed even in its absence) would presumably be met by applying the contract law principles of the home jurisdiction, with one possible exception. If a unanimous shareholder agreement contains clauses that have purely contractual effect between the parties, and if those clauses were crucial to the bargain struck, then it would create injustice to declare the corporate constitutional terms alone valid. In such circumstances, if the document fails to meet the requirements for a contract in the applicable jurisdiction, then it should also not be recognized as a valid unanimous shareholder agreement.

²⁵⁷ See Chapter Four for a discussion of the contractual approach to enforcing unanimous shareholder agreements.

²⁵⁸ One factor that might be relevant to such determinations is the presence of purely contractual terms (*i.e.* any terms that granted rights and imposed obligations as between the parties, outside the specific scope of the unanimous shareholder agreement as a statutorily-authorized corporate governance tool). If a document can be a valid unanimous shareholder agreement while not being a valid contract, that would render any purely contractual terms unenforceable. This is the reverse of a question discussed elsewhere in this dissertation: whether a document that fails to meet the criteria for a unanimous shareholder agreement can still be a valid contract. The same principle should govern both scenarios. If, on the facts, the "contractual" and "corporate constitutional" clauses are inextricable and formed a single bargain, then the document must be either both or neither. If, again on the facts, the invalid terms can be severed, that should be done, regardless of which those are. See note 323.

²⁵⁹ *Duha*, *supra* note 24, par 66. I classify the last sentence of this as *obiter* because, while the necessary criteria for the formation of a unanimous shareholder agreement were central to the judgment, there was no issue regarding whether the document in question constituted a valid contract, only whether it was required to restrict the directors and/or whether it did so; see par. 74, which used the term "otherwise

It is debatable whether it is the words "otherwise lawful" in that particular statutory definition that led the Supreme Court to the conclusion that a unanimous shareholder agreement needs to meet the "other, general requirements for a lawful and valid contract". The connection may seem evident, but it is also plausible that the same position would have been taken even if the legislative language had not included that particular phrase.

As a general rule, judges use contract law principles to determine the existence of a unanimous shareholder agreement, but this is not generally done with reference to the "otherwise lawful" criterion in the statute. Issues such as fraud, lack of certainty, *et cetera* appear in judgments and are simply taken as self-evidently applicable; several examples appear in the following sections of this chapter, particularly where such principles are invoked in cases that also dealt with the unanimity requirement.

One case that did make explicit the connection between the "otherwise lawful" criterion and contract law is the trial decision of *Sumner v. PCL Constructors Inc.*²⁶⁰ Manderscheid J. noted that, unlike the *C.B.C.A.*, the *A.B.C.A.* does not include an explicit requirement that a unanimous shareholder agreement be lawful, and the judge suggested that this implied a "broader meaning".²⁶¹ The result, in his view, was that unanimous shareholder agreements under the Alberta act did not have to meet the general requirements of contract law, as they would under the federal one; for example, they could lack consideration.²⁶²

The Court of Appeal²⁶³ disagreed:

The *Alberta Business Corporations Act*, under which this dispute is to be decided, defines a unanimous shareholders agreement as "a written agreement". This minor difference does not mean that Albertan unanimous shareholders agreements are fundamentally any different from Manitoban unanimous shareholders agreements. This minor difference in the wording cannot mean that in Alberta an "unlawful" unanimous shareholders agreement is possible. The observations in *Duha Printers* that a unanimous shareholders

lawful" to refer to the former criterion, regarding which there was "really no room for debate" (par. 74) that it had been satisfied. It was therefore not necessary for the Supreme Court to determine in this case whether being a valid contract is a precondition for being a unanimous shareholder agreement.

²⁶⁰ *Sumner v. PCL Constructors Inc.*, 2010 ABQB 536, [2011] 2 W.W.R. 313, 2010 CarswellAlta 1637, 2010 C.L.L.C. 210-046, 87 C.C.E.L. (3d) 1, 192 A.C.W.S. (3d) 159, [2010] A.W.L.D. 4659, [2010] A.W.L.D. 4660, [2010] A.W.L.D. 4661, [2010] A.W.L.D. 4662, [2010] A.W.L.D. 4724, [2010] A.W.L.D. 4726, [2010] A.W.L.D. 4729, [2010] A.W.L.D. 4730, [2010] A.W.L.D. 4731, [2010] A.J. No. 948, 76 B.L.R. (4th) 65, 32 Alta. L.R. (5th) 239 (Alta. Q.B. Aug 23, 2010) (hereinafter "*Sumner QB 1*").

²⁶¹ *Ibid.*, par. 197.

²⁶² *Ibid.*, par. 197.

²⁶³ *Sumner v. PCL Constructors Inc.*, 2011 ABCA 326, [2012] 1 W.W.R. 649, 515 A.R. 231, 2011 CarswellAlta 1934, 532 W.A.C. 231, 95 C.C.E.L. (3d) 255, 210 A.C.W.S. (3d) 117, [2012] A.W.L.D. 194, [2012] A.W.L.D. 196, [2012] A.W.L.D. 197, [2012] A.W.L.D. 198, [2012] A.W.L.D. 238, [2012] A.W.L.D. 239, [2012] A.W.L.D. 240, [2012] A.W.L.D. 241, [2012] A.W.L.D. 242, 93 B.L.R. (4th) 138, 51 Alta. L.R. (5th) 266 (Alta. C.A. Nov 22, 2011) (hereinafter "*Sumner CA*").

agreement is a form of contract apply in Alberta.²⁶⁴

While this disagreement did not affect the outcome of the case in any direct way, as there was no apparent issue with the document's "otherwise lawful" nature, it might be seen as tied to the overall philosophies of the two judgments; the trial judge viewed unanimous shareholder agreements as distinct instruments, subject to their own rules, while the Court of Appeal explicitly found that they were simply a specialized form of contract and should be enforced as such.²⁶⁵ If the Court of Appeal's decision is correct, then the words "otherwise lawful" in various statutory provisions on unanimous shareholder agreements are indeed redundant, insofar as the same criterion would be imputed into a statute that lacked it. As noted earlier, this could be counter to legislative wording that literally affirms the validity of any agreement that meets the listed requirements.

Both sets of reasons for judgment in *Sumner* (and possibly the Supreme Court in *Duha*) took as a given that the "otherwise lawful" criterion refers to contract law. An alternative possibility, however, is corporate law. From that perspective, one might suggest that it is oppression, unfair prejudice, and unfairly disregarding interests that would render an agreement less than "otherwise lawful" and invalid. These concepts, too, appear in reasons for judgment involving unanimous shareholder agreements, although again without reference to the "otherwise lawful" criterion; the oppression remedy trumps the unanimous shareholder agreement, so it is not necessary to invalidate the agreement when it can be overturned or modified instead. If the "otherwise lawful" criterion refers to corporate law principles, not contract law, then possibilities such as unanimous shareholder agreements unsupported by consideration would not be problematic.

4. "Written"

The requirement that a unanimous shareholder agreement be in writing appears to have sparked no debate.²⁶⁶ Presumably, whatever benefits oral agreements might offer are not considered sufficient to overcome the lack of evidentiary certainty they pose, nor is the written requirement considered unduly onerous.

From a theoretical perspective, the requirement that a unanimous shareholder agreement be in writing is in itself not particularly illuminating and it is difficult to draw any inferences. Presumably the

²⁶⁴ Ibid, par. 40.

²⁶⁵ See Chapter Four for more details.

²⁶⁶ Martel, *supra* note 11, p. 8, did comment that the law requires the unanimous shareholder agreement to be in writing and agreed to by all shareholders, but it did not specify that the document must be *signed* by all shareholders, and he hypothesized that if one wants to "jouer sur les mots" (p. 8; my translation: "play with words"), a written document that receives oral assent rather than signatures may be

justification for the requirement is to provide certainty as to the terms,²⁶⁷ although it apparently does not preclude the use of extrinsic evidence for interpretation purposes in the case of ambiguity²⁶⁸ and at least one case has come to the conclusion that an amendment to the agreement does not need to be in writing to be effective,²⁶⁹ although another has come to the opposite conclusion.²⁷⁰ This might indicate that, assuming sufficient evidence exists as to the terms of the agreement, the writing requirement could be treated more flexibly. Despite this, the couple of reported cases in which the lack of a physical document was made an issue determined that a unanimous shareholder agreement in writing is necessary for shareholders to legitimately take power from the directors.²⁷¹

valid.

²⁶⁷ Smith, *supra* note 228, p. 307 provided the explanation that only a written document could satisfy the statutory provisions mandating that it be included in the company's records and available for all shareholders. Turgeon, *supra* note 9, p. 216 stated that the agreement is a special mechanism that must be in writing for the same reasons as the statute is, although what those might be was not elaborated upon and it is debatable which (if any) justifications for written legislation apply to unanimous shareholder agreements. Ratti, *supra* note 16, p. 114, stated that this requirement exists because these documents have the capacity to affect individuals who were not party to their formation (and that is tied to the requirement that they be kept in the company's records and made available to certain classes of people). Alain Robitaille, "Les Conventions d'Actionnaires" (1982) 42 R. du B. 147, at p. 171, similarly identified the capacity of the agreement to affect directors and future shareholders as underlying the writing requirement.

²⁶⁸ In *Ziegler Estate v. Green Acres (Pine Lake) Ltd.*, 2009 ABQB 464, 479 A.R. 396, 2009 CarswellAlta 1349, 181 A.C.W.S. (3d) 273, [2009] A.W.L.D. 3632, [2009] A.W.L.D. 3633 (Alta. Q.B. Aug 04, 2009), ambiguity was found to exist such that an unsigned earlier draft was admissible as extrinsic evidence, with no reference being made to the statutory requirements of a unanimous shareholder agreement. *Rumbolt v. Labrador Timber Products Inc.*, 1999 CarswellNfld 303, 1 B.L.R. (3d) 232 (Nfld. T.D. Sep 07, 1999), also did not make specific reference to the statutory requirements, and while the document therein was found to be clear enough that extrinsic evidence was not necessary, the possibility was allowed in principle and considered in the alternative.

²⁶⁹ In *Perricelli v. R.*, [2002] G.S.T.C. 71, 2002 CarswellNat 1346, 2002 CarswellNat 5126, 2002 G.T.C. 244 (T.C.C. (G.P.) Jun 05, 2002) (hereinafter "*Perricelli*"), although the unanimous shareholder agreement was never amended in writing (par. 15), the appellant argued that it had been verbally amended (par. 21), and Miller T.C.J. accepted that the failure to alter the agreement to reflect changing circumstances was simply a "lack of attention to the legal paperwork" (par. 44). The judge wrote that this was the result of small businessmen failing to pay attention to legalities and was not intended to be deceptive (par. 44), which was apparently sufficient basis for implicitly finding that the agreement had indeed been amended. The relative ease with which it was accepted that the agreement had been verbally amended may be explained by the fact that it was not any party to the document who was attempting to enforce it as written, but rather the government, for the purpose of obtaining tax revenue, although the determination of whether the agreement had been legally amended should have been the same regardless of who subsequently argued otherwise. The case is discussed further in Chapter Five.

²⁷⁰ In *Auger c. Auger Groupe conseil inc.*, 2011 QCCS 5799, 2011 CarswellQue 12052, EYB 2011-197824 (C.S. Que. Oct 3, 2011), Legris J.C.S. found that because a unanimous shareholder agreement was not a simple contract, but a special instrument that legally bound subsequent transferees, all amendments to it had to be in writing, as did its termination (par. 9). One party took the position that, based upon the opposing one's history of non-compliance, the agreement was no longer in effect (par. 8). The judge found that this was incorrect; the agreement continued in force until terminated in writing (par. 9).

²⁷¹ An agreement amongst three shareholders/employees in *Lavin Associés inc. c. Ministre du Revenu national*, 2012 TCC 87, 2012 CCI 87, 2012 CarswellNat 848, 2012 CarswellNat 1800, 217 A.C.W.S. (3d)

Simonelli v. Ayron Developments Inc.,²⁷² however, suggests one possible way that principle can be adhered to in theory while possibly subverted in practice. The three shareholders of a corporation entered into an oral agreement.²⁷³ Only one of them was a director,²⁷⁴ but one term of this agreement was that all three shareholders would make decisions jointly.²⁷⁵ After disagreements had arisen, the parties had entered into a consent order under which a variety of corporate decisions required all of their consent,²⁷⁶ and this decision concerned whether that order should be continued or varied. As part of the analysis, Park J. considered whether the oral agreement was sufficient grounds for the earlier order, and determined that:

38 The Plaintiffs' allegation is that Simonelli, Chaluk and Ona entered into an agreement to share information and jointly make decisions regarding Ayron. These three individuals are not shareholders of Ayron. They are shareholders in their own individual corporations, which are themselves shareholders of Ayron. They are thus beneficial shareholders of Ayron. There is no allegation or evidence that a written USA exists between Ayron's corporate or beneficial shareholders.

39 Thus, the power and duty to make decisions, including decisions about the expenditure of Ayron's funds and the contracts that it will enter into, rests with and has always rested with its sole director, Ona. If Simonelli or his nominee corporation, Elbow Lake, disagree with Ona's management of Ayron, absent any wrongful acts by the Defendants (discussed below), Simonelli's remedy is to remove Ona as a director, by ordinary resolution at a special shareholders meeting under s. 107(g) of the *ABCA*.²⁷⁷

Despite the conclusion that the agreement itself was ineffective, there was a finding that sufficient evidence existed upon which to make a claim for oppression.²⁷⁸ While based on a number of different allegations, one factor that the judge considered was the minority shareholder's reasonable expectations that

606 (T.C.C. [Employment Ins.] Mar 23, 2012) that guaranteed that the employees' work would not be directed or controlled was found, on the basis that it was oral and not written, to be a term of their contract of employment rather than a unanimous shareholder agreement restricting the director, a distinction which had tax consequences (par. 17).

²⁷² *Simonelli v. Ayron Developments Inc.*, 2010 ABQB 565, [2011] 3 W.W.R. 140, 506 A.R. 50, 2010 CarswellAlta 1753, 192 A.C.W.S. (3d) 1343, [2010] A.W.L.D. 5053, [2010] A.W.L.D. 5054, [2010] A.W.L.D. 5058, [2010] A.J. No. 1000, 34 Alta. L.R. (5th) 341 (Alta. Q.B. Sep 03, 2010) (hereinafter "*Simonelli*").

²⁷³ *Ibid.*, par. 3. Technically, the individuals held their shares through a holding corporation.

²⁷⁴ *Ibid.*, par. 5.

²⁷⁵ *Ibid.*, par. 11.

²⁷⁶ *Ibid.*, par. 13.

²⁷⁷ Despite that conclusion, later in the reasons for judgment, while discussing whether an attachment order was appropriate, the oral agreement was again mentioned at the stage of the test determining whether the plaintiff has a reasonable likelihood of establishing a claim, and this time the judge's response to it was not that it was legally ineffective but rather only that "[t]he Plaintiffs in the case at bar allege that the parties entered into an oral agreement, but the affidavit evidence is conflicting on this issue" (*Simonelli*, *supra* note 272, par. 150). The agreement proved extraneous to the analysis, since the plaintiff's case passed this stage of the test on the basis of other aspects of their claim (par. 152).

²⁷⁸ *Ibid.*, par. 55.

he would not be excluded from corporate decision-making.²⁷⁹ Although no direct mention was made of the oral agreement as a basis for reasonable expectations, it may have been an implicit factor.²⁸⁰ If it was, that would subvert the importance of having an actual valid unanimous shareholder agreement. As discussed in the next chapter, one common means of enforcing these documents is through the oppression remedy, by providing legal protection to the "reasonable expectations" they created that their terms would be followed. If equivalent expectations can be created without a written unanimous shareholder agreement to ground them, then the legal significance of the instrument is diminished.

Conversely, the lack of a written unanimous shareholder agreement might *protect* shareholders who manage to exert control over directors (despite lacking the legal power to do so). In *United Canadian Malt Ltd. v. Outboard Marine Corp. of Canada Ltd.*²⁸¹ various defendants brought a motion to strike out the statement of claim as against them for disclosing no reasonable cause of action.²⁸² One of these was the parent company of the corporation that was the main defendant.²⁸³ Nordheimer J. found that:

19 In one respect, I agree with the submissions of the defendants. In paragraph 6 of the proposed amended statement of claim, the plaintiff pleads and relies on section 146(5) of the *Canada Business Corporations Act*, R.S.C. 1985, C-44. It asserts that the American parent is the sole shareholder of the Canadian subsidiary and therefore is in the same position as if it were a director of the Canadian subsidiary. However, that assertion fails on the clear wording of the section which only applies where there is a unanimous shareholder agreement which, according to the express wording of the section, must be a written unanimous shareholder agreement. There is no allegation in the proposed amended statement of claim of such an agreement existing here. The section cannot therefore have any application to the facts as pleaded in this case.

The allegations that the statement of claim *did* contain included that the parent company "effectively controlled" the subsidiary,²⁸⁴ which was found to be sufficient to ground a claim against the parent company directly.²⁸⁵ Unless there were unmentioned other shareholders in the subsidiary, it was apparently the requirement for a *written* directive from the parent that was the missing element in alleging a unanimous shareholder agreement (although it is difficult to believe that the parent could have exerted the control described without ever resorting to written instructions). Ironically, this suggest that if shareholders are confident of their ability to control directors through means other than legally removing their powers,

²⁷⁹ Ibid, par. 50.

²⁸⁰ Ibid, par. 50.

²⁸¹ *United Canadian Malt Ltd. v. Outboard Marine Corp. of Canada Ltd.*, 48 O.R. (3d) 352, 34 C.E.L.R. (N.S.) 116, 2000 CarswellOnt 1445, 96 A.C.W.S. (3d) 948 (Ont. S.C.J. May 05, 2000) (hereinafter "*United Canadian Malt*").

²⁸² Ibid, par. 1.

²⁸³ Ibid, par. 3. It was not entirely clear from the judgment whether it was the sole shareholder, though it was consistently described as the "parent" and no other shareholders are mentioned.

²⁸⁴ Ibid, par. 22.

²⁸⁵ Ibid, par. 24.

they would be well served to make sure they do not do so in writing.

While the writing requirement may not have much theoretical depth, these couple of cases where it proved a decisive element do provide an introduction to the relationship between a unanimous shareholder agreement and the corporate power structure. On the one hand, without such an instrument, recognized by the legislature, there can be no legally binding restriction of the directors' powers nor is there an automatic accompanying transfer of their responsibilities. However, as these cases also both demonstrate, even in the absence of such an arrangement, shareholders might still have legally enforceable "reasonable expectations" and also they may be potentially liable for their *de facto* exertion of corporate control, even if *de jure* they do not have the directors' powers and responsibilities. The unanimous shareholder agreement can allow for alterations of the legal power arrangement within a corporation, but it never exists in a vacuum.

5. "All the Shareholders"

5.(a) Justification for the Unanimity Requirement

The quintessential trait of the unanimous shareholder agreement is that all of the shareholders must be a party to it.²⁸⁶ Transferees are deemed parties.²⁸⁷ Though the justification for this might at first appear self-evident, the unanimity requirement is actually anomalous in the context of Canadian corporate law procedures; it is not required for amending the articles, electing directors who manage the corporation, or passing shareholders' resolutions. The closest analogue is dissent rights, which also acknowledge that there are decisions for which the minority cannot be expected to simply abide by the will of the majority, but even there, the outcomes are not actually stopped. The unanimity requirement that characterizes these agreements is therefore not self-evident at all; it stands in opposition to the general principle in corporate law that the majority (or special majority) rules.

The real explanation for the unanimity requirement appears to be that the unanimous shareholder agreement is not derived from the same principles that underlie most of Canadian corporate law, where a corporation is a creature of statute governed by pseudo-democratic "majority rules" principles. It comes instead from a model where the company is an arrangement created out of the presumed consent of all the investors; such an arrangement can be amended only with the agreement of *all* the parties to it, here

²⁸⁶ Turgeon, *supra* note 9, pp. 215-216 was critical of the term "unanimous shareholder agreement" not only for being misleading insofar as not every agreement amongst all the investors qualifies, but also because it suggests that unanimity is a definitive trait of this sort of instrument. He pointed out that it was possible to create a legal regime where the shareholders may non-unanimously restrict the directors' powers.

²⁸⁷ *e.g.* C.B.C.A. 146(3).

assumed to be all of the shareholders (and *only* the shareholders, out of all the corporate stakeholders). While this approach may have been overtly modelled on partnerships originally,²⁸⁸ and the partnership analogy continues to be made,²⁸⁹ it is effectively identical to the shareholder-centric variant of the "nexus of contracts" theory of the corporation discussed in Chapter Two.

There are other possible interpretations that might explain the unanimity requirement even in the context of a statutory model that normally favours majority rule. One possibility is that it is necessary to "protect" shareholders generally, or minority shareholders specifically, with their informed consent to the agreement presumed to be adequate protection of their interests. It is debatable whether shareholders might need greater protection from the consequences of restricting directors' powers than from, for example, the consequences of those powers being exercised by individuals whose election they opposed. Quack argued that since the views of the majority of shareholders are not synonymous with the best interests of the company, allowing the majority to overrule the directors (who must look to those best interests) would frustrate the benefit to minority shareholders of seeing that the best interests of the company prevail.²⁹⁰ While this argument is susceptible to the criticism that the totality of the shareholders' interests are also not synonymous with the best interests of the company, he did not argue otherwise, saying instead only that minority shareholders cannot object to an agreement to which they have consented.²⁹¹ Martel went further and asserted that one reason for this criterion *is* that when there is unanimous agreement amongst all the shareholders, the distinction between them and the company vanishes;²⁹² as discussed in Chapter Five, this is not an accurate depiction of Canadian law at present. Quack also assumed that unanimous shareholder agreements are only used in closely-held companies where minority shareholders are especially vulnerable due to a lack of market for their shares and their potential involvement as employees, both of which he

²⁸⁸ Dickerson Report, *supra* note 26, Volume 1, at p. 11.

²⁸⁹ See Christian Herbert Quack, *Shareholder Agreements In Canadian Close Corporations* (LLM Thesis, McGill University, Faculty of Law, 1982) (Ottawa: National Library of Canada, 1985), online: digitool.library.mcgill.ca/thesisfile62560.pdf. Quack argued that close corporations are similar to partnerships, and thus the partnership principle of unanimity "seems appropriate" (p. 41) for the sort of corporate power restructuring a unanimous shareholder agreement allows (p. 41); this justification is obviously lacking in depth. Analogies between small corporations and partnerships have also appeared in the caselaw, e.g. *Clarfield v. Manley*, 14 B.L.R. (2d) 295, 1993 CarswellOnt 167, [1993] O.J. No. 878 (Ont. Gen. Div. (C.L.) Apr 21, 1993) (hereinafter "*Clarfield*") at par. 45.

²⁹⁰ Quack, *supra* note 289, p. 40.

²⁹¹ *Ibid.*, p. 40.

²⁹² Martel, *supra* note 11, pp. 5, 42. He further argued that when the distinction between shareholders and company vanishes in that manner, as a direct consequence, there is no longer a reason to distinguish between the roles of shareholders and directors (p. 5). Smith, *supra* note 228, p. 305 fn 15 made a similar, although perhaps not quite identical, argument that there is no longer a benefit ("aucun avantage") to maintaining a distinction between the interests of the company and those of the shareholders when an agreement is in place. Elsewhere, Smith described the effect of a unanimous shareholder agreement as an *exception* to the general rule that directors must be independent and look to the best interests of the company, which is literally the opposite perspective on whether there exist "best interests" of the company separate from the wishes of investors as expressed in the agreement (pp. 304-305).

believed render oppression likely, but which a unanimity requirement can help forestall;²⁹³ why minority shareholders would be any more likely to be oppressed through an agreement than the actions of majority-controlled directors was not elaborated upon. Nor does the unanimity requirement necessarily prevent majority shareholders from abusing the minority. In some circumstances, minority shareholders would have little bargaining power with regard to such agreements;²⁹⁴ normally the unanimity requirement is treated as a way to protect minorities by requiring their consent, but in fact such consent may be largely illusory. Further, the belief that every action taken through the mechanisms provided by a unanimous shareholder agreement must be acceded to by all of the shareholders is erroneous; the agreements must be unanimous at the time they are formed, but they can contain provisions that later become contentious. For example, shareholders might unanimously agree to transfer borrowing powers from the directors to themselves, to be exercised by majority vote; when it came time to exercise that authority, disagreements might arise.

The second potential justification for requiring unanimous consent is that these agreements impose duties and potential liabilities upon shareholders to the extent that they empower them. As an argument that creating a unanimous shareholder agreement is distinct from other corporate decisions, this has more weight. Public policy objectives require that shareholders bear the directors' duties if they have assumed their powers,²⁹⁵ and it is unfair to impose both the power and the responsibility upon shareholders who wanted neither. That said, allowing for dissent rights- either with regard to the agreement as a whole or to the actions taken by empowered investors pursuant to it- would seem an adequate solution to this problem, making the unanimity requirement again anomalous.

A third potential reason for the unanimity requirement is that it provides a *de facto* general size limit for corporations to which a unanimous shareholder agreement can apply, making a specific numeric limit unnecessary,²⁹⁶ although this presupposes that such a limit is desirable. Scavone took the position that "the diminished exit opportunities, high degree of personal involvement, and consensus-style decision-making typical of close corporations argue in favour of a legislative regime that allows shareholders to strike their own bargains".²⁹⁷ He also believed that there was less of an "agency cost" problem in close corporations, and thus less need for regulation designed to solve that type of problem,²⁹⁸ and asserted that investors in close corporations, unlike public ones, were well-informed and capable of contracting to

²⁹³ Quack, *supra* note 289, p. 40.

²⁹⁴ Scavone, *supra* note 9, p. 338.

²⁹⁵ This topic is discussed further in Chapter Five.

²⁹⁶ Quack, *supra* note 289, p. 41; Scavone, *supra* note 9, p. 338. Scavone did not feel that this was the case with public corporations, even if the consent of all new investors could be obtained or deemed to exist through transfer, because in his view there would still be greater potential for abuse (p. 339).

²⁹⁷ Scavone, *supra* note 9, p. 326.

²⁹⁸ *Ibid*, p. 326.

protect their interests.²⁹⁹ This assumption that close corporations do not have passive investors (or, perhaps, that passive investors would not become party to a unanimous shareholder agreement), while perhaps often correct, would nonetheless seem open to exceptions. Small business owners may seek equity funding from friends, family, acquaintances, and employees who are not involved in the management of the company and may not be sophisticated investors.

Another possible basis for the unanimity requirement is that shareholders have the right to have the company in which they have invested managed by dedicated directors and must consent to waive their rights; Turgeon dismissed this argument, but Martel found it compelling.³⁰⁰ Despite re-framing the matter in the language of "rights", this simply assumes the conclusion. If the law provided for the non-unanimous restriction of directors, then shareholders would no longer have the "right" to corporations managed by them. Even if one is not a legal positivist, it stretches credibility to suggest that the division of powers in the corporation between shareholders and directors constitutes an inherent right.

These possible explanations for the unanimity requirement thus all fail to demonstrate a compelling reason why the unanimous shareholder agreement should depart from the general corporate law principle of majority rule. While none of them are without merit, their status as *ex post* justifications are clear. The actual explanation is that the unanimous shareholder agreement has its origins in a conflicting conception of the corporation, one based upon a partnership/contractual model of voluntary arrangements.³⁰¹ Bearing that in mind, it is worth seriously considering whether the unanimity requirement should be maintained.

There have already been outright suggestions that it be abolished. Robitaille argued that, since the majority of the investors can collectively elect the directors who would run the corporation, it follows that the same majority should have the power to create a unanimous shareholder agreement (or rather, an instrument with the same effect).³⁰² Turgeon drew a different analogy, claiming that the "fundamental changes" which shareholders can approve by supermajority are "plus fondamentaux souvent qu'un simple transfert technique de la capacité décisionnelle".³⁰³ Presumably, this rests upon the premise that since the majority of shareholders can select who will be the decision-makers regardless, the use of this tool rather than elections to do so is relatively insignificant.

Turgeon's attack was more sustained.³⁰⁴ While he acknowledged that the criterion might have

²⁹⁹ Ibid, p. 328.

³⁰⁰ Turgeon, *supra* note 9, p. 255; Martel, *supra* note 11, p. 41.

³⁰¹ See the Dickerson Report, *supra* note 26, at p. 11. The analogy between a corporation governed by a unanimous shareholder agreement and a partnership is also one of the justifications put forth for the criterion by Martel, *supra* note 11, at p. 41.

³⁰² Robitaille, *supra* note 267, p. 176.

³⁰³ Turgeon, *supra* note 9, p. 255. My translation: "often more fundamental than a simple technical transfer of decision-making capacity".

³⁰⁴ He attributed the requirement primarily to the novelty of the concept having led the legislature to

some role in preventing the majority of shareholders from exploiting the others, he countered that it was overprotection that allowed the minority to act to the detriment of the majority.³⁰⁵ He further argued that a unanimity rule that only governed the *formation* of the agreement and not the exercise of the rights under it could not protect minority shareholders from exploitation.³⁰⁶ He did not, however, suggest that removing the criterion would somehow accomplish that, so one might rejoin that a highly imperfect protection (the requirement of initial consent to the document's terms) was still better than none at all. Turgeon's recommendation was that instead of the unanimity requirement, a two-thirds majority be required for a similar effect,³⁰⁷ with minorities protected by their statutory dissent rights,³⁰⁸ although he limited his proposal to closely-held companies, since in his view it would break the (unlisted) mechanisms that protect investors in public ones.³⁰⁹ Although obviously a profound change from how the unanimous shareholder agreement has existed in Canada, Turgeon referred to some American jurisdictions that had regimes similar to his suggestion, arguing that it was not "l'heresie juridique".³¹⁰

Other attacks upon the unanimity requirement in the literature have been indirect, taking the form not of openly querying its purpose but instead remaining implicit in two other lines of discussion. Firstly, comparisons of the benefits of the unanimous shareholder agreement as a means of corporate control with the articles and by-laws sometimes seem to at least ignore, if not reject, any need for a unanimity requirement. Sohmer pointed out that the unanimity requirement can be circumvented if the articles of incorporation are amended instead.³¹¹ (At the time, the articles could contain any provision which a unanimous shareholder agreement might, a feature of the 1975 Act³¹² that was later removed.) Sohmer noted that this can be seen as a criticism, since the unanimity requirement was intended to protect minority shareholders.³¹³ Despite this, he presented the possibility of using the articles as generally beneficial to shareholders, insofar as it would allow them to avoid liability unless characterized as *de facto* directors.³¹⁴ On the other hand, McCarthy was highly critical of the provision in *C.B.C.A. '74-'75* allowing for the articles to contain any term found in a unanimous shareholder agreement, pointing out that if that was

err on the side of caution (Turgeon, *supra* note 9, p. 255).

³⁰⁵ Turgeon, *supra* note 9, p. 255.

³⁰⁶ *Ibid.*, p. 256. He further stated that, once shareholders are empowered, some of them can even actively collude against others, given the difficulty of proving such side agreements.

³⁰⁷ *Ibid.*, p. 256. As a side point, he suggested that this would eliminate the need for a separate document at all; it could then be included within the articles (p. 257).

³⁰⁸ *i.e.* the right to withdraw if they dissent (Turgeon, *supra* note 9, p. 257).

³⁰⁹ Turgeon, *supra* note 9, p. 257. He did not elaborate on how or why his earlier arguments would be inapplicable in that context.

³¹⁰ *Ibid.*, p. 256. My translation: "judicial heresy".

³¹¹ David H. Sohmer, "Controlling the Power to Manage in Closely-Held Corporations Under the *Canada Business Corporations Act*" (1976) 22 McGill L. J. 673, at p. 677.

³¹² *C.B.C.A. '74-'75*, section 6(2).

³¹³ Sohmer, *supra* note 311, p. 677. He did not justify this assertion as to the intent or effect of the requirement.

permissible, it raised the question of why the unanimity criterion existed.³¹⁵ He also queried whether in the absence of unanimity, the directors' duty to act in the interests of the corporation could be curtailed,³¹⁶ under the assumption that only when the shareholders acted unanimously did the distinction between their interests and those of the company vanish.³¹⁷ McCarthy asserted that shareholders who used this method would still face liabilities as *de facto* directors, so that would not be an advantage to this technique;³¹⁸ circumventing the unanimity requirement would be the only reason to employ it. Hay and Smith also considered whether the articles or by-laws might be used instead of a unanimous shareholder agreement, noting that some specific restrictions can be placed upon directors through those methods, although they pointed out that since only unanimous shareholder agreements are specifically allowed to restrict directors, use of other methods might be subject to common law limitations.³¹⁹ They did not consider that using other methods to restrict directors would circumvent the unanimity requirement, focussing only on whether it was possible to avoid liability through this method, and concluded that it was not.³²⁰ Despite their differing conclusions, neither Sohmer nor Hay and Smith appear especially concerned with any perceived need for shareholder unanimity in altering the corporate power structure. Comparing the unanimous shareholder agreement to the articles and by-laws highlights the degree to which the former's unanimity requirement is unusual and may be unnecessary.

This contrast is taken a step further when one compares unanimous shareholder agreements to *themselves*. This is the second indirect form whereby the literature has examined the unanimity requirement: amendments. While it is taken largely as a given that all the shareholders must agree to create these agreements, the law regarding their amendment is more complex. Depending upon jurisdiction, non-unanimous amendments may be explicitly permitted, explicitly forbidden, or unaddressed by the legislative language.³²¹ This topic will be explored in a subsequent subsection.

The unanimity requirement is a part of the legislative definition of a unanimous shareholder agreement, and so judges who enforce it are applying the relevant act. While it is thus largely impossible for the judiciary to weigh in directly upon whether or not this criterion should even exist, the following subsections demonstrate that the degree of flexibility which the courts grant the requirement is not simply a matter of statutory interpretation. It is an expression of the conflict between the corporation as a

³¹⁴ Ibid, p. 677. See discussion in Chapter Five on this point.

³¹⁵ McCarthy, *supra* note 8, p. 470.

³¹⁶ Ibid, p. 470.

³¹⁷ See McCarthy *supra* note 8, p. 468, where he wrote that the unanimous shareholder agreement provision "abandons the distinction between the company and shareholders acting unanimously and recognizes the right of the latter to determine in advance, to whatever extent they wish, their own interests".

³¹⁸ McCarthy, *supra* note 8, p. 472.

³¹⁹ Richard James Hay and Lucinda Ann Smith, "The Unanimous Shareholder Agreement: A New Device For Shareholder Control" (1985) 10 Can. Bus. L. J. 440, at p. 449, citing *C.B.C.A.* s. 98(1).

³²⁰ Ibid, pp. 449-450.

³²¹ See full list later in this chapter.

statutorily-determined majority-led entity and the contractual model; in the former, a unanimity requirement is anomalous and possibly unnecessary, while in the latter, it is crucial.

5.(b) Unanimity Requirement Cases

The cases involving the unanimity requirement do not question the basic existence of the criterion, but rather involve difficulties with its application. It is perhaps surprising that something as seemingly straightforward as whether "all the shareholders" were party to an agreement can give rise to dispute. In fact, such litigation has been rare, and it would be an overstatement to describe this element as a potential minefield.³²² Nonetheless, problems have arisen in determining who exactly needs to be a party for an agreement to be effective.³²³ While largely a technical question, the resolution of such ambiguity has theoretical implications. If the unanimity requirement represents a contractual model of the corporation, determining who must be a party to such agreements is, in essence, a reconsideration of who are the deemed parties to the "corporate contract" in the first place. Further, how strictly the unanimity requirement is enforced reflects the degree to which the contractual model is replacing the looser majority-

³²² It was dealt with simply in *Glassco v. 554252 Saskatchewan Ltd.*, 2008 BCSC 523, 2008 CarswellBC 833, 166 A.C.W.S. (3d) 252, [2008] B.C.W.L.D. 4305 (B.C. S.C. Apr 29, 2008), where Beames J. stated that the agreement in question was not a unanimous shareholder agreement (par. 26) without explicitly justifying that finding, but since shareholders collectively holding approximately 30% of the shares had not signed it (par. 3) that was presumably the explanation. The agreement was found to contain terms that (purportedly) restricted the directors, meaning it would have met that criterion, but not being a unanimous shareholder agreement, those restrictions were held to be invalid (par. 17). The rest of the document was saved due to a severance clause (par. 27). In *Sasswood Holdings Ltd. v. Biz-Nix Software Inc.*, 2000 CarswellOnt 1514 (Ont. S.C.J. [Commercial] May 09, 2000), the refusal of shareholders owning 1.6% of the corporate shares to sign a unanimous shareholder agreement, thus rendering it ineffective, gave rise to an action (pars. 6-9). Wright J. confirmed that those shareholders were under no obligation to sign the agreement (and that they had never represented that they would do so) (par. 13). So the statement of claim was struck (par. 17).

³²³ While it is clear that an agreement that fails to meet the unanimity requirement cannot be a unanimous shareholder agreement in the statutory sense, it might be presumed to nonetheless be a binding contract amongst the signatories. However, the "shareholders' agreement" in *Morton v. Asper*, 1989 CarswellMan 304, 62 Man. R. (2d) 1, [1989] C.L.D. 1289, [1989] M.J. No. 482 (Man. Q.B. Oct 02, 1989) (hereinafter "*Morton* trial") was held to never have been legally binding because it contained a term that would fetter the discretion of directors and two of the shareholders were not parties to it; it was insufficient that the agreement stated that it was subject to their consent (par. 66). Morse J. found the entire agreement was ineffective, in part because of this illegal clause, and also in part because certain issues around the payment of interest had not been settled (pars. 70-81). The judgment specifically noted that the attempted restriction upon the directors was an essential term for one of the parties and that he would not have signed absent it (par. 67). Further, it was determined that the document's arbitration clause could not save it, because to do so would require the imposition of terms not agreed to by the parties (par. 68). In other circumstances, it is arguable that it might be possible to sever a problematic term that purported to restrict directors' powers or to use an arbitration clause to resolve the issue, and thus turn an ineffective unanimous shareholder agreement into a valid contract as between the parties.

driven standards that are the default in corporate law.

Most of the cases where this criterion is an issue are ones where, for whatever reason, it is unclear whether or not it was met. These include situations where not all the shareholders signed but related parties did (allegedly in their place), cases where it was unclear whether legal or beneficial shareholders or both needed to sign, cases where different shareholder classes complicated matters, and cases dealing with amending unanimous shareholder agreements. Each of these is discussed in turn in the following subsections. They present scenarios where judges have the opportunity to covertly reject the unanimity requirement if they so choose. Yet, as explored below, the courts have largely declined to do so; at most, judges have sometimes allowed that, when they perceived that all the shareholders had been in agreement, technical compliance problems arising from the unanimity requirement did not necessarily invalidate the documents.

Before turning to those grey areas, a case where the unanimity requirement was clearly not met deserves consideration. In *Couvre-Plancher Zénith Ltée v. Minister of National Revenue*,³²⁴ an agreement was entered into by two shareholders of a corporation at a time when there was another shareholder, but that third investor's shares were subsequently redeemed.³²⁵ It was argued that this had the effect of transforming the agreement into a unanimous shareholder agreement, but Dussault J.T.C.C. rejected that reasoning. In the judge's view, this development did not change the nature of the document or transform it into a unanimous shareholder agreement in the statutory sense; it remained a private agreement between the parties governing their relationship amongst themselves only.³²⁶ While reference was made to this being in accordance with what the document itself "suggest[ed]",³²⁷ the reasons for judgment were clear that a subsequent change in shareholdings cannot cure a failure to meet the unanimity requirement.³²⁸ If the point of the criterion is to protect all shareholders by ensuring that they have agreed to the document's terms, then this conclusion would be in error; all remaining shareholders being parties to the agreement should suffice, since there is no question they consented to it. By treating the requirement as a hurdle that could not be overcome by removing non-consenting investors, this case suggests either some other explanation for it, albeit not one that is articulated clearly, or else merely elevates strict statutory compliance over any purposive reading of the provision.

Martel, writing before this specific case and dealing with such a scenario as a hypothetical, had argued for the opposite conclusion. In his view, a would-be unanimous shareholder agreement not yet

³²⁴ *Couvre-Plancher Zénith Ltée c. Ministre du Revenu national*, [1995] 2 C.T.C. 2857, 1994 CarswellNat 1364, 1994 CarswellNat 2019, 95 D.T.C. 898 (Fr.) (T.C.C. Oct 11, 1994) (hereinafter "*Couvre-Plancher*"); see also the discussion of whether the agreement restricted the directors later in this chapter.

³²⁵ *Ibid*, par. 2.

³²⁶ *Ibid*, par. 13.

³²⁷ *Ibid*, par. 13.

³²⁸ *Ibid*, par. 13.

signed by all shareholders was ineffective until such time as it became unanimous, and it should make no difference whether that occurred through the consent of the other investors or their departure.³²⁹ Ratti also classified unanimity as a suspended condition which brought a document into effect when achieved, even if all shareholders did not initially sign,³³⁰ and Turgeon argued that a strict reading of the statute indicated that a unanimous shareholder agreement becomes effective whenever unanimity is achieved, even if not present from the start.³³¹ The closest to a dissenting view came from Robitaille, who considered it an open question whether the departure of non-consenting shareholders leaves unanimity in their wake.³³² The commentary is thus reasonably in accord, and in opposition to *Couvre-Plancher*, that unanimity may be achieved either by all shareholders consenting or by any hold-outs departing. If Martel's assumption that this would give effect to the intentions of the only remaining investors is correct,³³³ however, nothing would stop them from creating a new unanimous shareholder agreement at that time. This would eliminate the danger of the shareholders and directors unexpectedly finding themselves bound by a failed attempt to create a unanimous shareholder agreement, one long since abandoned.

5.(b)(i) Related Parties Sign In Place of Shareholders

While it would seem self-evident that in cases where all the shareholders did not sign the document, there cannot be a unanimous shareholder agreement, at least a few cases have considered whether it might be sufficient for related parties to sign in place of the shareholders (without an explicit agency relationship). This issue does not, in and of itself, suggest particularly interesting things about the development of unanimous shareholder agreements; it does not seem an especially desirable revision of the tool's requirements, the case law is predictably minimal, and the results tend to confirm what one might expect, namely that the consent of all shareholders is normally necessary for the agreement's formation and related parties cannot be freely substituted in place of that. What makes these cases nonetheless interesting is that they present one of the few plausible situations in which the unanimity requirement has clearly not been met where a judge might still find that a unanimous shareholder agreement had been formed. They therefore present a means of examining how seriously judges take the requirement that all the shareholders must be parties to the agreement, or whether the courts are willing to be flexible and allow other factors to predominate.

Such an argument actually proved successful in *Ming Minerals Inc. v. Blagdon*.³³⁴ The plaintiff

³²⁹ Martel, *supra* note 11, p. 11.

³³⁰ Ratti, *supra* note 16, pp. 115-116.

³³¹ Turgeon, *supra* note 9, pp. 227-228.

³³² Robitaille, *supra* note 267, p. 171.

³³³ Martel, *supra* note 11, p. 11.

³³⁴ *Ming Minerals Inc. v. Blagdon*, 163 Nfld. & P.E.I.R. 351, 1998 CarswellNfld 54, 503 A.P.R. 351

corporation, Ming Minerals, had originally had only two shareholders, Blagdon and Dimmell.³³⁵ In search of financing, they entered into negotiation with another company, Financial, which ultimately resulted in a "Letter Agreement".³³⁶ It was signed by a representative of Financial and by Blagdon on behalf of Ming Minerals; Blagdon did not sign it in his personal capacity and Dimmell did not sign it at all.³³⁷ The "Letter Agreement" was not referred to on the share certificates nor was it registered as a unanimous shareholder agreement.³³⁸ Initially, the terms of the "Letter Agreement" were followed by both parties, which included Financial investing in Ming and the board of directors being expanded to five.³³⁹ Blagdon subsequently died, and was replaced by his daughter as both shareholder and director.³⁴⁰ Finally, a dispute arose as to the selection of a new fifth director, one of the issues covered by the "Letter Agreement".³⁴¹

It was in this context that Mercer J. analyzed whether the "Letter Agreement" was a unanimous shareholder agreement, with consideration both of its unanimity and whether it restricted the directors' powers. It was obviously questionable at best whether "all the shareholders" had agreed. Only one of the two shareholders had signed this document, and not even in his personal capacity.

Dimmell, the shareholder who had not signed, provided evidence that during negotiations, both he and Blagdon had been "negotiating on behalf of themselves as shareholders of Minerals, as well as in their positions as the directors of Minerals".³⁴² He further stated that, subsequently, both he and Blagdon had acted in a manner consistent with their rights and obligations in the agreement, as if it bound and applied to them.³⁴³ Mercer J.'s ultimate conclusion that Blagdon had signed the document as Dimmell's agent- or more specifically, that he had signed it as an agent of the company which was in turn Dimmell's (and his own) agent³⁴⁴- could therefore have reasonably been based upon a finding of fact that Dimmell had authorized an agency relationship, and validation of the agreement would have been unexceptional.

But the conclusion was not made entirely on that basis. It was also derived from the terms of the document itself, because "[t]he Letter Agreement specified obligations which were beyond the control of Minerals and which clearly required benefits and detriments flowing directly to and from Samuel Blagdon and Dimmell in their personal capacity".³⁴⁵

(Nfld. T.D. Jan 16, 1998) (hereinafter "*Ming*").

³³⁵ Ibid, par. 7.

³³⁶ Ibid, par. 7. Mercer J. presumed it to have been drafted by Financial.

³³⁷ Ibid, par. 9.

³³⁸ Ibid, par. 10.

³³⁹ Ibid, par. 11.

³⁴⁰ Ibid, par. 13.

³⁴¹ Ibid, pars. 13-16.

³⁴² Ibid, par. 19.

³⁴³ Ibid, par. 19.

³⁴⁴ Ibid, par. 21.

³⁴⁵ Ibid, par. 20. These included that Ming Minerals would have a single class of shares (necessitating an amendment to the articles that would require Blagdon and Dimmell's approval *qua* shareholders), clauses concerning the composition of the board of directors that would require Blagdon and

Mercer J. may well have been correct that these clauses demonstrated that this document was intended by all concerned to create rights and obligations for the two shareholders in their personal capacities. From a legal perspective, though, it is not immediately obvious that they succeeded, at least prior to this judgment. A contract may grant benefits to individuals who are not parties to it; those individuals do not thereby become parties and usually may not sue on their own behalf to receive those benefits. As to the "obligations" of Blagdon and Dimmell, in the reproduced portions of the "Letter Agreement", these are *explicitly described* as obligations of Ming Minerals and not of the two men.³⁴⁶ These obligations may not have been within the power of the corporation,³⁴⁷ and a "reasonable man" standard of contractual interpretation might have read these clauses to bind the shareholders if they were already parties to the contract. Normally, however, the "reasonable man" standard would not be able to rope in additional parties just because they were needed to give effect to a contract's terms. While the circumstances of the negotiations apparently helped lead to a conclusion of agency, it seems possible that the close relationship of the corporation and its two shareholders/directors helped, in essence causing the judge to lift the corporate veil;³⁴⁸ if the parties had been at arm's length and there was no other reason to suggest an agency relationship, such terms would presumably have been found to either be ineffective, "good faith" requirements, conditions precedent, warranties, *et cetera*. Finally, the circularity of inferring additional parties from the phrase "all parties" is self-apparent.

Nonetheless, Mercer J. concluded that:

The negotiations leading to the Letter Agreement were carried out by Samuel Blagdon and Dimmell who were then the sole shareholders and directors of Minerals. The conferring of benefits and obligations upon Samuel Blagdon and Dimmell were fundamental to the implementation of the Letter Agreement. Accordingly I have concluded that Minerals, in executing the Letter Agreement acted not only on its own behalf but also as agent for Samuel Blagdon and Dimmell. The Letter Agreement was therefore an agreement between all the existing shareholders of Minerals and its potential new majority shareholder, Financial.³⁴⁹

According to this judgment, a unanimous shareholder agreement need not be signed by all

Dimmell's cooperation *qua* shareholders, a requirement that Blagdon and Dimmell enter employment contracts (relating to the two of them *qua* employees, not *qua* shareholders, but applying to them personally and not to the company nonetheless), an assurance that their shares would not be diluted, a right of Blagdon and Dimmell to acquire Financial shares, and a reference to "all parties" assisting in Financial obtaining regulatory approval.

³⁴⁶ *e.g.* in the quoted paragraph 8 of the "Letter Agreement", the phrase, "Ming Minerals shall immediately appoint two additional members to its Board of Directors[...]" reproduced at *Ming, supra* note 334, par. 7.

³⁴⁷ *e.g.* a corporation does not select its own directors.

³⁴⁸ In other words, the judge disregarded the distinction between the corporate entity and the individuals involved.

³⁴⁹ *Ming, supra* note 334, par. 21.

shareholders, provided that it claims to confer benefits and obligations on all of them and that they were part of the negotiations leading up to it. Particularly if this test can be applied to contracts entered with external parties, it makes the threshold for creating a unanimous shareholder agreement very low.³⁵⁰ This case might also demonstrate how that status can arise out of a contractual rather than a statutory analysis; starting from the premise that the document was a valid contract with a third party, the court found that its formation and contents gave rise to a conclusion that both shareholders were parties through an agent. Once they were found to be parties in that context, then it followed that the document was not just a contract with a third party but also a unanimous shareholder agreement. In order for this to follow, the phrase "all the shareholders" in the statute could not have been understood as a more stringent test than standard contractual interpretation rules.

The logic of this position was rejected in *Sedona Networks Corp. v. R.*³⁵¹ An unsuccessful argument was made that a non-shareholder's consent to an agreement could substitute for a related shareholder; in that case the signatory was a subsidiary and the necessary shareholder was a parent company. Archambault T.C.J. found that a management agreement that a corporation had entered into allowing a separate entity to exercise voting rights on shares the company owned was not a unanimous shareholder agreement *vis-a-vis* that corporation because its parent company (shareholder) was not a party to it,³⁵² had not itself created any written declaration regarding the management of the subsidiary,³⁵³ and had not even "at the very least intervened in the management agreement and made its intention clear"³⁵⁴ that it was restricting the power of the subsidiaries' directors.³⁵⁵

On appeal,³⁵⁶ it was argued that the management agreement was meant to bind the parent company and that the subsidiary had therefore signed it in part as an agent of the parent.³⁵⁷ Various terms of the document were identified in support of this proposition, which contained obligations on the parent toward the management company with which its subsidiary was contracting, including the requirement that a senior executive of the parent serve as a point of contact, the transfer of assets owned by the parent, the

³⁵⁰ See discussion of this point in the later section of this chapter on intent.

³⁵¹ *Sedona Networks Corp. v. R.*, 2006 TCC 80, 2006 CCI 80, [2006] 3 C.T.C. 2159, 2006 CarswellNat 573, 2006 CarswellNat 5692, 2006 D.T.C. 2486 (Eng.) (T.C.C. (G.P.) Mar 02, 2006) (hereinafter "*Sedona TCC*"). Both the trial and appeal also both addressed whether this management agreement restricted the directors, and those portions of the judgment are addressed later in this chapter. The case additionally mentioned an unrelated "shareholders agreement" of a different company that was also found not to be a unanimous shareholder agreement, because all the shareholders did not sign it and it did not restrict directors (par. 27).

³⁵² *Ibid*, par. 25.

³⁵³ *Ibid*, par. 25.

³⁵⁴ *Ibid*, par. 25.

³⁵⁵ *Ibid*, par. 25.

³⁵⁶ *Sedona Networks Corp. v. R.*, 2007 CAF 169, 2007 FCA 169, [2007] 3 C.T.C. 237, 362 N.R. 61, 2007 CarswellNat 991, 2007 CarswellNat 3671, 2007 D.T.C. 5359 (Eng.), 35 B.L.R. (4th) 283 (F.C.A. Apr 30, 2007) (hereinafter "*Sedona FCA*").

secondment of employees of the parent, and various other unspecified contractual obligations on the part of the parent.³⁵⁸ Based upon the type of logic employed in *Ming*, this would suggest that the document was intended to bind the parent as a party, and thus was a unanimous shareholder agreement. However, Malone J.A. determined instead that "[i]n my view, the Judge was correct to find that BMO [the parent company] is not a party to the Management Agreement. The items listed in paragraph 19 are simply provisions that enhanced Ventures' ability to perform its management function."³⁵⁹ Regardless of their purpose, these terms could only bind the parent company if it was a party to the agreement; the conclusion therefore only makes sense as a finding that these terms did *not* bind the parent, but merely represented options that the parent could take advantage of in order to enhance the benefit it was getting out of the management agreement.³⁶⁰

Whether *Ming* or *Sedona* is correct has significant implications for commercial transactions. *Sedona* appears to have the more viable approach, firstly because it would significantly complicate business contracts if they could be deemed unanimous shareholder agreements even when the shareholders had not all signed them, and secondly because it is more consistent with the current definition of a unanimous shareholder agreement. Alternatively, the law could evolve such that all business contracts became more binding upon corporations than has traditionally been the case, without the need for a strained finding of

³⁵⁷ Ibid, par. 18.

³⁵⁸ Ibid, par. 17.

³⁵⁹ Ibid, par. 19.

³⁶⁰ The implications of unanimous shareholder agreements which impose terms upon related companies were also discussed in *Cogismaq International inc. c. Lafontaine*, 2007 QCCS 1214, 2007 CarswellQue 2245, EYB 2007-117114 (C.S. Que. Mar 20, 2007). A company that was subject to a unanimous shareholder agreement had a subsidiary. The parent was explicitly a party to the agreement and of course bound by it (par. 12). The subsidiary was not, and the judge noted that arguably its omission was an indication that it was excluded (par. 54). While the document was not explicitly declared a unanimous shareholder agreement with regard to the subsidiary, which given its terms and the fact that its parent company was a party it arguably could have been (unless there were other shareholders), Moulin J.C.S. found that there were elements that suggested otherwise, including that it was a subsidiary, the human shareholders of the parent company ran the subsidiary, loss of shareholder status in the parent was related to loss of employment status with the subsidiary, and there was a relationship between price paid for shares in the parent and salary received from the subsidiary (par. 55). The judge therefore found that the involvement of the subsidiary in a dispute involving the sale of shares in the parent and related matters (par. 3) did not preclude the arbitration clause in the unanimous shareholder agreement from applying. This result may have been less a matter of binding the subsidiary to the agreement and more of a refusal to let the arbitration clause be subverted on a technicality, given that this was really a dispute among investors that should be covered by the procedure they had created (par. 56). It is debatable whether a unanimous shareholder agreement should be able to apply "downward" in a corporate hierarchy of wholly-owned subsidiaries. In such a situation, the "top" company would have the power, via unanimous shareholder agreement, to force its immediate subsidiaries to enter similar agreements, including forcing their subsidiaries *ad infinitum*. There is an artificiality to creating a multiplicity of documents in this manner, but it would clarify the situation should any of the subsidiaries subsequently have some or all of their shares purchased; if an agreement was in place respecting that specific subsidiary, the purchaser would learn of it and be deemed bound by it.

shareholder unanimity.

A similar issue arose in *Buttarazzi Estate v. Bertolo*.³⁶¹ Buttarazzi, Bertolo, and DiFlorio were the three shareholders of Con Steel until 1994, when DiFlorio transferred all of his shares to his wife; he remained an officer and a director of the corporation.³⁶² In 1996, the three men, but not the wife, signed a "shareholders agreement".³⁶³ Following Buttarazzi's subsequent death, his executors objected to various actions taken by the corporation and the other two men as oppressive.³⁶⁴ The respondents claimed that the "shareholders agreement" authorized their actions.³⁶⁵ The obvious flaw in that claim was that the "shareholders agreement" in question was not signed by all of the shareholders at the time. Sachs J. held that it was not a unanimous shareholder agreement and therefore could not be binding under the circumstances.

The respondents argued that the agreement was binding on two grounds. First, that it did not matter whether the husband or the wife had signed it, as they were spouses and Buttarazzi (from whom the plaintiff's interests derived) had consented to the transfer.³⁶⁶ Sachs J. held that, since a husband and wife are not indivisible in the eyes of the law, but are separate individuals, the husband was not a shareholder and the wife was.³⁶⁷ The judge was obviously correct that the spouses were separate people and should not be equated, but given the facts and the relationship between the two, it would have been easy to uphold the agreement on the basis of agency or trust.

The respondents also argued that Buttarazzi had signed the document, and therefore was bound by it even if not all other parties had signed it.³⁶⁸ Sachs J. rejected this approach as inapplicable to unanimous shareholder agreements, which by statute had to have the agreement of all shareholders;³⁶⁹ unlike the decision in *Ming*, she interpreted that requirement as superseding standard contract law. She further distinguished the present case by noting that, unlike in the authority presented to her, the respondents had not taken steps to carry out their duties under the contract.³⁷⁰ On appeal to the Ontario Superior Court of

³⁶¹ *Buttarazzi Estate v. Bertolo*, 2004 CarswellOnt 17, 40 B.L.R. (3d) 287, [2004] O.J. No. 20 (Ont. S.C.J. Jan 05, 2004) (hereinafter "*Buttarazzi Sup Ct J*").

³⁶² *Ibid*, pars. 1, 3.

³⁶³ *Ibid*, par. 6.

³⁶⁴ *Ibid*, par. 1.

³⁶⁵ *Ibid*, par. 4.

³⁶⁶ *Ibid*, par. 7.

³⁶⁷ *Ibid*, par. 8.

³⁶⁸ *Ibid*, par. 7.

³⁶⁹ *Ibid*, par. 9.

³⁷⁰ Finally, on an apparently only tangentially related point, Sachs J. noted that there was evidence that as late as 1998, after the three men had signed the contract, they were still negotiating terms for a shareholder agreement (*Buttarazzi Sup Ct J*, *supra* note 361, par. 10). It is possible that she meant that the parties understood that the original agreement had not been properly executed, but it appears just as plausible that she was ruling that the parties had repudiated the agreement. In either interpretation, the significance of this ongoing negotiation would seem redundant after the finding that the original agreement had not been signed by all of the shareholders.

Justice,³⁷¹ O'Driscoll J. upheld the judgment, confirming that the statute required that all shareholders sign a unanimous shareholder agreement.³⁷²

This case confirmed the necessity of "all the shareholders" agreeing; there is no latitude to substitute a related party in place of the actual shareholder. The husband was not the shareholder and the wife was. Accordingly, her agreement and not his was necessary. Significantly, the reasons for judgment did not contain any analysis as to whether the husband signed as agent for his wife or whether the wife held the shares in trust for her husband. If the former were the case, then the unanimous shareholder agreement should have been valid. If the latter, then an analysis similar to that in *Piikani*, discussed in a later subsection, would have been required to determine whether the agreement of the beneficial owner of shares suffices without the legal shareholders.

The wording of the legislation clearly requires that all the shareholders sign a unanimous shareholder agreement. These three cases call into question whether that requirement should hold even in the face of other factors, including the consent of a related party to the contract (who can possibly be deemed to have been an agent). It seems intuitively that it should; the eponymous quality of the unanimous shareholder agreement is difficult to disregard. None of these three judgments actually rule unanimity unnecessary, although *Ming* amounts to a *de facto* waiver.

While its fact pattern is unusual, *Kary Investment Corp. v. Tremblay*³⁷³ may also shed light on the substitution of related parties in satisfying the unanimity requirement, even though it dealt with a novation and not the initial formation of a unanimous shareholder agreement.³⁷⁴ The company at one point had two shareholders, who entered into a unanimous shareholder agreement.³⁷⁵ Five other people were subsequently invited to invest. A document, referred to as a "waiver and novation agreement", was prepared to be signed by the two existing shareholders and the five potential ones, listing the latter all in their individual capacities.³⁷⁶ The last person to sign, however, did so on behalf of his private holding

³⁷¹ *Buttarazzi Estate v. Bertolo*, 2005 CarswellOnt 2196, [2005] O.J. No. 2197, 6 B.L.R. (4th) 131 (Ont. Div. Ct. Jun 01, 2005) (hereinafter "*Buttarazzi Div Ct*"). O'Driscoll J. also made reference to the subsequent continued negotiation of the terms as a relevant factor (par. 2). As in the first judgment, the legal significance of this last element appears overstated given the other findings.

³⁷² *Ibid*, par. 2. Unlike *Buttarazzi Sup Ct J*, *supra* note 361, *Buttarazzi Div Ct* did not refer to the document as a unanimous shareholder agreement, but simply as a "shareholders' agreement". As a result, the literal meaning of the statement in *Buttarazzi Div Ct*, at par. 2, that "[t]he application judge found that there was no binding shareholders' agreement because one of the shareholders [...] had failed to sign the agreement" is imprecise at best.

³⁷³ *Kary Investment Corp. v. Tremblay*, 2004 ABQB 413, 2004 CarswellAlta 1364, 50 B.L.R. (3d) 116, [2005] A.W.L.D. 173 (Alta. Q.B. Jun 03, 2004) (hereinafter "*Kary QB*").

³⁷⁴ Cases dealing with amendments to unanimous shareholder agreements and the specific issues they raise are largely dealt with in a later subsection, but given the facts of this case and that the analysis did not emphasize any distinction between this novation and the initial formation of a unanimous shareholder agreement, it is appropriate to deal with it here.

³⁷⁵ *Kary QB*, *supra* note 373, par. 3.

³⁷⁶ The summary of the "waiver and novation agreement" in the judgment outlines its contents thus at

company. Subsequently, both he and another of the five (who had signed in his personal capacity) subscribed for shares through their personal corporations. Additionally, the spouse of one of the other signatories subscribed rather than the signatory himself. The remaining two apparently subscribed themselves. Finally, while the original two were still the only registered shareholders, but after five subscriptions had been received, one of the founders decided to exercise a put option.³⁷⁷ At issue was which parties were required to be notified of this put. At the time, no shares had been issued or registered for the new investors.³⁷⁸ One of the points under consideration was whether the other individuals were shareholders and thus had rights under the put option; Nation J. found that they did, as a matter of interpreting the second agreement, provided that they had signed that agreement and, in the same capacity as they had signed, advanced funds and signed the subscription agreement.³⁷⁹ It was left undecided whether those who had signed in one capacity but not yet advanced funds in the *same* capacity were shareholders.³⁸⁰

There is, obviously, no default requirement that anyone other than shareholders must agree to an amendment of a unanimous shareholder agreement.³⁸¹ At the time it was signed, the five new investors were definitely not shareholders, merely potential future shareholders. Since the agreement was signed by the only two individuals who actually were shareholders at the time, that would presumably suffice to amend the prior agreement, unless one proposes a doctrine that an amendment to a unanimous shareholder agreement that has been drafted to include parties other than all of the shareholders (as allowed by the *C.B.C.A.* and provincial and territorial acts) is not valid until all of the listed parties have executed it, including the non-shareholders. This was apparently the position of the plaintiffs, who argued that the second agreement was invalid because it had been an offer made to one person (the final new shareholder in his personal capacity), who had refused it, and that signing in his corporate capacity was in essence a counter-offer that the others had not accepted.³⁸²

Nation J. considered whether the substitution of one party for another was fatal to a contract and

Kary QB, *supra* note 373, par. 8: "[I]t references the USA; outlines the intention of parties for there to be new shareholders; waives rights that KIC and Tremblay would have under the USA in relation to the transaction; outlines that the new shareholders are required to acknowledge the existence of the USA; novates the new parties into the USA; and the new parties agree to be bound by it." Nation J. concluded that this agreement would amend the unanimous shareholder agreement if it was valid (par. 8) and that it was through this second document that the five new shareholders would become parties to the agreement (par. 9).

³⁷⁷ *Kary QB*, *supra* note 373, par. 5.

³⁷⁸ *Kary Investment Corp. v. Tremblay*, 2005 ABCA 273, 371 A.R. 339, 2005 CarswellAlta 1145, 354 W.A.C. 339, [2005] A.W.L.D. 3217, [2005] A.W.L.D. 3218, 55 Alta. L.R. (4th) 251, 8 B.L.R. (4th) 40 (Alta. C.A. Aug 26, 2005) (hereinafter "*Kary CA*"), par. 4.

³⁷⁹ *Kary QB*, *supra* note 373, par. 28.

³⁸⁰ *Ibid*, par. 29.

³⁸¹ A third party's consent to amendments could possibly be required by the unanimous shareholder agreement itself, but would not be presumed necessary by default.

found it to be a factual question, different in different situations.³⁸³ The original two shareholders gave evidence that they respectively did not care and did not consider whether the new shareholders were investing in a personal capacity or through a holding company.³⁸⁴ Nation J. determined that their concerns were that the new shareholders not overly dilute the interest of the originals, and that the manner in which they chose to invest was not a concern.³⁸⁵ Somewhat curiously, she added that no one except the investor in question and the solicitor even knew how he had signed and no subsequent inquiries were made;³⁸⁶ she apparently thought that this indicated that they were not concerned with the matter, rather than raising questions as to whether they might have been had they known. The original unanimous shareholder agreement, incorporated by reference into the new one, contained a term that "excluded out of the strict requirements of USA, any transaction between a shareholder and a limited corporation controlled by the shareholder. This indicates an acceptance that closely held corporations would not be strictly differentiated from those individuals who controlled them."³⁸⁷ Further, Nation J. found that as the involvement of the five new shareholders was as arm's length investors, unknown to each other, and not involved in the company's operations, it did not matter whether they participated in a corporate or individual capacity.³⁸⁸ She suggested that it might have been different if they had "roles" in the company's operations.³⁸⁹ Accordingly, she concluded that the agreement was validly executed by all parties. The judgment therefore did not consider whether the agreement might still have successfully amended the unanimous shareholder agreement even absent every contemplated non-shareholder party, by virtue of the participation of all the then-shareholders.

On appeal, Russell J.A., writing for the Court, agreed that since the unanimous shareholder agreement itself allowed for the substitution of corporations for individuals,³⁹⁰ it was up to the appellants to provide evidence that it was of importance at the time the document was signed whether the signatories were personal or corporate.³⁹¹ In deciding which parties had become shareholders entitled to notice, Russell J.A. found that Nation J. had "implicitly considered each of them [the shareholders] had separately contracted under the WNA,"³⁹² rather than that there had been one collective (and uncompleted) contract as

³⁸² *Kary QB, supra* note 373, par. 10.

³⁸³ *Ibid*, pars. 14-16.

³⁸⁴ *Ibid*, par. 13.

³⁸⁵ *Ibid*, par. 13.

³⁸⁶ *Ibid*, par. 13.

³⁸⁷ *Ibid*, par. 18.

³⁸⁸ *Ibid*, par. 20.

³⁸⁹ *Ibid*, par. 19.

³⁹⁰ *Kary CA, supra* note 378, par. 30.

³⁹¹ *Ibid*, par. 31. Russell J.A. also confirmed Nation J.'s interpretation of the second agreement as requiring that notice be given at least to the three signatories who had subscribed in the same capacity as they had signed (par. 44).

³⁹² *Ibid*, par. 34.

submitted by the appellants,³⁹³ and that this was a decision to be made on the facts, which had been done appropriately.³⁹⁴ This position- that whether a unanimous shareholder agreement is conceptually a single multilateral agreement or a group of bilateral ones is determined on a case-by-case basis- is problematic. The statutory purpose of restricting directors cannot be realized unless all the equity investors are parties, and in such circumstances, there seems little point in a conceptual division of it. If not all the shareholders have given their consent, the directors cannot be restricted, and any other rights and responsibilities the document may grant as among the investors may not have been intended to be effective unless all of the shareholders were included. Having such a document bind the individual parties in a staggered fashion *if at all* as they respectively sign creates the potential for great mischief and confusion with little apparent benefit.

In a concurring judgment, Berger J.A. agreed that the importance of the exact identity of the signatories was a question of fact and that Nation J. had made a correct decision.³⁹⁵ This was accompanied by a wider point regarding unanimous shareholder agreements, with regard to the right to receive notice of the put: "[T]here is no requirement that a shareholder be a 'registered' shareholder in order to benefit from rights under a unanimous shareholders agreement."³⁹⁶ In support of this, Berger J.A. cited the Supreme Court of Canada decision *Gaby v. Federal Packaging & Partition Co.*,³⁹⁷ which held that an individual who had purchased and paid for shares but not yet been registered as a shareholder should be considered one with regard to any matter of substantive rights.³⁹⁸ Arguably, this suggests they might need to be parties to any new agreement that arises while they wait to receive their shares. This seems again to fall under the question of when "beneficial" shareholders must be parties to a unanimous shareholder agreement, discussed below.

Kary, dealing as it does with amending a unanimous shareholder agreement through a contract with prospective shareholders, and with much of its discussion centred on interpreting that contract rather than general principles, is of limited application to the general question of who must be a party to a unanimous shareholder agreement. That said, it does have some wider implications. Similar to the other cases discussed in this section, the judgment raises the question of whether a related party to a shareholder can sign a unanimous shareholder agreement and thereby bind the shareholder to it. Because of the unique situation, some of the substitutions actually caused the related party to become the shareholder instead, such that the statutory unanimity requirement would not have been an issue. However, the case also raised

³⁹³ Ibid, par. 35.

³⁹⁴ Ibid, par. 36.

³⁹⁵ Ibid, par. 57.

³⁹⁶ Ibid, par. 61.

³⁹⁷ *Gaby v. Federal Packaging & Partition Co.*, [1966] S.C.R. 527, 57 D.L.R. (2d) 1, 1966 CarswellOnt 60 (S.C.C. Apr 26, 1966).

³⁹⁸ *Kary* CA, *supra* note 378, par. 61.

the question of whether someone who owns shares in one capacity but signs in another capacity³⁹⁹ could still help create a unanimous shareholder agreement. Unfortunately, the uniqueness of the fact situation under review makes it difficult to draw any wider conclusions. If the basis of the unanimity requirement is consent, then such a signature should be sufficient; regardless of the capacity in which he signed, the individual had consented. If, on the other hand, the requirement rests in part upon the obligations and potential liabilities imposed upon shareholders,⁴⁰⁰ then a unanimous shareholder agreement could only be created if all parties signed (or are deemed to have signed) in the appropriate capacity as shareholders. That approach could be seen as an extension of the rule regarding transferees, who are deemed to be parties. In effect, if the instrument is a valid unanimous shareholder agreement, then by definition all shareholders are bound by the agreement, regardless of who the signing parties were.⁴⁰¹

Whether related parties can sign in place of a shareholder is, from one perspective, a contractual question. If the signatory had the authority to act as agent for the shareholder, then the contract was validly made with the principal, the investor. If not, then the shareholder was not a party to the contract. In the unusual circumstances of *Kary*, some of the unexpected signatories became both shareholders and principals to the contract themselves, but whether that was permissible was resolved through an analysis of what was acceptable to the other parties, a method also compatible with contract law.

All of this presupposes that unanimity amongst the shareholders is required. This is of course part of the statutory definition, so it is unsurprising that it is not casually waived by the courts. The cases

³⁹⁹ A situation that arose in *Ming*, *supra* note 334, although in that case the capacity in which it was signed was that of the very company that the agreement was meant to affect, which could not be a shareholder of itself.

⁴⁰⁰ Every unanimous shareholder agreement must impose an obligation upon shareholders by definition, since any restriction of directors imposes corresponding potential liability upon shareholders, however limited or unclear. Certain possible power configurations make determining the corresponding shift of responsibility especially opaque, a topic discussed in Chapter Five.

⁴⁰¹ *Kary* also suggested that, if a unanimous shareholder agreement is intended to be signed by non-shareholder parties, their agreement might be necessary for the instrument to take effect, and it could be insufficient for the shareholders alone to sign it. This is a departure from the normal rule, and it illustrates how the instrument is (or can be) at the same time both a corporate document and a contract amongst the parties. It is for that reason that everyone who is expected to sign must actually do so, even non-shareholders. This follows not from the document's corporate nature nor the statute, but from the contractual element. The expectation of some sort of consideration from these outside parties might be crucial to obtaining the participation of shareholders, whose own consent is implicitly dependent upon all expected parties being bound to the specified terms. The case also held that while an individual party's rights under a unanimous shareholder agreement might be contingent upon performance of personal obligations, a total failure by anyone to perform does not necessarily invalidate the agreement as amongst the others. Although this sensibly prevents any investor(s) from invalidating a unanimous shareholder agreement and disturbing the rights of others through a refusal to honour their own obligations, Russell J.A.'s view that this unanimous shareholder agreement consisted of multiple bilateral contracts is problematic, for reasons discussed regarding *White v. True North Springs Ltd.*, 205 Nfld. & P.E.I.R. 181, 2001 CarswellNfld 257, 615 A.P.R. 181, [2001] N.J. No. 266 (Nfld. T.D. Sep 28, 2001) (hereinafter "*White SC (TD) 1*") in a subsequent subsection.

discussed in this subsection, however, can also be understood, not as analyses of whether all the shareholders had become parties to the agreement, but as challenges to the actual need for strict compliance with the unanimity requirement.

Read that way, the result in *Ming* can be seen as a rejection of the criterion, but it is notable that even in that case, the non-signing shareholder had by his subsequent acts acknowledged the contract and the finding was one of agreement via agency. Similarly, in *Kary*, most of the substitutions occurred in such a manner that the person who became a shareholder was also a signatory, with the sole exception being an individual who signed in his personal capacity yet the ultimate shareholder was his holding corporation; it may have been reasonable to infer that there was no issue of the latter not consenting. At most, one can perhaps find a judicial willingness to sometimes look past technical compliance so long as all of the shareholders have consented to the agreement; arguably, that speaks more to the "in writing" requirement than unanimity. The couple of other examples discussed reinforce that where the shareholders themselves are not explicitly parties to the agreement, their lack of direct participation can be fatal, even if terms of the document refer to them or they were merely "passive" investors and all the "active" ones had consented.

The substitution of related parties is not, in and of itself, a desirable reworking of the legal criterion. There is no overwhelming benefit and several possible drawbacks to generally allowing for one of these agreements to be formed if "all the shareholders (or some related party)" sign the document; to the extent that such an arrangement may be necessary or desirable, agency law principles already in effect would enable it where appropriate. But these cases allow us to see what happens in a situation where the statutory unanimity requirement has clearly not been met, yet where the judge has a remotely plausible excuse to pretend that it has. While it is foolish to draw strong conclusions from such limited data, it seems that the unanimity requirement still holds significant force in such circumstances, and that what flexibility exists applies only to deficits in technical signing-on-the-dotted-line compliance; all the shareholders must have agreed, at least in spirit.

5.(b)(ii) Beneficial Shareholders

In the preceding subsection, cases were analyzed where it was obvious that certain shareholders who would normally be expected to be parties to a unanimous shareholder agreement had not signed. The matter is sometimes more complicated. Among other ambiguities, the federal legislation did not clarify whether legal shareholders, beneficial shareholders, or both need to sign a unanimous shareholder agreement if there are multiple shareholders.⁴⁰² Oddly, however, the *C.B.C.A.* makes it clear that an

⁴⁰² A variant of this question, discussed by Smith, *supra* note 228, p. 306, is who must sign if shares have been sold to a non-shareholder, but the new owner has not yet been registered with the company and the old one continued to be. He concluded that all registered shareholders must be parties.

individual who is the "the beneficial owner of all the issued shares"⁴⁰³ can make a written declaration of the same effect as a unanimous shareholder agreement.

The "nexus of contracts" model of the corporation can be helpful in resolving this debate. Determining whether the legal or beneficial shareholders need to sign a unanimous shareholder agreement can be conceived of as asking which of the two was the actual party to the corporate "contract" in the first place. That suggests that the analysis must be fact-based, and that neither "legal owner" nor "beneficial" is always the correct answer.

This potential difficulty has not received much academic attention, although Hay and Smith did identify the issue and suggested that it would be prudent to have both legal and beneficial shareholders sign, to avoid any uncertainty.⁴⁰⁴ It has, however, been the source of litigation.⁴⁰⁵

In *Piikani Investment Corp. v. Piikani First Nation*,⁴⁰⁶ the Piikani First Nation received funds from Canada and Alberta subject to a Trust Agreement.⁴⁰⁷ The Nation and CIBC Trust Corporation signed this document.⁴⁰⁸ The Piikani Investment Company was subsequently incorporated pursuant to that Trust Agreement.⁴⁰⁹ As set out in the document, shares of the company were held by a shareholder-trustee, with the beneficiary being the Piikani First Nation.⁴¹⁰

McIntyre J. considered whether the Trust Agreement should be viewed as a unanimous shareholder agreement, and found that it was a lawful written document and that it restricted the directors' powers.⁴¹¹ As to whether the agreement was one among all of the shareholders, the judge described this as a "difficult" question,⁴¹² but since the shareholder-trustee was holding all of the shares for the Piikani First Nation, the latter was the beneficial owner, and under the *C.B.C.A.* was entitled to unilaterally make a

⁴⁰³ *C.B.C.A.* s. 146(2).

⁴⁰⁴ Hay and Smith, *supra* note 319, p. 445. They also recommend that a variety of non-shareholders sign, including spouses of investors and principals of shareholder corporations, simply to avoid potential issues (pp. 445-446). They further advised that the corporation itself sign, which they considered a prerequisite to imposing obligations upon it (p. 446); they apparently did not accept that a restriction on the directors who control the corporation to be a *de facto* restriction on it, or at least not an effective one.

⁴⁰⁵ In addition to the cases discussed in the main text of this subsection, in *Corp. immobilière Gleneagles de Montréal inc. c. Compagnie Montréal Trust*, 1996 CarswellQue 1747 (C.S. Que. Feb 01, 1996) (hereinafter "*Corp. immobilière*"), all of a corporation's shares were pledged as security for a loan (par. 5). After the debtor defaulted, the creditor took steps including creating a unanimous shareholder agreement (par.1). The debtor argued that it did not have the right to do so because it had not taken the proper legal steps to realize upon the security and was not a shareholder (par. 7). The creditor would have been able to exercise voting rights in such circumstances (pars. 8-12), and thus Lévesque J.C.S. upheld its ability to create a unanimous shareholder agreement as well (par. 13).

⁴⁰⁶ *Piikani*, *supra* note 234.

⁴⁰⁷ *Ibid*, par. 3.

⁴⁰⁸ *Ibid*, par. 4. Presumably some representative of the Piikani First Nation did the actual physical signing, but the judgment simply refers to the Nation having done so.

⁴⁰⁹ *Ibid*, par. 8.

⁴¹⁰ *Ibid*, par. 10.

⁴¹¹ *Ibid*, par. 24. Discussion of the restrictions on directors is in the next section of this chapter.

unanimous shareholder agreement.⁴¹³ The respondents argued that under section 146(1) of the *Act*, it was ambiguous whether the shareholders who needed to sign were the registered or beneficial owners, and if the latter, then the Trust Agreement did not meet the test, the registered shareholder-trustee not having signed.⁴¹⁴ No explanation was given as to why section 146(2) was not considered instead, as it would seem to have been on point, unless it was because this was not a unilateral declaration by the sole shareholder, as contemplated by section 146(2), but instead a contract with a third party. Regardless, McIntyre J. accepted that the Nation was the beneficial owner, ownership flowing through the shareholder-trustee, and the Nation was therefore entitled under s. 146 (no subsection specified) to enter into a unanimous shareholder agreement with a third party.⁴¹⁵ Notwithstanding his conclusion that it met all the statutory tests and qualified as a unanimous shareholder agreement, McIntyre J. preferred to analyze it using different language, for reasons relating to the "intent" criterion, discussed in a subsequent section.⁴¹⁶

Given the statutory allowance for sole beneficial owners to make unilateral declarations that have the status of unanimous shareholder agreements, this judgment appears sensible. If the presence of an additional party negated that ability, the result would be that the sole beneficial owner would have to sign two agreements, one with another party (presumably for some contractual benefit) and the other without (to achieve unanimous shareholder agreement status). That system might make sense if there were an "intent" requirement for unanimous shareholder agreements, but otherwise seems to be nothing but busywork. Worse, it allows canny sole beneficial owners to create documents that appear to be unanimous shareholder agreements while ensuring that they are not simply by adding other parties (including the corporation itself, whose participation would ironically create the illusion of greater certainty), while ignorant ones will be surprised by the same results.

What is unfortunate is that McIntyre J. did not specify under what heading of section 146 he found this agreement valid. If it was under subsection (2), the analysis in the preceding paragraph applies; a sole beneficial owner entitled to create a unanimous shareholder agreement by unilateral declaration is also able to have some other party sign that declaration without thereby preventing it from meeting the definition of a

⁴¹² Ibid, par. 25.

⁴¹³ Ibid, par. 26.

⁴¹⁴ Ibid, par. 25.

⁴¹⁵ Ibid, par. 26.

⁴¹⁶ Ibid, par. 27. A separate case dealing with the same document, *Nation v. Piikani Energy Corp.*, 2010 ABQB 352, 2010 CarswellAlta 1057, 196 A.C.W.S. (3d) 89, [2010] A.W.L.D. 4235, [2010] A.W.L.D. 4236, 73 B.L.R. (4th) 87 (Alta. Q.B. May 20, 2010), added to this that while it was a unanimous shareholder agreement with respect to Piikani Investment Company, it was *not* a unanimous shareholder agreement with respect to a wholly owned subsidiary, and therefore terms guaranteeing the former's independence from the Council did not apply to the latter (pars. 51-53, 61). The document did not place any restrictions on how companies in which the Piikani Investment Company invested were to be run (par. 52), and although that was not identified as the reason it was not a unanimous shareholder agreement with regard to the subsidiary, it would have sufficed. No factor is clearly identified as being the basis of the determination, leaving its logic ambiguous, albeit quite easily supportable.

unanimous shareholder agreement created under that subsection. However, since McIntyre J.'s analysis touched upon whether subsection (1) referred to registered or beneficial owners, it is possible that *that* was the question he was purporting to settle. If that is the case, then in a company with multiple shareholders, where some shares are held in trust, it is at least permissible for the beneficial owners to sign the agreement rather than the corresponding legal ones. Whether it is actually *mandatory* to involve the beneficial owners is equally unclear.

This approach is consistent with subsection (2), at least. If the beneficial owner of all of a company's shares is able to implement their will through a unanimous shareholder agreement without the participation of the registered shareholder, then it seems reasonable that a beneficial owner of *some* shares be allowed to work together with any other shareholders to do the same. One is, however, left wondering why the unanimous shareholder agreement should be an exception to the rules normally governing trust law.⁴¹⁷

Indeed, there are cases where the registered shareholder but not the beneficial shareholder was a signatory to the unanimous shareholder agreement, and the validity of these agreements was not questioned on that basis.⁴¹⁸ This is of course in line with the standard trust law approach. The result is possibly that *both* beneficial and legal owners could create separate unanimous shareholder agreements.

Which of the two subsections applies, and what the significance of that distinction might be, was considered more directly in *Colborne Capital Corp. v. 542775 Alberta Ltd.*,⁴¹⁹ albeit in the context of the *Alberta Act*. Virtue J. came to unusual conclusions about the unanimity requirement. In order to fully understand them, it is first necessary to review the facts in some detail. A corporation, referred to as "Group" in the judgment, owned all the shares of a subsidiary, referred to as "Petro".⁴²⁰ Thomas Pointer was an officer and director of Petro⁴²¹ who was instrumental in a reorganization of the corporate hierarchy that saw a new numbered company, "542", interposed between Group and Petro.⁴²² Group owned 100% of the shares of 542.⁴²³ The shares that Group owned in Petro were transferred to 542; the trial judgment

⁴¹⁷ It is not the only section in the *C.B.C.A.* to grant rights to beneficial owners. But the policy reasons for this specific provision's inclusion of them are unclear.

⁴¹⁸ For example, *Vaszi v. Ontario (Ministry of Labour)*, 2000 CarswellOnt 1748, [2000] O.E.S.A.D. No. 88 (Ont. E.S.B. (Adjud.) Mar 27, 2000) (hereinafter "*Vaszi*") stated explicitly that the legal owner of shares held in trust was a signatory but not the beneficial owner (par. 5).

⁴¹⁹ *Colborne Capital Corp. v. 542775 Alberta Ltd.*, [1995] 7 W.W.R. 671, 171 A.R. 241, 30 Alta. L.R. (3d) 127, 22 B.L.R. (2d) 226, 1995 CarswellAlta 194, [1995] A.W.L.D. 691 (Alta. Q.B. May 31, 1995) (hereinafter "*Colborne QB*").

⁴²⁰ *Ibid.*, par. 9.

⁴²¹ *Ibid.*, par. 37.

⁴²² *Ibid.*, par. 54.

⁴²³ Aside from a brief period immediately after its formation where Pointer and another individual owned 10% of the shares, which were quickly transferred to Group (*Colborne QB*, *supra* note 419, par. 54).

repeatedly said that 542 was to "hold Group's shares".⁴²⁴ The intention of Group was that the board of directors of 542 would mirror that of Petro, but Pointer set it up so that he was the sole director and president.⁴²⁵ Two other companies subsequently became interested in acquiring the shares of Petro. Group favoured one, Stampeder, and ultimately closed a deal with it.⁴²⁶ Pointer nonetheless took several steps to favour the other interested company, Colborne, including entering into a secret unanimous shareholder agreement.⁴²⁷ This agreement was executed by Pointer in his capacity as the sole director of 542, which was in turn the sole shareholder of Petro. Its terms included that Colborne's consent was necessary for Petro to consider any proposal (including the sale to Stampeder), that Colborne have the right to be represented on the board of Petro, and that the document was to remain secret.⁴²⁸

Virtue J. considered, among other issues, whether this unanimous shareholder agreement met the statutory definition.⁴²⁹ The relevant provision was s. 1(z) of the *A.B.C.A.*:

- (z) "unanimous shareholder agreement" means
- (i) a written agreement to which all the shareholders of a corporation are or are deemed to be parties, whether or not any other person is also a party, or
 - (ii) a written declaration by a person who is the beneficial owner of all the issued shares of a corporation,
- that provides for any of the matters enumerated in section 140(1).⁴³⁰

Much of his analysis depended upon the view that Group was the true shareholder of Petro. This was expressed most directly when, in first describing the alleged unanimous shareholder agreement, Virtue J. said, "The document is replete with conditions which purport to affect 'the shareholders of Petro' which, of course, was Group, the sole shareholder of 542."⁴³¹ This understanding, that Group was the sole shareholder of Petro, was repeated several times.⁴³² While portions of the judgment suggest that Group was somehow the shareholder of Petro outright, ultimately Virtue J.'s position was explained as being that while 542 was the *legal* owner, Group was the *beneficial* owner.⁴³³ "The shares of Petro were registered in the name of 542, and were beneficially owned by Group."⁴³⁴ On this basis, he wrote:

⁴²⁴ *Colborne* QB, *supra* note 419, pars. 52-54.

⁴²⁵ *Ibid*, par. 54.

⁴²⁶ *Ibid*, par. 221.

⁴²⁷ *Ibid*, pars. 206-208.

⁴²⁸ *Ibid*, par. 207.

⁴²⁹ *Ibid*, pars. 281-289.

⁴³⁰ Quoted *ibid*, par. 281.

⁴³¹ *Ibid*, par. 207.

⁴³² *Ibid*, pars. 245, 247.

⁴³³ The definition of "beneficial ownership" in the statute does not make it explicit whether a subsidiary corporation counts as a "trustee, agent, legal representative, or other intermediary" (*A.B.C.A.* s. 1(h); similar wording appear in *C.B.C.A.* s. 2(1)) by default (rather than on the facts) and therefore passes beneficial ownership to the parent corporation.

⁴³⁴ *Colborne* QB, *supra* note 419, par. 229.

I am of the view that subs. (ii), not subs. (i), was intended to control the situation where there is one beneficial owner of all the issued capital. I am led to this opinion by the use of the plural terms: "shareholders", "are", and "parties", which is inappropriate language if the subsection was intended to apply to a single shareholder.⁴³⁵

If it is on this distinction that this part of Virtue J.'s judgment rests, then the implications are as follows. If a corporation has only one legal and one (separate) beneficial owner of the shares, then it is only the latter who can make declarations that are unanimous shareholder agreements. However, since this point apparently turns upon which subsection applies, then if subsection (i) were operative by virtue of there being more than one beneficial owner, it would be the *legal* owners of the shares who would have the power to sign a unanimous shareholder agreement. Two anomalies immediately arise. If a corporation has only one registered owner but multiple beneficial ones,⁴³⁶ the logic of Virtue J. suggests that neither section could apply. Conversely, if a corporation has two (or more) registered shareholders but only one beneficial owner of the shares,⁴³⁷ then both sections would apply simultaneously, a result he apparently sought to avoid.

While Virtue J.'s conclusion may be a valid literal reading of the statute, it raises questions about the purpose of this division. Section 1(z)(ii) (and its equivalents, including *C.B.C.A.*, section 146(2)) was presumably enacted to allow sole shareholders to make declarations equivalent to unanimous shareholder agreements, in order to allow them access to the same tool they would be able to use if there were more than one shareholder. The alternative would be to either deny them this tool or force them to work around the limitation, *e.g.* by transferring some shares to trustees just to make agreements with them. But what is the significance of allowing *beneficial* owners to make declarations with the force of unanimous shareholder agreements, and why only if they are the sole shareholders? It seems pointless to allow a sole beneficial owner to make a declaration but prevent two beneficial co-owners from working together to do so. Conversely, reversing that situation for legal owners (who are not also beneficial owners) is just as inexplicable.

The utility of this tool for businesses could be impaired by this principle. In some multi-level corporate hierarchies, a corporation might be meant to be controlled by its immediate shareholder, not the company at the top of the structure.⁴³⁸ Virtue J.'s approach would deny them the ability to create such arrangements.

Assuming that 542 would normally have had the power to enter into a unanimous shareholder agreement with respect to Petro does not necessarily contradict Virtue J.'s conclusion that this was not a

⁴³⁵ Ibid, par. 284.

⁴³⁶ For example, one parent owning shares in trust for multiple children.

⁴³⁷ For example, two parents each owning 50% of the shares in trust for the same child.

⁴³⁸ For example, a foreign company with a Canadian subsidiary which in turn owns a number of local

valid declaration. The judge also found that Pointer did not legitimately occupy the position of sole director of 542, since its sole shareholder, Group, had ordered that its board mirror that of Petro.⁴³⁹ If he was not truly the sole director, he could not unilaterally cause 542 to enter into a unanimous shareholder agreement.

Further, Virtue J.'s general portrayal of Pointer and his actions was, to say the least, unflattering. For example, he wrote, "[T]he 542 [unanimous shareholder] agreement is unenforceable because, at best, it represents a sham transaction by which Grenon and Pointer sought to fraudulently impose legal obligations on 542 and Petro[...]"⁴⁴⁰ The *A.B.C.A.*, unlike the *C.B.C.A.*, does not make reference to unanimous shareholder agreements being required to be "otherwise lawful", and in any event, even the *C.B.C.A.* does not include that element in its definition when there is a sole (beneficial) shareholder. If one accepts Welling's view that this part of the statutory definition is redundant and would be assumed as a requirement regardless,⁴⁴¹ then this unanimous shareholder agreement is void not because the wrong people were parties to it, but because it was "a sham transaction" for "fraudulent" purposes.

That was essentially the approach taken by the Alberta Court of Appeal, when the case came before them.⁴⁴² The appellants argued that Virtue J.'s finding that the unanimous shareholder agreement was invalid was in error because 542 was "the legal and beneficial owner of Petroleum".⁴⁴³ The Court of Appeal did not directly address the trial judge's views on the corporate arrangement. They found that, under the circumstances, the corporate veil should be disregarded if necessary⁴⁴⁴ and that, even if they were to accept the appellants' arguments that the three companies should be viewed separately, liability would still attach to Pointer for breaching duties he owed to Petro and/or Group, regardless of any separate identity of 542.⁴⁴⁵ Unfortunately for those interested in the technical interpretive issues of unanimous shareholder agreements, the Court of Appeal had only this to say on the agreement's invalidity:

190 We are satisfied that the trial judge did not err in his conclusion that the conduct of Pointer, Grenon and Colborne was dishonest and deceitful. He was correct in dismissing the claims brought by GE against Petroleum, 542, Group, Stampeder and Ricinus. The documents on which those claims rested were correctly found to be the product of fraudulent conduct and therefore, void.

191 In the circumstances, it is not necessary to consider whether the trial judge was

subsidiaries might expect the top Canadian company to manage that wing of the empire.

⁴³⁹ *Colborne QB*, *supra* note 419, pars. 279-280.

⁴⁴⁰ *Ibid*, par. 288.

⁴⁴¹ See discussion earlier in this chapter.

⁴⁴² *Colborne Capital Corp. v. 542775 Alberta Ltd.*, 1999 ABCA 14, [1999] 8 W.W.R. 222, 228 A.R. 201, 69 Alta. L.R. (3d) 265, 45 B.L.R. (2d) 21, 1999 CarswellAlta 29, 188 W.A.C. 201, [1999] A.J. No. 33 (Alta. C.A. Jan 14, 1999) (hereinafter "*Colborne CA*").

⁴⁴³ *Ibid*, par. 102.

⁴⁴⁴ *Ibid*, par. 185.

⁴⁴⁵ *Ibid*, pars. 164-186.

correct in alternative interpretations leading to invalidation of any of the documents produced by Grenon and Pointer.

It therefore remains unclear whether the Court of Appeal would have endorsed Virtue J.'s interpretation of the distinction between the applicability of the two subsections.⁴⁴⁶

The current legislative provision is open to criticism for being at best needlessly ambiguous and at worst contradictory. That critique does not end the matter, as it leaves open the question of how to resolve this quandary. The best solution would be to distinguish situations where shares are held by an "intermediary" as that term is defined in the *C.B.C.A.*⁴⁴⁷ from other trust situations. The *Act* already recognizes that such an "intermediary" cannot exercise all the rights of a shareholder, and that in particular, the voting rights remain with the beneficial owner and cannot be exercised by the intermediary except with the beneficial owner's consent.⁴⁴⁸ I suggest that becoming a party to a unanimous shareholder agreement

⁴⁴⁶ Findings of fraud and oppression also complicate drawing any wider application from *American Reserve Energy Corp. v. McDorman*, 183 Nfld. & P.E.I.R. 40, 48 B.L.R. (2d) 167, 1999 CarswellNfld 178, 556 A.P.R. 40, [1999] N.J. No. 198 (Nfld. T.D. Jun 30, 1999) (hereinafter "*American Reserve*"). A secured creditor gave notice of default and exercised its rights to foreclose upon the corporation's stock, although the company did not accept this (pars. 18-22). Under the circumstances, Adams J. held that the creditor was the beneficial owner of the shares (par. 22). The (other/former) shareholders subsequently issued what the judge called a "unanimous shareholders' direction" (par. 113) to transfer the firm's principal asset to another corporation (par. 113), a transfer that was found to be a fraudulent conveyance (par. 78). Instead of focussing on the problems to unanimity that a beneficial shareholder's existence might pose, the judge instead noted that terms of their contract with the creditor were in effect whereby they could not vote their shares while in default, a limitation which the judgment implied also prevented the creation of a "unanimous shareholders' direction" (*i.e.* unanimous shareholder agreement) (pars. 113, 128). These investors argued that, at the time, there had not yet been a judicial ruling regarding the disputed issue of the foreclosure, and that until then, they could proceed as if they were still the only shareholders; the judge held that, while this was true, they also had to be prepared for the consequences of a contrary determination, and that their actions, if determined retroactively to be wrongful, could be considered oppression (par. 114). It is difficult to draw general conclusions from this about assessing the validity of a unanimous shareholder agreement; preventing fraud and oppression were likely more important factors than technical questions about the formation of this particular type of agreement. The same difficulty arises in the context of the director's liability for following it. The judge did not precisely articulate that the "unanimous shareholders' direction" upon which the director attempted to base a defence was fundamentally invalid for its failure to receive the approval of beneficial shareholders and therefore could not affect his power or remove his liability, but it was stated that given his knowledge at the time, the director "could have been under no illusion that his actions would be excused by [the creditor] as those of an officer/director of a company simply following the dictates of a unanimous shareholder's direction" (par. 181). Again, however, the judge found that the director did not act in good faith, was "self-serving", and "totally disregarded" the interest of a beneficial shareholder (par. 183); any rejection of the agreement/direction as a defence could be based upon those considerations rather than the necessity of satisfying the requirements of unanimous shareholder agreements. The appeal, *American Reserve Energy Corp. v. McDorman*, 2002 NFCA 57, 217 Nfld. & P.E.I.R. 7, 2002 CarswellNfld 263, 29 B.L.R. (3d) 161, 651 A.P.R. 7 (Nfld. C.A. Oct 02, 2002), upheld the general findings without explanation (par. 2) and dealt mainly with varying the quantum of damages awarded.

⁴⁴⁷ *C.B.C.A.* s. 147.

⁴⁴⁸ *C.B.C.A.* s. 153.

should be treated similarly to voting rights in such circumstances; the beneficial owner's agreement would be necessary, either directly or through explicit instructions to the intermediary. This would be true whether there was one or multiple shareholders.

Conversely, where the legal shareholder is not the beneficial one but is also not a mere "intermediary" holding shares on another's behalf, then the legal shareholder should be the one whose consent to the agreement is required, again regardless of the number of shareholders. This would allow for classic trustees to manage the trust property and also enable trust funds to become parties to unanimous shareholder agreements.⁴⁴⁹

Although the concept of an "intermediary" is already found in the statute, this suggestion also has much in common with a contractual understanding of the corporation, albeit one that must take a nuanced approach to determining whom the relevant contracting parties are. Where an "intermediary" is the legal shareholder, that person has much in common with an agent, who purchases, sells, and exercises rights on behalf of a principal; in contract law, it would be that principal, and not the agent, who was considered the party to the contract. Conversely, a true trustee actually would be a party to the corporate contract, much as any true trustee who purchases, sells, or otherwise deals with trust property is the contracting party, not the trust beneficiary.

5.(b)(iii) Share Classes

While there is some genuine ambiguity as to whether the relevant shareholders are the legal or beneficial ones or both, there is little that the owners of *all* shares, regardless of "share class", must consent to a unanimous shareholder agreement for it to take effect.⁴⁵⁰ An agreement amongst all the *voting* shareholders was found in *Simon v. Ramsay*⁴⁵¹ not to constitute a unanimous shareholder agreement because it did not include the holder of non-voting shares,⁴⁵² and therefore it could not restrict the directors.⁴⁵³ The justification for this determination was limited to a brief excerpt from an academic text⁴⁵⁴

⁴⁴⁹ Oddly, the current corporate statutes seem to classify all trustees as intermediaries.

⁴⁵⁰ *Q.B.C.A.* s. 213 is unusually explicit that non-voting shares are included, but since the other acts refer to "*all*" shareholders, to exclude some on the basis that they lacked voting rights would contravene the legislation regardless. An example of this rule being applied can be found in *9109-0068 Québec inc. c. Lambert*, 2010 QCCA 1662, 2010 CarswellQue 9604, EYB 2010-179320 (C.A. Que. Sep 15, 2010) (hereinafter "*9109 CA*"), where a unanimous shareholder agreement was invalid because, among other reasons, the holders of the preferred shares had not signed (par. 2).

⁴⁵¹ *Simon v. Ramsay*, 2003 CarswellQue 14619, EYB 2003-49465 (C.S. Que. Sep 16, 2003) (hereinafter "*Simon*").

⁴⁵² *Ibid.*, pars. 28-29.

⁴⁵³ *Ibid.*, par. 30.

⁴⁵⁴ Paul Martel and Luc Martel, *Les Conventions entre Actionnaires*, Eighth Edition (Montreal: Wilson & Lafleur, 2002), at p. 307.

that simply asserted that owners of non-voting shares must also be parties to the agreement.⁴⁵⁵

Another case to deal with the implications of multiple share classes was *White v. True North Springs Ltd.*,⁴⁵⁶ which raised the issue of whether separate agreements signed by each class of shareholders could collectively be considered a unanimous shareholder agreement assuming sufficient overlap in their terms. Such a situation is not necessarily limited to corporations with multiple share classes- multiple agreements could exist among the same share class, as in *Ekamant Canada Inc. c. R.*⁴⁵⁷ - but that seems one of the likelier places for it to arise, particularly since it is an obvious way to grant slightly different rights to the different classes, as here. A careful analysis of the case demonstrates, however, that this consolidation of separate documents only works if one focuses strictly on the statutorily-required unique function of the agreements, their restrictions upon directors, and becomes highly problematic if one takes into account their contractual aspects.

In *White*, the corporation in question had two classes of shares, Class A and Class B. Two documents, both purporting to be unanimous shareholder agreements, were signed, one by all of the Class A shareholders and the other by the then sole Class B shareholder, Kevin Bussey.⁴⁵⁸ Bussey was not one of the Class A shareholders who signed the Class A agreement.⁴⁵⁹ The purpose of the two share classes was a desire for the Class B shareholders to control the board of directors; they were entitled to elect three of the five, with the balance elected by Class A. It was intended that the founders would hold all of the Class B shares.⁴⁶⁰ For tax reasons, the two founders entered into a complicated transaction which, *inter alia*, granted the son of the other founder, French, the ability to acquire half the Class B shares held by Bussey.⁴⁶¹ The two founding shareholders subsequently had a falling out, and White, one of the Class A shareholders, purchased French's right to acquire half the Class B shares.⁴⁶² The remaining founding shareholder, Bussey, took the position that the two unanimous shareholder agreements were invalid.⁴⁶³

⁴⁵⁵ It has been argued that, because owners of non-voting shares must be parties to the agreement and under some statutes that automatically means they assume the directors' liabilities, it therefore follows that the legislation presumes they would be entitled to participate in the exercise of the transferred authority. See Robitaille, *supra* note 267, pp. 170-171; Ratti, *supra* note 16, p. 118.

⁴⁵⁶ *White SC (TD) 1*, *supra* note 401.

⁴⁵⁷ *Ekamant Canada Inc. c. R.*, 2009 TCC 408, 2009 CCI 408, 2009 CarswellNat 2412, 2009 CarswellNat 4379, 2009 D.T.C. 1271 (Fr.), 2010 D.T.C. 1039 (Eng.), 185 A.C.W.S. (3d) 793 (T.C.C. (G.P.) Aug 19, 2009) (hereinafter "*Ekamant*"). See note 483.

⁴⁵⁸ *White SC (TD) 1*, *supra* note 401, par. 17.

⁴⁵⁹ *White v. True North Springs Ltd.*, 2004 NLCA 29, 237 Nfld. & P.E.I.R. 42, 2004 CarswellNfld 134, 703 A.P.R. 42 (N.L. C.A. Apr 12, 2004) (hereinafter "*White CA*"), pars. 13-14.

⁴⁶⁰ *White SC (TD) 1*, *supra* note 401, par. 17.

⁴⁶¹ *Ibid*, par. 20.

⁴⁶² *Ibid*, par. 26.

⁴⁶³ Bussey's credibility was found wanting in a number of ways (*White SC (TD) 1*, *supra* note 401, pars. 69-76) and in a subsequent decision, the same judge found that his actions constituted oppression of White. (See *White v. True North Springs Ltd.*, 219 Nfld. & P.E.I.R. 1, 2002 CarswellNfld 298, 655 A.P.R. 1 (Nfld. T.D. Oct 28, 2002) (hereinafter "*White SC (TD) 2*").) This was theoretically irrelevant to

Specifically, he and his supporters argued that the creation of share classes through the agreements and the granting of specific board representation rights were ineffective.⁴⁶⁴ They sought to reorganize the corporation to have only one class of shares.

The basis of the allegation of invalidity was that there was not one unanimous shareholder agreement, but two, one for each class, neither of which had been signed by all the shareholders of the corporation.⁴⁶⁵ The opposing parties argued that the agreements differed in only a few substantial respects: each class received pre-emptive purchase rights only for shares of its own class, a different specific number of directors was promised to each class, the Class B pre-emptive purchase rights applied only if a shareholder was selling all of his shares, and Class B shareholders had "tag-along" rights on another shareholder's sale of Class B shares to a third party.⁴⁶⁶ Apart from these differences, the documents were "essentially identical".⁴⁶⁷

Hall J. considered the statutory requirements for a unanimous shareholder agreement under the Newfoundland *Corporations Act*, and found that:

[T]he principal concern of the section deals with a unanimous shareholders' agreement restricting in whole or in part the powers of the directors to manage the business and affairs of the corporation. The section provides that if an agreement amongst all of the shareholders is otherwise lawful and in writing, it can restrict the powers of the directors to manage the business and affairs of the corporation.⁴⁶⁸

Hall J. listed the various ways that these two agreements (assuming they were valid) limited the powers of directors.⁴⁶⁹ This provided the basis for his conclusion:

Assuming for the moment that these agreements are otherwise lawful written agreements, where there are two separate agreements and the Class A shareholders have not formally ratified the Class B unanimous shareholders' agreement and the Class B shareholders have not formally ratified the Class A shareholders' agreement, can these two agreements together constitute a unanimous shareholders' agreement under s. 245 of the *Corporations Act*? I am satisfied that they can. While it obviously would have been prudent to have had only one purported unanimous shareholders' agreement, it cannot be argued that the intent of these agreements was not to restrict the powers of directors in a uniform manner. The two agreements purport to do that uniformly. There are no differences in the manner in which each agreement purports to restrict the powers of directors. I am therefore satisfied that, if these agreements were otherwise lawful, they

establishing the agreements' validity, but given that judges sometimes prefer an equitable to a technical approach to that issue, such factors might have had an influence.

⁴⁶⁴ *White SC (TD) 1, supra note 401, pars. 30, 31.*

⁴⁶⁵ *Ibid*, par. 33.

⁴⁶⁶ *Ibid*, par. 33.

⁴⁶⁷ *Ibid*, par. 35.

⁴⁶⁸ *Ibid*, par. 37.

⁴⁶⁹ *Ibid*, par. 37.

can, read together, constitute a unanimous shareholders' agreement.⁴⁷⁰

He proceeded to note that he had the statutory power to amalgamate the two agreements into one unanimous shareholder agreement, but did not actually do so.⁴⁷¹ He undoubtedly had the power to accomplish that,⁴⁷² and given the facts before him, it might have been a perfectly appropriate move. What is less certain is the correctness of his decision that there existed a valid unanimous shareholder agreement without him ordering the creation of an amalgamated document. Also, while he referred in the above-quoted paragraph to the two classes not having "ratified" each other's documents, he had earlier noted that it was unclear whether the Class A shareholder had even *seen* the Class B agreement originally, which casts some additional doubt on the validity of the arrangement.⁴⁷³

A variety of other decisions were connected with this litigation, finally including a second judgment of the Court of Appeal that addressed the question of the two unanimous shareholder agreements.⁴⁷⁴ Rowe J.A. noted in this regard only that he found "no merit in the submissions of the Appellants".⁴⁷⁵ Despite this, he actually dismissed whatever objections were raised to the joining of the two unanimous shareholder agreements on "a different, albeit related, basis",⁴⁷⁶ namely that the appellants had consented to the share transfer through which White obtained his Class B shares and could not now object to it on the basis that some of the documents that led to it might have been invalid.⁴⁷⁷

According to the Supreme Court of Canada in *Duha*, even sections of a unanimous shareholder agreement that do not restrict directors are part of the agreement, so long as *some* restriction is present somewhere in it.⁴⁷⁸ Setting aside the merits of this approach, it presents a significant problem for Hall J.'s analysis, which was written post-*Duha*. Hall J.'s logic appears to be that the point of a unanimous shareholder agreement is for all the shareholders to unanimously agree upon a restriction of the directors' powers, and that between the two documents before him, they had done so. He therefore found a unanimous shareholder agreement was in place. However, he also implicitly imported into it the terms that differed between the two documents, most notably the number of directors that each class could appoint. These were terms that did *not* have explicit unanimous support of the shareholders,⁴⁷⁹ but were apparently granted status as if they did.

⁴⁷⁰ Ibid, par. 38.

⁴⁷¹ Ibid, pars. 39, 67.

⁴⁷² *N.L.C.A.*, s. 371(3)(c).

⁴⁷³ *White SC (TD) 1*, *supra* note 401, par. 35.

⁴⁷⁴ *White CA*, *supra* note 459.

⁴⁷⁵ Ibid, par. 62.

⁴⁷⁶ Ibid, par. 62.

⁴⁷⁷ Ibid, par. 63.

⁴⁷⁸ See discussion in the next section.

⁴⁷⁹ More accurately, since they were described as differences between the documents, these are terms for which there is a lack of written agreement demonstrating unanimous support.

Even if one accepts that, for example, the share transfer restrictions of each class are of concern only to owners of that class, it is obvious that the number of directors each class can elect concerns every other class and only has meaning in the context of what all the others have. Class A shareholders were allowed to elect two directors; whether Class B was allowed to elect one, two, or (as was the case) three directors completely changes the meaning of what Class A received, from a superior position to equality to inferiority.⁴⁸⁰

On this basis, then, Hall J.'s decision appears incorrect. Hypothetically, would it have been a problem if only the other differences were present? It is possible that members of a class of shareholders have an interest in matters that do not directly affect their own rights. Knowing that the Class B shareholders were receiving a "tag along" provision when other Class B shareholders sold their shares, for example, they might have insisted that the Class A shareholders receive one as well for sales of their own class. Indeed, one of the issues put before the court was whether the Class A shareholders should have had a pre-emptive right to purchase Class B shares (a right that the Class B shareholders had in their own agreement). Hall J. found that they did not have such a right, could not have been granted it by Bussey without French's permission, and that in any event, they had consented to the transfer of shares to White.⁴⁸¹ Any speculation about what difference it might have made had the Class A shareholders been aware at the time the documents were signed of the rights Class B shareholders had in their agreement obviously cannot be definitively addressed.

There is also the question of amending the documents. Neither agreement contained any provision preventing its members from amending it without obtaining the consent of the other class of shareholders.⁴⁸² If one class had amended its own agreement, would such amendments have been valid?⁴⁸³

The decision in *White* appears to ultimately rest upon the idea that the unanimity requirement was designed to protect the shareholders by ensuring that they had consented to the specified restructuring of corporate power, and that this criterion had been met in this case. That having been satisfied, the judge declined to void the agreement(s) for their possible technical non-compliance with the wording of the *Act*. In this regard, the case appears to have taken the opposite approach to *Couvre-Plancher*.⁴⁸⁴ The underlying assumption here was that the unanimous shareholder agreement fulfilled a narrow niche within the larger

⁴⁸⁰ If Class B had received zero or four or more directors, this would have further changed the meaning of Class A's two directors.

⁴⁸¹ *White* SC (TD) 1, *supra* note 401, par. 65.

⁴⁸² *Ibid*, par. 34.

⁴⁸³ The possibility of combining separate documents into one unanimous shareholder agreement was also considered briefly in *Ekamant*, *supra* note 457, although given that the documents in question did not involve all the shareholders as parties even if taken collectively and at least one contained no restrictions on the directors (being only an appointment of proxy by one shareholder to another) (par. 24), there was a surplus of reasons to reject the possibility that a unanimous shareholder agreement existed, as Archambault J. did (par. 24).

⁴⁸⁴ See discussion above.

legal structure, that of restricting directors, and that the criterion of unanimity was therefore only necessary for that purpose. Had the documents instead been conceived of as a renegotiation of the corporate arrangement, it would have been more important to ensure that the shareholders of every class were in accord on all matters. While the purposive approach in *White* is understandable and may have been fact-specific, if taken to its logical conclusion and applied generally, it would open the door to the aforementioned host of problems.

5.(c) Amendments

Amendments to unanimous shareholder agreements do not necessarily have to follow the unanimity rule that governs their formation. In some provinces and all territories, there is a statutory unanimity requirement for amendment.⁴⁸⁵ In Ontario, non-unanimous amendment is permitted by the legislation.⁴⁸⁶ In still other jurisdictions, including the *C.B.C.A.* itself, the situation is uncertain.⁴⁸⁷ The tension here is clearly between an assumptions derived from contract law, in which all parties to the "corporate contract" must consent to any changes, and a corporate law model, where majority (or super-majority) rule is normally sufficient to govern the company.

The Alberta Report recommended that, despite the fact that a partnership agreement could provide for lesser thresholds for amendment, once the shareholders had invoked "the principle of unanimity in relation to the ground rules under which they operate",⁴⁸⁸ they should be bound to that principle for all subsequent changes.⁴⁸⁹ It was successful in persuading that jurisdiction to require unanimity for amendments.

The Industry Canada Discussion Paper noted that allowing non-unanimous amendments arguably contradicted the (unstated) "philosophy"⁴⁹⁰ of unanimous shareholder agreements, but it did not elaborate on what actual issues this abandonment of the "philosophy" might raise, and instead noted that requiring unanimity for amendments could lead to inflexibility and require the oppression remedy to amend or terminate agreements that were being abused.⁴⁹¹ Dennis, responding to a working draft of the Industry Canada Discussion Paper, elaborated upon these arguments, stating that requiring unanimity for amendments is a means of protecting minority shareholders and their ability to participate in determining the decision-making structure of the corporation, although with the possible danger that this might be

⁴⁸⁵ *A.B.C.A.*, s. 146(8), *N.L.C.A.*, s. 245(9), *N.T.B.C.A.*, s. 148(8), *N.B.C.A.*, s. 148(8), *Y.B.C.A.*, s. 148(8).

⁴⁸⁶ *O.B.C.A.* 108(6)(a).

⁴⁸⁷ The issue is not addressed in the *C.B.C.A.*, *M.C.A.*, *N.B.B.C.A.*, *Q.B.C.A.*, and *S.B.C.A.*

⁴⁸⁸ Alberta Report, *supra* note 223, p. 26.

⁴⁸⁹ *Ibid.*, p. 26.

⁴⁹⁰ Industry Canada Discussion Paper, *supra* note 9, p. 52.

abused by a minority who found themselves benefiting to an oppressive or unfair degree from an agreement that they refused to allow to be amended.⁴⁹² Dennis apparently found the benefit more convincing than the drawback, as he included a unanimity requirement for amendment among his own recommendations for reform.⁴⁹³

The Ontario *Act* is the one that most clearly departs from a unanimity standard for amendment, as it allows a unanimous shareholder agreement to provide for non-unanimous amendment procedures. As Disney has noted, this could theoretically lead to extreme situations such as a single shareholder being able to unilaterally alter the agreement,⁴⁹⁴ and although he hypothesized that it would be rare for shareholders to agree to an amendment procedure that could exclude them, the Ontario approach is subject to criticism for "permit[ing] a 'tyranny of the majority' far more all-encompassing than would be permitted by the general scheme of the statute"⁴⁹⁵ which otherwise places limits on majority rule such as the directors' duties.⁴⁹⁶

Under some other statutes, such as the *C.B.C.A.*, the situation is simply uncertain, with the legislation itself being silent on the issue of amendment procedure. Disney asserted that while contract law generally requires unanimous amendment of a multi-party contract, there was no principle in law preventing a contract from providing otherwise;⁴⁹⁷ this view might be in error, since a contract as described could raise certainty of consideration problems that would affect its validity.⁴⁹⁸ Regardless, Disney balanced his understanding of contract law against the nature of the unanimous shareholder agreement, and noted that since the statute made unanimity a fundamental criterion of such documents, it could be seen as implicit that amendments would also need to be unanimous,⁴⁹⁹ or it could become "in substance, an agreement that purported to bind all the shareholders but to which they had not all agreed".⁵⁰⁰ Ewasiuk also warned that in many jurisdictions it was uncertain at best whether a term allowing for non-unanimous agreement would be valid, but since his concern was that as the number of shareholders increased, the ability to amend a unanimous shareholder agreement decreased, he suggested instead that this obstacle could be circumvented by having each shareholder appoint the same person (possibly the corporate president or the company itself) as their attorney for the purpose of consenting to amendments, conditional upon the amendments receiving some specified level of majority approval.⁵⁰¹ While this suggestion is

⁴⁹¹ Ibid, p. 52.

⁴⁹² Dennis, *supra* note 9, p. 132.

⁴⁹³ Ibid, p. 149.

⁴⁹⁴ Disney, *supra* note 9, p. 101.

⁴⁹⁵ Ibid, p. 102.

⁴⁹⁶ Ibid, p. 102.

⁴⁹⁷ Ibid, p. 101.

⁴⁹⁸ If a contract provided that all of its terms could be freely altered without the consent of one of the parties, then the consideration flowing to that party could be entirely removed.

⁴⁹⁹ Disney, *supra* note 9, p. 101.

⁵⁰⁰ Ibid, p. 101.

⁵⁰¹ Ricky W. Ewasiuk, *Drafting Shareholders' Agreements: A Guide* (Scarborough: Carswell, 1998) ,

ingenious, it completely ignores the problems of allowing majority approval of amendments, treating a unanimity requirement as an annoyance rather than a legitimate means of protecting all shareholder interests (or some other purpose). Martel too found the situation ambiguous, depending upon whether the amendment of unanimous shareholder agreements was governed by contract law⁵⁰² or whether these agreements were considered a unique exception that required unanimity to exist and therefore unanimity to amend, as doing so was equivalent to bringing a new agreement into effect;⁵⁰³ he preferred the latter interpretation, in order to protect minority interests.⁵⁰⁴ Although Ratti accepted Martel's argument that non-unanimous amendment was not legally permitted, he suggested that it would nonetheless be beneficial to have the agreement specify as much, in order to discourage (illegitimate) attempts to non-unanimously amend it and further protect minority shareholders.⁵⁰⁵

The confusing state of the law in this area can be illustrated by the contrast between *Consumer Impact Marketing Ltd. v. Shafie*⁵⁰⁶ and *Palumbo v. Research Capital Corp.*⁵⁰⁷ In *Consumer Impact*, the defendant, a former employee and shareholder, argued that the non-compete clause in his employment agreement superseded the broader one in the unanimous shareholder agreement he had earlier signed.⁵⁰⁸ Grace J. rejected this, saying, "The employment agreement was not intended to displace a multi-party agreement which dealt with wide ranging rights and obligations of the signatories in their capacity as shareholders, directors and officers of CIM."⁵⁰⁹

Similarly, in a motion in *Palumbo*, the plaintiff argued that his employment agreement, which contained a term that with regard to the employment relationship it took precedence over the unanimous shareholder agreement to which he was also a party, meant that he was not required to provide a release in the form required by the unanimous shareholder agreement in order to receive full compensation upon termination.⁵¹⁰ The issue was referred to trial;⁵¹¹ neither the trial⁵¹² nor the appeal⁵¹³ judgment mention this

at p. 17. (Discussion of unanimous shareholder agreements at pp. 11-18.)

⁵⁰² Specifically, given his focus upon Quebec, the civil law governing contracts.

⁵⁰³ Martel, *supra* note 11, pp. 35-36.

⁵⁰⁴ *Ibid.*, p. 36. He still held the same position in *Martel and Martel*, *supra* note 16, p. 374.

⁵⁰⁵ Ratti, *supra* note 16, pp. 128-129.

⁵⁰⁶ *Consumer Impact Marketing Ltd. v. Shafie*, 2010 ONSC 3257, 2010 CarswellOnt 3819, 189 A.C.W.S. (3d) 215, 71 B.L.R. (4th) 43 (Ont. S.C.J. Jun 07, 2010) (hereinafter "*Consumer Impact*").

⁵⁰⁷ *Palumbo v. Research Capital Corp.*, 50 C.C.E.L. (2d) 101, 2000 CarswellOnt 1238 (Ont. S.C.J. Apr 12, 2000) (hereinafter "*Palumbo Sup Ct J motion*").

⁵⁰⁸ *Consumer Impact*, *supra* note 506, par. 12.

⁵⁰⁹ *Ibid.*, par. 13. In addition to this broadly applicable determination, the specific facts supported the conclusion. The release the defendant had retained with regard to the employment agreement's non-compete clause had specifically excluded obligations under the unanimous shareholder agreement, a term that would have been rendered meaningless under the defendant's interpretation (par. 14).

⁵¹⁰ *Palumbo Sup Ct J motion*, *supra* note 507, pars. 6-7.

⁵¹¹ *Ibid.*, par. 10.

⁵¹² *Palumbo v. Research Capital Corp.*, 2002 CarswellOnt 4041, 2003 C.L.L.C. 210-023, [2002] O.J. No. 4475 (Ont. S.C.J. Nov 25, 2002) (hereinafter "*Palumbo Sup Ct J trial*"). Unlike *Palumbo Sup Ct J*

conflict between the agreements, and both applied the unanimous shareholder agreement.⁵¹⁴ In deciding the motion, Chapnik J. did not find anything amiss in the contention that a provision in an employment agreement granting it precedence over a unanimous shareholder agreement might be valid; while the terms in question did not relate to restricting the power of directors, and thus were more closely aligned with the "contractual" and not "corporate constitutional" aspect of these documents, the objection raised in *Consumer Impact* that a unanimous shareholder agreement is a multi-party one and thus not subject to renegotiation by two of the parties might still have merit on contract law grounds alone. Further, if one accepts the implication of *Duha* that the entirety of a unanimous shareholder agreement is part of the corporate constitution, not just the restrictions upon directors, then the idea that parts of it could be amended by the most directly affected parties without the consent of the others is yet more dubious. That said, while it might not be possible for a subset of the parties to amend the agreement, they could still potentially have the ability to grant releases regarding their personal claims against each other.

In some cases, however, amendment of a unanimous shareholder agreement clearly requires unanimity, if for no other reason than that the document in question specifies as much. While a technical distinction must still be maintained between contractually-required and statutorily-mandated unanimity, and some caution might be warranted with regard to the cross-applicability of precedents, one can nonetheless use these amendment cases to learn still more about how the courts view a unanimity requirement and what is required to satisfy it.

This is demonstrated by *Power v. Vitrak Systems Inc.*,⁵¹⁵ which illustrates that even shareholders with trivial holdings must be parties to an amendment if unanimity is required, and thus by extension that they must be parties to the original formation of the agreement.⁵¹⁶ In addition to this confirmation that a

motion, *supra* note 507, and *Palumbo v. Research Capital Corp.*, 72 O.R. (3d) 241, 190 O.A.C. 83, 2004 CarswellOnt 3572, 2005 C.L.L.C. 210-003, 35 C.C.E.L. (3d) 1, [2004] O.J. No. 3633 (Ont. C.A. Sep 07, 2004) (hereinafter "*Palumbo CA*"), both of which specifically identified the document as a unanimous shareholder agreement, *Palumbo Sup Ct J trial* refers to it only as a "Shareholders Agreement".

⁵¹³ *Palumbo CA*, *supra* note 512.

⁵¹⁴ *Palumbo Sup Ct J trial*, *supra* note 512, pars. 94-98 and *Palumbo CA*, *supra* note 512, pars. 44-49.

⁵¹⁵ *Power v. Vitrak Systems Inc.*, 258 Nfld. & P.E.I.R. 38, 2006 CarswellPEI 29, 779 A.P.R. 38, 2006 PESCTD 33, 150 A.C.W.S. (3d) 363, [2006] P.E.I.J. No. 36, 21 B.L.R. (4th) 103 (P.E.I. T.D. Jul 05, 2006) (hereinafter "*Power*").

⁵¹⁶ The company involved, Vitrak, had had a unanimous shareholder agreement among its original five investors; it was validly amended once, when an additional six people invested (*Power*, *supra* note 515, par. 3). At that point, one of the original shareholders held 62.80% of the shares, the other four original shareholders each held either 7.25% or 9.66%, and the six shareholders who were newly investing each held less than 1% of the shares (par. 55). The agreement itself provided that it could only be amended unanimously by the shareholders (par. 52). Among its provisions were restrictions on share transfers without the authorization of other shareholders and a right of first refusal (par. 52). Subsequently, a management consultant the company hired convinced the controlling shareholders to amend the agreement, for what ultimately turned out to be his own self-interested purposes. The consultant implemented what Campbell J. described as "a clear strategy and a well crafted plan to dilute Power's [the original controlling shareholder] shareholdings and influence within the company and acquire control for himself" (par. 23). In

literal unanimity requirement includes all shareholders, and not even an overwhelming majority suffices, the case is notable for the fact that the plaintiff, the then-majority shareholder, was one of the shareholders who actually *did* vote to pass the alleged amendments,⁵¹⁷ even though he subsequently questioned their validity.⁵¹⁸ Notwithstanding his participation in the very meeting in question, his right to assert it as a nullity apparently remained. Campbell J. ruled, "Neither the passage of time nor the continued improper or illegal acts of Lauer and/or others have the effect of quashing the rights of the shareholders to direct and manage the corporation as they set out in the USA, or, unless altered by the USA, as is set out in the *Act* or the by-laws of the corporation."⁵¹⁹ A lack of unanimity invalidated that which required unanimity, regardless of whether the one relying upon that lack was a participant. If this could be extended to a party to an alleged unanimous shareholder agreement challenging the very formation and validity of the document on the basis that it was not unanimous, it would again suggest that the purpose of the requirement extends beyond protecting the rights of shareholders who did not participate.

addition to the lawsuit under discussion here, he was eventually tried for criminal fraud for his actions and acquitted on appeal (see *R. v. Lauer*, 2009 CarswellPEI 72, [2009] P.E.I.J. No. 61 (P.E.I. T.D. Aug 06, 2009) (hereinafter "*Lauer SC (TD)*"), reversed by *R. v. Lauer*, 2011 PECA 5, 306 Nfld. & P.E.I.R. 289, 269 C.C.C. (3d) 127, 2011 CarswellPEI 9, 951 A.P.R. 289, [2011] P.E.I.J. No. 9 (P.E.I. C.A. Mar 09, 2011) (hereinafter "*Lauer CA*"). First, there was a purported transfer of nearly half of the majority shareholder's interest to a new party. This was accompanied by a purported amendment to the unanimous shareholder agreement, signed by at most the original five shareholders and not the six newer ones, to authorize this transfer (*Power*, *supra* note 515, par. 57). (The document presented in court only bore the signatures of three or four of the original shareholders, but there was oral evidence that the fifth had signed as well. The exact number was a moot point, since it was agreed that the additional six shareholders had not signed it.) Campbell J. simply found that "[w]ithout the 'unanimous written agreement' (Article 9.15) of the shareholders, no amendment is valid" (par. 57). The provisions governing share transfers were thus in effect, and as the six additional investors had not given consent nor declined their right of first refusal, the transfer itself was invalid under the unanimous shareholder agreement (par. 57). This reconfirms that the agreement of shareholders who collectively possess the vast majority of shares and who are all of the "active" investors is still insufficient to meet the definition of the word "unanimous". Although in this case, there was a clause confirming the requirement for amendment, the principle likely applies with at least as much force to the statutory criterion for creating one initially. Of course, this ruling was unknown at the time of the purported amendment, and the parties proceeded as if the transfer was legitimate. Subsequently, there was an even more radical attempt to rework the unanimous shareholder agreement. Although Campbell J. noted that "[n]o other agreements amending the USA were executed" (par. 58), the events which followed amounted to a *de facto* attempt, albeit a completely inadequate one. At a shareholders' meeting, various resolutions were passed to alter or terminate elements of the unanimous shareholder agreement (par. 61). Only four of the five original shareholders were notified of the meeting (and the notice was found to be inadequate (par. 65)); two attended, as did the "shareholder" under the transfer that was ultimately negated. At least one of the original shareholders and all six of the additional ones did not get notice (par. 62). Campbell J. found that the shareholders' meeting as a whole was a nullity, for failing to give proper notice to all shareholders (par. 66). He noted in passing that one of the purposes of the meeting was to amend the unanimous shareholder agreement, which would require consent of all the shareholders (par. 66), but he did not specifically belabour the point that, no unanimity having been achieved, the agreement could not have been altered even if the meeting had otherwise been properly held.

⁵¹⁷ *Power*, *supra* note 515, par. 61.

⁵¹⁸ *Ibid*, par. 40.

On the other hand, *Marque d'Or Inc. c. Clayman*⁵²⁰ took a looser approach to the amendment of unanimous shareholder agreements, albeit regarding non-compete clauses rather than terms restricting the directors. Despite objections that one of the shareholders had not consented to *de facto* amendments and that therefore they were ineffective under both the terms of that document itself and *C.B.C.A.* s. 140(2) (which was apparently assumed to require unanimity for amendment),⁵²¹ Gonthier J.C.S. concluded (for frankly dubious reasons⁵²²) that the shareholder had actually consented, and it was only an error on the part of the lawyers that had resulted in him not being a party to that particular document.⁵²³ It might therefore be appropriate to take this judgment as having waived the *writing* requirement in the context of amendments, rather than the need for unanimity.

The question also extends to whether non-shareholders who were parties must participate in the amendment, as the following two cases demonstrate. In *Gillespie v. Overs*,⁵²⁴ one shareholder unsuccessfully attempted to have the other sign a by-law which purported to alter arrangements specified in the pre-existing unanimous shareholder agreement.⁵²⁵ Sutherland J. considered whether such a by-law might have constituted an amendment to the unanimous shareholder agreement if signed by all shareholders,⁵²⁶ and the judge concluded that it would not have because the corporation itself had been a party to the original agreement and the corporation would not be a party to its own by-laws.⁵²⁷ While

⁵¹⁹ Ibid, par. 69.

⁵²⁰ *Marque d'Or Inc. c. Clayman*, [1988] R.J.Q. 706, 1988 CarswellQue 779, 21 C.P.R. (3d) 490 (C.S. Que. 1988) (hereinafter "*Marque d'Or*"). (The same judgment, with slightly different paragraph numbering, also appears at *Marque d'or inc. c. Clayman*, 1988 CarswellQue 898, J.E. 88-291, EYB 1988-77910 (C.S. Que. Jan 14, 1988).) A company based in Montreal had four investors (par. 4) who created a unanimous shareholder agreement with a non-compete clause covering Quebec (pars. 6-7). One of the shareholders (the defendant) left the company (par. 5) and along with two of the remaining ones formed another business to do the same work in Toronto (par. 6). This new company also had an agreement among its own shareholders with a non-compete clause covering Ontario, as well as a shotgun clause (par. 7). These three individuals then entered yet another agreement stating that if the shotgun clause was used within two years, all non-compete clauses were inapplicable (par. 7). This subsequently occurred, and the defendant was bought out (par. 8). At issue was whether he was still bound by the first corporation's non-compete clause covering Quebec.

⁵²¹ *Marque d'Or*, *supra* note 520, par. 15.

⁵²² The judge based this on the fact that the fourth shareholder had clearly accepted the departure of the other from the first corporation (*Marque d'Or*, *supra* note 520, par. 16). The logic connecting this to consent to amendment of the non-compete clause is tenuous at best, and becomes even more so when one considers that the contracts involved in the sale of his shares in that initial company *also* contained restrictive covenants covering Quebec (par. 12).

⁵²³ *Marque d'Or*, *supra* note 520, par. 16.

⁵²⁴ *Gillespie v. Overs*, 1987 CarswellOnt 3404, 5 A.C.W.S. (3d) 430, [1987] C.L.D. 1217, [1987] O.J. No. 747 (Ont. H.C. Aug 14, 1987) (hereinafter "*Gillespie*").

⁵²⁵ Ibid, par. 71.

⁵²⁶ See also the discussion of *Investissements Amiouny Inc. c. Placements A.A.A.H. Inc.*, 14 B.L.R. (2d) 161, 1993 CarswellQue 28, J.E. 93-1841, EYB 1993-84140 (C.S. Que. Nov 03, 1993) (hereinafter "*Investissements*") later this chapter.

⁵²⁷ *Gillespie*, *supra* note 524, par. 71.

obiter,⁵²⁸ this indicates that if non-shareholders are parties to a unanimous shareholder agreement, they must also be parties to an amendment. This makes sense from a contractual perspective, although not necessarily from one which views the unanimous shareholder agreement as nothing more than a statutory authorization for the shareholders to unanimously restrict the powers of the directors.

A loosely similar issue arose in *Papillon & Fils (J.C.) Ltée c. Gagnon*.⁵²⁹ The defendant had purchased (from existing shareholders) shares in the company that was the principal shareholder and managing company for the one where he worked,⁵³⁰ and he had confirmed that he was bound by the pre-existing unanimous shareholder agreement.⁵³¹ It contained a non-compete clause.⁵³² The defendant eventually sold his shares to four of the five other shareholders.⁵³³ The sale contract contained a term revoking all prior contracts among the parties, specifically including the unanimous shareholder agreement.⁵³⁴ The company then had a shareholder meeting where the sale was accepted and the revocation clause was repeated in writing, this time adding the final shareholder.⁵³⁵ All shareholders signed.⁵³⁶

The original unanimous shareholder agreement had included both the managing company and the operating company as intervenors, for the purpose of enforcing their rights under it⁵³⁷ and the non-compete clause specifically referred to them.⁵³⁸ Therefore, they argued, those companies could still have the benefit of the non-compete clause, never having waived it.⁵³⁹ Allard J. found that the parent company had waived the clause by virtue of the decisions made unanimously by its shareholders at the aforementioned meeting, where all of the original shareholders who had signed the agreement (plus one new one) had signed the revocation.⁵⁴⁰ The judge said that, in reading the document as a whole, it was clear that the intervenors had left it to the shareholders to modify the agreement.⁵⁴¹ The document stated that it would be terminated in

⁵²⁸ And possibly based on the terms of the document; the judge alluded to "a written agreement such as by the terms of the Agreement, is required if the Agreement is to be amended" (*Gillespie, supra* note 524, par. 71).

⁵²⁹ *Papillon & Fils (J.C.) ltee c. Gagnon*, 1989 CarswellQue 1669, J.E. 90-604, EYB 1989-79513 (C.S. Que. Nov 09, 1989) (hereinafter "*Papillon*").

⁵³⁰ *Ibid*, pars. 28-29.

⁵³¹ *Ibid*, par. 30. The document was a unanimous shareholder agreement and purported to restrict the directors (par. 31).

⁵³² *Ibid*, par. 32.

⁵³³ *Ibid*, par. 40.

⁵³⁴ *Ibid*, par. 41.

⁵³⁵ *Ibid*, par. 43.

⁵³⁶ *Ibid*, par. 44.

⁵³⁷ *Ibid*, par. 45.

⁵³⁸ *Ibid*, par. 46.

⁵³⁹ *Ibid*, par. 47.

⁵⁴⁰ *Ibid*, par. 48.

⁵⁴¹ *Ibid*, par. 50.

its entirety by the dissolution or bankruptcy of the company or the will of all the shareholders;⁵⁴² the text thus specifically allowed for the agreement to be terminated at the sole discretion of the shareholders, without the intervenors.⁵⁴³ Allard J. noted further that the agreement stated that it could be modified by the written consent of the "parties".⁵⁴⁴ With regard to that, the judge said, this being a unanimous shareholder agreement, it was understood that the term "parties" referred to the shareholders and not the companies that had been added as intervenors.⁵⁴⁵ Additionally, it was found to be relevant that, at the time the original agreement had been signed, the two companies had not intervened to create a right to enforce the non-compete clause against the defendant.⁵⁴⁶ (He had not then been a shareholder.) The non-compete clause had therefore been terminated.⁵⁴⁷ Unfortunately, the reasons for judgment contain some ambiguity as to whether it rests upon an interpretation of this document's terms, a general legal principle that the intervenors' consent was not required to amend a unanimous shareholder agreement, a determination that the intervenors actually had consented by proxy, or some combination of the above. While such a distinction was unimportant in this case, given that all of these factors were apparently present, in others it might be more relevant.

Some distinction exists between the unanimity requirement for the formation of unanimous shareholder agreements and its sometimes role in their amendment, but the latter situation can nonetheless shed light on the former. Specific interpretation of exactly how the criterion functions can likely be carried over, but more importantly, amendments provide a situation where the basic existence of the requirement can be questioned. To ask whether it should be possible to non-unanimously alter the control structure of a corporation by amending a unanimous shareholder agreement is, at heart, to ask why unanimity should ever be required to do so.⁵⁴⁸

If one views the corporation as a "contract" which all shareholders (and only shareholders) are parties to, then amending it requires the consent of all parties. Indeed, from this perspective, there would be no difference between creating and amending a unanimous shareholder agreement; both would

⁵⁴² Ibid, par. 51.

⁵⁴³ Ibid, par. 53.

⁵⁴⁴ Ibid, par. 54.

⁵⁴⁵ Ibid, par. 55.

⁵⁴⁶ Ibid, par. 49.

⁵⁴⁷ Ibid, par. 56.

⁵⁴⁸ In addition to provisions relating to control of the corporation, unanimous shareholder agreements can also contain clauses that govern other rights and obligations. Adding, subtracting, or altering such terms is outside the scope of corporate law principles and should obviously require unanimity, or at the very least the consent of all affected parties. See, for example, *Château St-François inc. c. 9087-5550 Québec inc.*, 2003 CarswellQue 1609, REJB 2003-44646, J.E. 2003-1639 (C.S. Que. June 12, 2003), where it was found that three quarters of the investors could not amend a unanimous shareholder agreement (generally described in the judgment as just a shareholder agreement, but referred to as a unanimous shareholder agreement at par. 42 in an extract reproduced from the pleadings) to add a non-compete clause and impose it upon the dissenting shareholders.

constitute revisions to the previously existing voluntary arrangement between the parties. That such a distinction is even conceivable represents a rejection of a strictly contractual understanding of the corporation. Conversely, accepting the tenets of that position requires that the unanimity requirement apply with equal force to amendments, unless the parties themselves have waived it (as they can in Ontario).

But if the corporation is instead viewed as a creation of statute, governed by rules designed to balance the interests of the shareholders (and perhaps even other parties) in a fair yet practical manner, in accordance with the will of the majority as tempered by legal protections for the minority, then non-unanimous amendment could be permissible... but so might the non-unanimous *creation* of an instrument to restrict directors' powers.⁵⁴⁹

5.(d) Summation

The very name of the unanimous shareholder agreement makes clear one of its fundamental criteria: all of the shareholders must be parties to it. This seemingly simple requirement hides a number of technical complications that the legislation fails to clearly address, some of which have been the subject of litigation. Lurking behind these practical problems, however, is the more fundamental question of why the unanimity requirement exists and what purpose it actually serves.

The position that the corporation can be represented as an extremely complex voluntary arrangement of individuals, a "nexus of contracts", would require the consent of all affected parties to any alteration of that structure; their consent is crucial to the hypothesis and cannot be imposed. The unanimous shareholder agreement clearly has commonalities with a version of this model, one that focuses upon the agreement of the equity investors as the sole relevant parties (to at least the governance aspects of the notional corporate contract). The unanimity requirement is, in such a framework, essential.

Yet the unanimity requirement is also problematic, because corporate law does not, as a rule, require it. The default power structure is controlled by representatives elected by majorities who in turn govern via majority rather than unanimity, subject to certain safeguards and duties; where shareholder direct participation is allowed or required by statute, it is again generally through majority or supermajority rule. The corporate framework set out in the legislation therefore stands in contrast to the "nexus of contracts" model, although can be rationalized with it by positing that there has been unanimous consent to this power arrangement.

Because the necessity for unanimity was included in the legislation with regard to this particular tool, the unanimous shareholder agreement's status as an incursion of "nexus of contracts" assumptions into the existing statutory model is on the one hand central; its basic criteria suggest a corporation that is a

⁵⁴⁹ This would obviously require amending the current wording of the statute(s), but such a change

contract amongst all the shareholders and requires all of their consent. But on the other hand, this also serves to subsequently disguise any conflict between the two models; enforcement of the unanimity rule becomes both adherence to the statute and in line with "nexus of contracts" axioms. Cases where the unanimity rule is simply not met do not garner much analysis; the situation is such that there would be no easy basis for judicial disagreement. The exception is circumstances where the unanimity rule is somehow rendered ambiguous: the substitution of related parties, legal versus beneficial shareholders, share classes with separate agreements, and amendments. These cases create an arena in which to ask the question of whose consent to a unanimous shareholder agreement is *really* required.

While the data remains limited, it is possible to cautiously draw the conclusion that even when judges have this sort of "cover" for waiving the unanimity requirement, they generally have no great appetite for doing so. That said, the (perceived) "spirit" of unanimity may sometimes overcome technical compliance issues, as *White, Kary, Piikani*, and *Ming* suggest. Where there is no clear indication of unanimity amongst the shareholders, however, there can be no unanimous shareholder agreement. It is seemingly inseparably bound to its eponymous criterion and to a conception of corporate power arising from the joint consent of *all* the shareholders.

6. "Restricts the Powers of the Directors"

6.(a) Scope of the Criterion

A unanimous shareholder agreement's ability to restrict the power of a corporation's directors⁵⁵⁰ is its unique feature. It is also, in the *C.B.C.A.* and some of the provinces,⁵⁵¹ the final criterion that the statute

would have theoretical justification.

⁵⁵⁰ Roger D. Wilson, in "Voting Agreements and Unanimous Shareholder Agreements" in *Shareholders and Shareholders Agreements: Edited Lectures from the Programme* (Toronto: Department of Continuing Education, The Law Society of Upper Canada, 1976) 61, at p. 67 queried whether one could restrict the liabilities of one director, since the statute refers to "directors". His answer was that the court would not allow unanimous shareholder agreements to be used to avoid justice, which sidesteps the interpretative question raised. Wilson appears to have been contemplating whether a unanimous shareholder agreement could restrict (and thus relieve) only one individual from amongst a larger group of directors. The legislation refers to "the power of the directors", and the definitive article (*the* directors) indicates a reference to the entire board collectively, so restricting the power of specific directors does not appear to have been contemplated or authorized. The power of the board collectively might nonetheless be restricted in a manner that altered the relative power of individual members, *e.g.* by requiring the assent of a director representing the minority shareholder before the board could perform certain acts. In the other situation where the pluralization of "directors" in the statute might be in issue, a corporation with only a single director, a unanimous shareholder agreement should still be effective; that lone individual wields "the power of the directors" until and unless restricted.

⁵⁵¹ See discussion earlier in this chapter.

sets out for a document to qualify as a unanimous shareholder agreement.⁵⁵² Only a unanimous shareholder agreement may restrict the power of the directors, but if the agreement *doesn't* contain such a restriction, it is merely a contract amongst all the shareholders.⁵⁵³ While the most obvious limitation on a non-unanimous shareholder agreement- that it cannot limit the directors- tautologically does not apply, there are other implications; it does not bind transferees, it is not a "constitutional" document with regard to determining *de jure* control, *et cetera*.

There has been debate in the literature, discussed further in Chapter Five, about whether the word "restricts" in the legislation refers only to a *negative* restriction, or if it can also include pre-made decisions and transfers of power.⁵⁵⁴ The case law, with a few isolated exceptions,⁵⁵⁵ seems to find all of them acceptable. What constitutes a "restriction" is not only the measure of what a unanimous shareholder agreement can accomplish,⁵⁵⁶ but also what terms meet the requirement of a (valid) limitation upon the

⁵⁵² Although *Duha* SCC, *supra* note 24, settled the necessity of a restriction, the opposite judicial view had found expression in the caselaw (*e.g. Duha Printers (Western) Ltd. v. R.*, [1996] 3 F.C. 78, 27 B.L.R. (2d) 89, [1996] 3 C.T.C. 19, 198 N.R. 359, 1996 CarswellNat 1458, 1996 CarswellNat 2573, 96 D.T.C. 6323, [1996] F.C.J. No. 738 (Fed. C.A. May 30, 1996) (hereinafter "*Duha* FCA"); *Investissements*, *supra* note 526). Martel, *supra* note 11, did not include it in his list of the *three* criteria of a unanimous shareholder agreement (p. 8), but he qualified that by noting that not all (written, lawful) agreements amongst all the shareholders are unanimous shareholder agreements. For example, a buy-sell agreement would not be. He wrote that the legislature meant an agreement that restricted the directors, and he went so far as to suggest that a better name for the tool would have reflected that purpose (p. 10). Such a name change would be necessary if the criteria for an instrument restricting the directors' powers were ever reduced from unanimity to majority (p. 11). In that regard, he was misinterpreted in *Investissements*, as discussed below. Daniel LaFortune, "La Convention D'Actionnaire" (2002) 36 R.J.T. n.s. 197, at pp. 212-213 also found it "l'oin d'etre evident" (my translation: "far from evident") that the provincial legislature had wanted restrictions upon the directors to be a requirement for the creation of a unanimous shareholder agreement.

⁵⁵³ Unlike a failure to meet the unanimity requirement, a lack of restriction upon the directors seems unlikely to invalidate whatever terms the document does include, assuming they were otherwise valid. It would simply be a contract amongst the investors, unless for some reason it failed to achieve even that legal status. Parties who had mistakenly believed that they were entering a unanimous shareholder agreement with all the attendant implications (*e.g.* that it would be binding upon transferees) might, once corrected, seek to have it nullified, but generally speaking, being wrong about the exact legal implications of a contract is not grounds to void it. The general rule that a would-be unanimous shareholder agreement that does not restrict directors is still an enforceable contract finds expression in *Landreville c. Chouinard*, [2000] J.Q. no 2411 (C.S. Que. Apr 17, 2000). A motion was brought to annul the acts of individuals who had recently been elected directors (par. 38) in violation of the quorum requirements in a unanimous shareholder agreement (pars. 7, 33). Although Dalphond J. specifically found that the document met all the criteria (including restricting the directors) and therefore was a unanimous shareholder agreement (pars. 7, 48), the judge said that even were that not the case, it would still constitute a binding pooling agreement, and it had still been violated (pars. 49-50).

⁵⁵⁴ Chapter Five also provides some recommendations for dealing with the various power configurations.

⁵⁵⁵ See the discussions of *9109-0068 Québec inc. c. Lambert*, 2008 CarswellQue 12469, J.E. 2009-44, EYB 2008-150855 (C.S. Que. Nov 10, 2008) (hereinafter "*9109* CS"); *9109 CA*, *supra* note 450; and *Couvre-Plancher*, *supra* note 324, in the section of this chapter on "Invalid Restrictions".

⁵⁵⁶ Discussed in greater detail in Chapter Five.

directors necessary to satisfy the statutory definition. It would create an absurdity if the exact same usage of the word "restricts" had a different meaning depending upon whether the issue was the *ability* to restrict or the *requirement* to restrict. From a prescriptive standpoint, rewording the statute to create such a separation between abilities and requirements⁵⁵⁷ has no apparent benefit.

The question of exactly what types of restrictions do meet that definition has received some attention in the case law, discussed below, although those judgments have not emphasized a contrast between negative restrictions and pre-made decisions, nor between restrictions and transfers. Generally speaking, all of these appear to be permissible, subject to some complications discussed in the next section.

The other issue upon which commentary has largely focussed is the existence of the criterion, or rather its exclusivity in some statutes, rather than precisely what types of restrictions are acceptable.⁵⁵⁸ The Alberta Report rejected the need to limit unanimous shareholder agreements to focussing upon restrictions on the directors, on the ground that shareholders might want to entrench other changes to the corporate structure, and that unanimous agreements amongst them might be the most appropriate means of doing so in some situations.⁵⁵⁹ It recommended a number of other possible topics that might be acceptable in place of, rather than in addition to, restrictions upon the directors: the regulation of shareholder rights among themselves, providing for the management of the corporation including restricting the powers of the directors, and any other provision contemplated in the *Act*.⁵⁶⁰ The explanation provided takes as a given that the corporate structure should be malleable and shareholders should be able to alter it: "Such an expansion would, we think, give the shareholders the maximum power to regulate their own affairs in accordance with the needs of the particular corporation, and by reason of other provisions of the *Act*, we do not think that the expansion would adversely affect third parties."⁵⁶¹ As discussed above, the legislation in Alberta and subsequently several additional jurisdictions followed this advice, although the *C.B.C.A.* and other provinces did not; notably, while the list of acceptable topics is broader than that in the *C.B.C.A.*, it is still not unlimited.

The Industry Canada Discussion Paper concluded, with minimal discussion, that "[f]rom a policy perspective, there do not appear to be strong reasons to prohibit shareholders from entrenching in a unanimous shareholder agreement 'any provision which they want to make about the internal affairs and organization of the corporation'".⁵⁶² Three articles by Dennis, Disney, and Scavone⁵⁶³ took strong

⁵⁵⁷ e.g. by making it explicit that a negative restriction was necessary to form a unanimous shareholder agreement, but then permitting pre-made decisions to be included as well once that criterion was met.

⁵⁵⁸ Some commentators have weighed in on the validity of various possible power structures. These views are discussed as part of the analysis of each arrangement in Chapter Five.

⁵⁵⁹ Alberta Report, *supra* note 223, p. 24.

⁵⁶⁰ *Ibid*, p. 25.

⁵⁶¹ *Ibid*, p. 25.

⁵⁶² Industry Canada Discussion Paper, *supra* note 9, p. 25, citing Alberta Report, *supra* note 223, p.

prescriptive stances for similarly widening the scope of unanimous shareholder agreements in the *C.B.C.A.*⁵⁶⁴ While the primary position being advocated was increased possible uses of the tool, including uses that may be currently impermissible, they as a corollary suggested that the agreements would no longer need to contain a restriction upon directors at all.

All three justified their position in part upon a perceived need to recognize and legitimize allegedly common existing practices in close corporations, which may operate in a manner that is informal (less charitably: illegal) and in contravention of various statutory requirements.⁵⁶⁵ I would suggest that the failure of companies to adhere to a given provision is not necessarily indicative that it serves no purpose. While the law must sometimes change in response to reality, non-compliance may indicate a problem with the non-compliers rather than with the law.

It is also telling that the unanimous shareholder agreement is advanced as the means whereby these anomalous business practices might be legitimized. There are doubtless provisions of the *Act* which

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⁵⁶³ Scavone had earlier co-authored another brief article recommending that the unanimous shareholder agreement be expanded to include more possible topics, similar to the options available in some American close corporations statutes. (See John Kazanjian and Robert Scavone, "Re-inventing Unanimous Shareholder Agreements" (March 1995) *International Corporate Law* 31.) His argument is significantly more developed in Scavone, *supra* note 9.

⁵⁶⁴ Although making a less forceful recommendation, a fourth author also suggested that the requirement that a unanimous shareholder agreement restrict the directors is flawed. In a case comment on *Sportscope Television Network Ltd. v. Shaw Communications Inc.*, 46 B.L.R. (2d) 87, 1999 CarswellOnt 630, 86 A.C.W.S. (3d) 527 (Ont. Gen. Div. (C.L.) Mar 10, 1999) (hereinafter "Sportscope"), Gray stated that this requirement (in the *O.B.C.A.*) was "anomalous" because the statute "contemplates a role for the U.S.A. that has nothing to do with whether the U.S.A. transfers board powers to shareholders". (Wayne D. Gray, "Creation and Termination of Unanimous Shareholder Agreements: *Sportscope Television Network Ltd. v. Shaw Communications Inc.*" (2001) 24 *Can. Bus. L. J.* 146, at p. 150) He listed a variety of specific items which various sections of the *O.B.C.A.* say a unanimous shareholder agreement may contain (these being separate from the elements it is defined as containing) (pp. 150-151). However, many of the items on the list could be considered forms of restricting directors' powers, although admittedly not all. Specifically, of the items listed on p. 150, the following could be so classified: increasing the proportion of votes of directors to effect action; restricting their power to issue shares; giving shareholders first refusal rights on new issuances; rules on the declaration of dividends; establishing board powers and duties; appointing officers and specifying their duties; fixing the remuneration of directors, officers, and employees; specifying information to be placed before shareholders; regulating borrowing powers; and stipulating events that would trigger a wind-up. By contrast, the following items are more difficult, if not impossible, to classify as restricting directors' powers: increasing the proportion of shareholder votes to effect action; restricting the transferability of shares; rules governing shareholders' meetings; amendment of the agreement itself; and arbitration. Gray wrote that it was unclear what effect, if any, a document governing these items would have if it failed to qualify as a unanimous shareholder agreement (p. 150-151). He argued that the courts have either ignored the requirement that a unanimous shareholder agreement restrict directors or have found it easily satisfied, and classified Blair J.'s ruling as of the latter type (p. 151). A point-by-point discussion of the case and Gray's critique of it is provided below.

⁵⁶⁵ Dennis, *supra* note 9, p. 117; Disney, *supra* note 9, p. 84; Scavone, *supra* note 9, p. 327; see also Industry Canada Discussion Paper, *supra* note 9, p. 8.

are unnecessary⁵⁶⁶ but it is not clear why any reform should be limited to close corporations⁵⁶⁷ or achieved through the expansion of unanimous shareholder agreements. If the legislation does contain a plethora of provisions that neither serve public policy nor protect third parties, then surely the redundant sections are best eliminated, rather than rendered subject to override by a unanimous shareholder agreement. Or, if the sections are not of such utility as to be mandatory but remain useful default arrangements, why reserve the power to override them to a unanimous shareholder agreement and not the articles, the by-laws, or even decisions of the board of directors? If the missing factor justifying these alleged vast swathes of semi-useless provisions (in the absence of a unanimous shareholder agreement) is minority protection, then is the unanimous enactment of an agreement sufficient to displace the policy goal of minority protection, including the protection of subsequent transferees?

The reason that these analysts have settled upon the unanimous shareholder agreement as the tool for their desired reforms is their belief that it is fundamentally associated with a contractual understanding of the corporation. Disney openly stated that the unanimous shareholder agreement has introduced "a shareholder-chosen contractual model of corporate governance formerly absent from Canadian law",⁵⁶⁸ and Scavone asserted that these documents are not merely a tool whereby shareholders might exert somewhat greater powers, but rather a radical shift in Canadian corporate law from a paradigm of statutory division of powers to contractual corporations.⁵⁶⁹

Accordingly, they suggested that a wider list of topics than just restricting directors should be present in the criteria for unanimous shareholder agreements, and that any provision in the corporate law statutes which does not affect third parties or public policy should be subject to variation through that same method.⁵⁷⁰ This would, of course, be a substantial shift in the law toward a contractual corporation, although the recognition of some legitimate concerns beyond the shareholders' self-interest prevents it from being a total embrace of the corporation as merely a complex private "contract" among the investors.

There are compelling arguments to be made that a restriction upon the powers of the directors is not the only possible arrangement amongst shareholders that would benefit from some degree of special statutory status that excluded it from the normal rules of contract law. For example, a right of first refusal on the sale of shares might be more useful if it automatically bound subsequent transferees who were not parties to the initial contract. But even if that is so, it does not follow that the unanimous shareholder agreement (as it currently exists) is the best or even an appropriate method to achieve such ends.

Dennis, Disney, and Scavone all endorsed a wide-ranging contractual model of the corporation,

⁵⁶⁶ Bearing in mind that some degree of predictability and uniformity amongst corporate structures may itself be a beneficial goal, even if the designated form is not inherently better than the alternatives.

⁵⁶⁷ See discussion above regarding the unanimity requirement.

⁵⁶⁸ Disney, *supra* note 9, p. 118.

⁵⁶⁹ Scavone, *supra* note 9, p. 333.

⁵⁷⁰ Dennis, *supra* note 9, p. 117 and 133; Disney, *supra* note 9, p. 95; Scavone, *supra* note 9, p. 337-

albeit one constrained by some legal safeguards. Despite its limited scope in the current legislation, each of them saw the unanimous shareholder agreement as a reflection of that approach, even as they advocated that it must be extensively overhauled in order to *truly* accomplish the goals they believed it should. There is a contradiction there. While the unanimous shareholder agreement allows for some alteration of corporate power, in its current form, that alteration occurs within limits. Even Alberta,⁵⁷¹ which presents additional options, is still only offering a tool to accomplish a few specified customizations of the corporation within a wider, largely set framework.

Strictly speaking, it would be possible to accomplish the aforementioned goals by altering the permissible scope of unanimous shareholder agreements, but leaving the necessary requirement unchanged. It is a mistake to conflate what unanimous shareholder agreements can accomplish with the criteria they must meet. All three authors not only wished to expand the permissible scope of the documents, but also to revise the criteria such that a contract amongst all the shareholders does not need to restrict the directors in order to qualify as a unanimous shareholder agreement. Assuming for the sake of argument that the more malleable corporation they envision is desirable and moreover that a unanimous shareholder agreement is the appropriate vehicle by which to accomplish that, it is not actually necessary to remove the criterion that the directors must be restricted. While such a term might be irrelevant in a contract primarily designed to achieve other ends, perhaps satisfied by a *pro forma* restriction unlikely to ever matter (*e.g.* "the directors may not authorize the borrowing of more than ten trillion dollars in debt financing"),⁵⁷² it could serve a useful function by signifying that the parties were deliberately choosing to enter into a unanimous shareholder agreement, not a mere agreement amongst all the shareholders.⁵⁷³

Dennis did not make such a distinction; he viewed the *C.B.C.A.* requirement that directors be restricted as "problematical, since it defines very narrowly the purpose and scope of a unanimous shareholder agreement. Shareholders may wish to vary other *C.B.C.A.* rules relating to internal governance in addition to or without altering the powers of the directors."⁵⁷⁴ This confuses "purpose and scope" with necessary criteria; while under the circumstances, some correlation may be inferred from what terms these agreements *must* include and their purpose, this utter conflation of the criteria with the purpose is not necessarily any more accurate than the assertion that the "purpose" of these documents is that they be in writing. Scavone was more cognizant of this potential difference between the criteria for these agreements and their purpose, although he suggested this may be a drafting error.⁵⁷⁵ Notwithstanding that, he accepted that at present the legislation has made restricting the directors into an actual requirement of a unanimous

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⁵⁷¹ And the other provinces and territories that use the same criteria as it.

⁵⁷² See Beauregard and Auger, *supra* note 16.

⁵⁷³ This is not to say that it is the only, or even best, method of signalling that. Explicit statements to that effect in the document would be more straightforward.

⁵⁷⁴ Dennis, *supra* note 9, p. 121.

shareholder agreement, and he was critical of a pair of judgments that suggested otherwise.⁵⁷⁶ Disney argued that that it was fruitless to allow the legal status of an agreement to be determined by whether it contained such a restriction⁵⁷⁷ and added the specific criticism that what constituted a restriction was debatable and could lead to uncertainty regarding whether a document constituted a unanimous shareholder agreement.⁵⁷⁸

It is therefore unsurprising that each of them offered a prescriptive suggestion for reform that dispensed with the requirement that a unanimous shareholder agreement restrict the directors.⁵⁷⁹ Dennis and Scavone suggested that a list be added to the legislation of permissible-and-sufficient topics for unanimous shareholder agreements, modelled respectively on the American close corporation statutes and the Alberta act,⁵⁸⁰ while Disney suggested instead a *negative* list of what topics cannot be changed,⁵⁸¹ although the view that it is easier to list those that *do* serve a purpose and cannot be contracted out of than those that do not is questionable.

Despite these general urgings toward a more expansive definition, Dennis explicitly rejected the idea that *every* agreement amongst all the shareholders, no matter the contents, be given the status of unanimous shareholder agreements, on the grounds that the uses for which they are "really intended"⁵⁸² were limited to "affect[ing] the internal governance of a close corporation in one or more ways and opt[ing] out of the procedural requirements of the *Act*".⁵⁸³ It is unclear how such a conclusion can be drawn from the existing legislation; it appears to be a prescriptive argument, based on his own view of the corporation and this tool's potential role in it.

Many of these suggested uses for the unanimous shareholder agreement are already possible. Even the Alberta variation with its four alternatives, which these authors endorse as superior to the federal requirement that the directors be restricted, arguably is more an expansion of the requirements for qualifying than of what the instrument itself can accomplish.⁵⁸⁴ Why then do they equate their desired role

⁵⁷⁵ Scavone, *supra* note 9, p. 336.

⁵⁷⁶ *Ibid.*, pp. 336-337. The cases mentioned were *Investissements*, *supra* note 526, and *Duha FCA*, *supra* note 552, discussed elsewhere in this chapter.

⁵⁷⁷ Disney, *supra* note 9, p. 105.

⁵⁷⁸ *Ibid.*, p. 105.

⁵⁷⁹ Ratti, *supra* note 16, p. 131, also generally recommended that the unanimous shareholder agreement provisions be amended to allow investors to manage companies in any way they wish, subject to not harming creditors or third parties.

⁵⁸⁰ Dennis, *supra* note 9, p. 117; Scavone, *supra* note 9, pp. 337-338.

⁵⁸¹ Disney, *supra* note 9, p. 98.

⁵⁸² Dennis, *supra* note 9, p. 122.

⁵⁸³ *Ibid.*, p. 122. His examples of contracts amongst all investors which would not necessarily be unanimous shareholder agreements include some obvious examples, such as shotgun clauses, but also include some that would restrict the directors, such as requiring majority shareholder approval for certain acts.

⁵⁸⁴ There does not appear to be reported case law dealing with this question. While the wording of the *A.B.C.A.* (and the provinces that followed its lead) may slightly expand the powers of unanimous

for the unanimous shareholder agreements with an alteration to the criteria for one's formation?

The reason that they argued for the removal of the requirement may be the confusion that has existed as to whether only *terms* that restricted directors were granted statutory status, with the other terms not subject to the special rules governing unanimous shareholder agreements. This question has received substantial attention in the literature, without consensus. Scavone considered the matter uncertain, but he noted that there are provisions in the *C.B.C.A.* that list other matters which may be dealt with in a unanimous shareholder agreement (and which do not themselves restrict the powers of directors), which in turn suggested to him that such agreements would be considered as a whole once they met the initial condition.⁵⁸⁵ Disney argued that any other clauses of such documents, including for example buy-sell agreements, would constitute part of the unanimous shareholder agreement but not bind transferees, which he describes as the "only sensible result"⁵⁸⁶ while noting that the *C.B.C.A.* is not explicit on this point. Ratti asserted the same conclusion.⁵⁸⁷ Martel took the position that under the *Q.C.A.* (as it then was) terms in a unanimous shareholder agreement unrelated to restricting directors would not bind transferees, although he considered the wording of the *C.B.C.A.* '74-'75 more expansive in that regard.⁵⁸⁸ Smith raised the concern that if a unanimous shareholder agreement contained terms that did not restrict the directors, not only would those items not bind transferees, but those terms or even the entire agreement might become ineffective with respect to *all* parties (even original signatories) in order to avoid that result.⁵⁸⁹ Ewasiuk discussed some of the problems that might arise if unanimous shareholder agreements are considered indivisible documents such that even the terms which do not restrict directors bind transferees (a result he did not necessarily find inevitable, merely possible⁵⁹⁰): some clauses may be of application to all shareholders and others to particular shareholders; some may relate to restrictions on directors' powers and others to shareholder issues unrelated to the directors; some may be of clear relevance to the shareholders *qua* shareholders and others may relate to them in some other capacity such as employees or lenders (or

shareholder agreements, it is arguable that all of the items specified could be achieved under the federal act, so long as a restriction upon directors was also present. It would depend upon how broadly the wordings of the first and third alternative were interpreted.

⁵⁸⁵ Scavone, *supra* note 9, p. 336.

⁵⁸⁶ Disney, *supra* note 9, p. 91.

⁵⁸⁷ Ratti, *supra* note 16, p. 125.

⁵⁸⁸ Martel, *supra* note 11, p. 37. He continued to hold that position when he co-wrote Martel and Martel, *supra* note 16, p. 380, wherein he described the two types of clauses as like apples and oranges and even went so far as to say that, when satisfying the statutory requirements to disclose the terms of a unanimous shareholder agreement, clauses other than limitations upon the directors could be redacted. In taking this position, he was careful to still assert that the presence of such additional terms did not in any way have a negative effect upon the efficacy of the restrictions.

⁵⁸⁹ Smith, *supra* note 228, p. 308-309. He therefore recommended placing those terms in a separate agreement.

⁵⁹⁰ Ewasiuk, *supra* note 501, p. 13.

even, though Ewasiuk does not go so far, capacities completely unrelated to the corporation).⁵⁹¹ In each case, the question arises as to whether a transferee is bound, be it to a clause that was specific to the shareholder-transferor and not to the shareholders generally, a clause that related to a matter other than the restriction of directors' powers, or a clause that applied to the original participants in a capacity other than shareholders.⁵⁹² And, in a parallel question, does a transferor escape those sorts of obligations?⁵⁹³

The Supreme Court of Canada decision in *Duha*, discussed in the next section, makes it clear that a unanimous shareholder agreement is a single unified whole, including terms that do not restrict directors. Aside from the technical complications Ewasiuk identified, this raises a more basic issue: why is it possible to grant the special status of a unanimous shareholder agreement to arbitrary contractual terms? Normally, it would not be possible to do so, and their inclusion in a document that also happens to include restrictions upon directors seems a poor reason to give special status to largely unrelated clauses. One justification might be that the other items could be the consideration for the restrictions, and to treat them differently might lead to unjust results, but it remains anomalous that terms which would normally be merely contractual are granted the special status that accompanies inclusion in a unanimous shareholder agreement. A more theoretically rigorous approach might have been to identify what specific terms both satisfy the criteria to qualify as unanimous shareholder agreements (or some similar status) and also to receive it, with all other terms being excluded.⁵⁹⁴ This would also avoid the technical complications that accompany the current state of the law, but it would require amendments to the legislation to remove references to unanimous shareholder agreements in sections covering unrelated aspects of corporate organization.

6.(b) Restriction Requirement Cases

6.(b)(i) *Duha Printers*

The last statutory requirement for a unanimous shareholder agreement to be valid under the *C.B.C.A.* is that it restricts in whole or in part the powers of directors. This necessity has been the subject of consideration by the Supreme Court of Canada, in their only major examination of the unanimous

⁵⁹¹ Ibid, p. 12.

⁵⁹² Ibid, pp. 12-13.

⁵⁹³ Ibid, p. 14.

⁵⁹⁴ See the discussion in the next subsection of *PriceWaterhouseCoopers Inc. c. R.*, 2012 TCC 120, 2012 CCI 120, [2013] 2 C.T.C. 2097, 2012 CarswellNat 1209, 2012 CarswellNat 5313, 2012 D.T.C. 1142 (Fr.), 2013 D.T.C. 1048 (Eng.), 223 A.C.W.S. (3d) 544 (T.C.C. (G.P.) Apr 12, 2012) (hereinafter "*PriceWaterhouse TCC*") and *PriceWaterhouseCoopers Inc. c. R.*, 2013 CAF 164, 2013 FCA 164, [2013] 6 C.T.C. 73, 449 N.R. 244, 2013 CarswellNat 2049, 2013 CarswellNat 3309, 2013 D.T.C. 5123 (Fr.), 2013 D.T.C. 5155 (Eng.) (F.C.A. Jun 21, 2013) (hereinafter "*PriceWaterhouse FCA*").

shareholder agreement, *Duha Printers (Western) Ltd. v. R.*⁵⁹⁵ They confirmed that it is a required element in order for a unanimous shareholder agreement to have statutory status, and they considered what might constitute such a restriction, as well as indirectly confirming that once that criterion had been met, the document as a whole was a unanimous shareholder agreement.

Before examining that decision, it is useful to review the lower level judgments that preceded it, first in the Tax Court of Canada,⁵⁹⁶ then at the Federal Court of Appeal.⁵⁹⁷ *Duha* concerned the question of who controlled, for tax purposes, a Manitoba *Act* company referred to as "Duha #2". If Marr's Leisure Holdings Inc. controlled it, then the tax losses of a different company which Marr's controlled could be applied to Duha #2 as a related company. If Marr's did not control Duha #2, then the losses could not be so transferred.⁵⁹⁸ Marr's owned the majority of the voting shares of Duha #2, but had entered into a unanimous shareholder agreement⁵⁹⁹ whereby the three directors of the corporation had to be selected from a list of four individuals: Emeric V. Duha and his wife Gwendolyn, William A. Marr (the majority shareholder of Marr's) and Paul S. Quinton, a friend of both Duha and Marr.⁶⁰⁰

At the trial level, Rip J.T.C.C. asserted that the agreement was not, in fact, a unanimous shareholder agreement. While he found that it was a valid legal contract amongst the shareholders,⁶⁰¹ it failed the statutory definition, since it did not restrict the powers of the directors.⁶⁰² In his view:

The agreement between the shareholders of Duha #2 and Duha #2 is not the unanimous shareholder agreement contemplated by the *Corporations Act* since it does not restrict one or more powers of the directors of Duha #2 in the management of its business and affairs. There are no provisions, for example, as there are in the agreement between the shareholders in *Alteco, infra*, in which the shareholders agreed to cause the corporation to do certain things that normally are within the powers of the directors to decide.⁶⁰³

The constating documents of the company, which in the judge's view excluded the agreement⁶⁰⁴ and consisted only of the articles and by-laws, did not limit the ability of the majority shareholder to control the election of the board of directors. Rip J.T.C.C. noted that even if he consulted the agreement, since Marr's could vote in both Marr himself and Quinton, who was viewed as a neutral party, Marr's could

⁵⁹⁵ *Duha SCC, supra* note 24.

⁵⁹⁶ *Duha Printers (Western) Ltd. v. R.*, [1995] 1 C.T.C. 2481, 1994 CarswellNat 1239, 95 D.T.C. 828, 51 A.C.W.S. (3d) 1381, [1994] T.C.J. No. 1140 (T.C.C. Dec 06, 1994) (hereinafter "*Duha TCC*").

⁵⁹⁷ *Duha FCA, supra* note 552.

⁵⁹⁸ *Duha TCC, supra* note 596, par. 4.

⁵⁹⁹ This term was disputed by Rip J.T.C.C., but the Supreme Court of Canada ultimately overruled him.

⁶⁰⁰ *Duha TCC, supra* note 596, par. 2.

⁶⁰¹ *Ibid*, par. 9.

⁶⁰² *Ibid*, par. 6.

⁶⁰³ *Ibid*, par. 9.

⁶⁰⁴ *Ibid*, par. 42.

control the board, or at least ensure that Duha did not.⁶⁰⁵ Accordingly, he ruled that Marr's was in control of Duha #2.

In *Alteco*, which will be discussed in greater detail below, the unanimous shareholder agreement mandated that the company would do various things, including obtaining specified financing, making certain banking arrangements, and entering a number of agreements. It also placed restrictions on new share issuances. The agreement was held to impose restrictions upon directors, but without any specific clauses providing the basis for this conclusion.⁶⁰⁶ Apparently, Rip J.T.C.C., in using the case as precedent, had inferred that the former elements were the basis of the decision.

As the Supreme Court of Canada would emphasize, the unanimous shareholder agreement in *Duha* also contained restrictions on share issuances.⁶⁰⁷ Rip J.T.C.C. either did not notice these restrictions or did not consider them to be restrictions upon the directors. While the point is not explicit, there is an implication that Rip J.T.C.C. considered the clearest evidence of restricting directors' powers to be a corresponding empowerment of shareholders. In *Duha* such empowerment, as located by the Supreme Court, was minimal; the written consent of shareholders was necessary for the directors to issue shares, allowing them a veto power.⁶⁰⁸ The shareholders did not take on any of the general powers of the directors nor did the agreement itself mandate that any actions be taken by the board. Looking to the empowerment of shareholders as evidence of a restriction on directors can be useful, but it should not replace looking for the restrictions themselves. Except insofar as the restriction is itself an example of shareholder decision-making, a unanimous shareholder agreement need neither make any specific decisions regarding the corporation's actions nor allocate to the shareholders such power in the future.

The Federal Court of Appeal overturned the trial decision. Linden J.T.C.C. delivered what was apparently the majority judgment; Isaac C.J. gave a brief concurring judgment endorsing Linden J.T.C.C.'s reasons, while Stone J.A. concurred for different reasons. According to the analysis of Linden J.T.C.C., Paul Quinton was a nominee of the Duha family, and therefore any combination of three directors elected from the possible four would leave the Duhas in control.⁶⁰⁹ Linden J.T.C.C. believed that, in coming to this conclusion, it made little difference whether the agreement was a unanimous shareholder agreement or not, as even without statutory status, an agreement amongst shareholders could determine control.⁶¹⁰ He nonetheless decided that it was, in fact, a unanimous shareholder agreement for two reasons:

I am, first, not convinced that that *Act* requires that a shareholders agreement restrict the

⁶⁰⁵ Ibid, par. 42.

⁶⁰⁶ *Alteco Inc. v. R.*, [1993] 2 C.T.C. 2087, 1993 CarswellNat 976, [1993] T.C.J. No. 213 (T.C.C. May 14, 1993) (hereinafter "*Alteco*"), par. 35.

⁶⁰⁷ *Duha SCC*, *supra* note 24, par. 79.

⁶⁰⁸ Ibid, par. 79.

⁶⁰⁹ *Duha FCA*, *supra* note 552, par. 71.

⁶¹⁰ Ibid, par. 76.

powers of directors in order to be a "unanimous shareholders agreement." No binding case law was put to me on this issue, and I do not read the subsection 140(2) as unambiguously requiring this.⁶¹¹

In the event that he was wrong, he added, with unfortunate vagueness:

I am not convinced that the agreement failed to restrict the powers of the directors. Certain of its provisions bound the directors directly, and others bound them indirectly by binding the company. This is, in my view, a sufficient restriction to meet the wording of subsection 140(2) of the *Corporations Act*.⁶¹²

With regard to his first point, the Manitoba *Corporations Act* section in question read:

140(2) An otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and a person who is not a shareholder, that restricts, in whole or in part, the powers of the directors to manage the business and affairs of the corporation is valid.⁶¹³

Technically, Linden J.T.C.C. is right that this section on its own does not create any requirements whatsoever for a unanimous shareholder agreement, merely declaring a certain type of agreement amongst all the shareholders to be valid. But the definition of "unanimous shareholder agreement" in section 1(1) explains it as an agreement of the type described in section 140(2).⁶¹⁴ Since the only type of agreement described in section 140(2) is one that restricts directors, it is difficult to see how such an element could be only "ambiguously" required, unless Linden J.T.C.C. considered the first and second halves of the sentence to be somehow separable.

Stone J.A., in his concurring judgment, went into a more lengthy analysis as to whether or not the agreement in question restricted the power of the directors.⁶¹⁵ The basis of his decision was that the agreement explicitly put the "affairs" of the corporation under the control of the directors; by omission, it removed the "business" of the corporation from their control.⁶¹⁶ Since directors normally have a statutory power over *both* the business and affairs of a corporation, that constituted a restriction.⁶¹⁷ This conclusion was bolstered in his view by the wording of the arbitration clause, which suggested that the shareholders (not directors) would resort to arbitration to settle differences regarding the business of the corporation.⁶¹⁸ The separate meaning of the "affairs" of the corporation, as opposed to its business, was in Stone J.A.'s

⁶¹¹ Ibid, par. 76.

⁶¹² Ibid, par. 76.

⁶¹³ Quoted *ibid*, par. 95.

⁶¹⁴ Or *M.C.A. s. 140(3)*, which concerns declarations by sole shareholders.

⁶¹⁵ *Duha FCA, supra* note 552, pars. 91-105.

⁶¹⁶ Ibid, par. 104.

⁶¹⁷ Ibid, par. 104.

⁶¹⁸ Ibid, par. 104.

view clear from the *M.C.A.*, where it was defined separately.⁶¹⁹ Based upon this reasoning, Stone J.A. found that Marr's did not control the corporation, because it had the power only to elect directors who would manage the affairs but not the business of it, which was not sufficient for control; the business of the company was to be controlled by the shareholders, and Stone J.A. found it implicit in the agreement that they were to do so by unanimous agreement and not by voting their shares, hence the need for an arbitration clause.⁶²⁰

Two objections might be made to Stone J.A.'s approach. The first is whether this division between "business" and "affairs" is plausible, notwithstanding the definitions in the statute. The second is whether shareholders, by specifically empowering directors in one area, are implicitly removing powers in others. It is not a standard assumption that the existence of a unanimous shareholder agreement removes all powers from the directors unless they are explicitly re-granted by the document. Generally, since the instrument specifies ways in which the corporation will deviate from default rules, it must explicitly remove powers the directors would otherwise have.⁶²¹ Only in a few situations would the granting of a certain power be implicitly a limitation on related ones. For example, a provision that "the directors may authorize the corporation to take out loans of one million dollars or less" might reasonably be read as eliminating the power to borrow greater amounts.⁶²² Whether a specific reference to "affairs" without "business" falls into this category is debatable; Stone J.A. concluded that it did, but the Supreme Court of Canada disagreed.

Iacobucci J. delivered the unanimous judgment of the Supreme Court. He stressed that in order to transfer the losses, the control of Duha #2 needed to be *de jure* and not *de facto*.⁶²³ He determined that a unanimous shareholder agreement was a constitutional document of the corporation and thus determined *de jure* control.⁶²⁴ Having so concluded, Iacobucci J. considered whether this particular unanimous shareholder agreement met the statutory requirements. He rejected Stone J.A.'s separation of the "business" and "affairs" as "difficult to accept"⁶²⁵ and ruled that clearer language would be needed for such an unusual result.⁶²⁶ He found that the reference to "business" in the arbitration clause referred only to that normally carried out by shareholders, not directors.⁶²⁷

He went on to write:

⁶¹⁹ Ibid, par. 103; *M.C.A.* s. 1(1).

⁶²⁰ *Duha FCA*, *supra* note 552, par. 106.

⁶²¹ If this were not the case, it would be significantly easier to find that a unanimous shareholder agreement restricted directors' powers; only if all the powers were re-granted would no such restriction exist.

⁶²² A more ambiguous example: granting a specific power to issue "non-voting shares" might be considered an implicit restriction on issuing voting shares.

⁶²³ *Duha SCC*, *supra* note 24, par. 35.

⁶²⁴ Ibid, pars. 57-73.

⁶²⁵ Ibid, par. 76.

⁶²⁶ Ibid, par. 76.

⁶²⁷ Ibid, par. 77.

Generally speaking, USAs exist to deal with major issues facing a corporation: corporate structure, issuance of shares, declaration of dividends, election of directors, appointment of officers, and the like. General business decisions are not ordinarily touched by such arrangements, and with good reason: it would not be efficient, for business purposes, to remit every decision, however minor, to a shareholder vote, let alone to require unanimous agreement among the shareholders on such decisions. Fundamental disagreements among shareholders are ordinarily dealt with by different means, such as, for example, buy-sell arrangements or other methods of dispute resolution. In exceptional cases, a USA may provide that an aggrieved shareholder may apply to the court for dissolution of the corporation and the return of his or her share capital. But these are long-term solutions which are agreed upon with a view to facilitating the ongoing operation of the business, undisturbed by the day-to-day wrangling and disagreements that often characterize the relationships among shareholders in closely-held companies, while permitting insurmountable disputes to be resolved by special measures. This is vastly different from requiring unanimous consent to every action taken in furtherance of the business of a corporation. Such an extraordinary corporate policy would require specific expression in the constating documents. In my view, the provisions cited by the Minister do not qualify as such.⁶²⁸

However, since the unanimous shareholder agreement required that written consent of all the shareholders was necessary before the directors could issue new shares, and since normally the directors would be free to do so at their discretion, he found that their powers had been restricted.⁶²⁹

Despite this document being a valid unanimous shareholder agreement, and despite his conclusion that it therefore determined *de jure* control, Iacobucci J. ruled that the actual terms of the agreement did not remove Marr's control, as it had the power to elect the board of directors and that board retained virtually its full powers.⁶³⁰

The Supreme Court of Canada thus established four important rules regarding the requirement that directors' powers be restricted. First, such a restriction *is* necessary under the *Manitoba Act*, and presumably under all similarly worded statutes. Second, so long as there is a restriction anywhere in the document, the whole thing has status as a statutory unanimous shareholder agreement, even provisions that have nothing to do with restricting directors' powers.⁶³¹ Third, a restriction on the issuance of new shares, and even more specifically a restriction only barring issues without written consent of the shareholders, is sufficient to qualify under that *Act*. Finally, a unanimous shareholder agreement that establishes a need for unanimous shareholder consent for every corporate decision (or a similar level of shareholder power) must do so explicitly; the courts should be hesitant to find provisions of that sort.

The first and second of these conclusions raise fundamental questions about what the unanimous

⁶²⁸ Ibid, par. 78.

⁶²⁹ Ibid, par. 79.

⁶³⁰ Ibid, pars. 83-84.

⁶³¹ This is implicit in the judgment's structure, rather than an explicit determination. See the discussion in the next subsection of *PriceWaterhouse TCC* and *PriceWaterhouse FCA*, both of which

shareholder agreement is and how it functions. Why should an agreement amongst all the shareholders whose sole provision was, for example, restricting the possible directors to a set list (as in *Duha*) fail to achieve statutory recognition, simply because it failed to include a completely unrelated provision requiring approval of share issuances? Conversely, why should the latter clause somehow elevate the former? While the decision of the Supreme Court of Canada was consistent with the statute, and allowed shareholders the maximum possible freedom in the circumstances as to what terms can fall under the ambit of a unanimous shareholder agreement, it might have been more logically consistent to hold that *only* terms which restricted directors would have the statutory status.⁶³² That, however, would have rendered nonsensical other sections of the *Act* that contemplate clauses in unanimous shareholder agreements for other purposes.⁶³³ This paradox is one of several that plague this tool. The possibility that a restriction upon directors serves a signalling function has some substance, but there are simpler means of accomplishing that goal.

Taken together, these two principles also present a contradictory picture as to whether the development of the unanimous shareholder agreement embodies a shift toward a contractual view of the corporation. On the one hand, by holding a restriction upon the directors as essential to the formation of this instrument (in some jurisdictions), the Supreme Court determined that there were statutory requirements that needed to be satisfied and that the written consent of all equity investors alone was not necessarily sufficient to alter the corporate structure. On the other, in ruling that all terms of the agreement were of equal status once that criterion was met, Iacobucci J. found that the ability of shareholders to collectively reconfigure aspects of the default corporation by agreement was not narrowly limited to restricting directors' power, but could extend beyond that. The former conclusion, however, could be viewed as simply an interpretation of relatively clear statutory language (although alternative readings of that section have been made); the latter, by contrast, being less clearly derived from the wording of the *Act*, might be more revealing as to whether the Supreme Court found it acceptable for the unanimous shareholder agreement to move Canadian corporations toward a contractual model.

Their third conclusion, in addition to providing an example of what might constitute a restriction on directors, has two general implications. First, the Court accepted that such a highly specific item, affecting only a single type of decision, was enough to qualify as a restriction. Second, this restriction was not in the form of an outright transfer of decision-making power to shareholders, even over this one area. The primary decision to issue shares still had to be made by the directors. It was the restriction, not the corresponding empowerment of shareholders, that was crucial. Treating the requirement in this manner

accepted this as the conclusion reached by the Supreme Court in *Duha*.

⁶³² See the discussion in the next subsection of this chapter.

⁶³³ For example, in the *C.B.C.A.*, section 6(3) allows for a unanimous shareholder agreement to set super-majority requirements for any shareholder decisions required under the *Act*. This is not a restriction of the directors.

simultaneously weakens any barrier it may pose to the formation of a unanimous shareholder agreement and grants investors greater freedom to customize the corporate power structure to their exact liking. While allowing for restrictions that only slightly curtail directors' powers means that the resultant corporations will stick closely to the statutorily-defined norm, it nonetheless suggests a comfort with the idea that shareholders have the ability to alter the board's authority as much or as little as they choose, that it is their right (not the statute's) to agree upon exactly what powers directors have.

The final point, that courts should be cautious in finding unanimous shareholder agreements have transferred power over routine decisions to shareholders, was one that has unfortunately been misinterpreted at times, as discussed below in the subsection on "invalid restrictions". While a careful reading of the judgment indicates that Iacobucci J. was again actually *empowering* shareholders to create unusual and precisely tailored reconfigurations of power within the corporation, provided they did so in a sufficiently clear manner that they overcame the presumption that this sort of arrangement was unlikely, subsequent decisions have misread the passage in order to disallow such deviations from the default structure.

The Supreme Court of Canada's decision in *Duha* is therefore consistent, in many ways, with the view that the unanimous shareholder agreement has moved Canadian corporate law a step closer to a contractual approach. It did not, however, abandon the statutory model. The judgment was clear that something more than just a contract amongst all the investors was needed; a unanimous shareholder agreement must meet requirements in the relevant legislation to be effective. And even though the judgment allowed all the document's terms to qualify for this enhanced status, it remains true that- although this was not directly addressed in the judgment- many aspects of corporate law are currently beyond the scope of these instruments to change. Nonetheless, within those parameters, the Supreme Court of Canada demonstrated comfort with the idea that an agreement amongst the shareholders has the ability to alter the corporation to better suit their desires.

6.(b)(ii) Alternatives to *Duha*

The conclusions, both explicit and implicit, reached by the Supreme Court of Canada in *Duha* are, aside from the statutory provisions themselves, the highest available authority on the nature of unanimous shareholder agreements. While they may be challenged on prescriptive grounds, those principles are, unless their merits are specifically being discussed, taken as a given throughout the rest of this dissertation. The subsections following this one, for example, takes it as axiomatic that a restriction is a required element.⁶³⁴ Given the isolated and contradictory nature of cases involving unanimous shareholder

⁶³⁴ Under some statutes; see discussion later in this chapter.

agreements (and, frankly, elements in their analysis that often invite question), one should be sceptical of the notion that any judgment has "settled" anything about them even in a purely doctrinal sense, let alone from the perspective of any other legal philosophy. That said, to ignore a Supreme Court of Canada precedent would render any further analysis at best overly abstract and at worst a form of "alternate history" of limited use to those interested in actual Canadian law.

There is nonetheless a utility to briefly examining alternative approaches; if sufficiently compelling, they may provide justification for reform, and if not, they will at least illuminate the current law through a contrast with the road not taken. Two cases in particular, one from before *Duha* and one from after, performed analyses of unanimous shareholder agreements that arrived at very different conclusions from the Supreme Court's. The first assumed a wider freedom on the part of shareholders to create contracts that had the status of unanimous shareholder agreements, without the need to include any particular type of term. The second, conversely, argued in favour of awarding that status only to those very terms. These two judgments thus present contrasts with *Duha* from either side, one granting even more freedom to investors to fundamentally affect corporations through contracts, the other preferring to limit contractual alterations to the corporation.

The one that came before *Duha* is *Investissements Amiouny Inc. c. Placements A.A.A.H. Inc.*,⁶³⁵ which determined that restrictions upon the directors were *not* an essential criterion of unanimous shareholder agreements. The issue was relevant because the company had passed a by-law requiring a 70% shareholder majority for the election of directors,⁶³⁶ but under the statute,⁶³⁷ this requirement could be included in a unanimous shareholder agreement, but not a by-law.⁶³⁸

The position that restrictions upon directors were necessary for a document to constitute a unanimous shareholder agreement was specifically considered- one of the parties pled it⁶³⁹- but Forget J.C.S. rejected it. Citing Martel,⁶⁴⁰ the judge held that the purposes of a unanimous shareholder agreement could include restrictions upon share transfers,⁶⁴¹ voting requirements,⁶⁴² and "fiduciary control",⁶⁴³ and that "[r]ien ne permet de croire qu'une convention unanime d'actionnaires doit en même temps restreindre les pouvoirs des directeurs pour être valide".⁶⁴⁴ The judge noted that the legislation specifically

⁶³⁵ *Investissements*, *supra* note 526.

⁶³⁶ *Ibid*, par. 14.

⁶³⁷ *C.B.C.A.* s. 6(3).

⁶³⁸ *Investissements*, *supra* note 526, par. 45.

⁶³⁹ *Ibid*, par. 59.

⁶⁴⁰ Specifically, citing at *Investissements*, *supra* note 526, par. 60 / fn 6: *La Compagnie au Québec, Vol. 1, Les aspects juridiques*, Éditions Wilson & Lafleur, p. 660. This citation did not specify edition, and I was unable to track down the exact reference.

⁶⁴¹ *Investissements*, *supra* note 526, par. 61.

⁶⁴² *Ibid*, par. 63.

⁶⁴³ *Ibid*, par. 64: "contrôle fiduciaire".

⁶⁴⁴ *Ibid*, par. 65. My translation: "Nothing permits me to believe that a unanimous shareholder

contemplated the use of unanimous shareholder agreements to change voting requirements.⁶⁴⁵ Forget J.C.S. held that, in the absence of clear legislative wording to the contrary- which was apparently found not to exist here- a unanimous shareholder agreement could set shareholder voting requirements without also restraining directors' powers.⁶⁴⁶

71 Il est sans doute possible de soutenir que les conventions d'actionnaires visent souvent à restreindre les pouvoirs des administrateurs, mais parfois elles poursuivent un but tout à fait différent, telles les restrictions sur le transfert des actions.

Citing again Martel,⁶⁴⁷ the judge determined that the *only* three requirements for a unanimous shareholder agreement were that it be written, lawful, and unanimous.⁶⁴⁸ (This was, in fact, a misreading of Martel's position in that article; although he only listed those three criteria at one point,⁶⁴⁹ he subsequently added that only agreements that met those criteria *and restricted the directors* were meant by the legislation to be considered unanimous shareholder agreements,⁶⁵⁰ describing such restrictions as their "but"⁶⁵¹ (goal).) Because the "by-law" in question met those criteria,⁶⁵² Forget J.C.S. found that it was a unanimous shareholder agreement.⁶⁵³

This decision has been the subject of a surprising amount of attention from commentators, all of it critical. Martel himself responded to it, at one point having mistakenly interpreted its finding to be that the "by-law" in question restricted the directors, such that he argued that that position was incorrect on the grounds that it could be revoked by the board, that by-laws generally do not restrict directors, and that the contents of this particular one specifically did not do so, with the result that it did not appear in any way to be a unanimous shareholder agreement.⁶⁵⁴ Later, Martel correctly stated that the case had simply rejected the restriction criterion, and thus was in conflict with *Duha*.⁶⁵⁵ Beauregard and Auger made his earlier

agreement must at the same time restrict the powers of the directors to be valid."

⁶⁴⁵ Ibid, par. 66, referring to *C.B.C.A.* s. 6(3).

⁶⁴⁶ *Investissements*, *supra* note 526, par. 72. My translation: "It is without doubt possible to argue that unanimous shareholder agreements frequently restrain the powers of the directors, but sometimes they are achieving a goal that is altogether different, like restricting share transfers."

⁶⁴⁷ Specifically, citing Martel, *supra* note 11.

⁶⁴⁸ *Investissements*, *supra* note 526, par. 67.

⁶⁴⁹ Martel, *supra* note 11, p. 8.

⁶⁵⁰ Ibid, p. 10.

⁶⁵¹ Ibid, p. 11.

⁶⁵² *Investissements*, *supra* note 526, par. 75-78.

⁶⁵³ This despite the fact that it was apparently not intended as such; see the discussion of "intent" as a requirement later in this chapter. Scavone, *supra* note 9, p. 336, critiqued this aspect of the judgment, saying, "It is difficult to see how the court could have characterized a by-law as an 'agreement' in the first place, much less a unanimous shareholder agreement[...]"

⁶⁵⁴ Maurice Martel and Paul Martel, *La Compagnie au Québec volume 1: Les Aspects Juridiques* (Ottawa: Wilson & Lafleur, 2007), at p. 27-9, par. 27-33: "[C]ette clause ne pouvait donc aucunement s'apparenter à une convention unanime."

⁶⁵⁵ Martel and Martel, *supra* note 16, p. 359 fn 9.

mistake, also interpreting the result as a finding that the "by-law" met the restriction requirement, and similarly criticized it because the directors can overturn by-laws and thus are never truly bound by them.⁶⁵⁶ To play devil's advocate, however, if this actually was a unanimous shareholder agreement, arguably it is the rules for amending those agreements that would apply, not the ones that normally govern by-laws. Scavone described the judgment as a "startling conclusion",⁶⁵⁷ blaming the decision on the judicial determination that the agreement was "valid", and arguing, "Of course, this misses the point, namely, that valid or not as a contract, an agreement that does not restrict the powers of the directors is not a unanimous shareholder agreement."⁶⁵⁸ That criticism presumably was invoking the statutory definition that specifically grants validity to agreements that restrict the directors (if they meet the criteria).

Is there, however, justification for the approach taken in *Investissements*, notwithstanding that the law subsequently followed a different path? There are sections in the legislation that contemplate unanimous shareholder agreements in contexts other than the restriction of directors, but simply because expanded uses of the agreements are being referred to does not necessarily mean that restrictions cannot be a necessary element, anymore than it means that being in writing or being unanimous are no longer required just because they are not repeated explicitly each time mention is made of this tool. It does, however, raise questions as to what the purpose is of having an arbitrary requirement to include an irrelevant term, not just as a prerequisite to allowing parties to apply these instruments for purposes which they themselves might invent, but which are specifically contemplated by the statutes.⁶⁵⁹ On the other hand, there would also be difficulties if any contract signed by all of the shareholders was treated as a unanimous shareholder agreement, binding subsequent transferees and possibly opening up corporate law remedies for enforcement.

This enigma also drove the decision in *PriceWaterhouseCoopers Inc. c. R.*⁶⁶⁰ which endorsed the opposite extreme, also in contrast to *Duha*, although the judge ultimately backed down and followed the Supreme Court's precedent. As in *Investissements*, Bedard J. in *PriceWaterhouse* stated in passing that while a unanimous shareholder agreement would normally need to restrict directors, it would also be valid if it did not do so but instead raised shareholder voting requirements as contemplated by the statute.⁶⁶¹ The bulk of the decision, though, concerned whether terms that did not individually meet *any* statutory criteria had the status of a unanimous shareholder agreement, or whether only the specific terms that met those

⁶⁵⁶ Beauregard and Auger, *supra* note 16.

⁶⁵⁷ Scavone, *supra* note 9, p. 336.

⁶⁵⁸ *Ibid*, p. 337.

⁶⁵⁹ Beauregard and Auger, *supra* note 16, queried whether a minor restriction, such as determining where the directors must hold their meetings, would satisfy the requirement. They suggested that when all the shareholders intended to create a contract that did not limit the directors, but wished it to have the status of a unanimous shareholder agreement, they could include such an arbitrary restriction, but they warned that the courts might not find that sufficient.

⁶⁶⁰ *PriceWaterhouse TCC*, *supra* note 594.

requirements did. Ultimately, the judge determined that a close reading of *Duha* indicated that they did⁶⁶² and with clear reluctance noted that he had "no choice but to follow the doctrine of the SCC, even though it may seem illogical".⁶⁶³

Before abruptly reaching that point, however, the consideration of the issue was lengthy. Bedard J. was critical of the idea that the same provision would have a different effect if it appeared in a unanimous shareholder agreement⁶⁶⁴ and a different agreement⁶⁶⁵ and endorsed a criticism of *Duha* put forth by Robert Couzin⁶⁶⁶ that he quoted, in which it was queried why a restriction upon the powers of directors elevates unrelated provisions, even when that restriction might make those other provisions less relevant.⁶⁶⁷ The judge described this objection as in line with fundamental principles of corporate law⁶⁶⁸ and also in accordance with the writings of Martel.⁶⁶⁹ The expanded criteria of the Alberta statute were also raised, and it was queried why that province would have found such a list necessary if an agreement entered into under the wording of the *C.B.C.A.* could have contained those clauses.⁶⁷⁰ (The answer that it would remove the necessity of *also* having a restriction was not considered.) It was similarly questioned why the federal legislators did not make it explicit that an agreement could contain other types of clauses, if that was their intention.⁶⁷¹ The logical inconsistencies and interpretive issues which the judge listed dovetail with his understanding of the tool as existing⁶⁷² for a single, narrow purpose, which he set out in no uncertain terms: "It also seems to me to be essential to conclude this overview of unanimous shareholders' agreements by stressing that the very nature of unanimous shareholders' agreements is to restrict the directors' power and expand the power of shareholders in the management of the corporation."⁶⁷³

Despite all that, and despite citing the precedent of *Leblanc c. Fertek inc.*⁶⁷⁴ to the effect that

⁶⁶¹ Ibid, par. 46.

⁶⁶² Ibid, par. 81.

⁶⁶³ Ibid, par. 82.

⁶⁶⁴ That is, one with restrictions upon directors.

⁶⁶⁵ *PriceWaterhouse TCC*, *supra* note 594, par. 82.

⁶⁶⁶ Ibid, par. 80.

⁶⁶⁷ Ibid, par. 77, citing Robert Couzin, "Some Reflections on Corporate Control" (2005) 53 Can. Tax. J. 305, p. 318.

⁶⁶⁸ *PriceWaterhouse TCC*, *supra* note 594, par. 78.

⁶⁶⁹ Ibid, par. 78, referring to Paul Martel and Luc Martel, *Les Conventions entre Actionnaires*, Ninth Edition (Montreal: Wilson & Lafleur, 2007), at pp. 340-341.

⁶⁷⁰ *PriceWaterhouse TCC*, *supra* note 594, par. 71.

⁶⁷¹ Ibid, par. 72.

⁶⁷² According to the relevant statute.

⁶⁷³ *PriceWaterhouse TCC*, *supra* note 594, par. 55.

⁶⁷⁴ Ibid, pars. 63, 79. *Leblanc c. Fertek inc.*, [2000] R.J.Q. 2921, 2000 CarswellQue 2384, J.E. 2000-2060, [2000] J.Q. No. 4045, REJB 2000-20884 (C.S. Que. Oct 18, 2000) (hereinafter "*Leblanc*") does contain a passage contrasting the two "aspects" of the agreement (pars. 49-53) and stating the importance of distinguishing them (par. 53). However, the distinction had only two consequences in that case. Firstly, an application for an order enforcing a unanimous shareholder agreement pursuant to *C.B.C.A.* s. 247 was found to be available only for sections of the agreement that restricted directors, while the other terms were

unanimous shareholder agreements can be divided into terms that have the status of unanimous shareholder agreements and terms that do not, the judge ultimately accepted that the Supreme Court of Canada had determined otherwise. On appeal,⁶⁷⁵ the analysis centred around whether *Duha* had been correctly interpreted and applied,⁶⁷⁶ and after noting that in that precedent the relevant clause had not itself been one that restricted directors,⁶⁷⁷ the Court of Appeal found that *Duha* meant that once the conditions for a unanimous shareholder agreement were met (including some restriction upon directors), the document as a whole qualified.⁶⁷⁸

The Court of Appeal noted the trial judge's reservations about the principle from *Duha*, but Gauthier J.A. explicitly rejected them:

58 With respect, I do not share this opinion. In my view, the SCC adopted a pragmatic, flexible approach that seems as valid today as it was in 1998. Clearly, clauses regarding the election of the board of directors can have a crucial impact on a majority shareholder's ability to effectively control a corporation. In order to avoid creating uncertainty for taxpayers, the SCC concluded that such clauses should not be taken into consideration when simply included in private agreements between shareholders. In seeking to strike a fair balance between these two concerns, it is logical that the special nature of USAs, which are constating documents, and the fact that USAs are easily accessible (for example, under subsections 20(1) and 21(2) of the *CBCA*, USAs are entered in the records of a corporation and kept at the corporation's registered office, and may be consulted by any representative of the corporation's shareholders or creditors) make a difference. It is not unusual in tax law to obtain a different result by using one form rather than another.

The Court of Appeal also rejected the idea that subsequent amendments to the *C.B.C.A.* had rendered *Duha* outdated, since the ones proposed as relevant literally amounted only to a renumbering,⁶⁷⁹ and further found that the inclusion of alternative criteria in the Alberta statute was simply that.⁶⁸⁰

properly enforced only through contract law (pars. 54-57). As discussed in Chapter Four, this understanding is not exceptional, and does not indicate that those clauses are not part of a unanimous shareholder agreement for many purposes, only that the enforcement mechanism is slightly different depending upon circumstances. Secondly, although the specific agreement in *Leblanc* required unanimity for all amendments (par. 60), the case implied that by default, while the statute required unanimity for the amendment of unanimous shareholder agreements, that only extended to terms that restricted directors (par. 59). This would represent a genuine divisibility of the agreement, and to the extent that it does, it is contrary to *Duha*. Perhaps more importantly, the potential for documents to be amendable *in part* by only some of their signatories creates obvious potential for confusion (since presumably these amendments would have no effect *vis-a-vis* the remaining parties), although the same effect could be achieved through the use of side agreements respecting rights and obligations as between specific parties. For a related issue, see the discussion of *White* in this chapter.

⁶⁷⁵ *PriceWaterhouse FCA*, *supra* note 594.

⁶⁷⁶ *Ibid.*, pars. 38-53.

⁶⁷⁷ *Ibid.*, pars. 51-52.

⁶⁷⁸ *Ibid.*, par. 53.

⁶⁷⁹ *Ibid.*, par. 59.

⁶⁸⁰ *Ibid.*, par. 60.

The contradiction at the heart of both these cases illustrates that the current wording of the legislation and the Supreme Court of Canada's decision in *Duha* lack analytic purity. In splitting the difference between having the unanimous shareholder agreement be a statutory tool limited to a single defined purpose and allowing any contract amongst all the investors to be a unanimous shareholder agreement regardless of what terms it does or does not include, the law is now in a situation that, while largely workable in practice, lacks commitment to either theory of the corporation and can lead to absurd results.

6.(b)(iii) Invalid Restrictions

Of the cases that have dealt with the requirement that a unanimous shareholder agreement restrict the directors, a number of them have found that the terms in the agreement that might appear to constitute such limitations were inadequate. In coming to this conclusion, judges appear to have applied preconceived notions of what sorts of restrictions were valid, rather than whether the terms in question would restrict directors if enforced. This would suggest greater comfort with a standardized role for directors than with granting investors the ability to alter it.

*O'Brien v. O'Brien Estate*⁶⁸¹ provides an excellent example. A father and son were the only shareholders of a charter airline company.⁶⁸² The father sold his shares of the company to the son, but before he did so, the two of them signed an agreement.⁶⁸³ The son subsequently transferred half the shares to his wife, and upon his death, she inherited his remaining shares as well and thus became the sole shareholder.⁶⁸⁴ At issue was whether the agreement between the father and son was enforceable; the wife repudiated it.⁶⁸⁵ Up until the son died, the company had honoured its terms.⁶⁸⁶

One of the grounds that the father advanced was that the document he had signed with his son was a unanimous shareholder agreement. It was in writing, was between the only two shareholders at the time, and restricted the directors insofar as it imposed obligations upon the corporation which the directors would need to ensure it met.⁶⁸⁷ The agreement was not registered,⁶⁸⁸ but the father argued that the purpose of registration was to give notice, and his daughter-in-law had had *actual* notice, so it should be effective as

⁶⁸¹ *O'Brien v. O'Brien Estate*, 23 E.T.R. (2d) 191, 169 Sask. R. 190, 1998 CarswellSask 436 (Sask. Q.B. Jun 09, 1998) (hereinafter "*O'Brien QB*").

⁶⁸² *Ibid*, pars. 1-2.

⁶⁸³ *Ibid*, par. 3.

⁶⁸⁴ *Ibid*, par. 2.

⁶⁸⁵ *Ibid*, par. 3.

⁶⁸⁶ *Ibid*, par. 7.

⁶⁸⁷ *Ibid*, par. 91.

⁶⁸⁸ Some of the statutes authorizing unanimous shareholder agreements require that they be registered. See *M.C.A.* s. 140(6), *N.L.C.A.* s. 245(11), *Q.B.C.A.* s. 215, and *S.B.C.A.* s. 140(5).

against her.⁶⁸⁹ Smith J. noted that the argument that this was a unanimous shareholder agreement had not been properly pled and was contrary to some of the father's other positions,⁶⁹⁰ but nonetheless considered its merits. In addition to the parties' intent, discussed later in this chapter, she determined whether the agreement restricted the directors. In order to understand Smith J.'s ruling and the subsequent Court of Appeal decision, one must first look at the contents of the agreement, or at least at her summary of them:

Clause 2 has a number of lettered subclauses. Subclauses B, C, D and E state that Jack O'Brien shall continue to receive a number of benefits from the company that he had enjoyed prior to the sale. These include: (Subclause B) the right to "Any flying done by" B.N.A. Ltd. on his behalf at cost price; (Subclause C) the use of B.N.A. Ltd.'s facilities for the maintenance of his own aircraft; the right to purchase airplane parts; and (Subclause D) fuel from B.N.A. Ltd. at cost; and (Subclause E) the right to operate his aircraft under the B.N.A. Ltd. charter and licence at no charge. Subclause F states that these benefits shall also be granted to Barry O'Brien, Jack O'Brien's other son who is also a pilot. Subclause A states that Jack O'Brien "shall have the unrestricted first right of refusal on all or any part of Buffalo Narrows Airways Ltd. if it is put up for sale" and Subclause G states: Unless otherwise agreed by Jack O'Brien at the time of sale, if Buffalo Narrows Airways Ltd. is sold, items C, D and E shall become part of the sale agreement and the new owners shall be compelled to honour this for a period of time agreeable to Jack O'Brien.⁶⁹¹

In Smith J.'s view, none of this constituted a restriction on the powers of the directors within the meaning of the statute. She stated that any argument to that effect must fail because it "can only succeed by assuming what it sets out to prove: that the legal effect of the agreement is to 'restrict, in whole or in part, the powers of the directors to manage the business and affairs of the corporation'".⁶⁹² This objection could, of course, be raised about *any* unanimous shareholder agreement's attempts to restrict the powers of the directors. If those restrictions are initially assumed to be ineffective, then the document is not a unanimous shareholder agreement, and therefore the restrictions are unenforceable. The reasoning is circular. Aside from this self-fulfilling assumption, the clauses of the agreement would seem *prima facie* to be restrictions on the company and therefore on the directors.

The root of Smith J.'s odd skepticism concerning these provisions is earlier in the reasons for judgment, in the analysis of the document's effects as a personal contract. Assuming that it was a personal contract between the father and son, it *could not* bind the company's actions, and therefore some other interpretation of what was being promised was necessary. Smith J. found it unreasonable to conclude that the son had been supplying a guarantee for the actions of a third party which he might not, in future, be in a position to control.⁶⁹³ She concluded that the agreement was only that the son would attempt, in good faith,

⁶⁸⁹ O'Brien QB, *supra* note 681, par. 91.

⁶⁹⁰ *Ibid*, par. 92.

⁶⁹¹ *Ibid*, par. 5.

⁶⁹² *Ibid*, par. 93.

⁶⁹³ *Ibid*, par. 66.

to use his influence over the company to cause it to follow the terms.⁶⁹⁴ In considering the effect of the clause purporting to bind subsequent owners, which contradicted her analysis that this was a personal contract between father and son for good faith efforts only, Smith J. declared that it

simply represents one of the unworkable provisions that Jack O'Brien inserted into the agreement, without any advice or much consideration about how the agreement might actually work, either practically or legally. In fact, it is impossible to see how any new owner not personally connected to Jack and Barry O'Brien in the same way that Dennis was could or would even consider accepting the burdens of these provisions.⁶⁹⁵

Having found it more plausible to view the contract's enforceability as against the son to be merely for "good faith efforts", Smith J. unfortunately did not consider anew the document's ability to actually effect what it purported to when she considered it as a unanimous shareholder agreement. There is again a circularity in this logic. As a personal contract, it cannot control the company's actions. Therefore it is not intended to do so. Therefore it is not a unanimous shareholder agreement. Therefore it is a personal contract.

The appeal was unfortunately similar.⁶⁹⁶ Lane J.A., writing for the Saskatchewan Court of Appeal, upheld the decision that this was not a unanimous shareholder agreement. After summarizing and agreeing with the trial judge's view that the document was prepared in a manner that suggested the intent was that it be a personal agreement and not a corporate document,⁶⁹⁷ Lane J.A. added an additional wrinkle: "It is clear a unanimous shareholders' agreement is an agreement concerning the governance of a corporation and the agreement between Jack and Dennis was not intended to dictate fundamental aspects of corporate governance."⁶⁹⁸

In support of this alleged principle, Lane J.A. cited the Supreme Court decision in *Duha*, specifically paragraph 78, with the following line being given emphasis:

Generally speaking, USAs exist to deal with major issues facing a corporation: corporate structure, issuance of shares, declaration of dividends, election of directors, appointment of officers, and the like. General business decisions are not ordinarily touched by such arrangements, and with good reason: it would not be efficient, for business purposes, to remit every decision, however minor, to a shareholder vote, let alone to require unanimous agreement among the shareholders on such decisions.⁶⁹⁹

Lane J.A. interpreted this comment, which was originally a descriptive remark that explicitly

⁶⁹⁴ Ibid, par. 73.

⁶⁹⁵ Ibid, par. 87.

⁶⁹⁶ *O'Brien v. O'Brien Estate*, 27 E.T.R. (2d) 117, 180 Sask. R. 33, 1999 CarswellSask 358, 205 W.A.C. 33 (Sask. C.A. Jun 03, 1999) (hereinafter "*O'Brien CA*").

⁶⁹⁷ Ibid, pars. 44-45.

⁶⁹⁸ Ibid, par. 46.

applied only "generally" and "ordinarily", *i.e.* not universally, that unanimous shareholder agreements only deal with major matters and not with minor ones for efficiency reasons, as creating a new legal principle that such a focus is a necessary feature of a unanimous shareholder agreement. This interpretation, quite simply, is not supported by the plain meaning of the words. It also ignores the explicit statement elsewhere in the Supreme Court's decision that a specific expression in the unanimous shareholder agreement could grant the shareholders power even over routine business decisions.⁷⁰⁰

A similar view appeared in *General Electric Capital Canada Inc. v. R.*⁷⁰¹ Hogan J. considered the powers that shareholders may have over a corporation's business, including but not limited to using a unanimous shareholder agreement.⁷⁰² He stated that while that tool means shareholders "can appropriate the powers of the board of directors",⁷⁰³ that the ability is narrow because:

As for the day-to-day operations of a business, the *Canada Business Corporations Act* (the "*CBCA*") does not specifically allow for shareholders to appropriate powers of officers. According to Bruce Welling, this reality is "formalistically consistent with the traditional corporate law notion that officers are limited functionaries appointed by the board of directors".⁷⁰⁴

As part of this analysis, he cited⁷⁰⁵ another extract from *Duha*:

Directors generally owe a duty not to the shareholders but to the corporation, and shareholders could not, therefore, control the day-to-day business decisions made by the directors and their appointed officers. In other words, although the shareholders could elect the individuals who would make up the board, the board members, once elected, wielded virtually all the decision-making power, subject to the ability of the shareholders to remove or fail to re-elect unsatisfactory directors. [emphasis in *General Electric*]⁷⁰⁶

This passage was in the original judgment explicitly describing the corporate set-up absent a unanimous shareholder agreement.⁷⁰⁷ Nonetheless, Hogan J. concluded that "the fundamental distinction remains that shareholders can appropriate the powers to appoint the officers, but not the powers of the officers to in fact manage the business. This is the result of a close reading of subsection 146(1) of the

⁶⁹⁹ *Duha* SCC, *supra* note 24, par. 78, cited at *O'Brien CA*, *supra* note 696, par. 45 with emphasis.

⁷⁰⁰ See discussion earlier in this chapter.

⁷⁰¹ *General Electric Capital Canada Inc. v. R.*, 2009 TCC 563, 2009 CCI 563, [2010] 2 C.T.C. 2187, 2009 CarswellNat 3961, 2009 CarswellNat 5603, 2010 D.T.C. 1007 (Eng.), 182 A.C.W.S. (3d) 1090 (T.C.C. (G.P.) Dec 04, 2009) (hereinafter "*General Electric*").

⁷⁰² *Ibid.*, pars. 240-246.

⁷⁰³ *Ibid.*, par. 242.

⁷⁰⁴ *Ibid.*, par. 243.

⁷⁰⁵ *Ibid.*, par. 244.

⁷⁰⁶ *Duha* SCC, *supra* note 24, par. 61.

⁷⁰⁷ *Ibid.*, par. 61.

CBCA.⁷⁰⁸ This result is only logical if one finds a statutory limitation on the power of *directors* to manage the business that forces them to appoint officers to do so, rather than such delegation being merely the most practical and common arrangement. In the absence of such a statutorily mandated distinction, directors could choose to make ordinary business decisions and therefore so can shareholders under a unanimous shareholder agreement. Conversely, if such clauses were invalid, then any agreement amongst all the shareholders which only contains restrictions of that sort is not a unanimous shareholder agreement, the conclusion reached in *O'Brien. General Electric* was not directly concerned with whether such a clause in a unanimous shareholder agreement would be valid, although apparently in Hogan J.'s view it would not.⁷⁰⁹

A different basis for rejecting restrictions as not the sort allegedly envisioned in the statute appeared in *9109-0068 Québec inc. c. Lambert*.⁷¹⁰ A unanimous shareholder agreement provided that, while meeting liquidity requirements, all extra net profits had to be distributed as dividends.⁷¹¹ The minority shareholder sued to enforce this term. The defendant argued that the decision to declare dividends was within the directors' discretion.⁷¹² Matteau J.C.S. analyzed the unanimous shareholder agreement to see whether it was effective. Citing Martel,⁷¹³ the judge found that a unanimous shareholder agreement had to restrict the directors,⁷¹⁴ and moreover that under the then-current Quebec legislation, such a restriction had to take the form of a transfer of power to the shareholders;⁷¹⁵ powers could not be simultaneously within the realms of the shareholders and directors.⁷¹⁶ The judge found that clear and precise language was needed to accomplish this transfer,⁷¹⁷ but the clause in question "ne rencontre pas les exigences requises pour soustraire au pouvoir des administrateurs leur discrétion à cet égard".⁷¹⁸

⁷⁰⁸ *General Electric, supra* note 701, par. 245.

⁷⁰⁹ The relevance was that the control over a subsidiary's financial decisions that a parent corporation exerted was determined to be not in its capacity as shareholder and therefore was not exempt from consideration in calculating the value of another contract between the two companies that was affected by the arrangement (*General Electric, supra* note 701, pars. 236-246). The parent company did exercise such control, on some other (apparently legitimate) basis that was left unclear (par. 246). Arguably, the instructions to allow only the parent company's treasury department to handle all treasury functions (par. 36) and/or the exercise of such functions *were* a unanimous shareholder agreement, although insufficient detail was given to determine this. The decision was upheld on appeal, *General Electric Capital Canada Inc. v. R.*, 2010 CAF 344, 2010 FCA 344, [2011] 2 C.T.C. 126, 414 N.R. 304, 2010 CarswellNat 4858, 2010 CarswellNat 5760, 2011 D.T.C. 5011 (Eng.), 196 A.C.W.S. (3d) 896 (F.C.A. Dec 15, 2010), where no reference to unanimous shareholder agreements was made.

⁷¹⁰ *9109 CS, supra* note 555.

⁷¹¹ *Ibid*, par. 9.

⁷¹² *Ibid*, par. 10.

⁷¹³ Maurice Martel and Paul Martel, *La Compagnie au Québec volume 1: Les Aspects Juridiques* (Wilson & Lafleur, 2008), at pp. 19-24 and 19-25 and Martel and Martel, *supra* note 669, p. 330.

⁷¹⁴ *9109 CS, supra* note 555, par. 19.

⁷¹⁵ *Ibid*, par. 20.

⁷¹⁶ *Ibid*, par. 22.

⁷¹⁷ *Ibid*, par. 21.

⁷¹⁸ *Ibid*, par. 23. My translation: "did not meet the requirements for removing from the powers of the directors their discretion regarding this matter".

Two other clauses affirming the binding nature of the agreement upon the shareholders' representatives and upon the company itself were further held to not transfer any of the directors' powers and to not create rights not found elsewhere in the agreement.⁷¹⁹ The Court of Appeal stated their support (without additional analysis) for Matteau J.C.S's reasoning⁷²⁰ and added that the unanimity requirement had also not been met.⁷²¹

Similarly, in *Couvre-Plancher Zénith Ltée v. Minister of National Revenue*,⁷²² the document was also found not to be a unanimous shareholder agreement because, among other reasons,⁷²³ Dussault J.T.C.C. determined that it did not restrict the directors. The basis for this was that "no clause of the agreement restricts the directors' powers over matters under their authority so that they can be exercised by the shareholders. The clause of the agreement referred to in clause 3(e)(iii) of the Agreement on Facts requires only the unanimity of the directors where there are only two directors."⁷²⁴ This appears to be a finding that a lack of *transfer* of powers to the shareholders means that there is no *restriction* on directors in the sense required, even though the agreement did contain reference to at least two restrictions upon them, as noted: that the number of directors be two and that their decisions must be unanimous.⁷²⁵ This is an illustration of how the concept of transfer of power can eclipse that of restriction *per se*. Dussault J.T.C.C. also appeared to ignore, when considering whether the directors' powers were restricted, that the agreement vested power over day-to-day operations in one of the parties,⁷²⁶ removing either the directors' authority to exercise such control or else to determine who has it. It is difficult to see how this would be anything other than a fundamental restriction of the board's normal powers.

The outright rejection in *9109-0068* and *Couvre-Plancher* of restrictions upon the directors not framed as transfers of power to the shareholders is anomalous; examples of such terms being enforced are found throughout this chapter and the next. The implications, both positive and negative, of restrictions that take the form of "pre-made decisions" in unanimous shareholder agreements are discussed in Chapter Five. Even if all restrictions upon directors are treated as transfers of power, there is no justification for simply ignoring them if not worded as such in the document.

While the preceding cases dealt explicitly with why some limitations might not form valid bases for unanimous shareholder agreements, others were less clear. Instead of providing a justification, they simply asserted that no restriction existed, even if terms were mentioned that could reasonably have qualified.

⁷¹⁹ Ibid, pars. 24-25.

⁷²⁰ *9109 CA*, *supra* note 450, par. 1.

⁷²¹ Ibid, par. 2.

⁷²² *Couvre-Plancher*, *supra* note 324.

⁷²³ See discussion of the unanimity requirement in *Couvre-Plancher* earlier in this chapter.

⁷²⁴ *Couvre-Plancher*, *supra* note 324, par. 13.

⁷²⁵ See also *Couvre-Plancher*, *supra* note 324, par. 2.

⁷²⁶ Ibid, par. 2.

The defendants in *Nicholson c. Gmiterek*⁷²⁷ argued that a document was not a unanimous shareholder agreement (in the statutory sense) because it did not restrict the directors in any way.⁷²⁸ They therefore argued that the court's power under the oppression remedy to amend a unanimous shareholder agreement did not apply.⁷²⁹ Ryan J.C.S. rejected this argument, but on the basis that the powers of the court under the oppression remedy were not limited to those listed, and could include the amendment of a shareholder agreement that was not a unanimous shareholder agreement.⁷³⁰ The judge therefore implicitly accepted that this particular document had failed to meet the criterion. Curiously, the claim for oppression included that the plaintiffs had been fired from posts as officers that were guaranteed to them in the agreement and that the defendant director had caused the company to repay a loan to his family without the plaintiff's consent, which was also said to be in violation of the agreement.⁷³¹ Arguably, these both represented restrictions upon the directors; the possibility was not addressed.

The management contract in *Sedona Networks Corp. v. R.*⁷³² was found not to be a unanimous shareholder agreement in part because the shareholder was not actually a party to it, as discussed earlier, but also because its contents were found not to restrict the directors. The corporation ("BMCC") owned shares, and it had granted the voting rights of those shares to another company, which the appellant argued was the removal of those voting rights from the directors.⁷³³ Archambault T.C.J. rejected this position, writing, "It does not affect the corporate constitution of BMCC. For instance, it is not a constating document limiting the powers of the BMCC's board of directors to manage its affairs."⁷³⁴ Unless this represents a determination that exercising the voting rights of shares that a corporation owns is not part of managing the affairs of said corporation, it is simply an incorrect interpretation of the facts. On appeal,⁷³⁵ the issue was similarly dealt with, Malone J.A. saying only, "[T]here is no basis for concluding that the Management Agreement restricted the powers of BMCC's board of directors to manage its business and affairs. Without this restriction, the statutory requirements for a unanimous shareholder agreement are not met."⁷³⁶ Again, this makes sense only if one assumes that exercising voting rights of shares owned by a company is not part of managing that company's business and affairs.⁷³⁷

⁷²⁷ *Nicholson c. Gmiterek* [1989] J.Q. no 2546 (C.S. Que. Apr 21, 1989) (hereinafter *Nicholson*).

⁷²⁸ *Ibid*, par. 18: "qui ne restreint en aucune façon les pouvoirs des administrateurs".

⁷²⁹ *Ibid*, par. 18.

⁷³⁰ *Ibid*, pars. 19-20.

⁷³¹ *Ibid*, par. 10.

⁷³² *Sedona TCC*, *supra* note 351.

⁷³³ *Ibid*, par. 20.

⁷³⁴ *Ibid*, par. 19.

⁷³⁵ *Sedona FCA*, *supra* note 356.

⁷³⁶ *Ibid*, par. 20.

⁷³⁷ If a distinction is maintained between a company's business and affairs, then this would generally fall under the latter.

Finally, *Higgins v. Wilson*⁷³⁸ may represent another example of this type, although it is more ambiguous.⁷³⁹

The common element in these decisions is that the documents in question did contain terms that would have, if enforced, restricted directors. But the judges either failed to recognize that or else determined that the restrictions were not a type these documents were intended to contain. This necessarily means that, in their view, the statutorily-defined powers of the board sometimes supersede the terms of a unanimous shareholder agreement that purportedly alter them, a rejection of "nexus of contracts" based assumptions that investors should have the right to freely determine the corporate arrangement. Ironically, in so doing, they departed from the definition of the unanimous shareholder agreement found in the legislation, substituting their own visions of the appropriate forms of shareholder intervention in corporate management for what the statute itself set out.⁷⁴⁰

6.(b)(iv) Valid Restrictions

There have, of course, also been cases where the restrictions in the unanimous shareholder agreement were found to be sufficient to meet the statutory requirements. As the examples in the previous

⁷³⁸ *Higgins v. Wilson*, 104 N.B.R. (2d) 242, 1989 CarswellNB 110, 261 A.P.R. 242 (N.B. Q.B. Nov 07, 1989) (hereinafter "*Higgins QB*").

⁷³⁹ Creaghan J.'s statement that he was "not convinced nor satisfied that the November 1980 contract is still in effect and binding, and if so, that it can today be held to be a 'unanimous shareholder agreement'" (*Higgins QB*, *supra* note 738, par. 11) was not explicitly justified, and on an application for leave to appeal, this language was interpreted as declining to determine one way or another whether a unanimous shareholder agreement existed, not as a determination that there was insufficient evidence to prove one did and therefore a finding that one did not (see *Higgins v. Wilson*, 1989 CarswellNB 489 (N.B. C.A. Dec 05, 1989) (hereinafter "*Higgins CA*").). However, that comment was immediately followed, possibly by way of explanation, by a summary of the documents' terms: a sale of shares between the parties, and "the initial appointment of the corporate officers, equal salaries for three of them, the holding of the sold shares in escrow, method payment of the same, establishment of four holding companies and possible transfer of shares". (*Higgins QB*, *supra* note 738, par. 12). Since one of the parties was suing to prevent his dismissal as a corporate officer, which he argued was contrary to the term of a unanimous shareholder agreement that bound the directors (*Higgins QB*, *supra* note 738, par. 8), it is significant that the judge framed the contract as relating to the *initial* appointment of officers. If that were literally what was written, it would presumably have sufficed to determine the case; this perspective may instead reflect a tendency toward reading terms in the manner that least restricts the board on an ongoing basis. Either way, Creaghan J. was unwilling to treat this document as a unanimous shareholder agreement that restricted the directors' power to terminate officers, although he did grant some subsidiary relief (*Higgins QB*, *supra* note 738, par. 23). The Court of Appeal determined this to have been a legitimate exercise of discretion even absent a binding unanimous shareholder agreement to serve as the basis for it (*Higgins CA*, par. 7).

⁷⁴⁰ That said, there are times when a contract (or other written arrangement) clearly does not restrict the directors. An agreement amongst investors regarding how they would deal with their shares and vote for directors was noted in passing by Glowacki J. in *RJB Investments Ltd. v. Ladco Co.*, 2000 MBQB 225, 2001 CarswellMan 19, 154 Man. R. (2d) 183 (Man. Q.B. Jan 19, 2001) as not a unanimous shareholder agreement because it placed no restrictions upon the board (par. 7), although this comment was *obiter*.

section illustrated, there is some dispute about what sorts of limitations are valid, and so it is worth exploring exactly what terms have been upheld as sufficient.

In *Ming Minerals Inc. v. Blagdon*, discussed in a previous section, Mercer J. noted that there was authority that a unanimous shareholder agreement need not restrict directors' powers, but that was based upon the then-current Court of Appeal judgment in *Duha*, before the Supreme Court re-established its necessity.⁷⁴¹ Regardless, Mercer J. found that clauses in the Letter Agreement restricted the directors' powers. Specifically, they

obliged the issuance of shares in specified circumstances, stipulated that the directors of Minerals were to reserve additional shares for issuance in specified circumstances and further prevented, in certain circumstances, the directors from diluting the Blagdon and Dimmell shareholdings to less than fifteen percent. The Letter Agreement further obligated the directors to execute employment contracts with Samuel Blagdon and Dimmell in the capacities of Mine Manager and Chief Geologist, presumably key positions for the future operations of Minerals. These were restrictions on the powers of the directors[...]⁷⁴²

White v. True North Springs, also discussed above, included the following examples of restricting directors' powers, which were explicitly referred to as being only some of the restrictions present: a quorum for directors' meetings; a requirement that the board meet at the call of the chair or at the last three directors' request; a stipulation that decisions of the board would be by majority, thus preventing them from establishing a super-majority requirement; time limits and notice requirements for meetings; requiring the unanimous consent of shareholders for the issuance of additional shares, articles of amendment, changes in the number of directors, and "many other"⁷⁴³ decisions not repeated in the judgment; and "providing that shareholders cannot sell, transfer, sign or otherwise dispose of their shares or mortgage, pledge, hypothecate, charge, or otherwise encumber them without the prior consent of the Board of Directors except as specifically provided in the various preemption clauses of each agreement".⁷⁴⁴ While the abundance of other restrictions makes it a moot point, the final item on that list is more properly viewed as a restriction on shareholders and not directors, and it should not have been included. Otherwise, the most interesting observation about this list is the presence of minor procedural requirements for directors to follow, rather than substantive restrictions. Establishing a quorum for directors' meetings or preventing them from setting super-majority requirements for themselves apparently qualifies as restricting the power of the directors, even if the board collectively retains its normal power to control the corporation.⁷⁴⁵

⁷⁴¹ *Ming*, *supra* note 334, par. 26.

⁷⁴² *Ibid*, par. 25.

⁷⁴³ *White SC (TD) 1*, *supra* note 401, par. 37.

⁷⁴⁴ *Ibid*, par. 37.

⁷⁴⁵ It appears to be widely accepted that imposing a supermajority or unanimity requirement upon decisions of the board would itself be a sufficient restriction, but that is not a universal opinion. Smith,

In *Piikani Investment Corp. v. Piikani First Nation*, discussed in a previous section, the directors were bound by the Trust Agreement to follow any instructions from the Piikani First Nation Council with respect to a list of issues, and the power of directors to fill vacancies was curtailed.⁷⁴⁶ The specific issues on which the Council could give directions⁷⁴⁷ were that it could direct the Piikani Investment Corp. to hold shares in and appoint directors of Piikani Business Entities,⁷⁴⁸ to monitor the management and operations of such entities, to provide managerial and other services to them, to report to Council on the operation, management, and financial status of such entities, to provide a written report on those topics, and to undertake related tasks.⁷⁴⁹ The point of interest here is that these restrictions, with the exception of filling vacancies, all arise only at the subsequent direction of the Council. Absent such direction, the board's powers would be as normal. So granting a group or individual the discretionary power to override the directors counts as a restriction upon them, even if they continue to be, by default, the decision-makers.

In *Alteco Inc. v. R.*,⁷⁵⁰ discussed briefly above, Bell T.C.C.J. found that a failure to file a unanimous shareholder agreement did not invalidate it.⁷⁵¹ He also confirmed that the document in question restricted the powers of the directors,⁷⁵² although without being clear as to which clauses were restrictions.⁷⁵³ The instrument mandated that the company would obtain certain financing, limited the corporation's ability to issue shares, set the number of directors, listed various agreements the corporation

supra note 228, p. 308 denied it. Turgeon, *supra* note 9, p. 230, noted that supermajority requirements are expressly allowed in the *C.B.C.A.*, but argued that they are not technically restrictions upon the powers of the directors. Such clauses do not restrict the range of actions that the board collectively may take, although in practice that could be the effect. But then, the same is true for granting shareholders approval power. Both place upon the directors whose opinion is in the simple majority the hurdle of acquiring the consent of additional parties before their decisions can come into force. In order to give effect to this, members of a majority thwarted by a supermajority requirement should be granted the same status as dissenters where applicable.

⁷⁴⁶ *Piikani*, *supra* note 234, par. 24.

⁷⁴⁷ Given in Paragraph I(c) of Schedule 2 of the Trust Agreement, reproduced in the judgment at *Piikani*, *supra* note 234, par. 24.

⁷⁴⁸ Defined at *Piikani*, *supra* note 234, par. 7, as a business in which the majority interest is held for the benefit of the Piikani First Nation.

⁷⁴⁹ *Piikani*, *supra* note 234, par. 24.

⁷⁵⁰ *Alteco*, *supra* note 606.

⁷⁵¹ *Ibid*, par. 35. (See note 688 for further discussion of the registration of unanimous shareholder agreements.)

⁷⁵² While Bell T.C.C.J. found that the document was a unanimous shareholder agreement, he rejected the view that such an agreement had a status equal to the articles (*Alteco*, *supra* note 606, par. 36); this was prior to the Supreme Court of Canada's *Duha* decision. Oddly, he also concluded that, since it was not a party to the agreement, the corporation had "no contractual obligation to comply with what the shareholders thereunder want to do" (par. 36). This is technically true, but ignored that it had a *legal* obligation to do what the shareholders wanted nonetheless; the obligation a corporation owes to obey its own directors is statutory, not contractual, and that principle would seem to extend to a unanimous shareholder agreement, although as Chapter Four discusses, this has not always been the logic used by courts.

⁷⁵³ *Alteco*, *supra* note 606, par. 35.

would enter into, and outlined banking arrangements for the corporation.⁷⁵⁴ While the Respondents apparently contested that it qualified as a unanimous shareholder agreement even aside from its being unfiled, presumably on the basis that it did not restrict the directors, they did not elaborate on that point.⁷⁵⁵ It is therefore unsurprising that Bell T.C.J.J. found as he did, but he at least set his mind to the question.

In *Fulmer v. Peter D. Fulmer Holdings Inc.*,⁷⁵⁶ McDermid J. noted that the document in question met the criteria to be recognized as a unanimous shareholder agreement because it restricted the directors,⁷⁵⁷ and while no example was provided immediately in the context of that determination, subsequently a term was specifically referred to as one that "restricts the powers of the directors in relation to the appointment of a president"⁷⁵⁸ and the judgment generally concerned the effects of that particular limitation.

A slightly different version of this same general question arose in *National Bank of Canada v. Bronfman*⁷⁵⁹; the status of the unanimous shareholder agreement as a whole was not the subject of contention, but rather whether a term in it that the directors could only pass certain resolutions if they had obtained shareholder approval fell within the ambit of the statutory provision, and specifically whether liability had therefore been transferred.⁷⁶⁰ Spence J. found that "[t]his provision 'restricts the powers of the director' as contemplated by s. 146(5) of the CBCA and gives to the shareholders the veto provided in s. 3.03(2)".⁷⁶¹

Finally, in *Sportscope Television Network Ltd. v. Shaw Communications Inc.*⁷⁶² Blair J. considered whether a unanimous shareholder agreement met the statutory test, although it does not appear to have been a contested issue.⁷⁶³ Clauses presented in support of this included the recitals that it concerned the business and affairs of the corporation, requirements that certain resolutions, by-laws, and agreements be approved, a right of one shareholder to bring a non-voting participant to directors' meetings, restrictions on share transfers, a requirement that if a shareholder sold its shares then its representative director must resign, and a clause requiring that so long as the shareholders or their nominees were directors, officers, and/or

⁷⁵⁴ Ibid, pars. 3, 10.

⁷⁵⁵ Ibid, pars. 15-16.

⁷⁵⁶ *Fulmer v. Peter D. Fulmer Holdings Inc.*, 36 B.L.R. (2d) 257, 1997 CarswellOnt 4430, 74 A.C.W.S. (3d) 771, [1997] O.J. No. 4121 (Ont. Gen. Div. Sep 22, 1997) (hereinafter "*Fulmer*").

⁷⁵⁷ Ibid, par. 9.

⁷⁵⁸ Ibid, par. 10.

⁷⁵⁹ *National Bank of Canada v. Bronfman*, 1998 CarswellOnt 2389 (Ont. Gen. Div. Jun 05, 1998) (hereinafter "*National Bank*").

⁷⁶⁰ Ibid, par. 11.

⁷⁶¹ Ibid, par. 11. Beauregard and Auger, *supra* note 16, present this case as a general authority for the proposition that granting approval or veto powers to shareholders is sufficient to meet the restriction requirement.

⁷⁶² *Sportscope*, *supra* note 564.

⁷⁶³ Despite concluding that this was a unanimous shareholder agreement, Blair J. found that it was not applicable as it did not survive an amalgamation and that the Respondent was not a "transferee" of shares

shareholders, they would act and vote to give effect to the terms of the unanimous shareholder agreement.⁷⁶⁴ This last provision was described by Blair J. as "a more or less blanket fettering of the discretion of the directors",⁷⁶⁵ but upon closer analysis, it is evident that it was almost completely redundant; the directors would already be bound to give effect to the agreement, so this was at most a clarification that, *e.g.*, they were still required to hold votes on these issues even if their votes were pre-determined. By definition, it did not expand or create any restrictions not found elsewhere in the agreement. The clause on share transfers also should not have been listed as affecting the directors' powers, nor did the recitals themselves, but since restrictions did exist, those would not have affected the outcome. Regardless of the correctness of the conclusion, the dubious items on this list invite us to consider how broadly the judge was interpreting, arguably misinterpreting, what could meet the criterion.⁷⁶⁶

Sportscope was the subject of a case comment, wherein Gray took just that position. He argued that this judgment is illustrative of a judicial tendency to find this requirement "easily satisfied".⁷⁶⁷ He stated that:

It is difficult to see how any of the foregoing provisions shift what would otherwise be board powers to the shareholders. Recitals do not even have binding legal effect. If the articles give the board of directors discretion to approve share transfers, it may be that the USA fetters the directors' discretion in that regard. However, Blair J. does not say whether, absent the USA, the directors would have the exclusive power to approve share transfers. Although Blair J. recognizes the shift of board powers to shareholders is a necessary qualifying condition in meeting the definition of a USA, his reasons also illustrate how lightly the courts will apply the requirement to the facts before them so as not to defeat the intentions of the parties on a technicality.⁷⁶⁸

The final generalization is inaccurate; as the cases discussed in the preceding subsection illustrate, courts have not always been reluctant to dismiss a unanimous shareholder agreement for failing to restrict the directors in a manner they considered sufficient.

Gray's analysis of *Sportscope* was unfortunately incomplete, marked by a failure to separately consider all of the elements Blair J. had put forth, and thus missed the obvious restriction on the board's power contained in the second listed element. If the unanimous shareholder agreement, directly or indirectly, made the decisions of the board subject to approval or veto by representatives of the two shareholding corporations, their power was restricted. Possibly, Gray had adopted the view that a "restriction" on directors power is synonymous with a transfer of those powers directly to the shareholders. Allowing the board to make decisions but having those decisions be subject to outside approval is a

bound by it (*Sportscope*, *supra* note 564, par. 25).

⁷⁶⁴ *Sportscope*, *supra* note 564, par. 23.

⁷⁶⁵ *Ibid*, par. 23.

⁷⁶⁶ It is also a caution on the use of the items on this list as precedent.

⁷⁶⁷ Gray, *supra* note 564, p. 151.

restriction, and Blair J.'s finding that the document was a valid unanimous shareholder agreement is justifiable on that basis. An argument could also be made that the requirement that directors resign under certain conditions is a restriction on their powers. The judgment thus need not be taken to have treated the "restriction" requirement as irrelevant or a formality, even if it did define it too broadly.

Collectively, these examples of restrictions upon directors which have received judicial approval indicate that at least *sometimes*, highly specific restrictions in a unanimous shareholder agreement are both valid and sufficient limitations to meet the statutory criterion. They also suggest that the requirement encompasses clauses framed in both positive and negative terms, not just negative restrictions. This versatility is in many ways in accord with the contractual view of the corporation; if the corporate structure represents only the agreement of the shareholders, then there would be no reason they could not alter it however subtly or specifically they wished.⁷⁶⁹

On the other hand, it is less clear from this particular sample set whether it is ever permissible to make a specific business decision in a unanimous shareholder agreement. All of the restrictions alluded to in the cases in this section at least arguably concern governance rather than operational matters. In concert with the cases in the previous subsection, this might suggest that, when a court is specifically reviewing the restrictions to determine if they meet the statutory requirements, that type of limitation would not be sufficient (and possibly not be valid as well).⁷⁷⁰ The view that governance choices are permissible within a unanimous shareholder agreement but operational ones are not would be more consistent with the traditional corporate structure that limits shareholders' direct powers while making directors the ultimate decision-makers for most purposes. This narrow view of the uses to which the tool might be put is difficult, if not impossible, to reconcile with the shareholders' ability to simply assume all of the directors' powers via a unanimous shareholder agreement, since that would allow them to make those sorts of decisions. It is thus difficult to justify this position on principle, save perhaps on the basis that the transfer of powers is less problematic than their division.⁷⁷¹

7. Intent

There is no statutory requirement of "intent" in the creation of unanimous shareholder agreements.⁷⁷² However, several judgments raise the question of whether intent is, or should be, necessary

⁷⁶⁸ Ibid, pp. 151-152.

⁷⁶⁹ Assuming no third party interests were implicated and a strong belief in freedom of contract.

⁷⁷⁰ Such clauses do appear in cases discussed in other chapters, where the question of whether the restrictions met the statutory criteria is not at issue.

⁷⁷¹ This type of restriction, which I term "pre-made decisions", is discussed at greater length in Chapter Five, including the problems they pose for the transfer of the directors' duties and liabilities.

⁷⁷² An "intent" requirement as discussed in this section refers to implicit intent, although explicit

to transform an agreement amongst all the shareholders into a unanimous shareholder agreement, with all that that status conveys.⁷⁷³ An intent requirement may have merit in avoiding unwanted outcomes, but if one is included in the definition, it must be accepted that this means that many documents would be rendered either partially or wholly inoperative, not merely downgraded in status to "contract". Only an agreement that restricts the directors qualifies as a unanimous shareholder agreement,⁷⁷⁴ but an agreement

statements that a unanimous shareholder agreement was intended would obviously suffice to meet such a standard. No statute requires either an explicit or implicit intent to create a unanimous shareholder agreement.

However, Alberta, Newfoundland and Labrador, the Northwest Territories, and Nunavut allow for a document that would otherwise be considered a unanimous shareholder agreement to "exclude the application to the agreement of all but not part" of the statutory section setting them out (*A.B.C.A.* s. 146(9), *N.L.C.A.* s. 245(10), *N.T.B.C.A.* s. 148(9), *N.B.C.A.* s. 148(9)). This is distinct from adding intent to the requirements for creating a unanimous shareholder agreement; unless the exclusion is invoked, it would appear to still be possible to form one accidentally by meeting all the criteria. This provision does, however, allow parties who do *not* intend to create a unanimous shareholder agreement to specifically prevent that from occurring while still meeting all the criteria, and so to that limited extent, it does add an "intent" element (as found in the document's terms, not inferred) to the question of whether a unanimous shareholder agreement has been created in those two provinces and two territories.

These four jurisdictions all also have the expanded criterion allowing for unanimous shareholder agreements that do not restrict the directors, and thus whose contents could be dealt with through a contract instead (albeit without the advantages the statutory tool confers, *e.g.* binding transferees). For example, they include unanimous shareholder agreements concerning "the regulation of the rights and liabilities of the shareholders, as shareholders, among themselves or between themselves and any other party to the agreement". It therefore makes sense to allow parties the option of choosing whether such an arrangements has the status of a unanimous shareholder agreement or just a contract. If, however, the document included restrictions upon the directors, it is unclear what effect invoking the exclusion provision would have. Giving effect to such an exclusion would necessitate invalidating any terms that could only be effective as part of a unanimous shareholder agreement. The difficulties presented by an "intent" requirement, as discussed herein, would apply.

⁷⁷³ *Bernier c. Cadrin*, 2009 QCCA 1237, 2009 CarswellQue 6262, 179 A.C.W.S. (3d) 339, J.E. 2009-1239, EYB 2009-160604 (C.A. Que. Jun 18, 2009) suggested that a specific intent might also be required to amend or terminate an existing unanimous shareholder agreement, rather than it happening "accidentally" in the course of the investors entering an unrelated contract. Two shareholders respectively holding 49% and 51% of a company signed a unanimous shareholder agreement, one term of which was to grant the 51% shareholder sole control of the company until certain conditions were fulfilled (pars. 12, 14, 57). Subsequently, a new investor entered into a contract with both of them, acquiring all 49% of the minority's holdings plus 1% from the formerly majority shareholder, resulting in an even split (pars. 52-53). One term of this share purchase contract was that all previous agreements amongst the shareholders were rescinded (par. 53). Despite that, the Court of Appeal found that the majority shareholder had only become a party to the contract to transfer the 1%, and unless expressly revoked, the term of the previous unanimous shareholder agreement granting sole control was still in effect, even though share ownership was now evenly split (par. 58). Also found relevant, however, was that the new shareholder had allowed the other to continue to control the company and had taken no steps at the time regarding this, so it was found that even if a right to object had existed, it had been renounced (par. 59). (The only place in this appeal where the agreement was referred to as a unanimous shareholder agreement was a passage reproduced at par. 67 from the original reasons for judgment.)

⁷⁷⁴ Under some statutes.

that does not qualify as a unanimous shareholder agreement cannot restrict the directors. While the parties to a lawful written agreement amongst all the shareholders that restricts the directors might not fully understand or appreciate the consequences of that fact, they surely intend that the terms of their agreement be effective. If there was a requirement added that the parties specifically intended for their contract to assume the status of a unanimous shareholder agreement, it might hinder more than help them.

That the benefits and drawbacks of the unanimous shareholder agreement are interrelated is a truth not always acknowledged. Disney noted that since, under the statute, there is no requirement of an intent to form a unanimous shareholder agreement, "many shareholder agreements that do not explicitly operate as unanimous shareholder agreements and may not have been consciously intended to take advantage of the statutory provisions may nonetheless, to some extent, constitute 'unanimous shareholder agreements' within the meaning of the *CBCA*".⁷⁷⁵ He warned that this could have "significant consequences"⁷⁷⁶ even aside from the transfer of liability⁷⁷⁷ and the binding of transferees with regard to the restrictions upon directors.⁷⁷⁸ While unclear, it appears that the "significant consequences" to which he alluded are that other terms in the agreement might *also* bind transferees.⁷⁷⁹ Scavone similarly noted that a shareholder agreement with a wide range of terms that "only incidentally restricts the powers of the directors automatically becomes a unanimous shareholder agreement even though the parties may not want to give the agreement that enhanced status".⁷⁸⁰

While such cautions are warranted, they do not address the fundamental problem with denying these documents the status of unanimous shareholder agreement: they would then fail to give effect to their terms. Scavone refers to "incidentally" restricting directors, but an incidental restriction was nonetheless intended. The choice then becomes either placing an enhanced status upon the agreement that the parties *may* not have known about or wanted, or nullifying terms (or entire agreements) that the parties definitely did want.

Given the normal presumption that the law governs parties even if they were unaware of it, the resolution to this dilemma seems clear. There does not appear to be much debate, for example, as to whether an individual who is elected director of a corporation must specifically be aware of and consent to all the legal responsibilities that that office entails in order for them to apply. One possible explanation for the increased concern over such an outcome in the context of unanimous shareholder agreements is the frequent equation of the tool with a contractual model of the corporation; this sort of unintended consequences would be antithetical to an approach based entirely around the alleged mutual consent of the

⁷⁷⁵ Disney, *supra* note 9, pp. 90-91.

⁷⁷⁶ *Ibid*, p. 91.

⁷⁷⁷ *Ibid*, p. 91, asserted this was largely redundant in a small corporation.

⁷⁷⁸ *Ibid*, p. 91, stated that this was probably intended.

⁷⁷⁹ *Ibid*, p. 91.

⁷⁸⁰ Scavone, *supra* note 9, p. 336.

parties to the arrangement. And yet, as noted in Chapter Two, there is nothing unusual about contracts being subject to the law, including aspects of it that the parties may not have anticipated. The onus is on them to be aware of the legal implications of their agreements.

This emphasis on intent may also derive from the opposite perspective, the preference for corporate structures to remain in the default form and scepticism of the notion that shareholders could alter them by agreement. Adherents of that position might require additional proof that such an outcome was intended before allowing it to occur. Conversely, openness to such alterations would lead to minimizing or rejecting any additional criteria such as "intent".

An intent requirement was both manufactured and awkwardly circumvented in *Piikani Investment Corp. v. Piikani First Nation*, the facts of which were discussed earlier, where after establishing that the Trust Agreement was both a document to which the correct shareholders were a party and that it restricted the power of the directors, McIntyre J. concluded, "For the reasons given above, I find the Trust Agreement fulfils the technical requirements of a USA according to s. 146 of the *CBCA*. However, it is not an easy fit and may be better described as a foundational document."⁷⁸¹ This reluctance to find the document a unanimous shareholder agreement resulted from the interpretation that "it is difficult to ascertain from the construction of the documents that the Nation intended to create a USA".⁷⁸² It was therefore preferable, in the judge's view, to treat it not as a unanimous shareholder agreement, but as a "foundational document".⁷⁸³ The significance of this new invented terminology was not well explored. He seemed willing to explicitly equate the legal status of this "foundational document" with what a unanimous shareholder agreement would possess, and rejected the idea that it was a "super USA" entitled to even greater power than a normal one.⁷⁸⁴ Indeed, in order to proceed with the analysis, he needed to work in terms of the pseudo-hypothetical condition "if the Trust Agreement is best described as a USA"⁷⁸⁵ to find that it should be read as having equal status to the articles and superior status to the by-laws.⁷⁸⁶

This distinction-without-a-difference intent requirement seems pointless. If it is necessary that the parties are aware of the unanimous shareholder agreement as a specific legal tool and intend to create one before that is the effect, then the logical corollary is that a failure to meet that requirement results in something that does not have the same status.

This was the conclusion reached in *O'Brien v. O'Brien Estate*,⁷⁸⁷ also discussed earlier. At the trial level, Smith J. noted that neither party appeared aware at the time the document was signed of the concept

⁷⁸¹ *Piikani*, *supra* note 234, par. 27.

⁷⁸² *Ibid*, par. 28.

⁷⁸³ *Ibid*, pars. 28, 50, 54.

⁷⁸⁴ *Ibid*, par. 41.

⁷⁸⁵ *Ibid*, pars. 37-39.

⁷⁸⁶ *Ibid*, pars. 37-38.

⁷⁸⁷ *O'Brien QB*, *supra* note 681.

of a unanimous shareholder agreement.⁷⁸⁸ She found various aspects of its creation, including the lack of professional consultation on its drafting and the father's deliberate choice to deal only with his son despite knowing that his daughter-in-law would likely soon become a shareholder, were evidence of it being a personal contract only.⁷⁸⁹ She was therefore apparently reading a requirement of "intent" into the statute. While she acknowledged that the document imposed obligations upon the company and not the son, that simply led her to classify those as referring to good faith efforts only. Curiously, she further found that the section of the agreement dealing with its effect upon subsequent transferees was evidence *against* the document being a unanimous shareholder agreement, because it was limited to only some provisions, allowed one and only one party to exercise discretion in holding transferees to the terms of the agreement, and would have been redundant if the agreement was a statutory unanimous shareholder agreement.⁷⁹⁰ On appeal, Lane J.A. summarized and agreed with the trial judge's view that the document was prepared in a manner that suggested the intent was that it be a personal agreement and not a corporate document.⁷⁹¹

Like *Piikani*, *O'Brien* seems to import an "intent" requirement into the unanimous shareholder agreement. But unlike in *Piikani*, the conclusion was that if something is not intended to be a unanimous shareholder agreement, it cannot have similar effect. Moreover, while the finding of fact was that neither party was at the time aware of the legal tool available to them, the agreement was meant to govern corporate actions, restrict director decision-making, and bind subsequent transferees. It was clearly intended that the contract have characteristics very much like a unanimous shareholder agreement. To rule that its very similarities meant it was not intended as one seems almost perverse. The clause dealing with the obligations of subsequent owners should, at most, have constituted a partial waiver of rights one party would have had by default through a unanimous shareholder agreement.

Whether the parties intended a document to constitute a unanimous shareholder agreement was also put at issue in *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*⁷⁹² The shareholders had entered into a "letter agreement" whose recitals included that "while it was not likely practical to have a complete shareholder agreement in place by closing, the shareholders would enter into a shareholder agreement".⁷⁹³ This letter agreement also included various provisions that the parties agreed would be incorporated into

⁷⁸⁸ Ibid, par. 93.

⁷⁸⁹ Ibid, pars. 68-69.

⁷⁹⁰ Ibid, par. 94.

⁷⁹¹ *O'Brien CA*, *supra* note 696, pars. 44-45.

⁷⁹² *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*, 2008 CarswellOnt 5615, 171 A.C.W.S. (3d) 842, [2008] O.J. No. 3715, 51 B.L.R. (4th) 301 (Ont. S.C.J. [Commercial] Sep 25, 2008) (hereinafter "*2082825 Sup Ct J*"); on appeal, *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*, 96 O.R. (3d) 467, 310 D.L.R. (4th) 754, 248 O.A.C. 266, 2009 CarswellOnt 1808, 176 A.C.W.S. (3d) 412, [2009] O.J. No. 1318, 56 B.L.R. (4th) 176 (Ont. Div. Ct. Mar 30, 2009) (hereinafter "*2082825 Div Ct*"), the appellants conceded Newbould J.'s finding that the document was a unanimous shareholder agreement, and the matter was not reconsidered (pars. 6-7).

⁷⁹³ *2082825 Sup Ct J*, *supra* note 792, par. 10.

the subsequent unanimous shareholder agreement, including a unanimity requirement for certain specified decisions, the positions of the shareholders within the company including the salary of the President, and the composition of the board of directors.⁷⁹⁴ No such agreement was subsequently signed.⁷⁹⁵ Ultimately, the majority shareholders/directors⁷⁹⁶ sought to terminate the employment of the President, contrary to the terms of the letter agreement specifying his office.⁷⁹⁷

Newbould J. found that:

In my view, the letter agreement and the acknowledgment of October 7, 2005 constituted a unanimous shareholder agreement. The terms were in writing in the letter agreement, and it is common ground that the terms were all agreed to. The acknowledgment of October 7, 2005 was in writing and signed on behalf of the two numbered companies as shareholders of the company to be acquired. The agreed terms restricted the powers of the directors to manage or supervise the management of the business and affairs of the corporation. The fact that a full blown shareholder agreement was not later signed does not mean that there was no unanimous shareholder agreement. The acknowledgment stated that upon execution of the anticipated shareholder agreement, it would supersede the letter agreement, which was an acknowledgment that the letter agreement was a binding document.⁷⁹⁸

There was no requirement that the parties intended the "letter agreement" itself to be a unanimous shareholder agreement *per se*, and some evidence that they did not at the time consider it one, but since it met the statutory requirements and the judge found that it was intended to be binding, it was so classified.

Though the question of intent was not raised there, a similar issue might have been present in *Ming Minerals*, discussed above. In that case, one of the shareholders on behalf of the company and the representative of what was then an arm's length party signed a contract. Setting aside the problem of the other shareholder not signing, the question remains as to whether it was intended to be a unanimous shareholder agreement. A contract the company enters with a third party presumably usually mandates it will take certain steps, meaning that if for some reason all the shareholders happen to sign a corporate contract, it might become a unanimous shareholder agreement despite that not being intended or desired.⁷⁹⁹ It is arguably beyond the power of the directors or officers of a corporation to violate a unanimous shareholder agreement.⁸⁰⁰ If one subscribes to the view that companies should be allowed to break

⁷⁹⁴ Ibid, par. 10.

⁷⁹⁵ Ibid, par. 12.

⁷⁹⁶ In which capacity they were acting was disputed by the parties, but is not relevant to this analysis (2082825 Sup Ct J, *supra* note 792, par. 17).

⁷⁹⁷ 2082825 Sup Ct J, *supra* note 792, par. 17.

⁷⁹⁸ Ibid, par. 30.

⁷⁹⁹ Assuming that all shareholders had signed a lawful written document, the only remaining criterion would be restricting the power of the directors. By binding the corporation to take certain steps, the power of the board to direct the company otherwise is curtailed, thus fulfilling the final criterion. See the discussion of "pre-made decisions" in Chapter Five.

⁸⁰⁰ See Chapter Four.

contracts when it is "economically efficient", then this scenario presents difficulties. Considering the contract a unanimous shareholder agreement might also shift liability arising from those acts from the directors to the shareholders, including transferees.⁸⁰¹

While the concern in the literature that the accidental creation of a unanimous shareholder agreement might be detrimental to the investors may have been based in the belief that these instruments should only reflect the voluntary intent of the parties, the case law reveals that the true effect of an intent requirement would not necessarily benefit shareholders. These judgments demonstrate both the drawbacks and possible benefits of an "intent" requirement, and suggest that this might be best solved by applying the "restriction" criterion in a more nuanced manner. If the parties intend to create a binding document that restricts directors, then it should be recognized as effective if it meets the statutory requirements. Looking for a specific desire to create a unanimous shareholder agreement leads only to the contradictions and circular logic found in *O'Brien*, not to mention increases legal uncertainty and penalizes parties who entered into what they thought would be a binding arrangement. It is true that there may be consequences of such a determination that the shareholders did not foresee or wish, but these dangers are easy to overstate and responsibility for avoiding them should rest upon the parties. If, on the other hand, a contract between the corporation and a third party is intended to impose contractual obligations upon the corporation *vis-a-vis* the third party, then, absent specific counter-indications, these should not be interpreted as restrictions upon the directors simply because all the shareholders happen to have signed the document for some reason. Although this might not fully avoid the problem of documents being classified as unanimous shareholder agreements (or not) contrary to the parties' intent, it will best give effect to their bargains and minimize unforeseen complications.

8. Conclusion

The four criteria of a unanimous shareholder agreement in the *C.B.C.A.* - that it be written, lawful, unanimous, and restrict the directors- appear straightforward. Mostly, they are. There are, however, a number of potential ambiguities within them, particularly the latter two, which can lead to practical difficulties. Moreover, while these requirements are now well-established, their theoretical bases are neither self-evident nor value-neutral, but are reflective of contestable and not necessarily consistent conceptions of both this tool and the corporation itself. Understanding the criteria necessary for the formation of a unanimous shareholder agreement is therefore necessary not only to clarify technical issues in order to maximize the tool's utility and resolve disputes, but also to help us comprehend these agreements' very nature, and perhaps therefore the nature of the corporations they can affect.

⁸⁰¹ Such liabilities would not normally include contractual ones, but could include liability for any

Arguments that the unanimous shareholder agreement's scope should be expanded and that correspondingly one should no longer need to restrict directors in order to be valid derive from the view that these documents are not simply a tool to achieve limited goals within a statutory framework, but rather that they embody a contractual corporation that may be altered by its alleged parties, the shareholders, within only the broadest of limits required by third party protection and social policy.⁸⁰² And yet, in fact, that is clearly not what the unanimous shareholder agreement currently is, at least not in the *C.B.C.A.* and the jurisdictions that follow similar models. The case law on forming unanimous shareholder agreements suggests that the opposite position still holds significant sway with the judiciary, who not only enforce the statutory requirements (as they must) but may take a view of it narrower than the wording of the legislation indicates, let alone necessitates, in order to more closely align these companies with the standard corporate arrangement. On this front, the case law does not support the position that the unanimous shareholder agreement has transformed Canadian corporations into contractual arrangements; it has simply provided a tool through which statutorily defined organizations can be manipulated to a limited extent.

The unanimity requirement itself, from which the tool derives its name, is also significant for this debate. It is an anomaly in corporate law, where majorities typically rule (subject only to general principles designed to safeguard minorities from exploitation). In that framework, the purpose of the requirement would presumably be the protection of minority interests, although it is unclear why unanimous consent is necessary here when it is not to, for example, elect the directors who normally control the corporation. Conversely, if the corporation is viewed as a contract, the unanimity criterion is an expression of the wider principle that all parties must consent to an amendment varying an agreement amongst them. The relatively small volume of reported case law makes it more difficult to draw conclusions here. Protecting the interests of shareholders who did not consent to the agreement (or an amendment to it) is sometimes the implicit or explicit reason for a judgment, but at other times this factor is clearly irrelevant or ignored. Reported cases lean toward strictly enforcing the unanimity requirement even when given potential "cover" for waiving it, but there are exceptions such as *Ming* or *White*. So, although the case law is not fully consistent with regard to the unanimity requirement, it appears that the judiciary is mostly supportive of it. Given that enforcing it creates a higher threshold for the creation of these instruments, adherence to a strict unanimity requirement does not necessarily represent sympathy for a contractual model; it may actually imply the opposite.

It is possible to find in the foregoing cases a number of specific rules. From the Supreme Court decision in *Duha*, we know that requiring shareholder consent for new share issues is a sufficient restriction upon directors' powers, that a restriction upon directors *is* necessary for a unanimous shareholder

torts or statutory violations that occurred as a result of the contract.

⁸⁰² It also appears to be based in part upon a confusion between the criteria and potential uses of a unanimous shareholder agreement.

agreement, and that once such a term is present the entire document has that status.⁸⁰³ The other decisions discussed come from lesser authorities, but results such as separate but very similar documents for each class being read together as one agreement or the need to have the actual shareholders and not their spouses sign might prove persuasive in some subsequent decision. However, by considering multiple decisions together, one can tentatively identify some larger principles at work, even while it becomes clear that other dilemmas remain unresolved.

Two of the more technically questionable decisions regarding the statutory requirements for unanimous shareholder agreements, *Colborne* and *White*, involved parties whose behaviour was generally found to be less than admirable. While the judges in both cases did provide statutory analyses to support their decisions, it is at least possible that they were affected by consideration of what would lead to an equitable outcome. Generally speaking, courts have not made decisions in this area that place a technical interpretation of the law over some more general conception of "justice". Even *O'Brien*, another of the more analytically dubious decisions, may represent an example of this principle; the plaintiff's attempt to hold family members to a strict standard of contractual obligation might have rendered him unsympathetic, as might the alleged contradictions in his position and the lateness of the additional argument that the contract was a unanimous shareholder agreement. Unfortunately, these judgments all presented their conclusions as if they were consistent with the general legal principles governing unanimous shareholder agreements, rather than as on-the-facts exceptions. This has both contributed to and been allowed by the vagueness of the statutes and the uncertainty in this area of the law.

Similarly, in *Ming*, *White*, and *Buttarazzi*, the subsequent behaviour of the parties was used as evidence as to whether or not a unanimous shareholder agreement existed, in the first two cases positively and in the other negatively. A variation appeared in *Plomberie J.C. Langlois Inc. c. R.*,⁸⁰⁴ where the parties' utter failure to follow the terms of their agreement meant that the judges at both the trial and appeal level disregarded it, although they did not find that no unanimous shareholder agreement existed. Counter-examples would include *Power* and *O'Brien*, where the parties subsequently behaved for at least a period of time as if a valid agreement had been made or amended. In both cases, however, it seems likely that it was not just the strict statutory requirements, but other fact-specific elements as well, which proved more persuasive than the parties having initially followed the agreements.

Even the use of an "intent" criterion may fall into this general category, another example of eschewing a narrow, objective, and technical analysis of the statutory criteria in favour of a broad,

⁸⁰³ Under the *M.C.A.*, at least.

⁸⁰⁴ *Plomberie J.C. Langlois Inc. c. R.*, 2004 TCC 734, 2004 CCI 734, 2004 CarswellNat 3844, 2004 CarswellNat 7322, 2004 D.T.C. 3595 (Eng.), 2006 D.T.C. 2997 (Eng.) (T.C.C. (G.P.) Nov 02, 2004); *Plomberie J.C. Langlois Inc. c. R.*, 2006 CAF 113, 2006 FCA 113, [2007] 3 C.T.C. 148, 357 N.R. 339, 2006 CarswellNat 675, 2006 CarswellNat 3752, 2006 D.T.C. 6508 (Fr.), 2007 D.T.C. 5662 (Eng.) (F.C.A. Mar 16, 2006). Only the latter referred to the document as a unanimous shareholder agreement.

subjective, and equitable analysis of the entire situation.

All of the foregoing suggests that determining whether or not a document is a unanimous shareholder agreement will not be done solely on the basis of a simple, technical test for the required statutory elements. Judges might look to surrounding factors, including the overall behaviour of the parties, whether everyone participated in the process, whether the parties subsequently treated the agreement as binding, and what their intent was in entering it. They may also compare the agreements to their own preconceptions and prejudices as to how a corporation should be run.

Although very narrow restrictions of corporate governance matters have been found sufficient to meet the statutory requirements, and thus the agreements can be used for some minute adjustments to the corporate power structure rather than its complete overhaul, terms that attempt to control the operational decisions of the company may be met with more resistance. When this occurs, it suggests a judicial pre-conception of the role of this tool that is largely in keeping with the traditional statutory division between shareholders and directors, rather than a full embrace of the more contractual perspective that investors may, through a unanimous shareholder agreement, assert whatever control over the corporation they wish.

The requirements for the formation of a unanimous shareholder agreement remain rife with grey areas. Despite their apparent simplicity, they contain any number of potential ambiguities which have to date been the subject of little or no reported judicial attention, making the state of the law uncertain. One of the few general principles that has emerged is that the court is likely to favour a contextual, equitable analysis over a technical one. Another is that a certain amount of judicial scepticism or even resistance may exist toward attempts to alter the corporate structure away from the traditional arrangement- to replace the default statutory model of directors' authority with one determined by a contract amongst the shareholders- and that this is made manifest in how the criteria are interpreted and applied.

Chapter 4: Enforcement

1. Introduction

Perhaps the question that throws into sharpest relief the unusual nature of the unanimous shareholder agreement is the multiplicity of approaches that Canadian courts have used to enforce them. A lack of consistent terminology or (frequently) analytic purity has often obscured the very existence of this divergence, let alone its primary factions, but a careful review of the case law reveals four significant frameworks that have been employed by the judiciary: the corporate constitutional approach, contract law, the directors' duties, and the oppression remedy.⁸⁰⁵ This chapter will examine those cases⁸⁰⁶ in depth, firstly to establish the existence and continued currency of these competing approaches, secondly to determine some of their implications in a practical context, and thirdly as a basis for arriving at normative conclusions as to how the conflicts in this area might best be resolved. The ultimate recommendation is that the corporate constitutional method is generally superior to the alternatives.

The corporate constitutional approach, briefly stated, is one where the unanimous shareholder agreement is taken to have fundamentally altered the powers of the directors, making any action that is contrary to the agreement *ultra vires* them.⁸⁰⁷ This approach is the only one that treats the terms of

⁸⁰⁵ This list is not exhaustive of all possible theoretical approaches, but is functionally exhaustive of all the ones that appear in reported Canadian cases, with a couple of minor exceptions. A fifth approach, based around judicial discretion, is discussed at note 895. Specific fact situations have given rise to cases where violations of a unanimous shareholder agreement were considered in the context of alleged criminal frauds, such as *Lauer SC (TD)*, *supra* note 516, and *Lauer CA*, *supra* note 516, but it would be difficult (and contrary to the *Lauer CA*, pars. 112-114) to extrapolate a doctrine that breaching these agreements is inherently an act of fraud, rather than an incidental element in some frauds. This list also excludes situations where a party's wilful failure to observe the document's terms constitutes bad faith, a lack of "clean hands", or similar concepts, but the specific nature of the legal dispute is difficult to characterize as even an indirect attempt to rectify those deficiencies themselves.

⁸⁰⁶ Judgments dealing with enforcement of unanimous shareholder agreements strictly in the context of rights existing as between shareholders, *e.g.* shotgun clauses, or rights the company has against shareholders outside the control context, *e.g.* non-compete clauses, will be excluded from the analysis unless they involve corporate governance issues or corporate law principles. While these cases do illustrate the other half of the agreements' hybrid nature, as discussed in *Duha SCC*, *supra* note 24, they generally proceed along strict contract law lines, although occasionally the oppression remedy is invoked.

⁸⁰⁷ But the resulting action is not *ultra vires* the corporation itself. In corporate law, the phrase "*ultra vires* doctrine" typically refers to the principle that certain acts are outside the legal capacity of a given corporation to perform, usually due to limitations in its authorizing statute or its articles of incorporation, and thus its attempts to perform them will be void. As the Supreme Court of Canada observed in *Communities Economic Development Fund v. Canadian Pickles Corp.*, [1991] 3 S.C.R. 388, 1991

unanimous shareholder agreements as literally placing restrictions upon directors. It therefore appears the most consistent with the legislative wording and also with the Supreme Court of Canada's decision in *Duha*. Even putting that authority aside, from a purely theoretical prescriptive standpoint, the corporate constitutional approach allows for greater certainty than any of the others, as well as allowing for more creative use of the unanimous shareholder agreement as a means of departing from traditional corporate structures.

CarswellMan 25, 1991 CarswellMan 402, [1991] S.C.J. No. 89, [1992] 1 W.W.R. 193, 10 W.A.C. 1, 131 N.R. 81, 29 A.C.W.S. (3d) 980, 76 Man. R. (2d) 1, 85 D.L.R. (4th) 88, 8 C.B.R. (3d) 121, J.E. 91-1789, EYB 1991-67199 (S.C.C. Nov 14, 1991) (hereinafter "*Communities*"), Canadian law has largely moved away from this *ultra vires* doctrine. Most of the statutes that authorize the creation of unanimous shareholder agreements explicitly provide that a corporation has all the capacity of a natural person. (See *C.B.C.A.* s.15(1), *A.B.C.A.* s. 16(1), *M.C.A.* s. 15(1), *N.B.B.C.A.* s. 13(1), *N.L.C.A.* s. 27(1), *N.T.B.C.A.* s. 15(1), *N.B.C.A.* s. 15(1), *O.B.C.A.* s. 15, *S.B.C.A.* s. 15(1), and *Y.B.C.A.* s. 18(1).) Thus, any act that a human being has the legal capacity to do cannot be *ultra vires* the corporation.

That does not mean, however, that it cannot be outside the powers of the directors to *cause* the corporation to perform such an act. This is simply the same principle by which, in the absence of a unanimous shareholder agreement, the shareholders lack the power to cause the corporation to act, or for that matter by which outside parties lack that power, without that being in any way relevant to the corporation possessing the capacity of a natural person. Making a decision *ultra vires* the directors is distinct from making the corresponding act *ultra vires* the corporation. A unanimous shareholder agreement that restricts the directors does not affect the corporation's legal capacity.

This remains the case even if, as discussed in Chapter Five, the effect of a unanimous shareholder agreement is to restrict the powers of the board without correspondingly granting powers to shareholders (or another party). Although the result may be that neither group (and thus no one) has the authority to cause the company to perform certain acts, the corporation itself nonetheless retains the legal capacity to perform those acts.

The corporate constitutional model of enforcing unanimous shareholder agreements therefore does not represent a revival of the "*ultra vires* doctrine". Actions nullified under this approach are not void because they were beyond the corporation's legal capacity, but rather because they were not authorized by the proper decision-maker(s) within the corporate structure.

With one exception, the sections of the various statutes that specifically provide that a corporate act is not invalid simply by reason that it failed to follow the relevant *Act* or its articles of incorporation do not mention unanimous shareholder agreements. (See *C.B.C.A.* s. 16(3), *A.B.C.A.* s. 17(3), *M.C.A.* s. 16(3), *N.B.B.C.A.* s. 14(3), *N.L.C.A.* s. 29, *N.T.B.C.A.* s. 16(4), *N.B.C.A.* s. 16(4), *S.B.C.A.* s. 16(3), and *Y.B.C.A.* s. 19(3). *O.B.C.A.* s. 17(3) provides that "no act of a corporation including a transfer of property to or by the corporation is invalid by reason only that the act is contrary to its articles, by-laws, a unanimous shareholder agreement or this *Act*". The Supreme Court in *Communities* determined that such sections must be understood as "part of a legislative scheme to abolish the doctrine of *ultra vires*" (par 48), which as was just explained is a development inapplicable to the restrictions in a unanimous shareholder agreement; the issue is not whether acts of the corporation were contrary to the agreement *per se*, but rather whether those who purported to cause those acts had the authority to do so. Nonetheless, s. 17(3) may represent a barrier to applying the corporate constitutional approach to unanimous shareholder agreements under the *Ontario Act*; see note 892.

The contractual approach to enforcement⁸⁰⁸ treats the agreement as a contract, subject to the normal rights and remedies of contract law. Directors retain the authority to breach these contracts, although they could potentially be held liable for any resulting damages, so there remains an incentive not to do so. Ultimately, in the event that the prohibited acts do occur, this model reduces the agreements to a form of insurance for shareholders, subject to the necessity of proving the quantum of harm. This would severely limit their flexibility and utility.

The directors' duties approach incorporates adherence to the unanimous shareholder agreement into the directors' duties to the corporation. The legislation states that directors must comply with unanimous shareholder agreements, but regardless of whether that is the basis of the claim, elements of this model may influence the analysis. In particular, this framework draws upon principles developed to govern the general statutory or common law duty of care and possibly to a lesser extent the duty of loyalty.⁸⁰⁹ This would allow directors to use their discretion as to whether following "restrictions" placed upon them was in the best interests of the company. The problems of enforcing the duty of care are well-known, and while that may be a necessary evil when it comes to reviewing most business decisions, it seems inappropriate for enforcing the set terms of an agreement.

The oppression approach uses the various aspects of the statutory oppression remedy to rectify any harm caused by violations of the agreement, if such remedy is warranted under the standards of that doctrine. Some cases suggest that the oppression remedy is not actually enforcing the specific terms of the agreement, but rather doing what it always does, namely controlling abuse of power in the corporate context by protecting reasonable expectations. To the extent that this is meaningfully distinct from enforcement of the agreement *per se*, the oppression remedy might retain a role in this area. But the considerations that it takes into account introduce unacceptable levels of uncertainty when the issue at hand is the enforcement of the terms of a unanimous shareholder agreement.

There are real and substantial differences between these approaches, both at a theoretical level and a practical one.

In addition to various procedural differences between them,⁸¹⁰ these frameworks may result in

⁸⁰⁸ The "contractual approach" (or "contractual model", *et cetera*) to enforcing unanimous shareholder agreements is different from the "contractual approach" (*et cetera*) to the corporation itself. Throughout this chapter, the phrase should be understood as referring to the contractual approach/model of enforcing these agreements.

⁸⁰⁹ Recent developments in the law, particularly the Supreme Court of Canada decision in *People's Department Stores Ltd.(1992) Inc., Re*, 2004 SCC 68, [2004] 3 S.C.R. 461, 244 D.L.R. (4th) 564, 326 N.R. 267 (Fr.), 326 N.R. 267 (Eng.), 2004 CarswellQue 2862, 2004 CarswellQue 2863, 49 B.L.R. (3d) 165, J.E. 2004-2016, [2004] S.C.J. No. 64, REJB 2004-72160, 4 C.B.R. (5th) 215 (S.C.C. Oct 29, 2004) (hereinafter "*Peoples*"), indicate that the duty of care would be the more appropriate one to cover any general obligation to follow the agreement regardless of whether self-interest is at stake, but the two duties are not always clearly delineated in the caselaw.

⁸¹⁰ *e.g.* limitation periods.

very different answers to the three most basic questions that arise regarding the enforcement of unanimous shareholder agreements: who can have them enforced, is enforcement necessary in a given case, and what form should enforcement take? The approach taken also provides insight into the very nature of unanimous shareholder agreements as a facet of corporate law. The question of how they should be enforced is entangled with the question of what they *are*. This in turn leads to the question of what a corporation is.⁸¹¹ The corporate constitutional approach is the most closely aligned with the "nexus of contracts" corporation, whose fundamental terms can be subject to renegotiation; the other three, conversely, largely maintain the default power arrangement found in the statutes, even as they incorporate these instruments into it through its existing mechanisms.

The recent Alberta case of *Sumner v. PCL Constructors Inc.* provides, at both the trial⁸¹² and appeal⁸¹³ level, the only extensive analysis in the reported case law to specifically contrast the corporate constitutional and contractual approach to the enforcement of unanimous shareholder agreements; the differing conclusions reached at the two levels serve to illustrate how the choice of theoretical framework can have practical consequences. Because of the scant judicial attention to this specific issue, the Court of Appeal decision is also *de facto* the leading authority on this topic. It is therefore useful to examine this case closely before proceeding to consider the various approaches separately, both as an introduction to some of those frameworks and as an illustration that the contrast between them is not merely "a distinction without a difference". The next section of this chapter will therefore review both levels of judgment in *Sumner*. The four following sections will then discuss the bases of the four approaches in turn, with an accompanying examination of cases embodying each.

2. *Sumner v. PCL Constructors Inc.*: The Choice of Approach Matters

2.(a) The Trial Judgment

Nearly all reported cases involving the enforcement of unanimous shareholder agreements do not spend substantial analysis determining which of the four approaches to the topic is appropriate. In that regard, the recent case of *Sumner v. PCL Constructors Inc.*⁸¹⁴ is exceptional, as detailed consideration is

⁸¹¹ Conversely, from a prescriptive perspective, a position regarding what a unanimous shareholder agreement is can lead to a position on how it should be enforced.

⁸¹² *Sumner* QB 1, *supra* note 260, and additional findings in *Sumner v. PCL Constructors Inc.*, 2011 ABQB 20, [2011] 7 W.W.R. 184, 2011 CarswellAlta 20, 197 A.C.W.S. (3d) 101, [2011] A.W.L.D. 1767, [2011] A.W.L.D. 1768, [2011] A.W.L.D. 1769, [2011] A.J. No. 23, 79 B.L.R. (4th) 300, 39 Alta. L.R. (5th) 249 (Alta. Q.B. Jan 12, 2011) (hereinafter "*Sumner* QB 2").

⁸¹³ *Sumner* CA, *supra* note 263.

⁸¹⁴ *Sumner* also contained a second issue, pay owing for wrongful dismissal, which is dealt with separately in the judgments and irrelevant to the current summary.

given to which of three possible enforcement methods should be used, and in particular whether the document should be treated as a part of the "corporate constitution" or merely a contract. Furthermore, the case offers contrasting views on that question at the trial and appeal level, which led directly to differing results.

In *Sumner*, the plaintiff was a former employee of one of the corporate defendants and a former shareholder of the other, its corporate parent.⁸¹⁵ Upon his termination, the latter corporation redeemed his shares, allegedly in accordance with the terms of a unanimous shareholder agreement.⁸¹⁶ Unfortunately, the redemption violated the agreement in at least one and possibly two ways. It was conceded by the defendants that, to follow the document's terms, there should have been a directors' resolution *before* the redemption rather than after it, as had in fact occurred.⁸¹⁷ More contentiously, there was disagreement as to whether the proper steps had been taken to have the plaintiff found disabled and unable to continue his employment, a precondition in the unanimous shareholder agreement to the redemption of his shares through the particular method used.⁸¹⁸ Manderscheid J., in the initial trial judgment, found that both these sections of the agreement had been violated.⁸¹⁹ The Court of Appeal subsequently disagreed, and found that only the former had been.⁸²⁰

Having found two violations of the unanimous shareholder agreement, Manderscheid J. proceeded to consider what consequences flowed from that determination. He noted that the parties had, in their arguments, both treated the unanimous shareholder agreement as a contract.⁸²¹ He held that this was wrong in law.⁸²² He pointed out several features that distinguished unanimous shareholder agreements from most contracts; "In that sense a USA is something other than a contract - it affects the authority of parties (the corporation and its directors) who are not even parties to the agreement."⁸²³

Drawing upon the precedent of the Supreme Court of Canada's decision in *Duha*,⁸²⁴ Manderscheid J. explained that unanimous shareholder agreements are constitutional documents for corporations.⁸²⁵ He rejected the argument that *Duha's* precedent regarding their constitutional nature was limited to the realm of

⁸¹⁵ *Sumner* QB 1, *supra* note 260, pars. 2 sub 1, 2 sub 19.

⁸¹⁶ *Ibid*, par. 2 sub 20.

⁸¹⁷ *Ibid*, par. 167.

⁸¹⁸ *Ibid*, pars. 168-176.

⁸¹⁹ *Ibid*, pars. 177-182.

⁸²⁰ See discussion below.

⁸²¹ *Sumner* QB 1, *supra* note 260, par. 153.

⁸²² *Ibid*, par. 153.

⁸²³ *Ibid*, par. 190. Of course, the corporation and/or its directors may be parties to the contract, but they do not have to be. Note the interesting and perhaps debatable claim that the authority of the corporation is automatically affected by the unanimous shareholder agreement, in addition to the board.

⁸²⁴ *Ibid*, pars. 191-193 cited *Duha* SCC, *supra* note 24, pars. 61 and 63-68; *Sumner* QB 1 also more briefly referenced *Piikani*, *supra* note 234, at pars. 194 and 200, and *O'Brien* CA, *supra* note 696, at par. 195, as further authority that a unanimous shareholder agreement is a constitutional document of the corporation. Both cases are discussed elsewhere in this chapter and in Chapter Three.

tax law.⁸²⁶ Further, because Manderscheid J. found that corporate constitutions were not contracts in Alberta and most other Canadian jurisdictions unless so deemed by statute, then if unanimous shareholder agreements were considered corporate constitutional documents, they must necessarily not be contracts.⁸²⁷ Making perhaps too much of Iacobucci J.'s reference in *Duha* to the *C.B.C.A.* requirement that a unanimous shareholder agreement be "lawful", a term not found in the *A.B.C.A.* definition, Manderscheid J. further found that under the Alberta *Act*, the normal requirements of contract law might be relaxed for a unanimous shareholder agreement, further distinguishing the two.⁸²⁸ In addition to generally rejecting the approach of the trial judge, the Court of Appeal specifically disagreed with this point, finding that there was no significance to the omission of the adjective "lawful" in the Alberta legislation.⁸²⁹

Despite this lengthy analysis concluding that a unanimous shareholder agreement was not a contract, Manderscheid J. proceeded to find that, in cases where a corporation was a party to the unanimous shareholder agreement, the corporation would be bound to the contract and contract law remedies might be available.⁸³⁰ This appears to contradict the earlier assertion that a corporate constitutional document is by definition not a contract, although the hybrid analysis is more in line with *Duha* and, as discussed below, solves problems that would otherwise arise. In this case, however, Manderscheid J. found that the corporation was not a party,⁸³¹ so for reasons of fact if not law, contract law could be of no help to the plaintiff.

This then left two possible avenues for enforcing the unanimous shareholder agreement: either the oppression remedy or "a court compliance or restraining order requiring adherence to the corporate constitution, including a valid unanimous shareholder agreement"⁸³² under s. 248 of the *A.B.C.A.*.⁸³³ After briefly setting out the "well developed" principles of the oppression remedy,⁸³⁴ Manderscheid J. provided a more in-depth review of the s. 248 (and equivalent provisions) jurisprudence, outside the area of unanimous shareholder agreements, to determine applicable principles, summarized thus:

208 The breach of corporate constitutional rules is a precondition for an application to the court to direct compliance or restraint, and order other appropriate relief. Where that breach is disputed then presumably a court would first engage in a preliminary inquiry as to whether unauthorized action or inaction had occurred. Then, with that step completed, a "complainant or creditor" may then apply to the court for its remedy. The procedure for this latter application is open-ended[....]

⁸²⁵ *Sumner* QB 1, *supra* note 260, pars. 184-200.

⁸²⁶ *Ibid*, par. 200.

⁸²⁷ *Ibid*, par. 196.

⁸²⁸ *Ibid*, par. 197. See Chapter Three for a further discussion of this point.

⁸²⁹ This question is discussed further below.

⁸³⁰ *Sumner* QB 1, *supra* note 260, par. 203.

⁸³¹ *Ibid*, par. 203. As discussed below, the Court of Appeal disagreed with this finding.

⁸³² *Ibid*, par. 204.

⁸³³ *Ibid*, par. 204.

⁸³⁴ *Ibid*, par. 205.

224 In summary, the reported case-law provides some guidance on how a court should apply *BCA*, s. 248. That said, the remedies for a breach of corporate constitution seem to be contextual, and are intended to address any injury suffered by an applicant or other affected party that result from the breach. In general, academic and judicial commentary has interpreted this kind of provision as providing a very broad authority to the court to craft an appropriate remedy to address injury, in addition to directing lawful corporate conduct.

As argued below, the logical application of the corporate constitutional approach would normally be a judicial finding that any acts the directors purported to perform outside their restricted powers would be nullities. Manderscheid J.'s conclusion, by contrast, while perhaps correct as a matter of statutory interpretation, grants an almost equitable flavour to the issue.⁸³⁵ Nonetheless, he concluded that s. 248 was not an equitable remedy, but on the contrary was designed to enforce strict compliance with legal rights, and therefore "need not strictly parallel the principles applied when ordering a remedy for oppressive conduct".⁸³⁶

In Manderscheid J.'s view, the plaintiff had framed his s. 248 argument essentially as an oppression claim.⁸³⁷ The defendants objected because oppression had not been pled,⁸³⁸ which the trial judge accepted.⁸³⁹ The defendants also objected that the unanimous shareholder agreement had specifically excluded the oppression remedy,⁸⁴⁰ although Manderscheid J. expressed doubt that it was possible to contract out of that remedy⁸⁴¹ and found that, regardless, the agreement specifically allowed claims of oppression in cases where it had itself been violated.⁸⁴² The trial judge found that his conclusions regarding s. 248 made it unnecessary to decide whether oppression had occurred.⁸⁴³

Finally, having dismissed both the contract and oppression approaches and having outlined some of the principles of s. 248, Manderscheid J. determined that it was possible to use that section to rectify prior breaches and not simply restrain future ones:

246 Bluntly, the Defendants' suggested s. 248 interpretation results in the very problematic result that a corporation or its directors could exceed their authority, and *fait accompli*, deny any remedy to affected parties. That cannot be correct.

⁸³⁵ The term "equitable" here does not refer to equity investments, but rather to the legal tradition originally associated with the historical Chancery Courts, which departed from the formalistic and rules-driven common law of the period in an effort to do justice between the parties, and continuing today in the form of equitable principles.

⁸³⁶ *Sumner* QB 1, *supra* note 260, par. 227.

⁸³⁷ *Ibid*, par. 231.

⁸³⁸ *Ibid*, par. 234.

⁸³⁹ *Ibid*, par. 241.

⁸⁴⁰ *Ibid*, par. 234.

⁸⁴¹ *Ibid*, par. 238.

⁸⁴² *Ibid*, par. 238.

⁸⁴³ *Ibid*, par. 236.

Manderscheid J. also rejected the plaintiff's position that the oppression remedy should serve as a guide for a s. 248 award,⁸⁴⁴ and illustrated how analyses under the two sections differed:

249 The facts of the present matter can be adapted to illustrate the difference between the oppression and s. 248 remedies. I have concluded that the notice to purchase the Plaintiff's PCLEH shares and the Director's declaration that the Plaintiff was disabled were premature, that PCLEH had no right at that time to require the Plaintiff sell his PCLEH. That is unfair, the Plaintiff was deprived of something to which he had a legal right.

250 In contrast, if the Plaintiff was properly notified of being categorized as disabled, a six month period elapsed without challenge, and then PCLEH issued a notice to purchase shares without the Plaintiff being designated by the Directors as a withdrawing shareholder, then the defect in PCLEH's conduct is procedural, rather than substantive. Put another way, in the hypothetical scenario the Plaintiff had not been deprived of any right. PCLEH had authority to require repurchase of the Plaintiff's shares - it just conducted that repurchase in a procedurally incorrect manner. Now there is no unfairness, and so oppression would not be available. However, I conclude s. 248 would still be available in this hypothetical case, as the Plaintiff has a right to have a court order to fix the consequence of procedural error. Similar to *Davidson v. FinancialCAD Corp.*, that right may not mean unwinding a series of corporate actions, but must have the result that the parties affected by non-compliance with the corporation's rules are not negatively affected. In that sense, s. 248 has a broader potential application than the oppression remedy; a complainant need not demonstrate "unfairness", rather simply that an unauthorized action occurred, and the complainant was affected.

This then led to a second decision, in which Manderscheid J. denied the plaintiff's application to amend the Statement of Claim to include a claim for oppression,⁸⁴⁵ allowed the plaintiff to amend the pleadings to include a s. 248 claim that the judge had essentially already found in favour of before it had been added,⁸⁴⁶ and considered what remedy to award for the s. 248 claim. This included a reiteration that the remedy could rectify prior wrongs⁸⁴⁷ and a finding that, on the wording of the Alberta act⁸⁴⁸ it was possible to award damages under s. 248 to plaintiffs who had suffered financial harm as a result of the non-compliance.⁸⁴⁹

Manderscheid J. considered how to rectify the violation of the unanimous shareholder agreement. Two options were presented: either the plaintiff could be treated as having redeemed his shares upon the end of his notice of termination period or upon his 64th birthday, as specified in a different redemption

⁸⁴⁴ Ibid, pars. 247-248.

⁸⁴⁵ *Sumner QB 2, supra* note 812, par. 15.

⁸⁴⁶ Ibid, par. 9.

⁸⁴⁷ Ibid, pars. 24-26.

⁸⁴⁸ Specifically, the words "any other order", discussed at *Sumner QB 2, supra* note 812, pars. 41-44.

⁸⁴⁹ *Sumner QB 2, supra* note 812, par. 50.

provision of the agreement.⁸⁵⁰ While noting that the amount would be the same in either event,⁸⁵¹ Manderscheid J. decided in favour of the latter date, both because it was earlier in time and because it was explicitly in accordance with the unanimous shareholder agreement.⁸⁵²

The argument that any award to the plaintiff would unfairly harm the other shareholders was also considered:

77 As for the argument that only innocents will be harmed, those innocents nevertheless are in possession of property that belongs to someone else. Any award I might make to Sumner will most likely mean the PCLEH owners receive a smaller dividend or bonus at some future date. In effect that balances out their 'windfall' from Sumner's unlawful PCLEH share repurchase.

As the Court of Appeal noted, the statement that the funds "belonged to someone else" depends upon the preceding corporate constitutional analysis, under which the redemption of the plaintiff's shares was a nullity.

On a technical level, it might have been preferable if the award had not been damages, but instead had been a declaration that the share purchase was invalid, which would have given the plaintiff the ability to separately pursue claims for the rights to which that would give rise if the corporation refused to pay the funds that would then be owing. Perhaps Manderscheid J.'s decision to award damages can be explained as an attempt to avoid a multiplicity of proceedings, but it lacks theoretical elegance.

The analysis in the second trial judgment contains one further curiosity, which unfortunately obfuscates the distinctive quality of a corporate constitutional approach as opposed to an oppression one. The defendants argued that, while they had not followed the unanimous shareholder agreement precisely, their intention to redeem the shares was clear and, had they pursued that intention properly as was available to them to do, the same outcome would have been reached; therefore, the plaintiff had not been harmed by the failure to follow the unanimous shareholder agreement.⁸⁵³ In responding to this argument, Manderscheid J. considered it crucial that it was not merely a failure to follow procedure that had occurred, but also a failure to notify the plaintiff of this.⁸⁵⁴ Despite having previously determined that s. 248 was not an equitable remedy, but that equity was in some unspecified way still "relevant", Manderscheid J. held that equity was determinative on this point.⁸⁵⁵ In knowingly concealing their breach, the defendants did not have "clean hands".⁸⁵⁶ Further, in misleading a minority shareholder, Manderscheid J. found that the

⁸⁵⁰ Ibid, par. 83.

⁸⁵¹ Ibid, par. 88.

⁸⁵² Ibid, par. 89.

⁸⁵³ Ibid, par. 52.

⁸⁵⁴ Ibid, par. 55.

⁸⁵⁵ Ibid, pars. 57-58.

⁸⁵⁶ Ibid, par. 58.

directors had breached a fiduciary duty to the shareholder.⁸⁵⁷ For these reasons, he declined to give effect to the defendants' intention (*i.e.* to redeem the shares in accordance with the unanimous shareholder agreement) rather than their actions.⁸⁵⁸ The judge explicitly stated that, had the corporation informed the plaintiffs that the original redemption notice had been premature, he would have given effect to their intentions and not found them in violation of the agreement.⁸⁵⁹ While the statement that equity is "relevant" to a corporate constitutional approach is unfortunately confusing, the most consistent interpretation of this section of the reasons for judgment would be that s. 248 is not in any way an equitable relief itself, but that Manderscheid J. considered and declined to give the defendants general equitable relief from s. 248.

The trial decision in *Sumner* thus explicitly demonstrates the corporate constitutional approach as contrasted with both the contractual and the oppression responses to the same set of facts. The Court of Appeal decision that followed would cast further light upon that contrast by first revisiting the question of which understanding of enforcement should predominate and then demonstrating the consequences of choosing differently.

2.(b) The Court of Appeal Judgment

The Court of Appeal disagreed with the lower court judge's conclusion that a unanimous shareholder agreement was not a contract.⁸⁶⁰ They found that the emphasis on the word "lawful" was misplaced and could not mean that an "unlawful" unanimous shareholder agreement would be valid.⁸⁶¹ They also relied upon *Duha*, but to the effect that a unanimous shareholder agreement was a form of contract: "The observations in *Duha Printers* that a unanimous shareholders agreement is a form of contract apply in Alberta."⁸⁶² The Court of Appeal did not discuss the findings in *Duha* that a unanimous shareholder agreement was also a constitutional document or what that might entail; it was simply treated as a contract, albeit one with unusual features. Regarding those other elements that distinguish unanimous

⁸⁵⁷ Ibid, par. 62.

⁸⁵⁸ Ibid, par. 62.

⁸⁵⁹ Ibid, par. 63.

⁸⁶⁰ Regardless of the legal nature of unanimous shareholder agreements, the Court of Appeal also ruled an error in law the trial judge going outside the parties' pleadings in considering the nature of the document as something other than a contract (*Sumner CA, supra* note 263, par. 43). Such a procedural failing is independent of any merits or flaws in the analysis. The trial judge was also criticized for not having recognized that the share purchase was a separate contract that would need to be rescinded under his approach and for not having taken into account income earned on the sale proceeds as set-off against the award (par. 46). These criticisms, valid though they may be, are also details that could have been easily incorporated into a corporate constitutional analysis.

⁸⁶¹ *Sumner CA, supra* note 263, par. 40.

⁸⁶² Ibid, par. 40.

shareholder agreements from standard contracts, the Court of Appeal found:

41 A unanimous shareholders agreement may well be described as a specialized form of contract because of its unusual ability to bind non-parties, and to override the constating documents of the corporation. It is, however, at its core, a contract. There are other specialized types of contracts that have features unique to them. For example, collective agreements are negotiated between unions and employers, yet they can have a significant effect on the rights of employees. There are also special dispute resolution procedures and remedies available under collective agreements that are not available under other contracts. Collective agreements are, nevertheless, contracts at their core: *Labour Relations Code*, RSA 2000, c. L-1, s. 1(f); Part 2, Div. 21; *St. Anne-Nackawic Pulp & Paper Co. v. C.P.U., Local 219*, [1986] 1 S.C.R. 704 (S.C.C.), at pp. 717-8. Similar comments can be made about other specialized types of contracts: insurance policies, surety agreements, guarantees, etc.

The Court of Appeal also found that, contrary to the lower court ruling, the corporation had been a party to the agreement, as it was one of the listed parties.⁸⁶³ (It is unclear, based upon the rest of the Court of Appeal's analysis, what remedy, if any, would have been available had this not been the case.) The Court of Appeal found, "The unanimous shareholders agreement in issue in this case is a contract, and the primary source of remedies for its breach is the law of contract."⁸⁶⁴

The Court of Appeal considered it "questionable" whether s. 248 could be used to award damages, but found that even if it could, an award of over a million dollars was "disproportionate", "excessive", and a "windfall"⁸⁶⁵ as a remedy for the directors having performed certain acts in the wrong order.⁸⁶⁶ Moreover, the Court of Appeal noted that the corporation was actually *obliged* by the unanimous shareholder agreement to repurchase the shares in question, albeit under a slightly different procedure, a factor that they also considered in favour of the corporation.⁸⁶⁷ It is also relevant to this finding that the Court of Appeal considered there to have been no real issue with regard to whether the plaintiff was truly disabled, leaving the only violation of the agreement that the resolution was done too late.⁸⁶⁸

Nonetheless, having identified a breach, the Court of Appeal said:

48 As previously found, a unanimous shareholders agreement is a contract, albeit one with some particular characteristics. The remedies for breach are primarily contractual. The trial judge made certain findings (see *supra*, para. 15) which, if he had realized he was dealing with a contract, he might have found were breaches of that contract. On a proper interpretation of the unanimous shareholders agreement they are not, however, breaches that now entitle the respondent to any remedy.

⁸⁶³ Ibid, par. 42.

⁸⁶⁴ Ibid, par. 43.

⁸⁶⁵ Ibid, par. 47 for all three terms.

⁸⁶⁶ Ibid, par. 47.

⁸⁶⁷ Ibid, par. 47.

⁸⁶⁸ Ibid, pars. 47, 75.

The Court of Appeal found that the trial judge, in considering a remedy, had been incorrect in taking it as less than a given that, had the procedural defects been made apparent, the corporation would simply have corrected them and proceeded to the same end, an inference that the Court of Appeal found "overwhelming".⁸⁶⁹

The Court of Appeal further found that the doctrine of "clean hands"- which the trial judge had invoked in declining to treat the corporation as having done what it should have and easily could have- did not apply, because it could only disentitle a party to relief, and could not create a right.⁸⁷⁰ As discussed, while the trial judgment was less than clear on this point, the most logically consistent interpretation is that this is exactly how the doctrine was so applied therein. They further appeared to deny that the corporation had unclean hands, while acknowledging that things had been done in the wrong order.⁸⁷¹ With regard to any alleged concealment of procedural defects from the plaintiff, the Court of Appeal found, "Generally speaking, a contracting party that is exercising rights or options under a contract, or that is calling for performance of a contract, is not under any obligation to advise the other contracting party of its rights under the agreement."⁸⁷² They found that the Notice To Sell which the corporation had sent could not be construed as a representation that all necessary preconditions under the unanimous shareholder agreement had been met,⁸⁷³ and that there was no fiduciary relationship, because the relationship was contractual.⁸⁷⁴

The Court of Appeal also denied that the "indoor management rule" could be relied upon by the plaintiff, pointing out that it was designed to prevent the corporation and its participants from invoking procedural flaws, not to allow third parties to take advantage of such flaws.⁸⁷⁵ While it is true that the "indoor management rule" itself is a shield, the Court of Appeal gave no consideration to whether it might be appropriate for a parallel doctrine to emerge as a sword.

Having determined that it was impossible⁸⁷⁶ for a third party to have a corporate act that violated a unanimous shareholder agreement nullified on a corporate constitutional basis, the Court of Appeal considered whether in this case the plaintiff could achieve such a nullification on contractual grounds.

⁸⁶⁹ Ibid, pars. 50-51.

⁸⁷⁰ Ibid, par. 56.

⁸⁷¹ Ibid, par. 56.

⁸⁷² Ibid, par. 53.

⁸⁷³ Ibid, par. 54. The Court of Appeal similarly found that the trial judge had been incorrect that the corporation had any obligation to notify the plaintiff that he could appeal the determination that he was disabled (par. 67), noting that nothing in the agreement explicitly created such a duty and that it was inconsistent for the plaintiff to both insist on strict adherence to the contract and to ask that terms be read into it (par. 68). They further determined that, even if there were such an obligation, no injury had been suffered through the breach of it, since the plaintiff would have been unable to show he was not disabled (pars. 69-71).

⁸⁷⁴ Ibid, par. 55.

⁸⁷⁵ Ibid, par. 57. The Court of Appeal noted that the common law "indoor management rule" was now set out in *A.B.C.A.* s. 19 (par 57).

⁸⁷⁶ In the context of the current *A.B.C.A.*

They found that "a contracting party has a limited ability to challenge a contract based on the nonexistence of a condition precedent (not amounting to a continuing covenant in the agreement) once the contract has been fully executed".⁸⁷⁷ Because the contract for sale of the shares had been fully completed, any condition precedent mandated by the unanimous shareholder agreement had ceased to apply.⁸⁷⁸ Further:

60 In any event, even if there were breaches in the procedural provisions of the unanimous shareholders agreement, that does not automatically undermine the validity of any actions taken. The trial judge found that PCL Employees Holdings was "in possession of property that belongs to someone else [the respondent]", which essentially assumes that the share transfer never actually happened, or was legally ineffectual (see 2011 ABQB 20 (Alta. Q.B.), at paras. 70, 77, 82). Breaches of procedural provisions in private contracts do not render subsequent actions "null and void": *New Brunswick (Board of Management) v. Dunsmuir*, 2008 SCC 9, at paras. 81-2, [2008] 1 S.C.R. 190 (S.C.C.); *H.S.A.A. v. Alberta Health Services*, 2011 ABCA 306 (Alta. C.A.) at para. 22. The directors of PCL Employees Holdings should have passed the "withdrawing shareholder" resolution first, but their failure to do so does not mean that the subsequent purported (and successful) exercise of the option to purchase the shares was a nullity. The most the respondent was potentially entitled to was any damages he could prove from a breach of this provision, and on this record those damages would appear to be nominal. It was clear that the respondent had in fact been unable to work for six continuous months, and the directors were entitled to declare him a withdrawing shareholder. The fact that the declaration was made in the wrong order did not cause any damage to the respondent.

There could be no clearer demonstration of the difference between a corporate constitutional approach and a contractual one than this passage. While the trial judge did not actually nullify the share purchase, the damage award served as a *de facto* cash substitute for the consequences of such a nullification, simply because that award flowed from the assumption that the directors *could not* do that which they had purported to do. The Court of Appeal, by contrast, took a contractual approach, found that no such nullification was appropriate, and instead looked to provable damages. As a result, the Court of Appeal found that the trial judge had been wrong on the quantum of his award, since a correct determination of the period over which damage occurred should have assumed that the corporation would have immediately rectified any procedural errors.⁸⁷⁹

The Court of Appeal concluded that:

76 In conclusion, with respect to the share sale the respondent at best had contractual rights under the unanimous shareholders agreement. As such, he was only entitled to be put in the same position he would have been in if the contract had been performed. On this record it is clear that the respondent was disabled at all times. The fact that the directors' resolution came after the Notice to Sell did not have any substantive effect on the price the respondent received for his shares, or his other

⁸⁷⁷ *Sumner CA*, *supra* note 263, par. 58.

⁸⁷⁸ *Ibid.*, par. 59.

⁸⁷⁹ *Ibid.*, par. 61.

entitlements. In any event, whatever remedies he might have been entitled to from a failure to follow the procedure set out in the unanimous shareholders agreement were overtaken by his acquiescence in PCL Employees Holdings' demand that he sell his shares, and the subsequent closing of the transaction.

The Court of Appeal here confused the two contracts. The contract of sale was completed, but that leaves open the possibility of damages under the unanimous shareholder agreement, even viewed as a contract. Granted, the finding was that the damages would be nil.⁸⁸⁰

The Alberta Court of Appeal's decision in *Sumner* is currently the most prominent Canadian case on the question of whether unanimous shareholder agreements should be enforced as "corporate constitutions" or contracts. Their answer was unequivocally the latter. As elaborated upon in the following section, however, the decision of the Court of Appeal in *Sumner* was, unfortunately, quite wrong in its interpretation of the Supreme Court of Canada's decision in *Duha*.

Regardless of the specific merits of the conclusions reached in either judgment in *Sumner*, the case contributes two valuable developments to the law regarding unanimous shareholder agreements. First, at both levels, different approaches to their enforcement were specifically identified by the judges and a conscious decision between them was made. This is, as the rest of this chapter illustrates, an all too rare occurrence. Secondly, it illustrates that the choice between these approaches is not a purely abstract matter; it can lead to different outcomes. Having established this as a basis, the remainder of this chapter will deal with the four approaches to the enforcement of unanimous shareholder agreements in turn: corporate constitutional, contractual, directors' duties, and oppression. *Sumner* juxtaposed three of these, but taking them one at a time and examining the cases that applied them sheds greater light on each of their distinct characteristics.

3. The Corporate Constitutional Approach

In a traditional corporation, the directors are empowered to manage or supervise the management of the business and affairs of the company.⁸⁸¹ That is their function in the corporate structure. While they are subject to duties in their exercise of this authority, which may give rise to liability if not met, there are very few *limitations* on their collective ability to make choices regarding the corporation, the principal one being the necessity of shareholder agreement for certain major decisions.⁸⁸²

The corporate constitutional approach to unanimous shareholder agreements is the view that such documents fundamentally alter the nature of the corporation and the directors' powers. With a unanimous

⁸⁸⁰ Or, one could argue, nominal.

⁸⁸¹ *C.B.C.A.* s.102(1).

⁸⁸² *C.B.C.A.* Part XV: Fundamental Changes.

shareholder agreement in place, some or all of the board's normal powers cease to exist (or are transferred to the shareholders). At that point, the restricted areas would be *ultra vires* the directors.⁸⁸³

The Alberta Report put forth as one of the primary reasons for the tool that, absent its statutory recognition, specific performance would be generally unavailable to enforce shareholder agreements⁸⁸⁴ and "[a]n act of the company which contravenes the [non-unanimous shareholder] agreement is valid".⁸⁸⁵ It suggested that the unanimous shareholder agreement, as then set forth in the *C.B.C.A.* and as it was recommending be implemented in Alberta, solved this problem within the scope of its effectiveness.⁸⁸⁶

The position that directors' powers can be literally removed by a unanimous shareholder agreement does not *require* acceptance of the idea that a corporation is just a "nexus of contracts". The ability to limit directors' powers by agreement is, after all, currently one of a number of specifically defined rights granted to the shareholders in a statutory framework; it is not a total abandonment of that framework. But this tool is obviously at the very least consistent with that theory. Proceeding from the opposite direction analytically reveals an even closer connection; if a corporation is just a complex set of contracts, renegotiating the contracts must change the corporation at a fundamental level. If the powers of the directors were always a notional "term" of that deal, then amending the arrangement actually would alter those powers. A distinction should still be maintained between the corporate constitutional approach to enforcement and a strong form of the "nexus of contracts" model of the corporation that entirely reduces the organization to a web of voluntary agreements- and specifically, the eventual endorsement in this chapter of the former does not extend to the latter- but it is appropriate to consider the discussions and analysis surrounding the choice of enforcement models in light of the recurring question of whether the unanimous shareholder agreement represents a shift toward a "nexus of contracts" corporation and, if so, to what degree.

If one takes the corporate constitutional notion seriously, then two important consequences follow from it regarding enforcement. Firstly, the required judicial analysis is vastly simplified, with the outcome determined solely by whether the restrictions in the agreement had been violated.⁸⁸⁷ No other considerations need to be taken into account; it is neither necessary for the complainant to provide additional evidence or argument as to why the agreement should have been followed, nor would the directors (or corporation) be able to put forward a defence on the basis that the violation was the correct

⁸⁸³ This is of course distinct from it being *ultra vires* the corporation itself. The issue is who has the authority to cause the corporation to do certain acts, not whether the corporation has the legal capacity to do those acts once properly authorized. See note 807.

⁸⁸⁴ Alberta Report, *supra* note 223, p. 22.

⁸⁸⁵ *Ibid*, p. 23.

⁸⁸⁶ *Ibid*, p. 24.

⁸⁸⁷ This might require a two-step process, beginning with interpreting the unanimous shareholder agreement to determine exactly what the restriction consisted of, and then examining the facts to detect violations of that restriction.

course of action in the circumstances.

This simplicity arises from the approach's fundamental axiom that the directors simply did not have the power to do what they purported to do. The desirability of their chosen action is beside the point. One possible analogy is that of a dissenting director who disagrees with the decision of the majority; the dissenter could not simply declare that their view would nonetheless carry the day on the basis that that would be the best course of action in the circumstances. Another comparison might be to a shareholder unhappy with the decisions of the directors, in a situation where no unanimous shareholder agreement applied; again, the shareholder would have no ability to override the directors.⁸⁸⁸

The second implication of the corporate constitutional approach is that the appropriate remedy is always nullification, unless third party⁸⁸⁹ interests are involved.⁸⁹⁰ Since the directors did not have the authority to do that which they purported to, the action is by definition of no force and effect.⁸⁹¹ Only where nullification is impossible, either for practical reasons or because third party interests would be affected, might damages be appropriate.⁸⁹²

⁸⁸⁸ Either of these situations might open the door to an oppression claim, and so too might a unanimous shareholder agreement.

⁸⁸⁹ Without notice.

⁸⁹⁰ See note 807 for a discussion of how this is distinct from the superficially similar *ultra vires* doctrine that Canadian law has largely abandoned.

⁸⁹¹ In addition to the various cases that found acts contrary to a unanimous shareholder agreement to be nullities, that position was also advanced by Robitaille, *supra* note 267, p. 174, who stated (without explanation) that, unless third party rights were involved, acts of the directors contrary to the agreement should be null. He added that where the parties themselves violate the agreement, the remedies would be contractual. This is consistent with the idea put forth by *Duha SCC*, *supra* note 24, that a unanimous shareholder agreement has both a corporate constitutional and contractual aspect. Turgeon, *supra* note 9, pp. 235-236 also stated that the authority of the shareholders to limit the power of the directors necessarily had priority over the decisions of those in whom that authority was normally placed, and so the board could not make a decision about a restricted matter. He nonetheless considered it a good idea to have them become parties to the document, in order to encourage them to ensure that its existence was noted on the share certificates.

⁸⁹² *O.B.C.A.* s. 17(3) provides that "no act of a corporation including a transfer of property to or by the corporation is invalid by reason only that the act is contrary to its articles, by-laws, a unanimous shareholder agreement or this *Act*". (It is unique in including unanimous shareholder agreements in such a provision; see *C.B.C.A.* s. 16(3), *A.B.C.A.* s. 17(3), *M.C.A.* s. 16(3), *N.B.B.C.A.* s. 14(3), *N.L.C.A.* s. 29, *N.T.B.C.A.* s. 16(4), *N.B.C.A.* s. 16(4), *S.B.C.A.* s. 16(3), and *Y.B.C.A.* s. 19(3).) The Supreme Court indicated in *Communities*, *supra* note 807, par. 48, that such sections were "part of a legislative scheme to abolish the doctrine of *ultra vires*". As discussed at note 807, the abolition of the *ultra vires* doctrine is not an obstacle to the corporate constitutional approach, because the issue is not the corporation's legal capacity but rather who in the corporate structure (if anyone) has the power to cause the corporation to exercise that capacity. For example, if a unanimous shareholder agreement transferred all the board's authority to the shareholders, but the directors nonetheless purported to cause the company to act (and, for whatever reason, it did so), the problem would not be the act itself, but rather the lack of proper authorization for it. I would suggest that s. 17(3) should not apply in such circumstances. Third party interests are already separately protected. The general arguments in this chapter in support of the corporate constitutional approach apply, including the implications of other aspects of the *O.B.C.A.* (e.g. if the duties and liabilities of the board have been transferred to the shareholders, what are the consequences if the directors can still cause the

At a technical level, there appear to be two possible avenues through which a corporate constitutional claim for enforcement of a unanimous shareholder agreement can be put before the courts. First, the complaining party could rely upon the statutory definition of the unanimous shareholder agreement as validly restricting directors' powers;⁸⁹³ enforcement would flow from the court's inherent power to declare acts for which the alleged actor had absolutely no legal authority to be of no force and effect. Second, the parties could rely upon the sections of the statute allowing them to ask the courts to enforce unanimous shareholder agreements.⁸⁹⁴ (This opens the door to a corporate constitutional analysis,

corporation to act?).

That said, there are two counter-arguments supporting the position that *O.B.C.A.* s. 17(3) applies to protect acts from being found invalid solely on the basis that, under a unanimous shareholder agreement, the directors lacked authority to decide upon them. First, although the terms of a unanimous shareholder agreement under the *O.B.C.A.* should properly be understood as restrictions upon the directors, they are often phrased as restrictions upon the corporation itself, making it appear *prima facie* that the issue raised is the corporation acting contrary to them. Second, if the conclusion outlined above is correct, then the inclusion of "unanimous shareholder agreement" in that section of the Ontario *Act* would be meaningless. The alternative reading limits one of the primary implications of the corporate constitutional approach, that restrictions upon the directors genuinely remove their authority and therefore any attempts by them to ignore those limitations have no effect (unless third party interests are involved). The subsection does not entirely negate this principle, since it refers specifically to acts of the corporation not being invalid only for that reason. That leaves it open for acts to be invalid partly (but not only) because they violate a unanimous shareholder agreement, for unperformed decisions of the board and purported corporate obligations to be void for only that reason, and for a court to order compliance on an ongoing basis with the restrictions set out in the document. It also remains possible for damages to be assessed in accordance with corporate constitutional reasoning, which might differ from calculations under other methods. (See the discussion of *Sumner* earlier in this chapter.) Nonetheless, to the extent that this section of the *O.B.C.A.* applies to decisions of the directors that ignore the restrictions upon them, it works against both the underlying logic and primary practical benefit of the corporate constitutional approach. Courts dealing with Ontario corporations do sometimes apply corporate constitutional principles when enforcing unanimous shareholder agreements, as several of the cases discussed in this section demonstrate; such decisions may be reconcilable with this reading of s. 17(3) on the basis that they fall into one of the categories listed above that circumvent the exact statutory language (*e.g.* other factors were involved so the acts were not invalid *only* for violating a unanimous shareholder agreement, it is an unperformed obligation rather than an act being voided, *et cetera*), but the reasons for judgment tend to simply ignore that section when indicating that directors do not have the power to ignore a unanimous shareholder agreement's restrictions upon them and their attempts to do so are invalid.

⁸⁹³ And the statutory definitions of the directors' powers themselves, which explicitly render them subject to a unanimous shareholder agreement. See *C.B.C.A.* s. 102(1), *A.B.C.A.* s. 101(2), *M.C.A.* s. 97(1), *N.B.B.C.A.* s. 60(1), *N.L.C.A.* s. 167, *N.T.B.C.A.* s. 102(1), *N.B.C.A.* s. 102(1), *O.B.C.A.* s. 115(1), *Q.B.C.A.* s. 112, *S.B.C.A.* s. 97(1), and *Y.B.C.A.* s. 102(1).

⁸⁹⁴ *C.B.C.A.* s. 247 provides, "If a corporation or any director, officer, employee, agent or mandatary, auditor, trustee, receiver, receiver-manager, sequestrator or liquidator of a corporation does not comply with this *Act*, the regulations, articles or by-laws, or a unanimous shareholder agreement, a complainant or a creditor of the corporation may, in addition to any other right they have, apply to a court for an order directing any such person to comply with, or restraining any such person from acting in breach of, any provisions of this *Act*, the regulations, articles or by-laws, or a unanimous shareholder agreement, and on such application the court may so order and make any further order it thinks fit." Equivalents appear at *A.B.C.A.* s. 248, *M.C.A.* s. 240, *N.B.B.C.A.* s. 172, *N.L.C.A.* s. 378, *N.T.B.C.A.* s. 249, *N.B.C.A.* s. 249,

but does not render it inevitable, since the court is given a choice of what remedy, if any, is appropriate.⁸⁹⁵)

A handful of cases, discussed in the following subsection, use the explicit terminology that unanimous shareholder agreements are part of the "corporate constitution" and thus capable of fundamentally altering directors' authority; these include the Supreme Court of Canada's decision in *Duha*, a significant endorsement. More common are cases that do not include the "corporate constitutional" terminology, but that accept the premise that the directors' powers have been genuinely restructured; some

O.B.C.A. s. 253(1), *Q.B.C.A. s. 460*, *S.B.C.A. s. 240*, and *Y.B.C.A. s. 249*. Another section upon which a claim might be brought is *C.B.C.A. s. 122(2)* and its equivalents (see note 1142), under which directors have a duty to comply with the *Act*, the regulations, articles, by-laws and any unanimous shareholder agreement. As discussed later in this chapter, the nature of this section may suggest the directors' duties approach to enforcement, but once the claim is before the courts, the principles applied could be drawn from the corporate constitutional framework instead.

⁸⁹⁵ See *C.B.C.A. s. 247* reproduced at note 894. The legislative wording grants a discretion to either decline to enforce the agreement or to choose some alternative remedy. Therefore, while this section (and its equivalents) provide a potential method for bringing a claim on the grounds that the directors are acting in violation of a central document of the corporation (as opposed to bringing a claim in contract, *et cetera*), the resultant analysis is not necessarily going to follow corporate constitutional principles. It may invoke the other approaches discussed in this chapter. And, given the discretion granted by the wording of this section, there is a further possibility, as illustrated by *Rogers v. Rogers*, 2011 NBQB 36, 368 N.B.R. (2d) 178, 2010 CarswellNB 645, 949 A.P.R. 178 (N.B. Q.B. Dec 23, 2010).

In *Rogers*, on an application under the similarly-worded *N.B.B.C.A. s. 172* to enforce terms of a unanimous shareholder agreement naming the applicant as a director and president (pars. 7-8), McLellan J. expressed "two concerns bother[ing him]" (par. 8) about the latter request, those being the potential for "misunderstandings" if the applicant were returned to the position while litigation was ongoing (par. 8) and an inappropriate decision the applicant had previously made while president (par. 9). On the basis of these concerns, the judge was "not persuaded that [he] should exercise [his] equitable jurisdiction" (par. 10). The Court of Appeal, in *Rogers v. Rogers*, 2011 NBCA 78, 374 N.B.R. (2d) 397, 2011 CarswellNB 491, 965 A.P.R. 397, 207 A.C.W.S. (3d) 256 (N.B. C.A. Sep 15, 2011), summarized this by saying, "The application judge determined he had a residual discretion to grant or deny the relief sought under s. 172, despite the clear language of the unanimous shareholders' agreement" (par. 3). While the existence of such discretion was not contested, only the use of it (par. 3), the Court of Appeal noted that McLellan J. had made no errors in law or the application of principles (par. 5). *Rogers* is unusual in the degree to which it foregrounds the judicial discretion allowed for by this legislative wording as the primary basis for a decision. (But it is not quite unique; *829194 Ontario Inc. v. Garibotti*, 2013 ONSC 5857, 2013 CarswellOnt 13503, 234 A.C.W.S. (3d) 732, 19 B.L.R. (5th) 118 (Ont. S.C.J. Sep 18, 2013) (hereinafter "*829194*"), discussed later in this chapter, used the permissive wording of this section of the statute as one (probably unnecessary) reason for determining the court had discretion under the oppression remedy to decline to strictly enforce the terms of a unanimous shareholder agreement. Conversely, in *Sumner QB 1*, it was concluded that the Alberta version of this section was not equitable but rather designed to enforce legal rights; see the discussion earlier in this chapter.) It is inevitable that the court must retain some latitude even in a corporate constitutional framework, in order to handle situations where a strict application of corporate constitutional principles is impossible, would harm third parties, or would be blatantly inequitable; the contractual, directors' duties, and oppression remedy methods each also contain various degrees of built-in flexibility. The wordings of *C.B.C.A. s. 247* and its equivalents go beyond that. As *Rogers* illustrates, they potentially create yet another approach to enforcing unanimous shareholder agreements: judicial discretion. The objections raised later in this chapter to the unnecessary uncertainty that is created by using oppression remedy principles as the primary method of enforcing a document's terms apply with even greater force to

of these are discussed in the next subsection thereafter. Following that, some of the less obvious implications of this particular approach will be reviewed through discussions of cases that employed the corporate constitutional approach as a legal "shield" and ones that involved the interaction between this framework and the "indoor management rule". Collectively, these cases embody the corporate constitutional model, first of the four ways of enforcing unanimous shareholder agreements.

3.(a) Explicitly Corporate Constitutional Cases

The corporate constitutional approach to enforcement arguably has support in the Supreme Court of Canada's only extensive consideration of the unanimous shareholder agreement, *Duha Printers (Western) Ltd. v. R.*⁸⁹⁶ The Court clearly stated that these agreements have a special statutory status with regard to the corporation, and are not merely agreements that exist alongside it. They are, instead, "part of the corporate constitution, along with and equivalent to the articles of incorporation and the by-laws".⁸⁹⁷ Unfortunately for any simple understanding of these agreements, the Supreme Court's analysis did not stop there; it concluded that the agreements are "a corporate law hybrid, part contractual and part constitutional in nature",⁸⁹⁸ although the constitutional aspect was said to be more "potent" than the contractual⁸⁹⁹ and formed the basis of the Supreme Court's conclusion that a unanimous shareholder agreement could affect *de jure* and not just *de facto* control.⁹⁰⁰

While *Duha* did not concern enforcement of a unanimous shareholder agreement, but rather one's tax implications,⁹⁰¹ Iacobucci J.'s analysis touched upon the nature of the restrictions that they placed upon directors, noting that "through a unanimous agreement, [shareholders] could strip the directors of some or all of their managerial powers as desired by the shareholders. Rather than removing the directors from their positions, a USA simply relieves them of their powers, rights, duties, and associated responsibilities."⁹⁰² He elaborated:

such a regime.

⁸⁹⁶ *Duha SCC, supra* note 24. As discussed in Chapter Three, *Duha* concerned whether provisions in a unanimous shareholder agreement regarding who could serve as director affected *de jure* control for tax purposes. While enforcement was therefore not at issue, the Supreme Court's general examination of the nature of unanimous shareholder agreements, defining them as "constitutional" documents of the corporation capable of affecting *de jure* control, included remarks significant to the current topic, as referred to herein.

⁸⁹⁷ *Ibid.*, par. 61.

⁸⁹⁸ *Ibid.*, par. 66.

⁸⁹⁹ *Ibid.*, par. 67.

⁹⁰⁰ *Ibid.*, par. 69.

⁹⁰¹ If a unanimous shareholder agreement affected *de jure* control, two companies would be "related", which meant that tax losses could be transferred between them. See the discussion in Chapter Three for more details.

⁹⁰² *Duha SCC, supra* note 24, par. 64.

69 Thus, a USA can play a vital role in the *de jure* control analysis. If the *Buckerfield's* test were to be followed slavishly and the inquiry limited only to the share register of the corporation, or even extended to the articles of incorporation and by-laws but not to USAs, then a company could circumvent the test or obfuscate the picture of corporate control simply by confining to a USA provisions that substantially alter the way in which corporate decisions are made. If, by a USA, the board of directors is deprived of the power to manage the business and affairs of the corporation, this is more than simply an issue of *de facto* control. It would defy logic to treat *de jure* control as remaining unaltered by an agreement which, by the very statute which governs the incorporation of the company and the governance thereof by its articles and by-laws, is given the same power as the articles to supersede the statutory provisions for corporate control. Not only is this a distinction without a difference, but it is also one without any principled foundation.

70 As I have said, the essential purpose of the *Buckerfield's* test is to determine the locus of effective control of the corporation. To my mind, it is impossible to say that a shareholder can be seen as enjoying such control simply by virtue of his or her ability to elect a majority of a board of directors, when that board may not even have the actual authority to make a single material decision on behalf of the corporation. The *de jure* control of a corporation by a shareholder is dependent in a very real way on the control enjoyed by the majority of directors, whose election lies within the control of that shareholder. When a constating document such as a USA provides that the legal authority to manage the corporation lies other than with the board, the reality of *de jure* control is necessarily altered and the court must acknowledge that alteration.

In stating that the unanimous shareholder agreement alters *de jure* control of the corporation and otherwise referring to a board of directors as "deprived" of its normal powers and lacking "actual authority", the Supreme Court of Canada endorsed the position that the restrictions placed upon boards of directors by these documents are real and insurmountable alterations to their normal powers, and not merely agreements as to how those powers may be used. Given that Iacobucci J. also affirmed that such restrictions were required to create a unanimous shareholder agreement, as discussed in Chapter Three, this forceful view of those limitations' effect is unsurprising; the Supreme Court of Canada understood restricting directors' authority as the quintessential role of this legal tool.

Nonetheless, as discussed throughout this chapter, the Supreme Court's decision in *Duha* has not in fact settled this matter, and other approaches to unanimous shareholder agreements continue to find expression in the case law.⁹⁰³ The remainder of this section, however, will consider cases consistent with the corporate constitutional approach, as briefly and perhaps indirectly endorsed in *Duha*, in order to consider its relative merits.

Other than *Duha* and *Sumner*, the reported case that delves most explicitly into the nature of unanimous shareholder agreements as constitutional documents is *Piikani Investment Corp. v. Piikani First*

⁹⁰³ Parties' decisions regarding how to plead their case can shape this even more than judicial analytic inclinations, as the difference between *Sumner* QB 1 and *Sumner* CA illustrated.

Nation.⁹⁰⁴ A First Nation was granted settlement funds by Canada and the province of Alberta, which were made subject to a trust agreement.⁹⁰⁵ A corporation was formed under the terms of the trust agreement⁹⁰⁶ to provide advice to the First Nation's Council about investing the funds and to help certain of the First Nation's businesses prepare business plans and financial arrangements.⁹⁰⁷ As discussed in Chapter Three, McIntyre J. held that the Trust Agreement met the requirements of a unanimous shareholder agreement, but preferred to refer to it as a "foundational document", a term apparently of the judge's own invention and uncertain legal implications.⁹⁰⁸ McIntyre J. specifically denied that it was a "super USA", but maintained that as a "foundational document" it had a "unique status".⁹⁰⁹ Presumably, this means unique even as compared to other unanimous shareholder agreements, though again, this was not entirely clear.

Despite extensively discussing the agreement's status as a constitutional document, McIntyre J. found the court's authority to enforce it was not automatic, but flowed in that case from a term of the agreement that expressly provided that the court could provide advice and direction concerning it.⁹¹⁰

At issue was whether certain amendments to the articles and by-laws of the corporation were in violation of the agreement. Citing *Duha*,⁹¹¹ McIntyre J. stated, "I have no difficulty in finding that a USA has equivalent status to the articles of a corporation. It forms part of the constitution of the corporation to which it relates."⁹¹² Therefore, because the articles supersede the by-laws, a unanimous shareholder agreement would supersede the by-laws.⁹¹³ On the other hand, McIntyre J. held that, if the Trust Agreement were "best described as" a unanimous shareholder agreement, it would not supersede the articles.⁹¹⁴ Because of the allegedly unique history of the parties, however, McIntyre J. held that the Trust Agreement as a "foundational document" superseded the articles in this case.⁹¹⁵

Despite the decision to treat the agreement in question as both a unanimous shareholder agreement

⁹⁰⁴ *Piikani*, *supra* note 234.

⁹⁰⁵ *Ibid*, pars. 2-4.

⁹⁰⁶ *Ibid*, par. 8.

⁹⁰⁷ *Ibid*, par. 9.

⁹⁰⁸ *Ibid*, par. 27.

⁹⁰⁹ *Ibid*, par. 41.

⁹¹⁰ *Ibid*, par. 80. As a result, the judge found it unnecessary to invoke the oppression remedy (par. 80). It is unclear whether the oppression remedy would have been used had the court not been explicitly given the power to intervene, nor whether an oppression analysis might have differed in any way from the one presented.

⁹¹¹ At *Piikani*, *supra* note 234, par. 22.

⁹¹² *Piikani*, *supra* note 234, par. 33.

⁹¹³ *Ibid*, pars. 37, 91.

⁹¹⁴ *Ibid*, par. 38.

⁹¹⁵ Discussion at *Piikani*, *supra* note 234, pars. 42-55, conclusion at par. 55. The actual determinations of which articles and by-laws were in compliance with the Trust Agreement, were not in compliance, or needed minor amendments to be in compliance, were done on the basis of the exact wordings of all the documents. McIntyre J. also held a shareholder's resolution for payment to the shareholder for unspecified "indispensable services" was void for being too broad and opposed to "the spirit and intent of the Trust Agreement" (par. 168).

and a *sui generis* "foundational document", *Piikani* provides a useful examination of how the unanimous shareholder agreement might relate to other constitutional documents of the corporation. Unfortunately, it technically leaves open the question as to how a conflict between the articles of a corporation and a unanimous shareholder agreement would normally be resolved.

Another case strongly influenced by the corporate constitutional approach of *Duha* is *Power v. Vitrak Systems Inc.*⁹¹⁶ The corporation at its centre had contracted with a company that supplied managerial services and obtained an individual as its manager.⁹¹⁷ Over time, that manager, who initially owned no shares of the corporation, became its majority shareholder (prior to determinations in this case).⁹¹⁸ He did so through a series of steps that Campbell J. characterized as "a clear strategy and a well crafted plan to dilute [the plaintiff]'s shareholdings and influence within the company and acquire control for himself".⁹¹⁹ This included misrepresentations to the shareholders,⁹²⁰ acquiring shares at 1/10th the rate the company had hitherto used,⁹²¹ and transferring corporate assets to another company he controlled.⁹²² Campbell J. ultimately concluded that this conduct was "unfair, prejudicial and oppressive"⁹²³ but that this "may not strictly be essential to the foundation of the decision [...] except in the alternative. It is, however, relevant to explain and support some aspects of the remedies I grant."⁹²⁴ The language is that of the oppression remedy: unfair, prejudicial, and oppressive. But Campbell J. also explicitly did not base the actual decision on that aspect. Instead, the analysis proceeded according to the corporate constitutional approach, first by noting that, per *Duha*, a unanimous shareholder agreement is a constitutional document:

51 It was confirmed in *Duha Printers (Western) Ltd. v. R.*, [1998] 1 S.C.R. 795 (S.C.C.), that the USA has a unique legal status given its statutory origins and recognition. Generally, shareholders agreements addressing issues such as voting rights and other arrangements give rise to contractual obligations, but they are not considered legal or constitutional in nature. However, the legislative intervention in the *Canada Business Corporations Act* materially altered that situation. A USA is to be read along side the corporation's constating documents and is to be considered *in pari materia* with the company's articles of incorporation and its by-laws. This conclusion is further supported by the fact that the very statute that governs the incorporation of the company creates the USA and gives it the same power as the articles to supercede the statutory provisions for corporate control.

On the basis of this constitutional importance of the unanimous shareholder agreement, Campbell

⁹¹⁶ *Power*, *supra* note 515.

⁹¹⁷ *Ibid*, par. 5.

⁹¹⁸ *Ibid*, par. 9.

⁹¹⁹ *Ibid*, par. 23.

⁹²⁰ *Ibid*, par. 45.

⁹²¹ *Ibid*, par. 37.

⁹²² *Ibid*, par. 48.

⁹²³ *Ibid*, par. 49.

⁹²⁴ These acts also gave rise to criminal fraud proceedings; see *Lauer SC (TD)*, *supra* note 516, and

J. found a number of actions in contravention of it to be nullities. First, the agreement had allegedly been amended, but this was held to be of no effect, because its own terms required unanimity for amendment, and only a majority had been involved in the attempt to do so.⁹²⁵ Second, a share transfer that had occurred without regard to the required consent or the right of first refusal specified in it was simply declared "a nullity".⁹²⁶ A purported "shareholders meeting" that did not satisfy either the notice requirements of the *Act* and the by-laws or the quorum requirements of the unanimous shareholder agreement was also a "a nullity and the business purportedly conducted is of no force or effect".⁹²⁷ Another meeting that also failed to meet these requirements was the one at which the individual defendant was made a director as well as manager, and therefore he never properly held that post.⁹²⁸ Other share transfers that contravened the unanimous shareholder agreement were also declared "invalid" simply for doing so.⁹²⁹ As a result, the shareholdings were returned to what they had been before these events began.⁹³⁰

While it would be difficult not to suspect that the judgment was based on the conduct of the individual defendant as much as any technicalities of corporate law, the analysis of the judge, the explicit description of the unanimous shareholder agreement's status in light of *Duha*, and the immediate invalidation of any acts that contravened its terms make *Power* one of the clearest examples of the corporate constitutional approach in action.

The Supreme Court of Canada decision in *Duha* set out a corporate constitutional approach whereby unanimous shareholder agreements altered the very nature of the corporation. Cases such as *Piikani* and *Power*, both of which explicitly followed from *Duha*, illustrate how when such an approach is explicitly applied, the results are clear and certain; anything that contravenes the unanimous shareholder agreement is a nullity. But while these cases represent the most obvious examples of a corporate constitutional approach, they are by no means the only ones, as the following subsection illustrates.

3.(b) Implicitly Corporate Constitutional Cases

Because the terminology in this area is as yet unstandardized, the corporate constitutional approach is not always easily identified by explicit reference to the concept of a corporate "constitution", and sometimes it must be identified in action through its fundamental characteristics. As noted above, these are (a) that any action by directors in contravention of the agreement is outside their powers and therefore a

Lauer CA, *supra* note 516, the latter of which resulted in acquittal.

⁹²⁵ *Power*, *supra* note 515, par. 57.

⁹²⁶ *Ibid*, par. 57.

⁹²⁷ *Ibid*, par. 66.

⁹²⁸ *Ibid*, par. 67.

⁹²⁹ *Ibid*, pars. 73, 74.

⁹³⁰ *Ibid*, par. 79.

nullity,⁹³¹ and (b) no further justification is required and no other considerations *as between the parties* may weigh against it, although the "indoor management rule"⁹³² still applies.

Based on these criteria, a few cases have appeared to follow a corporate constitutional model without so naming it, demonstrating that some judges are willing to take the restrictions upon directors as a real and absolute restructuring of power within the corporation. In addition, as discussed later in this chapter, a number of cases nominally under the oppression remedy have more in common with the corporate constitutional approach.

The summary of the effects of a unanimous shareholder agreement in *Leclerc c. Savard*⁹³³ demonstrates clearly how, even if they use some other terminology or none at all, judges may exhibit a corporate constitutional understanding of this tool, as that term is herein defined. Young J. stated:

La présente convention constitue une "convention unanime" au sens de la *Loi sur les corporations commerciales* (Voir l'article 30 de la C.U.A.). Le but d'une telle convention unanime des actionnaires est de restreindre en tout, ou en partie, les pouvoirs des administrateurs dans la gérance et dans les affaires internes de la compagnie. Le pouvoir de prendre des décisions est alors transféré des administrateurs aux actionnaires. Toutefois, lorsqu'accordés, les pouvoirs exercés ne peuvent s'étendre au delà des limites des restrictions précisées dans la C.U.A. Cette façon de faire permet plus de souplesse dans l'organisation corporative afin qu'elle puisse mieux représenter la négociation entre actionnaires.⁹³⁴

While *Leclerc* did not contain any specific label for it, the judge nonetheless did explicitly set out the principle being followed: unanimous shareholder agreements remove powers from directors, who thereafter cannot exceed those restrictions. It was therefore unsurprising that it was found that the director and company did not have the authority to transfer shares in contravention of a unanimous shareholder agreement and that the transfer was null and without effect *ab initio*.⁹³⁵

Other judgments have not been so explicit in setting out the general principles at work, but corporate constitutional-style premises can be found underlying determinations that directors cannot

⁹³¹ In certain circumstances, such as arose in *Sumner*, it may no longer be possible to actually reverse the offending acts, and therefore another order may be made of necessity, but theoretically nullification is the correct response under this approach.

⁹³² See note 999 for a discussion of the term "indoor management rule".

⁹³³ *Leclerc c. Savard*, 2011 NBBR 124, 382 N.B.R. (2d) 1, 2011 CarswellNB 752, 988 A.P.R. 1, 213 A.C.W.S. (3d) 92 (N.B. Q.B. May 05, 2011) (hereinafter "*Leclerc*").

⁹³⁴ *Ibid*, par. 89. My translation: "This agreement is a 'unanimous shareholder agreement' in the sense of the *Act* governing business corporations. (See s. 30 of the unanimous shareholder agreement.) The goal of such a unanimous shareholder agreement is to restrict, in whole or in part, the powers of the directors in the management and internal affairs of the company. The power to make decisions is therefore transferred from the directors to the shareholders. However, once agreed, the powers cannot extend beyond the limits of the restrictions set out in the unanimous shareholder agreement. This approach allows more flexibility in the organization of corporations since they can better represent the bargain between the shareholders."

⁹³⁵ *Ibid*, par. 113.

disregard a unanimous shareholder agreement and the restrictions it places upon them. This form of implicit corporate constitutional analysis is succinctly demonstrated in *Ming Minerals Inc. v. Blagdon*⁹³⁶ (the facts of which were discussed at greater length in Chapter Three) where, after having determined that a document was a unanimous shareholder agreement, Mercer J. said simply, "As the Letter Agreement is a unanimous shareholder agreement as contemplated by Section 245(1) the directors of Minerals must comply with it. See Section 203(2) and Section 167."⁹³⁷

The unanimous shareholder agreement in *Skrien v. Waterloo Junction Rail Tours Ltd.*⁹³⁸ required two thirds shareholder approval for the creation of any mortgage, charge, or encumbrance.⁹³⁹ The agreement also specified the terms of loans to three of the shareholders.⁹⁴⁰ The promissory notes issued contained additional terms regarding the payment of interest not found in the unanimous shareholder agreement.⁹⁴¹ Sills J. held that, by virtue of having been in the unanimous shareholder agreement, these loans (and generally speaking the notes which had been signed by the sole director, subject to the modification noted) were authorized by two thirds of the shareholders, but that "[t]he clause in the notes requiring monthly payments of interest is invalid as being contrary to s. 3.07(5) of the unanimous shareholder agreement but the notes and the security created by the general security agreement are otherwise valid and enforceable against the assets of the corporation".⁹⁴²

The Plaintiff in *Riverstar Inc. v. Hookenson*⁹⁴³ asked, *inter alia*, for an order that the various defendants be restrained from interfering in the Bailiff Consolidated Civil Enforcement Incorporated with respect to the distress for rent owing by one of the defendants to a corporation whose shares the plaintiff and the defendant owned.⁹⁴⁴ Watson J. declined to grant that relief because the unanimous shareholder agreement contained a unanimous resolution requirement that had not been met⁹⁴⁵ and therefore "it is not possible for that company on the direction of any single member or even members of the company or any shareholders or individual directors to instruct seizure of any kind as against any tenant in that particular

⁹³⁶ *Ming, supra* note 334.

⁹³⁷ *Ibid*, par. 28.

⁹³⁸ *Skrien v. Waterloo Junction Rail Tours Ltd.*, 32 O.R. (3d) 777, 1997 CarswellOnt 5635 (Ont. Gen. Div. Jan 27, 1997) (hereinafter "*Skrien* Ct J (Gen Div)"). The decision was appealed and upheld in a brief judgment, which included the Court of Appeal specifically agreeing that the general security agreement was valid due to being authorized by the unanimous shareholder agreement and that the promissory notes were null and void because they had not been (*Skrien v. Waterloo Junction Rail Tours Ltd.*, 1998 CarswellOnt 3598 (Ont. C.A. Sep 21, 1998), at par. 4).

⁹³⁹ *Skrien* Ct J (Gen Div), *supra* note 938, par. 14.

⁹⁴⁰ *Ibid*, par. 15.

⁹⁴¹ *Ibid*, par. 17.

⁹⁴² *Ibid*, par. 17. This was upheld on appeal; see note 938.

⁹⁴³ *Riverstar Inc. v. Hookenson*, 2004 ABQB 916, 2004 CarswellAlta 1744, [2005] A.W.L.D. 711 (Alta. Q.B. Dec 03, 2004) (hereinafter "*Riverstar*").

⁹⁴⁴ *Ibid*, par. 43.

⁹⁴⁵ *Ibid*, par. 60.

premises".⁹⁴⁶

In *Klein v. Viscount Mobile Homes Ltd.*,⁹⁴⁷ the unanimous shareholder agreement provided that share transfers could only occur with the consent of all shareholders.⁹⁴⁸ Upon the death of one shareholder, two of the remaining investors negotiated with his estate to acquire his shares, without notifying or receiving consent from the other shareholder.⁹⁴⁹ The purchasers' conduct with regard to the estate was found to be in violation of fiduciary duties arising out of the relationship.⁹⁵⁰ While that was the primary basis for this portion of the judgment, Brockenshire J. also noted that "[f]rom the point of view of the corporation, the very basic requirement of consent by the shareholders and directors was not only never obtained, it was never sought. Without it there could be no transfer of the shares."⁹⁵¹ This immediate nullification of acts contrary to the unanimous shareholder agreement is consistent with the corporate constitutional approach. There was a further issue with regard to share transfers from the same two shareholders to numbered companies and their families, again without the knowledge or consent of the last shareholder in violation of the agreement;⁹⁵² these were also declared void,⁹⁵³ again in accordance with the corporate constitutional model.

The agreement in *Simon v. Ramsay*⁹⁵⁴ was not a unanimous shareholder agreement,⁹⁵⁵ but the judge noted that if it had been, then "[i]t appears from the terms of clause 2.2 of the shareholders' agreement that Salmon and Ramsay [the directors] could not act to remove Simon from his position as officer of Continental without his participation in the vote".⁹⁵⁶ The language suggests a genuine inability to violate the agreement, a situation that was only circumvented due to defects in its formation.⁹⁵⁷

In *Gluckstein v. Checkmate Capital Partners Inc.*,⁹⁵⁸ after Newbould J. determined that the selection of corporate counsel had occurred without unanimous consent of the directors as was required by

⁹⁴⁶ Ibid, par. 61.

⁹⁴⁷ *Klein v. Viscount Mobile Homes Ltd.*, 44 B.L.R. (2d) 91, 1998 CarswellOnt 3038, 81 A.C.W.S. (3d) 444, [1998] O.J. No. 3065, 70 O.T.C. 161 (Ont. Gen. Div. Jul 24, 1998) (hereinafter "*Klein*"). There was also an attempted counter-argument by the respondents that the unanimous shareholder agreement should be declared null and void because the complaining shareholder had in the past allowed for cheques of more than \$2500 to be issued by the corporation without his consent, which the agreement would have required (par. 85). Brockenshire J. held that this did not even make the requirement for consent for cheques null and void, let alone an unrelated provision (par. 85).

⁹⁴⁸ Ibid, par. 60.

⁹⁴⁹ Ibid, par. 60.

⁹⁵⁰ Ibid, par. 69.

⁹⁵¹ Ibid, par. 70.

⁹⁵² Ibid, pars. 81-84.

⁹⁵³ Ibid, par. 87.

⁹⁵⁴ *Simon*, *supra* note 451.

⁹⁵⁵ See Chapter Three.

⁹⁵⁶ *Simon*, *supra* note 451, par. 27.

⁹⁵⁷ Ibid, par. 28.

⁹⁵⁸ *Gluckstein v. Checkmate Capital Partners Inc.*, 2013 ONSC 5244, 2013 CarswellOnt 11231, 231 A.C.W.S. (3d) 252 (Ont. S.C.J. [Commercial] Aug 13, 2013) (hereinafter "*Gluckstein*").

a unanimous shareholder agreement,⁹⁵⁹ without further explanation it was found that the resolution authorizing the retainer was therefore invalid.⁹⁶⁰

While the enforcement of the unanimous shareholder agreement was not a litigated issue in *Robinson v. Willis*,⁹⁶¹ it was mentioned in passing as part of the fact summary, and Mitchell J. endorsed the corporate constitutional understanding that, given that its terms required any change in management to receive support of 75% of shareholders,⁹⁶² the holder of 27.7% of the shares enjoyed an "effective veto"⁹⁶³ and "was right"⁹⁶⁴ that he could not be fired (without his consent).

The plaintiff in *Lavergne c. Bouchard*⁹⁶⁵ was removed from her positions as one of the directors and Vice-President of the company. The unanimous shareholder agreement provided that she could only be removed from her position as Vice-President if she ceased to be a shareholder or for cause,⁹⁶⁶ and the company had relied upon the former.⁹⁶⁷ Bishop J.C.S. determined that she was still a shareholder,⁹⁶⁸ and thus, without additional analysis or explanation, found that her removal from that position was *prima facie* illegal and a nullity.⁹⁶⁹ In a pure corporate constitutional analysis, this would have ended the issue, but as this was a request for an injunction and not a final determination of the matter, the reasons continued to the other stages of the test; not only had her *prima facie* case been established, but there was sufficient urgency and potential harm and the balance of convenience favoured her.⁹⁷⁰ With regard to the position of director, the unanimous shareholder agreement did not specifically provide that she would hold the office, but instead stated that each of the three shareholders could select one of the three directors and the others agreed to elect those choices.⁹⁷¹ The judge therefore found that removing her from her position had *prima facie* been accomplished according to the law and the company's articles.⁹⁷² It was left as a question for trial whether the same shareholder would thus have the right to select a replacement director whom the others would have to support under the terms of the agreement.⁹⁷³ This judicial reliance upon the literal

⁹⁵⁹ Ibid, pars. 14-26. There was an issue whether, given the wording of the agreement and the possibility of conflict on the part of one director, his approval was necessary.

⁹⁶⁰ Ibid, par. 27.

⁹⁶¹ *Robinson v. Willis*, 2013 PESC 5, 2013 CarswellPEI 14, 227 A.C.W.S. (3d) 697 (P.E.I. S.C. Apr 08, 2013) (hereinafter "*Robinson*").

⁹⁶² Ibid, second par. 16 (the numbering of paragraphs in the judgment resets halfway through).

⁹⁶³ Ibid, second par. 16 (the numbering of paragraphs in the judgment resets halfway through).

⁹⁶⁴ Ibid, second par. 15 (the numbering of paragraphs in the judgment resets halfway through).

⁹⁶⁵ *Lavergne c. Bouchard*, 2000 CarswellQue 2776, J.E. 2001-44, REJB 2000-21471 (C.S. Que. Nov 21, 2000) (hereinafter "*Lavergne*").

⁹⁶⁶ Ibid, par. 67.

⁹⁶⁷ Ibid, par. 68.

⁹⁶⁸ Ibid, par. 70.

⁹⁶⁹ Ibid, par. 71.

⁹⁷⁰ Ibid, pars. 72-88.

⁹⁷¹ Ibid, pars. 5, 62.

⁹⁷² Ibid, pars. 60-61.

⁹⁷³ Ibid, pars. 62-63.

wording of the document rather than what one might view as its "spirit" stands in contrast to how the situation might be handled under the oppression approach.

A unanimous shareholder agreement in *3103-0604 Québec inc. c. Éditions Gatineau ltée*⁹⁷⁴ provided that contracts between the company and a shareholder or related party had to be approved by 60% of the shareholders.⁹⁷⁵ Setting out the general effects of a unanimous shareholder agreement, Plouffe J.C.S. said:

Ses actionnaires peuvent, si tous y consentent et font une convention écrite à cet effet, restreindre le pouvoir des administrateurs. L'effet d'une convention restreignant le pouvoir des administrateurs est de substituer les actionnaires aux administrateurs dans les droits et pouvoirs et aussi dans les devoirs et responsabilités des administrateurs, dans la mesure de la restriction. Ce qui précède a trait à la convention unanime des actionnaires. En l'espèce, tous les actionnaires de la société-intimée se sont prévalus de cette prérogative.⁹⁷⁶

Therefore, a contract of employment purportedly entered into with a party related to a shareholder that had not received 60% shareholder approval was found, without further explanation, to have no legal effect.⁹⁷⁷

These cases, as well as the ones listed in the preceding subsection and a few others,⁹⁷⁸ demonstrate

⁹⁷⁴ *3103-0604 Québec inc. c. Éditions Gatineau ltée*, 2006 QCCS 1930, 2006 CarswellQue 3374, J.E. 2006-999 (C.S. Que. Apr 10, 2006) (hereinafter "*3103*").

⁹⁷⁵ *Ibid.*, par. 23.

⁹⁷⁶ *Ibid.*, par. 52. My translation: "Its shareholders can, if they all agree and make a written contract for this purpose, restrict the powers of the directors. The effect of an agreement restricting the power of the directors is to substitute the shareholders for the directors with regard to their rights and powers and also duties and responsibilities, to the extent of the restriction. The preceding has the features of a unanimous shareholder agreement. In this case, all the shareholders of the company took advantage of this prerogative."

⁹⁷⁷ *Ibid.*, par. 61.

⁹⁷⁸ See the discussion later in this chapter concerning oppression cases that employed corporate constitutional assumptions. The following additional examples may also represent this model, given that the choice of remedy was to enforce the agreement by reversing/nullifying acts taken contrary to it.

A unanimous shareholder agreement in *Leblanc*, *supra* note 674, required that both shareholders agree on major decisions, which included the firing and replacement of the company's CEO, called in the judgment the "directeur generale" (pars. 72-75). One of the investors had done this alone, claiming authority under the term of the agreement allowing for either shareholder to make routine business decisions (par. 69). The judge ordered the old CEO reinstated (par. 84).

Although the analysis was minimal, the judge in *Boudreau c. Després*, 2012 QCCS 4027, 2012 CarswellQue 8539, EYB 2012-210459 (C.S. Que. Jun 15, 2012) ordered on an interim motion that the plaintiff be restored to his position in the company (par. 16), in part because of the terms of a unanimous shareholder agreement (par. 8).

In *Arboriculture 3-R inc. c. Dontigny*, 2011 QCCQ 16051 (C.Q. Dec 21, 2011), a company sued its own director for, *inter alia*, transferring a car owned by the company to his wife in satisfaction of a debt the

that while the language of "corporate constitutional" unanimous shareholder agreements may not be commonly employed by judges, the underlying principles do have some wider currency, one whose sway on the judiciary's collective mind is at least competitive with the contractual approach. These cases demonstrate the analytic simplicity, even brevity, to which the corporate constitutional approach lends itself, and the absolutism in which it results. Outside the context of tax law, this is the most significant feature of the corporate constitutional view of unanimous shareholder agreements: in this model, the restrictions placed cannot be circumvented or ignored. Any attempt to do so is forbidden and void. This is what makes the corporate constitutional approach not just the simplest, but also the most radical approach to enforcing unanimous shareholder agreements.

While the treatment of restrictions as a genuine removal of (some of) the directors' powers, rather than a means of controlling how those powers are exercised, is the most crucial difference between the corporate constitutional approach- whether explicit or implicit- and the other three means of enforcing unanimous shareholder agreements, this model does have a couple of other distinct implications, as explored in the following two subsections.

3.(c) Shield

Because it renders purported corporate acts null and void, the corporate constitutional approach could also be used as a "shield" and not a "sword".⁹⁷⁹ A few cases provide examples of how this might occur, even if they do not demonstrate successful attempts. In *Jeffrey Pinder & Associates Inc. v.*

company owed her; it sued the wife as well (pars. 2, 13). A unanimous shareholder agreement shifted from the directors to the shareholders the power to sell all or substantially all of the corporation's assets (par. 17). The transfer of an automobile valued at \$3000 to satisfy an existing debt was found not substantial enough to run afoul of that restriction (pars. 19-22). It therefore remained within the director's power to sell or transfer it (par. 20). The judgment's wording, however, implied the board's authority in the specified areas was genuinely removed and only outside those restrictions did they retain their powers (see pars. 17, 20).

The plaintiff in *Autotte c. Innovations Voltflex inc.*, 2008 QCCS 3505, 2008 CarswellQue 7283, EYB 2008-142782 (C.S. Que. Jul 15, 2008) was removed from his position as director by the majority investor despite a unanimous shareholder agreement (par. 3). During an interim motion hearing for the production of documents (and the referral of a related claim to arbitration), Richard J.C.S. commented in passing that it would be up to the trial judge to determine whether to annul the shareholder's firing of him (pars. 21, 35). The impugned step was taken *qua* shareholder, which raises questions about whether the agreement would be enforced as a unanimous shareholder agreement or a pooling agreement. The unanimous shareholder agreement, as a specific statutory tool, is designed to restrict the powers of the directors, not the shareholders, and thus the corporate constitutional approach to enforcing them is not appropriate against the latter group. The same agreements can, however, impose obligations upon shareholders as well, and these are enforceable through other means, which may in some circumstances yield similar results.

⁹⁷⁹ A "shield" is a metaphorical term for a defence against a claim, in contrast with a "sword" which is a term for the legal basis for a claim.

Stephenson Fuels Ltd.,⁹⁸⁰ the applicant attempted to enforce a security agreement under which it had been appointed receiver.⁹⁸¹ The respondent argued that the security agreement contravened a unanimous shareholder agreement, to which the applicant was a party, and that therefore the security agreement was unenforceable.⁹⁸² Klebuc J. determined that the issues involved required a full trial to sort out conflicting evidence,⁹⁸³ so did not consider the issues raised at length, but did say this:

2 [4] If the unanimous shareholder's agreement was executed before the general security agreement, or the parties had agreed that the terms thereof would govern their relationship pending the execution thereof, the general security agreement may be unenforceable. In turn, the appointment of the applicant as receiver would be invalid.

In *C.S.A.E. Inc. v. Air Service S.A.*,⁹⁸⁴ the respondent brought a motion to dismiss the suit because, *inter alia*, it was not brought with the authority of the applicant.⁹⁸⁵ The primary basis for this claim was that the lawsuit had been initiated by the corporate president without either a directors' or shareholders' resolution.⁹⁸⁶ While most of the decision dealt with the situation as a general matter of corporate law, there was a unanimous shareholder agreement involved. It stated that shareholder approval was necessary for, in the words of Pepall J., "the making of any decisions or taking of any action with respect to the operation of the applicant".⁹⁸⁷ However, the judge concluded that "the institution of the lawsuit was not in the nature of an operational decision or action as described in the shareholders' agreement".⁹⁸⁸ While the precedent set is arguably a narrow one,⁹⁸⁹ a more interesting and potentially widely applicable aspect of the case is the implication regarding standing. The respondent was not a signatory to the unanimous shareholder agreement, but its motion (or at least the judicial consideration of that motion) was based in part on whether the agreement outright restricted corporate activities. This would suggest a corporate constitutional understanding. No other model would allow for third party "enforcement" of a unanimous shareholder

⁹⁸⁰ *Jeffrey Pinder & Associates Inc. v. Stephenson Fuels Ltd.*, 2002 SKQB 398, 2002 CarswellSask 664 (Sask. Q.B. Nov 27, 2002) (hereinafter "*Jeffrey Pinder*"); *Jeffrey Pinder & Associates Inc. v. Trollhaugen Management Inc.*, 2002 SKQB 484, 2002 CarswellSask 734 (Sask. Q.B. Nov 28, 2002) is a functionally identical decision arising out of the same facts, but with even less judicial discussion.

⁹⁸¹ *Jeffrey Pinder*, *supra* note 980, par. 1.

⁹⁸² *Ibid*, par. 1.

⁹⁸³ *Ibid*, par. 3.

⁹⁸⁴ *C.S.A.E. Inc. v. Air Service S.A.*, 2006 CarswellOnt 9896 (Ont. S.C.J. Sep 11, 2006) (hereinafter "*C.S.A.E.*"). The document in question was generally identified in the judgment simply as a "shareholders' agreement", but Pepall J. did make reference to the statutory tool by stating that "[t]he by-laws of the applicant provide that the directors shall manage or supervise the management of the business and affairs of the applicant unless otherwise specifically provided in any unanimous shareholder agreement" (par. 5).

⁹⁸⁵ *Ibid*, par. 1.

⁹⁸⁶ *Ibid*, par. 7.

⁹⁸⁷ *Ibid*, par. 6.

⁹⁸⁸ *Ibid*, par. 12.

⁹⁸⁹ In short, that a unanimous shareholder agreement referring to "operational decisions" would not include the bringing of lawsuits to collect on accounts owing.

agreement.⁹⁹⁰ Another detail of potential significance is that the target of the motion was specifically not the directors, who were explicitly not allowed to vote on the action, but the president (admittedly, also a director⁹⁹¹). While the president was a party to the agreement, and therefore might be bound by it *qua* signatory in addition to being restricted *qua* director, this returns us to the question of whether it was being enforced as a contract (impossible due to privity) or as a corporate document.

The "shield" argument was also raised in *Daigle c. 9004-3654 Québec inc.*,⁹⁹² but there it did not succeed. The directors had declared that a bonus was payable to one of the officers.⁹⁹³ Under the terms of a unanimous shareholder agreement, that power had been removed from them and transferred to the shareholders.⁹⁹⁴ The corporation subsequently took the position that the bonus was invalid because it had not been declared via a shareholders' resolution as set out in the agreement,⁹⁹⁵ prompting him to sue to receive it. The officer in question had signed the document and knew its terms.⁹⁹⁶ Because the company had historically not followed the requirements of the unanimous shareholder agreement in this regard,⁹⁹⁷ the judge found that it could not invoke that clause now to deny the bonus.⁹⁹⁸ A strict corporate constitutional approach would not have yielded this conclusion, but the specific logic employed did leave some room for the possibility that, had the company normally followed the agreement, the restrictions therein could have been used as a "shield" against the officer's claim.

While it is possible that a unanimous shareholder agreement might be used as a "shield" in an analysis performed under either the contractual or oppression models, depending upon the facts, the corporate constitutional approach allows for this much more easily, since its central implication is that

⁹⁹⁰ Except the oppression approach to a limited extent, but *C.S.A.E.* was not an oppression claim. *C.B.C.A.* s. 247, *A.B.C.A.* s. 248, *M.C.A.* s. 240, *N.B.B.C.A.* s. 172, *N.L.C.A.* s. 378, *N.T.B.C.A.* s. 249, *N.B.C.A.* s. 249, *O.B.C.A.* s. 253(1), *Q.B.C.A.* s. 460, *S.B.C.A.* s. 240, and *Y.B.C.A.* s. 249 permit a variety of groups (typically creditors, security holders, directors, the Director appointed by the Minister, and any person the Court in its discretion allows, with the Quebec version including "any interested person") to apply for, *inter alia*, an order that the corporation or the directors comply with or restrain from breaching a unanimous shareholder agreement, although the Court has discretion in dealing with such applications. The very existence of this provision suggests that the legislature envisioned a corporate constitutional approach to enforcement. If some other theory is adopted, however, the scope of these provisions as they apply to unanimous shareholder agreements may be read narrowly, with third parties either being denied permission to bring an application (if required) or else denied the relief sought.

⁹⁹¹ *C.S.A.E.*, *supra* note 984, fn 1.

⁹⁹² *Daigle c. 9004-3654 Québec inc.*, 2002 CarswellQue 1431, J.E. 2002-1331, REJB 2002-32875 (C.S. Que. Jun 19, 2002) (hereinafter *Daigle*). The judgment was upheld by the Court of Appeal, with very brief reasons that did not address this point specifically, in *Daigle c. 9004-3654 Québec inc.*, 2003 CarswellQue 2927, REJB 2003-51133 (C.A. Que. Nov 24, 2003).

⁹⁹³ *Daigle*, *supra* note 992, paras. 5-7. Some of the shareholders subsequently signed one of the directors' resolution as well.

⁹⁹⁴ *Ibid*, par. 8.

⁹⁹⁵ *Ibid*, par. 18.

⁹⁹⁶ *Ibid*, par. 20.

⁹⁹⁷ *Ibid*, paras. 21-27.

⁹⁹⁸ *Ibid*, par. 27.

directors simply have no authority to override the restrictions placed upon them and any purported attempt to do so is a nullity. *C.S.A.E.* also brings up another aspect of the corporate constitutional model, in the suggestion that third parties might be able to enforce unanimous shareholder agreements, because under this approach, enforcement is not a matter of *rights*, but a finding of fact, that the directors' alleged actions were beyond their power. This, again, makes it unique among the four approaches to enforcement, and demonstrates how the competing means through which unanimous shareholder agreements are enforced are also conflicting views of what they actually *are*.

3.(d) The "Indoor Management Rule"

Even under the corporate constitutional approach to the enforcement of unanimous shareholder agreements, the "indoor management rule" would protect third parties.⁹⁹⁹ Such a situation arose in *Royal*

⁹⁹⁹ The "indoor management rule" protects third parties who deal with a corporation in the belief that its internal decision-making processes are being followed. It prevents any failure on the part of the corporation and/or its participants to adhere to those processes from later being used by them as a basis on which to disregard their dealings with outsiders.

In the jurisdictions where the unanimous shareholder agreement exists, each of the statutes specifically identifies lack of compliance with one as among the procedural defects that may not be asserted against a third party unless they knew or ought to have known of that failure. The *C.B.C.A.* provides:

18. (1) No corporation and no guarantor of an obligation of a corporation may assert against a person dealing with the corporation or against a person who acquired rights from the corporation that
 - (a) the articles, by-laws and any unanimous shareholder agreement have not been complied with;
 - [...]
 - (2) Subsection (1) does not apply in respect of a person who has, or ought to have, knowledge of a situation described in that subsection by virtue of their relationship to the corporation.

See also *A.B.C.A.* s. 19(a), *M.C.A.* s. 18(a), *N.B.B.C.A.* s. 16(a), *N.L.C.A.* s. 31(a), *N.T.B.C.A.* s. 18(a), *N.B.C.A.* s. 18(a), *O.B.C.A.* s. 19(a), *Q.B.C.A.* s. 13(1), *S.B.C.A.* s. 18(a), and *Y.B.C.A.* s. 21(a).

Although it may be terminologically inexact to refer to these sections as the "indoor management rule" (a term originally describing a common law rule), that phrase is commonly associated with this principle. It appears as a heading for the section in the Ontario statute (but not the others), and it is employed by several of the cases discussed in this subsection. References in this dissertation to the "indoor management rule" should be taken to refer to the statutory provisions where applicable.

See also the discussion in Chapter Five or whether third parties unaware of the existence or terms of a unanimous shareholder agreement can rely upon the presumption that directors retain their normal liabilities, which falls outside the "indoor management rule".

Bank v. Ag-Com Trading Inc.,¹⁰⁰⁰ where for separate aspects of the claim, the outside party both was and was not protected by the "indoor management rule".¹⁰⁰¹ The corporation was subject to a "joint venture agreement" between the two corporations which owned it. Under the terms of this agreement, the majority shareholder would appoint three of the corporate directors and the minority shareholder would appoint two, but a two-thirds majority of the directors would be necessary for certain acts, effectively giving the minority shareholder a veto.¹⁰⁰² The corporation's bank, which was the plaintiff in the suit, was given a copy of the agreement, although its representative claimed not to have read it carefully.¹⁰⁰³ Subsequent to this, the corporation both guaranteed bank loans to its majority parent (funds which were in turn used to finance the corporation) and eventually took out a loan itself, all without obtaining the two-thirds director approval required under the agreement.¹⁰⁰⁴

Cameron J. considered the issue in the context of the statutory codification of the "indoor management rule" in the Ontario *Business Corporations Act*, which specifically includes unanimous shareholder agreements.¹⁰⁰⁵ The judge found that, generally, the bank's deemed knowledge of the contents of the agreement which it had been given, along with its actual knowledge of the general situation of the parties, combined to put it on notice as required by the "indoor management rule".¹⁰⁰⁶ "In these circumstances the Bank must bear the consequences of failing to examine the JVA for the terms that would impact on its relationship with Huron and failing to address that impact in future dealings with Huron."¹⁰⁰⁷

When obtaining one of the guarantees in question, the bank had received a signed form from a corporate officer¹⁰⁰⁸ which stated that the attached resolution of the corporation's directors satisfied any unanimous shareholder agreements and that there were no unanimous shareholder agreements which restricted the ability of the corporation or its directors from borrowing money.¹⁰⁰⁹ These assurances were false. However, Cameron J. determined that, in obtaining them, the bank had satisfied its duty to inquire with regard to that transaction, and therefore the "indoor management rule" protected it from the need for further investigation. It was entitled to take a corporate officer at his word that the unanimous shareholder

¹⁰⁰⁰ *Royal Bank v. Ag-Com Trading Inc.*, 2001 CarswellOnt 428, 2 P.P.S.A.C. (3d) 1, [2001] O.J. No. 474 (Ont. S.C.J. [Commercial] Feb 12, 2001) (hereinafter "*Royal Bank*").

¹⁰⁰¹ Another issue in the case was that the J.V.A. included an obligation on the majority shareholder to transfer equipment to the corporation. That property was subject to a security interest. The bank argued that the interest survived the transfer, which the judge agreed with, despite finding that the corporation would have expected to receive the equipment free of encumbrances.

¹⁰⁰² *Royal Bank*, *supra* note 1000, par. 8. At par. 68, Cameron J. noted that the agreement did not specifically list guarantees, but that the ones in question were liabilities over \$50 000, which were covered.

¹⁰⁰³ *Ibid*, par. 13.

¹⁰⁰⁴ *Ibid*, pars. 20-51.

¹⁰⁰⁵ *Ibid*, par. 64.

¹⁰⁰⁶ *Ibid*, pars. 67, 70.

¹⁰⁰⁷ *Ibid*, par. 67.

¹⁰⁰⁸ Actually the treasurer, but signing as secretary, a position he did not in fact hold; Cameron J. found this to be immaterial (*Royal Bank*, *supra* note 1000, par. 71).

agreements had been satisfied.¹⁰¹⁰

With regard to the loan made directly to the corporation, Cameron J. found that despite the fact that it had been made without proper authorization, because the benefit had been received by the corporation, the money advanced was repayable but unsecured.¹⁰¹¹ It is unclear on precisely what grounds this was done; Cameron J. noted at the conclusion of the judgment that the issue of unjust enrichment had not been considered, but that "equitable issues" had.¹⁰¹² By contrast, the judge declined to hold the corporation liable for the guarantees under the same general equitable principles, even though the funds had been used to finance it, on the grounds that the beneficiary of those loans was still the shareholder, who had used the funds as an investment in the corporation "by equity or by loan".¹⁰¹³ Therefore, the benefit of the loans had been received by the majority shareholder, not the corporation.

Both the voided guarantees and the unsecured loan represented nullifications of unauthorized corporate acts. Under a contractual approach, the directors might have been held liable by the shareholders, but corporate contracts with third parties would not be invalidated. So this appears to have been an example of the corporate constitutional approach, yet subject to the "indoor management rule".

Finally, in *609940 Ontario Inc. (Five Star Auto), Re.*,¹⁰¹⁴ the two 50% shareholders of the corporation¹⁰¹⁵ agreed that there was to be no "casting vote" and all decisions required both their consent.¹⁰¹⁶ One shareholder eventually decided to withdraw from the company and resigned his position as director; the other shareholder, then the sole director, subsequently had the company make an assignment in bankruptcy.¹⁰¹⁷ The first shareholder took the position that, his consent having been required by the unanimous shareholder agreement and not having been obtained, the assignment was void.¹⁰¹⁸ The judge framed the issue (as argued by the shareholder) in clearly corporate constitutional terms:

The grounds stated are simple: that by reason of the unanimous shareholder agreement the director was not authorized to adopt the enabling resolution without the consent of Mr. Cicco; the *Business Corporations Act* requires directors to comply with the shareholder agreement and to manage the affairs of the corporation subject to its provisions; therefore the assignment is void.¹⁰¹⁹

¹⁰⁰⁹ *Royal Bank*, *supra* note 1000, par. 30.

¹⁰¹⁰ *Ibid*, par. 72.

¹⁰¹¹ *Ibid*, par. 84.

¹⁰¹² *Ibid*, pars. 107-108.

¹⁰¹³ *Ibid*, par. 80.

¹⁰¹⁴ *609940 Ontario Inc. (Five Star Auto), Re.*, 1985 CarswellOnt 202, 57 C.B.R. (N.S.) 137, [1985] O.J. No. 1753 (Ont. S.C. Dec 19, 1985) (hereinafter "*609940*").

¹⁰¹⁵ *Ibid*, par. 2.

¹⁰¹⁶ *Ibid*, par. 3.

¹⁰¹⁷ *Ibid*, par. 5.

¹⁰¹⁸ *Ibid*, par. 7.

¹⁰¹⁹ *Ibid*, par. 7.

Under the terms of the *Bankruptcy Act*,¹⁰²⁰ the assignment could be annulled if it "ought not to have been made".¹⁰²¹ Henry J. stated that there was no precedent exactly on point,¹⁰²² although interestingly considering the subsequent analysis, noted also that one possible ground for annulling an assignment was lack of adequate notice of the directors' meeting at which it occurred.¹⁰²³ The judge concluded:

12 The shareholder agreement of 4th January 1985 is in my opinion a unanimous shareholder agreement as defined by the *Act*. It binds the directors but does it bind a third party dealing with the company who has no notice of the restrictive authority of its directors? In the case at least of the trustee in bankruptcy the answer is "no". The assignment is for the benefit of the creditors and the function of the trustee is to protect their interest. It is the policy of the *Act* that assets of an insolvent company are to be distributed to the creditors according to the scheme of priorities there described; a debtor or a creditor may set the machinery in motion.

13 Here the sole director has done so. The trustee, who has started his administration, in his affidavit deposes that at the date of the assignment the company was insolvent. There is a deficiency of assets; it is expected that some preferred creditors will be paid but that there will be nothing for the unsecured creditors. In these circumstances, the director made the decision to invoke the *Act*, justifiably so in my opinion. There is no question that the resolution and assignment are regular on their face; the director was duly appointed and qualified to act. The effect of the unanimous shareholder agreement is to limit his authority but in my opinion that is an entirely internal matter between the director and the shareholders. He may be accountable to them for failure to comply with the agreement and the statute but that does not render the assignment void or disentitle the trustee to rely on the assignment and supporting resolution. To hold otherwise would have the result that no trustee could safely act under a corporate assignment in bankruptcy without enquiring into the internal (and unpublished) fetters on the authority of the duly appointed directors convened in a regular meeting. In my opinion that cannot have been the intention of the legislature.

There are obvious reasons why third parties without notice should not find their dealings with a corporation nullified due to the operations of a unanimous shareholder agreement; it would create an unacceptable level of uncertainty in commercial transactions and lead to the potential abuse of innocent outsiders who transacted with the company in good faith. However, despite Henry J.'s conclusions, it is not immediately clear that these reasons extend to the trustee in bankruptcy. Likewise, the interests of the creditors are not necessarily relevant; if they had wished for this bankruptcy, as Henry J. appeared to assume it was in their interest, they could have begun the process. In short, if the assignment were to have been annulled, no one was detrimentally deceived by the unusual corporate structure.¹⁰²⁴ Further, as noted

¹⁰²⁰ *Bankruptcy Act*, RSC 1970, c. B-3, s. 151(1).

¹⁰²¹ 609940, *supra* note 1014, par. 10.

¹⁰²² *Ibid*, par. 10.

¹⁰²³ *Ibid*, par. 10.

¹⁰²⁴ I assume here no facts not referred to that might establish actual loss or reliance.

above, lack of proper attention to corporate formalities (such as notice of meetings) is an acceptable reason to annul an assignment into bankruptcy. This is inconsistent with the judge's logic.

Despite conceding that unanimous shareholder agreements bind directors, Henry J. did not fully accept the implications of the corporate constitutional model. In the paragraph quoted above, it was stated, "There is no question that the resolution and assignment are regular on their face; the director was duly appointed *and qualified to act*."¹⁰²⁵ (emphasis mine) Under a corporate constitutional model, the director would not have been qualified to act. But Henry J. defaulted to a more typical corporate arrangement in conceiving of directorial powers, stating that any restrictions upon them were a purely internal matter, leading only to potential liability to the shareholders.

This leads to two questions. Was Henry J.'s conclusion a rejection of the corporate constitutional approach in favour of a contractual one or was it a recognition that third party rights can only be protected through an "indoor management rule" that allows them to assume that directors have their normal powers?¹⁰²⁶ And is there a difference between the two? It was argued in the preceding subsections that the quintessential feature of the corporate constitutional approach is that directors simply do not have the power to take steps in contravention of unanimous shareholder agreements, and any of their decisions or actions that purport to do so are nullities. As these cases demonstrate, third party interests may require giving effect to these acts nonetheless, to protect outsiders from having to know the intricacies of a company's inner workings.¹⁰²⁷ At best, this could be viewed as a necessary compromise of theoretical purity in the face of practical considerations. At worst, this could suggest that another approach, such as the contractual view discussed in the next section of this chapter, might be a better way both of enforcing unanimous shareholder agreements and of conceiving of their fundamental nature.

¹⁰²⁵ 609940, *supra* note 1014, par. 13.

¹⁰²⁶ This case can be contrasted with 9226-5909 *Québec inc. c. 9126-9456 Québec inc. (Pourvoirie Monet)*, 2012 QCCS 1928, 2012 CarswellQue 4441, 222 A.C.W.S. (3d) 591, EYB 2012-206182 (C.S. Que. Apr 26, 2012) which explicitly considered it (par. 35) and declined to follow it because, in Quebec, the law required disclosure of a unanimous shareholder agreement in the application for bankruptcy (par. 36). Therefore, the corporation actually had disclosed it to the registrar (par. 37). As such, the agreement applied, and the director did not have the power to make a proposition under bankruptcy law; that was a decision out of the ordinary course of business and, under the document's terms, required shareholder approval (pars. 33-34). In other words, without a concern for harming third parties who had no notice, the situation defaulted to one where corporate constitutional principles applied, and the director could not overcome the restriction upon his power.

¹⁰²⁷ In another case dealing with the "indoor management rule", *Brosseau-Nestor c. Raymark Xpert Business Systems Inc.*, 2009 QCCS 940, 2009 CarswellQue 1920, EYB 2009-155716, D.T.E. 2009T-247, J.E. 2009-652 (C.S. Que. Mar 9, 2009), a corporate officer was found to be entitled to rely upon the apparent authority of her superior, the company's President and CEO, to renegotiate her employment contract (par. 59). She was not aware of the terms of a unanimous shareholder agreement that placed limits upon the superior's ability to do so unilaterally (par. 62). The "indoor management rule" was specifically invoked by the judge (par. 53).

3.(e) Summation

The first of four methods of enforcing unanimous shareholder agreements, the corporate constitutional approach, is intertwined with the idea that this tool genuinely restructures the corporation. This was the model adopted by the Supreme Court of Canada in *Duha*, who held that these documents become part of the "corporate constitution" and therefore place actual restrictions upon the authority of directors. Once one is in place, any attempts to ignore those limitations are nullities; directors who have had their powers removed could no more validly exert them than could, for example, a director who had been voted out.

Whether or not explicitly labelled as "corporate constitutional", cases that take literally the idea that directors lack the power to overcome the restrictions placed upon them demonstrate that this approach yields relative simplicity and certainty. With the significant exception of situations involving the "indoor management rule", directors' actions in violation of the agreements are nullities. This principle extends so far as to allow for the possibility of that nullification as a legal "shield". Even more than its consistency with apparent legislative intent and the Supreme Court of Canada's endorsement of it in *Duha*, it is that simplicity and certainty which are the chief practical virtues of the corporate constitutional approach as a means of enforcing unanimous shareholder agreements.

On a theoretical level, the appeal or lack thereof of this method of enforcement is inherently tied to whether or not unanimous shareholder agreements truly alter the corporation at a fundamental level. To accept that the corporate structure and the authority of the directors have been reshaped by the unanimous will of the shareholders is to endorse the nullification of actions taken in contravention of that restructuring, and *vice versa*. This is consistent with (and would be required by) a "nexus of contracts" understanding of the corporation, but it is also compatible with a statutory framework, with the result that the unanimous shareholder agreement is a legislatively-authorized tool, powerful but ultimately specialized, for removing powers from the directors. Yet as the other three approaches covered in this chapter demonstrate, there are alternative ways to conceive of both the enforcement of these documents and the nature of the agreements themselves.

4. The Contractual Approach

The restrictions that unanimous shareholder agreements place upon the directors do not have to be viewed as an alteration of their fundamental powers to control the corporation. An alternative conception of them is as the terms of a contract with the directors regarding how those powers are to be used.

Under the common law, directors were not permitted to enter into contracts detailing how they would exercise their powers, as that was seen to "fetter their discretion" and interfere with their ability to

make each decision as it arose in the best interests of the company, as their duty requires. One possible interpretation of the provisions in the various acts creating unanimous shareholder agreements is that they are a statutory override of this prohibition, under the specific circumstances that all shareholders agree. In other words, in the phrase "[a]n otherwise lawful written agreement among all the shareholders of a corporation [...] that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation is valid"¹⁰²⁸ it is the *agreement* and not the *restrictions* whose validity is being declared; this would replace the previous rule that a contract with the directors that restricted their discretion was not legally valid.

One immediate implication is the technical difficulties that could arise if the directors were not parties to the document. While they might typically also be shareholders, all of whom by definition must be parties or are deemed parties, there are any number of possible circumstances where non-shareholders might be elected as directors. Since contracts cannot typically be enforced against non-parties, it is possible that this would mean that the unanimous shareholder agreement could not be enforced against them. A similar question arose at the trial level in *Sumner*, with regard to whether the corporation itself was bound by the agreement.¹⁰²⁹ This problem might be circumvented by deeming directors and/or the

¹⁰²⁸ C.B.C.A. s. 146(1).

¹⁰²⁹ Commentators had previously weighed in regarding whether or not a corporation is a deemed party to a unanimous shareholder agreement, if it is not an explicit one. They concluded that the company is bound, but using two separate approaches, which arguably have different theoretical implications. One of these is corporate constitutional in nature (and also follows the "nexus of contracts" model). Ratti, *supra* note 16, p. 121, and Turgeon, *supra* note 9, p. 235, both argued that the corporation is itself bound by a unanimous shareholder agreement because it cannot ignore changes to the very documents that set out its parameters. I agree that the corporate constitutional approach to enforcement necessarily means that the company is bound by unanimous shareholder agreements (except where third party rights are involved), since any actions taken by directors in contravention of them are nullities. If these documents are enforced contractually against the directors, however, it is less clear what the situation might be regarding the company itself. This brings us to the second explanation. Robitaille, *supra* note 267, pp. 172-173, pointed out that since the corporation is legally a separate person from its shareholders, it is not automatically bound by a contract they sign, even a unanimous shareholder agreement. Despite that, he considered this distinction largely academic if the investors had assumed full power over it, and since he also believed that the statute at least implicitly required that directors be bound to follow a unanimous shareholder agreement, he concluded that it would be difficult to claim that the company was not. Martel, *supra* note 11, p. 31, argued that despite it not being explicit in the statute that the corporation was bound by the agreement whether or not a party to it, this was the only logical conclusion. Martel and Martel, *supra* note 16, p. 373, also argued that since both shareholders and directors were bound, so must the company be, because the unanimous shareholder agreement dissolved the distinction between them. If one adopts a contractual and not corporate constitutional approach to enforcement, it is not clear that legally binding the decision-makers is the same as binding the company. (This also assumes that the directors themselves are bound.) The distinction is not merely technical. Presumably, acts of the company that were prohibited would usually be imputed to the directors whether or not specifically authorized by them, but it is possible that this might not always occur. Further, although an order of specific performance against the board would *de facto* affect the company they control, if damages were awarded, resort would be limited to the directors' personal assets and exclude corporate ones. The ability of a unanimous shareholder agreement to bind the company is thus another potential difference between the corporate constitutional and contractual approaches. For

corporation¹⁰³⁰ to be bound by unanimous shareholder agreements as if they were parties.¹⁰³¹ On the other hand, one might take the position that this result is a feature, not a bug, and that directors should not be bound by restrictions to which they did not agree, even if the shareholders unanimously wish to impose them, essentially adding an additional requirement to those present in the statutes.

Conversely, privity bars non-parties from suing to enforce a contract. While, as discussed above, it is at least debatable whether it is open to a third party under a corporate constitutional approach to argue that an alleged corporate act was a nullity because it was not properly authorized, under traditional contract law there would be no such opportunity.¹⁰³² It might also complicate attempts by shareholders to enforce the agreement when their own personal rights are not obviously at stake.¹⁰³³

completeness, the final two models would address this dilemma as follows. If breach of an agreement is a violation of the directors' duties, then the corporation is necessarily the *claimant* (if often by proxy) rather than a defendant. The oppression remedy easily includes the company itself among potential defendants.

¹⁰³⁰ According to the legislation, a unanimous shareholder agreement restricts directors, not the corporation directly, although if it is enforceable against the former, this will generally not make a significant difference.

¹⁰³¹ If they were literally deemed parties, this would also have implications for the directors' and/or the corporation's ability to enforce the document against the shareholders. While not precisely on point, see *H & R Electric Ltd. v. Chieftain Industrial Contractors & Consultants Ltd.*, 91 Sask. R. 20, 1990 CarswellSask 480 (Sask. Q.B. Dec 18, 1990), where a corporation that was a party to its own unanimous shareholder agreement (par. 5) but not the accompanying covenants contemplated in it (par. 15) therefore could not enforce non-compete clauses in the latter documents against its investors (par. 21). Whether a corporation (or directors) not party to the unanimous shareholder agreement itself could enforce the terms therein as against a shareholder is not precisely the same situation, but bears consideration. Privity, if it is applicable, would bar such a claim; that could be reversed if they were legally deemed parties for the purpose of allowing enforcement as against them.

¹⁰³² While the present discussion has focussed on unanimous shareholder agreements as instruments that restrict directors and largely ignored cases dealing with intra-shareholder rights placed in the same document, *e.g.* shotgun clauses, it is perhaps notable that in a suit brought over a right of first refusal for share sales, *Groupe Bocenor inc. c. Lamiver inc.*, 2006 CarswellQue 4907, J.E. 2006-1481, EYB 2006-105490 (C.S. Que. May 12, 2006), Jacques J.C.S. held that in addition to the "indoor management rule" applying (the phrase was not used, but the principle was set out and the federal and Quebec statutes were cited (par. 178 and fn 58)), because on the facts the purchaser had no knowledge of the agreement (par. 183), so did the wider *Civil Code of Québec*, LRQ, c C-1991, c. 64 (hereinafter "*C.C.Q.*"), article 1440 also apply: "A contract has effect only between the contracting parties; it does not affect third persons, except where provided by law" (par. 179). The judgment did not specify if it applied generally to any term in a unanimous shareholder agreement or only to intra-shareholder rights. The court also commented that the remedy for a shareholder for a breach was therefore a suit for damages (par. 181), although again it was unclear if that was limited to intra-shareholder disputes or included restrictions upon directors.

¹⁰³³ In *Vaillancourt c. Lambert, ès qualités "Liquidateur succession Laurent Perreault"*, 1998 CarswellQue 2525 (C.S. Que. Apr 27, 1998), a unanimous shareholder agreement provided that the company was to repurchase the shares of a deceased investor (par. 9). Other shareholders sued to enforce this sale (par. 6). The remaining shareholders and the company brought a motion to dismiss (par. 1). The defendants argued that the plaintiffs lacked sufficient interest in the matter to bring a claim, as they would not be parties to the share purchase (pars. 15-16). Rochon J. found that they had sufficient interest to defeat the motion to dismiss, both since it related to a unanimous shareholder agreement to which they were parties and because any share repurchase by the company affected the rights they had through their own holdings (par. 21).

Undoubtedly the most significant implication of a contractual approach to unanimous shareholder agreements, however, is that contracts can be broken. There are penalties for doing so, to be sure, but generally these take the form of damages, financial compensation to the aggrieved party rather than forced compliance with the terms of the agreement. It is possible for a judge to order specific performance, but that is a discretionary remedy, and it is granted more rarely than damages.¹⁰³⁴ The amount of money awarded is generally calculated on the basis of the quantum of provable harm caused by the breach. Furthermore, completed actions that contravene contracts are not legal nullities.¹⁰³⁵

With regard to unanimous shareholder agreements, the contractual approach therefore suggests that directors would still retain their full power, and any contraventions of the agreement would be within their ability. They might incur liability, but they could do it. They would not, as in the corporate constitutional approach, be rendered powerless in the designated areas. The contractual approach is thus much less radical in its implications for the corporation. Rather than a customizable corporate form in which power could be restricted and reapportioned, one would find a traditional corporate structure in which directors could make contracts as to how they would vote, only to break them again if they were willing to pay the price.

The next subsection examines the contention, put forth by the Court of Appeal in *Sumner*, that the Supreme Court of Canada endorsed a contractual approach to unanimous shareholder agreements in *Duha*, a claim that I ultimately reject. The subsequent subsection examines how contract law principles are nonetheless often invoked in interpreting and applying these agreements. This is followed by consideration of one of the central implications of favouring the contractual approach over a corporate constitutional one: directors' actions taken in contravention of the agreements are not nullities. Finally, cases allowing for injunctions enforcing negative covenants are examined to demonstrate how they- and, by extension, any enforcement of contractual rights through injunction or specific performance rather than damages- blur the line between the two approaches.

4.(a) *Duha* Revisited

While the Supreme Court of Canada in *Duha*¹⁰³⁶ found that unanimous shareholder agreements were constitutional documents, they also recognized that the agreements had a contractual aspect:

66 In other words, the USA is a corporate law hybrid, part contractual and part constitutional in nature. The contractual element is immediately apparent from a reading of s. 140(2): to be valid, a USA must be an "otherwise lawful written agreement among

¹⁰³⁴ See *e.g.* *Sumner* CA.

¹⁰³⁵ See *e.g.* *Sumner* CA.

¹⁰³⁶ *Duha*, *supra* note 24.

all the shareholders of a corporation, or among all the shareholders and a person who is not a shareholder". It seems to me that this indicates not only that the USA must take the form of a written contract, but also that it must accord with the other, general requirements for a lawful and valid contract. More generally, the USA is by its nature able to govern both the procedure for running the corporation and the personal or individual rights of the shareholders: see Iacobucci, *supra*.

The unanimous shareholder agreement is thus, according to the Supreme Court of Canada, contractual in two senses. The first is both clear and largely trivial; the formation of a unanimous shareholder agreement necessitates that the general requirements for a lawful and valid contract be met.¹⁰³⁷ A unanimous shareholder agreement could therefore be challenged on the grounds of *non est factum*, unconscionability, lack of legal capacity, *et cetera*.¹⁰³⁸

The second contractual aspect, the "general" one alluded to in the last sentence, is unfortunately ambiguous when taken on its own or only within the context of the immediately preceding sentence, as it could be read to mean that the contractual nature of the unanimous shareholder agreement underlies both its ability to govern the procedures of the corporation and the personal and individual rights of other parties to the agreement. However, read in the context of the paragraph as a whole and the reasons for judgment as a whole, it seems more plausible to construe the last sentence as meaning that it is the hybrid nature of the unanimous shareholder agreement that allows it to both govern the procedure for running the corporation (through its constitutional aspects) and the personal rights of shareholders (through its contractual aspects).

Despite this, courts have sometimes interpreted the enforcement of unanimous shareholder agreements with regard to corporate governance as being itself contractual. The Court of Appeal in *Sumner* did so, allegedly relying upon the precedent of *Duha* as represented in the very paragraph reproduced above. This ignored the larger context and other passages of the reasons for judgment. As described in the next subsections, other decisions have independently come to the conclusion that unanimous shareholder agreements should be enforced as contracts.

4.(b) Contract Law Principles

The clearest indicator that a contractual approach to the unanimous shareholder agreement is being used is, of course, an analysis that explicitly proceeds on the basis that these instruments are just contracts, as the Court of Appeal in *Sumner* did.¹⁰³⁹ Absent that, the use of contract law principles to interpret the

¹⁰³⁷ Although the Supreme Court was unambiguous on this point, the comment was *obiter*, and Iacobucci J. did not specifically address scenarios that might call this principle into doubt. See the discussion of the "lawful" criterion in Chapter Three.

¹⁰³⁸ See Chapter Three.

¹⁰³⁹ In *Sumner CA*, *supra* note 263, the Court of Appeal did not simply categorize the case as a breach of contract, but applied contract law principles as well. It is possible for the former to occur without the

document or contract law remedies can serve as implicit indicators that the court approached the unanimous shareholder agreement as a contract. Over the centuries, a rich body of law has developed governing issues of contractual breach; if unanimous shareholder agreements are enforced simply as contracts, all of that law would be applicable to them.¹⁰⁴⁰

The contractual approach is obviously not the only one that rests upon interpreting the words of the document. The corporate constitutional method similarly requires that the words' meaning be applied by the courts, as ultimately do all the others, and similar principles may be followed to do so. On the other hand, the strict reading of the unanimous shareholder agreement in the first case discussed in this subsection was a choice based upon its classification as a "commercial contract"; alternatives include a more purposive approach to interpretation, one that would allow for extrinsic evidence normally barred by the rules of contract law, a bias in favour of the default corporate form requiring unusually clear language for any displacement of it, or a *contra preferendum* style presumption that favoured an expansive reading of shareholders' rights to the extent reasonably consistent with the agreement. As discussed later in this chapter, an oppression remedy approach to enforcing unanimous shareholder agreements can lean in this last direction, though it is questionable whether there is a benefit to a system that allows for unanimous shareholder agreements to be the basis of both a narrow contractual right and a broad oppression claim. All of the cases which follow demonstrate how utilizing contract law to interpret and enforce unanimous shareholder agreements can lead to outcomes that might not have been reached under a corporate constitutional, directors' duties, or enforcement model.

The aforementioned strict reading of a "commercial contract" is found in *BMO Capital Corp. v. Clear Picture Corp.*¹⁰⁴¹ Two corporations, BMO Capital Corporation (the plaintiff) and ACF Equity

latter. For example, in *Pollock v. Sasltech Inspection Ltd.*, 2013 SKQB 409, 432 Sask. R. 227, 2013 CarswellSask 882, 236 A.C.W.S. (3d) 342 (Sask. Q.B. Nov 19, 2013), Kovach J. allowed an amendment to the claim to add "breach of contract" regarding the company's alleged violations of a unanimous shareholder agreement (in terminating him without cause and redeeming his shares), stating simply that this constituted a *prima facie* meritorious case requiring trial (pars. 51-52). Although substantive analysis was thus deferred, the judge accepted that it was legally correct to categorize a corporation's violation of a unanimous shareholder agreement as a breach of contract. This classification is only meaningful, however, if the accompanying principles of this approach are ultimately applied.

¹⁰⁴⁰ While much of the following discussion alludes to common law contract principles, LaFortune, *supra* note 552, pp. 222-233 contained a discussion of how civil law contract principles would apply to shareholder agreements in Quebec; unanimous shareholder agreements were specified only where they differed from other shareholder agreements, *e.g.* the requirements for formation (p. 222). For an example of a case applying civil law contract interpretation to a unanimous shareholder agreement, see *Dupuis c. Disques Atlantis inc.*, 2013 QCCS 408, 2013 CarswellQue 804, EYB 2013-217709 (C.S. Que, Jan 29, 2013), pars. 46-75, or (in the context of an oppression claim) the discussion of *Matic c. Trottier*, 2014 QCCS 3376, 2014 CarswellQue 7200, EYB 2014-239877 (C.S. Que. Jul 14, 2014) (hereinafter "*Matic*") later in this chapter.

¹⁰⁴¹ *BMO Capital Corp. v. Clear Picture Corp.*, 2008 NSSC 230, 266 N.S.R. (2d) 378, 2008 CarswellNS 382, 851 A.P.R. 378, 168 A.C.W.S. (3d) 976, 47 B.L.R. (4th) 301 (N.S. S.C. Jul 18, 2008) (hereinafter "*BMO*").

Atlantic Inc. (granted intervenor status), were among the shareholders of the defendant corporation Clear Picture Corp.¹⁰⁴² Under the terms of the unanimous shareholder agreement, approval of both those two shareholders was required for the defendant corporation to issue securities or to issue or repay loans.¹⁰⁴³ The company subsequently borrowed from its shareholder ACF under terms that included a defined maturity date for the loan,¹⁰⁴⁴ with BMO approval,¹⁰⁴⁵ but then repeatedly agreed to extend the term of the loan without obtaining BMO approval.¹⁰⁴⁶ BMO objected to further extensions, arguing that its approval was required under the unanimous shareholder agreement.

The analysis began by setting out the contractual paradigm being used: "It is generally accepted that commercial contracts are to be interpreted in accordance with sound commercial principles to the extent the wording used permits such an interpretation."¹⁰⁴⁷ On that basis, Scaravelli J. cited authorities indicating that the proper approach to interpreting commercial contracts is to begin by determining whether there is more than one meaning possible.¹⁰⁴⁸ The judge concluded that there was not; the wording referred only to the issuance of new loans, not the extension of maturity dates.¹⁰⁴⁹ The fact that BMO was a "sophisticated commercial entity"¹⁰⁵⁰ and could have contracted in advance to include extensions in the clause, was also a factor.¹⁰⁵¹ In the alternative, Scaravelli J. noted that the terms of the debenture, to which BMO had originally consented, set the maturity date as either the one specified "or such later date as is agreed in writing by the Debenture holder"¹⁰⁵² and thus ruled that BMO had agreed to the possibility of extensions. This alternative analysis appears flawed, since the wording of the debenture refers to the holder agreeing to extend the date, not being granted a unilateral right to do so, and therefore the corresponding agreement of Clear Picture Corp. might still be conditional upon its pre-existing obligations such as the unanimous shareholder agreement.

Another case that applied contract law principles to determine that a party could not enforce a unanimous shareholder agreement was *Albert Estate v. Gionet*.¹⁰⁵³ McIntyre J. definitively placed the claim in the realm of contract law, ruling that "[t]he companies' obligation to the estate [of a deceased

¹⁰⁴² Ibid, par. 3. No directors were named as parties.

¹⁰⁴³ Ibid, par. 3.

¹⁰⁴⁴ Ibid, par. 4.

¹⁰⁴⁵ Ibid, par. 11.

¹⁰⁴⁶ Ibid, pars. 5-7.

¹⁰⁴⁷ Ibid, par. 9.

¹⁰⁴⁸ Ibid, par. 9.

¹⁰⁴⁹ Ibid, par. 12.

¹⁰⁵⁰ Ibid, par. 12.

¹⁰⁵¹ Ibid, par. 12.

¹⁰⁵² Ibid, par. 13.

¹⁰⁵³ *Albert Estate v. Gionet*, 133 N.B.R. (2d) 408, 1993 CarswellNB 77, 341 A.P.R. 408 (N.B. Q.B. May 07, 1993) (hereinafter "*Albert Estate*"). It was upheld on the appeal, *Albert Estate v. Gionet*, 160 N.B.R. (2d) 70, 1995 CarswellNB 382, 412 A.P.R. 70 (N.B. C.A. Mar 08, 1995). The Court of Appeal ruled that the trial judgment rested ultimately upon a finding of credibility, and declined to overturn the

shareholder] under the terms of the [unanimous shareholder] agreement was purely contractual".¹⁰⁵⁴ In context, this was a rejection of a claim that the companies' obligations under the agreement took the form of a trust, and not a rejection of a corporate constitutional analysis, but nonetheless, it makes clear the approach that the judge took, and the effects of this (as opposed to what the corporate constitutional model might have dictated) can be seen in the balance of the judgment.

In *Albert Estate*, the unanimous shareholder agreement for two related corporations contained provisions requiring the company to take out life insurance on its two shareholders¹⁰⁵⁵ and upon either of their deaths, to buy their shares from their estates at a specified price.¹⁰⁵⁶ After one of the two died, his widow initially declined to accept this buy-out.¹⁰⁵⁷ She became a director of the companies.¹⁰⁵⁸ Soon after, she unsuccessfully attempted to negotiate the sale of her shares¹⁰⁵⁹ to the other shareholder, outside the price framework in the agreement.¹⁰⁶⁰ Finally, several months after initially declining to sell, and after the company's fortunes had fallen further, the widow remitted the shares in both companies and demanded payment in compliance with the unanimous shareholder agreement.¹⁰⁶¹

McIntyre J. determined that the widow had acted in a manner "totally inconsistent with the terms of the shareholders' agreement"¹⁰⁶² and that, while the other shareholder and the corporation had been willing to fulfill their obligations under it,¹⁰⁶³ the widow's "refusal to perform [at the appropriate time] entitles [the other shareholder] and the companies to a discharge of their obligation".¹⁰⁶⁴ Because the approach to the unanimous shareholder agreement was conceived of as contractual, the corporation (and the directors') obligations under it could be discharged by the widow's refusal to perform at the appropriate time. Under a corporate constitutional approach, the directors (and company) would have been legally powerless to *not* perform (although in the circumstances of this case, some sort of equitable defence might have been justifiable).

In *Clarfield v. Manley*,¹⁰⁶⁵ there was a term in the unanimous shareholder agreement that stated

decision (pars. 8, 10).

¹⁰⁵⁴ *Albert Estate*, *supra* note 1053, par. 58.

¹⁰⁵⁵ Technically, one of the shareholders owned some of his shares through a holding company, rather than personally (*Albert Estate*, *supra* note 1053, par. 6).

¹⁰⁵⁶ *Albert Estate*, *supra* note 1053, par. 19.

¹⁰⁵⁷ *Ibid.*, pars. 22, 30. The two parties gave differing accounts as to exactly why this refusal occurred, with the widow claiming that she was told she also had to sell her shares in two other companies not covered by the agreement and the other shareholder saying she voluntarily decided to remain with the company.

¹⁰⁵⁸ *Ibid.*, par. 31.

¹⁰⁵⁹ In these two companies and two other related companies.

¹⁰⁶⁰ *Albert Estate*, *supra* note 1053, pars. 38-39.

¹⁰⁶¹ *Ibid.*, par. 40.

¹⁰⁶² *Ibid.*, par. 62.

¹⁰⁶³ *Ibid.*, par. 63.

¹⁰⁶⁴ *Ibid.*, par. 63.

¹⁰⁶⁵ *Clarfield*, *supra* note 289.

that the management contract the corporation had entered into with a company controlled¹⁰⁶⁶ by one of its shareholders¹⁰⁶⁷ could only be terminated with the unanimous consent of all its shareholders.¹⁰⁶⁸ He argued that this arrangement granted him a lifetime contract which should be taken into account in a winding up order.¹⁰⁶⁹ While there was no issue of this clause being violated by one of the parties, and thus it did not give rise to enforcement issues in the strict sense, Blair J.'s treatment of this contention is interesting in the context of the divide between the corporate constitutional and contractual approaches. The judge rejected the argument:

63. [...] As between Mr. Manley - or more technically, Altrim Lumber - and Clear Customs itself, the employment contract is terminable on 30 days' notice. It is only Mr. Manley's position as a shareholder and a party to the agreement that protects him against termination because unanimity is required. In my view, this provision of the agreement could not have been intended by the parties to apply to a situation where the business is being wound up as between them and will no longer be carried on. It was meant to protect one of them from being frozen or squeezed out by the others while the business continued to be carried on, and is buttressed by the requirement that if one of the shareholders sells his shares to a third party, the purchaser of those shares must assume the obligations under the agreement.

[...]

65. Mr. Manley's argument, it seems to me, is founded upon an unsustainable premise. It confuses a contractual claim as an employee, protected by a contractual right as a shareholder, with a claim as a shareholder to additional equity in the company. The latter does not follow from the former.

While the court would have the power to override or disregard a unanimous shareholder agreement regardless of whether it was following a corporate constitutional or contractual approach, the judge here, in deciding not to take into account the value (both economic and otherwise) of rights under a unanimous shareholder agreement because they were merely contractual and not part of the shareholder's equity in the company, was adopting an explicitly contractual approach to it. This does not account for the possibility that the agreement had fundamentally changed the nature of the corporate structure and thus the shareholders' interests in it.

Similarly, in *Houle, Re*,¹⁰⁷⁰ provisions in a unanimous shareholder agreement naming an individual to positions as director and officer of the company were treated as contractual, no different from

¹⁰⁶⁶ It was not explicit in the reasons for judgment whether he owned all the shares, but it was referred to as "his company" (*Clarfield, supra* note 289, par 3) and generally treated as synonymous with him (see *e.g.* par. 63).

¹⁰⁶⁷ The one responsible for the oppression discussed below.

¹⁰⁶⁸ *Clarfield, supra* note 289, par. 12.

¹⁰⁶⁹ *Ibid.*, par. 61.

¹⁰⁷⁰ *Houle, Re*, 2004 CarswellQue 9344, EYB 2004-60483 (Que. Bkcty. Apr 08, 2004) (hereinafter "*Houle*").

an employment contract. The person in question was fired after various improper behaviours diverting corporate assets to himself were discovered.¹⁰⁷¹ A unanimous shareholder agreement bound the shareholders to elect him as one of the two directors and included terms the effect of which was that removing him from his position as officer required unanimity among the board.¹⁰⁷² The other director unsurprisingly had acted alone in firing him.¹⁰⁷³ In addition to the unanimous shareholder agreement, the company's articles stated that directors could only be removed by a shareholder's resolution, which had also not occurred; Chaput J.C.S. appeared to consider that this procedure trumped the provision of the unanimous shareholder agreement that bound them to elect him.¹⁰⁷⁴ The individual brought a motion to be restored to his position pending trial.¹⁰⁷⁵

Chaput J.C.S. stated that the ex-officer had been an employee with a contract of indeterminate length, and thus could be fired by the company,¹⁰⁷⁶ whether the dismissal was wrongful or with cause, the corporation had put an end to his employment.¹⁰⁷⁷ The judge further determined that it was not in the company's best interests for him to be reinstated, but that pending trial he was entitled to his salary and access to corporate records.¹⁰⁷⁸ While the allegations of inappropriate behaviour doubtless played a role in the outcome, the classification of this situation as merely an employment contract of indeterminate length is, as in *Clarfield*, a rejection of the possibility that a unanimous shareholder agreement can entrench individuals in given positions effectively permanently, their assigned role a fundamental part of the corporation's structure. As always, interpreting arrangements codified in a unanimous shareholder agreement through the lens of contract law- here, specifically the principles which govern contracts of employment- represents a choice, and one which starkly contrasts with the other models.

Because all attempts to enforce a unanimous shareholder agreement, regardless of the approach used, ultimately amount to giving effect to the terms of an agreement, the influence of contract law can unsurprisingly be seen even when a strictly contractual analysis is not being followed. But when such an approach *is* predominant, it brings with it a host of specific rules, and however natural the rules of contract law may grow to seem to those steeped in them, they still represent choices, and it is possible to envision competing principles. Each of the cases in this subsection might have come out differently had the restrictions in the agreements been taken as literal and absolute rather than subject to contract law principles, or perhaps had an oppression remedy analysis been performed. But if unanimous shareholder agreements are treated as contracts, then aside from the areas where these agreements are unusual by

¹⁰⁷¹ Ibid, pars. 16-19.

¹⁰⁷² Ibid, par. 20.

¹⁰⁷³ Ibid, par. 23.

¹⁰⁷⁴ Ibid, pars. 21-25.

¹⁰⁷⁵ Ibid, par. 4.

¹⁰⁷⁶ Ibid, par. 27.

¹⁰⁷⁷ Ibid, par. 31.

¹⁰⁷⁸ Ibid, pars. 32-33.

definition (deemed parties, for example), the natural presumption would be that the law of contracts would and should apply. If they are not simply a form of contract, the extent to which contract law applies becomes more debatable, and other outcomes become possible.

4.(c) Remedies for Contractual Breach

The use of a contractual approach to analyzing unanimous shareholder agreements can affect whether enforcement occurs, as the previous subsection demonstrated, but even if that is the conclusion, this method leads to a very different sort of remedy from the corporate constitutional one. Unlike that model, it does not automatically nullify the actions of directors who violate the unanimous shareholder agreement. It has this in common with the directors' duties and oppression remedy theories of enforcement, discussed later in this chapter, so it is not always clear which of the three a case is following when it suggests without elaborating that actions taken in contravention of a unanimous shareholder agreement might be problematic, but are not ineffective.¹⁰⁷⁹

The typical remedy for contractual breach is damages. As the Court of Appeal decision in *Sumner* demonstrated, the principles used in calculating damages can result in quite miniscule awards, and rely

¹⁰⁷⁹ For example, while not explicitly framed as a contractual case, the approach taken in *Bekkering v. Lakeside Feeders Ltd.*, 1992 CarswellAlta 754, [1992] A.W.L.D. 608 (Alta. Q.B. Jun 26, 1992) also appears most consistent with the view that a unanimous shareholder agreement imposes contractual obligations upon the directors, rather than restricting their powers outright, despite concluding that those terms constituted a barrier to the validity of certain acts. The plaintiffs had entered into negotiation with the defendant regarding the sale of shares of a subsidiary of the former to the latter (par. 12). (Technically, it was a subsidiary of the corporate plaintiff only. The other plaintiffs were in turn the shareholders of the parent company (par. 6).) The position of the plaintiffs was that an agreement had been reached, which was denied (pars. 2-3). Principally on grounds having to do with terms not having been settled, Waite J. found for the defendants (pars. 17, 21). However, the judge also examined an alternative ground. The defendant corporation had a unanimous shareholder agreement which required the consent of a certain shareholder for any purchases of this scope, consent which had not been granted (par. 23). Despite disagreement on this point, the defendants' evidence was accepted that they had notified the plaintiffs during the negotiations that this approval would be required for the sale to proceed (par. 24). The judge's conclusion was framed as follows: "However, even if the course of dealings between the parties had been such as to sustain the inference that terms had been agreed upon and a contract made, those terms and that contract would be unenforceable because of a condition precedent established at the meeting of July 19th" (par. 23). The invalidity of the sale contract (assuming no other problems) was rested on an unfulfilled condition precedent, not the lack of authority of the directors to breach a unanimous shareholder agreement. While in this case, the result was the same, the distinction is important. The agreement itself did not bind the directors or the company, but rather their own choice to invoke it as a condition precedent. Anything might be made a condition precedent; this would mean that a unanimous shareholder agreement has no special ability to restrict the board. (In fact, the decision does not necessarily grant this instrument even the force of a contract, as regards the shareholders' ability to enforce it.) This could mean that a unanimous shareholder agreement would not affect such external negotiations even if the third party had notice, if the directors had told the third party that they were choosing not to follow it, or if the third party had somehow learned of it through other channels.

upon proof of quantifiable harm caused by the breach.¹⁰⁸⁰ This stands in contrast not only to the potential value of having the restricted act "undone" through the corporate constitutional approach, but also the other two models as well. As elaborated upon later in this chapter, the legislation allows for a wide array of remedies for oppression including financial compensation for the unmet "reasonable expectations" that are oppressed or unfairly disregarded, rather than loss in the contract law sense *per se*, and the directors' duties approach potentially (if problematically) includes the duty of loyalty, which can require the disgorgement of profits even if the beneficiary suffered no corresponding loss.

*Bergeron c. Paré*¹⁰⁸¹ demonstrates the connection between conceiving of enforcement in contractual terms and providing contractual remedies. A motion was brought pending arbitration requesting that the petitioners be restored to their former positions in the company.¹⁰⁸² The directors' meeting at which they had been fired was alleged to have been invalid under the terms of a unanimous shareholder agreement.¹⁰⁸³ Allard J.C.S. held that the balance of convenience did not favour restoring them to their positions pending arbitration.¹⁰⁸⁴ Notably, the judge found that this was unlikely to prejudice them, because even if they were successful at arbitration, the standard award for contractual breach was damages, not specific performance.¹⁰⁸⁵ The connection between approach, remedy, and even outcome is clearly illustrated; had the unanimous shareholder agreement been viewed not as a contract but instead in corporate constitutional terms, the outcome might have been different.

It is also important to remember that the parties themselves can shape the analysis through the relief they request. In *Lemire c. Nault*,¹⁰⁸⁶ the plaintiff argued that his firing from his employment with the company was contrary to a unanimous shareholder agreement that required the consent of all shareholders and resort to arbitration.¹⁰⁸⁷ Arguing that this firing did not follow the agreement and was therefore illegal,

¹⁰⁸⁰ There may also be an issue regarding whether an investor attempting to enforce terms in a unanimous shareholder agreement primarily for the benefit of the company has a sufficient interest therein under *Code of Civil Procedure*, CQLR c C-25, s. 55. Such an argument was discussed regarding a shareholder agreement in *Banque Nationale du Canada c. Titley*, 1997 CarswellQue 1588, J.E. 98-736, REJB 1997-05978 (C.S. Que. Dec 09, 1997) at pars. 10-11; the document was not explicitly identified as a unanimous shareholder agreement in the judgment (though it seemingly met the criteria), so its applicability as precedent regarding unanimous shareholder agreements may be debatable, but regardless, the issue may be applicable.

¹⁰⁸¹ *Bergeron c. Paré*, 2005 CarswellQue 3313, J.E. 2005-995, EYB 2005-86736 (C.S. Que. Mar 21, 2005) (hereinafter "*Bergeron*").

¹⁰⁸² *Ibid*, par. 9.

¹⁰⁸³ *Ibid*, par. 6. The case was distinguished from *Larvegne*, *supra* note 965, because that precedent involved a unanimous shareholder agreement that specifically provided that, pending arbitration, a party contesting being fired would continue to receive the same advantages, privileges, and remuneration (pars. 26-32).

¹⁰⁸⁴ *Ibid*, par. 45.

¹⁰⁸⁵ *Ibid*, pars. 46-47.

¹⁰⁸⁶ *Lemire c. Nault*, 2011 QCCS 5356, 2011 CarswellQue 11153, J.E. 2011-1847, D.T.E. 2011T-725, 209 A.C.W.S. (3d) 302, EYB 2011-197048 (C.S. Que. Oct 7, 2011) (hereinafter "*Lemire*").

¹⁰⁸⁷ *Ibid*, par. 33.

he requested thirty-three months of severance, later lowered to two months.¹⁰⁸⁸ His framing of the claim in this manner, rather than demanding that the dismissal be nullified under corporate constitutional principles, may have been what led the judge's analysis to focus not on the agreement, but instead upon whether the termination had been for cause and whether there had been adequate warning of problems and potential consequences.¹⁰⁸⁹ The award was four weeks severance.¹⁰⁹⁰

It is self-evident that a payment of damages is quite different from having an act nullified, but it is also possible under a contractual approach to have the violation of the unanimous shareholder agreement's restrictions reversed, a form of specific performance. This is still not the same as nullification, and the distinction can be important, as illustrated by *Hurley v. Slate Ventures Inc.*¹⁰⁹¹ While I have suggested that the most sensible reading of *Duha* is that the corporate constitutional approach should guide analyses of restrictions of the directors but a contractual one should govern situations where the unanimous shareholder agreement (also) includes personal rights of the shareholders, that division is not always clear-cut. Normally, for example, a shotgun provision would relate to personal rights,¹⁰⁹² but to the extent that the corporation gives effect to the share purchase thereunder, *Hurley* demonstrates how the application of the shotgun may involve governance issues. One of two shareholders attempted to use a shotgun clause in a unanimous shareholder agreement to obtain the shares of the other, despite the other's objections that the clause had not been properly followed, and after paying funds to the alleged purchasee's bank account, caused the corporation to transfer the shares to the purported buyer.¹⁰⁹³ Orsborn J. held that the offer did not comply with the terms of the shotgun clause.¹⁰⁹⁴

Orsborn J. rejected the view that the defaults in the exercise of the shotgun clause were a matter for the oppression remedy, however, and explained that this was a case for contract law:

¹⁰⁸⁸ Ibid, pars. 33-34.

¹⁰⁸⁹ Ibid, pars. 89-107.

¹⁰⁹⁰ Ibid, par. 103.

¹⁰⁹¹ *Hurley v. Slate Ventures Inc.*, 142 Nfld. & P.E.I.R. 127, 28 B.L.R. (2d) 35, 1996 CarswellNfld 168, 445 A.P.R. 127, [1996] N.J. No. 4071 (Nfld. T.D. Jul 19, 1996) (hereinafter "*Hurley SC (TD)*").

¹⁰⁹² A "shotgun clause" is a term sometimes found in a unanimous shareholder agreement (or other shareholder agreement). In its simplest form, it sets out a procedure whereby one shareholder can inform another that the clause is being invoked and name a price per share. The shareholder receiving this notice then chooses either to buy all the other's shares at that price or to sell the recipient's own shares at the same price. Often, though not always, both shareholders have the right to initiate this procedure. This theoretically motivates the party invoking the clause to determine a fair price, neither too high nor too low. Shotgun clauses may be complicated by factors such as additional shareholders, multiple share classes, *et cetera*.

¹⁰⁹³ *Hurley SC (TD)*, *supra* note 1091, pars. 1, 36.

¹⁰⁹⁴ The corporation had three classes of shares, and the offer was conditional upon the recipient accepting the offeror's interpretation as to how those classes would be dealt with in the structure of the respective "buy" and "sell" portions of the offer (*Hurley SC (TD)*, *supra* note 1091, pars. 57-58). Orsborn J. held that the way the share classes were dealt with in the offer did not follow the formula set out in the unanimous shareholder agreement, under which the price being offered for the other's shares was too low compared to the offer to sell (pars. 63-67).

91 But there is also authority which suggests that when dealing with disputes involving a shareholders' agreement, those disputes should be resolved within the parameters of the agreement - any remedy would be based on a breach of contract. In other words, a breach of contract is not the sort of conduct which can ground relief under the oppression provisions. See *Bernard v. Montgomery* (1987), 36 B.L.R. 257 (Sask. Q.B.); *Camroux v. Armstrong* (1990), 47 B.L.R. 302 (B.C.S.C.). This view commends itself to me. Where the parties have agreed upon and have carefully and at length set out the rules that will govern their relationship, it is their intention and expectation that the agreement will be the yardstick against which their conduct will be measured. If the agreement is breached, the appropriate contractual remedy can be fashioned. I have earlier indicated that, in a contractual situation, the Court should be able to fashion a remedy that addresses the consequence of a breach. This flexibility of remedy is perhaps all the more necessary when dealing with the shareholders of a closely-held corporation. In such a small commercial 'family', ongoing relationships are critical, and the fact that a court is dealing with a breach of contract should not preclude remedial creativity. However, this flexibility would not, I believe, extend so far as the range of remedies contemplated by the oppression provisions - such as, for example, directing an issue or exchange of securities or amending a shareholders' agreement.

92 Here, the improper acquisition of Hurley's shares is properly considered as a contract issue. The allegation is that the contractual requirements were not followed. The conduct should be measured against those requirements and not the oppression standard.

No specific consideration was given to the actions taken by the defendant *qua* director in having the corporation give effect to the illegitimate share transfer.¹⁰⁹⁵ It is unclear whether Orsborn J. intended those acts to be included in the above conclusion that the proper analysis was a contractual one, or whether that aspect was one that the judge simply had not considered.

Because the principles employed were contractual, the share transfer was not a nullity; instead, the remedy for the breach was for them to be transferred back. The distinction was significant, because the alleged buyer had, while it was the "sole shareholder", issued substantial additional shares to itself in exchange for an injection of capital into the corporation, as a result of which it would have substantially diluted the interests of the other shareholder if only his original shares were returned.¹⁰⁹⁶ Orsborn J. held that it was not necessary to use the oppression remedy to resolve this issue either, because "resorting to its inherent jurisdiction if necessary, the Court should be able to fashion a remedy to address the consequences, if any, of actions which, although legal in themselves, are made possible - their foundation laid - only through a breach of contract".¹⁰⁹⁷ The judge suggested that the proper contractual remedy would

¹⁰⁹⁵ See the discussion of *Gottlieb v. Adam*, 21 O.R. (3d) 248, 16 B.L.R. (2d) 271, 1994 CarswellOnt 246, [1994] O.J. No. 2636 (Ont. Gen. Div. Nov 17, 1994) (hereinafter "*Gottlieb*") later in this chapter for a similar situation.

¹⁰⁹⁶ *Hurley SC (TD)*, *supra* note 1095, pars. 73-74.

¹⁰⁹⁷ *Ibid*, par. 75.

be to require the shareholder to offer 50% of the new shares to the other.¹⁰⁹⁸ The judge described this as a means to "put [the shareholder] in the position he would have been in had his shares not been purchased".¹⁰⁹⁹ This ignores the possibility that, had his shares not been purchased, he might have blocked the issuance of new ones that he did not wish either to pay for or to have his holdings diluted by. Because the shareholder had already declined an offer to conditionally participate in the new share offering while the legal issues awaited resolution, Orsborn J. found it unnecessary to actually make an order to give him a second chance.¹¹⁰⁰

Orsborn J. did "without expressing an opinion [...] assume that Hurley is entitled to seek oppression relief" on the share issuance, for the purpose of considering that issue.¹¹⁰¹ On the facts, the share issuance was held not to be oppressive, because of the opportunity to conditionally participate¹¹⁰² and the legitimate business purposes of raising capital.¹¹⁰³ So as between the contractual approach and oppression, on these facts the same result would have been reached, given Orsborn J.'s wide view of contractual remedies. Indeed, given that broad take on them, there would be a much smaller difference between the contractual and corporate constitutional approaches as well.

The plaintiff was offered two alternatives: either his shares could be returned, with equal representation on the board of directors but *not* equal shareholdings, or he could have the full price that would have been payable under the agreement.¹¹⁰⁴ He selected the latter,¹¹⁰⁵ and while the general determination in the plaintiff's favour was not appealed, the specific award was. The appellant raised both procedural issues¹¹⁰⁶ and the argument that, if the offer had not been made in compliance with the shotgun clause, it was therefore outside it, and that the events which had occurred should therefore be handled as conversion (subject to restitution) rather than a breach of contract. Writing for the majority, Marshall J.A. held that the remedy was appropriate because, *inter alia*, simply reversing the share transfer would not be sufficient to restore the plaintiff to his original position due to the intervening share transfer, which was the

¹⁰⁹⁸ Ibid, par. 106.

¹⁰⁹⁹ Ibid, par. 106.

¹¹⁰⁰ Ibid, par. 107.

¹¹⁰¹ Ibid, par. 93.

¹¹⁰² Ibid, par. 97.

¹¹⁰³ Ibid, par. 103.

¹¹⁰⁴ Ibid, pars. 128-129.

¹¹⁰⁵ *Hurley v. Slate Ventures Inc.*, 167 Nfld. & P.E.I.R. 1, 1998 CarswellNfld 195, 513 A.P.R. 1, [1998] N.J. No. 225 (Nfld. C.A. Aug 04, 1998) (hereinafter "*Hurley CA*") at par. 59. Unlike *Hurley SC* (TD), *supra* note 1091, *Hurley CA* does not refer to the document as a unanimous shareholder agreement, but instead as a "Shareholder's Agreement".

¹¹⁰⁶ The plaintiff had not originally requested this remedy and it had been dealt with only incidentally at trial. There were also questions raised about the trial judge's use of "inherent jurisdiction". Marshall, J.A. found, for a variety of reasons, that these procedural issues should not bar the remedy (*Hurley CA*, *supra* note 1105, pars. 61-89) and also noted that the damages in conversion would not necessarily have been any different (pars. 103-107). Conversely, Cameron J.A. found these objections convincing (pars. 161-176).

appellant's fault.¹¹⁰⁷ In a dissenting opinion, Cameron J.A. found that even if (for the sake of argument¹¹⁰⁸) this was dealt with as a breach of contract claim, while the normal rule was that "[t]he object of damages for breach of contract is generally stated to be to put the innocent party in the position he or she would have been in had the contract been performed (the expectation interest)",¹¹⁰⁹ in these circumstances, had the offer been in made compliance with the agreement, it would have been at a different price, which made it unjust to enforce it as written¹¹¹⁰ and compensating the plaintiff for any *actual* damages caused by the share issuance was sufficient.¹¹¹¹ Despite differing conclusions, both Court of Appeal judges were dealing with the limits of reversing breaches of contract as a means of restoring the parties to their initial state.

These decisions, like *Sumner*, illustrate that in a contractual model, actions contrary to a unanimous shareholder's agreement are not automatically nullities, but it also demonstrates that even when contractual enforcement leads to the reversal of the improper acts, rather than an award of damages, the result is not the same as retroactively voiding them. Sometimes, as in *Hurley*, reversing the impugned actions may be so inadequate that an award of damages really is a better way to restore the parties to some approximation of their original states. The line between enforcing unanimous shareholder agreements as contracts that govern the directors' exercise of their powers and as corporate constitutional documents that actually remove those powers may be blurred when the remedy is reversal, but the line still remains. The next section, however, covers a situation where the line is blurred to the point where it almost disappears.

4.(d) Negative Covenants

If the general hallmark of the corporate constitutional approach is that directors simply cannot exert powers they no longer possess, then this finds some echo in contract cases that deal specifically with injunctions to enforce negative covenants. As the following two cases illustrate, an injunction issued by the court to prevent the directors from violating the terms of a unanimous shareholder agreement has a similar effect to treating the instrument as a corporate constitutional document; the directors are legally barred from taking actions that ignore the restrictions placed upon them. However, the sheer cumbersomeness of this procedure, whereby a court order is required to give substance to prohibitions in the unanimous shareholder agreement, highlights the theoretical difference between the two approaches even as it brings their practical results closer together. The comparison is not favourable for the utility of the contractual

¹¹⁰⁷ *Hurley CA, supra* note 1105, pars. 72-73.

¹¹⁰⁸ Cameron J.A. determined that, since the offer was not in compliance with the agreement, it was outside it, and therefore the proper claim was not breach of contract (*Hurley CA, supra* note 1105, pars. 139-141).

¹¹⁰⁹ *Hurley CA, supra* note 1105, par. 147.

¹¹¹⁰ *Ibid*, par. 158.

¹¹¹¹ *Ibid*, par. 159.

model; as explored further below, the terms in these agreements are not exceptional, and *all* restrictions upon directors may be conceived of as negative covenants. If the appropriate enforcement method is injunctions, it may be theoretically simpler and more efficient in practice to discard the contractual approach and proceed directly to a corporate constitutional model.¹¹¹²

*Klassen v. Klassen*¹¹¹³ concerned an interim motion to prevent the corporation and its directors from implementing a directors' resolution to remove the plaintiff from his positions as president and chief executive officer.¹¹¹⁴ The corporation had a unanimous shareholder agreement that stated, "Sermelory and Eljo shall annually or more often as may be necessary, elect the Chairman of the Board and the President of the Corporation and such officers shall be subject to removal only with the approval of both Sermelory and Eljo."¹¹¹⁵ In applying the first stage of the test for an injunction, De Graves J. concluded that on the basis of the agreement, the plaintiff had a strong *prima facie* case.¹¹¹⁶ The judge stated that the board was "limited in its right"¹¹¹⁷ to appoint a president.¹¹¹⁸ (It is possible that this suggests some corporate constitutional element, since a purely contractual analysis would mean that their right to appoint a president could not be limited, but that they might be liable for damages if they did not follow the agreement.) In the second stage of the analysis, irreparable damage, De Graves J. found that the standard had not been met¹¹¹⁹ but that that was unnecessary in the case of an implied negative covenant:¹¹²⁰ "Section 3(c) of the agreement of November 28, 1979, is in effect a prohibitive or negative provision preventing the appointment of anyone as chairman of the board and president other than the nominees of Eljo and Sermelory."¹¹²¹ On that basis, after briefly and without analysis noting that the balance of convenience also favoured the plaintiffs, the injunction was granted.

Similarly, in *MTM Commercial Trust v. Statesman Riverside Quays Ltd.*,¹¹²² two companies set up

¹¹¹² One advantage of employing the corporate constitutional framework is that a general prohibition against violating a unanimous shareholder agreement might not be sufficiently specific and certain to form the basis of an injunction. See note 1138.

¹¹¹³ *Klassen v. Klassen*, 42 B.L.R. 261, 1989 CarswellMan 16, 62 Man. R. (2d) 106, [1989] C.L.D. 695 (Man. Q.B. Mar 20, 1989) (hereinafter "*Klassen*").

¹¹¹⁴ *Ibid*, pars. 3-4.

¹¹¹⁵ *Ibid*, par. 6. The chief executive officer position was not mentioned in the section of the agreement reproduced, though De Graves J. appeared to treat it as if it was since no distinction was made between the two positions at issue, and on that point his analysis seems to have been in error.

¹¹¹⁶ *Ibid*, par. 12.

¹¹¹⁷ *Ibid*, par. 10.

¹¹¹⁸ There was some analysis leading up to this conclusion regarding whether a subsequent agreement had superseded this document, but after it was concluded that this agreement was the one in force, this limitation and the resulting strong *prima facie* case were treated as givens.

¹¹¹⁹ *Klassen*, *supra* note 1113, par. 13.

¹¹²⁰ *Ibid*, par. 14.

¹¹²¹ *Ibid*, par. 14.

¹¹²² *MTM Commercial Trust v. Statesman Riverside Quays Ltd.*, 2010 ABQB 647, 2010 CarswellAlta 2041, 98 C.L.R. (3d) 198, 193 A.C.W.S. (3d) 1284, [2011] A.W.L.D. 5, [2011] A.W.L.D. 8, [2011] A.W.L.D. 35, [2011] A.W.L.D. 37, [2011] A.W.L.D. 66, [2010] A.J. No. 1189, 70 C.B.R. (5th) 233 (Alta.

a joint venture by creating a limited partnership and another corporation to serve as general partner.¹¹²³ Under the terms of the unanimous shareholder agreement governing the general partner, both shareholders were represented equally on the board of directors and major decisions required unanimity.¹¹²⁴ Management of the project was assigned to a related party of one of the shareholder corporations, although under the terms of the Management Agreement, it was required to submit a variety of major decisions for approval by the "Managing Committee".¹¹²⁵ Finally, there was also a Limited Partnership Agreement, which contained general obligations of good faith.¹¹²⁶

The by-laws of the corporation allowed one of the two shareholders a casting vote.¹¹²⁷ However, Romaine J. found that the wording of both the unanimous shareholder agreement and the by-law indicated the agreement should have precedence.¹¹²⁸ In addition to that fact-specific finding, Romaine J. noted that "the nature of a USA does not allow its provisions to be trumped by a procedural by-law, and the provisions of the USA that require approval by all directors of certain major decisions cannot in effect be vitiated by such a by-law".¹¹²⁹ As noted above in the discussion of *Piikani*, this view of unanimous shareholder agreements is associated with a corporate constitutional approach, but the balance of the judgment referred to the agreement explicitly as a "contract" giving rise only to "contractual rights".¹¹³⁰

Without the necessary approval by the directors (or any "Managing Committee"), one of the shareholders, through its control of day to day operations via the managing company, entered the corporation into over \$12 500 000 of construction contracts of over \$100 000 each.¹¹³¹ The motion before the court was for an interim injunction to prevent further work being done without authorization. Romaine

Q.B. Oct 12, 2010) (hereinafter "*MTM*"). *MTM* also illustrated a different aspect of contract law, aside from the implications of injunctions for negative covenants. The respondent argued that the applicant's refusal to give consent was not commercially reasonable (par. 28). Romaine J. found that "[t]hat is not within the province of this court to decide: Matco is not under any contractual obligation to act in a commercially reasonable manner in giving or withholding its consent, and Matco's motives or judgments in respect of its decision are not properly at issue before me, except to the extent that they may relate to considerations of irreparable harm or balance of convenience" (par. 28). A corporate constitutional approach would likely have come to the same conclusion; the commercial reasonableness of the proposed actions would have been insufficient to grant directors powers they otherwise did not have. However, a different conclusion might have been reached under either a directors' duties or an oppression remedy analysis.

¹¹²³ Ibid, par. 14. They each owned half the general partner's shares.

¹¹²⁴ Ibid, par. 15. Major decisions included contracts for more than \$100 000, related party transactions, and requiring capital contributions (par. 15).

¹¹²⁵ Ibid, par. 16. The term "Managing Committee" was not clearly defined in the document, and Romaine J. noted that it may or may not refer to the board of directors (par. 42).

¹¹²⁶ Ibid, par. 17.

¹¹²⁷ Ibid, par. 29.

¹¹²⁸ Ibid, par. 30.

¹¹²⁹ Ibid, par. 30.

¹¹³⁰ Ibid, pars. 64, 65.

¹¹³¹ Ibid, par. 22.

J. found that the plaintiff had a strong *prima facie* case for breach of contract¹¹³² and that this was "a negative obligation, which is in substance the obligation not to proceed to the next phase of construction without obtaining Management Committee approval or the approval of all of directors of SRQL under the USA".¹¹³³ On the balance of convenience, Romaine J. found in favour of the applicant, as "failure to grant the injunction would nullify its contractual right to be part of the decision to proceed".¹¹³⁴

By definition, unanimous shareholder agreements restrict the powers of directors. Viewed as a contract with the directors rather than an actual removal of their powers, such restrictions would be negative covenants. Indeed, one early commentator, David H. Sohmer, hypothesized that it might be legally necessary to frame a *de facto* positive obligation in a unanimous shareholder agreement as a *de jure* negative obligation (a double-negative restriction against refraining from the desired act),¹¹³⁵ though subsequently this artificial procedure has never been required by the courts and positive obligations have been accepted as restrictions.¹¹³⁶ Indeed, the development of the law with regard to restrictions in unanimous shareholder agreements has illustrated the symmetry of all positive and negative obligations.¹¹³⁷ The law on negative covenants, conversely, rests entirely upon a continuing distinction between the two.

If all restrictions upon directors in unanimous shareholder agreements are conceptually negative covenants, and if the appropriate means of enforcement for negative covenants on a going-forward basis is injunctions, then the contractual model creates a curious split between violations which occur *before* a court order and can only be reversed or compensated for by damages, and future violations, against which directors may be enjoined.¹¹³⁸

¹¹³² Ibid, par. 52.

¹¹³³ Ibid, par. 53.

¹¹³⁴ Ibid, par. 65.

¹¹³⁵ Sohmer, *supra* note 311, p. 675.

¹¹³⁶ An exception is the *obiter* comment in *Ghanotakis c. Imprimerie régionale A.R.L. Ltée.*, 2001 CanLII 18511 (QC CS) (C.S. Que. Dec 21, 2012) by Dalphond, J.C.S. at par. 59, "Les pouvoirs des administrateurs peuvent certes être limités ou enlevés par une convention unanime des actionnaires; mais on ne saurait forcer les administrateurs à agréer à une résolution s'ils ne le veulent pas." (My translation: "The powers of a director can certainly be limited or removed by a unanimous shareholder agreement, but one cannot force them to assent to a resolution that they do not want.") The statement was made by way of analogy regarding a director's compliance or lack thereof with a court order.

¹¹³⁷ One is reminded of Coase's writing on the symmetrical nature of rights in R. H. Coase, "The Problem of Social Cost" (1960) 3 *Journal of Law and Economics* 1-44.

¹¹³⁸ There are obstacles to using injunctions as a general method of giving greater effect to a unanimous shareholder agreement. Even if the three part test were not a problem, the content of the injunction itself needs to be clearly defined. General adherence to an agreement could be too broad. In *Placements G.N.P. inc. c. Kuen*, 2007 QCCS 5465, 2007 CarswellQue 11044, J.E. 2008-358, EYB 2007-126670 (C.S. Que. Nov 27, 2007) a request brought as part of an oppression claim (par. 79) for an injunction requiring the defendants to generally respect the law, the articles, and the unanimous shareholder agreement (par. 29) was rejected for being too vague (par. 103). Jacques J.C.S noted that the agreement might be subject to different interpretations by the parties (par. 106). (There was also no real threat that the agreement would be violated (par. 109). Jacques J.C.S rejected a variety of complaints for failing to constitute breaches (pars. 42-80), and found that the parties were following the document (par. 71). The

4.(e) Summation

Despite the Supreme Court of Canada endorsing the corporate constitutional approach over the contractual, the law of contract still holds substantial sway over judicial enforcement of unanimous shareholder agreements. There is utility in this; contract law has a well-developed set of principles for enforcing the terms of a written agreement.¹¹³⁹ It must be understood, however, that these principles are neither inevitable nor neutral; they represent a certain perspective upon the enforcement of agreements and they directly affect outcomes. The other three approaches discussed in this chapter present alternatives. In particular, not all contract law rules may be appropriate in this area; some elements (such as the requirement that both parties to the suit be parties to the contract) might prove problematic given the unusual nature of unanimous shareholder agreements.

The most significant implication of using contractual rather than corporate constitutional principles is that they do not render acts in violation of the agreements null. While some of the problems posed might be dealt with by obtaining injunctions or specific performance awards, the default rule of contractual enforcement is the award of provable damages *ex post*. This limits the usefulness of unanimous shareholder agreements as a means of controlling corporate behaviour. They become instead at best a means of incentive and form of limited insurance.¹¹⁴⁰

To the extent that injunctions and the reversal of prohibited acts are used to enforce contracts, they represent an imperfect substitute for nullification. They replicate its benefits to a limited extent, but not fully. This can only be justified if one starts from the assumption that unanimous shareholder agreements are a contract which directors remain free to break, until such time as a court order stops them from doing so or forces them to take steps to reverse what they have done, rather than an actual restructuring of the

most interesting allegation related to the term mandating that shareholders must unanimously approve expenses above \$50 000 (par. 51). An expense of \$51 000 had been incurred for repairing a wall (par. 50). The original contract had been for \$48 000, but the cost ended up increasing by \$3000 (pars. 52, 54). The judge found that it had been reasonable for the directors to approve the additional amount, following the recommendations of the engineer, and shareholder consent had not been required (pars. 56-57). This seems to have been an "agreements in context" approach to the oppression remedy, of the type discussed below.)

¹¹³⁹ As discussed earlier, it is arguable that a document that would not constitute an enforceable contract could still be considered a valid unanimous shareholder agreement. Assuming this to be the case, then a claim of breach of contract *per se* could not be used for enforcement. However, contract law *principles* might still underlie a judgment that enforced the agreement as a statutorily authorized corporate law tool.

¹¹⁴⁰ Alternatively, it might encourage the use of unanimous shareholder agreements which dispensed with directors, if that were allowable. Whether it is permissible to eliminate directors entirely or whether a "powerless" board must be retained has been the subject of some debate among commentators. See note 1675. But if directors' powers could not truly be restricted, then no board would ever actually be "powerless".

allocation of power within a corporation.

5. The Directors' Duties Approach

The third possible approach to enforcing unanimous shareholder agreements is to include adherence to them among directors' duties.¹¹⁴¹ It is similar to the contractual model in that rather than

¹¹⁴¹ For parties other than directors, adherence to the unanimous shareholder agreement can also be classified as a duty owed to the corporation. In *HSBC Bank Canada v. 1100336 Alberta Ltd.*, 2011 ABQB 748, [2012] 9 W.W.R. 596, 530 A.R. 177, 2011 CarswellAlta 2114, 209 A.C.W.S. (3d) 722, [2012] A.W.L.D. 3245, [2012] A.W.L.D. 3271, [2012] A.W.L.D. 3272, [2012] A.W.L.D. 3273, 97 B.L.R. (4th) 264 (Alta. Q.B. Dec 01, 2011), a bank had lent funds to a corporation. The corporation's business was subsequently transferred to another company (par. 18), leaving the original with no assets for the bank to collect upon (par. 22). The bank sued for the tort of civil conspiracy (par. 57). The second element of the tort of civil conspiracy is that the conduct in question must be unlawful (pars. 57, 72). With regard to the three individual defendants, Marshall J. found their conduct to be unlawful because they had breached their statutory duties to the corporation (par. 92). The analysis began by referring specifically to s. 122(1)(a) and the Supreme Court's definition of the duty of loyalty in *Peoples* (at par. 86), but the subsequent analysis did not maintain a rigorous distinction between the duties of care and loyalty (see *e.g.* pars. 88, 91). In the midst of this, and without clearly integrating it, the judge wrote, "It is also noteworthy that 828 had a Unanimous Shareholders Agreement executed by Mr. Kendrick and HBC. It included a provision that neither would compete with the business of 828. Mr. Fuss signed the Agreement and was a directing mind of HBC. His action in incorporating 1100 directly breached his covenant in the Agreement" (par. 90). Marshall J. may have found that fact "noteworthy", but it is unclear why it appeared where it did in the judgment, in a section generally concerned with directors' duties. Fuss, who was singled out for violating the agreement, was not a director of 828. It is possible that Marshall J. meant that the parties to a unanimous shareholder agreement can (and in this case did) owe duties to the corporation according to its terms, which Fuss was in violation of, despite not being a director, and that this violation was also an "unlawful act" that met the criteria for the tort of civil conspiracy. (The bank, the plaintiff, was not a shareholder and thus presumably not a party to the agreement.) This unanimous shareholder agreement was not mentioned in the appeal, *HSBC Bank Canada v. 1100336 Alberta Ltd.*, 2013 ABCA 235, 553 A.R. 342, 2013 CarswellAlta 1062, 583 W.A.C. 342, 229 A.C.W.S. (3d) 909, [2013] A.W.L.D. 3125, [2013] A.W.L.D. 3127, [2013] A.W.L.D. 3167, [2013] A.W.L.D. 3291, [2013] A.W.L.D. 3292, [2013] A.W.L.D. 3293 (Alta. C.A. Jun 25, 2013).

Secondly, *Stevens v. HSBC James Capel Canada Inc.*, 1998 CarswellOnt 1537, [1998] O.J. No. 1692, 57 O.T.C. 161 (Ont. Gen. Div. Apr 23, 1998) suggests that following the provisions of a unanimous shareholder agreement might be part of the *employment* duties of a corporate officer who is also a director. The plaintiff was the president of a corporation who sued for wrongful dismissal (par. 1). He had involved the company, a securities dealer, in an announcement of a takeover bid in a foreign market that carried with it huge reputational, financial, and legal risks, against the advice of experts (summarized at pars. 201-209). These actions also ran contrary to a unanimous shareholder agreement that all "new major strategic business initiatives" were to be approved by the "executive committee" (par. 82). Sutherland J. found that, given this bid's size and that the corporation had not previously been involved in this type of transaction, it qualified as the sort of decision referred to in the agreement (par. 83). It was therefore a decision that the plaintiff "did not have the authority to cause [the corporation] to enter into" (par. 83). It is unclear how much of a deciding role the breach of the unanimous shareholder agreement played in the finding that this was not a wrongful termination. In a seven paragraph concluding summary, Sutherland J. devoted one paragraph to again noting, "The plaintiff contravened applicable provisions of the unanimous shareholders'

literally removing directors' powers, as the corporate constitutional view would have it, it instead regulates the powers which directors retain. Instead of using contract law principles as the means of regulation, it incorporates the contents of the unanimous shareholder agreement into the directors' duties to the corporation, borrowing legal terms and concepts from that branch of the law instead.

According to the various corporate statutes, every director has a specific duty to obey the legislation, the articles, the by-laws, and unanimous shareholder agreements.¹¹⁴² But the directors' duties approach (as herein considered) does not revolve around that legal obligation *per se*. It is the wider position that the general enforcement of a unanimous shareholder agreement should be analyzed in terms of the principles and procedures governing the directors' duties of care and loyalty, regardless of the basis on which a claim is founded. As the examples below demonstrate, attempts to invoke this model can appear in cases brought on other grounds, such as the oppression remedy or breach of contract, although their success has admittedly been limited.

It is well established in Canada that directors owe duties to the corporation. These duties, at both common law and by statute, consist of both a duty of care and a duty of loyalty.¹¹⁴³ While some confusion exists around these duties, the former can be defined as a means of preventing *incompetence*, while the

agreement, which required the transactions to be approved by the executive committee of Capel Canada. It was an important part of the plaintiff's duties to understand and to comply with the main features of that agreement" (par. 203). On the other hand, this factor was not singled out as especially important, and in context, there would likely have been enough problems with the plaintiff's conduct even absent it.

It is also possible, in unusual circumstances, for adherence to a unanimous shareholder agreement to form part of some other legal duty. In *Fortin c. Fortin*, 2008 QCCS 447, 2008 CarswellQue 847, J.E. 2008-569, EYB 2008-129677 (C.S. Que. Jan 28, 2008), one of the findings against an executor accused of negligence and bad faith was that he had used the estate's controlling interest in a corporation to grant himself a position and salary without the consent of all the other shareholders, as was required by a unanimous shareholder agreement (par. 71). In *Desjardins Capital de développement Estrie inc. c. Labbé*, 2010 QCCS 233, 2010 CarswellQue 937, 187 A.C.W.S. (3d) 339, EYB 2010-169549 (C.S. Que. Jan 29, 2010), a motion to dismiss a claim against receivers in bankruptcy for negligence was denied; the alleged negligence consisted of failing to follow a unanimous shareholder agreement that required shareholder approval for certain steps (par. 2).

¹¹⁴² C.B.C.A. s. 122(2), A.B.C.A. s. 122(2), M.C.A. s. 117(2), N.B.B.C.A. s. 79(2), N.L.C.A. s. 203(2), N.T.B.C.A. s. 123(2), N.B.C.A. s. 123(2), O.B.C.A. s. 134(2), S.B.C.A. s. 117(2), Y.B.C.A. s. 124(2). The Q.B.C.A. does not contain a similar section.

¹¹⁴³ C.B.C.A. s. 122(1), A.B.C.A. s. 122(1), M.C.A. s. 117(1), N.B.B.C.A. s. 79(1), N.L.C.A. s. 203(1), N.T.B.C.A. s. 123(1), N.B.C.A. s. 123(1), O.B.C.A. s. 134(1), S.B.C.A. s. 117(1), Y.B.C.A. s. 124(1). These doctrines originated in common law principles. See *e.g. BCE Inc., Re*, 2008 SCC 69, [2008] 3 S.C.R. 560, 301 D.L.R. (4th) 80, 383 N.R. 119, 2008 CarswellQue 12595, 2008 CarswellQue 12596, 71 C.P.R. (4TH) 303, 172 A.C.W.S. (3d) 915, J.E. 2009-43, [2008] S.C.J. No. 37, 52 B.L.R. (4th) 1 (S.C.C. Dec 19, 2008) (hereinafter "*BCE*"), par. 37 ("The fiduciary duty [of loyalty] of the directors to the corporation originated in the common law.") and *Peoples, supra* note 809, par. 59 ("That directors must satisfy a duty of care is a long-standing principle of the common law, although the duty of care has been reinforced by statute to become more demanding."). Q.B.C.A. s. 119 is similar, but it bases the directors' obligations to the corporation in the *C.C.Q.*

latter prevents *self-interest*.¹¹⁴⁴ To the extent that directors' self-interest was involved in the violation of a unanimous shareholder agreement, the duty of loyalty might be invoked; if the directors failed to take sufficient efforts to ensure compliance, the duty of care could cover the situation. Because the former requires an additional element beyond the breach (self-interest), only the latter has theoretical validity as a blanket means of enforcing all unanimous shareholder agreements.

The purest form of this model would simply classify violations of the agreement in that manner. What appears in the case law, however, is not so straightforward. Like the previous two approaches, what the cases demonstrate is often less the application of a clearly understood line of analysis and more the influence of a legal tradition. Two elements of the directors' duties to the corporation in particular have been invoked to deal with enforcing unanimous shareholder agreements: the derivative action and the business judgment rule. Neither of these would have relevance to any of the other approaches; judicial consideration of these principles in this context implies a directors' duties analysis. Further, some cases have considered whether the directors' duty of care might override the terms of a unanimous shareholder agreement; ironically, this line of analysis actually suggests that the agreements are not in conflict with the duty, but rather one component of it, to be balanced against other considerations.

The very factors that illustrate this approach also provide arguments against it. Thanks to the business judgment rule, the duty of care is notoriously unenforceable. Generally speaking, the ephemeral nature of this duty might be inevitable in areas where directors must be free to operate within an uncertain business environment and to take risks without fear of being reviewed by judges armed with the benefit of hindsight.¹¹⁴⁵ But these well-worn justifications do not apply to a director's actions in contravention of a unanimous shareholder agreement. The clarity of a well-worded restriction, or even the relative clarity of a poorly-worded one, stands in sharp contrast to the uncertainty of the business environment, and it is not unreasonable second-guessing for a judge to determine whether it was properly adhered to. Nor is it appropriate to encourage risk-taking even at the expense of such adherence. To argue otherwise, that the business judgment rule includes the choice of whether to follow a unanimous shareholder agreement, makes the "restrictions" merely discretionary suggestions. It would be simpler and more honest to eliminate this legal tool; non-binding shareholder proposals would serve the same purpose.

Case law considering the relevance of the derivative action and the business judgment rule to the enforcement of unanimous shareholder agreements is reviewed in the following subsections. The reception has been, at best, tepid, with these concepts rejected as often as accepted.¹¹⁴⁶ And yet, even when rejected,

¹¹⁴⁴ *Peoples*, *supra* note 809. In the last decade, the Supreme Court of Canada has presented a multi-faceted view of the duty of care. How unanimous shareholder agreements fit into that paradigm is discussed in Chapter Five.

¹¹⁴⁵ Consideration of the general problems with the duty of care and possible solutions is beyond the scope of the current discussion.

¹¹⁴⁶ In addition to the cases mentioned in the following sections, it was mentioned in passing in

the very fact that they were considered at all suggests that there may be some potential (or, at least, potential appeal) lurking in the directors' duties approach to unanimous shareholder agreements. If nothing else, the directors' duties provide an existing framework for taking legal action against them when they have allegedly behaved inappropriately, and it is presumably for that reason that these concepts have found some limited life in the unanimous shareholder agreement case law.

5.(a) Derivative Actions

The duties of care and loyalty are owed directly to the corporation, not to the shareholders. As a result, they may only be enforced by the corporation or through a derivative action, wherein a shareholder is granted permission by the court to advance a suit on the company's behalf.¹¹⁴⁷ This stands in contrast to a contractual model, which would allow any party to the agreement to enforce it, and a corporate constitutional one, which arguably allows *anyone* to ask the court to recognize the agreement's consequences. Invoking the directors' duties approach, a few cases have dealt with whether unanimous shareholder agreements must be enforced through derivative actions, rather than by shareholders on their own behalf.¹¹⁴⁸ The reported case law in this area is divided between cases where leave to bring a

McAteer v. Devoncroft Developments Ltd., 2001 ABQB 917, [2002] 5 W.W.R. 388, 307 A.R. 1, 99 Alta. L.R. (3d) 6, 2001 CarswellAlta 1694, 24 B.L.R. (3d) 1, [2002] A.W.L.D. 108, [2001] A.J. No. 1481 (Alta. Q.B. Nov 07, 2001) (hereinafter "*McAteer*") that a director's violation of a unanimous shareholder agreement was a failure of his duties to the corporation (par. 737). *McAteer* was primarily an oppression case, and is discussed later in this chapter.

¹¹⁴⁷ See *C.B.C.A.* s. 239, *A.B.C.A.* s. 240, *M.C.A.* s. 232, *N.B.B.C.A.* s. 164, *N.L.C.A.* s. 369, *N.T.B.C.A.* s. 241, *N.B.C.A.* s. 241, *O.B.C.A.* s. 246, *Q.B.C.A.* s. 445, *S.B.C.A.* s. 232, and *Y.B.C.A.* s. 241. The phrase "derivative action" is commonly used to refer to such actions, and that term appears in the headings for all the aforementioned sections except those of New Brunswick and Quebec.

¹¹⁴⁸ *C.B.C.A.* s. 247 provides that a shareholder (or other complainant) can apply to the court for an order directing that the corporation or its directors comply with or restrain from breaching a unanimous shareholder agreement and that the court may so order or make any other order it thinks fit. Equivalents are found at *A.B.C.A.* s. 248, *M.C.A.* s. 240, *N.B.B.C.A.* s. 172, *N.L.C.A.* s. 378, *N.T.B.C.A.* s. 249, *N.B.C.A.* s. 249, *O.B.C.A.* s. 253(1), *Q.B.C.A.* s. 460, *S.B.C.A.* s. 240, and *Y.B.C.A.* s. 249. These sections indicate that, under the current statutes, a derivative action cannot be the only means of enforcing a unanimous shareholder agreement against the directors. The legislatures specifically permitted a different method of enforcement from the directors' duties approach.

That said, these sections do not guarantee that such applications to court will result in the relief sought. If the directors' duties approach to enforcing unanimous shareholder agreements were adopted by the courts, then the restrictions placed upon the board would be treated as obligations owed to the corporation, not its shareholders. Such a premise could easily lead to attempts to enforce unanimous shareholder agreements under s. 247 (and its equivalents) finding little success. One way to justify the existence of this statutory procedure in the context of the director' duties model would be to limit its applicability to terms that specifically benefit the complainant; this compromises the theoretical consistency of the directors' duties model, but would retain the idea that restrictions upon the board are *in general* obligations owed to the corporation itself and should only be enforced by it, while allowing that specific terms might constitute

derivative action was granted and where it was not required; from a practical perspective, this might suggest a judicial tendency toward allowing claims to proceed regardless of whether they are pursued personally or on behalf of the corporation, but at a theoretical level, it leaves confusion as to whether a derivative action is the appropriate means of enforcing a unanimous shareholder agreement.¹¹⁴⁹

In *1199918 Alberta Ltd. v. TRL Holdings Inc.*,¹¹⁵⁰ the applicant sought leave to bring such a derivative action. With regard to whether the proposed suit would be in the best interests of the corporation, Graesser J. wrote:

79 To the extent that Mr. Liu's interests are in ensuring that the revenues and assets of TRL not be improperly diverted from the corporation, an action to recover assets for the corporation would certainly appear to be in its best interests as well. Holding directors accountable for their actions is an important function of corporate law and is at the root of s. 240 of the *ABCA*.

As with some of the oppression claims discussed below, it is difficult to determine to what extent the violations of the unanimous shareholder agreement alluded to were influential in the decision to allow a derivative action, and to what extent one might have been allowed regardless in response to the offending acts, here the alleged improper diversion of corporate revenue.¹¹⁵¹ There is also insufficient detail in the

exceptions.

¹¹⁴⁹ *Pellin c. Bedco, division de Gérodon inc.*, 2002 CarswellQue 2735, J.E. 2003-217, REJB 2002-36127 (C.S. Que. Nov 27, 2002) should be distinguished from this category. While the claim was made in the context of a unanimous shareholder agreement (although the document was only referred to as such in reproduced pleadings at pars. 9 and 10), it was not a request for enforcement, but for the share valuation provisions of the agreement to *not* apply (par. 9). The complaining investor alleged that various acts of the defendants had cost the company value in favour of a related one, which had in turn affected the value of his shares (summarized at par. 44). Frappier J.C.S. found that this had to be brought as a derivative claim, since it was primarily a loss suffered by the company and only indirectly by the shareholder (pars. 45-58). It was further noted that the courts should not interfere with internal business decisions made in all legitimacy, with no fraud or "*ultra vires*" (pars. 74-75) and that, since the agreement set out a valuation procedure, the judge did not want to set it aside (pars. 60-69).

¹¹⁵⁰ *1199918 Alberta Ltd. v. TRL Holdings Inc.*, 2011 ABQB 506, 523 A.R. 274, 2011 CarswellAlta 1393, 205 A.C.W.S. (3d) 677, [2012] A.W.L.D. 326, [2012] A.W.L.D. 327, [2012] A.W.L.D. 328, [2012] A.W.L.D. 329, [2012] A.W.L.D. 330, [2012] A.W.L.D. 331, [2012] A.W.L.D. 332, [2012] A.W.L.D. 336, 90 B.L.R. (4th) 73, 53 Alta. L.R. (5th) 68 (Alta. Q.B. Aug 12, 2011) (hereinafter "*1199918*")

¹¹⁵¹ *Ibid.*, par. 80:

I am satisfied that some of the matters raised by the Applicants are not bound to fail. It is arguable that 1252104 should have held Cornerstone and Mr. Ostermayer to the maximum per square foot cost for the construction of the units for McLeod Gardens. That may have resulted in profits for TRL albeit at Mr. Ostermayer's expense. There are payments from TRL to Mr. Regenwetter or entities related to him that may have been made contrary to the unanimous shareholders agreement or otherwise made to divert funds from TRL. It is curious and suspicious that all creditors of 1252104 have been paid but for Mr. Liu's Professional Corporation and CRA, and the latter in an amount similar to the amount of security placed for the Professional Corporation's builder's lien.

judgment to determine how those payments may have been in breach of the agreement.¹¹⁵² However, because this appears in a motion for leave to bring a derivative action, it suggests that the duty to follow the agreement is a duty to the corporation. While the applicant was also bringing a claim personally, Graesser J. specifically noted that the derivative action was necessary because it was the only way to bring suit against the directors for "breach of fiduciary duty or other wrongdoing".¹¹⁵³

Similarly, in *Johnson v. Meyer*,¹¹⁵⁴ the applicant sought leave to commence a derivative action against directors for alleged breaches of negative covenants and of their duty of good faith and fiduciary obligations. The allegation that the defendants were, *inter alia*, violating the unanimous shareholder agreement by performing work apparently forbidden by it was treated as supporting the proposition that it was in the best interest of the corporation for the application to be allowed and the derivative action to go forward.¹¹⁵⁵ The respondents submitted that the derivative action should not proceed because there was also a personal suit ongoing to enforce the negative covenants.¹¹⁵⁶ (It is not clear whether these were distinct from whatever provisions of the unanimous shareholder agreement were being violated.) Despite this, the action was allowed to proceed because the relief sought was different.¹¹⁵⁷

Malata Group (HK) Ltd. v. Jung,¹¹⁵⁸ on the other hand, rejected the view that violations of unanimous shareholder agreements were *exclusively* violations of the directors' duties to the corporation. The defendants brought a motion to dismiss oppression claims on the grounds that they were really derivative and no leave had been sought.¹¹⁵⁹ With regard to the portion of the statement of claim alleging violations of a unanimous shareholder agreement and seeking relief pursuant to it, Ground J. held that these were properly oppression claims of the plaintiff personally.¹¹⁶⁰

¹¹⁵² The unanimous shareholder agreement also contained a term that the applicant would be a director, though he was not, something which was noted in passing but of which nothing was made (1199918, *supra* note 1150, par. 5).

¹¹⁵³ 1199918, *supra* note 1150, par. 75. This may refer to the duty of care and not the fiduciary duty of loyalty.

¹¹⁵⁴ *Johnson v. Meyer*, 62 Sask. R. 34, 1987 CarswellSask 635, [1987] C.L.D. 1400, [1987] S.J. No. 668 (Sask. Q.B. Oct 09, 1987) (hereinafter "*Johnson*"). This successful application corrected some technical defects (par. 15) that had resulted in the failure of an identical (par. 13) previous application (see *Johnson v. Meyer*, 57 Sask. R. 161, 1987 CarswellSask 631, [1987] C.L.D. 387, [1987] S.J. No. 123 (Sask. Q.B. Feb 12, 1987)).

¹¹⁵⁵ *Ibid.*, par. 23. The applicants made repeated demands to have the differences between the parties brought to arbitration, as the unanimous shareholder agreement provided, but they were refused (par. 20). This was treated as evidence of the applicant's good faith in bringing the motion (par. 21).

¹¹⁵⁶ *Ibid.*, par. 30.

¹¹⁵⁷ *Ibid.*, par. 31.

¹¹⁵⁸ *Malata Group (HK) Ltd. v. Jung*, 2007 CarswellOnt 2730, 157 A.C.W.S. (3d) 317, [2007] O.J. No. 1704 (Ont. S.C.J. May 01, 2007) (hereinafter "*Malata*"); The decision was appealed on other grounds and upheld, in *Malata Group (HK) Ltd. v. Jung*, 2008 ONCA 111, 89 O.R. (3d) 36, 290 D.L.R. (4th) 343, 233 O.A.C. 199, 2008 CarswellOnt 699, 44 B.L.R. (4th) 177 (Ont. C.A. Feb 15, 2008).

¹¹⁵⁹ *Malata*, *supra* note 1158, par. 2.

¹¹⁶⁰ *Ibid.*, par. 5.

In *Ellins v. Coventree Inc.*¹¹⁶¹ as well, an issue was raised that this was an improperly brought derivative action; the unanimous shareholder agreement stated that the CDO limitation (a term of the unanimous shareholder agreement that bound the parent company, which the applicant shareholders were trying to enforce against the parent company through an oppression claim) could only be enforced by the company, but this application had been brought by three minority shareholders.¹¹⁶² Lax J. concluded, "It is not known what steps the Board would have recommended Nereus [the corporation] take, but I do not think it lies in Coventree's [parent company's] mouth to deny Nereus its day in court on this issue because three of its minority shareholders brought this application. They are here because of Coventree's conduct. Nereus shall have carriage, instructed by management."¹¹⁶³ Obviously, this differs from the norm in that the agreement was being enforced against a parent company rather than the directors and because of the contractual requirement that the claim be advanced only by the corporation itself. Nonetheless, the court's willingness to allow the action to proceed despite that suggests a strong amount of lenience for shareholders to directly enforce unanimous shareholder agreements, rather than requiring derivative actions.

All of these decisions invoke the idea, if in some cases only to reject it, that enforcement of a unanimous shareholder agreement is properly a claim of the company, and that a derivative action is the means whereby shareholders might advance it. One thing this small group of cases has in common is that, in all of them, the claim was allowed to proceed, whether it was a judge granting permission for a derivative action or ruling one unnecessary. There does not seem to be much enthusiasm for denying shareholders the right to enforce terms of a unanimous shareholder agreement.

The cases that grapple with the issue of derivative actions are therefore inconclusive as to whether obeying a unanimous shareholder agreement should be treated as part of the directors' duties to the corporation and enforcement handled through a procedure that classifies it as such, although the possibility is certainly not foreclosed so much as not consistently required.

5.(b) The Duty of Care and the Business Judgment Rule

A few cases have considered whether the business judgment rule may be invoked to protect directors who decided to violate unanimous shareholder agreements, allegedly in the *bona fide* belief that doing so served the company's best interests.¹¹⁶⁴ If such a doctrine were adopted- and it generally has not

¹¹⁶¹ *Ellins v. Coventree Inc.*, 2007 CarswellOnt 1725, [2007] O.J. No. 1118, 28 B.L.R. (4th) 292 (Ont. S.C.J. Mar 27, 2007) (hereinafter "*Ellins*").

¹¹⁶² *Ibid.*, par. 68.

¹¹⁶³ *Ibid.*, par. 68.

¹¹⁶⁴ *Cramer v. Focus Group Holding Inc.*, 2013 ABPC 24, 2013 CarswellAlta 215, 225 A.C.W.S. (3d) 998, [2013] A.W.L.D. 2458, 12 B.L.R. (5th) 299 (Alta. Prov. Ct. Feb 22, 2013) also raised the point that

been accepted- then it would implicitly incorporate the unanimous shareholder agreements into the duty of care, *i.e.* directors should consider them but have the discretion to ignore them without penalty if they reasonably believed that it was in the company's best interests. Neither the corporate constitutional nor the contractual approach would allow directors to ignore a unanimous shareholder agreement without penalty simply because they believed that doing so was in the company's best interests, although such a belief might weigh in the assessment of damages.

In evaluating whether directors have met their duty of care, the courts have developed "the business judgment rule", a doctrine that judges should show deference to the "business judgment" of directors and not second-guess their decisions.¹¹⁶⁵ The basis of this deference is twofold; firstly, that it is

the directors were bound to act in the best interest of the company when valuing shares the company was obliged to repurchased pursuant to a clause in a unanimous shareholder agreement (a clause they were alleged to be in breach of), it not being in the company's interest to give them a high value (par. 59, see also par. 71). The situation was unusual, in that Sharek Prov. J. was not evaluating whether the board's actions were correct in the context of the unanimous shareholder agreement, but whether the directors had acted in bad faith that would invalidate a release (pars. 47, 51). Further, the agreement had specifically allowed the board discretion in valuing the shares (par. 71). On that standard and under the document's, the directors' choice of valuation procedures was found to be acceptable (par. 78), although the judge did note in coming to that conclusion that, "the Board did not act in bad faith and acted in what they believed to be in the best interests of the corporation in establishing the Share value" (par. 80) suggesting that their belief that they were acting in the best interests of the company (*i.e.* the business judgment rule) was a relevant factor in evaluating their compliance (or at least evaluating their lack of bad faith). The fact-driven use of a "bad faith" standard limits this case as a means of understanding the enforcement of unanimous shareholder agreements generally.

¹¹⁶⁵ In *Peoples*, *supra* note 809, the Supreme Court of Canada set out the position that the business judgment rule was implicit in a proper understanding of the directors' statutory duty of care:

64 The contextual approach dictated by s. 122(1)(b) of the *CBCA* not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders. Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand, have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.

In *BCE*, *supra* note 1143, par 40, the Supreme Court elaborated, "The 'business judgment rule' accords deference to a business decision, so long as it lies within a range of reasonable alternatives[...]"

easy with the benefit of hindsight and the leisure of reflection to criticize decisions made when outcomes were uncertain and time may have been pressing, and secondly, because when attempting to guide a successful business, risk is often to be embraced rather than avoided, if there are potential profits to be made in the gamble. In practice, the business judgment rule has made it all but impossible to successfully prove that directors failed to meet their duty of care in situations short of the most egregious incompetence or the violation of certain specific subsidiary rules.¹¹⁶⁶

*Matthews Investments Ltd. v. Assiniboine Medical Holdings Ltd.*¹¹⁶⁷ is the clearest example of how this might work in the context of a directors' duties framework for enforcing unanimous shareholder agreements; the business judgment rule was held to allow the board the discretion to disregard the agreement. Joyal J. concluded that directors should firstly be granted judicial deference with regard to their interpretations of unanimous shareholder agreements and secondly should be allowed to weigh their obligations under the agreement against their views of the best interests of the corporation. While not strictly speaking relegating adherence to these agreements to a component of the duty of care, which would have created standing issues, the judgment otherwise appears most consistent with the analysis one would expect in a duty of care case.

The unanimous shareholder agreement in question contained a provision that allowed the directors some discretion in retaining capital, but stated that to the "greatest extent reasonably possible" they must declare dividends.¹¹⁶⁸ Historically, the corporation had always paid dividends annually equal to the company's net income,¹¹⁶⁹ although it had run deficits and taken mortgages to accomplish this.¹¹⁷⁰ When the corporation stopped paying dividends, a suit was brought.¹¹⁷¹ The situation was further complicated because the corporation had a multi-class share structure, and retired or deceased employees had their shares converted to a class that was non-voting and redeemed automatically after eight years, but received full dividends for those eight years.¹¹⁷²

¹¹⁶⁶ e.g. the rules against fettering discretion and against delegation.

¹¹⁶⁷ *Matthews Investments Ltd. v. Assiniboine Medical Holdings Ltd.*, 2008 MBQB 52, [2008] 12 W.W.R. 493, 2008 CarswellMan 59, 227 Man. R. (2d) 9, 165 A.C.W.S. (3d) 453, 43 B.L.R. (4th) 206 (Man. Q.B. Feb 14, 2008) (hereinafter "*Matthews*").

¹¹⁶⁸ Ibid, par. 2. The clause read in full:

The directors of Assiniboine in each fiscal year when establishing operating budgets, shall be permitted in their discretion, to accumulate reasonable reserves in their discretion for operating expenses anticipated to be incurred by Assiniboine in the next fiscal year. Thereafter, to the greatest extent reasonably possible, the balance of Net Income (or Loss) for Tax Purposes as determined in paragraph 10.5, shall be allocated and distributed on an annual basis to those Shareholders of Assiniboine otherwise entitled to share the Net Income (or Loss) for Tax Purposes of Assiniboine.

¹¹⁶⁹ Ibid, par. 20.

¹¹⁷⁰ Ibid, par. 111.

¹¹⁷¹ Ibid, par. 3.

¹¹⁷² Ibid, pars. 15-16.

Joyal J. first considered the situation without applying the oppression remedy. In that context, the words of the document were held to be straightforward enough that extrinsic evidence would not be consulted to determine their meaning, per standard contract law principles.¹¹⁷³ The judge concluded that, under the agreement, the directors no longer had absolute discretion as to whether to declare dividends¹¹⁷⁴ and that "[g]iven the comparatively exposed status of the plaintiffs in this case, the fettering of the directors' discretion pursuant to the 1993 agreement provides important protection from potential abuse of conduct at the hands of directors".¹¹⁷⁵ Given the subsequent conclusions, it is not entirely clear what those limits were or if they were anything but illusions. On the wording, it was found that the directors retained "a necessary discretion".¹¹⁷⁶

Joyal J. then essentially imported the business judgment rule as the standard of review for directors' interpretations of their own power under a unanimous shareholder agreement:

104 It is clear that a unanimous shareholder agreement like that of the 1993 agreement can fetter the otherwise wide discretion afforded the directors of a corporation. However, even where that has occurred, while the directors' remaining discretion may no longer be absolute, it is a discretion with which interference by a court will take place reluctantly and cautiously.

105 The phraseology of paragraph 10.7 in the 1993 agreement is such that it ensures that even if qualified, the directors of AMHL are provided and retain a necessary discretion that is consistent and compatible with exigencies of corporate governance.

106 Absent error in the directors' legal interpretation of a unanimous shareholder agreement, when examining the directors' exercise of their discretion - either in the context of their application of a unanimous shareholder agreement or in relation to the evaluation of possible oppressive conduct - courts are understandably cautious about substituting their own judgment for the judgment of the directors. This is especially so in relation to the often subtle and nuanced considerations that interact to inform and impact corporate decision-making.

[...]

109 Assuming a correct interpretation of the 1993 agreement and more specifically, the correct interpretation of the clear but qualified discretion set out in paragraph 10.7 (the correctness of the defendants' interpretation is indeed confirmed below at paragraph 122), the satisfaction of the above three steps [essentially, the basic standards of the duty of care under the business judgment rule] may be taken into account when examining the defendants' application of paragraph 10.7 and the plaintiffs' attack on the genuineness of the defendants' justification to not declare dividends for the years in question.

It is not particularly novel to suggest that the directors' decision should not be disturbed if the

¹¹⁷³ Ibid, par. 95.

¹¹⁷⁴ Ibid, par. 99.

¹¹⁷⁵ Ibid, par. 102.

¹¹⁷⁶ Ibid, par. 105.

agreement was correctly followed. What is radical is the implication that the business judgment rule applies to the very question of *whether* the agreement was followed.

Joyal J. also brought in a related principle, that the court should not compel commercially unreasonable behaviour,¹¹⁷⁷ and held that the directors' decision not to declare dividends was commercially reasonable¹¹⁷⁸ and also that they were protecting the corporation's interests in accordance with what was called their "fiduciary" duty.¹¹⁷⁹ Further, the judge "accept[ed] the defendants' argument that any provision of a shareholder agreement that would compel a declaration of dividends in a way that would require a director to betray his or her fiduciary duties to the corporation could very well be *ultra vires* the shareholders of that corporation".¹¹⁸⁰ While the language is speculative and the comment possibly *obiter*,¹¹⁸¹ Joyal J. nonetheless was openly sympathetic to the position that a director's own conception of their duties to the corporation would override the restrictions of a unanimous shareholder agreement. This is clearly incompatible with any approach other than incorporating the agreements directly into the duty of care. Just as an outvoted minority director could not assert power over the corporation to satisfy a perceived duty to it, a director stripped of power by a unanimous shareholder agreement could not, under a corporate constitutional approach, assert power that they simply did not possess, duty or no duty. It is similarly outside of a contractual approach, under which the entire point of unanimous shareholder agreements is to allow for contracts that might fetter the discretion of directors, something otherwise forbidden, with the potential for contractual damages in the event of violations.

Ultimately, these points about the business judgment rule, commercial reasonability, and fiduciary duty lead to one of two inferences. The first possibility is that Joyal J. was making determinations specifically regarding the discretion explicitly granted in this particular unanimous shareholder agreement, *i.e.* this ruling was unique to these facts. Alternatively, despite some early indications that this decision was in line with a corporate constitutional or contractual approach, it was in fact an example of treating adherence to unanimous shareholder agreements as a component of the duty of care¹¹⁸² and therefore subject to substantial judicial deference to directors under the business judgment rule.

While the use of the oppression remedy as an enforcement mechanism for unanimous shareholder agreements is discussed more fully in a later part of this chapter, it is useful to compare how that method was employed in *Matthews Investments* with the aforementioned analysis. The plaintiffs argued that even if the directors were technically within their rights, the larger situation (including the history of the corporation, the unanimous shareholder agreement, the share structure, *et cetera*) could form the basis of an

¹¹⁷⁷ Ibid, par. 110.

¹¹⁷⁸ Ibid, pars. 112-115.

¹¹⁷⁹ Ibid, par. 120.

¹¹⁸⁰ Ibid, par. 122.

¹¹⁸¹ Since the unanimous shareholder agreement in question was interpreted in such a manner that it did not contain such a requirement.

oppression claim.¹¹⁸³ Joyal J. held that, for this branch of the analysis, extrinsic evidence could demonstrate reasonable expectations.¹¹⁸⁴ Nonetheless, the failure on the directors' duties grounds essentially proved fatal to the oppression claim:

156 I have already expressed my determination that on my interpretation of the 1993 agreement, if the decision of the directors of AMHL falls within the discretion provided by paragraph 10.7, the declaration of dividends is not obligatory. Accordingly, with that determination, I have confirmed the existence of a qualified discretion to not declare dividends, a qualified discretion that, by definition, may be used if the circumstances warrant. [...]

157 The very existence of a qualified discretion like that in paragraph 10.7 of the 1993 agreement and the creation of a finite eight-year period attached to class C withdrawing shareholders, give rise to the possibility that in respect of the declaration of dividends, some class C shareholders (in some years or periods) may be treated differently than others in past years. That result is rooted in the reasonable discretionary power found in the articles and further qualified in the 1993 agreement to which the plaintiffs contracted.

Joyal J. held that the expectations of the plaintiffs were therefore not reasonable.¹¹⁸⁵

While the decision in *Matthews* might be explained as entirely derived from discretion specifically granted in the wording of the agreement, the judgment as a whole contains numerous references to the need for directors to have such discretion, and indeed suggests that it might be impossible for a unanimous shareholder agreement to remove it. It reflects, overall, a tendency toward the standard judicial habits when reviewing directors' conduct, the established deference toward their decision making, even when considering the enforcement of unanimous shareholder agreements. Several other cases, however, have taken the opposite stance. A pair of judgments suggest that the business judgment rule cannot protect directors who disregard a unanimous shareholder agreement, while a further pair indicate only that violating the agreement would normally be so egregious a violation of the duties that it went beyond even the business judgment rule, leaving open the possibility that in unusual circumstances, it might be a legitimate exercise of their discretion.

The appeal in *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*¹¹⁸⁶ centred around the respondents' attempt to invoke the business judgment rule, an issue not dealt with directly in the original judgment.¹¹⁸⁷ Even though it was an oppression case, the directors argued that their decision to fire the applicant despite the unanimous shareholder agreement was made in good faith and in the best interests of

¹¹⁸² Possibly aside from standing issues.

¹¹⁸³ *Matthews*, *supra* note 1167, par. 152.

¹¹⁸⁴ *Ibid*, par. 154.

¹¹⁸⁵ *Ibid*, par. 171.

¹¹⁸⁶ *2082825 Div Ct*, *supra* note 792.

¹¹⁸⁷ *2082825 Sup Ct J*, *supra* note 792.

the corporation, and therefore it should be respected according to the business judgment rule, because it trumped any specific provisions of a unanimous shareholder agreement (or other reasonable expectations of a shareholder).¹¹⁸⁸

The court rejected this argument. According to Wilson J., the business judgment rule protected directors "making decisions on behalf of shareholders [...] in accordance with their responsibilities as agreed upon by shareholders".¹¹⁸⁹ Therefore, "the business judgment rule has no application where, as in the circumstances of this case, the shareholders have put their minds to a particular business issue and have agreed upon terms."¹¹⁹⁰ This is a definition of directors' duties within the context of the corporate constitutional approach; directors have discretion only in areas where unanimous shareholder agreements have not already predetermined the outcome. The court also set out the obvious point that if the business judgment rule overrides a unanimous shareholder agreement, then the latter is effectively useless:

If the business judgment rule were held to override the express terms of a unanimous shareholder agreement, such agreements would be of negligible value to a minority shareholder who becomes an equity owner in reliance on the protection contained in terms of a unanimous shareholder agreement. Instead of providing protection, such agreements could easily become the instruments of a "bait and switch" if controlling shareholders were permitted to shelter under the business judgment rule when violating the terms of a unanimous shareholder agreement to the prejudice of a minority.¹¹⁹¹

While the above paragraph seems applicable regardless of how the unanimous shareholder agreement is conceived, the specific method being used to enforce it was the oppression remedy, and the court also endorsed the general principle that the business judgment rule does not allow directors to violate the "reasonable expectations" of the shareholders, *i.e.* to commit oppression.¹¹⁹²

In another oppression case, *Le Maitre Ltd. v. Segeren*,¹¹⁹³ it was similarly held that the business judgement rule and the director's own views as to his duties to the corporation did not permit him to override a unanimous shareholder agreement:

46 [...] While a director owes a fiduciary duty to act in the best interests of a corporation, I do not believe that the Supreme Court's decision in *BCE Inc.* stands for the proposition that a director may violate agreements and the reasonable expectations of shareholders provided he or she considers the decision to be in the best interests of the corporation. Rather, as the Court stated, "The corporation and the shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual shareholders unfairly." The business judgment rule accords deference to a business

¹¹⁸⁸ 2082825 Div Ct, *supra* note 792, par. 18.

¹¹⁸⁹ *Ibid*, par. 19.

¹¹⁹⁰ *Ibid*, par. 20.

¹¹⁹¹ *Ibid*, par. 20.

¹¹⁹² *Ibid*, par. 28.

¹¹⁹³ *Le Maitre Ltd. v. Segeren*, 2009 CarswellOnt 773, 174 A.C.W.S. (3d) 1049, [2009] O.J. No. 634, 55 B.L.R. (4th) 123 (Ont. S.C.J. [Commercial] Feb 11, 2009) (hereinafter "*Le Maitre*").

decision so long as it is within a range of reasonable alternatives. Mr. Segeren's actions and decisions were not within that range. [Footnote omitted]

[...]

51 The more fundamental argument that Mr. Segeren advances, however, is that he is acting in the best interests of LMSE. In making this submission, however, he ignores two key facts. Firstly, in light of the provisions of the USA and the parties' reasonable expectations, the assessment of the best interests of LMSE is not his alone to make. Secondly he disregards the purpose for which LMSE was established, namely to serve as a distributor of LML products in North America.

The judges in both *2082825* and *Le Maitre* found that the business judgment rule cannot permit directors to override the terms of a unanimous shareholder agreement, because deference to directors' decision-making would destroy the utility of a tool designed to limit that very discretion and because, under the terms of the document, the assessment of the interests of the corporation was no longer the directors' to make. A further pair of decisions achieved a similar result, but were on a technical level more cautious; they asserted instead that the breach of a unanimous shareholder agreement is normally so blatant a violation of the directors' duties as to take their decision beyond even the generous protection of the business judgment rule.

While resolving the oppression allegations in *Ellins v. Conventree Inc.*,¹¹⁹⁴ Lax J. noted with regard to acts that ignored the shareholders' reasonable expectations, to which a limitation in the unanimous shareholder agreement was "central", that "[t]he business judgment rule will only shield directors and officers from court intervention in decisions that have been made in good faith and on reasonable grounds that appear to be in the best interests of the corporation".¹¹⁹⁵ Implicitly, Lax J. found that the acts in question were not made in good faith. However, the corollary was that, if the actions *were* in good faith, the business judgment rule might apply even if the directors were violating a unanimous shareholder agreement and in so doing oppressively disregarding the shareholders' reasonable expectations.

Main v. Delcan Group Inc.,¹¹⁹⁶ yet another oppression case, might not have involved a unanimous shareholder agreement,¹¹⁹⁷ but is notable for being one of the cases cited by the Supreme Court of Canada regarding shareholder agreements and the oppression remedy.¹¹⁹⁸ It allows similar inferences, as Lederman J. found that "[i]t is difficult to imagine that any decision which runs contrary to both the *CBCA* and the Shareholders' Agreement could nevertheless be said to be honest, and in good faith. Accordingly, I must

¹¹⁹⁴ *Ellins, supra* note 1161.

¹¹⁹⁵ *Ibid*, par. 52.

¹¹⁹⁶ *Main v. Delcan Group Inc.*, 47 B.L.R. (2d) 200, 1999 CarswellOnt 1605, 88 A.C.W.S. (3d) 788, [1999] O.J. No. 1961, 105 O.T.C. 27 (Ont. S.C.J. [Commercial] Jun 02, 1999) (hereinafter "*Main*").

¹¹⁹⁷ The document in *Main* was never explicitly referred to as a "unanimous shareholder agreement" (or synonym).

¹¹⁹⁸ *BCE, supra* note 1143, par. 79.

find that the Respondent cannot rely on the Business Judgment Rule as support for its argument."¹¹⁹⁹ On the one hand, the principle is established that breaches of a shareholder agreement are violations of the directors' duties outside the permissible discretion covered by the business judgment rule, but on the other, it is only "difficult to imagine", not "legally impossible" for the outcome to be otherwise. Given the correct facts, a violation of a shareholder agreement could be honest and in good faith. If it were, this mode of analysis would allow the complainant no recourse, neither the nullification of the corporate constitutional model nor an award for contractual damages.

The majority of the preceding cases determined that the business judgment rule did not excuse directors who had chosen to violate a unanimous shareholder agreement, either because it was generally inapplicable or because only highly unusual circumstances would allow it to do so. Any inclination to default to the usual judicial deference to directors' discretion seems to have, with one notable exception, been outweighed by a sense that the board could not freely disregard an explicit restriction upon them, else the restriction would have no meaning. The normal rationale for the business judgment rule is that courts should not substitute their own decision-making for that of directors, but where the terms of a unanimous shareholder agreement are available as guidance, a review of the directors' actions does not constitute second-guessing legitimate business decisions with the benefit of hindsight. Nonetheless, while there is only an isolated endorsement for the proposition that the business judgment rule would protect directors' choices to violate unanimous shareholder agreements, two of the judgments that rejected it still analyzed the board's obligation to obey the restriction as part of their duty to the corporation, just one that superseded their normal discretion.

5.(c) Summation

A pre-existing mechanism through which the law controls directors' actions is their duties of care and loyalty. The directives found in unanimous shareholder agreements could be explicitly categorized as part of the directors' usual duties to the company; the legislation does separately provide that directors have a duty to comply with them. Even if adherence to the unanimous shareholder agreement is not explicitly being treated as one manifestation of the directors' general duties to the company, those larger obligations can serve as another model for enforcing these instruments. As a theoretical conception of unanimous shareholder agreements and as a set of legal principles pertaining to them, directors' duties present an alternative to both the corporate constitutional and contractual approaches. While the case law suggests that this method has limited favour, portions of the model nonetheless may have some currency; at the very least, the merits of invoking aspects of it have received judicial consideration, even if only to be rejected.

¹¹⁹⁹ *Main, supra* note 1196, par. 36.

Two implications of directors' duties in particular have emerged as objects of consideration. The first is the requirement that enforcement occur through a derivative action, and the second, the "business judgment rule" that allows directors wide discretion in determining what is in the best interests of the company. The (admittedly few) reported judgments have been almost entirely against the use of these principles to defeat claims, although the case law has left slightly more room in the abstract for the possibility that they have some relevance to the issue when circumstances warrant.

The directors' duties approach to the unanimous shareholder agreement is notable for providing a distinct contrast with the corporate constitutional and contractual models at both a theoretical and practical level, demonstrating that that dichotomy does not encompass all possible understandings of this legal tool, and that no conclusion regarding the unanimous shareholder agreement is inevitable. Instead of the genuine removal of directors' powers or a set of contractual obligations, the restrictions in a unanimous shareholder agreement could be a part of the duties that directors already owe to the company. Instead of the corporate constitutional approach's default nullification for want of authority or the many rules of contract law that might govern when breaches of these instruments result in damages, the legal principles governing directors' duties of care and loyalty might have application both for determining if a remedy is required and what it should be.

But there is a reason for the aforementioned judicial coolness toward this approach. The directors' duties are designed to allow them flexibility to operate in an uncertain and unpredictable economic environment while still maintaining a measure of accountability. They are thus an uneasy fit for the unanimous shareholder agreement, which can create clearly defined restrictions. And yet, the final approach, the oppression remedy, is even more flexible, and as the final section of this chapter explores, it has proven quite influential.

6. The Oppression Approach

The oppression remedy is, like the unanimous shareholder agreement, a statutory addition to corporate law innovated in Canada.¹²⁰⁰ Its purpose is to prevent directors and controlling shareholders from abusing their control of the corporation to "oppress" minority shareholders or creditors, and to that end the court is granted a wide range of powers. While this explanation of the purpose of the oppression remedy might suggest that it should be reserved for situations where no other legal wrong is occurring, in fact the oppression remedy has evolved into a parallel structure, existing alongside whatever other rights and

¹²⁰⁰ In jurisdictions that currently allow for unanimous shareholder agreements, the oppression remedy provision appears at *C.B.C.A.* s.241; *A.B.C.A.*, s. 242; *M.C.A.*, s. 234; *N.B.B.C.A.*, s. 166; *N.B.C.A.*, s. 243; *N.L.C.A.*, s. 371; *N.T.B.C.A.*, s. 243; *O.B.C.A.*, s. 248; *Q.B.C.A.*, s. 450; *S.B.C.A.*, s. 234; and *Y.B.C.A.*, s. 243. Throughout this dissertation, the phrase "oppression" is sometimes used to refer to any of the wrongs

remedies may or may not apply.

As a result, the commonplace use of the oppression remedy to enforce unanimous shareholder agreements against directors and the corporation- and more than half of the reported cases in this area invoke the oppression remedy¹²⁰¹- does not necessarily shed light on the legal theory underlying unanimous shareholder agreements. The oppression remedy could exist alongside any of the three approaches described above. It could also be applicable even if unanimous shareholder agreements were otherwise no more than unenforceable promises.

To the extent that the oppression remedy is viewed in isolation or as the primary means of enforcing unanimous shareholder agreements, however, there are two significant implications regarding the nature of this legal tool.¹²⁰² Firstly, the body of law surrounding oppression has its own emerging

caught by these provisions, including unfair prejudice and unfair disregard.

¹²⁰¹ This estimate is based upon my own research. It may reflect biases, including my research methodology and my own judgment about what constitutes the enforcement of a unanimous shareholder agreement and/or invoking the oppression remedy.

¹²⁰² The discussion that follows concerns the use of the oppression remedy as a means of enforcing the terms of a unanimous shareholder agreement, *i.e.* the alleged oppression consists (in whole or in part) of the violation of its terms. This can be contrasted with a number of other scenarios where a unanimous shareholder agreement might itself give rise to an oppression lawsuit.

The first is where the power arrangement set out in the document is alleged to be oppressive in and of itself, independent of any usage of it. Such a claim seems unlikely to succeed, at least when brought by a shareholder, since the investor's reasonable expectations would not have been violated. In *Comuzzi v. 705542 Ontario Inc.*, 1998 CarswellOnt 3461, 82 A.C.W.S. (3d) 464, [1998] O.J. No. 3572 (Ont. Gen. Div. Sep 01, 1998), a unanimous shareholder agreement that excluded a majority investor from any control over the company (by mandating who would be elected as directors) was found not to be oppressive; the company was being well-run (pars. 38-49). In *Equity Development Inc. v. Akokli Creek Development Inc.*, 2012 BCSC 42, 2012 CarswellBC 105, [2012] B.C.W.L.D. 7379 (B.C. S.C. Jan 13, 2012), a term in the unanimous shareholder agreement requiring that decisions of the board occur by supermajority was accepted by Melnick J. as a justification for one large block of investors "control[ling] the show" (par. 29) to the displeasure of the few dissenters; the board's actual uses of that power were found not to have violated the petitioners' reasonable expectations (pars. 28-35). In *Hurley SC (TD)*, *supra* note 1091, Orsborn J. rejected the argument that a change in shareholdings from equal to vastly unequal rendered oppressive the term guaranteeing both parties equal representation on the board of directors; this conclusion was based both upon the wording of the document dictating this outcome and upon the responsibility for the change in investment ratio resting with the party now complaining of the result (as discussed earlier in this chapter) (pars. 108-124). Finally, a variation appeared in *Corp. immobilière*, *supra* note 405, when a creditor to whom all of a company's shares had been pledged as security created a unanimous shareholder agreement after a default on the loan granted it the ability to do so, in order to remove the directors from power. Lévesque J.C.S. rejected an oppression claim, noting that the creditor was entitled to exercise its rights and protect its investment without being accused of abusive behaviour (par. 20) and that no acts of oppression were occurring that needed to be rectified (pars. 23-27).

A second way in which a unanimous shareholder agreement might give rise to an oppression claim is when empowered shareholders exercise the authority they have been granted in (what is alleged to be) an oppressive manner. When this occurs, the remedy remains available, although of course the behaviour in question may not actually warrant sanction. *152581 Canada Ltd. v. Matol World Corp.*, [1997] R.J.Q. 161,

1996 CarswellQue 1211, [1996] Q.J. No. 4017, EYB 1996-87739 (C.S. Que. Dec 05, 1996) presents an example; a shareholder granted sole managerial power over a company proceeded to behave unilaterally and ignore the other investors/directors in a manner that was found to be oppressive (pars. 89-96). Gomery J. stated that he "may have been legally entitled to adopt this attitude, in the sense that he may indeed have had the authority which he claimed to exercise as a result of the signature of the shareholders' agreement, but his disregard of the views and interests of the others was, in the circumstances, unfair" (par. 92). An apparently more common variant occurs when an investor granted a veto power by a unanimous shareholder agreement proceeds to use it oppressively. In *Gillespie, supra* note 524, one shareholder's refusal to attend meetings so that the quorum requirements in the unanimous shareholder agreement would prevent certain decisions from being made was found to be unfairly prejudicial (par. 177). In *Fiber Connections Inc. v. SVCM Capital Ltd.*, 2005 CarswellOnt 1963, [2005] O.J. No. 3899, 10 C.B.R. (5th) 192, 5 B.L.R. (4th) 271 (Ont. S.C.J. Mar 10, 2005), a single investor's invocation of a term that required its approval for all changes to the corporate structure in order to block an insolvency Proposal supported by all other interested parties was held to be oppressive, and Campbell J. permitted the company to amend its unanimous shareholder agreement (pars. 21-34). In *McNeil c. Joly*, 1987 CarswellQue 1325, J.E. 87-1118, EYB 1987-79639 (C.S. Que. Aug 28, 1987), Dionne J. initially remarked that when a unanimous shareholder agreement granted each of the two equal shareholders a veto, the exercise of that right was not oppressive (par. 32). However, because the shareholder that was refusing to allow the company to raise funds required for its survival had implicitly accepted the necessity and was withholding its consent in order to put pressure upon the other investor to sell its shares, the judge granted the requested relief, ordering the intransigent shareholder be bought out, rather than resorting to liquidation (pars. 33-59). This was not the only case to recognize that investors were entitled to use their veto rights without it necessarily constituting oppression, even if the result was a deadlock. In *Korogonas v. Andrew*, [1992] 4 W.W.R. 399, 128 A.R. 381, 1 Alta. L.R. (3d) 316, 1992 CarswellAlta 22, 32 A.C.W.S. (3d) 405, [1992] A.W.L.D. 333 (Alta. Q.B. Mar 19, 1992) (hereinafter "*Korogonas*"), the deadlock between the two parties was found to be a foreseen result of them both being granted a veto over management decisions, and thus not oppressive; the dispute resolution method provided by the agreement, a shotgun clause, was the appropriate solution (pars. 30-45). In *Gold v. Rose*, 2001 CarswellOnt 5, 102 A.C.W.S. (3d) 83, [2001] O.J. No. 12 (Ont. S.C.J. [Commercial] Jan 02, 2001), the refusal of the minority of the investors to agree with the majority's choice of manager, which under the unanimous shareholder agreement required a supermajority, was held to not be oppressive; the agreement was found to have effectively given the shareholders vetoes that they were entitled to exercise, and they were not doing so for an improper purpose (pars. 9-14). Swinton J. did, however, find that the company was deadlocked and ordered that various parties buy out the others (pars. 15-32). In *Klein, supra* note 947, a shareholder used the requirement that cheques of more than \$2500 have his approval to effectively freeze the company's assets for a brief time; Brockenshire J. found that this use of the agreement had not been oppressive, since the other shareholders were causing problems and this step led to "immediate remedies" (par. 86). Further weighing against a finding of oppression, the context was not a request to rectify this alleged wrong *per se*, but rather an argument that it should render the agreement void in its entirety and thus validate share transfers that were in contravention of it (par. 86). In *Kirtzinger v. Schlosser*, 2010 SKQB 478, 2010 CarswellSask 886, [2010] S.J. No. 812, 85 B.L.R. (4th) 306 (Sask. Q.B. Dec 30, 2010), the unanimous shareholder agreement provided that both investors would have a single director on the board, which resulted in deadlock and one party bringing an oppression claim. Because the situation was causing the company immediate harm, Konkin J. ordered that there be a third director (pars. 11-15). This decision was more practical problem-solving than a true finding of oppression, as the judge made it "without pointing fingers at either the applicant or the respondent" (par. 13), a procedure that seems inconsistent with the remedy's nature.

A third variation is when the agreement authorizes or contemplates a specific action or outcome. In that situation, acts which otherwise would constitute oppression may not be. If the parties have specifically anticipated or even intended something, it cannot be a violation of their reasonable expectations. In *Thomas v. Beringia Tours Ltd.*, 1999 CarswellYukon 3, [1999] Y.J. No. 21 (Y.T. S.C. Mar 23, 1999), a

corporation's refusal to provide business records to one of its investors beyond what was required by law (since that investor was a competitor of the company's clients) was found not to constitute oppression in part because the unanimous shareholder agreement to which the petitioner had consented specifically stated that this would occur (pars. 23-26). In *Novel Energy (North America) Ltd. v. Glowicki*, 148 A.R. 161, 16 Alta. L.R. (3d) 26, 1994 CarswellAlta 14, 45 A.C.W.S. (3d) 180, [1994] A.W.L.D. 181, [1994] A.J. No. 14 (Alta. Q.B. Jan 07, 1994), debt financing, a corporate reorganization, and management bonuses were found not to be oppressive because they were each specifically contemplated in the unanimous shareholder agreement (pars. 122-123, 131, 133, 138).

All of the above scenarios assume that the term giving rise to the oppression claim is a restriction upon the directors, the quintessential function of the unanimous shareholder agreement. It is also possible that some other clause is at issue. Where the document anticipates or authorizes specific behaviours, those would presumably no longer violate the reasonable expectations of any of the parties. Where, however, the acts complained of constitute an unexpected abuse of general rights, oppression may be found. *Rosetown & District Community Bond Corp. v. Precision Metal Fabricating Ltd.*, 145 Sask. R. 231, 1996 CarswellSask 407, 64 A.C.W.S. (3d) 575 (Sask. Q.B. Jun 11, 1996) dealt with the general misuse of the powers of the directors, who relied upon a shareholder agreement (generally not directly referred to as "unanimous", but Kyle J. specifically referred to the Court's power to amend a unanimous shareholder agreement at par. 12) that locked them in place as the board (par. 5), while they proceeded to act oppressively (pars. 12-15). Kyle J. amended the agreement to allow the replacement of the directors (par. 16). The decision was successfully appealed, in *Rosetown & District Community Bond Corp. v. Precision Metal Fabricating Ltd.*, 152 Sask. R. 235, 1997 CarswellSask 251, 140 W.A.C. 235, 71 A.C.W.S. (3d) 1061 (Sask. C.A. May 06, 1997), on the basis that Kyle J. had been incorrect in asserting that there were no facts in dispute (par. 1) and determinations on the evidence were required (par. 5), but the choice of remedy itself was not rejected.

More specific terms of the agreement might also give rise to successful oppression claims if abused by the company. In *Deluce Holdings Inc. v. Air Canada*, 12 O.R. (3d) 131, 98 D.L.R. (4th) 509, 8 B.L.R. (2d) 294, 1992 CarswellOnt 154, 13 C.P.C. (3d) 72, 36 A.C.W.S. (3d) 724, [1992] O.J. No. 2382 (Ont. Gen. Div. (C.L.) Nov 10, 1992) (hereinafter "*Deluce*"), the corporation terminated the employment of a shareholder in order to trigger the share purchase clause in a unanimous shareholder agreement (pars. 7-12). Blair J. distinguished between strict legal rights and the wider interests that the oppression remedy protects (par. 51). The judge, based upon the entire agreement and the parties' intentions in enacting it, found that there was a reasonable expectation that the shareholder would only be terminated for legitimate business reasons; what had occurred was therefore held to be oppressive (pars. 49-50). In *U v. Watters Environmental Group Inc.*, 2012 ONSC 7019, 2012 CarswellOnt 15670, 224 A.C.W.S. (3d) 16, 42 C.P.C. (7th) 401, 10 B.L.R. (5th) 165 (Ont. S.C.J. Dec 11, 2012) (hereinafter "*Watters*"), the plaintiff alleged that his termination and subsequent mandatory share repurchase pursuant to the unanimous shareholder agreement was oppressive (pars. 4-7), and although the matter was referred to arbitration, the judgment implied that these acts could have been so. In an interim motion in *Tremblay c. Michot*, 2000 CarswellQue 312, J.E. 2000-438, REJB 2000-17047 (C.S. Que. Jan 06, 2000) (hereinafter "*Tremblay*"), the claim was made that cash calls and share issuances pursuant to the terms of a unanimous shareholder agreement had been oppressive insofar as they diluted the interests of a shareholder unable to participate; this argument was found to have enough potential substance to pass the first stage of the test for an injunction (pars. 29-38), although the balance of convenience determined that the matter could wait for trial (par. 39). In *Bury v. Bell Gouinlock Ltd.*, 48 O.R. (2d) 57, 12 D.L.R. (4th) 451, 1984 CarswellOnt 1265, 28 A.C.W.S. (2d) 151 (Ont. H.C. Nov 08, 1984) (hereinafter "*Bury*"), the company (without particular justification) invoked a term of the unanimous shareholder agreement that extended the period of the mandatory share repurchase of a departing employee, which due to securities law interfered with his attempts to seek new employment (par. 9). Eberle J. found that this was oppressive (par. 10). The fact that "the activities giving rise to the litigation were also the subject matter of a written contract between the parties" (par. 3) was an issue, and the judge concluded at par. 4:

Indeed, s. 247(3)(c) expressly provides that the court may make any order it thinks fit including without limiting the generality of the foregoing, 'an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;' this is a far-reaching provision. Since the court has been given power to remodel a shareholders' agreement, it seems to me that the court must also have authority under the section to set limits to the exercise of a power given by a shareholders' agreement, if the court finds that a particular exercise of such power has the effect aimed at by s. 247(2).

This reference to the court's authority to amend a unanimous shareholder agreement in apparent reference to the document in question is the sole use of that term in the judgment, which otherwise used only "shareholders' agreement". Beauregard and Auger, *supra* note 16, agreed that this case dealt with a unanimous shareholder agreement, since they used it as an example of oppression leading a court to amend one.

Finally, where the terms of the document grant rights to shareholders that do not correspond to restrictions upon the directors or even other governance issues, *e.g.* a shotgun clause, it is debatable whether the oppression remedy should be available to rectify misbehaviour. If the portions of a unanimous shareholder agreement that deal with non-governance issues are part of their "contractual" and not "corporate constitutional" aspect, following the analysis of *Duha SCC*, then the abuse of such rights would be better dealt with through whatever contract law principles apply, if any, *e.g.* unconscionability. In *119629 Canada Inc. v. Heath Holdings*, [1989] Q.J. No. 110 (C.S. Que. Jan 23, 1989), the shareholders' election of directors contrary to the terms of a unanimous shareholder agreement was found to not be a valid source for an oppression claim, because they were acting *qua* shareholder, and not exercising the powers of directors. Further, s. 247 (s. 240 at the time the case was argued, but renumbered shortly before judgment) was found not to apply, because it specified that complainants could ask the court to enforce a unanimous shareholder agreement against "a corporation or any director, officer, employee, agent, auditor, trustee, receiver, receiver-manager or liquidator", but did not list shareholders. Guthrie J. found that the ability of shareholders under the *C.B.C.A.* to apply to the court for liquidation if that right was granted to them in a unanimous shareholder agreement, without the necessity of proving fault on the part of the corporation and therefore potentially as a means to resolve disputes among the shareholders, was an isolated one. An election contrary to the unanimous shareholder agreement was also found not to trigger provisions in the statute concerning election controversies; interestingly, the judge noted that the election had not been contrary to the act, the articles, or the by-laws. Guthrie J. concluded that a civil action (for breach of contract) might be possible, but not the requested relief. Nonetheless, oppression claims are sometimes successfully brought against shareholders abusing powers granted them in a unanimous shareholder agreement that are not normally held by directors. For example, in *Woerly c. Banque de developpement du Canada*, 2003 CarswellQue 4943, EYB 2003-39869 (C.S. Que. Apr 03, 2003), the agreement provided that two minority investors would have representatives on the board and that decisions required their participation (par. 13). Those investors subsequently refused to select new directors after their initial ones resigned (par. 17). This paralyzed the company; the judge agreed that it could not act (pars. 20, 57). The majority shareholder brought an oppression action asking, *inter alia*, for the unanimous shareholder agreement to be rescinded (par. 31). Notably, *Woerly* contains analysis of the same issues sometimes discussed in the context of the oppression remedy as a tool for enforcing these instruments. As part of the motion to dismiss, one of the defendants argued that since the parties had agreed that the documents were their entire agreement, external evidence should be excluded (par. 39). Blondin J.C.S. found that, under the circumstances, the exterior evidence could help explain their contractual obligations, and specifically could help identify the majority shareholder's reasonable expectations (par. 42). The defendant also argued that this was not a proper oppression claim, and that it was really only an action for breach of contract (par. 43). The judge noted that the relief sought included things which were available under the oppression remedy

principles, most notably that it looks to the "reasonable expectations" that the shareholders have developed through their history together, and then it determines whether, in the context of those expectations, there has been oppression, unfair prejudice, or unfair disregard.¹²⁰³ The principles and precedents that have developed differ from the more strict, "legalistic" rules that often govern contract law, and are just as far from the relatively clear-cut implications of corporate constitutionalism, or the deference with which courts interpret directors' duties.

The most obvious expression of this is that an oppression analysis might not be limited to the restrictions in the unanimous shareholder agreement, instead placing them in the context of other factors that may alter their meaning or even override them entirely. The agreement might be treated not as enforceable in and of itself, but simply taken as evidence of the parties' positions. The Supreme Court of Canada in *BCE* listed "shareholder agreements" (without the "unanimous", though citing at least one precedent that specifically dealt with a unanimous shareholder agreement) as a possible source of reasonable expectations,¹²⁰⁴ immediately before referring to other documents that might also affect them,¹²⁰⁵ all of which were in turn part of a long list of factors the Court put forth that can shape such expectations.¹²⁰⁶ This context de-emphasizes the unanimous shareholder agreement as a significant tool for reshaping corporations, though it does not erase it entirely.

The corporate constitutional, contractual, and directors' duties approaches must often be identified via their characteristics. Oppression, by contrast, is identified by the explicit framing of the claim. As a result, it proves the most mutable of the four approaches; as will be discussed below, the oppression approach to enforcing unanimous shareholder agreements contains a variety of different sub-approaches, and indeed contains some cases that might more properly be viewed as belonging to one of the other models, framing of the claim notwithstanding.

but not through a civil action for contract damages, including the revocation of the unanimous shareholder agreement (par. 45). Further, the actions of the minority shareholders were preventing the company from acting (par. 57). Thus, Blondin J.C.S. found that a trial was necessary to determine whether there was a valid claim against the defendant shareholders concerning the way they were exercising their powers "as directors" ("à titre d'administrateurs", par. 58). This was a misformulation of the issue; their refusal to nominate new directors should have been classified as an action *qua* shareholder. That aside, the judge determined that, *prima facie*, the minority shareholders had acted against the other's rights and his reasonable expectations (par. 61). The allegations of harm required the weighing of evidence (pars. 62-63). The claim was therefore allowed to proceed (par. 73).

All of these examples illustrate that, in a number of a different ways, a unanimous shareholder agreement can lead to oppression even if, and possibly because, it is being followed. The power structures it can create are just as vulnerable to abuse as the default ones. While the consent of investors to the arrangement may place the result within their reasonable expectations, it is easily possible for what occurs to go beyond that, into the realm of oppression, unfair disregard, and unfair prejudice.

¹²⁰³ *BCE*, *supra* note 1143.

¹²⁰⁴ *Ibid*, par. 79.

¹²⁰⁵ *Ibid*, par. 80.

The next subsection will briefly discuss who the possible claimants under the oppression remedy might be and how that differs from the other approaches. This is followed by a more general discussion of the appropriateness of applying the oppression remedy to the enforcement of unanimous shareholder agreements. The subsequent three subsections each deal with one view of how these agreements interact with the "reasonable expectations" of the parties, a core component of the oppression remedy: as direct statements of their reasonable expectations, as one part of a larger fact pattern forming those expectations, and as the basis for expectations which might extend beyond the literal meaning of the terms themselves. Following the aforementioned subsections discussing how the oppression remedy might be used to enforce the parties' reasonable expectations as they relate to a unanimous shareholder agreement, two subsections deal with cases that are framed as oppression claims but that, in their analysis, do not follow a "reasonable expectations" model. The first group appear to be applying a corporate constitutional understanding, while the second is more varied. Finally, the last subsection on the oppression remedy concerns situations where the violation of a unanimous shareholder agreement was incidental to the alleged oppression, rather than the central component of it.¹²⁰⁷

¹²⁰⁶ Ibid, pars. 70-88.

¹²⁰⁷ There is a general question whether a unanimous shareholder agreement can explicitly remove the parties' ability to bring oppression claims. In addition to the general impact of such a provision, it would exclude this method of enforcing the agreement itself. Eliminating the oppression remedy is not a restriction upon the directors' powers, but might fall within the wider criteria found in some provincial statutes, and in any event, the documents can contain terms beyond their core function, assuming such clauses are either contemplated by statute or allowed by contract law. Proponents of a renegotiable "nexus of contracts" corporation would presumably support allowing the shareholders to unanimously eliminate the oppression remedy, but it is doubtful that this is currently permissible. As a matter of policy, permitting parties to generally waive it appears undesirable, as by definition that opens the door to the potential for abuse. If the shareholders desire allowing *specific* actions that they fear might potentially run afoul of the remedy, they should be allowed to do so, in the same way they can agree to perform specific acts that might otherwise violate the directors' duties; this accords with the "reasonable expectations" standard. Although caselaw on this point is not extensive, there is some indication that a unanimous shareholder agreement cannot eliminate the oppression remedy. In *Sumner* QB 1, *supra* note 260, at par. 238, Manderscheid J. wrote, "I question whether a person can contract out of their right to seek an oppression remedy via the BCA. This issue has been discussed but not determined by Canadian courts[...]" Based upon the wording of the document, he found it unnecessary to settle the issue and the question was not dealt with in the successful appeal. Further, it seems that while an agreement can move the oppression remedy from the jurisdiction of the courts to arbitration (*e.g. Watter, supra* note 1202), if the arbitration clause does not empower the arbitrator to settle oppression claims, the remedy endures and simply remains with the courts. (See *Scozzafava v. Prospero*, 2003 ABQB 248, [2003] 6 W.W.R. 351, 2003 CarswellAlta 401, 32 B.L.R. (3d) 105, [2003] A.W.L.D. 192, [2003] A.J. No. 354, 13 Alta. L.R. (4th) 236 (Alta. Q.B. Mar 14, 2003), par. 68; *Bouchan v. Slipacoff*, 94 O.R. (3d) 741, 2009 CarswellOnt 155, 173 A.C.W.S. (3d) 988, 58 B.L.R. (4th) 96 (Ont. S.C.J. Jan 15, 2009), at pars. 21-29; *Camirand c. Rossi*, [2003] R.J.Q. 1081, 2003 CarswellQue 555, J.E. 2003-828, REJB 2003-39879 (C.A. Que. Apr 07, 2003) generally; *Tremblay c. Acier Leroux inc.*, 2003 CarswellQue 1876, J.E. 2003-1539, REJB 2003-45796 (C.S. Que. Jul 14, 2003), par. 23 and *Tremblay c. Acier Leroux inc.*, [2004] R.J.Q. 839, 2004 CarswellQue 449, J.E. 2004-669, REJB 2004-55099 (C.A. Que. Mar 11, 2004), pars. 39-41 (only the former refers to the document as a unanimous shareholder agreement); *Deluce, supra* note 1202, pars. 71-72.)

6.(a) Eligible Parties to Enforce

The oppression remedy, like each of the other three approaches, has its own rules for when enforcement can occur. In the corporate constitutional model, theoretically anyone could rely upon the terms of the unanimous shareholder agreement; only the parties to the agreement could use it as the basis of a contract claim; the directors' duties can only be enforced by the corporation itself or through a derivative action; and those eligible to take advantage of the oppression remedy as a means of protecting themselves and their interests are listed in the statute: "any security holder, creditor, director or officer".¹²⁰⁸

The remainder of this section will focus upon investors as claimants under the oppression remedy, but it is also possible for creditors, directors, and officers to bring suits based upon the violation of unanimous shareholder agreements.¹²⁰⁹ The most likely scenario is one where they were also parties to the document, but even if they were not, their reliance upon its terms may have constituted a reasonable expectation worthy of protection or otherwise given rise to oppression. General references to "shareholders" as claimants under it should thus be read as potentially, if infrequently, applicable to these other groups as well.

While this might seem to offer the second-broadest list of potential claimants of any of the approaches, a threshold issue for enforcing unanimous shareholder agreements via the oppression remedy

¹²⁰⁸ *C.B.C.A.* s. 241(2). Technically, it is open to a "complainant" to bring an application (*C.B.C.A.* s. 241(1), *A.B.C.A.* s. 242(1), *M.C.A.* s. 234(1), *N.L.C.A.* s. 371(1), *N.B.B.C.A.* s. 166(1), *N.T.B.C.A.* s. 243(1), *N.B.C.A.* s. 243(1)), *O.B.C.A.* s. 248(1), *Q.B.C.A.* s. 450 (which uses the term "applicant"), *S.B.C.A.* s. 234(1), and *Y.B.C.A.* s. 243(1)). "Complainant" is defined by *C.B.C.A.* s. 238 as

- (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates, (b) a director or an officer or a former director or officer of a corporation or any of its affiliates, (c) the Director, or (d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.

It is given roughly similar (but not necessarily identical) definitions by *A.B.C.A.* s. 239(b), *M.C.A.* s. 231, *N.L.C.A.* s. 368(b), *N.B.B.C.A.* s. 163, *N.T.B.C.A.* s. 240, *N.B.C.A.* s. 240, *O.B.C.A.* s. 245 and 248(1), *Q.B.C.A.* s. 439, *S.B.C.A.* s. 231(b), *Y.B.C.A.* s. 240.

However, the oppression remedy specifically protects against conduct "that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer" (*C.B.C.A.* s. 241(2); see also *A.B.C.A.* s. 242(2), *M.C.A.* s. 234(2), *N.L.C.A.* s. 371(2), *N.B.B.C.A.* s. 166(2), *N.T.B.C.A.* s. 243(2), *N.B.C.A.* s. 243(2) *O.B.C.A.* s. 248(2), *Q.B.C.A.* s. 450 (which omits creditors), *S.B.C.A.* s. 234(2), and *Y.B.C.A.* s. 243(2)).

¹²⁰⁹ See *Casurina Ltd. Partnership v. Rio Algom Ltd.*, 2002 CarswellOnt 2746, 28 B.L.R. (3d) 44, [2002] O.J. No. 3229 (Ont. S.C.J. [Commercial] Aug 22, 2002) (hereinafter "*Casurina*") in Chapter Five for a case where a creditor brought an oppression claim for the *use*, rather than the violation, of a unanimous shareholder agreement.

is raised in *Khan v. Aquino*.¹²¹⁰ The applicants were entitled under the terms of a unanimous shareholder agreement to have their shares repurchased by the corporation.¹²¹¹ Other shareholders who were not applicants also had the same right.¹²¹² The corporation did not have the funds to repurchase any of the shares.¹²¹³ The application for oppression was dismissed because:

5 The onus is on the applicants under s. 234 to demonstrate that the actions of the corporation or its directors are or have been "oppressive or unfairly prejudicial to or that unfairly disregards the interests of..." themselves as security holders. This, they have failed to do. At the present time they are not being treated any differently than every other investor shareholder in the corporations who all have a right to have their shares repurchased under one clause or another in the unanimous shareholders agreement.

That oppression only occurs if shareholders are treated unequally was also considered in *Lyall*,¹²¹⁴ although there it was found that the applicant had distinguished himself because, while all were treated equally financially, he alone had had his rights to participate in control of the corporation violated.

This threshold would not exist in either the corporate constitutional or contractual approaches, which allow every shareholder to enforce the agreement, regardless of whether that particular investor's personal interests were *more significantly* impinged than any other. Given that unanimous shareholder agreements may restrict directors in ways that have nothing to do with differentiating between shareholders, this represents a crucial limitation on the use of the oppression remedy as an enforcement mechanism. Hypothetically, were this to be the only approach available, that would severely limit what the tool could accomplish.

6.(b) The Compatibility of the Oppression Remedy and Unanimous Shareholder Agreements

A central hurdle to the enforcement of unanimous shareholder agreements via the oppression remedy is whether it is even appropriate to integrate these two areas of law. The oppression remedy was meant to prevent directors and controlling shareholders from abusing their position within the corporation, but it is debatable whether it should create a parallel system for complaints that might otherwise be made, such as for the enforcement of legal rights granted by unanimous shareholder agreements. In a subsequent part of this chapter, this issue will be revisited in the context of defining the parties' "reasonable

¹²¹⁰ *Khan v. Aquino*, 143 Sask. R. 20, 1996 CarswellSask 225 (Sask. Q.B. Apr 11, 1996) (hereinafter "*Khan*").

¹²¹¹ *Ibid*, par. 2.

¹²¹² *Ibid*, par. 3.

¹²¹³ *Ibid*, par. 3.

¹²¹⁴ *Lyall v. 147250 Canada Ltd.*, 106 D.L.R. (4th) 304, 12 B.L.R. (2d) 161, 33 B.C.A.C. 64, 84 B.C.L.R. (2d) 234, 1993 CarswellBC 281, 54 W.A.C. 64, [1993] B.C.W.L.D. 2202, [1993] B.C.J. No. 874 (B.C. C.A. Aug 23, 1993) (hereinafter "*Lyall*").

expectations", but before even that point is reached, there is the question of whether the oppression remedy is the right method at all for the enforcement of an agreement, or whether the parties must use one of the other three approaches instead. As already mentioned, in *Hurley* it was determined that the oppression remedy was an inappropriate tool for enforcing a unanimous shareholder agreement; contractual principles should be used. Other cases, however, have allowed for the integration of the two; this section is replete with examples. But only a small handful of those judgments directly considered the question of whether oppression was the right tool for the task. The passage from *Hurley* that rejected use of the remedy in the context of a unanimous shareholder agreement was discussed in the section of this chapter dealing with the contractual approach, and the first case in this subsection, *Johnston v. Woodford*, also suggested that where a unanimous shareholder agreement governs the relationship between the parties with respect to a given issue, the oppression remedy may not be appropriate. The remainder of the judgments discussed, however, came to the opposite conclusion, for two different reasons. First, a pair of cases explicitly found that the oppression remedy should be open to the complainants because it offered a wider range of considerations and remedies. Second, a couple of judgments held that, despite the breach of an agreement, the *substance* of the case was the oppression one party had committed against the other. These represent the two most obvious justifications for why the oppression remedy might be a suitable approach to enforcing unanimous shareholder agreements, as opposed to the corporate constitutional, the contractual, or the directors' duties models.

The rejection of the oppression claim in *Johnston v. Woodford*,¹²¹⁵ as in *Hurley*, was on the basis that the existence of a "contractual" arrangement between the parties should preclude the court from applying that particular remedy. The plaintiff owned 75% and the defendant owned 25% of the shares of a corporation which was a franchisee.¹²¹⁶ They entered into a number of agreements, including a unanimous shareholder agreement.¹²¹⁷ The original agreement¹²¹⁸ of the parties was that the 25% shareholder would eventually own 100% of the shares.¹²¹⁹ The franchisor did not get along with the minority shareholder and threatened to terminate the franchise if he remained in charge.¹²²⁰ A shareholders' meeting was held where he was removed from his position as director, contrary to the unanimous shareholder agreement.¹²²¹ The

¹²¹⁵ *Johnston v. Woodford*, 2001 NBQB 50, 2001 CarswellNB 203, 17 B.L.R. (3d) 42 (N.B. Q.B. Jun 06, 2001) (hereinafter "*Johnston*"). The case also involved interpretation issues with the shotgun clause in the unanimous shareholder agreement; see. *Johnston v. Woodford*, 2000 CarswellNB 394, [2000] N.B.J. No. 394, 100 A.C.W.S. (3d) 577, 230 N.B.R. (2d) 188, 593 A.P.R. 188 (N.B. Q.B. Oct 11, 2000) and *Woodford v. Wilbur*, 2006 NBQB 421, 2006 CarswellNB 695, 153 A.C.W.S. (3d) 990, 307 N.B.R. (2d) 121, 795 A.P.R. 121 (N.B. Q.B. Dec 11, 2006).

¹²¹⁶ *Johnston*, *supra* note 1215, par. 5.

¹²¹⁷ *Ibid*, par. 5.

¹²¹⁸ It is unclear in which document, if any.

¹²¹⁹ *Johnston*, *supra* note 1215, par. 5.

¹²²⁰ *Ibid*, par. 9.

¹²²¹ *Ibid*, par. 9.

minority shareholder was subsequently excluded from the business.¹²²² He alleged that the other had caused the corporation to be run in a manner that was oppressive,¹²²³ and brought an application asking for an investigation and for his shares to be bought out.¹²²⁴ The majority shareholder argued that to allow the defendant to continue to run the company would have been its ruin.¹²²⁵

Rideout J. noted that a "third party" (namely the franchisor) was a possible cause for the problems between the parties¹²²⁶ and continued:

27 As a consequence, the Court is faced with a situation in which most, if not all of alleged "oppressive, unfairly prejudicial or unfairly disregarded" acts of the Respondents are either acts covered by contractual agreements or acts that could have been instigated by the Third Party. In these circumstances, should the Court order the remedies requested?

*Camroux v. Armstrong*¹²²⁷ was cited as authority for the proposition that the oppression remedy should not be applied where rights granted under a shareholder agreement were involved.¹²²⁸ This is a misapplication of *Camroux*, where the acts that were alleged to be oppressive were performed *in accordance* with an employment agreement and a shareholder agreement.¹²²⁹ The logic of *Camroux* would seem to have little application when the oppression alleged was a violation of the parties' agreements.

With regard to disclosure, Rideout J. said, "Clearly he has been provided with more than is normally available to a shareholder."¹²³⁰ This ignored that the defendant, under the unanimous shareholder agreement, was entitled to be a director and therefore to greater disclosure, but the judge found that all requested information had either been provided or was in the process of being provided.¹²³¹ The judicial conclusion was that an investigation was not warranted, for a variety of reasons including the existence of contractual agreements that would need to be interpreted at trial, the (misapplied) precedent of *Camroux*, the shareholder's access to documentation under a previous court order, the involvement of a third party,

¹²²² Ibid, par. 12 provides lengthy portions of the minority shareholder's affidavit summarizing the situation.

¹²²³ Ibid, par. 24.

¹²²⁴ Ibid, par. 1.

¹²²⁵ Ibid, par. 24.

¹²²⁶ Ibid, par. 26.

¹²²⁷ *Camroux v. Armstrong*, 47 B.L.R. 302, 1990 CarswellBC 351, [1990] B.C.W.L.D. 1253, [1990] C.L.D. 627, [1990] B.C.J. No. 1027 (B.C. S.C. Apr 23, 1990) (hereinafter "*Camroux*").

¹²²⁸ *Johnston*, *supra* note 1215, par. 28.

¹²²⁹ The agreement in *Camroux*, *supra* note 1227, although entered into by all the shareholders, was not a unanimous shareholder agreement. That tool was not even available under the relevant legislation, the *British Columbia Company Act*, R.S.B.C. 1979, c. 59. The relevant term involved a mandatory sale of shares between the shareholders (par. 10).

¹²³⁰ *Johnston*, *supra* note 1215, par. 29.

¹²³¹ Ibid, par. 29.

and the probability that the impugned acts had been necessary in the circumstances.¹²³²

Because of the determination that, on the evidence presented, no oppression had occurred, the case is not necessarily a decisive rejection of the court's ability to find oppression in situations where unanimous shareholder agreements apply. It does appear to represent authority for the position that, where a unanimous shareholder agreement exists, this may help to weigh against a finding of oppression, even when the agreement has been violated. On the other hand, the conclusion that the acts taken were necessary to save the corporation may have had greater weight. The rights of complainants under the oppression remedy might appear at first glance wider than those under the corporate constitutional or contractual approaches, but *Johnston* provides one example that such is not always the case; this will be returned to in following subsections.

While *Johnston* and *Hurley* largely rejected the oppression remedy approach, a number of other judgments have explicitly found that the existence of a unanimous shareholder agreement does not preclude this type of claim. The first explanation for this, as put forth by the following two cases, is that the considerations and available remedies under the statutory oppression remedy are wider than might be available through the direct (contractual) enforcement of the agreement itself, and plaintiffs should not be denied access to those benefits.

The corporation in *Curry v. CPI Plastics Group Ltd.*¹²³³ was the subject of a unanimous shareholder agreement that provided that the plaintiff would be the vice-president and that the corporation would enter into a specific distribution contract.¹²³⁴ Subsequently, the company purported to fire the plaintiff.¹²³⁵ It also cancelled the distribution contract and entered into a contract with the same company on different terms.¹²³⁶ A lawsuit was commenced on a variety of grounds.¹²³⁷ The personal defendants brought a motion to strike the statement of claim and dismiss the actions against them.

Regarding the oppression claim against all three personal defendants, Ground J. found:

11 Where the oppressive acts complained of include an allegation of breach of contract, a finding of oppression allows the court to grant a wider range of remedies than would be granted in a simple action for breach of contract. (See *Gottlieb v. Adam* (1994), 16 B.L.R. (2d) 271 (Ont. Gen. Div.)). For an order to be made against directors and

¹²³² Ibid, par. 34.

¹²³³ *Curry v. CPI Plastics Group Ltd.*, 2001 CarswellOnt 4344, [2001] O.J. No. 4870 (Ont. S.C.J. Dec 06, 2001) (hereinafter "*Curry*").

¹²³⁴ Ibid, par. 4. The unanimous shareholder agreement was signed by the plaintiff who owned 50% of the shares, one defendant who owned the other 50%, that defendant's father who had an option to purchase 10% of the shares and who controlled the other company in the distribution agreement, and that other company, as well as the corporation itself (par. 4).

¹²³⁵ Ibid, par. 6.

¹²³⁶ Ibid, par. 5.

¹²³⁷ Against the other shareholder, the other shareholder's father, the other corporation, and the Director/Chairman of the corporation (not a shareholder, but a shareholder of the other corporation (*Curry*, *supra* note 1233, par. 2)) who had purported to fire him.

officers personally, the court must be satisfied that there are acts pleaded as against specific directors or officers which, taken in the context of the entire pleadings, provide the basis for finding that the business of the corporation was conducted in an oppressive manner or that the powers of the directors of the corporation were exercised in an oppressive manner. [...]

The oppression claim was therefore allowed to proceed.¹²³⁸ It is undeniable that this method has a wider range of possible remedies than contract law would typically allow, but this only serves to further emphasize the question of whether it is the appropriate vehicle for enforcing unanimous shareholder agreements.

I use the phrase "enforcing unanimous shareholder agreements" loosely throughout this chapter, to indicate a court granting a legal remedy when a unanimous shareholder agreement has been breached.¹²³⁹

¹²³⁸ Another issues canvassed in the motion to dismiss (*Curry, supra* note 1233) was fiduciary duty, which was addressed as follows:

13 The plaintiff is alleging a breach of fiduciary duty by the personal defendants, in their capacity as directors and officers of EOS, to the plaintiff as a shareholder of EOS. It is trite law that directors and officers owe a fiduciary duty to the corporation but not to individual shareholders of the corporation unless there are special circumstances establishing a fiduciary relationship between the director and the individual shareholder. The criteria to establish such a fiduciary relationship are that the fiduciary has scope for the exercise of some discretion or power, that the fiduciary can exercise this power or discretion so as to affect the interests of the beneficiary and that the beneficiary is peculiarly vulnerable to the fiduciary having such discretion. No such allegations are pleaded in the statement of claim in this action. Accordingly, in my view, it is plain, obvious and beyond doubt that the claim against the personal defendants based on fiduciary duty cannot succeed and should be struck.

Breach of contract was also considered:

14 The contract alleged to be breached is the USA relating to EOS. The defendant Donaldson is not a party to the USA and, in my view, the claim for breach of contract cannot succeed as against Donaldson. With respect to PFC and SJC, it appears to me that the statement of claim and in particular paragraphs 12, 13 and 19 thereof contain allegations which, if proven, establish actions taken by the defendants PFC and SJC constituting a breach of the USA to which they are parties and it is not plain, obvious and beyond doubt that such claim for breach of contract could not succeed as against PFC and SJC.

Regarding the tort of inducing breach of contract, Gound J. found that because there were no allegations that any of the defendants were acting outside their roles as directors and officers to do anything independent of the breach itself, there were no grounds for that claim (par. 15).

¹²³⁹ Similar issues can arise even when there is technically no breach alleged. *Grace c. Martineau, Provencher & Associates Ltd* dealt with the question of whether the *threat* of violating a unanimous shareholder agreement in order to extract a waiver of other rights (not grounded in the agreement) was oppressive. Since the tactic had been successful, the unanimous shareholder agreement itself had never been violated. The ex-shareholder subsequently brought an oppression claim to invalidate the waiver. The trial judge (*Grace c. Martineau, Provencher & Associates Ltd.*, 1998 CarswellQue 345, J.E. 98-896, REJB

But there is a technical difference between enforcing the terms *per se* and allowing for a successful oppression action whose basis is those terms. Herold J. called attention to that distinction in *Reed v. Reed Monahan Nicholishen Investment Counsel Inc.*,¹²⁴⁰ with this comment early in the analysis: "In any event the law is clear that a S.247 application cannot be used to enforce the terms of a Shareholders' Agreement but the existence of the Agreement and the terms thereof are certainly relevant in putting the conduct of the parties into context."¹²⁴¹ No authority was cited for that proposition. The degree to which the courts are willing to maintain a distinction between the terms of the unanimous shareholder agreement and the parties' reasonable expectations will be returned to, but *Reed* drew explicit attention to the idea that the oppression remedy is not intended to be a tool of contractual enforcement *per se*. However, as explored in the following few subsections of this chapter on "Reasonable Expectations", the degree to which there is any real difference between enforcing the agreement itself and enforcing expectations based upon the agreement varies heavily, and at one extreme, it amounts to a "distinction without a difference".

As in *Curry*, *Reed* granted the complainant shareholder greater rights than the strict wording of the document would have allowed. The applicant was a 20% shareholder¹²⁴² who left his employment with the company.¹²⁴³ Under the terms of a unanimous shareholder agreement, 90% of the retained earnings of the corporation were to be distributed as dividends each year.¹²⁴⁴ Despite this, the company's practice for tax reasons was not to pay dividends but to instead pay management fees and bonuses to the four shareholders.¹²⁴⁵ Herold J. found that these fees and bonuses were in fact distributions to the shareholders.¹²⁴⁶ In the year that the applicant left the company, the other shareholders agreed that for one of the distributions, the applicant should receive only 7.5/12ths of 20%, representing the portion of the year he had worked.¹²⁴⁷ Herold J. determined this to be oppressive, because the distributions were truly for

1998-06491 (C.S. Que. Mar 09, 1998)) found the company's acts oppressive and nullified the waiver (pars. 34, 85). On appeal (*Grace c. Martineau, Provencher & Associates Ltd.*, [2001] R.J.Q. 2414, 29 C.C.P.B. 214, 2001 CarswellQue 2413, J.E. 2001-1787, [2001] J.Q. No. 4272, REJB 2001-26513 (C.A. Que. Sep 24, 2001)), the majority agreed that there had been oppression but upheld the waiver (pars. 15, 96, 143-159), with a dissent that the waiver was oppressive and that, given that it had been provided under protest, his rights were preserved (pars. 254, 255, 259). The latter opinion in particular was explicitly based upon the reasonable expectation of shareholders that directors would abide by a unanimous shareholder agreement, although with some apparent confusion between the rights under that agreement (which had not been breached) and the shareholder's rights under another contract (which were the subject of the waiver) (par. 255).

¹²⁴⁰ *Reed v. Reed Monahan Nicholishen Investment Counsel Inc.*, 1990 CarswellOnt 3456, [1990] C.L.D. 1153 (Ont. Gen. Div. Oct 05, 1990) (hereinafter "*Reed*").

¹²⁴¹ *Ibid*, par. 4.

¹²⁴² *Ibid*, par. 2.

¹²⁴³ *Ibid*, par. 3.

¹²⁴⁴ *Ibid*, par. 13.

¹²⁴⁵ *Ibid*, par. 13.

¹²⁴⁶ *Ibid*, par. 13.

¹²⁴⁷ *Ibid*, par. 14.

shareholding and not for work done.¹²⁴⁸ Therefore, the judge "[found] this conduct on the part of the respondent corporation to be conduct which unfairly disregards the interests of the applicant".¹²⁴⁹ The former employee had asked for an order that the corporation purchase his shares, but Herold J. found this too extreme, and instead ordered that he be paid the rest of the 20% of the distribution.¹²⁵⁰

This was not enforcement of the unanimous shareholder agreement in a contractual sense, since the decision went outside its terms. But it was also not a case where a larger pattern of oppression incidentally included a violation of a unanimous shareholder agreement as one component. It appears the judge granted a broad interpretation to the agreement, one broader than strict contract law might allow, but in a way that was nonetheless meant to enforce the spirit of its terms. This type of oppression approach will be considered at greater length in a subsequent subsection dealing with reasonable expectations.

The preceding two cases allowed the oppression remedy for what might be termed utilitarian reasons; it encompassed considerations and remedies that the judges perceived as otherwise unavailable, in large part because they were contrasting it with a contract claim. That can be taken as a broad endorsement of the merits of the oppression approach to enforcing unanimous shareholder agreements, presumably applicable in all or nearly all situations. This justification is distinct from a determination that the oppression remedy is appropriate in the specific circumstances, as in the following two examples.

In the Ontario Superior Court of Justice's decision in *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*,¹²⁵¹ discussed in more detail below, Wilson J. examined whether it was appropriate to deal with a wrongful dismissal as part of an oppression claim. The judge determined that it was in this case.¹²⁵² The applicant's decision to purchase a minority position in the corporation was inseparable from the terms of the unanimous shareholder agreement and the employment it guaranteed.¹²⁵³ The benefits of the positions he was guaranteed balanced out his minority status.¹²⁵⁴ Therefore, the two claims were linked.

The relationship between oppression and other methods of enforcing unanimous shareholder agreements was similarly examined in *Alofs v. Temple Insurance Co.*¹²⁵⁵ The defendant in *Fiorillo*¹²⁵⁶ (a case discussed in a later subsection), a former director, brought an application to have his insurance

¹²⁴⁸ Ibid, par. 14.

¹²⁴⁹ Ibid, par. 14.

¹²⁵⁰ Ibid, par. 15.

¹²⁵¹ *2082825 Div Ct, supra note 792.*

¹²⁵² Ibid, pars. 40-41.

¹²⁵³ Ibid, par. 43.

¹²⁵⁴ Ibid, par. 48.

¹²⁵⁵ *Alofs v. Temple Insurance Co.*, 2005 CarswellOnt 4983, 32 C.C.L.I. (4th) 40 (Ont. S.C.J. Oct 12, 2005) (hereinafter "*Alofs*"). The document in question was referred to as a "shareholders agreement" except in an extract from the pleadings in *Fiorillo v. Krispy Kreme Doughnuts Inc.*, 98 O.R. (3d) 103, 2009 CarswellOnt 3344, 178 A.C.W.S. (3d) 491, [2009] O.J. No. 2430, 60 B.L.R. (4th) 113 (Ont. S.C.J. [Commercial] Jun 09, 2009) (hereinafter "*Fiorillo*"), reproduced at par. 3. In *Fiorillo*, the document was regularly called a "unanimous shareholder agreement".

¹²⁵⁶ *Fiorillo, supra note 1255.*

company pay for his defence in that action under a Management Liability Insurance Policy.¹²⁵⁷ Only acts of the defendant as a director¹²⁵⁸ were subject to this insurance.¹²⁵⁹ At issue was whether all the claims made were so covered or only some.¹²⁶⁰ Siegel J. found that the essence of the entire lawsuit was oppression, and that specifically "the breach of contract claims based on breach of the shareholders agreement are 'derivative' claims in that they are subsidiary to the oppression claims".¹²⁶¹ However, Siegel J. also found (for the purpose of this suit) that the claims for misrepresentation and deceit did not represent separate causes of action but were also part of the oppression, which was not how those were ultimately dealt with in the resolution of the actual case.¹²⁶²

It is easier for the oppression remedy to co-exist with the other three approaches than for any of them to co-exist with each other. Allowing the use of the oppression remedy does not depend upon a particular conception of what the agreements *are*, but only how they affect the parties. But as these cases demonstrate, there is still a determination to be made as to whether it is appropriate for the oppression remedy to be used in enforcing unanimous shareholder agreements. An argument can be made that, where the parties have determined their rights by agreement, the oppression remedy is no longer the correct tool to govern the situation, and should neither enforce the document nor any parallel rights (which the agreement would implicitly preclude). On the other hand, the temptation to allow the oppression remedy may be strong, due to its flexibility and its emphasis on the particular expectations of the parties rather than abstract doctrines, as well as its range of remedies.¹²⁶³ Nonetheless, if the issue could be determined on the basis of clear legal principles, either corporate constitutional or contractual or even directors' duties, it is unclear why it is particularly appropriate *here* to replace those with a flexible, "equitable"¹²⁶⁴ approach. The alternative would be to limit the parties to one of the other three methods. The relative merits of the four models will be returned to in the concluding portions of this chapter, but for now, it suffices to say that the oppression remedy is in fact frequently used to handle violations of unanimous shareholder agreements, as the rest of this section demonstrates, and careful consideration of those cases may help us to understand whether it really does offer a superior means of enforcement.

¹²⁵⁷ *Alofs, supra* note 1255, par. 1.

¹²⁵⁸ Or otherwise specifically covered.

¹²⁵⁹ *Alofs, supra* note 1255, par. 20.

¹²⁶⁰ *Ibid*, par. 21.

¹²⁶¹ *Ibid*, par. 29.

¹²⁶² *Ibid*, pars. 32-34. See discussion of *Fiorillo* in the next subsection.

¹²⁶³ The list of available remedies for oppression can be found at *C.B.C.A.* s. 241(3) and includes s. 241(3)(c): "an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement". How judges interpret their broad discretion in crafting a remedy may also be influenced by which theory of enforcement they subscribe to. Even in this context, logic influenced by corporate constitutional or contractual principles may encourage judges to grant remedies typical of those models, while a truly unique oppression response might incorporate more flexible, even unpredictable solutions.

¹²⁶⁴ "Equitable" refers here to equitable principles, not equity investment. See note 48.

6.(c) Reasonable Expectations

The statutory definition of the oppression remedy is vague. As a result, the courts have had to develop methods of determining when conduct qualifies as oppression. One way of doing so, which has been endorsed by the Supreme Court of Canada¹²⁶⁵ is to look to the shareholders' "reasonable expectations" as distinct from their legal rights, and then determine whether those have been oppressed or disregarded. The Supreme Court has actually specified that "[s]hareholder agreements may be viewed as reflecting the reasonable expectations of the parties".¹²⁶⁶ Many of the cases dealing with unanimous shareholder agreements and the oppression remedy have adopted this approach, and used the agreements to inform an understanding of what the parties' reasonable expectations might be.

The specific relationship between the unanimous shareholder agreement and the shareholders' "reasonable expectations" therefore bears careful attention. If the terms of the agreement automatically double as the shareholders' "reasonable expectations", then the first stage of the oppression analysis becomes subsumed. Only at the second stage, determination as to whether the violation of a reasonable expectation amounted to conduct that oppressed, unfairly disregarded, or unfairly prejudiced the interests of the shareholder, does there remain a possibility that the oppression remedy would not collapse into direct enforcement of the document, but the case law indicates that when the agreements' terms are held to be "reasonable expectations", a finding of oppression, unfair disregard, or unfair prejudice almost always follows their breach. Conversely, if the "reasonable expectations" of the parties are subject to further scrutiny, including consideration of other factors beyond the document, then the oppression remedy gives rise to a unique system of analysis at both the first stage, where the "reasonable expectations" might differ from the terms of the agreement, and the second stage, where oppression, unfair disregard, or unfair prejudice may require more than a breach of those terms. Depending upon the facts, this can result in either a broader or narrower application of the rights and obligations specified in the agreement than standard rules of interpretation would allow. Unfortunately, the case law does not always make this distinction clear; it is possible that decisions which appear to limit reasonable expectations to the terms themselves merely reflect a factual determination that, on the evidence, there were no other significant factors influencing those expectations.

¹²⁶⁵ *BCE*, *supra* note 1143.

¹²⁶⁶ *Ibid*, at par. 79. Notably, the reference was to shareholder agreements generally, not unanimous shareholder agreements specifically, and other documents that might influence such expectations were also listed; there was, in other words, no indication that the specific statutory ability of the unanimous shareholder agreement to alter the corporation was being referenced or that the oppression remedy was being put forth as the best method for enforcing it. Two precedents were cited for the proposition that a shareholder agreement could affect reasonable expectations, without specific comment upon either case:

The next subsection examines cases where the terms of the agreement were treated as equivalent to the parties' "reasonable expectations" and where their violation was more-or-less automatically sufficient to pass the second stage of the test. The two following subsections deal with examples where the unanimous shareholder agreement was a factor in creating the parties' reasonable expectations, but not synonymous with them: first where the terms were considered in light of the full factual context that formed the parties' reasonable expectations, and then where the terms formed the basis of reasonable expectations that went beyond their contractual meaning.

6.(c)(i) The Terms As Reasonable Expectations

The simplest way of using the oppression remedy to handle the violation of a unanimous shareholder agreement is to treat the terms of that document as identical to the shareholders' reasonable expectations and the breach as equivalent to oppressing, disregarding, or prejudicing those expectations.

Is there then any difference between what the oppression remedy is accomplishing and enforcement of unanimous shareholder agreements? There might be, as discussed, some question about the appropriateness of using the remedy to give effect to an agreement *per se*. One possible answer is maintaining a distinction between actually enforcing the document itself and enforcing the expectations of the parties which, naturally, would be reflected by its terms. The cases in this section demonstrate the artificiality and practical unworkability of maintaining such a distinction in that context. If the contents of the agreement are all that is used to determine "reasonable expectations", then the former are not just evidence of the latter, they *are* the latter. The only significant qualifier that remains is the degree to which judges stress the individual *terms* as reasonable expectations, rather than compliance with the document as a whole; this may constitute the first theoretical step toward a more context-dependant application of the oppression remedy, as discussed in the subsection following this one. Regardless, many cases openly refer to compliance with a unanimous shareholder agreement as a reasonable expectation. Others, as will be explored, come to the same conclusion implicitly. In short, the oppression remedy is a fourth approach to enforcing unanimous shareholder agreements; it does not merely exist in parallel to them.

These factors are illustrated in *Fiorillo v. Krispy Kreme Doughnuts Inc.*¹²⁶⁷ A director of the corporation secretly sold all his shares and resigned,¹²⁶⁸ providing a false reason for doing so to another

Lyall, *supra* note 1214, and *Main*, *supra* note 1196, both discussed in this chapter.

¹²⁶⁷ *Fiorillo*, *supra* note 1255. Newbould J. also held that the individual director was liable for fraudulent misrepresentation to the one investor to whom he had directly lied (par. 83), but not to the other two to whom he had not lied directly (par. 90). For the same reason, Newbould J. found no negligent misrepresentation with regard to the other two shareholders (par. 113).

¹²⁶⁸ *Ibid*, par. 34.

investor¹²⁶⁹ and falsely suggesting he still owned shares to that same investor.¹²⁷⁰ The other shareholder and two further individuals in the same informal group subsequently invested additional funds.¹²⁷¹ When the corporation eventually became insolvent, they sued, claiming that they would not have invested had they known the former director had withdrawn his own funding.¹²⁷²

Under the terms of a unanimous shareholder agreement, any transfer of shareholdings needed to be approved by a "special shareholders resolution"¹²⁷³ which meant a resolution that had passed and was approved by all of the founding shareholders, who the plaintiffs were not among.¹²⁷⁴ Newbould J. found that, based upon the wording of the agreement, a "special shareholders resolution" still had to be passed by all shareholders (not *just* the founding ones).¹²⁷⁵ Instead, the share transfer had been approved at a directors' meeting, where the founding shareholders had been present and had all approved it.¹²⁷⁶ Newbould J. held that a fundamental right of shareholders was to vote, regardless of whether their votes would have changed the outcome.¹²⁷⁷ That had been denied the plaintiffs. Therefore:

158 In this case, the plaintiffs had, on a proper reading of the USA, a reasonable expectation that they would be entitled to notice of the transfer of Mr. Alofs' shares and a right to consider whether to consent in writing to the transfer.

The reasonable expectations of the shareholders were directly derived from the terms of the unanimous shareholder agreement. The second stage of the oppression analysis continued this trend, and here the impugned conduct was specifically identified as problematic because it was "a breach of the USA":

161 While the conduct of the directors may not have been sufficiently harsh to constitute oppression, it was in my view conduct that unfairly prejudiced the plaintiffs and unfairly disregarded their interests. It was a breach of the USA, a document fundamental to the rights of the plaintiffs, and a breach of the basic right of a shareholder to vote on shareholder matters. The directors were required by s. 134(2) of the *OBCA* to comply with the USA.

At both stages of the analysis, the unanimous shareholder agreement was directly used as the standard for determining whether oppression (or rather, "unfair disregard" and "unfair prejudice") had

¹²⁶⁹ Ibid, par. 41.

¹²⁷⁰ Ibid, par. 47.

¹²⁷¹ Ibid, par. 60.

¹²⁷² Ibid, par. 3.

¹²⁷³ Ibid, par. 138.

¹²⁷⁴ Ibid, par. 142.

¹²⁷⁵ Ibid, par. 146.

¹²⁷⁶ Ibid, par. 150. Further, since it was not a written resolution, it was found to be only "questionable" whether it satisfied the requirements of the unanimous shareholder agreement even if the other investors did not need to be allowed to vote (par. 152).

occurred. While the earlier passage could be interpreted to signify only that the agreement was evidence of the parties' expectations, in the latter one, breach of the agreement was found to be unfairly prejudicial and unfairly disregarded the plaintiffs' interests. The oppression remedy served as an enforcement tool for the terms of the agreement.¹²⁷⁸

A similar situation arose in *McAteer v. Devoncroft Developments Ltd.*¹²⁷⁹ There, the terms of a unanimous shareholder agreement required that a director's financial interest in loans the corporation was obtaining be disclosed to the shareholder and her consent obtained, which did not occur.¹²⁸⁰ Despite the finding that the terms of these loans were fair and enforceable¹²⁸¹ and that the company itself would have no claim for oppression,¹²⁸² the plaintiff's reasonable expectations were found to have been violated¹²⁸³ because "[t]he 'wrong to be remedied' was depriving [the plaintiff] of the choice, as a shareholder, to participate or not participate in the Loans which, while creating an opportunity for [the company], also created a risk for her as a trustee shareholder".¹²⁸⁴ She was denied not just the information, but the ability to make choices based upon it, including the choice of exiting the company.¹²⁸⁵ Although various other elements were collectively indicative of oppression,¹²⁸⁶ the judge stated that "the primary infringing act was

¹²⁷⁷ Ibid, par. 148.

¹²⁷⁸ The former director in *Fiorillo* who had sold his shares was also found to be liable for oppression, on the grounds that he had been a director at the time and, it was specifically noted, was thus bound by the unanimous shareholder agreement (*Fiorillo, supra* note 1255, par. 162). Newbould J. found it appropriate to hold all of the directors personally liable because they had benefited personally by buying the departing director's shares (par. 165). They had also benefited by keeping the departure a secret and thus encouraging more investment, which they wanted (par. 167). One director who had not been at the meeting in question was found by Newbould J. to have consented by virtue of the *Act*, since he did not dissent afterwards (par. 165). Another had resigned before this had happened and was therefore not liable (par. 169). Newbould J. concluded with regard to their personal liability:

168 The effort of the board of Kremeko to keep the sale by Mr. Alofs secret and not give notice to the shareholders was successful. The plaintiffs invested in the third tranche, which they would not have done had they been given notice of the sale to which they were entitled. Such notice and the right to consent or not was a reasonable expectation they had under the USA. See *BCE, supra*. Whether Kremeko would have been able to raise the needed funds from other investors is not the point. The rights of the plaintiffs were disregarded and they have suffered by making their investment without knowledge of the sale by Mr. Alofs. In these circumstances it is appropriate that the plaintiffs be compensated by the board members in the amount of their lost investment in the third tranche.

¹²⁷⁹ *McAteer, supra* note 1146.

¹²⁸⁰ Ibid, par. 441.

¹²⁸¹ Ibid, pars. 357-375.

¹²⁸² Ibid, pars. 449-450.

¹²⁸³ Ibid, par. 439.

¹²⁸⁴ Ibid, par. 450.

¹²⁸⁵ Ibid, par. 455.

¹²⁸⁶ Ibid, par. 448.

the lack of disclosure and consent contrary to the USA and *ABCA*".¹²⁸⁷ The agreement itself was therefore key to the oppression.¹²⁸⁸

The concept of compliance was further emphasized as the basis for the reasonable expectations of the shareholders in *Lyall v. 147250 Canada Ltd.*¹²⁸⁹ Two of the three directors caused a corporation to take unsuccessful legal steps, via a defence and counter-claim, to avoid fulfilling contractual obligations to sell its shares in a subsidiary to another company.¹²⁹⁰ The third director objected to this, and he went so far as to obtain separate counsel to support the opposing party's demand for specific performance.¹²⁹¹ Subsequently, the directors sued each other for their respective legal expenses in those proceedings.¹²⁹² The lone director took the position that the other two had behaved oppressively; the chambers judge found that they had not, since they had exercised their majority power in a good faith belief that they were acting in the interests of the corporation¹²⁹³ and because all shareholders had been treated the same.¹²⁹⁴ The chambers judge did not consider the implications of a unanimous shareholder agreement,¹²⁹⁵ so that decision was not an example of the directors' duties approach to this topic.

The judgment of the Court of Appeal as delivered by Legg J.A., on the other hand, was entirely centred around that agreement. Since the Court of Appeal did not explicitly reject the chambers judge's reasoning on its own terms- that absent a unanimous shareholder agreement there would have been no oppression- this decision provides an unusually clear demonstration that violating a unanimous shareholder agreement may be oppressive (or "unfairly prejudicial"¹²⁹⁶) even if the actions themselves are not. The centrality of the unanimous shareholder agreement to the successful appeal was emphasized by Legg J.A.:

52 The learned chambers judge did not refer in his reasons to the Unanimous Shareholders Agreement or to Lyall's rights under it. His reasoning proceeded on the basis that Lyall was bound by decisions of the majority of the shareholders. In my respectful opinion, he overlooked the provisions of the Unanimous Shareholders Agreement and the restrictions imposed upon the majority of the shareholders by that

¹²⁸⁷ Ibid, par. 448.

¹²⁸⁸ Oppression was found with regard to both directors for their failure to live up to the terms of the unanimous shareholder agreement, despite one of them relying upon representations from the other that he had told the shareholder about the situation. While the director who relied upon that representation was found liable for oppression, she was also entitled to an indemnity from the director who had made it (*McAteer, supra* note 1146, pars. 653-673).

¹²⁸⁹ *Lyall, supra* note 1214.

¹²⁹⁰ Ibid, pars. 8-23.

¹²⁹¹ Ibid, par. 25.

¹²⁹² Ibid, pars. 26-27. The two directors sued the third for his *pro rata* share of the corporate legal expenses.

¹²⁹³ Cited *ibid*, par. 28.

¹²⁹⁴ Cited *ibid*, par. 29.

¹²⁹⁵ Ibid, par. 52.

¹²⁹⁶ The third director conceded that the actions were not "oppressive" in the sense of the first part of the three facets of the oppression remedy, and based the claim on the other two (*Lyall, supra* note 1214, par. 53).

Agreement.

The agreement required unanimous approval of the directors for actions outside the ordinary course of business.¹²⁹⁷ Legg J.A. held that both refusing to perform the sale which the company had been formed to complete¹²⁹⁸ and entering into legal battles over it were outside the ordinary course.¹²⁹⁹ Therefore, those actions required unanimous approval.¹³⁰⁰

While Legg J.A. did not use the term "reasonable expectations", the analysis began with the statement that the third director "was entitled to expect from the other shareholders and directors that in making corporate decisions, they would respect and adhere to the provisions of the Unanimous Shareholders Agreement and would refrain from making corporate decisions contrary to the fundamental business purpose of the Company in the absence of [his] consent"¹³⁰¹ and that "acts of [the other directors] in repudiating the Share Purchase Agreement and then endeavouring to sustain their wrongful position in protracted litigation constituted a wrong to [him] in that they breached the Unanimous Shareholders Agreement entered into with him and abrogated his legitimate interests and expectations as a shareholder of the Company".¹³⁰² In other words, shareholders have a (reasonable) expectation that unanimous shareholder agreements will be complied with and their rights thereunder respected.

Legg J.A. also found that "[u]nder the Unanimous Shareholders Agreement, Duke and Klenman had no authority by themselves to effect such a fundamental change in the business of the Company"¹³⁰³ as repudiating the contract which was its central purpose. This is the logic of the corporate constitutional approach; one cannot validly do what one has no authority to do. However, rather than proceeding down that analytic path, these actions were found to have been unfairly prejudicial to the third director.¹³⁰⁴ Similarly, the litigation "was unfairly prejudicial to Lyall's interests and contrary to the Unanimous Shareholders Agreement".¹³⁰⁵

Legg J.A. noted that it was the agreement itself that formed the basis of a distinction between the shareholders; only one had had his rights under it denied.¹³⁰⁶ It was therefore irrelevant that they had all received the same financial compensation.¹³⁰⁷ *Lyall* provides an excellent demonstration of how the

¹²⁹⁷ *Lyall, supra* note 1214, par. 46.

¹²⁹⁸ The purpose of the company, according to the unanimous shareholder agreement, was to complete the sale (*Lyall, supra* note 1214, par. 42).

¹²⁹⁹ *Lyall, supra* note 1214, par. 46.

¹³⁰⁰ *Ibid*, par. 46.

¹³⁰¹ *Ibid*, par. 48.

¹³⁰² *Ibid*, par. 49.

¹³⁰³ *Ibid*, par. 50.

¹³⁰⁴ *Ibid*, par. 50.

¹³⁰⁵ *Ibid*, par. 51.

¹³⁰⁶ *Ibid*, par. 53.

¹³⁰⁷ *Ibid*, pars. 54-55. There was also a dispute as to whether the shareholders had actually received a higher price because of the litigation and the implications for the oppression claim if that were true, but the

existence of a unanimous shareholder agreement can be crucial to determining the parties' reasonable expectations, rendering oppressive acts that otherwise would have been legitimate.

Similarly, in *Agrium Inc. v. Hamilton*,¹³⁰⁸ it was found that compliance with the agreement was itself a reasonable expectation. The majority shareholder of the corporation was negotiating to buy the rest of a company's shares.¹³⁰⁹ At the same time, he entered into negotiations to sell the company to a third party,¹³¹⁰ without informing the minority shareholder.¹³¹¹ As part of the external negotiations, the majority shareholder provided confidential information to the potential purchaser,¹³¹² despite a unanimous shareholder agreement that forbade disclosing confidential information.¹³¹³ *Hawco J.* held that it was "not unrealistic or unreasonable for [the minority shareholder] to have expected that if [the majority shareholder] was giving any serious consideration to selling Flagstaff, he may well let [the minority shareholder] know"¹³¹⁴ (something not required by the unanimous shareholder agreement), but more importantly that, "[c]ertainly, he had a legitimate expectation that [...] Mr. Hamilton would abide by the terms of his shareholders' agreement and have the Board of Director's approve of such actions, as they were required to do under that agreement".¹³¹⁵ Later, the judge noted, "They had a unanimous shareholders' agreement. Shareholders should be entitled to assume their agreements will be honoured."¹³¹⁶ Yet again, reasonable expectations¹³¹⁷ included compliance with the terms of a unanimous shareholder agreement. Although other factors were also listed, such as the need for shareholders to be treated equally and the majority investor being aware that the other one had a concern that the shares would be "flipped",¹³¹⁸ the treatment of the unanimous shareholder agreement makes it seem probable that its violation alone would have been sufficient.

*Champion Hiltz Venture Capital Ltd. v. Seely's Motel Ltd.*¹³¹⁹ was slightly more ambiguous about whether compliance *per se* was an expectation or whether the agreement merely evidenced the parties'

Court of Appeal declined to make a finding on this point because of the evidence available and the parties' agreement to the form of the trial (par. 61).

¹³⁰⁸ *Agrium Inc. v. Hamilton*, 2005 ABQB 54, 2005 CarswellAlta 121, [2005] A.W.L.D. 1275, [2005] A.W.L.D. 1276, [2005] A.W.L.D. 1277, [2005] A.J. No. 83, 44 Alta. L.R. (4th) 177, 2 B.L.R. (4th) 3 (Alta. Q.B. Jan 19, 2005) (hereinafter "*Agrium*").

¹³⁰⁹ *Ibid.*, par. 7.

¹³¹⁰ *Ibid.*, par. 12.

¹³¹¹ *Ibid.*, par. 15.

¹³¹² *Ibid.*, par. 13.

¹³¹³ *Ibid.*, par. 2.

¹³¹⁴ *Ibid.*, par. 34.

¹³¹⁵ *Ibid.*, par. 34.

¹³¹⁶ *Ibid.*, par. 37.

¹³¹⁷ Assuming that the term "legitimate expectation" is not in any way different from "reasonable expectation".

¹³¹⁸ *Agrium*, *supra* note 1308, par. 37.

¹³¹⁹ *Champion Hiltz Venture Capital Ltd. v. Seely's Motel Ltd.*, 2004 NBQB 123, 273 N.B.R. (2d) 322, 2004 CarswellNB 134, 717 A.P.R. 322 (N.B. Q.B. Mar 26, 2004) (hereinafter "*Champion Hiltz*").

expectations. The plaintiff had invested in two related corporations, buying common shares of both and preferred shares of one, and entered into a pair of unanimous shareholder agreements (one for each company) with the two individuals who were the other shareholders of both.¹³²⁰ One of the agreements included: that the company would set aside a certain amount of money each month as a reserve to pay the Preferred Share dividends, that a shareholder's loan to one of the existing investors was reduced and payment was to be postponed (without interest) until all realty mortgages were paid in full, that dividends on the Preferred Shares were to be declared and paid annually, and that, after a certain date, the holder of the Preferred Shares could tell the company to retract them.¹³²¹ Despite this, dividends were only paid on the preferred shares in one year,¹³²² payments were made on the shareholder's loan,¹³²³ and the company did not retract the shares when asked to do so.¹³²⁴

In analyzing the claim for oppression, Savoie J. found that "pursuant to those [unanimous shareholder] agreements"¹³²⁵ the plaintiffs' reasonable expectations were that the shareholder loan would not be repaid, the reserve fund would be established, and the preferred shares would be retractable.¹³²⁶ In other words, on the basis of the agreement, there were reasonable expectations reflecting each of its terms.¹³²⁷ The wording implied that the reasonable expectations were directly derived from- rather than merely evidenced by- the document, but the division of the reasonable expectations into separate items rather than one unified expectation that the agreement would be followed may reflect an attempt to maintain at least a technical separation between the oppression remedy and contractual enforcement.

*Le Maitre Ltd. v. Seeger*¹³²⁸ appeared at first to do the same, with reasonable expectations defined via a list of the terms of the agreement (and therefore possibly in parallel to the document itself), rather than compliance *per se* as a reasonable expectation, but then it turned to the latter approach. Four investors together owned all the shares of a pyrotechnics manufacturing company in the United Kingdom.¹³²⁹ The same investors collectively owned 50% of the shares of a Canadian company formed to help distribute their product in North America; the individual respondent owned the other 50%.¹³³⁰ A variety of agreements were entered into, including a unanimous shareholder agreement (for the North American company both

¹³²⁰ Ibid, par. 7.

¹³²¹ Ibid, par. 10.

¹³²² Ibid, par. 12.

¹³²³ Ibid, par. 16.

¹³²⁴ Ibid, par. 21.

¹³²⁵ Ibid, par. 23.

¹³²⁶ Ibid, par. 23.

¹³²⁷ The personal defendant who had received the shareholders' loan payment was ordered to repay that money to the corporation and the corporation was ordered to redeem the shares (*Champion Hiltz, supra* note 1319, par. 29).

¹³²⁸ *Le Maitre, supra* note 1193.

¹³²⁹ Ibid, par. 3.

¹³³⁰ Ibid, par. 6. A variety of subsidiaries of this company (also respondents) were to do the actual distribution.

sides owned half the shares of) that provided that the individual respondent would be the company's sole director and that 75% of the shareholders needed to approve any material change in the nature of its business.¹³³¹ The company in the United Kingdom, the jointly owned company, and its subsidiaries also entered into a distribution agreement, which subject to a few limited exceptions required the North American companies to only sell products manufactured by the one in the United Kingdom and not to manufacture their own.¹³³² Contrary to these agreements, the director eventually entered into arrangements with a different North American manufacturer, attempting to have the company buy it and, despite the actual purchase falling through, taking over the operations of the other manufacturer and operating it as if it were a subsidiary.¹³³³ The other shareholders were not initially informed of this, and when they learned of it, first attempted to block it¹³³⁴ and then eventually decided that their best option was to allow the purchase of the other company's assets in order to convert it to exclusively manufacturing their products.¹³³⁵ As a result of this acquisition of manufacturing facilities, the North American companies' purchase of the United Kingdom-based manufacturer's products decreased even while the total North American sales increased.¹³³⁶ The director had also had the North American companies violate the exclusive distribution arrangement by selling products of yet a third manufacturer.¹³³⁷

The United Kingdom shareholders brought an action for oppression. Pepall J. first considered what their expectations were, and provided a list that ran parallel to the terms of the agreements without referring to it directly.¹³³⁸ Next came consideration of whether these were reasonable and a finding that

¹³³¹ Ibid, par. 10.

¹³³² Ibid, par. 13.

¹³³³ Ibid, pars. 20-23.

¹³³⁴ The subject of another judgment, *Le Maitre Ltd. v. Segeren*, 2007 CarswellOnt 3226, [2007] O.J. No. 2047, 33 B.L.R. (4th) 224 (Ont. S.C.J. May 24, 2007), regarding the applicants' earlier attempts to enjoin the purchase of the assets of the North American manufacturer. On roughly the same logic, though with less detail, Pepall J. held at par. 31 that there was a *prima facie* case of oppression:

In this case, the applicants meet the test regardless of the articulation of its application. Applying the test advocated by the respondents, the applicants have established a strong *prima facie* case of oppression. They are 50% shareholders who had entered a unanimous shareholders' agreement, a distribution agreement, a service agreement and a management agreement. In examining the interests of the shareholders as opposed to their strict legal rights, these agreements serve to inform the reasonable expectations of the shareholders.

¹³³⁵ *Le Maitre*, *supra* note 1193, par. 21.

¹³³⁶ Ibid, par. 27.

¹³³⁷ Ibid, pars. 17-18.

¹³³⁸ Ibid, par. 42. The list provided in the reasons for judgment read:

The UK Shareholders state that their expectations were that: i. Mr. Segeren would operate LMSE in a way that was mutually beneficial to LMSE's business as a distributor of LML's products and LML's business as a manufacturer of pyrotechnic products and FX machines; ii. the business of LMSE and its affiliates would be the sale of pyrotechnic

"[t]he agreements that governed the parties may be seen as a reflection of their reasonable expectations",¹³³⁹ and later similar language was used more specifically: "[The respondent] did not seek 75% shareholder approval as required by the USA which in turn reflected the parties' reasonable expectations."¹³⁴⁰ These passages suggested that reasonable expectations flow in parallel to the agreement but may find reflection therein, rather than consisting of compliance with the document itself. However, Pepall J. continued that:

the evidence, objectively viewed, supports a reasonable expectation that Mr. Segeren and the corporate respondents *would comply with the agreements*, would not manufacture pyrotechnic products, would not purchase and sell third party pyrotechnic products absent compliance with the terms of the agreements, and would inform and seek the UK Shareholders' approval (up to the 75% threshold) to the entering into of a letter of intent with Luna Tech and that absent same, they would not transition LMSE and the other respondents into companies manufacturing product that competed with that of LML.¹³⁴¹ (emphasis mine)

Adherence to the agreement *per se* was thus included as one of the reasonable expectations.¹³⁴²

The next issue was fashioning a remedy, which was again guided in part by the parties' reasonable expectations as embodied in the unanimous shareholder agreement. The applicants had asked for the

products manufactured by LML, and the manufacture and sale of FX machines, including those manufactured by LML; iii. the business of LMSE and its affiliates would not change without the consent of the UK Shareholders; iv. LMSE and its affiliates would only purchase and sell LML pyrotechnic products unless there was a demonstrated customer need for products which LML did not manufacture and LML accepted that it could not fulfill that need; v. LMSE and its affiliates would not, under any circumstances manufacture pyrotechnic products; vi. the respondents would honour all contractual and other obligations to LML and the UK Shareholders; vii. the respondents would not directly or indirectly manufacture or sell competing products sold by LML; viii. the respondents would not undertake actions to dilute or jeopardize the 'Le Maitre' trademark by selling competing products; and ix. the respondents would obtain the approval of the shareholders for their activities. They say that it was never expected that Mr. Segeren would operate LMSE and its affiliates in a manner that would undermine the North American sales of LML products or would compete with LML in North America and elsewhere in the world. In my view, the evidence does support the expectations asserted by the applicants.

¹³³⁹ Ibid, par. 45. In setting out the terms of the agreement that reflected these expectations, attention was also called to those that emphasized its limited exit provisions, presumably as further evidence that the shareholders had expected the document to be binding (par. 45). Also, some of the language used had the ring of corporate constitutionalism, such as the statement that "there could be no material change in the nature of the corporation without the approval of at least 25% of the UK Shareholders" (par. 45).

¹³⁴⁰ Ibid, par. 46.

¹³⁴¹ Ibid, par. 48.

¹³⁴² Having found oppression, Pepall J. went on to consider two arguments by the respondent. With regard to the eventual approval of the United Kingdom shareholders of the purchase of another manufacturer, the finding was that the acts were still oppressive at the time they occurred, but that the approval would be taken into account in fashioning a remedy (*Le Maitre*, *supra* note 1193, par. 49). The respondent also argued that what had occurred was in the best interests of the North American companies, as required by his statutory duties; that part of the judgment was discussed earlier in this chapter.

appointment of an additional director, which Pepall J. declined because "[i]t was also not within the parties' reasonable expectations that additional directors would be appointed absent consent by 75% of the shareholders".¹³⁴³ This was apparently a reference to the unanimous shareholder agreement, though a mistaken one, since that agreement named a director and the 75% requirement was in a different clause.¹³⁴⁴ Pepall J. also considered this to be simply a flawed remedy in the circumstances that would not solve the company's problems.¹³⁴⁵ The respondent had asked for an order that he purchase the applicants' shares,¹³⁴⁶ which Pepall J. was hesitant to grant given that he was the oppressor.¹³⁴⁷ So, despite it not being the relief requested, the applicants were given the option to buy the respondent's shares, failing which he could buy theirs.¹³⁴⁸ The terms of the agreement thus helped guide the choice of a remedy appropriate to the parties' reasonable expectations, although in coming to a decision, the judge had to consider not just the document but all the facts to determine an appropriate solution; other examples of that methodology and its implications are considered in the next subsection.

The present concern remains those cases that take the unanimous shareholder agreement as a representation of the parties' reasonable expectations and how they often blur the line between a reasonable expectation that the agreement itself will be followed and reasonable expectations which run in parallel with it. In *Claisse c. Simard*,¹³⁴⁹ a unanimous shareholder agreement¹³⁵⁰ provided that a shareholder's employment wages could only be reduced if the investors unanimously agreed.¹³⁵¹ Without his agreement, his wages and benefits were subsequently cut¹³⁵² and then he was fired, which Gervais J.C.S. classified as a 100% reduction in his wages contrary to the agreement.¹³⁵³ On an oppression claim, the judge said simply that he had "no hesitation in finding"¹³⁵⁴ that to continue to work for the company at his former salary was a reasonable expectation.¹³⁵⁵ His firing was found to have been illegal and oppressive.¹³⁵⁶ The Court of

¹³⁴³ *Le Maitre, supra* note 1193, par. 60.

¹³⁴⁴ It is possible that the judge concluded that these two terms had combined to create a reasonable expectation not directly derived from either of them, but given the lack of explanation to that effect, it is unlikely.

¹³⁴⁵ *Le Maitre, supra* note 1193, par. 60.

¹³⁴⁶ *Ibid.*, par. 55.

¹³⁴⁷ *Ibid.*, par. 58.

¹³⁴⁸ *Ibid.*, pars. 62-63.

¹³⁴⁹ *Claisse c. Simard*, 2005 CarswellQue 6608, J.E. 2005-1586, EYB 2005-93210 (C.S. Que. Jul 27, 2005) (hereinafter "*Claisse CS*"). The document was not generally referred to as a unanimous shareholder agreement in the judgment, except in an excerpt from the agreement itself at paragraph 78 and in reproduced correspondence at paragraph 155.

¹³⁵⁰ *Ibid.*, par. 29.

¹³⁵¹ *Ibid.*, par. 35.

¹³⁵² *Ibid.*, par. 153.

¹³⁵³ *Ibid.*, par. 340.

¹³⁵⁴ *Ibid.*, par. 396; my translation of "je n'hésiterais pas introduire ici le fait".

¹³⁵⁵ *Ibid.*, pars. 396-397.

¹³⁵⁶ *Ibid.*, par. 344; Certain other factors were also found to have been oppressive (par. 185).

Appeal,¹³⁵⁷ however, disagreed. They stated that the reasoning of the trial judge was erroneous.¹³⁵⁸ They summarized his equation of termination with a reduction in salary subject to the agreement,¹³⁵⁹ but declined to follow it. Instead, the Court of Appeal found that the employee's conduct had warranted termination.¹³⁶⁰ Given the explicit rejection of the trial judge's treatment of the termination, this could have been a fact-specific finding that it fell outside the terms of the agreement, but it seems at least as plausible that it was a ruling that, given sufficiently problematic behaviour by an employee, firing that individual may be justified and non-oppressive even if it violates a unanimous shareholder agreement.

*Stephanson v. Phillips*¹³⁶¹ is a final example that simultaneously suggests that compliance *per se* is a reasonable expectation and that reasonable expectations run in parallel to the agreement. The applicant alleged a variety of wrongful acts, some of them in violation of the (unspecified) terms of a unanimous shareholder agreement, including unauthorized payments, withdrawal of funds, the cancellation of the applicant's signing authority, and a failure to provide financial information.¹³⁶² After briefly summarizing the principles of the oppression remedy, Foley J. determined that "[i]n this case the disregard for the unanimity required by the unanimous shareholder agreement and the violation of a reasonable expectation that the corporation's bank accounts and signing authority will not be interfered with are oppressive".¹³⁶³

This is essentially the entire analysis regarding whether the acts specified justified a finding of oppression. Foley J. was unable to determine on the evidence whether the disbursements and withdrawals "violate the terms of the unanimous shareholder agreement or are or are not legitimate expenses experienced by the corporation or are otherwise beyond the shareholders [sic] expectations"¹³⁶⁴ and therefore ordered the corporation to first provide clearer financial records, after which the court would determine what to do.¹³⁶⁵ The division in both passages between the concepts of violating the agreement and the shareholder's reasonable expectations suggests that, notwithstanding the findings that linked the two, Foley J. did not completely equate them, although they were clearly seen as intertwined.

The preceding cases demonstrate the difficulty of distinguishing between use of the oppression remedy to enforce a unanimous shareholder agreement and giving effect to reasonable expectations that exist in parallel with the document but are not, technically, the agreement itself. In each of these cases,

¹³⁵⁷ *Claisse c. Simard*, 2007 QCCA 700, 2007 CarswellQue 4423, 165 A.C.W.S. (3d) 1036, 165 A.C.W.S. (3d) 1048, J.E. 2007-1118, D.T.E. 2007T-506, EYB 2007-119870 (C.A. Que. May 22, 2007) (hereinafter "*Claisse CA*"). The document was never referred to as a unanimous shareholder agreement in this judgment. See note 1349.

¹³⁵⁸ *Ibid.*, par. 152.

¹³⁵⁹ *Ibid.*, par. 152.

¹³⁶⁰ *Ibid.*, pars. 153-156.

¹³⁶¹ *Stephanson v. Phillips*, 2004 SKQB 356, 2004 CarswellSask 636, 1 B.L.R. (4th) 297 (Sask. Q.B. Aug 26, 2004) (hereinafter "*Stephanson*").

¹³⁶² *Ibid.*, par. 2. The respondent admitted to some of these acts and denied others (pars. 3-4).

¹³⁶³ *Ibid.*, par. 10.

¹³⁶⁴ *Ibid.*, par. 16.

however, those reasonable expectations were found to have actually been oppressed, disregarded or prejudiced. *Szijarto v. Densham*¹³⁶⁶ allows for the examination of this issue when the reasonable expectations of the plaintiff were *not* violated. The shareholders of the corporation had entered into a unanimous shareholder agreement.¹³⁶⁷ Eventually, only two of the original ones remained, and the shares of the departing investors ended up owned by a new company incorporated for the purpose, whose shares were in turn owned by the two remaining original shareholders.¹³⁶⁸ The plaintiff resigned from the corporation and sued to, *inter alia*, enforce provisions of the unanimous shareholder agreement requiring the other shareholder and/or the corporation to buy his shares of both the original corporation and the new one.¹³⁶⁹ The suit was brought both as a contract claim and an oppression claim.¹³⁷⁰ Spence J. determined that, since the relief sought was the purchase of the shares in both corporations, it was not necessary to determine whether the plaintiff might be entitled to the purchase only of his shares of the original company, as that was not what had been requested.¹³⁷¹ Given the remainder of the analysis, that decision was crucial.

Spence J. undertook to follow the standard rules of interpreting business contracts when dealing with the unanimous shareholder agreement, *i.e.* to give effect to their intent and thus give business efficacy to them.¹³⁷² Much of the remainder of the analysis was distinctly contractual, focussing on technical arguments about the meaning of the terms; the significant issue was whether the buy-back provisions of the unanimous shareholder agreement applied to the shares of the new company.¹³⁷³ It was a deemed party to the unanimous shareholder agreement, but that applied to the shares of the original corporation it held, not its own shares.¹³⁷⁴ Despite the plaintiff appearing *prima facie* to have a good case under the agreement for at least the sale of his shares of the original company, Spence J. denied the claim on an all-or-nothing basis; because there was no right to sell back the shares of the second corporation, the whole claim failed.¹³⁷⁵

The oppression argument was not seriously dealt with as an independent line of analysis. Spence

¹³⁶⁵ Ibid, par. 18.

¹³⁶⁶ *Szijarto v. Densham*, 2006 CarswellOnt 6643, 24 B.L.R. (4th) 153 (Ont. S.C.J. [Commercial] Oct 27, 2006) (hereinafter "*Szijarto* Sup Ct J"). In a brief oral decision, the Court of Appeal upheld this judgment, saying, "We reject the argument that the trial judge erred in failing to grant specific performance of the shareholders' agreement insofar as it related to the appellant's shares in the company. The trial judge was not asked to address the applicability of the shareholders' agreement to the appellant's personal shares apart from the applicability of the agreement to all of the shares that were in issue." (See *Szijarto v. Densham*, 2007 ONCA 747, 2007 CarswellOnt 7500, [2007] O.J. No. 4211, 37 B.L.R. (4th) 50 (Ont. C.A. Oct 25, 2007) (hereinafter "*Szijarto* CA"), at par. 2.)

¹³⁶⁷ *Szijarto* Sup Ct J, *supra* note 1366, par. 7.

¹³⁶⁸ Ibid, pars. 7-9.

¹³⁶⁹ Ibid, par. 55.

¹³⁷⁰ Ibid, par. 55.

¹³⁷¹ Ibid, par. 56.

¹³⁷² Ibid, par. 59.

¹³⁷³ Ibid, par. 62.

¹³⁷⁴ Ibid, pars. 65, 69.

¹³⁷⁵ Ibid, par. 80.

J. simply stated that, if there was no claim on contract grounds that the other shareholder or the corporation must buy the plaintiff's shares, then "there would seem to be no basis for the claim that in failing to make an offer for such a purchase, Cast or Densham has unfairly disregarded the interests of the Plaintiff".¹³⁷⁶ The analysis with regard to reasonable expectations was brief:

81 The dealings between the parties with respect to the proposed sale of the Plaintiff's interest in Cast were always directed entirely toward the effort to negotiate an acceptable contract for that purpose. Nothing in the course of those dealings gave rise to a reasonable expectation on the part of the Plaintiff that he would be able to effect that sale under the terms of the Shareholders' Agreement. Nor did he have any such reasonable expectation before those dealings commenced. In the absence of such a reasonable expectation there is no basis for a claim that the Plaintiff had an interest in that respect for the purposes of s. 248(2) of the *OBCA*.

Given the fact situation, it is arguable that the plaintiff had a reasonable expectation that all his shares in the *enterprise*, being both the original corporation and the new one, would be bought back upon his leaving. The dismissal of that argument was on the basis that he could not have had a "reasonable expectation" beyond the strict limits of his contractual rights, which extended only to one of the two companies. For good or ill, closely integrating "reasonable expectations" with the terms of a unanimous shareholder agreement can eliminate the flexibility that is sometimes seen as the chief virtue of this tool. In the next subsection of this chapter, the opposite perspective is explored.

The contrast between a flexible, responsive version of the oppression remedy and one where the exact wording of a unanimous shareholder agreement is determinative of the parties' "reasonable expectations" can be seen in the differences between the trial¹³⁷⁷ and appeal¹³⁷⁸ decisions in *Sieminska v. Boldt*. The case was not an attempt to enforce an agreement *per se*, but rather to assert that corporate acts allegedly taken in accordance with one were oppressive because they did not actually follow its terms. The document provided that if any shareholders became involved in divorce proceedings or entered a separation agreement, the company could force them to sell back their shares if the remaining investors so voted.¹³⁷⁹ The clause was invoked against two shareholders, who had left their respective spouses and become romantically involved with each other.¹³⁸⁰ One of them argued that it was inapplicable against her because, while she had become estranged from her husband, there was no separation agreement to trigger the

¹³⁷⁶ Ibid, par. 71.

¹³⁷⁷ *Sieminska v. Boldt*, 2013 SKQB 4, 2013 CarswellSask 31, 226 A.C.W.S. (3d) 739, 10 B.L.R. (5th) 107 (Sask. Q.B. Jan 02, 2013) (hereinafter "*Sieminska QB*"). This decision referred to the document only as a "shareholders agreement", but the appeal specified that it was a unanimous shareholder agreement.

¹³⁷⁸ *Sieminska v. Boldt*, 2013 SKCA 136, 427 Sask. R. 166, 2013 CarswellSask 859, 591 W.A.C. 166, 236 A.C.W.S. (3d) 114, 22 B.L.R. (5th) 173 (Sask. C.A. Dec 17, 2013) (hereinafter "*Sieminska CA*").

¹³⁷⁹ *Sieminska QB*, *supra* note 1377, par. 4.

¹³⁸⁰ Ibid, par. 5.

procedure.¹³⁸¹ Although the other shareholder was involved in divorce proceedings and the clause could apply to him,¹³⁸² he argued that since the first applicant was still a valid shareholder for the preceding reasons and she had not voted to invoke the clause, it had not properly been used against him either.¹³⁸³ They brought oppression proceedings.¹³⁸⁴

At trial, Acton J. first reviewed the reasonable expectations standard.¹³⁸⁵ Applying it to these facts, the judge found that the "intent of the parties"¹³⁸⁶ was to avoid the company being affected by shareholders' marital difficulties, and therefore the applicants could not reasonably have expected the clause would not be invoked against them; the lack of an actual separation agreement was only a technicality.¹³⁸⁷ In the alternative, it was found that even if their reasonable expectation had been that the clause would not be invoked if no actual separation agreement had been signed, its usage had been in the best interest of the company.¹³⁸⁸ Presumably, this meant that it was not oppressive, unfair prejudice, or unfair disregard. The second shareholder's claim consequently failed as well.¹³⁸⁹ Acton J. thus declined to use a strict interpretation of the document's wording as a substitute for the parties' reasonable expectations, instead making an actual enquiry into what they would reasonably have expected in all of the circumstances.

On appeal, things went differently. Caldwell J.A applied the rule that extrinsic evidence should only be used to interpret contracts when they were unclear and, this unanimous shareholder agreement having been clear, it was inappropriate to go beyond its literal wording.¹³⁹⁰ The shareholder's reasonable expectations were found to be that the clause would only apply in the specific circumstances set out.¹³⁹¹ Caldwell J.A provided a succinct summary of the logic guiding the decision, equating unanimous shareholder agreements with any other contract and their terms with reasonable expectations:

I say this because a unanimous shareholders agreement is simply a contract by and among shareholders and their corporation by which they agree to alter their statutorily prescribed relationships in accordance with their expectations. A unanimous shareholders agreement is therefore perhaps the best evidence of shareholder expectations at the time of its making. Moreover, the shareholder expectations it evidences must be presumed to have been reasonable because they received the unanimous agreement of the

¹³⁸¹ Ibid, par. 9.

¹³⁸² Ibid, par. 6.

¹³⁸³ Ibid, par. 7.

¹³⁸⁴ Ibid, par. 1.

¹³⁸⁵ Ibid, pars. 13-20.

¹³⁸⁶ Ibid, par. 24.

¹³⁸⁷ Ibid, par. 24. The delay in bringing the claim was also used as a factor to determine that no reasonable expectations had been violated (par. 26).

¹³⁸⁸ Ibid, par. 28.

¹³⁸⁹ Ibid, par. 30. Additionally, it failed because it was found that even if the first shareholder had voted, she would have been outvoted (par. 31).

¹³⁹⁰ *Sieminska CA*, *supra* note 1378, pars. 24-30.

¹³⁹¹ Ibid, par. 33.

shareholders and the corporation.¹³⁹²

Any distinction between corporate law and contract law was thus erased.

The shareholder's reasonable expectations having been established, Caldwell J.A. continued that what had occurred was unfair prejudice or disregard of those interests;¹³⁹³ each shareholder had, based upon the agreement, a reasonable expectation that the company would not take action against them without the proper procedures being followed, and the unanimous shareholder agreement enhanced rather than diminished those rights.¹³⁹⁴ The second shareholder's rights, pre-existing and enhanced, had also been transgressed, regardless of whether he would have been removed in any event, and that likewise violated his reasonable expectations in an oppressive manner.¹³⁹⁵

The Court of Appeal in *Sieminska* not only articulated that the terms of a unanimous shareholder agreement reflected the parties' reasonable expectations, but actively rejected the possibility that oppression requires a wider enquiry than a contract claim. In this conception, oppression might offer some procedural advantages and a wider range of remedies, but in a very real way, it lacks distinct substance as a means of enforcing a unanimous shareholder agreement. The underlying basis becomes nothing more than contract law.¹³⁹⁶

¹³⁹² Ibid, par. 33.

¹³⁹³ Ibid, par. 34.

¹³⁹⁴ Ibid, par. 35.

¹³⁹⁵ Ibid, par. 36. Caldwell J.A. did not, however, consider it appropriate under the circumstances to restore the shares. Instead, on the basis that the first shareholder no longer had a place in the company, it was ordered that her shares were to be purchased for current market value, rather than the formula in the agreement, because her shares could not validly be purchased through that clause (par. 38). The second shareholder, against whom the clause could be invoked, would have his shares purchased according to the formula, but recalculated at the current date, the original invocation having been invalid (par. 39). The oppression caused by the company's procedural irregularities was further compensated via a small damage award (par. 41).

¹³⁹⁶ A counterpart to the position that actions taken in accordance with the agreed-upon terms of a unanimous shareholder agreement must by definition be within the party's reasonable expectations is that they may violate such expectations but that they by definition do not do so in a manner that is oppressive, unfairly prejudicial, or unfairly disregarding of interests. In *Groupe Renaud-Bray inc. c. Innovation F.G.F. inc.*, 2014 QCCS 1683, 2014 CarswellQue 3835, EYB 2014-236339 (C.S. Que. Apr 10, 2014) (hereinafter "*Renaud-Bray*"), the terms of the unanimous shareholder agreement in question specified that the shares of a deceased investor were to be repurchased at a rate that, due to the company's massive increase in value over the years, would now take about forty years to complete in full, rather than about five as would have originally been the case (pars. 15-21). After establishing in a contractual analysis that the terms were not ambiguous and therefore must be applied literally (pars. 27-52), Turcotte J.C.S. rejected the argument that this could be oppressive. Although the judge did accept that the party's reasonable expectations were being frustrated (par. 57), it was found that this was not due to oppressive conduct, since the parties had clearly and freely consented to the terms that were now being applied (par. 61). Interestingly, one of the passages reproduced as precedent specifically stated that, however bad the deal might be, a party could not have reasonable expectations beyond its contractual rights (the more common formulation as to why a contract precludes the oppression remedy) and thus did not support the alternative logic used here. (The precedent was *AbitibiBowater inc., Re*, 2010 QCCS 6365, 2010 CarswellQue 14132, 197 A.C.W.S. (3d) 11, J.E.

The foregoing cases demonstrate the trend of simply equating the terms of a unanimous shareholder agreement with the parties' reasonable expectations. Even if one accepts this principle, however, it must be borne in mind that the meaning of the terms themselves is not necessarily beyond debate. Contract law developed because documents are subject to interpretation, and this does not cease to be true when they become the basis of oppression claims.

Whatever debate there may be about the appropriateness of using the oppression remedy as a means of enforcing unanimous shareholder agreements, this is one of the approaches that the courts have employed. When judges have equated unanimous shareholder agreements with the parties' reasonable expectations, it has proven unlikely that the courts would maintain any rigorous distinction between protection of expectations which simply happen to be exactly the same as the agreements' contents and enforcement of the agreements themselves. Treating the documents strictly as a convenient list of expectations would make their unique legal status irrelevant- a contract that did not meet the statutory criteria would serve the same purpose- but judges' willingness to explicitly or implicitly accept compliance itself as a reasonable expectation more obviously acknowledges that these are instruments specially designated by statute to limit directors (unless even other documents, which *shouldn't* bind directors, were treated the same way in the oppression context¹³⁹⁷). If what actually constitutes compliance (or the lack thereof) is determined via some other approach, such as contract law principles, then the oppression remedy model would be distinct primarily for its particular range of remedies.

The cases discussed in this subsection, however, were specifically limited to only those which treated the terms of the unanimous shareholder agreement and the parties' reasonable expectations as functionally identical. It is unsurprising that, when that occurs, the oppression remedy becomes a *de facto* tool for enforcing the agreement in a traditional sense. On the other hand, if the specific terms were evaluated for whether they actually qualified as "reasonable expectations" and they were weighed against other factors, that might appear to make the oppression remedy something other than a fourth method for enforcing unanimous shareholder agreements. I would argue, however, that this characterization remains accurate even then. As these cases have established, the oppression remedy *is* an approach to enforcing unanimous shareholder agreements. It simply happens to have, as the following subsection illustrates, its own particular set of principles for doing so.

6.(c)(ii) The Agreements in Context

2011-192, [2010] Q.J. No. 14,111, EYB 2010-184247 (C.S. Que. Dec 23, 2010) par. 156, cited at par. 60; that case did not deal with a unanimous shareholder agreement).

¹³⁹⁷ A comprehensive review of what judges have accepted as constituting reasonable expectations is beyond the scope of the current discussion.

If the terms of a unanimous shareholder agreement always constituted reasonable expectations, if there were never any other factors considered in determining said expectations, and if violating those terms (according, presumably, to a contractual standard) always qualified as oppression, unfair disregard, or unfair prejudice, then the oppression remedy would barely constitute a fourth distinct model for enforcing unanimous shareholder agreements. It would, in essence, collapse into something much like the contractual view, distinguished primarily by its much wider range of remedies, admittedly a significant feature.

But the three posits in the preceding paragraph do not fully describe the potential application of the oppression remedy to unanimous shareholder agreements. One can question whether the terms of the agreement constitute reasonable expectations, consider them in the context of other factors, and find that their breach is not necessarily oppressive. In so doing, the oppression remedy emerges as separate on every level from the other three approaches to enforcing unanimous shareholder agreements. A serious inquiry into the parties' reasonable expectations in all the circumstances, rather than a rote acceptance that the terms of the document can substitute for them, stands as an alternative to the principles of contract law, the rigidity of the corporate constitutional approach, and even the directors' discretion to determine the corporate interest in the satisfaction of their duties to it.

The two judgments in *Sieminska*, discussed in the preceding subsection, illustrate this dichotomy.¹³⁹⁸ The Saskatchewan Court of Appeal took the document as the definitive guide to the parties' reasonable expectations and declined to look beyond it. The trial judge, on the other hand, did not treat the oppression claim as a contract suit by another name, and attempted to discern the parties' reasonable expectations not through a narrow reading of the document's terms, but through a wider inquiry. The differing results demonstrate the significance of the exact role a unanimous shareholder agreement plays in an oppression analysis.

But even if the document's terms are not taken as synonymous with the parties' reasonable expectations, the oppression remedy remains a method of enforcing them, albeit one subject to its own considerations. That an agreement was not considered solely determinative of the parties' expectations does not mean that it was irrelevant to them, and often a serious examination of all the relevant factors leads right back to those terms.¹³⁹⁹

¹³⁹⁸ *Renaud-Bray*, *supra* note 1396, also considered whether reasonable expectations might extend beyond the rights explicitly found in a unanimous shareholder agreement's terms and specifically rejected this approach (pars. 53-62).

¹³⁹⁹ While not an oppression remedy case, the concept of reasonable expectations arising from a unanimous shareholder agreement in the context of all the circumstances was also considered in *Hollinger v. Prados-Hollinger*, 2012 QCCA 1682, 2012 CarswellQue 9746, EYB 2012-211490, 226 A.C.W.S. (3d) 406 (C.A. Que. Sep 21, 2012). The appellant asked the court to use its equitable jurisdiction to protect her reasonable expectations in the context of a liquidation (pars. 2-5). A unanimous shareholder agreement provided that if the applicant had need of money, the corporation would first redeem her shares and then issue new shares to her of nominal value upon which it would provide dividends at her request (par. 10). In determining whether reasonable expectations were at stake, the judge focussed on the wording of the

*Main v. Delcan Group Inc.*¹⁴⁰⁰ illustrates how a more contextual approach that treats a shareholder agreement as merely one element among several to be considered¹⁴⁰¹ can in the end lead to its terms being enforced, even while acknowledging that that result might not be inevitable. Lederman J. stated that "the Shareholders' Agreement is often viewed as reflecting the reasonable expectations of the shareholders",¹⁴⁰² thus accepting it as evidence of those expectations while implicitly limiting it to that role. The judge found that the spirit and letter of the agreement might be looked to in order to determine the intentions of the parties,¹⁴⁰³ implicitly equated here with their reasonable expectations. However, it was also noted that shareholders' expectations were not static and evolved over time, and that a "practical standpoint" must be used to determine them.¹⁴⁰⁴ The significance of these comments was not made explicit, but the implication is that the expectations found in the document might grow outdated, and that therefore subsequent developments can supersede its terms, at least insofar as the parties' reasonable expectations are concerned.

Lederman J. went on to consider reasonable expectations in light of both the terms of the agreement and other factors. The respondents argued that the applicants sought to take advantage of a "minor technical inconsistency"¹⁴⁰⁵ to assert a claim to a bonus paid after they were no longer shareholders, contrary to an established practice of the company.¹⁴⁰⁶ The applicants argued that, if the agreements had been followed, they would not have been bought out until after the bonuses had been paid.¹⁴⁰⁷ Lederman J.

agreement and its use of the term "require", which was held to mean to need and not just to want (par. 13), and the applicant was on the facts unlikely ever to actually need funds (par. 19). Although it was not explicit, the reference to external evidence to determine whether the applicant would need funds might be considered the inclusion of additional factors in the party's reasonable expectations, in conjunction with a contractual analysis of the agreement itself.

¹⁴⁰⁰ *Main, supra* note 1196. The document was never referred to explicitly in the judgment as a "unanimous shareholder agreement" (or synonym), but the case is important due to it being cited as a precedent in *BCE* alongside *Lyll* as to the relationship between shareholder agreements (including unanimous shareholder agreements) and the oppression remedy.

¹⁴⁰¹ The corporation had a program, set out in the unanimous shareholder agreement, whereby employee shareholders who wished to sell their shares to other employees would "bank" them with the company Secretary (*Main, supra* note 1196, pars. 9-10). The shares could only be purchased by other employees, unless the selling shareholder opted to sell them back to the corporation (par. 9). Despite this, the corporation at one point decided to purchase the currently banked shares, and notified the selling shareholders that it was doing so, using the power of authority already granted (pars. 16-20). This was not in accordance with the unanimous shareholder agreement and also violated the *C.B.C.A.* since there was not a separate offer made to each selling shareholder (par. 17). Subsequent to this share repurchase, the corporation paid a bonus to the remaining shareholders (par. 24). This bonus, unpaid to the bought-out shareholders, formed the basis of an oppression application.

¹⁴⁰² *Main, supra* note 1196, par. 29.

¹⁴⁰³ *Ibid*, par. 29.

¹⁴⁰⁴ *Ibid*, par. 30.

¹⁴⁰⁵ *Ibid*, par. 33.

¹⁴⁰⁶ *Ibid*, par. 33.

¹⁴⁰⁷ *Ibid*, pars. 38-29. The shareholder agreement would have needed to be amended and the requirements of the *Act* followed regarding separate offers.

accepted the latter position as their reasonable expectation¹⁴⁰⁸ and also examined the company's history of paying bonuses to recently bought-out shareholders, finding that although it was inconsistent, the corporation had always tried to treat investors fairly.¹⁴⁰⁹ That too was part of their reasonable expectations.¹⁴¹⁰ The oppression analysis concluded:

50 The case of *Patel, supra*, is authority for the position that the Shareholders' Agreement can be used as a guide when determining the reasonable expectations of the shareholders. In the case at bar, the 1994 transaction directly violated the provisions of the Shareholders' Agreement. In the absence of clear acquiescence by the Applicant shareholders, an action in violation of the Shareholders' Agreement and the *CBCA* cannot possibly be said to be reasonably expected by the Applicants. Nor can the Business Judgment Rule be applied in such circumstances in order to prevent judicial intervention.

51 There was a breach of the letter and spirit of the Shareholders' Agreement. Previous to the conduct in question, the Board had always sought timely shareholder approval and did not ratify its actions by way of retroactive amendments. It is my conclusion that the unilateral manner in which the sale took place and the blatant disregard for the opinions and positions of the retired employees support the Applicants' position that they could not have reasonably expected this sale or the associative exclusion from the shareholder bonus. As such, it follows that the transaction was oppressive, unfairly prejudicial to and/or it unfairly disregarded the interests of the retired shareholders, in contravention to s.241(2) of the *CBCA*. Consequently, an Order pursuant to s.241(3) of the *CBCA* should issue directing that DGI compensate the Applicants for their loss resulting from such conduct.

Unanimous shareholder agreements being characterized as "a guide" to reasonable expectations is linked to the use of other factors to fully determine them. They were ultimately found here to be fully consistent with the letter and spirit of the agreement, but that is not always the case.

A similar observation, that the agreement is to be looked to in determining the parties' reasonable expectations but is not solely determinative of them, appears in *Gibson v. Gibson*,¹⁴¹¹ a dispute arising between two brothers who owned equal shares of a corporation.¹⁴¹² One brought an oppression application to receive fair value for his shares, using the method specified in their unanimous shareholder agreement.¹⁴¹³ Flynn J. ordered that the issue be tried together with their pre-existing suit for wrongful dismissal.¹⁴¹⁴ In ordering that a full trial was necessary to determine the share value, despite the agreement, the judge noted that the related wrongful dismissal claim might be central to whether oppression

¹⁴⁰⁸ Ibid, par. 52.

¹⁴⁰⁹ Ibid, pars. 42-47.

¹⁴¹⁰ Ibid, par. 52.

¹⁴¹¹ *Gibson v. Gibson*, 2009 CarswellOnt 1015, 175 A.C.W.S. (3d) 59 (Ont. S.C.J. Feb 19, 2009) (hereinafter "*Gibson*").

¹⁴¹² Ibid, par. 2.

¹⁴¹³ Ibid, par. 12.

¹⁴¹⁴ Ibid, par. 37.

occurred,¹⁴¹⁵ and wrote:

32 But in determining whether the impugned conduct is oppressive or unfairly prejudicial to Scott, and in deciding an appropriate remedy, the court must look to the reasonable expectation of the parties.

33 While the court will look to the letter and spirit of the Unanimous Shareholders' Agreement to determine those reasonable expectations, one must be mindful in this case of the family dynamic in the business, a dynamic defined by a relationship between the principals of the business which may be very different than in a normal commercial setting.

[...]

35 In any event, this family dynamic and the reasonable shareholder expectations that flow from it can only come to full factual flower in a trial court.

The endpoint of such reasoning would be a finding that, in the circumstances, the parties' reasonable expectations did not include adherence to the unanimous shareholder agreement. This was arguably what occurred in *Cavendish Investing Ltd., Re.*¹⁴¹⁶ A shareholder had a right under a unanimous shareholder agreement to demand dissolution of the company, which it exercised.¹⁴¹⁷ When that dissolution did not occur, it brought an application under s. 214, which expressly provides that the court may order a dissolution upon an application by a shareholder who is granted the ability to ask for one in a unanimous shareholder agreement.¹⁴¹⁸ The applicant acknowledged that equity might limit its right and suggested that "reasonable expectations" were the guiding principles; it is unclear whether McMahon J. entirely accepted this framing of the issue.¹⁴¹⁹ The judge considered several precedents having to do with unanimous shareholder agreements, albeit none particularly similar to the case at hand; *Korogonas v. Andrew*¹⁴²⁰ was described as "the reverse of the present application",¹⁴²¹ but *Bury v. Bell*¹⁴²² and *Oakley v. McDougall*¹⁴²³ were acknowledged as cases that, while not precisely on point, illustrated that courts might

¹⁴¹⁵ Ibid, par. 25.

¹⁴¹⁶ *Cavendish Investing Ltd., Re.*, 190 A.R. 3, 42 Alta. L.R. (3d) 345, 29 B.L.R. (2d) 139, 1996 CarswellAlta 692, [1996] A.W.L.D. 867, [1996] A.J. No. 743 (Alta. Q.B. Aug 14, 1996) (hereinafter "*Cavendish*").

¹⁴¹⁷ Ibid, par. 8.

¹⁴¹⁸ Ibid, par. 11.

¹⁴¹⁹ Ibid, par. 23.

¹⁴²⁰ *Korogonas*, *supra* note 1202, described at that note.

¹⁴²¹ *Cavendish*, *supra* note 1416, par. 24.

¹⁴²² *Bury*, *supra* note 1202, as well as its affirmance in *Bury v. Bell Gouinlock Ltd.*, 49 O.R. (2d) 91, 14 D.L.R. (4th) 448, 48 O.R. (2d) 57 (Ont. Div. Ct. Feb 22, 1985).

¹⁴²³ Specifically, the second ruling of the Court of Appeal in the matter, *Oakley v. McDougall*, 14 B.C.L.R. (2d) 128, 37 B.L.R. 47, 1987 CarswellBC 144, [1987] B.C.W.L.D. 2411, [1987] C.L.D. 973, [1987] B.C.J. No. 1226 (B.C. C.A. Jun 05, 1987) (hereinafter "*Oakley CA 2*"). The case did not involve a unanimous shareholder agreement, but it was nonetheless identified in *Cavendish* as a precedent involving a

override the provisions of a unanimous shareholder agreement.¹⁴²⁴ McMahon J. noted that the language of the statute was permissive ("may") and not mandatory,¹⁴²⁵ and held that a variety of factors such as manifest unreasonableness and the interests of other classes of shareholders might lead a court to intervene.¹⁴²⁶ Because of a lack of evidence about the exact consequences of doing so, the judge declined to order a dissolution on this application.¹⁴²⁷ Instead, it was merged with an existing oppression suit between the parties.¹⁴²⁸ While not a particularly strong precedent, *Cavendish* was later cited in *Fulmer*, discussed below, as authority for the proposition that the courts were not required to enforce the terms of a unanimous shareholder agreement.

Gillespie v. Overs.¹⁴²⁹ was another oppression case where the court arguably departed from considering the terms of a unanimous shareholder agreement to include other factors, although the judge framed the analysis as an interpretation of the agreement, by turns extremely narrow and extremely broad, rather than it being outright overridden by circumstances. The two shareholders¹⁴³⁰ had both brought oppression applications against each other. There was a unanimous shareholder agreement in place which was relevant to both claims, and although Sutherland J. seemingly acknowledged its corporate constitutional status, noting that such instruments "restrict or reduce, to the extent stated in the agreement, the powers of management otherwise exercisable by the directors",¹⁴³¹ since the wrong had been framed by the parties as oppression, it was on that basis that the analysis proceeded.

Sutherland J. began by setting out the relationship between a unanimous shareholder agreement and the parties' reasonable expectations:

61 Where, as here, there are applications under s. 247 of the *OBCA* alleging oppression or unfairly prejudicial conduct, the corporate structure and the power relationships under what may be termed the "constitution" of the corporation are usually not the end of the matter but rather the beginning. However, such 'constitutional' matters form an important part of the continuing background against which the reasonableness of the expectations of the parties is to be considered, and in the light of which discretions conferred upon the Court by the *OBCA* are to be exercised if, but only if, the Court is satisfied that one or more of the threshold conditions in s.s. 247(2) are met. They must also be considered no relation to the question of whether such threshold conditions have

unanimous shareholder agreement. In *Oakley* CA 2, Lambert J.A. declined to resolve the deterioration of the parties' relationship via the shotgun clause in their agreement, because "it requires the equitable remedy of specific performance. The trial judge made no findings of fact about the conduct of the parties or where the equities lay" (par. 16). Instead, the parties who had been managing the company were granted the right to buy out the others (par. 18).

¹⁴²⁴ *Cavendish*, *supra* note 1416, par. 30.

¹⁴²⁵ *Ibid*, par. 21.

¹⁴²⁶ *Ibid*, par. 25.

¹⁴²⁷ *Ibid*, par. 34.

¹⁴²⁸ *Ibid*, pars. 37-38.

¹⁴²⁹ *Gillespie*, *supra* note 524.

¹⁴³⁰ Including shareholdings held via their respective holding corporations.

¹⁴³¹ *Gillespie*, *supra* note 524, par. 49.

been met.

A unanimous shareholder agreement was thus a part of but not determinative of the parties' reasonable expectations, a distinction that would prove crucial.

The minority shareholder was guaranteed in the agreement the position of "president of the corporation with such duties as the directors may from time to time determine".¹⁴³² The board had by resolution defined those duties as the management of the corporation.¹⁴³³ The unanimous shareholder agreement also specified that the two shareholders would be the only two directors, that a quorum would consist of two directors, and that the majority shareholder would have a casting vote.¹⁴³⁴ Disagreements had arisen as to the management of the company. The minority shareholder brought an action for oppression due in part to the majority shareholder attempting to intervene in the management of the corporation, despite the other's position as president.¹⁴³⁵ The majority shareholder, meanwhile, brought an action for oppression¹⁴³⁶ due to the minority shareholder's refusal to attend directors' meetings, without whom there could be no quorum, because at such a meeting the majority shareholder intended to strip the other of his management powers.¹⁴³⁷

With regard to the former claim, the decisive element was that the powers of the president could be defined by the directors.¹⁴³⁸ In Sutherland J.'s view, that was "subject [...] to the unwritten limitation that [he] could not be given duties and responsibilities of a menial or lowly nature or otherwise inconsistent

¹⁴³² Cited *ibid*, par. 50.

¹⁴³³ *Ibid*, par. 54.

¹⁴³⁴ Cited *ibid*, par. 50.

¹⁴³⁵ *Ibid*, pars. 117-126, 150-154.

¹⁴³⁶ Sutherland J. confirmed that a majority shareholder can be a complainant in an oppression application (*Gillespie*, *supra* note 524, par. 174).

¹⁴³⁷ *Gillespie*, *supra* note 524, pars. 104, 177, 182.

¹⁴³⁸ This can be contrasted with *Oakley v. McDougall*, 1986 CarswellBC 1500, [1986] B.C.W.L.D. 4206 (B.C. S.C. Apr 03, 1986), where an agreement (not a unanimous shareholder agreement) was interpreted to provide the exact opposite power. It required unanimous consent of the directors to an amendment to any of their employment contracts, which Bouck J. determined covered alterations to *e.g.* "their salary, hours of work, or position" (par. 27) but excluded firing them. The judge held that terminating their employment did not require unanimity, because, "[t]o give that interpretation to the agreement would allow either Oakley, McDougall or Fraser to continue as employees of Harbour Air no matter what wrong they did to the company" (par. 27). Although presented as a matter of interpreting the document, Bouck J.'s conclusion that firing them was not an amendment to the terms of their employment seems somewhat strained; it suggests a general unease with actually preventing the directors from removing an individual from office, which could occur under a corporate constitutional approach. The issue was not addressed in the two parts of the appeal, *Oakley v. McDougall*, 17 B.C.L.R. (2d) 134, 37 B.L.R. 31, 1987 CarswellBC 257, [1987] B.C.W.L.D. 991, [1987] C.L.D. 503, [1987] B.C.J. No. 272 (B.C. C.A. Feb 27, 1987) and *Oakley CA 2*, *supra* note 1423. (As discussed at note 1423, *Cavendish*, *supra* note 1416, at par. 30 specifically identified *Oakley CA 2* as dealing with a unanimous shareholder agreement, although that tool was not available under the relevant legislation.)

[with] the office of president",¹⁴³⁹ but it was possible for some or all of the duties and authority normally associated with the position to be removed¹⁴⁴⁰ or for the president to be placed entirely under the direct control of the board of directors.¹⁴⁴¹ Sutherland J. repeatedly emphasized that the minority shareholder was incorrect in asserting that the unanimous shareholder agreement granted him the power to manage the company, and that instead it granted him only the office of president, which merely happened at the time under a directors' resolution to have management authority over the company.¹⁴⁴²

It is unclear on what basis Sutherland J. made that determination: reasonable expectations (this being an oppression claim), an "officious bystander" interpretation of the contract (as was used elsewhere in the judgment) or simply a general principle. On the one hand, the result is not literally what appears in the document; a limitation against menial responsibilities is read in. On the other, the complete removal of all powers is apparently acceptable. It is doubtful that either "reasonable expectations" or an "officious bystander" would permit the guaranteed position of corporate president to be a merely ceremonial title. The unspoken logic appears to be a resistance to an upending of the standard corporate form that would allow for a minority shareholder to be permanently guaranteed the office of president even in the face of the majority's wishes. The document's explicit wording underlies the judge's reasoning that some degree of redefinition was contemplated, but even so, that was found to be subject to implied limitations, at which point the question that arises is how one decides where to draw the line.

This is even clearer when contrasted with how the other oppression claim was resolved. There, while acknowledging that the casting vote could be interpreted consistently with the minority shareholder having a *de facto* veto through the quorum requirement, Sutherland J. held that it was not in the reasonable expectation of the parties that the minority shareholder have the office of president insulated from the majority's control of his responsibilities and that an "officious bystander" would assume a contractual term preventing him from avoiding meetings.¹⁴⁴³ While Sutherland J. did not conflate the two standards, referring to the "officious bystander" as a relatively restrictive test in implicit contrast with "reasonable expectations", the use of contract law principles at all in the midst of this oppression analysis serves as another reminder of the co-existence of enforcement mechanisms and their influence upon one another.

It was found that the majority shareholder's interference in management decisions was not oppressive, but the minority shareholder's refusal to attend directors' meetings was, because the majority shareholder "already had ultimate management control all along".¹⁴⁴⁴ Sutherland J. further suggested that the minority shareholders' specific decisions on various issues "collectively [...] amounted to a situation

¹⁴³⁹ *Gillespie, supra* note 524, par. 53.

¹⁴⁴⁰ *Ibid*, par. 53.

¹⁴⁴¹ *Ibid*, par. 52.

¹⁴⁴² e.g. *Ibid*, par. 55.

¹⁴⁴³ *Ibid*, par. 118.

¹⁴⁴⁴ *Ibid*, par. 125.

justifying, in the sense of making not unfairly prejudicial, formal action by [the majority shareholder] to reduce the powers and responsibilities of [the minority shareholder] as president".¹⁴⁴⁵ It is unclear whether the reduction in powers might have been found oppressive absent these problematic decisions, *i.e.* whether the reasonable expectations were that the president's powers could be reduced *only if justified by his actions*. Elsewhere in the reasons for judgment, Sutherland J. suggested the majority shareholder could have stripped the president of all powers as a simple right, but there was some implication that that might be, absent a good reason, unfairly prejudicial. It was also determined that, following the normal rule, the court would not enforce specific performance of a contract of employment at the behest of either party.¹⁴⁴⁶ On this point, Sutherland J. confused the issue. The employer here was the corporation, not the majority shareholder or directors; if the unanimous shareholder agreement bound the board, then they could not direct the corporation to fire the president; if the corporation was not so directed, then the employer (the corporation) and employee would both be consenting to the continuation of the employment contract. The issue was one of corporate governance, not employment law.

On the other hand, by refusing to allow directors' meetings to occur, the minority shareholder was held to be behaving in an unfairly prejudicial manner.¹⁴⁴⁷ The relief granted was firstly that the board be increased to three, with the third appointed by the majority shareholder, but more importantly with respect to the present topic, it was found that it would not be oppressive for the directors to remove all of the president's powers and that "[f]rom there it is but a short step for the court to amend the Agreement to remove therefrom the provision stating that Gillespie is to be president of PPL".¹⁴⁴⁸ The judge wrote:

185 In my opinion, given the unfairly prejudicial conduct of Gillespie toward Overs it is appropriate and just that, in addition to the power to re-define the duties of the president so as to remove almost all his executive power, Overs as majority shareholder and as the person to be in a position to control the board of PPL should have the power to cause PPL to dismiss Gillespie as president. In other words the Agreement should be amended to delete the provision requiring that Gillespie be president of PPL. Upon such deletion the board of directors will resume its normal control powers with respect to the employment and dismissal of a president. Those corporate powers include the power to act in breach of contract, if that be the case.

Despite this, Sutherland J. did not actually order the minority shareholder removed as president, and left open the possibility that such removal might give rise to a wrongful dismissal claim.¹⁴⁴⁹ The judge also declined to remove the minority shareholder's guaranteed position as a director, though he left the

¹⁴⁴⁵ Ibid, par. 153.

¹⁴⁴⁶ Ibid, par. 169.

¹⁴⁴⁷ Ibid, par. 178.

¹⁴⁴⁸ Ibid, par. 183.

¹⁴⁴⁹ Ibid, par. 186.

matter open to a subsequent application.¹⁴⁵⁰

While the issue in *Gillespie* may appear to be fact-specific, turning upon an explicit right in the agreement to redefine the president's role, the implications of the case cannot be dismissed so easily. Given other guaranteed-position unanimous shareholder agreement cases, a line of reasoning that classified those as guaranteeing only a title and not a role¹⁴⁵¹ would be a significant development. It is difficult to justify such a position on either "reasonable expectations" or contractual interpretation grounds, but as this judgment demonstrated, such a result can occur. And this is because of the second significant aspect of this case, an apparent bias toward the normal corporate form. At its most extreme, and despite Sutherland J.'s framing, this leads to the parties' "reasonable expectations" being determined by the standard corporate power structure, not the unanimous shareholder agreement.

A similar issue and a similar analysis,¹⁴⁵² but the opposite conclusion, can be found in *Fulmer v.*

¹⁴⁵⁰ Ibid, par. 189.

¹⁴⁵¹ Unless, of course, the parties had the foresight to guarantee the role as well.

¹⁴⁵² A similar issue but a different analysis appears in *Timoschuk c. Indoco Industrial Door Co.*, [1989] R.J.Q. 1880, 1989 CarswellQue 1597, J.E. 89-1095, EYB 1989-77187 (C.S. Que. May 18, 1989). While also dealing with the oppression remedy, and specifically an application for an injunction under it (par. 1), the description provided of the criteria for the remedy did not include reasonable expectations (pars. 16-17) and the analysis did not refer to them. Similar to *Gillespie* and *Fulmer*, the unanimous shareholder agreement in *Timoschuk* named individuals who would be the company's chairman, president, and secretary-treasurer (par. 9) and one of the alleged grounds for oppression was that the individual who was named as president in the agreement had been constructively dismissed from his role as "Chief Executive Officer" by the board limiting his powers and refusing to grant him a raise (heading b above par. 37). Legault J. noted that, firstly, the agreement did not mention the term "chief executive officer" (par. 37), and that while it did grant him the position of "President", it was stated at par. 37 that there was "no indication that he was assured of the post no matter what for the rest of his days". (My translation of "S'il est vrai qu'au moment de la signature du document P-7, le titre de président fut assigné au requérant Timoschuk, il n'existe aucune indication que celui-ci était assuré de conserver ce poste contre vents et marées pour le reste de ses jours.") That aside, the case also considered whether it was necessary that the officers named would have the ability to exercise the functions normally attached to those titles (par. 38) and found that there was insufficient evidence to determine that (par. 38), indicating that the titles did not necessarily have to be associated with their typical authority. Furthermore, Legault J. found, based on various precedents, that as an employee/shareholder who had been constructively dismissed, the petitioner could not make use of the oppression remedy, because the wrong related to him in his capacity as employee, not shareholder (par. 39). The fact that a unanimous shareholder agreement on this point was in place was not considered specifically. The judge also commented that there was a personality conflict between the president and the majority shareholders, and that the point of the oppression remedy was not to settle personality conflicts among investors (par. 40). In contrasting this judgment with the others discussed in this section, one can see how "reasonable expectations" arising from a unanimous shareholder agreement lead to a very different analysis than is found in an oppression remedy case that does not focus upon them.

A second alleged violation of the agreement was also an issue, wherein the majority shareholders passed a motion that they be issued additional shares in contravention of the term specifying shareholdings and proportions (par. 41). The judge found that this was sufficient grounds for an oppression claim to pass the first stage of the test for an injunction (par. 44) but that it did not meet the second stage, because a final order would be sufficient to undo any harm done by the shares being issued (par. 47).

*Peter D. Fulmer Holdings Inc.*¹⁴⁵³ The applicant owned 49% of the company's shares.¹⁴⁵⁴ Under the terms of the unanimous shareholder agreement,¹⁴⁵⁵ the applicant was entitled to elect one director and the majority shareholder to elect two.¹⁴⁵⁶ Moreover, unlike in *Gillespie*, the agreement provided that the minority shareholder was "vested with the day-to-day operating control and management".¹⁴⁵⁷ McDermid J. found that the applicant "was president, (or had the day to day management and control of the corporation, which in all practical terms was the same thing under the by-laws)".¹⁴⁵⁸ The majority shareholder informed the other that he intended to have him removed as president if he did not resign (the implications of the unanimous shareholder agreement not being discussed at that time) and the minority shareholder, believing that the other had the power to remove him, resigned.¹⁴⁵⁹ McDermid J. determined that, under the circumstances, the resignation could not be treated as voluntary.¹⁴⁶⁰

The respondent argued that this was a dismissal for cause. Citing *Cavendish*,¹⁴⁶¹ McDermid J. wrote that "although counsel were unable to provide any authority directly on point, there appears to be some suggestion that the Court has a discretion to override part or all of a unanimous shareholder agreement where there is bad faith or fraud, or where it would be unjust or unfair to allow a party to insist on its strict legal rights".¹⁴⁶² McDermid J. essentially settled this question by boiling it down to the issue of "reasonable expectations", as part of the oppression remedy, to determine whether the agreement needed to be followed.¹⁴⁶³

McDermid J. found that the applicant's reasonable expectations were based on a combination of the agreement, the corporate by-laws, and the general understanding between the parties:

14 What were the reasonable expectations of the parties? From Fulmer's point of view, it was understood and agreed between him and Richardson that as long as Fulmer

¹⁴⁵³ *Fulmer, supra* note 756.

¹⁴⁵⁴ *Ibid*, par. 2 sub 29.

¹⁴⁵⁵ McDermid J. actually considered whether the agreement met the definition of a unanimous shareholder agreement, and found that it did (*Fulmer, supra* note 756, pars. 8-9).

¹⁴⁵⁶ *Fulmer, supra* note 756, par. 5.

¹⁴⁵⁷ *Ibid*, par. 7.

¹⁴⁵⁸ *Ibid*, par. 23. The by-law was set out more fully in paragraph 14, which defined the president as "the chief operating officer and, subject to the authority of the Board, shall have general supervision of the business of the corporation, and he shall have such other powers and duties as the Board may specify. During the absence or disability of the Managing Director or if no Managing Director has been appointed, the President shall also have the powers and duties of that office." In equating the powers granted by the agreement with the position of president, McDermid J. ignored the possibility that the applicant might theoretically have been moved to a different position with similar powers, such as Managing Director, a situation that admittedly did not actually occur. McDermid J. did note instead that no powers were taken from the minority shareholder as president to create a managing director (par. 15).

¹⁴⁵⁹ *Ibid*, par. 2 sub 34.

¹⁴⁶⁰ *Ibid*, par. 33.

¹⁴⁶¹ *Cavendish, supra* note 1416, discussed above.

¹⁴⁶² *Fulmer, supra* note 756, par. 12.

¹⁴⁶³ *Ibid*, par. 13.

was a shareholder of the corporation he would have the day to day operating control and management of it and, therefore, would be its president. He did not see himself entering into an employer/employee relationship with Richardson. Rather, in accordance with the partnership agreement outline, he and Richardson were going to be "partners", albeit in the context of a corporate entity. I find this was a reasonable expectation and perception on Fulmer's part. It was he who knew the steel business and brought Richardson into Misteelco. When Richardson and Fulmer bought Anderson's interest, Richardson became a shareholder in Holdings, which had been incorporated by Fulmer in 1988, when he and Anderson were operating Misteelco. Fulmer's reasonable expectations would be conditioned by his understanding with Richardson, by the partnership agreement outline and the shareholder agreement with Richardson, and by the by-laws of Holdings.

While the unanimous shareholder agreement obviously played a central role in McDermid J.'s analysis of the applicant's reasonable expectations, it was not an exclusive one. Expectations were "conditioned by" and "in accordance with" the agreements; they were not simply that the terms would be followed.

On the other hand, McDermid J. also considered the defendant's claims of his own reasonable expectations, which all amounted to variations on the applicant doing a good job as president.¹⁴⁶⁴ This is an idiosyncratic approach to oppression remedy analysis; it would be more appropriate to categorize these elements as qualifiers on the applicant's own reasonable expectations, rather than introduce them as competing ones.

McDermid J. was "not satisfied on a balance of probabilities that the corporation suffered any decline in profit under Fulmer's management or that they were sufficient to permit Richardson to engineer Fulmer's dismissal from the office of president in the face of the unanimous shareholder agreement".¹⁴⁶⁵ The implication was that there might be some decline in profit sufficient to allow for a dismissal contrary to a unanimous shareholder agreement. The analysis surrounding the applicant's honesty was more lengthy, and ultimately more qualified; he was found to have been dishonest in some small ways, but nothing that substantially affected the corporation,¹⁴⁶⁶ and despite the company's profitability, the respondent did have some legitimate grounds for complaint.¹⁴⁶⁷ Despite these issues, McDermid J. concluded:

23 One must bear in mind that Fulmer was not president under an express or implied contract of employment, or at the pleasure of the Board of Directors, or at Richardson's pleasure, as Richardson seemed to think. Fulmer was president, (or had the day to day management and control of the corporation, which in all practical terms was the same thing under the by-laws), by virtue of the unanimous shareholder agreement between himself and Richardson. It specifically provided that he was to enjoy the day to day operating control and management of the corporation so long as he was a

¹⁴⁶⁴ Ibid, pars. 16-22.

¹⁴⁶⁵ Ibid, par. 17.

¹⁴⁶⁶ Ibid, par. 18.

¹⁴⁶⁷ Ibid, par. 21.

shareholder. There were no qualifications attached to that absolute position. Given the essential nature of the relationship between Fulmer and Richardson, namely that of partners, and their joint intention as expressed in Article 4.03 of the shareholder agreement, I am not prepared to import into the agreement any additional terms. I take the agreement to express the intention of the parties completely and refrain from inferring that they intended that Fulmer might be dismissed for cause. Fulmer was not hired to be the President of Misteelco. He became President because he recruited Richardson to be his partner and they reached an agreement about his role that was expressed clearly and fully in Article 4.03. If either wanted to end their relationship, he could resort to the shotgun clause. Therefore, as repugnant as some of Fulmer's actions may have been to Richardson, I find that Richardson did not have the right in these circumstances simply to remove or cause the board of directors to remove the day to day operating control and management of the corporation from Fulmer by dismissing him from the office of president. Although Fulmer was motivated to some degree by a desire to retaliate against Anderson when he invoked the shotgun clause in their shareholder agreement, he also very much wanted to secure control of Misteelco in order to take charge of its operations and to continue in the steel business. Fulmer's reasonable expectation in aligning himself with Richardson was that he would have the day to day operating control and management of the corporation so long as he was a shareholder.

It is clear that elements of the corporate constitutional approach informed this oppression remedy analysis, *e.g.* absent a term in the agreement authorizing the dismissal of the president for cause, it was impossible for that to occur.¹⁴⁶⁸ Further, despite discussion elsewhere of other elements that might influence the parties' reasonable expectations, there was in this passage a finding that the agreement represented the complete intention (here apparently synonymous with reasonable expectations) of the parties and was not qualified by additional factors. Nonetheless, in context, this was a conclusion about the particular situation, after a serious consideration of the alternatives; the reasons for judgment explicitly, if inconsistently, suggested that other elements might be taken into consideration if appropriate, and that here, it was that very consideration of external factors that had led to the understanding that the agreement itself fully and accurately represented the parties' reasonable expectations.

Such expectations being formed not just by the terms of a unanimous shareholder agreement but also by surrounding circumstances was similarly what occurred in *King City Holdings Ltd. v. Preston Springs Gardens Inc.*¹⁴⁶⁹ Three investors in a corporation had a falling out.¹⁴⁷⁰ The applicant, who owned 40% of the corporate shares¹⁴⁷¹ but had voting control under the terms of the unanimous shareholder

¹⁴⁶⁸ The applicant also brought a separate claim for wrongful dismissal based on the terms of the unanimous shareholder agreement, but McDermid J. determined that there was always a risk of losing his position if the shotgun clause were to be employed (*Fulmer, supra* note 756, pars. 70-71). While that was not what had occurred, it was found that there was no entitlement to notice beyond that which the shotgun clause would have provided (par. 71).

¹⁴⁶⁹ *King City Holdings Ltd. v. Preston Springs Gardens Inc.*, 2001 CarswellOnt 1364, 14 B.L.R. (3d) 277, 104 A.C.W.S. (3d) 867, [2001] O.J. No. 1464 (Ont. S.C.J. Apr 06, 2001) (hereinafter "*King City*").

¹⁴⁷⁰ The three each owned shares through corporations of which they were the respective "principal" (*King City, supra* note 1469, par. 2).

¹⁴⁷¹ *King City, supra* note 1469, par. 2.

agreement,¹⁴⁷² sought a winding up order.¹⁴⁷³ One of the respondents, who owned 50% of the shares,¹⁴⁷⁴ opposed the winding up and asked instead that the applicant be removed as a director so that the respondent could manage the company.¹⁴⁷⁵ The respondent alleged that the applicant had breached the unanimous shareholder agreement by treating as a builder's lien funding which the agreement specified would be considered a shareholder's loan.¹⁴⁷⁶ MacKinnon J. found that the applicants had apparently breached the agreement and that this would be an issue for trial.¹⁴⁷⁷ However, the judge did not find that those actions negated it being just and equitable to wind up the corporation as they asked, because "the court should strive to craft a remedy that is both minimally intrusive and is consistent with the reasonable expectations of the parties".¹⁴⁷⁸ Immediately following that statement, and therefore presumably as an implicit determination of what formed the parties' reasonable expectations, MacKinnon J. noted that "[t]he unanimous shareholder's agreement provided during construction for Dancy to have the right to sell the property and for voting control of the Corporation."¹⁴⁷⁹ Still in the same apparent context, MacKinnon J. also found that the facts "equate to the concept of unforeseen circumstances in the shareholder's agreement".¹⁴⁸⁰ It was deemed inequitable to impose a shotgun clause due to one party's superior financial position, even though that party already had a right under the unanimous shareholder agreement to sell the lands.¹⁴⁸¹ MacKinnon J. determined that ordering the corporation be wound up and there be a trial regarding the breaches would be "minimally intrusive on the rights of the parties in the context of the terms of the unanimous shareholders' agreement, and is an effort [...] to meet the reasonable expectations of the parties".¹⁴⁸² While the analysis was not always explicit, it appears that the unanimous shareholder agreement served to inform part of the reasonable expectations, but what were allegedly "unforeseen circumstances" were also included. This raises the obvious contradiction of reasonable expectations regarding the unforeseen, a limit to what this method can handle.

In *Richards v. Richards*,¹⁴⁸³ as part of an oppression claim, a motion was brought for an injunction to *inter alia* enforce the terms of a unanimous shareholder agreement under which the applicant's consent would be required for various corporate acts.¹⁴⁸⁴ There was disagreement as to whether the agreement was

¹⁴⁷² Ibid, par. 14.

¹⁴⁷³ Ibid, par. 1.

¹⁴⁷⁴ Ibid, par. 2.

¹⁴⁷⁵ Ibid, par. 6.

¹⁴⁷⁶ Ibid, par. 14.

¹⁴⁷⁷ Ibid, par. 14.

¹⁴⁷⁸ Ibid, par. 16.

¹⁴⁷⁹ Ibid, par. 16.

¹⁴⁸⁰ Ibid, par. 16.

¹⁴⁸¹ Ibid, par. 16.

¹⁴⁸² Ibid, par. 18.

¹⁴⁸³ *Richards v. Richards*, 2013 NSSC 163, 331 N.S.R. (2d) 202, 2013 CarswellNS 481, 1051 A.P.R. 202, 229 A.C.W.S. (3d) 542 (N.S. S.C. Jun 10, 2013) (hereinafter "*Richards*").

¹⁴⁸⁴ Ibid, par. 129.

in force¹⁴⁸⁵ and evidence that it had historically been adhered to in part¹⁴⁸⁶ but not strictly.¹⁴⁸⁷ In analyzing whether this passed the first stage of the test for an injunction, Muise J. stated that a trial judge could ultimately find that the reasonable expectations of the parties were that the agreement should be followed "in spirit" as it allegedly had been historically,¹⁴⁸⁸ strictly given the current relationship of the parties,¹⁴⁸⁹ or that parts of the agreement might no longer be considered reasonable expectations in light of the situation and history;¹⁴⁹⁰ the judge also noted that, even if the conduct in question did not violate the agreement, it might be oppressive.¹⁴⁹¹ This (along with other alleged oppression) was sufficient to pass the first stage of the test for an injunction.¹⁴⁹²

On another interim motion for relief from oppression, *829194 Ontario Inc. v. Garibotti*,¹⁴⁹³ the requests included that the plaintiff be appointed to co-manage the company and financial disclosure.¹⁴⁹⁴ A shareholder agreement¹⁴⁹⁵ provided that the company have four directors, although it only had two, of which the plaintiff was one.¹⁴⁹⁶ For reasons that are not entirely clear, Broad J. characterized the relief requested as being in line with rights granted by the act and the shareholder agreement.¹⁴⁹⁷ Unless the document specifically promised the plaintiff the position of director, something not mentioned in the judgment, the relief was not in fact grounded in it, but rather in the position of director that he had been elected to.

Broad J. considered s. 253(1) of the *O.B.C.A.* (which allowed for applicants to ask the court to

¹⁴⁸⁵ Ibid, pars. 135, 138.

¹⁴⁸⁶ Ibid, pars. 147-152.

¹⁴⁸⁷ Ibid, par. 137.

¹⁴⁸⁸ Ibid, par. 289.

¹⁴⁸⁹ Ibid, par. 290.

¹⁴⁹⁰ Ibid, par. 291.

¹⁴⁹¹ Ibid, par. 292.

¹⁴⁹² Ibid, par. 310. While the remainder of the analysis was technically outside the ambit of the oppression remedy, being instead part of the law of injunctions, it is worth mentioning that despite determining that there was a credible oppression claim, Muise J. found that given the corporation's continued profitability (pars. 337-338), the second stage of the injunction test was not met as there was no risk of harm (par. 349). Even if there were, the judge found that the balance of convenience was against granting the relief sought, because of the danger that the applicant would assert her veto power under the agreement to pressure the other parties and not for "legitimate business reasons" (par. 424). While this decision was made on an injunction motion and not as a final determination of rights, the disregard for the terms of the agreement in favour of contextual elements is striking, and stands in contrast not just to the principles of a corporate constitutional approach, but even to injunctions enforcing negative covenants.

¹⁴⁹³ *829194*, *supra* note 895.

¹⁴⁹⁴ Ibid, par. 20.

¹⁴⁹⁵ The agreement was referred to as simply a "shareholders agreement" throughout. Despite this, Broad J. considered the procedure for applications to court under s. 253(1), albeit only to inform analysis of the oppression remedy in this context (*829194*, *supra* note 895, pars. 21-22). It is therefore debatable whether the judge considered the agreement in question a unanimous shareholder agreement in the statutory sense.

¹⁴⁹⁶ *829194*, *supra* note 895, par. 20.

¹⁴⁹⁷ Ibid, par. 20, and implicitly in pars. 22 and 23.

enforce the act, articles, by-laws, or unanimous shareholder agreements) and noted that the language was permissive, not mandatory.¹⁴⁹⁸ Similarly, it was stated that under the oppression remedy, the court could make any order it saw fit in the circumstances.¹⁴⁹⁹ The judge concluded that "[a]ccordingly, an interim order of this nature may deviate from or override the strict requirements of a shareholders agreement in order to achieve these objectives".¹⁵⁰⁰ Because "notwithstanding the Shareholders Agreement",¹⁵⁰¹ the defendant director had historically managed day-to-day operations, the least disruptive course was to allow him to continue to do so for the time being,¹⁵⁰² although the plaintiff director would be allowed to exercise the overall powers of the position with regard to non-routine matters.¹⁵⁰³ Despite giving some effect to the terms of the agreement, this is yet another example of an oppression analysis that treated them as one factor among many, to be enforced or not as the overall circumstances dictated.

These cases represent the point at which the oppression approach to enforcing unanimous shareholder agreements truly comes into its own. The corporate constitutional and contractual models both take the obligations in the agreement as a given, subject to very little qualification and minimal extrinsic evidence.¹⁵⁰⁴ Only the directors' duties approach is at all similar, contextualizing the restrictions as part of a larger responsibility, but the standard that governs the duty of care is quite distinct from the "reasonable expectations" of the shareholders. A wide "reasonable expectations" approach is therefore a true alternative. It possesses both the positive and negative aspects of any "equitable" doctrine: at best, a flexible sensitivity to the parties' situation, and at worst, an unpredictable replacement of defined legal rights with judicial sensibilities. While there are undoubtedly benefits to being responsive to realities beyond the confines of a written document, a "reasonable expectations" approach that puts too little stock in said agreement risks rendering it unenforceable (or driving parties to use other approaches, if those alternatives remain open) and replacing the rights the parties' bargained for with whatever the judge thinks is an appropriate "reasonable expectation" in the circumstances.

6.(c)(iii) Extending the Terms

The complement to treating the rights in a unanimous shareholder agreement as subject to interpretation or limitation based upon other reasonable expectations is allowing for them to give rise to expectations greater than the wording actually sets out. This is another departure from the corporate

¹⁴⁹⁸ Ibid, pars. 21-22. See the discussion of this topic at note 895.

¹⁴⁹⁹ Ibid, par. 22.

¹⁵⁰⁰ Ibid, par. 22.

¹⁵⁰¹ Ibid, par. 23.

¹⁵⁰² Ibid, pars. 23, 25.

¹⁵⁰³ Ibid, pars. 24, 26.

¹⁵⁰⁴ The officious bystander being one of the few.

constitutional or contractual approaches, which again would normally be associated with a more restrictive, literal reading of the document, and a further demonstration that the oppression remedy is a distinct model for enforcing unanimous shareholder agreements.¹⁵⁰⁵

That was exactly the path taken in *864789 Alberta Ltd. v. Haas Enterprises Inc.*¹⁵⁰⁶ The personal plaintiff had owned through his holding company (also a plaintiff) 10.1% of the corporation which employed him.¹⁵⁰⁷ Subsequent to a restructuring, his holding company instead became owner of shares of the employer's parent company.¹⁵⁰⁸ Under the terms of a unanimous shareholder agreement, if the personal plaintiff's employment was terminated (as it eventually was), his shares would be repurchased.¹⁵⁰⁹ Unfortunately, because the unanimous shareholder agreement entered into after the restructuring referred to employment with the parent company, but the employee had continued to receive payment and T4s from the subsidiary,¹⁵¹⁰ the parent corporation eventually took the position that he had never been its employee and therefore had not been terminated by it and thus the repurchase of his shares was not required.¹⁵¹¹ Shelley J. determined that the plaintiff had performed duties for the parent,¹⁵¹² but that regardless the unanimous shareholder agreement should be interpreted to mean employment within the corporate group in order to give it sense.¹⁵¹³ After the termination of the employee but before trial, both the parent company and subsidiary in question had had their assets distributed and were dissolved.¹⁵¹⁴ The employee had not taken advantage of any dissent rights, due to his position that he was no longer a shareholder.¹⁵¹⁵

Shelley J. considered whether this suit was properly framed as an oppression claim, and if so which defendants should be liable. After noting the basic principles of the remedy, including that it pertained to reasonable expectations¹⁵¹⁶ and that bad faith could be a factor but was not a necessary element,¹⁵¹⁷ the judge determined that a corporate restructuring that left a company unable to pay for breach of contract actions disregarded the applicants' reasonable expectation that a fund would be maintained to cover this potential liability, and that this was oppressive regardless of whether it was specifically intended

¹⁵⁰⁵ Some might say that in these situations, it is no longer the unanimous shareholder agreement being enforced, but that argument presupposes the validity of a contract law perspective.

¹⁵⁰⁶ *864789 Alberta Ltd. v. Haas Enterprises Inc.*, 2008 ABQB 555, 445 A.R. 90, 2008 CarswellAlta 1188, 172 A.C.W.S. (3d) 646, [2008] A.W.L.D. 4090, [2008] A.W.L.D. 4091, [2008] A.W.L.D. 4092, 98 Alta. L.R. (4th) 329 (Alta. Q.B. Sep 09, 2008) (hereinafter "864789").

¹⁵⁰⁷ *Ibid*, par. 5.

¹⁵⁰⁸ *Ibid*, par. 7.

¹⁵⁰⁹ *Ibid*, par. 8.

¹⁵¹⁰ *Ibid*, par. 6.

¹⁵¹¹ *Ibid*, par. 13.

¹⁵¹² *Ibid*, par. 40.

¹⁵¹³ *Ibid*, par. 41.

¹⁵¹⁴ *Ibid*, pars. 14-16.

¹⁵¹⁵ *Ibid*, par. 59.

¹⁵¹⁶ *Ibid*, par. 48.

¹⁵¹⁷ *Ibid*, par. 49.

to frustrate recovery.¹⁵¹⁸ In deciding which of the respondents bore liability, it was noted that all of them were parties to the unanimous shareholder agreement.¹⁵¹⁹ Shelley J. found the personal defendant, the sole director, had caused oppression, first by taking (and thus causing the corporation to take) an interpretation that would have rendered portions of the unanimous shareholder agreement meaningless, and then making "significant decisions regarding acquisitions and restructuring without consulting with the Applicants as required under the [unanimous shareholder agreement]".¹⁵²⁰ Shelley J. rejected the respondent's position that those obligations were meaningless and not intended to be binding, as that would require accepting that the parties to the document had not intended its provisions to have any effect.¹⁵²¹ Instead, the judge emphasized that unanimous shareholder agreements were entered into for a reason, which was here presumed to be rewarding the applicant for his work. The purposive, rather than literal, manner in which the unanimous shareholder agreement had created reasonable expectations was summed up thus: "The USAs provided an escape to all parties, in case they decided to part ways. It was a reasonable expectation that the shares would be purchased when Gibson was no longer personally involved in day-to-day operations." Additionally, apparently also as part of determining reasonable expectations, Shelley J. examined the respondents' conduct after the applicant's employment had ceased and found it consistent with that interpretation.¹⁵²² This is an example of how reasonable expectations can be intertwined with unanimous shareholder agreements without being synonymous with them; ultimately, the expectation was slightly wider than what the documents literally provided. This is the opposite logic and result to that found in *Szjarto*, discussed earlier, in which on similar facts, it was found that the reasonable expectations of the parties extended only to the rights literally provided.

Another case where "reasonable expectations" arising out of a unanimous shareholder agreement arguably went beyond its actual contents, *Ellins v. Coventree Inc.*,¹⁵²³ concerns an application brought by three minority investors not over a violation *per se* but over another shareholder's attempts to block enforcement of the agreement. The terms specified that the corporation and its corporate majority shareholder¹⁵²⁴ would focus on different aspects of the CDO business.¹⁵²⁵ A dispute arose as to whether the parent company had violated that agreement. A Special Committee of the board determined that the parent had violated the CDO limitation provisions.¹⁵²⁶ The unanimous shareholder agreement required that at

¹⁵¹⁸ Ibid, par. 51.

¹⁵¹⁹ Ibid, par. 52.

¹⁵²⁰ Ibid, par. 56.

¹⁵²¹ Ibid, par. 56.

¹⁵²² Ibid, par. 57.

¹⁵²³ *Ellins*, *supra* note 1161.

¹⁵²⁴ Technically, the corporate majority shareholder held its shares through a "wholly owned subsidiary" (*Ellins*, *supra* note 1161, par. 2).

¹⁵²⁵ *Ellins*, *supra* note 1161, par. 9.

¹⁵²⁶ Ibid, par. 21.

least one nominee director representing the parent corporation be at meetings.¹⁵²⁷ Presumably in order to frustrate events, the two nominee directors first refused to attend a meeting¹⁵²⁸ and then resigned, with the parent refusing to replace them.¹⁵²⁹ The parent company purported to hold a shareholders meeting at which four of the existing directors were removed from office, three new ones (all employees of the parent) were elected to replace them, and the size of the board was reduced.¹⁵³⁰ Lax J. held that this meeting violated provisions in the unanimous shareholder agreement requiring at least one employee shareholder be present¹⁵³¹ and provisions in the *Act* and by-laws requiring that shareholder meetings be chaired by a shareholder.¹⁵³²

These technical barriers aside, Lax J. held that the parent company's replacement of the board was oppressive, because "[t]he CDO Limitation is central to the reasonable expectations of [the] shareholders".¹⁵³³ It was further held that it was a triable issue whether those actions had been contrary to the best interests of all shareholders and not just oppressive to the minority.¹⁵³⁴ Lax J. ordered that the parent company appoint two replacement directors and take no other steps to affect the board composition,¹⁵³⁵ and also ordered a trial regarding the CDO limitation violation.¹⁵³⁶ The replacement of the board of directors was at a significant enough remove from the CDO limitation itself to raise a question as to whether that was an enforcement of a term of the unanimous shareholder agreement (through its status as a reasonable expectation) or whether the term created wider expectations that not only would the majority shareholder refrain from entering that aspect of the CDO market (the term) but would also not abuse its control of the corporation to prevent it from taking necessary legal action (beyond the scope of the term).

Finally, *Johnson v. Cava Secreta Wines & Spirits Ltd.*¹⁵³⁷ contained a variation. The agreement was not mentioned during the "reasonable expectations" portion of the analysis,¹⁵³⁸ but was referred to during the stage establishing that the shareholders' interests had been unfairly disregarded.¹⁵³⁹ The

¹⁵²⁷ Ibid, par. 26.

¹⁵²⁸ Ibid, par. 26.

¹⁵²⁹ Ibid, par. 28.

¹⁵³⁰ Ibid, par. 32.

¹⁵³¹ Ibid, par. 61.

¹⁵³² Ibid, par. 61.

¹⁵³³ Ibid, par. 52. There is some ambiguity as to whether the CDO Limitation *qua* term of the agreement was central to their expectations, or whether the CDO Limitation *qua* limitation was, although the use of the specific capitalized phrase suggests that it was the former.

¹⁵³⁴ Ibid, par. 52.

¹⁵³⁵ Ibid, par. 67.

¹⁵³⁶ Ibid, par. 66.

¹⁵³⁷ *Johnson v. Cava Secreta Wines & Spirits Ltd.*, 2011 SKQB 405, 378 Sask. R. 57, 2011 CarswellSask 745, 209 A.C.W.S. (3d) 842, 93 B.L.R. (4th) 171 (Sask. Q.B. Oct 26, 2011).

¹⁵³⁸ Ibid, par. 22.

¹⁵³⁹ Ibid, par. 38.

unanimous shareholder agreement guaranteed each investor one nominee on the board of directors.¹⁵⁴⁰ While that promise itself was not broken, the majority shareholder functionally ignored the board. This would probably have been oppressive in any event, but the existence of the unanimous shareholder agreement helped bolster the finding that interests were being unfairly disregarded, even though it only guaranteed board representation, which had technically been granted.

While each of these cases could arguably fit under a very broad, purposive approach to interpreting the documents in question, the "reasonable expectations" method of enforcing unanimous shareholder agreements makes it analytically easier to justify expansive readings. The meaning of the words need not be tortured nor somehow found ambiguous enough to require an "officious bystander"; it suffices to determine that the parties would not have reasonably expected this outcome. As with weighing the agreement against other "reasonable expectations", however, there is the possibility that gains in fairness may be traded off against increased uncertainty.

6.(c)(iv) Summation on Reasonable Expectations

The Supreme Court of Canada recently noted that the oppression remedy has two stages; the first involves consideration of the parties' reasonable expectations, and the second a determination as to whether the violation of those expectations has resulted in them being oppressed, unfairly prejudiced, or their interests unfairly disregarded.¹⁵⁴¹ Up to this point, my discussion of the oppression remedy has focussed upon cases that more-or-less proceeded in line with this methodology,¹⁵⁴² and in particular that emphasized "reasonable expectations" or some analogous term. Taken collectively, despite all their contradictions, they arise from a specific conception of the oppression remedy, and it is possible to treat them as one approach to enforcing unanimous shareholder agreements based upon protecting reasonable expectations.

If a unanimous shareholder agreement is in place and contains restrictions, those have an obvious relevance to the reasonable expectations of the shareholders. While it is theoretically possible to maintain a distinction between expectations that exist in exact parallel with the terms of the agreement and the agreement itself, the case law demonstrates that, in practice, the two are largely inseparable. To enforce one is to enforce the other. What therefore makes the oppression remedy a distinct fourth approach to enforcing unanimous shareholder agreements is that the "reasonable expectations" of the parties do not have to precisely correlate with the document's terms. The surrounding circumstances, existing relationships, changes since the documents were enacted, *et cetera*, are all also considerations in determining what the parties can expect. Further, "reasonableness" itself provides a unique standard by

¹⁵⁴⁰ Ibid, par. 7.

¹⁵⁴¹ *BCE*, *supra* note 1143.

¹⁵⁴² Although many of them predate that particular authority.

which to interpret the restrictions contained in a unanimous shareholder agreement. Sometimes all of these will reinforce that the document reflects the parties' expectations, but not always.

This method thus allows for different outcomes than either the strict nullification of unauthorized acts through the corporate constitutional model or the principles and remedies of contract law. "Reasonable expectations" in the circumstances may not include some terms of the document, or might be variations upon them, and it is possible for the agreement to give rise to expectations beyond its actual contents.

The second stage of the test has received less attention, but even if there are "reasonable expectation" based upon a unanimous shareholder agreement, their breach in some circumstances might not constitute conduct that was oppressive, unfairly prejudicial, or unfairly disregarding of interests. Again, this would be a contextual determination, based upon all of the surrounding facts.

Judgments using this method can take into account considerations beyond the document and may come to conclusions that are *prima facie* inconsistent with it, but this remains nonetheless a model for enforcing unanimous shareholder agreements. That its principles differ from, for example, contract law is the *point*. A context-dependant approach to enforcement is still an approach to enforcement.

Like the previous three, the oppression model suggests particular understandings of this legal tool's nature. But while the others each presented a single theory- that it was a fundamental rearrangement of power, that it was a contract, that it was part of the directors' existing obligations to the company- there are two possible variations of what the unanimous shareholder agreement *is* in this paradigm. On the one hand, it might be nothing more than a list of agreed-upon items to serve as evidence of expectations. If that is all that it is, then its special statutory status is irrelevant; even a document that failed to meet the legislative requirements could serve as a record of the parties' expectations.¹⁵⁴³ On the other hand, the very

¹⁵⁴³ It is obvious that the parties' reasonable expectations can, in some circumstances, arise from or be reflected in other documents, the most famous being perhaps the trust document in *BCE*, *supra* note 1143. However, it is equally obvious that the unanimous shareholder agreement's inclusion in corporate statutes was meant to create a tool with the capacity to restrict the corporation in ways other documents would not. Focussing on the oppression remedy as a means of enforcing these agreements blurs that. Perhaps the most explicit indication of this is in *Doucet v. Spielo Manufacturing Inc.*, 2009 NBQB 196, 352 N.B.R. (2d) 1, 2009 CarswellNB 305, 907 A.P.R. 1, 179 A.C.W.S. (3d) 113, [2009] N.B.J. No. 217, 62 B.L.R. (4th) 29 (N.B. Q.B. Jul 13, 2009), where Rideout J. interpreted *BCE* to mean that "recent decisions conclude there is no oppression according to the reasonable expectations test if the transaction is within or does not change the underlying contract" (par. 202) which the judge stated was the trust agreement in *BCE* (par. 202), the unanimous shareholder agreement in 2082825 Div Ct, *supra* note 792 (par. 203; 2082825 is discussed elsewhere in this chapter), and the employment contract and share subscription plan in *Doucet* itself (par. 200). In that manner, the unanimous shareholder agreement was completely equated with any other agreement, and the finding in 2082825 Div Ct functionally divorced from any recognition that it was the enforcement of an instrument with unique statutory status to bind corporate directors. On appeal, *Doucet v. Spielo Manufacturing Inc.*, 2011 NBCA 44, 372 N.B.R. (2d) 1, 332 D.L.R. (4th) 407, 2011 CarswellNB 227, 2011 CarswellNB 228, 961 A.P.R. 1, 91 C.C.E.L. (3d) 177, 201 A.C.W.S. (3d) 689, [2011] N.B.J. No. 153, 83 B.L.R. (4th) 171, 4 C.P.C. (7th) 1 (N.B. C.A. May 12, 2011), Robertson J.A. rejected Rideout J.'s general approach to such documents, stating that it was possible for behaviour that technically fell within the wording of a contract to nonetheless be oppressive if it was "opportunistic or vindictive behaviour" that

reason why the parties might have a reasonable expectation of *compliance* with the agreement could be because it is, by virtue of its statutory status, understood to be binding upon directors, as only a unanimous shareholder agreement can be.

As the following subsection explores, not all decisions nominally decided as oppression claims have gone this route. Some rely more heavily upon one of the other three approaches. But it is not the basis on which the claim is brought that defines this as a true fourth alternative;¹⁵⁴⁴ it is the distinct analytic principles surrounding "reasonable expectations" that make the oppression remedy a unique model for understanding and enforcing the unanimous shareholder agreement, alongside the corporate constitutional, contractual, and directors' duties approaches.

6.(d) Alternative Oppression Approaches

The most distinctive version of the oppression remedy approach is the contextual analysis of the parties' "reasonable expectations". This incarnation, whatever its merits and flaws, can be understood as a coherent and unique model for addressing violations of these agreements. But because the oppression remedy provides a statutory basis for bringing a claim, rather than just an analytic framework for determining one, decisions in unanimous shareholder agreement cases that are nominally brought in this manner do not, in fact, all adhere to any given theoretical model. This may be attributable to wider issues with the remedy, debates concerning it and evolutions it has undergone. While it is developing a degree of rigour, as seen in *BCE*, its governing principles have not always been as clear.¹⁵⁴⁵ If the resulting analyses were devoid of any reference to oppression, the heading under which these claims were brought would be strictly of technical interest. The statutory provision authorizing these claims would become just another door through which lawsuits could be brought, differing only in the available remedies, while the resulting decisions fell under one of the other three approaches.

The more likely alternative, as the case law demonstrates, is that the oppression remedy will be applied in a manner that presupposes the correctness of one of the other three approaches to understanding and enforcing unanimous shareholder agreements, while using its language and some elements from it. The next subsection examines those oppression cases where a corporate constitutional understanding was assumed. The following subsection considers judgments where the principles guiding the analysis do not refer to "reasonable expectations", and instead contractual principles seem to be having an influence on the

violated the parties' reasonable expectations (par. 10), but did not explicitly address, let alone disagree with, the trial judge's classifying all such documents as more-or-less equally valid sources of reasonable expectations.

¹⁵⁴⁴ Although from a procedural perspective, this may be significant, it is a theoretically shallow distinction.

¹⁵⁴⁵ As discussed in *BCE*, *supra* note 1143.

determination of whether oppression occurred. Ultimately, both types are problematic, and review of them suggests that there is little productive to be gained by this merger of doctrines. Regardless of their outcomes, they are analytically unsatisfying, the unfortunate result of a claim brought under the heading of oppression before judges more inclined to a different model.

The other extreme is also possible. Cases may arise which are quite clearly decided on the basis of oppression, but where the violation of a unanimous shareholder agreement was largely incidental, rather than a decisive factor. In such circumstances, an oppression claim is appropriate, though the resulting judgments may have little to say about enforcing unanimous shareholder agreements, as the last of the following subsections explores.

6.(d)(i) Oppression and Corporate Constitutional Analyses

The cases discussed in this subsection, while framed as oppression claims, include discussions of unanimous shareholder agreements that fit the description of "corporate constitutional"; the directors' behaviour in contravention of restrictions is described as being without authority, invalid, or some similar phrase. These do not appear to be conclusions regarding the allegations of oppression, but rather simple statements that such actions were not within the board's legal powers. They seem to be the result of judges operating from a corporate constitutional position as they hear an oppression claim. Although it is impossible to completely dismiss the view that they were nullifying actions contrary to unanimous shareholder agreements on inadequately articulated oppression grounds, the result is, at the very least, a strong corporate constitutional influence on one strand of the oppression cases. At most, these are a series of decisions nominally concerned with oppression that, at least with regard to these issues, were making findings on an outright corporate constitutional basis quite apart from any principles unique to that remedy. One can reconcile this by using the corporate constitutional model to understand the default nature and effect of unanimous shareholder agreements, but also acknowledging that disregarding them might be oppressive- *i.e.* that the oppression remedy coexists with other legal rights rather than being precluded by them- but this conflation of two different frameworks can lead to unnecessary confusion.

For example, in *2082825 Ontario Inc. v. Platinum Wood Finishing Inc.*,¹⁵⁴⁶ the individual applicant had entered into business with the defendants on a minority basis, paying slightly more than his proportional share to do so,¹⁵⁴⁷ and they created a unanimous shareholder agreement which specified that he would be the corporate defendant's president and general manager and set his salary.¹⁵⁴⁸ Despite this,

¹⁵⁴⁶ *2082825 Sup Ct J, supra* note 792. The appeal was discussed above.

¹⁵⁴⁷ *Ibid*, par. 9.

¹⁵⁴⁸ *Ibid*, par. 10.

the other directors¹⁵⁴⁹ cut off his salary when he became ill¹⁵⁵⁰ and, shortly after he returned to work, removed him from his positions.¹⁵⁵¹ The applicant claimed oppression,¹⁵⁵² for which he sought his shares being bought out, and wrongful dismissal.¹⁵⁵³

Newbould J. began the oppression analysis using the terminology developed for that area of the law:

32 This situation does not reflect, to use the language of Farley J. in *820099 Ontario Inc. v. Harold E. Ballard Ltd.* [(Ont. Gen. Div.)], the compact made by the shareholders of Platinum. The compact made by the shareholders, and thus their expectation, was that Mr. Barbieri invested \$350,000 into a company that he was to run as president and general manager and over which he, through his holding company, had secured protection for his position as against the Herwynen brothers by virtue of the unanimous shareholder agreement. [...] To exclude Mr. Barbieri from management and the board of directors of Platinum while keeping his equity in the company was not only to unfairly disregard his interests as a shareholder, officer and director but was also conduct that was harsh and wrongful amounting to oppression.

The final sentence suggested that any finding of oppression need not rely upon the unanimous shareholder agreement; taking his money but denying him input into management was inherently oppressive. But the earlier direct equation of the "compact" amongst the shareholders with their expectations presaged a turn to what appears to be simply a corporate constitutional approach, without the accouterments of oppression analysis. The determination shortly thereafter was that, "[u]nder the unanimous shareholder agreement, his salary could not be changed without his consent".¹⁵⁵⁴ Newbould J. elaborated on that point, fully in the mode of corporate constitutionalism:

35 If, as asserted by the respondents, the meeting of June 14, 2008 at which Mr. Barbieri was said to be voted out of his position was a directors' meeting, the removal of Mr. Barbieri was not in accordance with the unanimous shareholder agreement and there was no power in the directors to do what they did. By virtue of the unanimous shareholder agreement, the directors did not have the ability to change matters that were covered by the unanimous shareholder agreement. It had been agreed by the shareholders that Mr. Barbieri was to be the president and general manager and his salary was something over which he had control. Purporting to terminate him at a directors' meeting and terminating his salary was contrary to the unanimous shareholder agreement. Taking steps to remove him as a required signatory to cheques was also contrary to it. So far as purporting to remove Mr. Barbieri as a director is concerned, directors do not have such power.

¹⁵⁴⁹ Who were also named individually as defendants in the suit.

¹⁵⁵⁰ *2082825 Sup Ct J, supra* note 792, par. 3.

¹⁵⁵¹ *Ibid*, par. 4.

¹⁵⁵² There was also an unrelated ground for oppression, having to do with the business relationship between the corporation in question and another company controlled by the individual defendants, which was itself also named as a defendant; the finding there was also for the applicant.

¹⁵⁵³ *2082825 Sup Ct J, supra* note 792, par. 5.

¹⁵⁵⁴ *Ibid*, par. 34.

36 It is doubtful that the meeting on June 14, 2008 was a shareholder meeting because there was more than one Herwynen brother there voting at it. Each shareholder, being a holding company, would have the right to nominate one person to attend on its behalf. However, assuming that it was a shareholder meeting, it would be a breach of the unanimous shareholder agreement for the Herwynen interests to vote against Mr. Barbieri being president and general manager.

While the overall nature of the judgment was a finding of oppression, this passage does not appear to be in that vein. Instead, it rests upon the corporate constitutional argument that the restrictions in a unanimous shareholder agreement simply cannot be overridden by directors; the oppression remedy is beside the point.

The analysis then returned abruptly to that topic, as Newbould J. considered the respondents' arguments that they dismissed the applicant out of concerns regarding his management, ruling that these "came nowhere near what would justify a dismissal and the exclusion of Mr. Barbieri contrary to the their [sic] shareholder expectations, the compact made by the shareholders".¹⁵⁵⁵ Along similar lines but with an additional qualification, Newbould J. found that "even if the respondents were not precluded by the unanimous shareholder agreement from purporting to terminate Mr. Barbieri in the manner which they did, the concerns raised by Peter Herwynen come nowhere close to justifying a dismissal contrary to the shareholder expectations of the shareholders. They also come nowhere close to justifying a dismissal with cause."¹⁵⁵⁶ The framing is significant; even a warranted dismissal would be contrary to the shareholder's expectations. Presumably, it is at the second stage of the test that termination in such circumstances would have been found not to be oppressive.

2082825 did not completely abandon the oppression remedy in favour of corporate constitutionalism, since it contained some consideration of whether violating a unanimous shareholder agreement might ever be possible or permissible. But the language in establishing the wrong exhibited a clear corporate constitutional character, not simply equating the agreement with reasonable expectations but outright declaring that directors had no power to do that which they had attempted.

Another case to decide an oppression claim on largely corporate constitutional logic was 827365 *Alberta Ltd. v. Alco Gas & Oil Production Equipment Ltd.*¹⁵⁵⁷ The corporation had three shareholders, two of whom held equal numbers of voting shares and one of whom held non-voting shares.¹⁵⁵⁸ Eventually,

¹⁵⁵⁵ Ibid, par. 37.

¹⁵⁵⁶ Ibid, par. 66. The phrase "shareholder expectations of the shareholders" in the judgment presumably should read "reasonable expectations of the shareholders".

¹⁵⁵⁷ 827365 *Alberta Ltd. v. Alco Gas & Oil Production Equipment Ltd.*, 285 A.R. 221, 2001 CarswellAlta 471, 14 B.L.R. (3d) 223, [2001] A.W.L.D. 483 (Alta. Q.B. Mar 16, 2001) (hereinafter "827365").

¹⁵⁵⁸ Ibid, par. 6.

they each transferred their shares to their holding companies.¹⁵⁵⁹ The parties entered into a series of unanimous shareholder agreements, with the eventual result that the two owners of voting shares were named therein as the only directors, and the quorum was set at two directors.¹⁵⁶⁰ One of the shareholders was also named in the unanimous shareholder agreements as the corporate president and the other as vice-president.¹⁵⁶¹ The director/president subsequently died. After his death, the remaining director purported to name himself president and to appoint a third party as a director.¹⁵⁶²

The heirs of the deceased brought an oppression claim to, *inter alia*, retroactively invalidate any acts taken during that period. As part of the oppression analysis,¹⁵⁶³ Murray J. retroactively nullified any and all resolutions passed during that time. The logic employed took much from the corporate constitutional model, since it did not explicitly invoke oppression remedy language, instead treating nullification as a given; the analysis consisted of little more than a statement that the judge was "satisfied that the resolutions [...] were invalid and if not already rescinded are set aside".¹⁵⁶⁴ Further, although Murray J. specifically noted that no loss or damage had been caused by these actions, they were nonetheless invalid because the quorum had not been met.¹⁵⁶⁵ Despite this, the conclusion was that the proper course of action would have been to call a special meeting of the shareholders to appoint a new director;¹⁵⁶⁶ this would have been inconsistent with the unanimous shareholder agreement unless it was amended.

The reasons for judgment contained other deviations from corporate constitutional principles as well. Following the period described above, the heirs of the deceased, the holding company of the deceased, the surviving director, and his holding company entered a so-called "stand still agreement" with a defined expiration date, the terms of which included appointing one of the heirs as a director.¹⁵⁶⁷ A resolution was then passed by the three shareholders, which did not directly mention the stand-still agreement, naming the surviving director and one of the heirs as the two voting directors and the (indirect) owner of non-voting shares as a non-voting director. The resolution set their term of office as until the next general meeting.¹⁵⁶⁸ Upon the subsequent expiration of the "stand still agreement", the original director took the position that he was once again the only one; the heirs asserted that the shareholders' resolution

¹⁵⁵⁹ Ibid, pars. 10, 16.

¹⁵⁶⁰ Ibid, par. 22.

¹⁵⁶¹ Ibid, par. 9.

¹⁵⁶² Ibid, par. 27.

¹⁵⁶³ Ibid, par. 58.

¹⁵⁶⁴ Ibid, par. 59.

¹⁵⁶⁵ Ibid, par. 60.

¹⁵⁶⁶ Ibid, par. 60.

¹⁵⁶⁷ Ibid, par. 34. The holding company which owned the non-voting shares was not listed as a party to this agreement, and therefore it may technically not have been able to modify the existing unanimous shareholder agreements, although this was not discussed.

¹⁵⁶⁸ Ibid, par. 35.

was still in force.¹⁵⁶⁹ Without discussion, Murray J. wrote, "I am of the opinion, as noted, that this [the heirs' position] is correct."¹⁵⁷⁰ Potentially the shareholders' resolution itself constituted a unanimous shareholder agreement modifying the earlier ones, but Murray J. did not pursue this; on the face of it, the reasoning appears to have been that the appointment of a director by shareholders' resolution simply trumps a unanimous shareholder agreement, an unusual result. The decision may have been pragmatic, rather than principled.

Another issue was the validity of certain share transfers. The unanimous shareholder agreements allowed for transfers to holding companies.¹⁵⁷¹ There had been transfers on both sides which Murray J. determined were technically not to holding companies as described in the document,¹⁵⁷² but were within the spirit of the agreement, because the corporations were controlled by the heirs of the original shareholders.¹⁵⁷³ The holding company's status as a shareholder was contested, and Murray J. determined that it could not be granted standing as a shareholder, and therefore could not invoke any statutory right dependant upon that status.¹⁵⁷⁴ However, the judge stated that the applicants would "likely"¹⁵⁷⁵ be able to apply to the court under s. 240, which allowed "a complainant" to apply to enforce a unanimous shareholder agreement.¹⁵⁷⁶ Unfortunately, since the holding company which had previously held shares no longer existed, Murray J. concluded that an application under s. 240 could not work, on the basis that the only possible remedy under it would be to order shares that had been purportedly transferred contrary to the unanimous shareholder agreement to be transferred back, which would have been functionally impossible.¹⁵⁷⁷ For reasons not clearly explained but presumably having to do either with fairness, consistency, or relative simplicity in the judgment, Murray J. decided that if one of the transfers could not be determined using s. 240, neither would be,¹⁵⁷⁸ and instead resorted to the general authority of the court to determine contracts (under the judicature act).¹⁵⁷⁹

The various methods and conclusions in 827365 illustrate both the influence that corporate constitutional logic can have on oppression analyses and the confusion and uncertainty that results when the oppression remedy is applied to unanimous shareholder agreements without clear, consistent principles to guide the analysis.

The view that directors cannot disregard restrictions on their authority also found expression in the

¹⁵⁶⁹ Ibid, par. 42.
¹⁵⁷⁰ Ibid, par. 42.
¹⁵⁷¹ Ibid, par. 6.
¹⁵⁷² Ibid, pars. 88, 93.
¹⁵⁷³ Ibid, pars. 101-104.
¹⁵⁷⁴ Ibid, pars. 76-77.
¹⁵⁷⁵ Ibid, par. 78.
¹⁵⁷⁶ Ibid, par. 78.
¹⁵⁷⁷ Ibid, par. 79.
¹⁵⁷⁸ Ibid, par. 80.
¹⁵⁷⁹ Ibid, par. 81.

oppression claim of *Zysko v. Thorarinson*,¹⁵⁸⁰ The corporation had two 50% shareholders, each a holding company wholly owned by an individual.¹⁵⁸¹ One of the shareholders (the respondent) provided greater amounts of capital, some in the form of a loan¹⁵⁸² while the other (the applicant) provided management services and was a contractor for the construction of the building the corporation owned, which was acknowledged in the unanimous shareholder agreement as constituting part of its contribution to equity.¹⁵⁸³ The agreement specifically provided that any financing of the project, as well as all "material or important decisions", required the shareholders' unanimous consent.¹⁵⁸⁴ Despite this, two of the three directors executed a mortgage against the building that was the corporation's principle asset to secure their companies' loan to it.¹⁵⁸⁵ They also, again acting as directors (and also as president), executed a general security agreement to cover the loan.¹⁵⁸⁶ Neither of these was agreed to by the remaining director, who controlled the other shareholder.¹⁵⁸⁷ The respondent, acting as president, also purported to pass by-laws that granted the board of directors greater borrowing power.¹⁵⁸⁸ Finally, at a meeting of the three directors, the two-to-one majority passed a resolution ratifying their borrowings¹⁵⁸⁹ and a resolution removing the third director from any power over the project and building.¹⁵⁹⁰

Chrumka J. first held that adding security to an existing loan violated the unanimous shareholder agreement and was thus simply invalid.¹⁵⁹¹ After apparently having already concluded that, on corporate constitutional grounds, the security was void, the judge proceeded to consider whether it was oppressive, labelling this "the next issue".¹⁵⁹² This was apparently considered necessary in order to set it aside, despite the earlier conclusion: "If the granting of the Bluebird security is either oppressive, unfairly prejudicial or unfairly disregards the interests of ES'J Developments or Joseph Zysko pursuant to 242(3) of the *Act* a Court can set aside the Bluebird security."¹⁵⁹³ Oddly, after a review of some general principles of oppression, Chrumka J. did not return to the question of the loan security and determine whether it was oppressive, but instead turned to the directors' resolutions that removed the applicant from "their

¹⁵⁸⁰ *Zysko v. Thorarinson*, 2003 ABQB 911, [2004] 10 W.W.R. 116, 345 A.R. 139, 2003 CarswellAlta 1589, 42 B.L.R. (3d) 75, [2004] A.W.L.D. 52, 25 Alta. L.R. (4th) 110 (Alta. Q.B. Nov 07, 2003) (hereinafter "*Zysko*").

¹⁵⁸¹ *Ibid*, pars. 2-5.

¹⁵⁸² *Ibid*, pars. 11-12.

¹⁵⁸³ *Ibid*, par. 13.

¹⁵⁸⁴ *Ibid*, par. 12.

¹⁵⁸⁵ *Ibid*, par. 19.

¹⁵⁸⁶ *Ibid*, par. 22.

¹⁵⁸⁷ *Ibid*, par. 21.

¹⁵⁸⁸ *Ibid*, pars. 24-25.

¹⁵⁸⁹ *Ibid*, par. 27.

¹⁵⁹⁰ *Ibid*, par. 28.

¹⁵⁹¹ *Ibid*, par. 70.

¹⁵⁹² *Ibid*, par. 71.

¹⁵⁹³ *Ibid*, par. 72.

contractual role".¹⁵⁹⁴ They were found to be oppressive and therefore invalid.¹⁵⁹⁵ On the other hand, the mortgage was invalidated on corporate constitutional grounds (it contravened both the unanimous shareholder agreement and the by-laws) and because it violated a different section of the *Act* relating to disclosure.¹⁵⁹⁶ This judgment represents another confusing mix of multiple approaches, without a clear rationale for which applies when and why.

These cases were overtly brought under the oppression remedy, but careful reading indicates that they were heavily influenced by the corporate constitutional approach, with its axiom that directors cannot disregard restrictions on their authority and any attempts to do so are void. Framing them as oppression and using related concepts only served to add complications and unnecessary ambiguity; in the next subsection, a similar pattern involving the intermingling of the oppression remedy and the contractual approach will yield similar problems. If it is not going to be applied through a "reasonable expectations" test unique to it, it would be preferable to dispense with the oppression remedy and simply use whichever other method seems most apt for handling the enforcement of these instruments. In these cases, similar results could have been achieved through a straightforward corporate constitutional approach, with greater simplicity, certainty, and consistency.

6.(d)(ii) Oppression and Contractual Analyses

Without a clearly developed set of principles to guide judgments, such as "reasonable expectations", use of the oppression remedy to enforce unanimous shareholder agreements requires some substitute standard to serve as the basis for judgment. In the previous subsection, claims brought under the oppression remedy but decided using a corporate constitutional model were examined. That is not the only available alternative. The contractual approach provides another.

I earlier suggested that even when "reasonable expectations" determine the outcome of an oppression claim, insofar as they are themselves derived from the wording of a unanimous shareholder agreement, the contractual approach may play a role, either implicit or explicit, in determining whether they are met. When the notion of "reasonable expectations" is removed from the analysis, a similar phenomenon can occur. Sometimes, the lack of consideration given to them may be because the judgment was too preliminary to contain much substance at all, as in *Klianis v. Poole*¹⁵⁹⁷, *Tremblay c. Michot*,¹⁵⁹⁸

¹⁵⁹⁴ Ibid, par. 78.

¹⁵⁹⁵ Ibid, par. 79.

¹⁵⁹⁶ Ibid, par. 80.

¹⁵⁹⁷ In *Klianis v. Poole*, 1992 CarswellOnt 3204, 33 A.C.W.S. (3d) 1228, [1992] O.J. No. 1172 (Ont. Gen. Div. Jun 05, 1992), a corporation had three shareholders, all of whom were directors (par. 4). Two of them requested that the court order they have access to the records of the company, pursuant to the legislation and a term of the unanimous shareholder agreement (par. 7). Ground J. ordered that they have

Hames v. Greenberg,¹⁵⁹⁹ and *Groeneveld v. 1034936 Alberta Ltd.*¹⁶⁰⁰ In other cases, such as the five discussed below, something akin to a contractual analysis appears to be taking place, although each provided its own spin. The first, while framed as an oppression claim, used what were clearly contract law principles as the entire basis for the judgment. In the second, a finding of breach of contract was followed, with minimal explanation, by the statement that this constituted oppressive and unfairly prejudicial conduct, although the damages were determined to be identical. The next two simply took violations of a

the access guaranteed by the statute and that, in accordance with the terms of the agreement, they could have a chartered accountant appointed to audit the records (par. 9). This issue was dealt with first outside the realm of the oppression remedy, and it is not entirely clear whether it was a contractual or corporate constitutional approach being used, although the choice of forcing the parties to comply with the document's terms rather than awarding damages might imply the former. With regard to the claim that having been prevented from accessing the records (in contravention of the legislation and the agreement) was oppressive, Ground J. simply stated that "authorities have been cited to me as to whether a failure by a majority shareholder to cause the corporation to permit inspections or audits provided for by statute or by shareholders' agreement, amounts to oppressive action within the meaning of s. 248 of the *Act* so as to give the court jurisdiction to make orders of the nature listed in subs. 248(3) of the *Act*. In my view, it is premature to decide this question at this time" (par. 10). Ground J. found that the minimum remedy for such a finding would be to order that access to the records be allowed, as was being done regardless (par. 10). Any further finding of oppression would depend upon what those documents revealed (par. 10).

¹⁵⁹⁸ *Tremblay*, *supra* note 1202. On an interim motion as part of an oppression claim, among other determinations, an injunction was granted against removing the plaintiff from the position of director he was guaranteed in the unanimous shareholder agreement; the brief analysis focussed on the balance of convenience, with the underlying substance addressed only through a reference to his "apparent right" ("droit apparent") to be a director (par. 39).

¹⁵⁹⁹ *Hames v. Greenberg*, 2014 ONSC 245, 2014 CarswellOnt 664, 237 A.C.W.S. (3d) 649, 23 B.L.R. (5th) 117 (Ont. S.C.J. [Commercial] Jan 20, 2014). On a motion for interim costs in an oppression claim, Brown J. listed possible violations of a unanimous shareholder agreement that it was determined would require a trial, then stated that the allegations constituted a case of sufficient merit to meet that stage of the test for interim costs (pars. 34-38). Other possible sources of oppression had also been alleged (pars. 26, 31), but the judge's finding of a case of sufficient merit rested primarily upon the violation of the agreement. (The agreement was usually referred to simply as a shareholder agreement or "SHA" in the judgment, but was referred to as a "unanimous shareholder agreement" in a reproduced statement of the plaintiff at par. 24.)

¹⁶⁰⁰ In *Groeneveld v. 1034936 Alberta Ltd.*, 2005 ABQB 834, 2005 CarswellAlta 1681, 144 A.C.W.S. (3d) 471, [2006] A.W.L.D. 148, [2006] A.W.L.D. 208, [2005] A.J. No. 1554 (Alta. Q.B. Nov 07, 2005), the minority shareholder brought an application for an interim injunction removing the two majority shareholders from control of the company and giving it to him, pending the trial of his oppression claim. The applicant's position was based on allegations that he had been excluded from management of the company and that it was mismanaged (par. 13). There was a unanimous shareholder agreement in place which specified that the applicant was to be the company's treasurer (par. 12); the majority shareholders had removed him from this position, which Gallant J. found "appears to offend" (par. 12) the agreement. There had also been an investigation by an inspector pursuant to an earlier consent order, which had found a variety of problems with the management of the business (par. 14). These included accounting practices contrary to the unanimous shareholder agreement (par. 14) but no emphasis was placed on that element in the judgment as compared to the other mismanagement. Gallant J.'s analysis regarding the oppression claim *per se* was limited to setting out the facts and then stating during the first stage of the three part injunction test that "there is a serious issue to be tried" (par. 21). The judge did not find that there was a strong case for the remedy sought in this injunction (par. 21). The potential harm could be rectified by

unanimous shareholder agreement as *prima facie* oppressive. In the final one, relief was granted even though the conduct was found not to be oppressive, on contractual grounds. Like the oppression claims determined through corporate constitutional principles, the oppression remedy adds little to what were essentially examples of the contractual approach.¹⁶⁰¹

In the nominally oppression-based case *3356175 Canada Inc. (Judithco) c. Kruco Inc. (Kruco)*,¹⁶⁰² one of the investors had executed a put option found in the unanimous shareholder agreement.¹⁶⁰³ It stated that the price paid was subject to subsequent recalculation in the event that the government reassessed the corporation's tax obligations for a period prior to the exercise of the option in a manner that would have affected the price calculation under the prescribed formula.¹⁶⁰⁴ The corporation successfully appealed tax assessments for that period.¹⁶⁰⁵ There was a dispute as to whether the term in the unanimous shareholder agreement only worked to retroactively lower the put price, or whether it could raise it as well.

damages (par. 26) and the balance of convenience favoured the respondents (par. 29).

¹⁶⁰¹ *Callahan v. King George Square Properties Inc.*, 2002 CarswellOnt 3025, [2002] O.J. No. 3513 (Ont. S.C.J. Sep 03, 2002) also illustrates how the assumptions of the contractual model can influence the enforcement of a unanimous shareholder agreement through the oppression method, specifically the choice of remedy. The decision was part of an oppression claim (par. 2). The applicant sought as injunctive relief that, pending trial, he not be removed from his position as manager of the corporation (par. 1), a position guaranteed in the unanimous shareholder agreement (par. 3). The company continued to pay him his salary (par. 2). Ground J. denied injunctive relief on the basis that there was no irreparable harm to him being removed as manager (par. 2) but there might be if he was not (par. 4). Though an on-the-facts interpretation of this particular agreement, it included the declaration that a unanimous shareholder agreement never completely insulates a manager from being fired when the majority of the investors have lost trust in them, and that damages are the appropriate remedy:

3 Moreover, I am unable to interpret the Unanimous Shareholders Agreement as giving Mr. Callahan some entrenched right to continue on as manager until the Unanimous Shareholders Agreement is terminated or the corporation wound up. It cannot be that Section 3.12 of the Agreement prevents the directors from terminating Mr. Callahan as manager if they believe, rightly or wrongly, that he has not been performing his duties competently, honestly and in the best interests of the corporation, and in my view, Section 3.15 sets out the mechanism for doing so. If the court should ultimately find that the directors are acting improperly, Mr. Callahan will be compensated in damages.

Although it is common to award damages for oppression, and thus this is not necessarily an example of the contractual approach being applied through the mechanism of the oppression remedy, the out-of-hand dismissal of any other remedy suggests it as a possible influence. Certainly, a judge inclined to the contractual method of enforcement would be likely to, if faced with a claim framed as oppression, turn to damages as the solution.

¹⁶⁰² *3356175 Canada Inc. (Judithco) v. Kruco Inc. (Kruco)*, 2006 QCCS 3994, 2006 CarswellQue 7335, J.E. 2006-1812, EYB 2006-108106 (C.S. Que. Jul 28, 2006) (hereinafter "*3356175 CS*").

¹⁶⁰³ *Ibid.*, par. 10.

¹⁶⁰⁴ *Ibid.*, par. 8.

¹⁶⁰⁵ *Ibid.*, par. 14.

Although the shareholder who had exercised the put option brought an action for oppression,¹⁶⁰⁶ the analysis of Tingley J.S.C. was distinctly contractual in nature. There were no references to "reasonable expectations". Instead, the language of the agreement was interpreted in light of the stated intent and purposes in the preamble and of the document as a whole,¹⁶⁰⁷ the subheadings,¹⁶⁰⁸ the apparent intent of the provision in question,¹⁶⁰⁹ the parties' knowledge that their tax appeal might be successful,¹⁶¹⁰ the exact language of the document,¹⁶¹¹ and whether contingent claims are normally considered assets under accounting principles.¹⁶¹² The parties' intent and understanding of the document could theoretically speak to their "reasonable expectations", but that terminology was not invoked, and the overall structure and language of the judgment was simply one of contract.

The Quebec Court of Appeal upheld the lower court judgment.¹⁶¹³ Three of their four reasons involved the specific wording employed in the document, although the last one was a general principle of equality amongst the shareholders that the Court of Appeal found underlay the agreement.¹⁶¹⁴ The oppression remedy was again handled little differently from how one might expect the analysis to run in any breach of contract case.¹⁶¹⁵

Gottlieb v. Adam,¹⁶¹⁶ on the other hand, made a point of drawing a distinction between contractual enforcement and the oppression remedy, but in applying the latter, it contained no mention of "reasonable expectations", skipping to what the Supreme Court described as the second step of the oppression remedy analysis. The corporation in question had two shareholders. The minority one purported to exercise a shotgun clause, in which she set a nominal price for the shares¹⁶¹⁷ and attempted to offset the parties' shareholder loans against one another "in proportion with [their] shareholdings" such that she offered to pay nothing for the other party's shareholder's loan and would accept a reduced amount as compensation for

¹⁶⁰⁶ Ibid, par. 16.

¹⁶⁰⁷ Ibid, par. 21.

¹⁶⁰⁸ Ibid, par. 22.

¹⁶⁰⁹ Ibid, par. 23.

¹⁶¹⁰ Ibid, par. 24.

¹⁶¹¹ Ibid, par. 27.

¹⁶¹² Ibid, par. 28.

¹⁶¹³ *3356175 Canada Inc. (Judithco) c. Kruco Inc. (Kruco)*, 2008 QCCA 1158, 2008 CarswellQue 5231, 171 A.C.W.S. (3d) 100, J.E. 2008-1280, EYB 2008-134601 (C.A. Que. Jun 12, 2008) (hereinafter "3356175 CA"). Unlike 3356175 CS, *supra* note 1602, 3356175 CA does not refer to the document as a unanimous shareholder agreement.

¹⁶¹⁴ 3356175 CA, *supra* note 1613, par. 43.

¹⁶¹⁵ The Court of Appeal did mention that this claim has been brought under the oppression remedy, at 3356175 CA, *supra* note 1613, par. 22, but there is no elaboration of any legal principles that might suggest.

¹⁶¹⁶ *Gottlieb*, *supra* note 1095. The document is generally referred to only as a "shareholder's agreement" in the reasons for judgment, but is called a unanimous shareholder agreement in correspondence reproduced at par. 18.

¹⁶¹⁷ Either \$51 or \$39 in the respective portions of the offer.

hers.¹⁶¹⁸ Despite protests from the other investor, the minority shareholder then used the power of attorney granted by the agreement and her status as director to transfer the applicant's shares to her.¹⁶¹⁹ Spence J. held that the treatment of the shareholder's loans was not in accordance with the agreement, because the full amount should have been part of the offer.¹⁶²⁰ After finding that the respondent was liable for breach of contract under r. 14.05 (presumably *qua* shareholder), Spence J. went on to consider the oppression remedy:

40 It appears to me that this is a proper case for relief under s. 248, given the actions of the respondent. She took steps in her capacity as a director of the corporation to cause the company to give effect to her acquisition of the applicant's interest in the company and his consequent removal from any involvement in its affairs. Since her acquisition was in breach of the shareholders' agreement, her use of her capacity as a director to implement the acquisition was oppressive and unfairly prejudicial to the interests of the applicant as a security holder of the company. I recognize that s. 248 might at first glance not be expected to apply in this case. The respondent was a minority shareholder and the applicant was the majority shareholder at the time. The oppressive conduct related to a shareholders' agreement, a private contractual arrangement between the parties rather than an element of the corporate structure of the company. While these facts, viewed in isolation, might seem to make the oppression remedy inapplicable, further consideration leads to the opposite conclusion. The minority shareholder employed her capacity as a director to carry out the appropriation of the shares of the majority holder. It is the use of the director's position in this manner, to effect that appropriation, that is oppressive. The fact that the respondent was only a minority shareholder and that the appropriation came about as a result of a purported exercise of rights under a shareholders' agreement does not make the conduct any less oppressive.

The relationship between the unanimous shareholder agreement and the oppression remedy in this passage is unclear and almost contradictory. On the one hand, the rather vague analysis suggested that simply because the acquisition breached the terms of the agreement, the respondent's actions *qua* director in implementing it were *prima facie* oppressive; indeed, no further explanation was given for this conclusion. On the other, it was then suggested that since the agreement was merely a private contract and not a part of the corporate structure (an incorrect position, per *Duha*) that that might "in isolation" make the oppression remedy inapplicable, but that "further consideration" revealed that appropriation in violation of an agreement is not less oppressive than any other appropriation. Spence J. also emphasized that the oppressive acts were those done *qua* director in giving effect to the transfer, not those done *qua* shareholder in making the defective offer; this was an enforcement of the unanimous shareholder agreement as a component of the corporate governance structure, not as an ordering of private rights between investors.

Spence J. found that contractual damages (owed in the capacity of shareholder) should put the applicant in the position he would have been in had there been no breach, *i.e.* if he had been paid the

¹⁶¹⁸ *Gottlieb, supra* note 1095, par. 15.

¹⁶¹⁹ *Ibid*, par. 19.

recorded (rather than actual) value of the shareholder loans.¹⁶²¹ Despite the respondent's arguments that the loans were worthless, the amount awarded against her *qua* director for the oppression¹⁶²² was the same as that for breach of contract.¹⁶²³ Although it was noted that normally the remedy would only have entitled the applicant to the fair value of the security, on these facts "it would seem unfair"¹⁶²⁴ to the judge for him to receive less than the amount the respondent would have had to pay but for the oppressive conduct.¹⁶²⁵ Despite this, and despite noting that the respondent's arguments that the actual value of the loans (zero) should be used "[did] not seem compelling",¹⁶²⁶ the judge technically declined to decide the matter because the conclusions already reached made it unnecessary.¹⁶²⁷ Even after explicitly contrasting the oppression remedy with contract law, *Gottlieb* ultimately used contractual damage as the yardstick for measuring the oppression award.

The judgment in *Clarfield v. Manley*¹⁶²⁸ was a winding-up order,¹⁶²⁹ not technically an oppression one, but nonetheless, the conduct of one of the shareholders/directors was found to be oppressive.¹⁶³⁰ In establishing that, two elements were specifically highlighted, both tied to the unanimous shareholder agreement. First, he had called a directors meeting without informing the other shareholder (who was not then a director but had been promised he would be appointed one), at which important decisions were made; Blair J. noted, "At the very least, this conduct contravened the provisions of the unanimous shareholders' agreement."¹⁶³¹ Further, the judge wrote, "the unanimous shareholders' agreement requires that 'all decisions (apart from those requiring unanimity) affecting the operations of the Company shall be determined by a majority of the [parties to the agreement]' [...]. Mr. Manley has been utilizing his position as a director of Clear Customs to frustrate Mr. Clarfield in this regard. He is not entitled to do so, in my view."¹⁶³² Since that was the extent of the analysis, the implication was that violating a unanimous shareholder agreement is *prima facie* oppressive. Arguably, this was not an example of the contractual approach, since it was not explicit that contract law principles were used, but something along those lines is the most likely explanation, since there was no reference to "reasonable expectations" nor suggestion that

¹⁶²⁰ Ibid, par. 23.

¹⁶²¹ Ibid, par. 33.

¹⁶²² In order not to prejudice creditors, the oppression remedy was found to lie against the respondent director personally and not the company (*Gottlieb, supra* note 1095, par. 42).

¹⁶²³ *Gottlieb, supra* note 1095, par. 43.

¹⁶²⁴ Ibid, par. 43.

¹⁶²⁵ Ibid, par. 43.

¹⁶²⁶ Ibid, par. 44.

¹⁶²⁷ Ibid, par. 44.

¹⁶²⁸ *Clarfield, supra* note 289.

¹⁶²⁹ Blair J. concluded, after reviewing a variety of conflicts among the shareholders, that sufficient animosity existed to justify a winding up order (*Clarfield, supra* note 289, par. 48).

¹⁶³⁰ *Clarfield, supra* note 289, par. 51.

¹⁶³¹ Ibid, par. 53.

¹⁶³² Ibid, par. 54.

the improper acts were nullities.

Similarly, in *Boulangier c. GSI Environnement inc.*,¹⁶³³ an ex-employee argued that the company's refusal to buy back his shares in accordance with a unanimous shareholder agreement was oppressive.¹⁶³⁴ The analysis of Viens J.C.S was brief, avoiding any detailed oppression remedy methodology and apparently accepting that a violation of the agreement was *prima facie* oppressive:

114 A notre avis, le simple fait qu'il a quitté son emploi en septembre 1999 sans que tout soit mis en oeuvre pour que ses actions soient rachetées par la compagnie montre qu'on refuse de prendre en considération ses intérêts et qu'en conséquence, on abuse de ses droits comme actionnaire minoritaire de GSI.¹⁶³⁵

115 Nous sommes d'opinion qu'en ce sens, le demandeur est victime d'oppression et qu'il y a lieu d'intervenir, de passer outre aux dispositions de la convention unanime des actionnaires (P-3) et d'enjoindre la société GSI de racheter les 780 actions catégorie A de son capital-actions détenu par le demandeur.¹⁶³⁶

Despite finding that the refusal to buy back the employee's shares was *prima facie* oppressive and ordering them bought- a step described by Viens J.C.S as outside the agreement, but apparently only in a procedural sense, rather than a substantive one- the judge declined to hold the company liable for moral damages for its oppressive acts,¹⁶³⁷ including but not limited to the aforementioned refusal to buy back the shares.¹⁶³⁸ Despite the various other allegations of oppression reviewed, the methodology and result with regard to the share purchase appear less like a judgment under that remedy than one in contract.¹⁶³⁹

The recent case of *Matic c. Trottier*¹⁶⁴⁰ took this even further. Despite being brought in part as an oppression claim¹⁶⁴¹ and Corriveau J.C.S. specifically noting the wide range of remedies this made

¹⁶³³ *Boulangier c. GSI Environnement inc.*, 2002 CarswellQue 1784, J.E. 2002-1680, [2002] R.J.D.T. 1089, REJB 2002-33553 (C.S. Que. Aug 05, 2002).

¹⁶³⁴ Ibid, par. 109.

¹⁶³⁵ My translation: "In our opinion, the simple fact that he quit his job in September 1999 without everything being in place for his shares to be purchased by the company shows that they refused to consider his interests and consequently, they abused his rights as a minority shareholder in GSI."

¹⁶³⁶ My translation: "We are of the opinion that in that sense, the plaintiff is the victim of oppression and it is necessary to intervene, to go outside the terms of the unanimous shareholder agreement and order the company GSI to buy the 780 of its category A shares held by the plaintiff."

¹⁶³⁷ *Boulangier*, *supra* note 1633, par. 136.

¹⁶³⁸ Ibid, pars. 100-109.

¹⁶³⁹ This could have been a corporate constitutional analysis as well, but the judge's framing of the court's intervention as outside the agreement *per se* speaks against that interpretation.

¹⁶⁴⁰ *Matic*, *supra* note 1040. The dispute between the shareholders involved the interpretation of a term specifying a 2.1% raise for all corporate employees if benchmarks were met and whether certain expenses had to be taken into account in such calculations (pars. 9-12). The case is also authority that the existence of a shotgun provision in a unanimous shareholder agreement does not exclude the court's jurisdiction in favour of mandatory execution of said clause in the event of dispute (pars. 15-25).

¹⁶⁴¹ Ibid, par. 20.

available,¹⁶⁴² the general principles of contract interpretation from article 1426 of the *Civil Code of Quebec*¹⁶⁴³ were applied in order to determine which of the two shareholders' understanding of the agreement was correct.¹⁶⁴⁴ Demonstrating the extent to which this judgment veered away from oppression and toward contract, Corriveau J.C.S. specifically declined to find that disagreement was abusive,¹⁶⁴⁵ even while ordering specific performance.¹⁶⁴⁶ Given that choice of remedy, and that there was no serious consideration that the unanimous shareholder agreement could be ignored subject to damages, a corporate constitutional influence is visible as well.

It is perhaps inevitable that contract law will play some role in enforcing unanimous shareholder agreements. While the choices represented by it are not the only possible principles for interpreting documents, it is simply too convenient and too ingrained in legal minds to be ignored. But while the corporate constitutional model or a "reasonable expectations" framework might make use of contract law principles, they integrate them into a distinct methodology. When an oppression analysis discards "reasonable expectations" and uses breach of contract as a proxy instead, there is little point to avoiding direct resort to the contractual approach. The only advantage that oppression retains is its wider range of remedies, and while that is a significant benefit, it could easily be granted by statute to the contractual enforcement of unanimous shareholder agreements as well. This would allow for a straightforward contractual approach, and avoid unnecessary complications or uncertainty arising from its conflation with the oppression remedy. Conversely, a principled oppression analysis that was not overly reliant upon contract-based logic, such as the "reasonable expectations" model, would also be preferable.

6.(d)(iii) Larger Patterns of Oppression

Unlike the corporate constitutional and contractual approaches to enforcing unanimous shareholder agreements, the oppression remedy can make it difficult to determine what role the agreement itself plays in the analysis. Whatever acts are occurring in violation of it are most likely also generally detrimental to the interests of the complainant. This is true in other models as well, but in those cases, the very nature of the analysis will call attention to the agreement. In oppression cases, the fact pattern as a whole can be set out and then deemed oppressive. Even when violations of the unanimous shareholder agreement are identified as part of that pattern, the judicial emphasis might be elsewhere to the point where it seems likely that the same conclusion would have been reached even had the agreement not existed, as in

¹⁶⁴² Ibid, par. 20.

¹⁶⁴³ *C.C.Q.*, a. 1426, cited at *Matic*, *supra* note 1040, par. 45.

¹⁶⁴⁴ *Matic*, *supra* note 1040, pars. 30-46.

¹⁶⁴⁵ Ibid, par. 52.

¹⁶⁴⁶ Ibid, par. 55.

Journet c. Superchef Food Industries Ltd.,¹⁶⁴⁷ *101114752 Saskatchewan Ltd. v. Kantor*,¹⁶⁴⁸ *Metcalfe v. Anobile*,¹⁶⁴⁹ *Trackcom Systems inc. c. Trackcom Systems international inc.*,¹⁶⁵⁰ *Trudel-Giguère c. Tremblay*,¹⁶⁵¹ and perhaps *167806 Canada Inc v. Ain & Zakuta (Canada) Inc.*,¹⁶⁵² *Tilley v. Hails*,¹⁶⁵³ *Joffre*

¹⁶⁴⁷ *Journet c. Superchef Food Industries Ltd.*, [1984] C.S. 916, 29 B.L.R. 206, 1984 CarswellQue 28, J.E. 84-698 (C.S. Que. May 23, 1984). The respondent took a variety of illegitimate and dishonest steps to take over a corporation (summarized at par. 48). Among other things, these violated a unanimous shareholder agreement that required equal shareholdings between the family of the petitioner and the respondent (par. 10), but there was no emphasis on this in the judgment; in Gomery J.'s summary of all the oppressive acts, it is subsumed without being specifically mentioned into item 12, "operating and administering the business and affairs of Superchef in complete disregard of his legal and contractual obligations to the other shareholders, and as though he were its only shareholder" (par. 48).

¹⁶⁴⁸ *101114752 Saskatchewan Ltd. v. Kantor*, 2012 SKCA 64, [2013] 2 W.W.R. 425, 399 Sask. R. 36, 2012 CarswellSask 434, 552 W.A.C. 36, 218 A.C.W.S. (3d) 417, [2012] S.J. No. 396, 3 B.L.R. (5th) 171 (Sask. C.A. Jun 25, 2012). As part of an oppression action, an injunction was granted to have the proceeds of the sale of potash paid into court (pars. 2-3). The minority shareholder had concerns that these funds would otherwise be appropriated by the majority shareholder, and while only an incidental part of the judgment, Jackson J.A. did briefly note that a unanimous shareholder agreement guaranteed the minority shareholder a portion of the company's potash product (par. 50) and that "[i]f 9711 SaskCo distributes all of the proceeds from the sale of the potash proceeds, it is highly unlikely that Article 7.1 [of the unanimous shareholder agreement] will be fulfilled" (par. 52).

¹⁶⁴⁹ *Metcalfe v. Anobile*, 2010 ONSC 5087, 2010 CarswellOnt 8036, 194 A.C.W.S. (3d) 476, [2010] O.J. No. 4548, 77 B.L.R. (4th) 293 (Ont. S.C.J. Oct 26, 2010). The defendants bought 96% of the shares of a company, with the plaintiff owning almost all of the remainder (par. 16), and proceeded to ignore the plaintiff's interests while removing all corporate value for themselves (par. 64). The plaintiff had expected to have a buy-back clause in the unanimous shareholder agreement used to have the corporation redeem his shares for "fair value", but it never was (par. 67). The judge noted that the agreement specified it could be amended by shareholders owning two-thirds of the shares, which the defendants possessed, and thus they could have amended it in their favour, but they never did (par. 66). While this suggests that compliance with the agreement (in a hypothetical amended form) might have avoided the finding of oppression, and that therefore the violation of the agreement was a key factor, the general behaviour of the defendants seems very likely to have constituted oppression regardless.

¹⁶⁵⁰ *Trackcom Systems inc. c. Trackcom Systems international inc.*, 2013 QCCS 4487, 2013 CarswellQue 9378, EYB 2013-226943 (C.S. Que. Sep 23, 2013). In this interim motion, Castonguay J.C.S. described the oppressive acts of the defendants as numerous (par. 101) and then proceeded to list eight principal examples- while noting that there were others- which included two that were identified as in contravention of a unanimous shareholder agreement: the *de facto* firing of the plaintiff from his position as director and the *de facto* cessation of operations without approval (par. 103). Although the appeal, *Trackcom Systems inc. v. Trackcom Systems international inc.*, 2014 QCCA 1136, 2014 CarswellQue 5192, J.E. 2014-1060, EYB 2014-238036 (C.A. Que. Jun 02, 2014), primarily concerned the choice of remedy, the Court of Appeal did confirm the finding of oppression, mentioning violation of a unanimous shareholder agreement twice in passing while listing off various oppressive elements the trial judge had identified (pars. 27 and 39), but placing the greatest focus on the failure to provide financial information (par. 41).

¹⁶⁵¹ *Trudel-Giguère c. Tremblay*, 2011 QCCS 7258, 2011 CarswellQue 14823, 216 A.C.W.S. (3d) 634, EYB 2011-200895 (C.S. Que. Jan 16, 2011). The reasons for judgment reproduced a lengthy list of allegations from the plaintiff's affidavit, including that the defendant causing the company to purchase a car without approval of the board of directors and in violation of a unanimous shareholder agreement, then subsequently put the vehicle to personal use (par. 10).

¹⁶⁵² *167806 Canada Inc v. Ain & Zakuta (Canada) Inc.*, 1996 CarswellQue 2535, J.E. 96-1758, [1996] Q.J. No. 2689, EYB 1996-85038 (C.S. Que. Aug 23, 1996). The corporation made an offer to the

petitioner to redeem its shares; it was inspired by provisions in the unanimous shareholder agreement granting the other shareholders the option to purchase its shares, but did not actually follow any terms of said agreement (par. 49). The petitioner accepted, but it subsequently became apparent that the corporation would soon be wound up and that, by virtue of the terms of the share redemption, the petitioner could receive more per share than the other investors (par. 55). This prompted them to have the corporation declare a dividend, which was paid in priority to the amount owed for the share redemption (par. 59). In analyzing whether oppression had occurred, Dalphond J.C.A. listed the following factors: that the shareholders (other than the petitioners) had transferred shares amongst themselves in a manner that did not comply with the unanimous shareholder agreement (par. 58); the declaration of a dividend while ignoring the corporation's commitment to pay the petitioner for its shares and without obtaining approval from the shareholders as required by the unanimous shareholder agreement (par. 58); that the majority shareholders had earlier set up a competing company and caused the corporation to invest in it, all without informing the petitioner, in breach of obligations to its shareholders and creditors, and in violation of provisions of the unanimous shareholder agreement (par. 60); the termination of the petitioner as an employee while retaining the majority shareholders (par. 61); and the purported cancellation of unpaid portions of a dividend owed to the petitioner (under the corporation's then position that the earlier offer to redeem had been revoked rather than accepted) without notice or consent, something not permitted by law in any event (par. 62). Given all these factors, it is difficult to sort out the degree to which breaches of the unanimous shareholder agreement constituted oppression, but it is noteworthy that the share transfer between minority investors was listed, since that does not seem particularly oppressive, save that it violated the agreement. On the other hand, the declaration of the dividend was described in substantially negative terms and Dalphond J.C.A. stated that it was unfairly prejudicial to the petitioner, all before adding that "moreover" it was in violation of the agreement (par. 59).

¹⁶⁵³ *Tilley v. Hails*, 7 O.R. (3d) 257, 6 B.L.R. (2d) 298, 1992 CarswellOnt 141 (Ont. Gen. Div. Jan 30, 1992). Two 50% shareholders had had a falling out and become deadlocked (par. 12). Although normally this would have been a situation where winding up the company was appropriate, both parties asked that the court make use of the broad powers it would have under the oppression remedy (par. 13). Borins J. determined that the question to be resolved was which party was responsible for the deadlock (par. 47). The two shareholders had a unanimous shareholder agreement (the reasons for judgment do not usually describe it using that term, although the phrase does appear when the judge notes that the court has the power to amend a unanimous shareholder agreement (par. 53)) in place that named them both as directors, with one named as president and the other as vice-president (par. 8). After relations between the two soured, the vice-president took various steps to interfere in aspects of the company normally overseen by the president and to otherwise harass him, including having him arrested on spurious firearms possession charges (pars. 14-22). Various allegations were also made against the president (pars. 29-39). Borins J. concluded that the vice-president was the one at fault. The bulk of the analysis referred to the history of the parties and their actions and expectations generally, without invoking any violation of the unanimous shareholder agreement (pars. 48-51). However, and although technically this was not an oppression claim, Borins J. stated, "The evidence satisfies me that the conduct of Hails [the vice-president], which I have summarized, was intended to remove Tilley from asserting his proper role in the management of Tilley Endurables contrary to the terms of their shareholders' agreement with the ultimate goal of forcing him out of the company and is a clear case of oppression contrary to s. 247 of the *Business Corporations Act, 1982*" (par. 50). On appeal, *Tilley v. Hails*, 8 O.R. (3d) 169, 6 B.L.R. (2d) 320, 1992 CarswellOnt 142, [1992] O.J. No. 937 (Ont. Div. Ct. May 05, 1992), the judgment was substantially upheld (par. 19), although the evidence of an oral agreement was excluded because of a whole agreement clause in the document (par. 15) and details of the award were altered. (The appeal did not refer to the document as a unanimous shareholder agreement.)

¹⁶⁵⁴ *Joffre c. A.V.I. Financila Corp. (1985) Inc.*, 2003 CarswellQue 1054, J.E. 2003-873, REJB 2003-40956 (C.S. Que. Mar 14, 2003). There was a finding of oppression based upon a violation of the parties' reasonable expectations (pars. 152-153), mostly arising out of the failure of the company to maintain and

*Management inc.*¹⁶⁵⁶

The contrast between an oppression analysis based significantly on the violation of a unanimous shareholder agreement and one wherein any such violation is incidental is illustrated by the different emphases in the trial and appeal judgments for *White v. True North Springs Ltd.*¹⁶⁵⁷ The various claims amongst the parties included opposing accusations of oppression, arising in part from violations of a unanimous shareholder agreement. The agreement itself was the source of substantial debate, particularly concerning whether it was legitimately formed, and it is clearly not an insignificant part of the reasons for

provide financial records required by the *C.B.C.A.* and the unanimous shareholder agreement (pars. 48-50). Although there are repeated references throughout the reasons for judgment to this being in violation of the agreement, these were almost always accompanied by the statement that it was in violation of the legislation as well (pars. 71, 72, 79, 142, 169, 170, 173, *etc.*), and it seems probable that the latter would have sufficed to succeed in the claim. Additionally, the company had made consulting fee payments to the majority shareholder without the periodic approval of the directors required by the unanimous shareholder agreement (pars. 111-113), and while it was specifically noted that a reasonable payment would have been warranted but only in compliance with the agreement (par. 131), the judge's discussion of this as a benefit to one investor at the expense of the others was generally reproving, (see *e.g.* pars. 126-130) even aside from references to the agreement being violated.

¹⁶⁵⁵ *Murphy v. Wise*, 2010 ONSC 5185, 2010 CarswellOnt 6964, 193 A.C.W.S. (3d) 421, 17 P.P.S.A.C. (3d) 308, 75 B.L.R. (4th) 94 (Ont. S.C.J. [Commercial] Sep 22, 2010). The assets of a corporation in which the applicant had a 30% interest were transferred to another company in which he had no interest, without his consent or even knowledge (pars. 52-55). Newbould J. found this transaction to be in violation of a unanimous shareholder agreement, related party restrictions in the *O.B.C.A.*, and the *Personal Property Security Act*, RSO 1990, c. P.10. (Par. 79 sums up his conclusions.) Ultimately, drawing upon the broad discretion with regard to remedies provided by both the oppression provision and the *P.P.S.A.* (par. 79), it was ordered that the new corporation held the old corporation's assets in trust (par. 82), because a franchise had been transferred to the new one and it would require the franchisor's consent to transfer it back (par. 80). With regard to the unanimous shareholder agreement, the specific analysis was brief, explaining what clause was violated and then noting immediately afterward that the transfer was "clearly oppressive" without it even being explained whether that was because of the unanimous shareholder agreement, the other agreements and statutes being violated, or simply general principles of the oppression remedy and the overall facts (par. 68).

¹⁶⁵⁶ *Global Aviation Concept c. Richthofen Management inc.*, 2014 QCCS 1208, 2014 CarswellQue 2713, EYB 2014-235233 (C.S. Que. Mar 31, 2014). On this interim motion, various allegations of oppression were made against a director, including that he was involved with a rival business (in violation of a non-compete clause in a unanimous shareholder agreement) (pars. 20-22), that he was violating the unanimous shareholder agreement in various other ways (par. 15), and that he unilaterally cancelled a service contract the company had with one of the plaintiffs (par. 19). There were repeated mentions of the unanimous shareholder agreement in the judgment, most notably it being listed as one reason there was a strong *prima facie* case, (par. 31), and the relief granted included orders that the terms of the agreement be abided by (pars. 45, 50, 52). Nonetheless, while the unanimous shareholder agreement received more attention in the reasons for this judgment than some others discussed in this subsection, many of the impugned acts would likely have been considered *prima facie* oppressive regardless of the agreement's existence. The judgment was appealed and upheld, in *Global Aviation Concept c. Richthofen Management inc.*, 2014 QCCA 1103, 2014 CarswellQue 5127, J.E. 2014-1091, EYB 2014-237878 (C.A. Que. May 30, 2014); see pars. 22-24 for a brief confirmation that the unanimous shareholder agreement was one basis for the oppression claim.

¹⁶⁵⁷ *White* SC (TD) 2, *supra* note 463, and *White* CA, *supra* note 459.

the trial judgment.¹⁶⁵⁸ With regard to one party's oppression claim, the breaches were critical to the analysis,¹⁶⁵⁹ although with regard to the opposing party's claim, the agreement was largely incidental.¹⁶⁶⁰ This was made clearer in the Court of Appeal decision wherein they upheld the finding that the shareholders' meeting had been oppressive, but did not even mention the violations of the unanimous shareholder agreement in that context.¹⁶⁶¹ Instead, the justification for determining that oppression had occurred was simply that "[i]ndeed, if their actions to strip Jerry White of his 350,000 Class B shares did not amount to oppression, it is difficult to see what use or meaning s. 371 of the *Corporations Act* could possibly have".¹⁶⁶² This underscored that, despite all the attention given to the unanimous shareholder agreement at the trial level, oppression existed independent of it. The trial judgment may have implied as much, but the appeal left no doubt.

Situations such as this, where actions happen to violate a unanimous shareholder agreement but would have been oppressive regardless, are where the most coherent argument can be made that this remedy should coexist with other enforcement approaches. It is debatable whether oppression is the appropriate tool to enforce unanimous shareholder agreements, but in these cases, that is not truly what is

¹⁶⁵⁸ The validity of the agreement was itself the subject of dispute, and was discussed in Chapter Three.

¹⁶⁵⁹ The first claim, wherein the unanimous shareholder agreement was treated centrally, consisted of objections to a directors' meeting that had been called without the amount of notice required by the document, and Hall J. found that the meeting was invalid for that reason (*White SC (TD) 2, supra* note 463, par. 18). The judge determined that the actions taken at the meeting were not themselves oppressive, but that calling it with less than the required notice was (par. 102). Even here, the analysis was not necessarily determined on the basis of strict rights under the agreement, as Hall J. also noted that the lack of notice had been unnecessary and had made it impossible for the complainant to attend in person (par. 102). There were \$5000 in damages awarded to the excluded director, to compensate him for steps he had taken to determine whether the meeting had been valid (par. 103).

¹⁶⁶⁰ There was a complaint that abusive events had occurred at a shareholders' meeting the party had not attended, including the declaration that no unanimous shareholder agreement existed, a change in the number of directors from that specified in the unanimous shareholder agreement, the merger of the two share classes into one without the unanimous consent of Class B shareholders (of which he was one); that the changes to the authorized and issued share capital were fundamental changes under the *Act* but were not authorized by special resolution as required; that a decision was made to offer shares without the unanimous consent of both classes of shareholders as required by the unanimous shareholder agreement; that there had been a refusal to recognize that he had held 350 000 class B shares (which were essentially stripped from him in the revised single class structure adopted); and other complaints not related to the unanimous shareholder agreement, such as his removal as director and the failure to make records available to him (*White SC (TD) 2, supra* note 463, par. 31). The argument that individuals acting *qua* shareholders when voting at a shareholders meeting cannot be oppressive was rejected, although the analysis stressed that the individuals in questions were also directors, potentially differentiating this from any situation where individuals who were *not* directors are accused of acting oppressively when voting as shareholders (par. 88). Despite much discussion earlier of the unanimous shareholder agreement, in concluding that these acts were oppressive, the trial judge's emphasis was simply on the attempt to remove the other party's shareholdings, rather than the violations of the agreement (pars. 77-93).

¹⁶⁶¹ *White CA, supra* note 459, par. 64.

¹⁶⁶² *Ibid*, par. 64.

occurring. The agreements (and their enforcement) exist in true parallel with the oppression claim. It is necessary to distinguish, however, between cases where the existence and breach of a unanimous shareholder agreement is central to the alleged oppression and those where it is incidental, and the line is not always clear.

6.(d)(iv) Summation on Alternative Oppression Approaches

Because the oppression remedy is a statutory basis for bringing a claim, rather than just a model of the unanimous shareholder agreement, cases that nominally fall under it exhibit a variety of analytic approaches. A model unique to the oppression remedy exists, based around "reasonable expectations". But not all oppression cases fall into that mould. Some of them are decided in a manner that presupposes the correctness of a corporate constitutional view of unanimous shareholder agreements. Others apply contractual principles to determine their outcomes. While they may involve findings of oppression for procedural reasons, these judgments- properly understood- endorse whichever other model they draw upon as a means of understanding and enforcing unanimous shareholder agreements.

There seems little benefit to this mixing of approaches. It is a mislabelling at best, and at worst, confusion and uncertainty can result when concepts from different models are blended without a coherent framework. If the analysis is not to be grounded in the unique principles of the oppression remedy itself, if the logic of another approach is the preferred method of determining such claims, then it would be best if they were not brought under this heading at all. Such cases therefore do not represent viable alternatives. Only the "reasonable expectations" version of oppression stands as a truly coherent and unique fourth method of enforcing unanimous shareholder agreements, equal to but distinct from the corporate constitutional, contractual, and directors' duties views.

On the other hand, some oppression cases tell us little about how the remedy interacts with unanimous shareholder agreements because the breach of one's restrictions was incidental, not the basis for the finding. This can be obvious, but it is occasionally tricky to determine whether improper acts were oppressive primarily because they violated a unanimous shareholder agreement or whether they were inherently so. If the latter, then they fall outside the scope of the current question; there does come a point when the oppression remedy ceases to be a flexible method of enforcement for unanimous shareholder agreements and becomes something else entirely.

7. Conclusion

This chapter has examined in depth many of the reported judgments concerning the enforcement

of unanimous shareholder agreements, to determine how the law in this area has developed. But rather than a single definitive answer, the cases have borne out that there are at least four distinct analytic threads that continue to find expression: the corporate constitutional, the contractual, the directors' duties, and the oppression remedy. The case law has demonstrated not only that all four approaches continue to exist, if not always in clearly delineated form, but that they can come to very different results on the basis of very similar or even identical facts. Further, because the law in this area remains poorly articulated, the same judgment may shift between or intermingle them, resulting in yet further confusion.

The decisions in *Sumner* represent perhaps the clearest illustration of the significance of this issue. At the trial level, the judge applied a corporate constitutional approach (distinguishing it from both the contractual and oppression remedy models) and came to one conclusion. The Court of Appeal disagreed, holding that the contractual view of unanimous shareholder agreements was correct, and accordingly, on the exact same facts,¹⁶⁶³ arrived at a quite different result.

A detailed review of cases dealing with the enforcement of unanimous shareholder agreements has revealed not just the persistence of four models, but also has given some insight into their unique features.

The corporate constitutional approach treats the unanimous shareholder agreement as a genuine reassignment of power. Any attempt by the directors to make decisions or take actions in contravention of the restrictions upon them would therefore properly be viewed as null and void; they would no more be able to exert the board's default authority than would a director who had resigned or been outvoted, or indeed an officer or employee. While not quite on point, the discussion of unanimous shareholder agreements by the Supreme Court of Canada in *Duha* provides support for this view. Although only a few cases employ the phrase "corporate constitution", the premise that directors' (purported) breaches of these agreements are void has found expression in a number of judgments, including some nominally under the oppression remedy. A second hallmark of this approach is that the inability of the directors to ignore the limitations upon them is simply a fact, not a right, and thus could potentially be relied upon by anyone, including non-shareholders, including even directors themselves as a "shield". As elaborated upon below, the corporate constitutional approach is highly compatible with a "nexus of contracts" view of the corporation, but it does not necessarily require that model as a basis.

The second approach, the contractual, stands as a stark contrast. It treats the unanimous shareholder agreement as a contract binding the directors, but there is a difference between contracting how one will use (or not use) power and losing that power. Directors would retain the ability to violate unanimous shareholder agreements, subject to liability for damages. The use of contract law principles when enforcing these agreements is one sign of the influence of this model; although they are a convenient tool for the interpretation and application of legal documents, and they might find some place in any approach- as indeed they have- they are not an inevitability. It is debatable whether concepts such as

privity or consideration should have relevance here. Other rules could also be created to handle unanimous shareholder agreements. The clearest indicator of the contractual model, though, is the remedies it offers. The default order for breach of contract is an award for damages. This has a very different practical effect from giving force to the restrictions placed upon directors. It is still possible under a contractual model for improper actions to be ordered reversed, but that is distinct from nullifying them, or for courts to grant an injunction, which is the most similar to the true reassignment of power in the corporate constitutional model.

A third method, which has found relatively little judicial favour, is to treat restrictions upon directors' powers in a unanimous shareholder agreement similarly to the general obligations they owe the corporation. Almost all the relevant statutes explicitly state that directors must obey unanimous shareholder agreements, but this approach extends beyond that; even when the agreements are not being explicitly categorized as part of the directors' duties, the influence of principles normally applied when claims are brought against them can sometimes be seen. In particular, two such rules have been discussed, if not necessarily adopted. One is the notion that the company itself might be the proper complainant if the restrictions upon the board are breached; while shareholder requests to bring claims as derivative actions have been granted, arguments that this is the required procedure have met little success. The other is the "business judgment rule", the deference which courts normally exhibit toward directors' decision-making so that they can pursue what they perceive as the corporate interest without being subject to undue after-the-fact scrutiny. There has been some question whether this might allow directors a discretion to disregard the restrictions in a unanimous shareholder agreement if they thought doing so would benefit the company. Courts have more commonly (but not universally) rejected this position and found that these limitations are not subject to the board's own judgment.

Finally, the oppression remedy may be used as a means of enforcing unanimous shareholder agreements. As a statutory tool itself, it has its own list of eligible parties and available remedies. Because it is a basis for a claim, rather than just an analytic approach, not all cases that nominally apply the oppression remedy should be considered true examples of this theoretical model; many are actually far more influenced by a corporate constitutional or contractual understanding. (Conversely, a finding of oppression may be derived from the overall facts, not an incidental breach of the agreement.) The oppression remedy as a distinct model of enforcement for unanimous shareholder agreements begins by identifying "reasonable expectations" and then protects them from conduct that is oppressive, unfairly prejudicial, or that unfairly disregards interests. In practice, this often does mean enforcing the agreement, and the case law demonstrates the futility of maintaining a technical distinction between "reasonable expectations" reflected in the terms of the document and a reasonable expectation that the agreement itself will be complied with. However, these expectations, and what constitutes their oppression (or unfair

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Although admittedly subject to a few somewhat different inferences.

prejudice or disregard) are determinations that should be made in light of all the relevant facts. Other elements- the surrounding circumstances, the parties' relationships with one another, any changes since the agreements' formation, *et cetera*- may mean the literal contents of the unanimous shareholder agreement do not perfectly reflect the parties' "reasonable expectations". They may be narrower, wider, or just different.¹⁶⁶⁴

At present, then, there exists neither consensus nor predictability as to how cases enforcing unanimous shareholder agreements will be brought, who can bring them, how they will be decided, or what the available remedies are. As a reflection of this, there seems to be no commonly accepted answer as to what unanimous shareholder agreements actually *are*: a fundamental part of the corporate constitution, a contract, a component of the directors' duties, or a factor in the parties' reasonable expectations.

Taking it as axiomatic that it would be better if the situation were clearer, some further prescriptive analysis is warranted as to how the law in this area should develop. Effectively, this means choosing between the four approaches discussed.¹⁶⁶⁵ Although the Alberta Court of Appeal in *Sumner* disagreed, *Duha* suggests that the corporate constitutional approach has the weight of the Supreme Court of Canada behind it.¹⁶⁶⁶ But even there, the Court was not directly addressing the issue, and clearly the indirect implications of its decision have hardly proven definitive as yet.

One must therefore extend the inquiry beyond the case law. The next place to turn is the statutes. As already discussed, whether the particular section creating the unanimous shareholder agreement supports a corporate constitutional or a contractual view depends upon where one puts the emphasis: is it the *restriction* or the *agreement* that the legislation declares valid?

The legislation, however, also states that to the extent that directors' powers are restricted, their duties and liabilities pass to the shareholders.¹⁶⁶⁷ As a matter of statutory interpretation, that should settle the question of whether the restrictions on directors are genuinely limits upon their authority or merely contracts as to the use of that power.¹⁶⁶⁸ If they still retain the ability to disregard the agreement, excusing them from liability makes no sense. Only if their power has been removed would it be consistent to absolve them from responsibility for decisions which they can no longer control. This is made even clearer

¹⁶⁶⁴ It is also possible that, even if the terms of the document reflect "reasonable expectations", an act in contravention of them might not be oppressive, unfair disregard, or unfair prejudice. See the discussion of *Renaud-Bray*, *supra* note 1396.

¹⁶⁶⁵ It is possible to create or adapt yet another framework, but the justification for it would need to be strong enough to be worth the further complications. No such candidate springs to mind. The "judicial discretion" model, discussed at note 895, is at best an inferior alternative to the oppression approach.

¹⁶⁶⁶ See the discussion earlier.

¹⁶⁶⁷ *C.B.C.A.* s. 146(5); *A.B.C.A.*, s. 146(7); *M.C.A.*, s. 140(5); *N.B.C.A.*, s.148(7); *N.B.C.C.A.*, s. 99(5); *N.L.C.A.*, s.245(8); *N.T.B.C.A.*, s.148(7); *O.B.C.A.*, s.108(5); *Q.B.C.A.*, s. 214; *S.B.C.A.*, s. 140(4); *Y.B.C.A.*, s. 148(7).

¹⁶⁶⁸ Although the fact that the statute explicitly removed their powers should itself have been sufficient.

by the fact that the shareholders themselves assume the liability the directors shed; it would be doubly unfair to allow directors to override unanimous shareholder agreements (even if they were potentially liable in damages) while holding shareholders responsible for the areas covered by those agreements.

As between the corporate constitutional and contractual approaches, then, the legislative intent is clear.¹⁶⁶⁹ Unanimous shareholder agreements are meant to genuinely restrict the directors' powers; this is why their liability is removed to the same extent.

Similarly, if such restrictions are real, then the directors' duties and the oppression remedy cannot be the intended methods of enforcement. The scope of the former is limited to the areas where the directors have power. As will be discussed in Chapter Five, it appears that the statute *removes* the directors' duties of care and loyalty in the areas affected by a unanimous shareholder agreement; it would be contradictory to suggest that that was then the expected enforcement mechanism. The sections of the various statutes explicitly stating that directors must obey unanimous shareholder agreements are thus misleading, but they serve as redundant reminders that directors cannot disregard these documents.¹⁶⁷⁰

Because the oppression remedy has a wider ambit, covering any business or affairs of the corporation that might oppress or unfairly prejudice a shareholder's interests,¹⁶⁷¹ it is more compatible with the unanimous shareholder agreement provisions. It can work in parallel with other legal remedies, when warranted, so such co-existence is unproblematic.¹⁶⁷² However, the strand of oppression cases most consistent with the statute are those in which the remedy was applied against a background understanding that the agreements had, in a corporate constitutional manner, genuinely limited the directors' powers. By contrast, judicial determinations that the parties' "reasonable expectations" allowed directors to circumvent restrictions upon them are less consistent with the statute.

Moving another step away from the doctrinal and toward pure prescription, it remains to be considered what approach would be ideal, regardless of the current statute, both because the legislation can

¹⁶⁶⁹ With one caveat in Ontario. *O.B.C.A.* s. 17(3) states, "[N]o act of a corporation [...] is invalid by reason only that the act is contrary to [...] a unanimous shareholder agreement[...]" The degree to which this conflicts with the corporate constitutional approach is discussed at note 892. At the very least, it must be acknowledged that, in the Ontario statute, s. 17(3) can be read as inconsistent with a pure corporate constitutional approach to enforcement, under which an act of a corporation would be invalid by reason only that the decision to act had not been made by those authorized to do so pursuant to the restrictions in a unanimous shareholder agreement. If that enforcement method is adopted as the standard one, this subsection should therefore be amended. (Third parties are adequately protected by *O.B.C.A.* s. 19(a).) This provision aside, the remainder of the Ontario *Act* is, like the other statutes, most consistent with the corporate constitutional approach.

¹⁶⁷⁰ The same sections list the statutes themselves as among the items which the directors must obey, and it is not as though directors would have the power to ignore provisions in the legislation absent this. See *C.B.C.A.* s. 122(2), *A.B.C.A.* s. 122(2), *M.C.A.* s. 117(2), *N.B.B.C.A.* s. 79(2), *N.L.C.A.* s. 203(2), *N.T.B.C.A.* s. 123(2), *N.B.C.A.* s. 123(2), *O.B.C.A.* s. 134(2), *S.B.C.A.* s. 117(2), *Y.B.C.A.* s. 124(2).

¹⁶⁷¹ *C.B.C.A.* s.241; *A.B.C.A.*, s. 242; *M.C.A.*, s. 234; *N.B.B.C.A.*, s. 166; *N.B.C.A.*, s. 243; *N.L.C.A.*, s. 371; *N.T.B.C.A.*, s. 243; *O.B.C.A.*, s. 248; *Q.B.C.A.*, s. 450; *S.B.C.A.*, s. 234; and *Y.B.C.A.*, s. 243.

¹⁶⁷² Or, depending upon one's perspective, part of a much larger issue with the oppression remedy.

be amended and in the interest of intellectual rigour. Which of the four approaches would be the best method of enforcing these agreements?

This returns us to the most fundamental question of unanimous shareholder agreements: to what degree should the corporation be customizable? More specifically, should the roles of directors and shareholders be subject to change at the behest of the latter group. In Chapter Two, the theory of the corporation as a "nexus of contracts" was reviewed. That doctrine has many adherents, but is also in some ways out of step with contemporary Canadian law and its increasing attention to stakeholder groups, an issue that will be returned to in the next chapter.

If it is true that the corporation is merely an elaborate web of implied contract, then the terms of those contracts could be changed. The powers of directors would only exist in the first place because they were set out in those notional agreements; they could be restricted or altered in any way imaginable, and those alterations would be *real*. Just as an employee's authority can be determined by an employer, made greater or lesser, the directors' could. This is the same reasoning that underlies the corporate constitutional model.¹⁶⁷³

That does not mean that *only* a "nexus of contracts" model of the corporation can justify a corporate constitutional approach to enforcing unanimous shareholder agreements. Even conceived of as bound by the legislative framework, the corporation is customizable in many ways. It is not a contradiction to assert that the ability to genuinely alter the directors' powers via a unanimous shareholder agreement has been included amongst those legislatively-authorized options, but the corporation still remains an entity created by the statute, tied to a large number of predetermined elements found therein, and possessing unique features not available through contracts. That said, because the balance of power between directors and shareholders is such a key element, allowing it to be altered does represent a shift, however qualified, away from a predetermined structure and toward agreement-based, shareholder-selected ones.

Because it is compatible with both the "nexus of contracts" and statutorily-defined entity theories, it might appear that the corporate constitutional approach contributes nothing to the debate regarding which understanding of the corporation is correct. But that is not true. This method of enforcement does align Canadian corporate law more with the "nexus of contracts" model than has historically been the case. That alignment is not definitive, however; given the limits upon the unanimous shareholder agreement as a tool for customizing the corporate structure, applying this model of enforcement within that scope does not require a rejection of the statutorily-defined entity view of the corporation as a whole. The theoretical implications of the corporate constitutional approach may therefore be described as ambiguous. That very ambiguity is telling, however, when contrasted with the contractual, directors' duties, and oppression models. Although all four methods of enforcement can be rationalized within either theoretical framework, choosing any of the other three would constitute a rejection of the principle that the division of power

within the corporate structure is derived from the consent of the shareholders and thus can genuinely be rearranged by them. If directors cannot truly have their powers removed by a unanimous shareholder agreement, that would significantly undermine the "nexus of contracts" model of the corporation, or at least the shareholder-centric, libertarian version of the theory that is often advocated. If, on the other hand, the corporate constitutional approach is accepted as the method for enforcing unanimous shareholder agreements, then while that does not mean that the "nexus of contracts" view is necessarily correct, it would indicate that it is at least still viable. Bearing this association in mind, the choice between the corporate constitutional approach and one of the other three has implications for the fundamental nature of the corporation. Some judges have been resistant to the redistribution of authority associated with this method of enforcing unanimous shareholder agreements; it seems likely they would be even less comfortable with a true "nexus of contracts" framework.

While both traditionalism and paternalism might underlie reluctance to allow shareholders to freely remove directors' powers, the perceived role of the board as a mediator amongst different groups in the corporation might also justify hesitancy. An inherent assumption of unanimous shareholder agreements is shareholder primacy.¹⁶⁷⁴ Investors can directly or indirectly use them to advance their own interests at the expense of other groups. Adopting one of the other three approaches to enforcement could theoretically help mitigate that problem; when they are not merely serving as indirect vessels for corporate constitutional reasoning, they all assume that directors still retain the power to override the restrictions upon them, albeit respectively subject to contractual damages, meeting the standards of the duty of care, or avoiding unfairly disregarding "reasonable expectations". They reject, in other words, a fundamental altering of the directors' role in the corporation, in favour of one more layer of potential liability for the misuse of that role.

This creates problems for terms that explicitly assign some or all of those powers to the shareholders, if any approach but the corporate constitutional were adopted. Whether the statutes would necessitate the retention of a "phantom board", one stripped entirely of its powers but required by statute to exist, has been debated by commentators.¹⁶⁷⁵ The contractual, directors' duties, and possibly oppression

¹⁶⁷³ But not the contractual approach, an unfortunate conflict in nomenclature.

¹⁶⁷⁴ This is the position that corporations exist for the sole purpose of serving shareholder interests, generally assumed to be profit maximization. It should not be confused with the shareholder-centric version of the "nexus of contracts" model discussed in Chapter Two, but the two are compatible. Such a framework can acknowledge that the *de jure* beneficiary of the directors' duties is the corporation, but the underlying justification is still assumed to be profiting the shareholders.

¹⁶⁷⁵ It should be noted that "phantom board" is not a standardized phrase in the literature on unanimous shareholder agreements, but the concept referred to has been frequently discussed; for convenience, I will use the term here. (I do not believe I am originating its usage in this context, but I have been unable to relocate the source I am adopting it from.) The Alberta Report, *supra* note 223, p. 25, advocated for the retention of a phantom board to create the illusion of regularity and as a source of apparent authority for outsiders to rely upon. The Industry Canada Discussion Paper, *supra* note 9, pp. 40-44, argued that "the retention of a board of directors without any powers seems to make little sense" (p. 41) but noted that director-less corporations might be problematic if the shareholders were corporations (pp.

models would mean that this "phantom board" could still exercise powers it was not supposed to have. A similar challenge is posed when directors retain some authority but have had the rest passed to the shareholders. This sort of arrangement is contemplated by the statute- note again the transfer of liability to the same extent- but can only truly be accommodated by the corporate constitutional approach. This, however, is merely a new variant of the question as to whether shareholders should be allowed to change the role of directors.

If they should not, then the unanimous shareholder agreement itself is a mistake, an anomaly that needs to be corrected. It is possible, albeit through the use of controversial assumptions, to construct a rationale for the corporate constitutional approach from base principles, that is while assuming that the unanimous shareholder agreement did not already exist. One possibility, already mentioned, is to resort to "nexus of contract" notions, from which the corporate constitutional approach easily follows. Another is to locate policy reasons why such flexibility should be included as one of the customization options within a statutory framework. To the extent that the result is problematic, one adjusts what restrictions are permissible,¹⁶⁷⁶ rather than the nature of the restrictions themselves. If expanded shareholder control of corporations proves undesirable regardless, then the very idea of unanimous shareholder agreements would need to be rethought, although that direction might lead to other, even more profound, reconsiderations of the corporation.¹⁶⁷⁷

It is more difficult to justify, from base principles, a contractual approach to enforcing unanimous shareholder agreements. In essence, what this amounts to is a "penalty clause", where money would need

42-43) or if outside parties proved reluctant to deal with such an unfamiliar power structure, while acknowledging that a *misleading* power structure was itself detrimental. (p. 43) Sohmer, *supra* note 311, pp. 674-675, interpreted the statute as not permitting for the elimination of a board of directors, only the restriction of its powers. Hay and Smith, *supra* note 319, p. 447, asserted that since some individuals will always be needed to exercise managerial power, it would be best to mandate that at least one director be retained in order to preserve the applicability of existing precedents regarding such control; they did not fully consider the difficulties posed if the nominal director is no longer the person(s) filling the function they describe. Disney, *supra* note 9, pp. 106-110 argued against retaining phantom boards who hold no power. Dennis, *supra* note 9, p. 123-124, also argued that if directors no longer have any power whatsoever to manage the business and affairs of the corporation, they should be eliminated. Scavone, *supra* note 9, pp. 341-342, suggested that a phantom board should be retained in order to satisfy statutory obligations such as residency requirements, rather than transferring those to shareholders, although he admits this is "a bit absurd" (p. 342). Martel, *supra* note 11, p. 20, simply assumed that the board must be retained, and used this as one basis for his argument that it is not permissible to remove *all* of its powers, hence it would never be a true phantom board; he argued, however, that if it was made permissible to render the board powerless, then the law should be amended to allow for its elimination in order to avoid confusion (p. 41). See also Robitaille, *supra* note 267, p. 172; Ratti, *supra* note 16, pp. 111-112; Turgeon, *supra* note 9, pp. 233, 258.

¹⁶⁷⁶ For example, for policy reasons, one might forbid a unanimous shareholder agreement that prevented directors from cooperating with employee unionization attempts.

¹⁶⁷⁷ A departure from shareholder-elected boards of directors, for example.

to be paid if a restriction was violated.¹⁶⁷⁸ That assumes, of course, that provable damage actually occurs.¹⁶⁷⁹ If the limitations on directors in these agreements are simply a means for investors to insulate themselves from the perceived potential for provable harm, that might suffice; they would be compensated up to the level of the harm, which achieves effectively the same result.

But it would discard the possibility of unanimous shareholder agreements that did anything else. Restrictions can be attempts to foreclose avenues leading to harms that would be impossible to estimate or even definitely confirm. They might even be restrictions that were themselves "harmful" to the shareholders, at least in the economically quantifiable sense, such as ones enshrining "corporate social responsibility" principles. A contractual approach to enforcement renders such terms meaningless, just as it makes difficult a more substantial role for direct shareholder participation in corporate governance via the assumption of some or all of the board's normal authority.

If unanimous shareholder agreements serve only as a form of *de facto* insurance for investors against the provable harm that might befall them should directors choose to violate their terms, it would be preferable to frame them that way, rather than as "restrictions" upon the board.

The directors' duties also seem a poor method for enforcing unanimous shareholder agreements. By their very nature, they set the standard that directors must meet in the exercise of their discretion. If the terms of the agreement are absolute obligations, they must almost by definition not be part of the duties at all. But if they are merely one factor that directors have to consider as they weigh their options, then they would be easily ignored. The difficulty of enforcing the duty of care in the face of the business judgment rule has been widely noted. That might be a necessary evil when dealing with areas where directors must have discretion to deal with a range of unpredictable situations, but it is hardly ideal for handling clearly defined restrictions.

Finally, the oppression remedy (taken in isolation) has the advantages of flexibility and context-sensitivity. But like the duties of care and loyalty, its design is most suited to dealing with the misuse of the directors' legal power; it is questionable whether it should be used to police the defined limits of that power. Further, its outcomes have a relatively high degree of uncertainty as compared to the other methods, with the potential for a variety of factors creating "reasonable expectations" at odds with the obvious meaning of the document. A unanimous shareholder agreement would seem to be an attempt to impose certainty. For all the drawbacks of contract law, there is a reason why it has developed as it has; some unpredictability is inevitable, but parties seeking to determine their future rights would usually be best served by having it minimized. The oppression remedy should nonetheless retain a role in situations where enforcement of the instrument is not the primary goal, such as larger patterns of behaviour that only

¹⁶⁷⁸ It also assumes there are no privity issues, or that these are disregarded.

¹⁶⁷⁹ There is also an issue as to who would pay the damages. If it was the directors, perverse incentives arise; they would likely only subject themselves to such liability if they personally stood to gain,

incidentally involve breaching its terms or acts which the agreement might permit but are nonetheless oppressive.

One returns then to two alternatives: either shareholders can customize the corporation (within limits) by restricting directors' powers or they cannot. If they can, then the corporate constitutional method is superior. If they cannot, then the contractual approach is the next best alternative, but it would be better to rethink the entire idea of unanimous shareholder agreements.

The corporate constitutional method also has the implicit support of the Supreme Court of Canada in *Duha* and is the only consistent way of reading the statutes. So long as unanimous shareholder agreements do continue to be a part of Canadian corporate law, it is the direction that one should hope future cases follow.

Chapter 5: The Transfer of Directors' Duties

1. Introduction

The unique feature of the unanimous shareholder agreement is its ability to restrict the powers of corporate directors, which now appears to non-controversially include directly transferring those powers to shareholders. In previous chapters, the questions of what constitutes a valid restriction and how it might be enforced have been examined. And yet, there is a third aspect that also deserves consideration: the accompanying elimination or transfer of directors' duties and liabilities.¹⁶⁸⁰

As usual with the unanimous shareholder agreement, the drafting of the *C.B.C.A.* and its counterparts opens the door to a variety of technical questions as to how this might work and whether it is open to exploitation. It is simple to say that if directors have all of their power restricted, they should likewise have their liability removed.¹⁶⁸¹ But the statute allows for them to retain some or most of their

¹⁶⁸⁰ Although all statutes currently specify both duties and liabilities, this was not always the case. *C.B.C.A.* '74-'75 relieved directors of both to the extent that their powers were restricted, but only stated that shareholders received the directors' duties, without mentioning their liabilities. The Alberta Report, *supra* note 223, p. 29, mentioned this, but simply recommended that Alberta not repeat this anomaly. The Industry Canada Discussion Paper, *supra* note 9, p. 31 described it as an ambiguity and noted that it "may not be clear" (p. 31) whether statutory liabilities are imposed upon the shareholders or removed from the directors. Martel, *supra* note 11, p. 29, and Hay and Smith, *supra* note 319, p. 451, both described the omission as "curious"; Hay and Smith suggested that the legislators may have considered "liabilities" implicit in "duties". Disney, *supra* note 9, pp. 93-94 believed this wording created genuine ambiguity. Most extremely, Scavone, *supra* note 9, p. 348, argued that this distinction had significance, because in his view, some of the directors' liabilities, including for unpaid wages, did not arise from duties and were therefore not covered by the wording. Subsequent amendments have fortunately resolved this issue. This historical controversy notwithstanding, throughout this chapter, general references on my part to the transfers of directors' "duties" and "liabilities", as well as occasionally "responsibilities", are all meant to refer to both directors' legal duties and legal liabilities, unless context clearly indicates otherwise.

¹⁶⁸¹ From a transfer of liability perspective, it appears relatively straightforward that where all powers of the directors are restricted, so too should all their responsibilities be assumed by the shareholders. Perhaps the only dissent on this point is that of Ratti, *supra* note 16, p. 119-120, who took the position that these sorts of statutory responsibilities are tied to the office of director, regardless of power, and thus liability for unpaid employee wages and taxes *et cetera* would remain with the board (except where the legislation expressly alters this rule, as the *C.B.C.A.* does with regard to employee wages); he acknowledged that this would be a difficult situation for directors who had had their powers removed but retained some liability. Even accepting for the sake of argument that this is consistent with the letter of the provision (presumably falling into a loophole in the qualifier that responsibilities shift "to the same extent" as powers), it serves neither justice nor policy goals to hold powerless office-holders liable while allowing the real decision-makers to escape the consequences of their choices. Although the use of the phrase "in whole or in part" in the *C.B.C.A.* has generally pre-empted controversy about whether the directors' powers

traditional authority while nonetheless being restricted in some areas, and it is in no way clear what the exact implications would be for their liabilities. These questions are of practical concern (although in fact have seldom or ever been litigated, at least not in reported cases), but perhaps just as importantly, they force us to reconsider the nature and purpose of directors' responsibilities.

The unanimous shareholder agreement thus serves as a sort of "stress test". By considering how legal principles should adapt to fit the new arrangements these instruments can contort the corporation into, we learn more about the principles that underlie the law generally. To know how to handle the removal or transfer of responsibilities when directors' powers are restructured in unusual ways, we must first reconsider the purpose and function of those duties and liabilities.

There are also issues specific to the possible transfer of the duties of care and loyalty, which again force us to examine not just how they can be adapted to fit new arrangements, but their very nature. One conception of them is that they are designed to ensure that directors safeguard shareholders' interests. A debate has therefore arisen amongst commentators as to whether these duties are necessary or meaningful when investors have assumed direct control. I argue that even assuming a shareholder-driven rationale for these duties, they remain useful as a means of protecting empowered investors from one another.

The decisions of the Supreme Court of Canada over the last fifteen years cast this question in a different light. If directors' duties are not designed solely to serve shareholders (with the "corporation" serving as a proxy for investors' presumed desire for maximized financial gain), but instead may take into account the interests of other stakeholders, what are the implications of the unanimous shareholder agreement and its potential effect upon those duties? Various scenarios suggest that it could subvert attempts to develop a stakeholder model of the corporation. But the difficulties with making this legal tool practically or philosophically compatible with a model of corporate law that recognizes stakeholder interests are only reflections of a broader problem; the unanimous shareholder agreement is simply the most explicit manifestation of the assumption of shareholder primacy that underpins corporate law in this country.

As the previous chapters have explored, these agreements to some extent bring aspects of a "nexus of contracts" understanding of the corporation into Canadian law. Although such a shift should not be overstated, this legal tool does allow shareholders to, by agreement, alter significant aspects of the normal

could be restricted in their entirety, earlier Quebec legislation lacked that phrase; see however Martel, *supra* note 11, pp. 19-20, and Ratti *supra* note 16, p. 112, who found some ambiguity in the wording of the *C.B.C.A.* Martel argued that the legislation *only* permitted the transfer of some powers, and did not allow all of the directors' powers to be removed, based on a counterintuitive reading of the phrase "in whole or in part" as referring to the selection of directors' powers that might be affected, but not the degree. Ratti considered the provision's wording contradictory, with "restricts" implying only partially but "in whole or in part" meaning the opposite. The current version of the *Q.B.C.A.* clearly allows for the removal of all the board's powers, as acknowledged by Martel and Martel, *supra* note 16, p. 358 and Beaugard and Auger, *supra* note 16. If any individual power of the directors can be removed, the only additional difficulty of

corporate structure. Insofar as the directors' liabilities are a part of that structure, the friction this creates and how it is handled represent yet another manifestation of a conflict between two possible conceptions of the corporation.

This chapter will focus on these issues, beginning with the general justification for director liability and what that means when their powers have been split between them and shareholders. After this framework has been established, the transfer of the duties of care and loyalty will be considered, first in the context of a shareholder primacy understanding of the corporation and then through stakeholder theory.

2. General Considerations for the Transfer of Responsibilities

2.(a) The Basis for Director Liability

The *Canada Business Corporation Act* currently provides that:

146(1)(5) To the extent that a unanimous shareholder agreement restricts the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation, parties to the unanimous shareholder agreement who are given that power to manage or supervise the management of the business and affairs of the corporation have all the rights, powers, duties and liabilities of a director of the corporation, whether they arise under this *Act* or otherwise, including any defences available to the directors, and the directors are relieved of their rights, powers, duties and liabilities, including their liabilities under section 119, to the same extent.¹⁶⁸²

The first question that this raises is *why* the duties and liabilities of directors are removed alongside their rights and powers, and why they are then imposed upon whomever is given those rights and powers. This might appear self-explanatory, but some commentators have approached the consequences of this section (and its equivalents) as a trap for shareholders to avoid if possible, while still obtaining their desired outcomes.

Sohmer began from the premise that the goal of the unanimous shareholder agreement provision was to allow investors to control small corporations¹⁶⁸³ and that this was a laudable development.¹⁶⁸⁴ The

removing all of them simultaneously would be the "phantom board" issue discussed at note 1675.

¹⁶⁸² This provision has not always had this form and the wording does not precisely correspond to any of the current analogues in the provincial statutes. See *A.B.C.A.*, s. 146(7); *M.C.A.*, s. 140(5); *N.B.C.A.*, s.148(7); *N.B.C.C.A.*, s. 99(5); *N.L.C.A.*, s.245(8); *N.T.B.C.A.*, s.148(7); *O.B.C.A.*, s.108(5); *Q.B.C.A.*, s. 214; *S.B.C.A.*, s. 140(4); *Y.B.C.A.*, s. 148(7). While each of these sections causes the directors to be relieved of their duties and liabilities to the extent that they are restricted, all the provincial statutes except the *Q.B.C.A.* still assume that when such restrictions occur, all of the shareholders automatically receive those powers as well as the accompanying responsibilities. Generally speaking, the following discussion assumes a *C.B.C.A.* framework, although much of it remains applicable to the provincial equivalents.

¹⁶⁸³ Sohmer, *supra* note 311, p. 673.

¹⁶⁸⁴ *Ibid.*, p. 674.

limitations of taking a purely shareholder primacy approach, at the expense of considering the interests of other groups and wider principles of accountability, can be seen in his argument that investors may prefer to use amendments to the articles of incorporation rather than this method, as that would enable them to avoid the "danger" of the duties and liabilities that a unanimous shareholder agreement would impose upon them.¹⁶⁸⁵ At the time, the articles could contain any provision which a unanimous shareholder agreement might, a feature of the 1975 *Act*¹⁶⁸⁶ that was later removed. What is striking is how neutrally he presents the argument that shareholders might prefer to utilize a method whereby they assumed power without corresponding responsibility. They well might, but one would think that it would be noteworthy that the position of directors and third parties is thereby compromised. The only drawback Sohmer identified to going this route would be that, without the unanimity requirement, minority shareholders might be unprotected from the tyranny of the majority.

Similarly, Fitzwilliam, writing about the importation of the unanimous shareholder agreement from Canada to Trinidad and Tobago, stated that its introduction into the legislation precluded an apparently previously valid practice in that country of granting additional control rights to minority investors via agreements that were entered into by all the shareholders, but were not "unanimous shareholder agreements" in the current sense.¹⁶⁸⁷ Under the new regime, such arrangements would be deemed to be unanimous shareholder agreements with the full legal consequences that would imply. This would either discourage investors from entering into them or else result in minority shareholders receiving additional rights only at the cost of potential liability. The difficulty with Fitzwilliam's analysis is that it included no particular acknowledgment that there is any logical or legal reason *why* unanimous shareholder agreements shift duties and liabilities as well as powers. He treated it as a purely arbitrary decision by legislators. It was from that perspective that he preferred a similar mechanism lacking said responsibilities, rather than questioned it.

Hay and Smith also considered circumstances in which articles or by-laws might limit directors' powers, for example by raising voting requirements.¹⁶⁸⁸ They noted the obvious advantage for shareholders is that the statute does not explicitly transfer liability if they use these alternate methods.¹⁶⁸⁹ However, Hay and Smith concluded that resorting to these mechanisms was ultimately pointless, since "liability for misuse of traditional director prerogatives must ultimately fall on some human actors in the corporation",¹⁶⁹⁰ and therefore, the shareholders would bear responsibility anyway. But it is uncertain if this would hold true in practice, given the traditional reluctance of courts to hold shareholders liable for

¹⁶⁸⁵ Ibid, p. 677.

¹⁶⁸⁶ *C.B.C.A. '74-'75*, section 6(2).

¹⁶⁸⁷ Fitzwilliam, *supra* note 9, at section 5. The legal status of such agreements under the former legal regime in Trinidad and Tobago was not fully explained and is beyond my own fields of study.

¹⁶⁸⁸ Hay and Smith, *supra* note 319, p. 449.

¹⁶⁸⁹ Ibid, p. 449.

corporate acts. It is possible that no humans would be found responsible or that the *wrong* humans, the powerless directors, would be. Further, as the duties of care and loyalty illustrate, there is significant disagreement on the degree to which the responsibilities of directors would fall unaltered upon empowered shareholders even in the context of statutory language explicitly transferring duties and liabilities; in the absence of such a provision, the situation could be even murkier.

Turgeon similarly classified the statutorily-mandated assumption of responsibilities by empowered shareholders as simply a particular application of the doctrine of *de facto* directors.¹⁶⁹¹ Following the same logic in reverse, he also concluded that it would be unjust to impose the normal responsibilities of directors upon a board rendered powerless, because not only they did not make the decisions that presumably gave rise to any liabilities, they legally could not have made those decision.¹⁶⁹²

The point which Hay and Smith and Turgeon grasp, and which Sohmer and Fitzwilliam downplay, is that directors' powers are accompanied by their responsibilities in order to serve purposes. This is not to say that the current structure of directors' duties and liabilities is anywhere close to perfect at achieving those objectives, or even that the desired ends themselves are never dubious, but their responsibilities reflect attempts by legislators and judges to accomplish goals that have been deemed worthy of pursuit. While it might be in the shareholders' self-interest to get the benefits of directors' powers without the drawbacks, that would defeat those larger purposes.

The constitutional ramification of this transfer, specifically whether as a matter of law it affects duties and liabilities set out in other statutes, is one area where commentators have recognized that directors' responsibilities exist for a reason.¹⁶⁹³ Disney argued that, despite some possible ambiguity in the legislation, the exclusion of responsibilities under other statutes was illogical, as their presumed purposes were only served if they fell upon the corporation's true decision-makers.¹⁶⁹⁴ Having established that, he dismissed the constitutional problem of liabilities under provincial legislation being altered by a unanimous shareholder agreement authorized by the federal statute or *vice versa*, as neither legislature would be purporting to eliminate a responsibility created by the other, merely to identify who it applied to, and holding the true decision-makers accountable served the purposes of statutory liability rather than defeating them.¹⁶⁹⁵ Similarly, Scavone addressed the constitutional implications by denying there was a problem. Who the liable "directors" under a statute were was, in his view, a question of fact, and the statute under

¹⁶⁹⁰ Ibid, pp. 449-450.

¹⁶⁹¹ Turgeon, *supra* note 9, p. 242.

¹⁶⁹² Ibid, p. 241.

¹⁶⁹³ Alberta Report, *supra* note 223, p. 29, raised the constitutional issue without such a purposive inquiry, and it is perhaps for that reason that it concluded that a unanimous shareholder agreement under the *A.B.C.A.* might transfer duties and liabilities created by other provincial acts, but would be ineffective with regard to responsibilities imposed by federal legislation.

¹⁶⁹⁴ Disney, *supra* note 9, p. 125.

¹⁶⁹⁵ Ibid, p. 127.

which the corporation operated was only evidence to help settle it.¹⁶⁹⁶ Liability would fall upon those who actually operated as the directors, exercising the powers typical of that office.¹⁶⁹⁷ It was also in the context of this jurisdictional dilemma that the Industry Canada Discussion Paper noted that most of the statutory penalties that directors face arise either out of their actions or their failure to exercise the appropriate due diligence,¹⁶⁹⁸ concluding that "[i]t might defeat the purpose of the statute imposing the liability on a director if the shareholders were not effectively subject to such liability where they had entered into a unanimous shareholder agreement removing the powers of the directors, since only the shareholders would then have the necessary degree of involvement in the conduct constituting the offence to attract statutory liability".¹⁶⁹⁹ Such logic applies even where no jurisdictional issues arise. It is the basic justification for ensuring that, when a unanimous shareholder agreement is in effect, the powers and responsibilities normally held by directors remained linked, and whoever wields one must bear the other.

In *Vaszi v. Ontario (Ministry of Labour)*,¹⁷⁰⁰ a case heard by the Ontario Labour Relations Board, the principle was summed up as follows:

21 A director is someone who has the power and duty to manage the business affairs of the corporation. Where no USA exists, a director is not subject to shareholders' control in the exercise of his or her powers. In the absence of an USA, directors have the power to make decisions that directly impact on whether the business will be in a position to pay employees their vacation pay and wages. The *OBCA* thus renders them liable where their decisions result in a situation where employees are not paid.

22 A director's powers can be limited by a valid USA. A USA allows the shareholders to effectively take over the powers that would otherwise belong to the directors. In such cases, given that the shareholders have the power to make decisions that affect whether the business will be able to pay its employees their vacation pay and wages, it is the shareholders that are made liable in the event of default and not the directors.

23 It is apparent that the *OBCA* and the *Act* are designed to impose liability on the individuals who have the power to make decisions for the corporation that will directly impact on the corporation's ability to pay its employees. No liability is imposed on officers or senior management of a corporation notwithstanding that such individuals typically have considerable influence with respect to the operation of the corporation. Liability is imposed on directors or shareholders signatory to a USA alone as it is those individuals who have ultimate control over the decisions made by the corporation.

The board applied this principle to determine that, with regard to shares held in trust, the beneficial owner would be liable only if she had the power to *control* how the shares were voted, which she did

¹⁶⁹⁶ Scavone, *supra* note 9, p. 354.

¹⁶⁹⁷ See on this point *C.B.C.A.* s. 2(1).

¹⁶⁹⁸ Industry Canada Discussion Paper, *supra* note 9, p. 38.

¹⁶⁹⁹ Industry Canada Discussion Paper, *supra* note 9, p. 38.

¹⁷⁰⁰ *Vaszi*, *supra* note 418.

not.¹⁷⁰¹ Involvement short of actual control was insufficient to incur penalties, because "[t]he *Act* does not impose liability [...] on advisors or investors. It imposes liability on those who have the power and responsibility to make decisions that impact on the corporation's ability to pay."¹⁷⁰²

Similarly, in *Perricelli v. R.*,¹⁷⁰³ a unanimous shareholder agreement specified that three investors would each elect one director, and initially they selected themselves.¹⁷⁰⁴ Most of the judgment proceeded as if the document had specifically designated those individuals as directors and would technically require amendment for them to vacate those positions.¹⁷⁰⁵ One of them subsequently resigned,¹⁷⁰⁶ although there were a variety of issues surrounding the validity of that resignation,¹⁷⁰⁷ including that the agreement had not been amended. In determining whether the (ex-)director was liable for unremitted G.S.T., Miller T.C.J. first found that his resignation was effective such that he was no longer a *de jure* director, in which analysis no reference was made to the agreement,¹⁷⁰⁸ and then further found that despite a few facts to the contrary, including a "lack of attention"¹⁷⁰⁹ to the unanimous shareholder agreement, he was also not a *de facto* director because "he never thought he had any authority to advise, influence or control the management or direction of the Company".¹⁷¹⁰ Regardless of the conclusions reached about the amendment and breach of unanimous shareholder agreements, this judgment demonstrated again the connection between exercising the authority of a director and bearing the responsibilities of that office.

Although this dissertation has generally avoided the debates about what procedures should govern decision-making after investors have assumed control through a unanimous shareholder agreement, they do have one potential consequence for the current discussion. Turgeon considered whether, if empowered shareholders still vote on a per share basis (rather than per shareholder), it is unjust to hold each investor equally responsible.¹⁷¹¹ In the situation that illustrates this most obviously, a majority shareholder would have total control over the company, and the others would be limited to, at most, attempting to influence outcomes indirectly.¹⁷¹² The minority might be able to exercise dissent rights, but not in all circumstances.¹⁷¹³ Turgeon concluded that even if it seemed inequitable, one who has consented to an

¹⁷⁰¹ Ibid, par. 27.

¹⁷⁰² Ibid, par. 26.

¹⁷⁰³ *Perricelli*, *supra* note 269.

¹⁷⁰⁴ Ibid, par. 4.

¹⁷⁰⁵ Ibid, pars. 21, 29, 42, 44.

¹⁷⁰⁶ Ibid, par. 7.

¹⁷⁰⁷ These included the lack of formality surrounding the resignation (described at *e.g. Perricelli*, *supra* note 269, par. 32), and the occasional writing of cheques on behalf of the company, and continued representation that he was a director to one of the corporate creditors (summarized at par. 42).

¹⁷⁰⁸ *Perricelli*, *supra* note 269, pars. 31-39.

¹⁷⁰⁹ Ibid, par. 44.

¹⁷¹⁰ Ibid, par. 45.

¹⁷¹¹ Turgeon, *supra* note 9, pp. 260-261.

¹⁷¹² Ibid, p. 261.

¹⁷¹³ Ibid, p. 261.

action must accept the consequences, and that this is not as exceptional as it seems, given that directors on a board may be the puppets of a controlling shareholder as well.¹⁷¹⁴ This response avoided the deeper issues raised; responsibilities only have purpose if borne by those who wield the corresponding power. It therefore might be better either to mandate that empowered shareholders vote per individual or, alternatively, to treat a majority shareholder as the sole decision-maker, just as if so designated in the document.¹⁷¹⁵

While all of the foregoing establishes why empowered shareholders should be subject to the responsibilities normally borne by directors, there remains an argument that the board should not necessarily be excused from them in turn. As a means of influencing corporate decision-making, it is useless to impose duties and liabilities upon those without authority.¹⁷¹⁶ But it is possible that third parties relied upon the *appearance* that those individuals were in charge, either as a signal of the company's quality or as reassurance that they could look to those specific people to satisfy the board's potential liabilities.¹⁷¹⁷ The "indoor management rule"¹⁷¹⁸ generally applies to claims made against companies, not directors.¹⁷¹⁹ It might therefore be open to powerless directors to assert that, according to the statute, the agreement had removed their liabilities, even against a third party who had no knowledge of it. The *C.B.C.A.* specifically authorizes them to do so in the case of unpaid wages.¹⁷²⁰

Given that partially or fully depowered directors have colluded in the creation of a potentially misleading situation, if only through their continued membership on the board, it is reasonable that they should bear some responsibility when innocent third parties are indeed misled. The "indoor management rule" has long held that outsiders are not required to investigate whether a corporation's inner workings deviate from the norm; this should be extended to the liability of directors.¹⁷²¹ The specific reference in the

¹⁷¹⁴ Ibid, p. 261.

¹⁷¹⁵ If shareholdings are unequal but no one investor has the majority (or no clear "control block" exists), it might still be fair to hold all shareholders equally liable even if they had unequal voting power, since all of them had some influence on the outcome.

¹⁷¹⁶ This assumes that the powerless directors are not nonetheless acting as if they remained in authority, or else they would be liable as *de facto* directors. Turgeon, *supra* note 9, pp. 252-253, drew a distinction between, on the one hand, powerless directors violating the restrictions upon them and thus becoming *de facto* directors, and on the other, powerless directors acting in the role of authorized agents of the company. He pointed out that, under Quebec law, principals and not agents bear responsibility. Although this is true, the potential confusion caused by powerless directors acting as agents of the corporations they no longer control seems to warrant they be held liable too when third parties are understandably misled.

¹⁷¹⁷ McCarthy, *supra* note 8, p. 472 warned that creditors and unpaid employees may rely upon the reputation of the directors, and be deprived of the rights they thought they had. Turgeon, *supra* note 9, p. 252 makes the same point.

¹⁷¹⁸ See the discussion of this term at note 999.

¹⁷¹⁹ McCarthy, *supra* note 8, p. 472; Turgeon, *supra* note 9, p. 252.

¹⁷²⁰ *C.B.C.A.* s. 146(5).

¹⁷²¹ Martel, *supra* note 11, p. 31 suggested that since third parties were not deemed to be aware of the existence or terms of a unanimous shareholder agreement, they could rely upon the normal presumption

legislation to employee wages as among the responsibilities removed should be eliminated. None of this is as onerous as it might at first appear, since directors can restore their freedom from liability through the simple expedient of making it known that they are no longer the decision-makers.¹⁷²² Encouraging such disclosure would, in addition to compensating misled third parties, be the policy goal of such a rule.

It is clear, when one takes a wider view of the law instead of focussing on what benefits shareholders, that the duties and liabilities of directors should pass to investors when they assume power over the corporation. That is the only way to ensure that responsibilities meant for the company's ultimate decision-makers are borne by the proper parties. However, as the following subsections will explore, possible arrangements under unanimous shareholder agreements complicate this apparently simple principle.

2.(b) Shareholder Corporations and Residency Requirements

Before considering various divisions of power that the unanimous shareholder agreement makes possible, there is a general issue that can apply even to the most straight-forward arrangement: the implications of corporations entering into unanimous shareholder agreements with regard to other companies in which they have invested.

It is not possible for a corporation to be elected director of another corporation.¹⁷²³ It is, however, possible for one corporation to own shares in another, and it seems clear that corporations may therefore be parties to unanimous shareholder agreements. In addition to corporations just happening to own shares in a company whose investors wish to enter into a unanimous shareholder agreement,¹⁷²⁴ common uses of this

that directors retained their full powers and responsibilities, and therefore unpaid employees, receivers in bankruptcy, and government organizations and municipalities enforcing laws against directors could all bring claims against the board as normal, with the directors being limited to indemnification from the true decision-makers, the shareholders.

¹⁷²² Ratti, *supra* note 16, pp. 119-121, argued that statutory liabilities of directors remain with those who hold that office even if all their powers are transferred (unless the legislation explicitly provides otherwise), and therefore if claims were brought against them pursuant to those, their only recourse would be to turn to the shareholders as guarantors. Although I disagree with the position that as a matter of law their statutory liabilities do not transfer, in the event that a claim was successfully brought against a powerless director, the idea of pursuing the shareholders as guarantors has potential. Curiously, if one accepts Ratti's logic, it is unclear under what basis such a claim would be advanced, since the provisions transferring liability to the shareholders are inoperative.

¹⁷²³ At least, corporations cannot become directors under present Canadian law. In the statutes relevant to unanimous shareholder agreements, see *C.B.C.A.* s. 105(1)(c), *A.B.C.A.* s. 105(1)(c), *M.C.A.* s. 100(1)(b), *N.B.B.C.A.* s. 63(1)(c), *N.L.C.A.* s. 172(1)(c), *N.T.B.C.A.* s. 106(1)(a), *N.B.C.A.* s. 106(1)(a), *O.B.C.A.* s. 118(1)(3), *Q.B.C.A.* s. 108, *S.B.C.A.* s. 100(1)(c), and *Y.B.C.A.* s. 106(1)(c).

¹⁷²⁴ This includes situations where an investor chooses to own shares through a holding company, thus making the holding company the shareholder who must be party to the agreement.

tool include exerting control over "wholly-owned subsidiaries"¹⁷²⁵ and "joint ventures" involving a small number of companies. Unfortunately, these scenarios raise questions concerning the transfer of directors' duties and liabilities to corporations, duties and liabilities that were not intended to be borne by legal entities.

The case law is replete with examples of unanimous shareholder agreements which included amongst their parties a shareholding corporation. Generally speaking, that passes without comment. An exception is *Allard c. Myhill*,¹⁷²⁶ which addressed whether the fact that the shareholder was a corporation was an obstacle to the transfer of responsibility for unpaid wages. The case concerned whether or not certain individuals¹⁷²⁷ would be excused from liability, not directly whether it could attach to the shareholding corporation, but that would seem to be the corollary of the conclusion reached. The decision of the trial judge was that while removing the individuals' responsibility "raise[s] certain issues",¹⁷²⁸ it was "not only legal, it [was] specifically contemplated and authorized in section 146 of the *CBCA*".¹⁷²⁹ On appeal, however, it was found that since the purpose of directors' liabilities was to hold accountable the people who possessed ultimate decision-making power in the company,¹⁷³⁰ and that since a corporation can only "act" through the actions and decisions of humans,¹⁷³¹ it was "absurd"¹⁷³² to allow those humans to so act and decide without holding them to those responsibilities.¹⁷³³ The Court of Appeal found that it was the individuals who managed the company on behalf of the corporate shareholder and subject to its control who were nonetheless the relevant parties to bear this burden, although that appears to have been a determination of fact, not law.¹⁷³⁴ No other individuals were explicitly considered as candidates, but the obvious alternative would have been to look to the directors of the shareholder company.

Martel criticized the Court of Appeal for going beyond a factual determination that these individuals were *de facto* directors and denying in principle the possibility that shareholder corporations could use a unanimous shareholder agreement to take on the powers and responsibilities normally held by a

¹⁷²⁵ "Wholly-owned subsidiary" is the commonly used phrase for a corporation whose shares are entirely owned by another corporation. Although easily understood, the term is not an accurate description of the legal relationship; the subsidiary itself is not owned, but only its shares.

¹⁷²⁶ *Allard c. Myhill*, [2005] R.J.Q. 1189, 2005 CarswellQue 891, 2005 CarswellQue 13748, 196 A.C.W.S. (3d) 713, J.E. 2005-775, EYB 2005-88272 (C.Q. Feb 23, 2005) (hereinafter "*Allard CQ*"), reversed by *Allard c. Myhill*, 2012 QCCA 2024, 2012 CarswellQue 12026, 232 A.C.W.S. (3d) 672, J.E. 2012-2181, D.T.E. 2012T-821, EYB 2012-213993 (C.A. Que. Nov 14, 2012) (hereinafter "*Allard CA*").

¹⁷²⁷ As discussed elsewhere in this chapter, whether they were properly classified as directors was itself an issue.

¹⁷²⁸ *Allard CQ*, *supra* note 1726, par. 206. The issues were not elaborated upon beyond this remark.

¹⁷²⁹ *Ibid*, par. 207. See also the discussion at pars. 126-128, 151, 159-162, 206.

¹⁷³⁰ *Allard CA*, *supra* note 1726, par. 33.

¹⁷³¹ *Ibid*, par. 35.

¹⁷³² *Ibid*, par. 37.

¹⁷³³ *Ibid*, par. 37.

¹⁷³⁴ See discussion later in this chapter.

subsidiary's board.¹⁷³⁵ He argued that only if a corporation has been inserted into the position of empowered shareholder specifically so that human directors can avoid liability should the court disregard what would otherwise be the legal result: the shareholder corporation itself possessed of a director's normal rights and responsibilities.¹⁷³⁶

Although the law allows for corporations to enter into unanimous shareholder agreements,¹⁷³⁷ this ability was one of the subjects put forth in the Industry Canada Discussion Paper as a possible target for legislative reform. After acknowledging the utility this option offered parent companies,¹⁷³⁸ some potential problems were summarized:

81 On the other hand, from an accountability perspective, there may be some concerns raised about corporate shareholders using unanimous shareholder agreements, particularly in conjunction with the issue of whether the board can or should be entirely eliminated where all of the powers of the directors have been reserved to the shareholders under a unanimous shareholder agreement. The *CBCA* and other corporate laws require directors to be natural persons. It could therefore be questioned whether it is incongruous to allow the transfer of directors' responsibilities to corporate entities.

82 A key accountability consideration is whether the powers or responsibilities imposed on directors can/should be transferred to a corporate entity. If the purpose of the liability (for example, penal environmental liability) is to encourage key decision-makers, through the imposition of personal liability, to monitor the corporation's actions and change its conduct where required, the transfer of powers to a corporate entity could undermine this purpose.

83 If the purpose of the liability is to ensure adequate compensation for injured parties (for example, directors' liability for employee wages), a plaintiff may benefit from being able to sue the shareholder, which may have larger resources. However, a corporate structure might be designed to see that liability is transferred to an under-capitalized corporate entity. Again, the purpose of directors' liability might be defeated.¹⁷³⁹

The Industry Canada Discussion Paper also noted that unanimous shareholder agreements could be used to bypass director residency requirements.¹⁷⁴⁰ Proposed solutions included the retention of the *status quo*, a rule that only some but not all of the board's powers could be transferred to corporations, a requirement that some parties to the agreement be natural persons and only they receive the powers and duties of the directors, and entirely forbidding corporations from entering unanimous shareholder

¹⁷³⁵ Martel and Martel, *supra* note 16, p. 377 fn 89.

¹⁷³⁶ *Ibid*, p. 377 fn 89.

¹⁷³⁷ LaFortune, *supra* note 552, p. 216, asserted that since the federal and provincial legislators were aware that corporations could be shareholders and did not expressly forbid them from using unanimous shareholder agreements, it should be permissible for them to do so. He did not, however, engage with the reasons this may create difficulties.

¹⁷³⁸ Industry Canada Discussion Paper, *supra* note 9, pp. 28-29.

¹⁷³⁹ *Ibid*, p. 29.

agreements.¹⁷⁴¹

Dennis, responding to a draft of this Discussion Paper,¹⁷⁴² expressed puzzlement at the recommendation that if the unanimous shareholder agreement removed the board of directors (*i.e.* entirely transferred their powers to shareholders), then only natural persons¹⁷⁴³ be allowed to be parties, but by implication corporations could enter agreements that only partially altered those powers.¹⁷⁴⁴ He asked what reason existed to limit such a prohibition to situations where the directors' authority was entirely removed.¹⁷⁴⁵ One explanation might be that it ensures that some humans are still involved in running the company who could be held accountable if necessary, but that would seem to hold little comfort if the *relevant* powers were removed from those individuals and placed in the hands of unaccountable shareholder corporations. Perhaps taking this into account, Dennis suggested that it would be sufficient to instead limit the recipients of transferred powers to natural persons rather than all shareholders,¹⁷⁴⁶ an additional scenario found in the final draft of the Discussion Paper. He is correct that this would normally satisfy the underlying policies. It would ensure the applicability of responsibilities designed under the assumption that ultimate power over corporations would always be held by human beings.

That was not Dennis' recommendation *per se*, however, merely one of his critiques of the opposing position. He asserted that limiting unanimous shareholder agreements in this manner would remove a significant function, controlling subsidiaries.¹⁷⁴⁷ He did not believe that residency requirements should be maintained at all; he rather vaguely asserted that the real reasons for them were "not germane to corporate law".¹⁷⁴⁸ Notwithstanding this, he posited that even if there was some legitimate justification, it must have to do with protecting passive investors, and therefore did not apply to close corporations.¹⁷⁴⁹ In focussing only on shareholders, he missed another possible explanation; despite having elsewhere discussed the transfer of directors' liabilities under various statutes,¹⁷⁵⁰ Dennis did not consider that residency requirements may have relevance in enforcing them. His conclusion was therefore that the *C.B.C.A.* should be amended to allow for corporations to exert power over their subsidiaries through this method;¹⁷⁵¹ presumably he meant amended to make it explicit.

¹⁷⁴⁰ Ibid, pp. 29-30.

¹⁷⁴¹ Ibid, p. 30.

¹⁷⁴² Dennis, *supra* note 9, p. 115. Differences between the draft he consulted and the final version are not known to me, beyond what can be inferred.

¹⁷⁴³ And further, resident Canadians.

¹⁷⁴⁴ Dennis, *supra* note 9, pp. 129-130.

¹⁷⁴⁵ Ibid, p. 130.

¹⁷⁴⁶ Ibid, p. 130.

¹⁷⁴⁷ Ibid, p. 130.

¹⁷⁴⁸ Ibid, p. 116.

¹⁷⁴⁹ Ibid, p. 130.

¹⁷⁵⁰ Ibid, p. 128.

¹⁷⁵¹ Ibid, p. 130.

Disney¹⁷⁵² noted that, thanks to unanimous shareholder agreements, powerless directors who have no liabilities may satisfy residency requirements.¹⁷⁵³ However, he argued that limiting the transfer of authority to individuals the majority of whom were Canadian (a hypothetical proposal to deal with the alleged issues) would worsen the situation, as it would encourage foreign investors to use "tame" directors instead of a unanimous shareholder agreement, there being no true way to prevent foreign control of Canadian corporate decision-making.¹⁷⁵⁴ He did admit that where shareholders were not residents of this country, bringing proceedings against them may be difficult, and this might incline courts to find Canadian directors liable as convenient targets, but he denied that there was any reason to believe that this might be the basis of residency requirements.¹⁷⁵⁵ This ignored the genuine utility to the legal system of having resident Canadian individuals to serve as defendants. Further, some statutes specifically allow jail time for directors, and whether this is intended as a deterrent or a punishment, it is clear that it relies upon the existence of individuals who can be incarcerated. The danger that even directors who *de jure* retain full power can be no more than fall guys controlled by shareholders is undoubtedly real, but one might hope that their fear of personal consequences could make them serve at least sometimes as gatekeepers, resisting control to protect themselves, which is perhaps a reason not to dismiss their existence as readily as Disney did.

Scavone analyzed this issue first in terms of whether shareholders "became" directors under an agreement granting them full control.¹⁷⁵⁶ He took the position that this was not what the *Act* said, and that therefore elements such as residency requirements arguably did not apply.¹⁷⁵⁷ He suggested that the purpose of retaining a powerless board might be to satisfy those provisions; he considered this situation "absurd" but noted that it provided a buffer between shareholders and certain procedural requirements.¹⁷⁵⁸ His critique was more compelling than his counter-argument. If powerless directors are to be retained, some more legitimate reason should be advanced.

For present purposes, the most important aspect of residency requirements is their relevance to enforcement. This extends beyond shareholder corporations; unanimous shareholder agreements also allow individuals who reside in other countries to control Canadian companies. Unless empirical data emerges suggesting otherwise, extra-jurisdictional enforcement could be adequate. If that does not prove to be the case, then it might be necessary to impose residency requirements upon empowered shareholders (or in the case of empowered shareholder corporations, upon their directors). The commentators discussed above have criticized this as hampering unanimous shareholder agreements' ability to facilitate the management of

¹⁷⁵² Responding to the Alberta Report, *supra* note 223, which he cites at Disney, *supra* note 9, p. 112.

¹⁷⁵³ Disney, *supra* note 9, p. 112.

¹⁷⁵⁴ *Ibid*, p. 112; see also Alberta Report, *supra* note 223, p. 25.

¹⁷⁵⁵ Disney, *supra* note 9, p. 130.

¹⁷⁵⁶ Scavone, *supra* note 9, p. 341.

¹⁷⁵⁷ *Ibid*, p. 341.

corporate groups, but that cannot be the law's sole priority. While "tame" directors might be largely under the control of investors regardless, they can serve some gatekeeper function if they must weigh benefiting the shareholders against their personal risk.

Scavone warned of the potential for harm to third parties posed by empowered shareholder corporations, that "the personal liability to which members of the board are subject may become meaningless or attenuated".¹⁷⁵⁹ He noted that while on the one hand, recourse to asset-rich shareholder corporations may be a boon to plaintiffs, the other extreme, shell companies, was just as possible.¹⁷⁶⁰ He considered capitalization requirements as a solution, but that raised the questions of how such requirements would be set and whether they might create problems if the shareholder corporation's assets declined, perhaps unexpectedly reviving director liability as a result.¹⁷⁶¹ An alternative considered was responsibility flowing through to the directors or managers of the shareholder corporation.¹⁷⁶² Scavone argued that it would be inappropriate, however, for the board of a minority shareholder to be liable for decisions that were *de facto* wholly made by the board of a majority shareholder.¹⁷⁶³ That objection might be raised by any minority investor, though, and there is no reason for this scenario to receive special treatment. His proposed solution, also his proposed general model for empowered shareholder liability, was that certain individuals (in this case, directors of the parent companies) would be designated as responsible for decision-making for the subsidiary, but that this would be a rebuttable presumption.¹⁷⁶⁴ Scavone also identified as a problem the conflict of interest such directors would allegedly face between their duties to the parent and the subsidiary.¹⁷⁶⁵ He apparently considered it unsolvable and therefore another argument against holding directors of shareholder corporations liable.¹⁷⁶⁶ This issue is discussed below in the context of the *Indalex* decision; properly understood, it is not as difficult as Scavone believed, since the parent company itself owes a duty to the subsidiary, and its directors should give effect to that.

Beauregard and Auger also identified frustrating creditors by moving liability to asset-less shell companies as one of the potential reasons to employ a unanimous shareholder agreement, if perhaps an illegitimate one.¹⁷⁶⁷ They argued that the boards of the shell companies would not in turn bear these responsibilities, and indeed would functionally have no potential liabilities at all since the shell companies would have no employees, *et cetera*.¹⁷⁶⁸ The oppression remedy was their recommended solution,

¹⁷⁵⁸ Ibid, pp. 340-341.

¹⁷⁵⁹ Ibid, p. 355.

¹⁷⁶⁰ Ibid, p. 355.

¹⁷⁶¹ Ibid, p. 355.

¹⁷⁶² Ibid, p. 356.

¹⁷⁶³ Ibid, p. 356.

¹⁷⁶⁴ Ibid, p. 356.

¹⁷⁶⁵ Ibid, p. 356.

¹⁷⁶⁶ Ibid, p. 357.

¹⁷⁶⁷ Beauregard and Auger, *supra* note 16.

¹⁷⁶⁸ Ibid.

particularly given that it allows for the modification of unanimous shareholder agreements.¹⁷⁶⁹ Although Beauregard and Auger concluded that this strategy to avoid liability might be unlikely to survive such a legal attack, they asserted that there was little downside to trying.¹⁷⁷⁰ Oppression is certainly one method of dealing with problematic corporate arrangements, but that remedy is best reserved for situations that are not amenable to pre-existing rules. If transferring power to shell companies is *always* oppressive, one might as well simply prohibit it, or else create a standardized doctrine with a predictable outcome.¹⁷⁷¹ That would create greater certainty, serve as a clearer deterrent to misbehaviour, and aid in efficiently redressing wrongs.

The primary recipient of the directors' duties and liabilities after a unanimous shareholder agreement has transferred their powers to a shareholder corporation should be that company. Only to the extent that this fails to meet policy goals is it necessary to look beyond it. Therefore, for example, if the only issue is recovery of funds (such as to pay employee wages) and the parent company can meet those needs, nothing more is required. If, however, those are insufficient, then further recourse may be appropriate. While it is true that directors themselves do not always have adequate assets to meet their legal liabilities, the easy transfer of those responsibilities to undercapitalized companies would allow for claimants to go unsatisfied and policy goals to be completely frustrated while allowing decision-makers to escape unscathed.¹⁷⁷² The same justifications for forcing directors to bear certain duties and liabilities personally should cause the board of an empowered shareholder corporation to do so as well. Similarly, where legislation holds directors liable in an attempt to alter and/or penalize behaviour at the individual level, that too should be transferred to the humans who run the parent company.¹⁷⁷³

This solution, the one that Scavone rejected, seems the best method of avoiding many of the problems presented by corporations assuming the powers of directors. It moves the duties and liabilities from one group of humans to another; to the extent that they were effective upon the first, they can be expected to be effective upon the other. The objections he raised to this proposal are not as significant as

¹⁷⁶⁹ Ibid.

¹⁷⁷⁰ Ibid.

¹⁷⁷¹ The nature of the oppression remedy as a contextual tool based upon "reasonable expectations" was reviewed in Chapter Four.

¹⁷⁷² Under current law, a corporation is not deemed a party to a unanimous shareholder agreement signed by a subsidiary for its own subsidiary, allowing for the interposition of an undercapitalized intermediate corporation, so long as a certain degree of separation is observed. In *Innvest Real Estate Investment Trust v. Choice Hotels International*, 2010 ONSC 5717, 2010 CarswellOnt 8263, 194 A.C.W.S. (3d) 366 (Ont. S.C.J. [Commercial] Oct 15, 2010), one of the shareholders of a corporation was itself a corporation that was a wholly owned subsidiary of yet a third corporation (pars. 5-6). Another shareholder of the second attempted to enforce the unanimous shareholder agreement, specifically the arbitration clause, against the third company (par. 9). It was found not to be bound by the terms of the unanimous shareholder agreement that its subsidiary had signed (par. 22). One reason given for this was that "[e]ach of IREIT and I.M.H.L. has separate Boards of Directors and management albeit with some common members" (par. 23).

he made them out to be; holding the board of directors of a minority shareholder liable is no more problematic than holding an individual minority shareholder liable.¹⁷⁷⁴ The alleged conflict of interest between their duties to the two companies can be easily resolved by remembering that the primary obligator of the duty to the subsidiary is the parent company itself; since the parent must therefore look to the subsidiary's interests before its own, so too should the directors in the exercise of their double duties place the subsidiary's interests first.¹⁷⁷⁵ Such an approach might be contrary to current expectations and practice, but it is theoretically sound.

3. Unusual Restrictions

Having established that there is a justification for the removal or transfer of directors' duties and liabilities when their powers are restricted, the next question is how this would function. The provision might seem straightforward, but the unanimous shareholder agreement is a flexible tool, and the phrase "to the extent" hides a complex series of options whose implications are not at all clear. These include transferring specific powers to shareholders while leaving others in the hands of the directors,¹⁷⁷⁶ pre-made decisions on particular issues while leaving the board to manage the company otherwise,¹⁷⁷⁷ making some or all corporate decisions subject to shareholder approval or override while leaving primary management responsibility with the directors,¹⁷⁷⁸ and transferring powers to parties other than the shareholders.¹⁷⁷⁹

¹⁷⁷³ If necessary, this would flow up several levels of a corporate ladder.

¹⁷⁷⁴ It is still problematic, but this is best addressed by a general rule dealing with majority shareholders, *e.g.* treating them as the sole decision-makers. There is no need to create a special rule where the majority and minority investors are both themselves corporations.

¹⁷⁷⁵ This approach is discussed further with regard to *Indalex Ltd., Re*, 2013 SCC 6, 354 D.L.R. (4th) 581, 301 O.A.C. 1, 439 N.R. 235, 2013 CarswellOnt 733, 2013 CarswellOnt 734, 223 A.C.W.S. (3d) 1049, J.E. 2013-185, [2013] W.D.F.L. 1591, [2013] W.D.F.L. 1592, D.T.E. 2013T-97, 20 P.P.S.A.C. (3d) 1, [2013] S.C.J. No. 6, 96 C.B.R. (5th) 171, 8 B.L.R. (5th) 1 (S.C.C. Feb 01, 2013) (hereinafter "*Indalex*") later in this chapter.

¹⁷⁷⁶ For example, transferring the power to declare dividends to the shareholders while leaving other management decisions to the directors.

¹⁷⁷⁷ A common example would be guaranteeing employment to a named individual, as happened in a number of the cases discussed in Chapter Four. In theory, a wide variety of business decisions could be "pre-made" through a unanimous shareholder agreement.

¹⁷⁷⁸ For example, requiring shareholders to approve any single expense exceeding a set amount.

¹⁷⁷⁹ LaFortune, *supra* note 552, p. 212 used slightly different categories, listing them as the transfer of all powers to all shareholders, the transfer of some powers to all shareholders, the transfer of some or all powers to some shareholders, the imposition of supermajority requirements for decisions of the board of directors, or requiring directors to obey the instructions of shareholders. He wrote that in the case of imposing supermajority requirements, there would be no transfer of responsibilities (p. 214). Martel, *supra* note 11, pp. 12-22, also used slightly different categories: supermajority requirements for director decisions, terms in the agreement of the type I refer to as "pre-made decisions" (although he does not use that phrase), requiring shareholder ratification for certain decisions, and directly transferring powers from the directors to the shareholders. Ratti, *supra* note 16, p. 126-128, classified the different possible power

These intermediate situations raise questions about what "the same extent" means in terms of removing or transferring liability, and in the following subsections, each are considered in turn.¹⁷⁸⁰

Virtually all of the reported cases on unanimous shareholder agreements set out facts that fall into these problematic categories; that is, there is some restriction on the board's powers,¹⁷⁸¹ but they retain significant authority to manage the company.¹⁷⁸² Situations that give rise to complicated questions about how directors' duties and liabilities change when their powers are partially but not fully restricted are therefore common, at least by the standards of unanimous shareholder agreements. Curiously, however, despite some academic interest, there is very little reported case law actually on that topic, resulting in a contradictory sense that these unanswered questions are both pressing and yet largely theoretical.

3.(a) Only Some Powers Transferred

The section of the *C.B.C.A.* that outlines how directors' legal responsibilities are affected by a

arrangements as veto rights, power of instruction, agreements that specify how empowered shareholder will vote, supermajority requirements for board decisions, and general transfers of power to the shareholders, although he cautioned that these are not all valid under all statutes. McCarthy, *supra* note 8, p. 469, listed the transfer of all powers, of specific powers, making director decisions subject to approval of shareholders or creditors, requiring supermajorities or unanimity for board decisions, and the exercise of directorial power on a one-time basis (*i.e.* pre-made decisions). These alternative classifications largely overlap with the ones discussed in this subsection, with one notable exception. Supermajority or unanimity requirements are not dealt with at length herein because, generally speaking, their implications for directors' duties and liabilities need not be complex. An individual director is either on the side whose votes carry the decision or the one whose do not. The respective responsibilities associated with those two positions is well-established. The actual threshold for decision-making is thus irrelevant. Smith, *supra* note 228, p. 308, and Turgeon, *supra* note 9, p. 230 fn 435, pp. 250-251 agreed that supermajority requirements for board decisions do not transfer responsibility to the shareholders.

¹⁷⁸⁰ Since the arrangement must restrict the directors, it at first glance seems impossible to create a structure where shareholders assume the same power as the board but do not either relieve the latter of it or directly subordinate them to the investors' authority. Although primarily making the point in rejection of veto/approval powers, Smith, *supra* note 228, pp. 307-308, argued that restrictions always had the effect of fully removing authority over the specified area from directors and vesting it in shareholders; he theorized that the (Quebec) legislature did not want two groups concurrently exercising power. On the other hand, Robitaille, *supra* note 267, p. 170 took the position that having a power be concurrent between the directors and shareholders is a "very partial" restriction upon the former. (Turgeon, *supra* note 9, p. 233, explicitly agreed with Robitaille and rejected Smith.) Robitaille gave as one example allowing both groups the ability to declare dividends. While such a scenario is not a "restriction" upon the power of the directors in any traditional sense, it does mean that they would no longer have absolute control over the topics normally within their authority, a limitation of sorts. In the preceding example, their normal ability to ensure that a dividend is *not* declared is compromised. The situation is not that dissimilar from a supervisory power; the directors remain the default authority until and unless the shareholders become involved. Depending upon the exact arrangement, it might be appropriate to divide liabilities either as if only some powers had been transferred or as if a supervisory power had been created, as discussed later in this section.

¹⁷⁸¹ Necessary by definition, of course.

¹⁷⁸² See, for example, most of the cases discussed in Chapter Four.

unanimous shareholder agreement has the strange quality of explicitly anticipating a very specific way in which the tool might be used- to transfer some but not all of their powers to other individuals- and purporting to set out the consequences of such a situation, while still utterly failing to deal with the implications of that very scenario.¹⁷⁸³

Westlake devoted the bulk of his brief comment on unanimous shareholder agreements to exploring possible configurations of the restrictions in them. He distinguished between a "comprehensive" agreement which affected all of the directors' powers and "restricted" agreements that were limited in some way,¹⁷⁸⁴ and identified several subtypes of the latter.¹⁷⁸⁵ These included transferring power over certain activities, such as borrowing money or altering banking arrangements, to the shareholders while leaving other powers with the board.¹⁷⁸⁶ Despite identifying these arrangements, Westlake did not consider their full implications, addressing liability issues only to state that the concept of *de facto* directors and statutory language defining "directors" as the persons occupying such a position regardless of title should resolve any issue.¹⁷⁸⁷

Disney addressed this problem more directly, noting that "[i]f a unanimous shareholder agreement restricts the powers of the directors only in part, it may be difficult to determine to what extent the liabilities of the directors have thereby been limited".¹⁷⁸⁸ He recommended firstly that if the liability could be clearly tied to a power that was or was not restricted, that should be determinative.¹⁷⁸⁹ Where the situation was not so clear-cut, such as when a general failure of management was to blame, he suggested that the courts might apportion the liability based upon degree of fault.¹⁷⁹⁰ This seems reasonable at first

¹⁷⁸³ Some commentators have questioned whether partial restrictions upon the directors are limited to those powers which the statute explicitly provides are subject to a unanimous shareholder agreement. Since no rational basis has been identified for the seemingly arbitrary way that this qualifier appears throughout the legislation, the consensus has been that it is redundant and all director powers are subject to potential restriction. See Robitaille, *supra* note 267, pp. 169-170; McCarthy, *supra* note 8, p. 469; Turgeon, *supra* note 9, pp. 224-225.

¹⁷⁸⁴ Bruce C. Westlake, Comments On "The Unanimous Shareholder Agreement: Opting Out Of Statutory Norms" in *The Future of Corporation Law: Issues and Perspectives: Papers Presented at the Queen's Annual Business Law Symposium 1997* (Scarborough: Carswell, 1999) 380, at p. 381.

¹⁷⁸⁵ Another subtype put forward is agreements which have only a limited lifespan and then return power to the directors, which Westlake suggested might be useful for some transactions such as corporate reorganizations or to circumvent situations where the directors are unwilling or unable to take a certain action (Westlake, *supra* note 1784, p. 381). Beauregard and Auger, *supra* note 16, also mentioned this type.

¹⁷⁸⁶ Westlake, *supra* note 1784, p. 381-382. Westlake was writing when restricting director powers in such areas (probably) automatically transferred the powers to shareholders, which is no longer true under the current *C.B.C.A.*

¹⁷⁸⁷ *Ibid*, p. 383.

¹⁷⁸⁸ Disney, *supra* note 9, p. 129.

¹⁷⁸⁹ *Ibid*, p. 129. The example he used is of a dividend made in contravention of statute. If it was the shareholders who had been granted the power to declare that dividend and had done so, liability would fall upon them.

¹⁷⁹⁰ *Ibid*, p. 129.

glance, but is ultimately only a slightly broader version of the first recommendation, and it ignores situations where degree of fault is co-extensive, impossible to determine, or legally irrelevant.¹⁷⁹¹ Even if liability is apportioned as between the directors and investors, there needs to be a more detailed analysis as to how that might function than a vague reference to "degree of fault".¹⁷⁹²

To illustrate this, consider a situation where shareholders were empowered to hire, fire, and set salaries for senior officers, but all other powers of the board remained unaltered, including their authority over those same senior officers in the normal course of business.¹⁷⁹³ The corporation subsequently becomes insolvent, with employees still unpaid. Directors normally have a responsibility for those wages. But in this circumstance, how should that liability be handled? Alternatively, consider the board's "due diligence" requirements to insure that environmental statutes are being followed by those senior employees.¹⁷⁹⁴ Should the directors be relieved of those responsibilities in whole, in part, or not at all? Should those responsibilities be imposed on the shareholders in whole, in part, or not at all? And is it realistic or desirable to treat the answers to the preceding two questions as automatically symmetrical?

Although not strictly on-point, the trial judgment in *Allard c. Myhill*¹⁷⁹⁵ suggests that if the only powers that the board continues to possess are closer to the responsibility level that one might associate with officers, while the more important ones have been shifted to the shareholders, this should be treated as if it was a full transfer of all the directors' powers and accompanying liability. The decision was reversed on appeal; for reasons that are not fully articulated but were seemingly based upon testimony regarding the actual powers and responsibilities of the individuals in question,¹⁷⁹⁶ Dalphond J.C.A. stated that they were

¹⁷⁹¹ Directors have some statutory liabilities that are independent of any finding of fault, such as liability for unpaid wages.

¹⁷⁹² It is also worth considering burden of proof issues. Who has the burden of proof for holding the directors and/or shareholders at fault? What is the default assumption?

¹⁷⁹³ I am not aware of any cases involving a corporation with a unanimous shareholder agreement containing this precise set-up, but the example is not particularly implausible or artificial.

¹⁷⁹⁴ See e.g. *R. v. Bata Industries Ltd.*, 9 O.R. (3d) 329, 70 C.C.C. (3d) 394, 7 C.E.L.R. (N.S.) 245, 1992 CarswellOnt 211, [1992] O.J. No. 236 (Ont. Prov. Div. Feb 07, 1992) (hereinafter "*Bata*").

¹⁷⁹⁵ *Allard CQ*, *supra* note 1726. In *Allard*, as discussed elsewhere in this chapter, the question was whether individuals who had resigned as *de jure* directors were liable as *de facto* directors; the shareholder company had assumed power through a unanimous shareholder agreement, but the individuals continued to have day-to-day management responsibility, subject to significant control by it, with the trial judge finding that they made only a single decision that was "comparable to a decision normally made by corporate directors" (par. 203) and that particular action was further described as not so much a decision in the circumstances as the only rational reaction (par. 205). They were found at trial to have no liability for unpaid wages (par. 212). On appeal, the individuals were found on the facts to be *de facto* directors (*Allard CA*, *supra* note 1726, pars. 40-41). Even assuming that the standard used in the trial judgment was not overturned by the appeal, only its application, it may not have been meant to apply to individuals who held the title of director (see on this point the remarks at *Allard CQ*, par. 210 that stressed that the legislation used the word "director" exclusively). Granting all of these cautions, when a unanimous shareholder agreement has created an unusual power arrangement, evaluating the roles and responsibilities of individuals to see whether they are more akin to officers or directors is a potentially useful standard.

¹⁷⁹⁶ *Allard CA*, *supra* note 1726, par. 40.

de facto directors.¹⁷⁹⁷ Since this was apparently a finding of fact rather than law, it does not necessarily preclude the principle that a director sufficiently stripped of power is no longer a *de facto* director but instead akin to an officer. Regardless, the model advanced by the trial judge is worth taking seriously as a means of handling situations where the board no longer have any of the substantive powers normally associated with their offices. This still leaves open the question of how to respond when the powers unique to directors are truly split.

The Industry Canada Discussion Paper, like Disney, distinguished between situations where the decision that incurred the liability is clearly tied to a specific power exercised by either the directors or the shareholders- such as declaring a dividend- and ones where the responsibility is not as obvious, particularly if the general management of the company is to blame.¹⁷⁹⁸ Two alternatives were proposed to handle these more complex scenarios: either, as previously discussed, leave it to the courts to determine degree of fault in specific instances, or else impose joint and several liability as the general rule.¹⁷⁹⁹ The paper noted that the latter would be more effective at ensuring that third parties are compensated for harms done to them,¹⁸⁰⁰ but there are other reasons it might be preferable as well. Joint and several liability has the advantages of greater legal certainty for both claimants and defendants, greater deterrent effect in forcing all concerned to make decisions as if the full cost might fall on them rather than hoping they will be found less at fault, and less incentive to create arrangements that would mislead the courts as to the exact balance of power.¹⁸⁰¹

Broadly speaking, there are three ways that directors can face liability. First, they can be found liable for a specific decision that they made or action they undertook; for example, authorizing a dividend contrary to the statute.¹⁸⁰² Second, they can be found liable because they did *not* make some decision or undertake some action that they should have; for example, failing to meet their due diligence requirements under environmental law.¹⁸⁰³ Third, they can be found liable automatically by virtue of their offices, without any specific action or inaction being impugned; for example, simply for having been a director at the relevant time, they may owe unpaid employee wages.¹⁸⁰⁴

With the first type, it will sometimes be easy to determine whether the directors or the empowered

¹⁷⁹⁷ Ibid, par. 41.

¹⁷⁹⁸ Industry Canada Discussion Paper, *supra* note 9, p. 45.

¹⁷⁹⁹ Joint and several liability is also the recommendation of Quack, *supra* note 289, for the supervisory arrangement discussed in a subsequent subsection.

¹⁸⁰⁰ Industry Canada Discussion Paper, *supra* note 9, p. 45.

¹⁸⁰¹ Smith, *supra* note 228, p. 308, proposed that where there is doubt as to who had authority, the directors or shareholders, the default assumption should be the directors, as an agreement that alters the statutory balance of power should be read narrowly. The difficulty with employing this as a means of determining liability is that it could easily be abused by the very investors who drafted the document.

¹⁸⁰² C.B.C.A. s. 118(2)(c).

¹⁸⁰³ See *Bata*, *supra* note 1794, which applied the *Ontario Water Resources Act*, RSO 1980, c. 361, s. 75(1) and *Environmental Protection Act*, RSO 1980, c. 141, s. 147a to corporate officers and directors who incurred but failed to meet due diligence requirements.

¹⁸⁰⁴ C.B.C.A. s. 119(1).

shareholders should be liable, because one or the other clearly held the relevant power and made the troublesome decision. If both groups took steps that (may have) led to the problem, then there are two possible ways of proceeding; either full joint and several liability or else the determination of respective contributions to the harm. Unless one group clearly bears the overwhelming majority of responsibility, joint and several liability is preferable. It will decrease litigation, increase certainty, and provide stronger deterrence incentives. There are some fairness concerns, but given that both directors and shareholders entered a joint power arrangement and both took steps that (may have) helped cause the harm, it is not overly harsh that they bear the responsibility for it, even if strictly speaking their share of the liability may be disproportionate to their actual degrees of fault.

A similar logic can be employed for liability arising from inaction. If one group clearly had the authority to take the required steps and the other did not, then responsibility would naturally attach to the former. Where it is unclear which group had it, or where both had some relevant power, then joint and several liability is again appropriate. This will motivate both partially empowered shareholders and partially depowered directors to be diligent in meeting their legal duties and encouraging each other to do so.¹⁸⁰⁵

The most difficult scenarios involve liability that arises solely as a result of the directors' position, with no further requirement that anything they have done or failed to do form the basis of the claim.¹⁸⁰⁶

¹⁸⁰⁵ A situation of approximately this type arose in *Wong c. R.*, 1996 CarswellNat 2860, 1996 CarswellNat 2861 (T.C.C. Apr 16, 1996). A unanimous shareholder agreement split a company into two divisions that operated autonomously and kept their own finances, each one operating a separate restaurant, and further transferred certain powers to the shareholders (par. 10). When one "division" ended up owing unpaid taxes, the Minister of National Revenue pursued the individuals who ran the other (pars. 4-8). Tardif T.C.J. held that the agreement offered no protection against third parties (par. 18). The judge further found that the directors could not rely upon the instrument to excuse them from their legal responsibility to monitor the entire corporation's affairs and ensure compliance with the law (par. 20); their adherence to the agreement and the company's division into two autonomous operations had nothing to do with the directors' legal responsibilities, which continued to encompass the entire corporation, and they could not ignore fifty percent of it (par. 32). Presumably, Tardif T.C.J. was assuming that the directors remained empowered to manage the whole company either as a determination of fact or law, *i.e.* either the specific terms of this document did not effectively restrict the board in such a manner, or else the agreement was something other than a corporate constitutional removal of powers. Otherwise, the position that they were neglecting half their duties makes no sense. The result was that even when a unanimous shareholder agreement arguably removed half the directors' powers, they were found to have a liability arising out of their positions and failure to exercise the care required of them.

¹⁸⁰⁶ This is a distinction that was perhaps missed by Smith, *supra* note 228, pp. 310-311, who argued that shareholders would be subject to statutory liabilities if the relevant power was transferred to them, but in addition to listing abilities that must be positively exercised to trigger liability (such as declaring dividends), he included the responsibility for unpaid wages, which he tied to the authority to pay employees. Others have appreciated the difficulties this situation poses. Robitaille, *supra* note 267, p. 172, pointed out that some director responsibilities, such as for employee wages, are difficult to tie to a given power, and thus found it unclear under what circumstances they were removed. Ratti, *supra* note 16, p. 119-120, took the position that, unless the legislation explicitly provides otherwise, these sorts of statutory responsibilities are tied to the office of director regardless of how their powers are curtailed. That position

However, while such responsibilities do not rely upon a finding of *fault*, they are nonetheless grounded in the fact that the board were the ultimate decision-makers in the corporation and thus bear responsibility for it, otherwise holding them accountable would be arbitrary and senseless.¹⁸⁰⁷ When that ultimate decision-making power is divided, it might be tempting to suggest that in order to determine who bears responsibility and in what proportion, causality should be established for whatever situation has given rise to a liability (likely the insolvency of the corporation), even though that is not normally a required element of the claim. But such a test might very easily prove impossible to satisfy and defeats the very purpose of this category, which by definition is not based upon the actions or inaction of the directors. If both groups possess ultimate control over some significant aspect of the corporation, as opposed to powers that are more akin to officers¹⁸⁰⁸ or largely trivial, then joint and several liability should once again apply.¹⁸⁰⁹

It has been suggested that a unanimous shareholder agreement might empower investors regarding a given area without restricting the board's own authority.¹⁸¹⁰ For example, the ability to declare dividends might be granted to the shareholders, but not removed from the directors. It is debatable whether such a term would fall within the meaning of the word "restricts" in the unanimous shareholder agreement provisions.¹⁸¹¹ If this was permissible, then the same rule of joint and several liability for overlapping authority would apply, except where a given *exercise* of that power was the problem and could be clearly attributed to either group.

3.(b) Pre-Made Decisions

One of the necessary characteristics of a unanimous shareholders agreement is that it must in some way restrict the powers of the directors. Such limitations can take many forms, but one of the most obvious is to predetermine some decision(s) that would normally be within their authority. A common restriction of this type is installing a specified individual into some position in the corporation.¹⁸¹² Another simple example would be requiring that a specified minimum dividend be paid if there are sufficient profits to do

seems likely to create injustice and frustrate policy goals.

¹⁸⁰⁷ See the quotation from *Vaszi*, *supra* note 418, pars. 21-23, reproduced above. I would like to acknowledge Edward Waitzer for pointing out to me that responsibility could be grounded in decision-making capacity without implying a fault requirement.

¹⁸⁰⁸ See the discussion of *Allard CQ* and *Allard CA*, *supra* note 1726, elsewhere in this chapter.

¹⁸⁰⁹ Martel, *supra* note 11, p. 29, noted that this is a difficult problem. He suggested that where shareholders have assumed all or nearly all of the directors' powers, they would be liable. Short of that, he did not provide recommendations, only a caution that the liability should not be tied to direct power over payroll, since the capability to make payments was affected by other decisions.

¹⁸¹⁰ See note 1780.

¹⁸¹¹ Arguably, it restricts the directors' ability to ensure that something within their normal authority does *not* occur. See note 1780.

¹⁸¹² Numerous examples were discussed in Chapter Four.

so. Conversely, the restriction might be literally that, a prohibition on some undesired activity, such as excessive borrowing or engaging in business practices that the shareholders considered unethical.¹⁸¹³ The key feature of this arrangement is that it is not a transfer of future decision-making power to the investors, either directly or in an oversight capacity; the decision is made at the time the unanimous shareholder agreement is entered into and cannot be changed thereafter other than by amending or terminating the agreement itself. The term "pre-made decisions" will be used for these.

Such scenarios are consistent with the current wording of the *C.B.C.A.*, seem very much in line with a general concept of "restricting" directors' powers, and have a long history in practice,¹⁸¹⁴ but this is actually a relatively new development from a strictly statutory perspective. Earlier versions of the federal legislation¹⁸¹⁵ and most current provincial and territorial equivalents¹⁸¹⁶ automatically deem that any power of the board that is restricted has been passed to the shareholders.¹⁸¹⁷ The current version of the *C.B.C.A.*, by contrast, separates the concepts of powers that are restricted and powers that are given without automatically equating the two, and this in turn allows for the possibility that some powers might be restricted yet given to no one. This may have been an inadvertent effect of a revised drafting meant to deal with a separate issue,¹⁸¹⁸ but it nonetheless opens up new and potentially useful possibilities.

This approach to the unanimous shareholder agreement is not entirely without precedent. Despite the former wording of the *C.B.C.A.* providing that shareholders received all the powers of the directors that were restricted, Sohmer, writing soon enough after the original enactment of the provision and before any

¹⁸¹³ Such as selling firearms or doing business in countries with a history of human rights violations, and other familiar topics from corporate social responsibility and ethical investing.

¹⁸¹⁴ Many of the cases discussed in Chapter Three and Chapter Four involved such limitations. Although on rare occasions restrictions that did not function as transfers have been rejected for failing to meet the statutory requirements (see the discussion in Chapter Three of *9109 CS* and *9109 CA* and *Couvre-Plancher*) and *Ming* considered the issue specifically to allow them, the vast majority of cases in which they appeared simply accepted the validity of these terms as a given. In some cases, they were actively found to be valid ways of meeting the statutory criterion that unanimous shareholder agreements restrict the directors.

¹⁸¹⁵ *C.B.C.A.* '74-'75, s. 140(4).

¹⁸¹⁶ *A.B.C.A.* s. 146(7), *M.C.A.* s. 140(5), *N.B.B.C.A.* s. 99(5), *N.L.C.A.* s. 245(8), *N.T.B.C.A.* s. 148(7), *N.B.C.A.* s. 148(7), *O.B.C.A.* s. 108(5), *S.B.C.A.* s. 140(4), *Y.B.C.A.* s. 148(7). The sole exception is *Q.B.C.A.* s. 214, which, similarly to the *C.B.C.A.*, specifies "parties to the unanimous shareholder agreement who are given those powers" rather than all the shareholders.

¹⁸¹⁷ It was, however, never certain what this meant in the context of a unanimous shareholder agreement that set out a defined decision of the type discussed here. Possibly the shareholders were granted some unspecified power to overturn those decisions, but it is worth considering that the statutory provisions are also totally unclear as to how decision-making amongst empowered shareholders should work. A well-drafted agreement could set such arrangements out, but one that makes a decision or places a restriction but does not explicitly transfer powers at all would presumably be the least likely to define such a decision-making process, unless perhaps arrangements were set out for a different purpose (a different power that was explicitly transferred) that could be used.

¹⁸¹⁸ The most obvious intent for this change would be that it allows for some designated shareholders to receive directors' powers, rather than all of them.

tradition had developed around this facet of the law, was guided in his understanding by the key word "restricts". His interpretation veered to the opposite extreme, considering the narrow possibility that a "restriction" might not even include a requirement for positive action,¹⁸¹⁹ and explicitly denying that a transfer of powers to shareholders was even permissible,¹⁸²⁰ let alone automatic. (Sohmer viewed these as defects, it must be noted.¹⁸²¹) Turgeon pointed out that Sohmer's anti-transfer interpretation was not supported by the rest of the provision, and in particular noted that it cannot be reconciled with the ability to remove the directors' powers as a whole, given that it would mean that no one would then have the power to initiate corporate action.¹⁸²² Hay and Smith also explicitly rejected Sohmer's view that the word "restricts" precluded terms mandating positive steps,¹⁸²³ and they argued that "[t]he legislators cannot have expected that shareholders would restrict director power when the result is a power vacuum".¹⁸²⁴ In support of this, they pointed out that the statute as it then was contained a separate provision which granted to shareholders who were parties to the agreement the "rights, powers, and duties" of a director.¹⁸²⁵ Recent amendments to the *Act* have rendered this more ambiguous, as the *C.B.C.A.* now grants the rights and powers of directors only to "parties to the unanimous shareholder agreement who are given that power to manage or supervise the management of the business and affairs of the corporation",¹⁸²⁶ a more tautological wording that allows for a vacuum to exist.

Welling acknowledged that the current *C.B.C.A.* provision contains what he perceived as ambiguity about the result of powers being restricted without a specified transferee, but his own analysis begs the question. He began by asking, "Who, then, exercises those managerial powers [that have been restricted]?"¹⁸²⁷ He did not appear to have considered that managerial powers might simply *be restricted*. Instead, he pointed out that some of the provincial statutes clearly transfer any restricted powers to shareholders.¹⁸²⁸ He therefore "reckon[ed] that would be the default position under the *C.B.C.A.* if the unanimous shareholder agreement fails to state who will exercise the restricted powers, although the

¹⁸¹⁹ Sohmer, *supra* note 311, p. 675.

¹⁸²⁰ *Ibid.*, p. 674.

¹⁸²¹ *Ibid.*, p. 674.

¹⁸²² Turgeon, *supra* note 9, p. 223. Turgeon, at pp. 223-224, acknowledged that linguistically speaking the word "restricts" is not normally synonymous with the concept of "transfers", but he countered that the additional phrase "in whole or in part" changed matters. As a result, he concluded that a partial restriction did not transfer power to the shareholders, but a restriction of all the directors' powers must.

¹⁸²³ Hay and Smith, *supra* note 319, p. 450.

¹⁸²⁴ *Ibid.*, p. 450. Fitzwilliam, *supra* note 9, section 8, considered Hay and Smith's point about a "fiduciary vacuum", when he conceded that his proposal to allow shareholders to restrict directors without assuming their responsibilities would create such a vacuum, although in that case, it was not a *power* vacuum, but only a *responsibility* vacuum.

¹⁸²⁵ Hay and Smith, *supra* note 319, p. 450.

¹⁸²⁶ *C.B.C.A.*, s. 146(5).

¹⁸²⁷ Welling 3rd ed., *supra* note 256, p. 464.

¹⁸²⁸ *Ibid.*, p. 465.

section isn't clear on that point".¹⁸²⁹ This view takes for granted a transfer of power, excluding any other arrangement.

Beauregard and Auger also considered it nebulous whether a pre-made decision (using the example of an annual dividend or pre-determined directors) would be a valid restriction. They suggested instead that shareholders who needed to circumvent the directors on a one-time basis implement a very narrow time-limited transfer of power to themselves.¹⁸³⁰ This would be effective at achieving their objective in the short-term, but would require a steady stream of agreements to influence corporate behaviour on an ongoing basis.

As discussed in greater detail later in this chapter, unanimous shareholder agreements that include specific decisions have traditionally been analyzed by commentators (but not the courts) as if they were firstly a transfer of power to the shareholders and secondarily an agreement (not necessarily binding in an absolute sense) as to how the transferees would exercise that power, a so-called fettering of their discretion. There is apparently some resistance to conceiving of a restriction that does not function as a transfer, although the current wording of the *C.B.C.A.* allows for it. And yet any objection rests on a surprisingly unstable foundation, the belief that all the powers normally possessed by directors must be exercisable by *someone* lest problems ensue. This claim is not convincing, and allowing for the alternative (a restriction that does not function as a transfer) may in some cases be a practical solution, when the desired outcome genuinely is to prevent or mandate a specific act. It is absurd to argue that a corporation cannot function unless *all* legally permissible options are at all times open to *some* decision-maker.¹⁸³¹ While any restriction, no matter how narrow, might eventually become a problem, the agreement can be amended or terminated. In fact, if a transferred power requires unanimity amongst shareholders for its *exercise*, then it is no easier (and in some cases harder) to use that authority than amend the agreement itself.

This does create questions as to how the corresponding duties and liabilities would be dealt with. There do not appear to be any reported cases dealing with this issue, although *Parton v. R.*¹⁸³² may come the closest. The corporation's directors¹⁸³³ were held liable for its failure to remit the source deductions it

¹⁸²⁹ Ibid, p. 465.

¹⁸³⁰ Beauregard and Auger, *supra* note 16.

¹⁸³¹ The history of the *ultra vires* doctrine (the principle that the corporation itself lacked the legal capacity to perform actions in violation of its articles, and therefore its attempts to do so would be void) demonstrates a similar point, although admittedly that principle did prove problematic and Canadian law has largely done away with it. (See generally *Communities*, *supra* note 807, and in particular the Supreme Court's critique of the *ultra vires* doctrine at par. 34.) The distinction between "pre-made" decisions in unanimous shareholder agreements and the *ultra vires* doctrine is discussed further at note 807.

¹⁸³² *Parton v. R.*, 45 B.L.R. (2d) 298, [1999] 2 C.T.C. 2755, 1999 CarswellNat 573, 1999 CarswellNat 3921, 99 D.T.C. 738 (T.C.C. Apr 06, 1999) (hereinafter "*Parton*").

¹⁸³³ Whether they were directors or not was itself the subject of dispute, although it was found that they were (*Parton*, *supra* note 1832, pars. 47-48).

had made, pursuant to the *Income Tax Act*.¹⁸³⁴ There was a unanimous shareholder agreement in place, the only term of which the reasons for judgment set out was that "[t]he board of directors did not have power or authority to allot, reserve or issue additional shares in the capital of the Corporation".¹⁸³⁵ Despite examining whether the directors' powers were curtailed on other grounds,¹⁸³⁶ Lamarre Proulx T.C.J. did not explicitly consider the ramifications of the restriction mentioned in the unanimous shareholder agreement, which plausibly might be connected to the corporation's ultimate insolvency and inability to pay to the fiscal authorities the remitted funds it had instead put to other business purposes. The directors' liability was not curtailed, and they were found fully liable.¹⁸³⁷ This was a missed opportunity for the judiciary to weigh in on the question, but it at least serves to demonstrate that, while rare, such situations do actually occur.

Martel asserted that shareholders would assume the full responsibility for "instructions" (as he called them) in unanimous shareholder agreements, with the directors having acted only as their agents.¹⁸³⁸ He qualified that with an exception: where the pre-made decision was a negative restriction, neither power nor liability passed to the shareholders.¹⁸³⁹ Although the simplicity of this may hold appeal, it fails to address the complexities that might emerge with either type of pre-made decision.

As already noted, it serves neither policy goals nor justice to hold directors accountable for choices that they did not have the power to make. Therefore, they should not be held liable for consequences obviously attributable to decisions placed beyond their control. Conversely, if they still possessed the relevant authority, the corresponding obligations would naturally continue with them as well. When the connection between the liabilities that have arisen and their remaining powers is either complex or legally irrelevant, they should also retain responsibility just as was argued for split powers.

When authority is relocated from directors to shareholders, duties and liabilities follow. But if it is possible to restrict the board's powers without transferring them- as seems true under the current *C.B.C.A.*- then the result might be that directors can be absolved of some of their responsibilities without anyone else receiving them. Indeed, on a strict wording of the statute, this might currently be the state of the law.

One alternative- not well supported by the current wording but perhaps theoretically valid- would

¹⁸³⁴ *Parton, supra* note 1832, par. 1.

¹⁸³⁵ *Ibid*, par. 17. It is unclear whether those powers were transferred to the shareholders or simply restricted.

¹⁸³⁶ Aside from the restriction discussed, the directors argued that they were subject to the supervision of a "group of advisors" representing the shareholders (*Parton, supra* note 1832, par. 5), and should thus not be liable, in a manner similar to that discussed in the following subsection of this chapter. That arrangement was apparently not part of the unanimous shareholder agreement and Lamarre Proulx T.C.J. found that "[t]here is no evidence that they acted under forcible threat. They are accountable for their own actions" (par. 54).

¹⁸³⁷ *Parton, supra* note 1832, par. 59.

¹⁸³⁸ Martel, *supra* note 11, p. 14.

¹⁸³⁹ *Ibid*, p. 15.

be to consider the creation of the unanimous shareholder agreement itself as a form of exercising the "power to manage or supervise the management of the business and affairs of the corporation"¹⁸⁴⁰ and thus susceptible to the attendant responsibilities.¹⁸⁴¹ (There is no reason to exclude negative restrictions, as Martel does, if they have somehow led to liability.) This would mean that the shareholders who originally implemented the agreement would be liable for any harm it caused. However, at the time that the agreement was entered into, the problems that it eventually resulted in may not have been foreseeable, or at least not probable. Where liability derives from action or inaction, policy goals are unlikely to be served if one penalizes decision-making that may have been reasonable, even desirable, at the time. Furthermore, this approach binds shareholders almost inescapably to the company, until such time as the agreements are terminated (or perhaps amended), because even if they divest their holdings, they can still be found responsible for having helped create the unanimous shareholder agreement.

Another possible answer would be to hold *current* investors liable. This could be justified on the grounds that they have an obligation to update the unanimous shareholder agreement on an ongoing basis to reflect changing circumstances, and thus they are *de facto* decision-makers similar to shareholders in the split powers arrangement. Directors, after all, must revisit corporate decisions and policies in light of new developments. Unfortunately, unanimous shareholder agreements may be more difficult to amend than director decisions are to overturn.

These difficulties may justify the transfer-then-fetter interpretation, which reduces to the split powers arrangement already discussed, but that has its own drawbacks, discussed later in this chapter.

3.(c) Shareholder Supervision

Another potential power structure which a unanimous shareholder agreement can create is one where the directors remain the primary decision-makers but are subject to some level of shareholder supervision. Such oversight could apply to some or all of their decisions. It might take the form either of a veto/ratification right where actions would *de jure* still need to originate with directors, or alternatively, shareholders might grant to themselves the ability to make decisions if and when they so chose (with an authority that superseded the directors'), but in the absence of such investor decision-making, the board would continue to manage the corporation as normal.

Dennis argued that "[a] common form of agreement among some or all of the shareholders of a

¹⁸⁴⁰ This exact phrase is taken from *C.B.C.A.* s. 146(5).

¹⁸⁴¹ Put another way, to consider "restrict[ing], in whole or in part, the powers of the directors" as a form of "exercising the powers of directors". That perspective also has implications with respect to the exact statutory language in the current *C.B.C.A.* that permits shareholders to fetter their discretion when exercising the powers of directors under a unanimous shareholder agreement. See the discussion later in this chapter.

close corporation currently in use [...] may [...] impose the requirement for specified majority shareholder approval of certain decisions of the directors where no such approval is required under the *Act*[...] Such an agreement should continue to be permitted under the new regime without the necessity to qualify as a unanimous shareholder agreement."¹⁸⁴² He suggested that such restrictions could be placed into by-laws, but that the law should also be amended to allow these agreements to be recognized as contracts "in much the same fashion as a pooling agreement"¹⁸⁴³ without being unanimous shareholder agreements as currently defined. Dennis' objection was to the unanimity requirement, which he believed unnecessary for this type of arrangement. He implicitly contrasted them with what he believed the unanimous shareholder agreement provisions were "really intended"¹⁸⁴⁴ to govern, documents which "affect the internal governance of a close corporation in one or more ways and opt out of some or all of the procedural requirements of the *Act*".¹⁸⁴⁵ For those, Dennis believed the unanimity requirement necessary.¹⁸⁴⁶ It is dubious whether a non-unanimous group of shareholders should have the authority to place themselves as a supervisory body over the directors, or how doing so fails to meet his own definition of a change in governance structure that opts out of the provisions of the *Act*. But Dennis did not even address how this might affect the duties and liabilities of directors.

Ewasiuk did reflect upon that issue, specifically as part of his consideration of the duties of care and loyalty, although his logic could apply to any responsibility of the board. Presenting several competing theories, he proposed that investors could be subject to duties when they directly assume power, but not when they merely have supervisory authority, using as an example the distinction between shareholders who are given borrowing powers versus directors who must obtain shareholder approval for borrowings over a certain amount.¹⁸⁴⁷ However, Ewasiuk noted that any such distinction was initially "compelling" but ultimately "artificial"¹⁸⁴⁸ because "in exercising supervisory or veto-like powers, the shareholders are still making directors' decisions".¹⁸⁴⁹

There is no consensus upon this question. Martel once declared that, since a ratification power meant that shareholders ultimately decide whether or not a resolution comes into effect, it constitutes a genuine transfer of authority to them, and would thus subject them to the entire responsibility normally borne by directors; initiative might remain the domain of the board, but the final decision-making power has been transferred.¹⁸⁵⁰ Despite that being his understanding of the state of the law, he argued that it

¹⁸⁴² Dennis, *supra* note 9, p. 122.
¹⁸⁴³ *Ibid*, p. 122.
¹⁸⁴⁴ *Ibid*, p. 122.
¹⁸⁴⁵ *Ibid*, p. 122.
¹⁸⁴⁶ *Ibid*, p. 122.
¹⁸⁴⁷ Ewasiuk, *supra* note 501, p. 16.
¹⁸⁴⁸ *Ibid*, p. 16.
¹⁸⁴⁹ *Ibid*, p. 16.
¹⁸⁵⁰ Martel, *supra* note 11, pp. 17-18.

would have been preferable if the statute had provided for joint and several liability between directors and shareholders in such circumstances, because both had participated in the process.¹⁸⁵¹ He more recently wrote, without explanation for what had prompted his admitted reconsideration, that perhaps liability actually was joint.¹⁸⁵² LaFortune thought, similarly to Martel's original position, that if directors were following instructions in accordance with the terms of a unanimous shareholder agreement, they would be viewed as the agents of the investors.¹⁸⁵³ Turgeon took the opposite position, on the basis that there were longstanding precedents of shareholders having approval rights regarding certain types of decisions, and that this had not entailed the assumption of responsibility for them. In his view, approval/veto powers granted through a unanimous shareholder agreement would simply represent an expansion of that, not a transfer of power and accompanying responsibilities, and as a result imposed absolutely no additional duties or liabilities upon investors.¹⁸⁵⁴ McCarthy, like Martel more recently, posited that the directors would not be relieved of their responsibilities but the shareholders would receive them as well, although he admitted to being "by no means certain" of this.¹⁸⁵⁵ This very uncertainty was one of the reasons that Smith warned against the possibility of such arrangements; based upon the *Q.C.A.* as it then was, which was clearer that investors empowered by a unanimous shareholder agreement would manage the company as if they were the directors, he argued that a term requiring the board to submit decisions to shareholders for approval (rather than transferring primary decision-making power to them) would not be a valid restriction.¹⁸⁵⁶ This statutory basis aside, he presented a theoretical justification for his objections: questions would be raised as to the shareholders' responsibilities if they approved acts of the directors that were illegal.¹⁸⁵⁷ In Smith's view, it would be unjust to hold them liable when the harms had been initiated by others.¹⁸⁵⁸

The difficulty that such a situation presents, that has so confounded and divided commentators, is that in one sense the directors have had no power removed, and in another, they have had all their powers removed.¹⁸⁵⁹ So long as the board remain the primary decision-makers for the corporation, there might be a continuing benefit to holding them accountable for the consequences of those choices. On the other hand, to the extent that they are not the *ultimate* decision-makers, it is unfair to hold them solely responsible when their decisions were subject to override.

¹⁸⁵¹ Ibid, p. 18.

¹⁸⁵² Martel and Martel, *supra* note 16, p. 364.

¹⁸⁵³ LaFortune, *supra* note 552, p. 214.

¹⁸⁵⁴ Turgeon, *supra* note 9, pp. 222-223, fn 405.

¹⁸⁵⁵ McCarthy, *supra* note 8, p. 471.

¹⁸⁵⁶ Smith, *supra* note 228, p. 307.

¹⁸⁵⁷ Ibid, p. 307.

¹⁸⁵⁸ Ibid, p. 307.

¹⁸⁵⁹ Assuming for the sake of simplicity that all powers are covered by the agreement's granting of supervisory authority to shareholders; if only some of them are, then see again the discussions of split powers in the preceding subsection.

One temptation might therefore be to look to the actual exercise of the shareholder's supervisory authority as determinative; where they did not intervene, the directors remain liable, and where they did, liability transfers. But this can be misleading. Investors who decline to intervene are giving tacit endorsement to decisions made, and their failure to appropriately exercise powers that they possess might itself be a valid source of liability. Further, whether or not they actually exercise their override abilities, a power dynamic could be created such that directors' decisions are subject to control even without a formal exercise of the shareholders' authority.

One possible analogy for this situation, albeit an imperfect one, is corporate officers. Officers bear duties and can face liabilities, and they often make choices that have a significant impact upon the company, but they are not the *de jure* ultimate authority in the corporation, and are not subject to all of the same responsibilities as directors. Directors subject to override by shareholders might be considered analogous, in that they inhabit an intermediate level in the corporate power structure, despite making decisions not normally within the authority of officers.

It has been noted that in many companies, the *de jure* power relationship between directors and officers can bear little resemblance to the *de facto* one, if disengaged directors allow entrenched officers to dictate corporate policy.¹⁸⁶⁰ And that might be equally true as regards shareholders empowered to override directors. This presents a danger that the board might *de facto* retain their full powers, while transferring away their duties and liabilities via the creation of a never-exercised override authority. At the very least, a supervisory power structured in a way that makes it difficult or impossible to actually use should not shift responsibility from those who actually make the decisions onto those who cannot effectively exert control.

Where the override is at least potentially useable, the issue remains as to how to deal with the board's duties and liabilities. The same three questions posed earlier apply. Should the directors be relieved of their responsibilities in whole, in part, or not at all? Should those responsibilities be imposed on the shareholders in whole, in part, or not at all? And is it realistic or desirable to treat the answers to the preceding two questions as automatically symmetrical?

This issue was considered in *National Bank of Canada v. Bronfman*,¹⁸⁶¹ where a motion was brought to dismiss the third party claim against individual directors.¹⁸⁶² Although they were struck on other grounds,¹⁸⁶³ Spence J. considered in the alternative the implication of a unanimous shareholder agreement that was in place. The basis of the suit was that the directors were allegedly participants in a threatened veto of a settlement proposal, which would take the form of their company refusing to amend a partnership

¹⁸⁶⁰ e.g. Belle Kaura, "Corporate Governance Conundrum: Re-Inventing the Board of Directors and Board Committees" in Poonam Puri and Jeffrey Larsen, eds, *Corporate Governance and Securities Regulation in the 21st Century* (Markham: LexisNexus, 2004) 7.

¹⁸⁶¹ *National Bank*, *supra* note 759.

¹⁸⁶² *Ibid*, par. 1.

¹⁸⁶³ *Ibid*, pars. 4-7.

agreement.¹⁸⁶⁴ Under the terms of a unanimous shareholder agreement, the directors could not cause their company to agree to said amendment without the approval of its shareholders,¹⁸⁶⁵ one of whom had actually threatened the aforementioned veto.¹⁸⁶⁶ The question therefore became, if the company refused to amend the partnership agreement, could liability attach to the board?

11 The argument for the defendants is that the terms of s. 3.03 of the unanimous shareholder agreement do not go far enough to engage the exemption from directors duties and liabilities in s. 146(5) of the *CBCA*. Reference was made to legal articles which propose that the exemption should not apply where the directors are not entirely dispossessed of the powers in question. Whether that proposition has merit is of course a matter to be assessed by reference to the terms of the unanimous shareholder agreement and the relevant *CBCA* provisions. Sections 3.03(2) of the unanimous shareholder agreement is clear that on "Important Matters", which apparently includes an amendment to the Partnership Agreement of the type envisaged, "the Board of Directors shall not adopt any resolution... without the prior unanimous consent of the Shareholders". This provision "restricts the powers of the directors" as contemplated by s. 146(5) of the *CBCA* and gives to the shareholders the veto provided in s. 3.03(2). Accordingly, pursuant to the terms of s. 146(5) of the *CBCA*, s. 3.03(2) relieves the directors of their duties and liabilities in respect of such a resolution until it has been approved by the shareholders. On this basis, a threat that a resolution to approve the amendment would not be approved in Topco would have to be construed as a threat that NBC would exercise its shareholder's veto. There would be nothing for the directors to do in respect of the resolution unless and until the resolution had received unanimous shareholders' consent, and if that had happened (contrary to the "threat") there is no evidence the directors would not have done as the Agreement provided. So a threat of the kind alleged is not a threat of a director's negative vote.

Therefore, the only situation in which they would be liable would be if the shareholders approved the action but the board failed to carry it out. If the shareholders refused, the directors would be powerless to act and could not be held liable. While not explicit in the judgment, the corollary would be that the investors had assumed responsibility for the decision.

If shareholders have placed themselves in a supervisory role *vis-a-vis* the directors, then they must bear the duties and liabilities that accompany ultimate power over the corporation. This would, firstly, include those that normally derive from the office itself and are independent of action or inaction.¹⁸⁶⁷

It is obvious that investors with this authority must bear responsibility for decisions in which they actively took part, but they must also be held responsible for decisions which they were empowered to participate in but chose not to. If that restraint allowed harm to occur, they must bear the same liability for that as if they had actively endorsed it. This would doubtless not be popular with investors, who would

¹⁸⁶⁴ Ibid, par. 10.

¹⁸⁶⁵ Ibid, par. 11.

¹⁸⁶⁶ Ibid, par. 3.

¹⁸⁶⁷ Quack, *supra* note 289, p. 43, recommended joint and several liability in this situation, specifically mentioning employee wages.

presumably prefer the power to intervene when it suited them without any accompanying responsibility to monitor corporate decision-making otherwise, but power brings with it duties and liabilities.

When the directors are subject to shareholder supervision, then they are, in substance, officers. The decisions they make might be more high-level than those which officers normally do, but they nonetheless are no longer the ultimate authority in the corporation. Their duties and liability should be adjusted accordingly. Typically, this would involve some degree of continued responsibility for their actions and inaction, as determined by whatever statute or part of the common law was relevant, but liability exclusively reserved for directors, including that which arises simply from holding the office, should no longer apply.¹⁸⁶⁸

If the shareholders' powers do not include originating corporate decisions, but only vetoing/ratifying those of the board, then it is still appropriate to hold them liable for actions that they have explicitly or implicitly endorsed (through a failure to intervene). It is, however, neither fair nor does it serve any policy goals to hold them liable for the directors' *inaction*, since they had no ability to rectify it. Conversely, the board should bear full responsibility for that inaction; they are the sole cause of it, and holding them accountable provides the necessary incentives to meet their obligations. Because directors retain a significant exclusive power in this arrangement, the ability to initiate action, they should be jointly and severally liable for position-derived responsibilities that are independent of action or inaction.

3.(d) Designated Shareholders and/or Third Parties Empowered

A final configuration is for a unanimous shareholder agreement to transfer power from the

¹⁸⁶⁸ In *American Reserve*, *supra* note 446, the director asserted that he had no personal liability because he was following what the judgment referred to as a "unanimous shareholders' direction" (par. 142). As discussed in Chapter Three, the judge found the direction was itself created without proper authority. Portions of the analysis suggested that, even if it were valid, the director would still be liable, as in the course of considering whether the unanimous shareholders' direction (agreement) shielded him, the judge asserted at par. 185:

He was involved to such a degree in the unlawful acts that he must be deemed to have made them his own. His actions amount to a deliberate course of conduct that he knew or ought to have known would constitute a tort. At best, they reflect a total indifference to the likelihood of the risk of a tort. In either case, on the authorities, McDorman is personally liable for his actions.

This is the same standard for liability that normally applies to employees and officers involved in corporate torts. See *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299, 1992 CarswellBC 315, 1992 CarswellBC 913, [1992] S.C.J. No. 84, [1993] 1 W.W.R. 1, [1993] B.C.W.L.D. 037, 13 C.C.L.T. (2d) 1, 143 N.R. 1, 18 B.C.A.C. 1, 31 W.A.C. 1, 36 A.C.W.S. (3d) 669, 43 C.C.E.L. 1, 73 B.C.L.R. (2d) 1, 97 D.L.R. (4th) 261, J.E. 92-1650, EYB 1992-67042 and Juzda, *supra* note 167, pp. 71-82.

directors to specified individuals, either a subset of the shareholders or third parties.¹⁸⁶⁹ This was not always possible, and is not currently possible in all jurisdictions,¹⁸⁷⁰ at least according to the strict wording of the legislation.¹⁸⁷¹ The exact statutory language has had other unfortunate results here as well. The Alberta Report noted that, while the *C.B.C.A.* as it then was allowed shareholders to transfer the directors' powers to third parties, a literal reading would be that their duties still fell upon the investors.¹⁸⁷²

Scavone recommended that liability attach only to shareholders who expressly assumed decision-making authority;¹⁸⁷³ the *C.B.C.A.* has since done exactly that. Because of the danger that judgment-proof nominees could be used, he suggested that the agreement only constitute *prima facie* evidence as to who the true decision-makers were and thus who would be liable, leaving room for proof that it was actually someone else.¹⁸⁷⁴ Dennis, also writing before those amendments to the *C.B.C.A.*, similarly recommended that it should be possible for only some shareholders to assume power, and that only they "should be treated as directors",¹⁸⁷⁵ presumably including the accompanying responsibilities. Turgeon went further, objecting not just to the imposition of liability on the owners of non-voting shares (who he assumed would still have no vote after the shareholders assumed power), but also to extending it to "passive investors" who simply agreed to some exercise of the directors' powers.¹⁸⁷⁶ (One might ask whether such an investor still qualified as "passive".) He argued that there was a distinction between the transfer of power and the exercise of it, and that while all shareholders must agree to the former, only those who actually utilize that authority afterward should bear responsibility for it.¹⁸⁷⁷ In support of this, he pointed out that shareholders normally bore no legal liabilities for electing the directors, and that there was no reason to deviate from that principle simply because a different mechanism for selecting the company's ultimate decision-makers was

¹⁸⁶⁹ The term "third party" here refers to individuals (or entities) who are neither shareholders nor directors. This possibility was also discussed at Welling 3rd ed., *supra* note 256, p. 464. Turgeon, *supra* note 9, pp. 231-232, gave as examples that officers could be empowered to function without director supervision or that creditors could be given veto rights over decisions that affected the company's ability to repay loans, such as dividends, salaries, and expenses over a set amount.

¹⁸⁷⁰ Only the federal and Quebec legislation allow for it (see *C.B.C.A.* s. 146(5) and *Q.B.C.A.* s. 214). All other provincial and territorial statutes deem that all shareholders receive all the powers of the directors that have been restricted (see *A.B.C.A.* s. 146(7), *M.C.A.* s. 140(5), *N.L.C.A.* s. 245(8), *N.B.B.C.A.* s. 99(5), *N.T.B.C.A.* s. 148(7), *N.B.C.A.* s. 148(7), *O.B.C.A.* s. 108(5), *S.B.C.A.* s. 140(4), and *Y.B.C.A.* s. 148(7)).

¹⁸⁷¹ Smith, *supra* note 228, p. 307 specifically noted that while the *C.B.C.A.* would allow this, the *Q.C.A.* would not; the wording of both acts have since been amended. Turgeon, *supra* note 9, pp. 364-367 considered whether the older *Q.C.A.* provision would technically bar clauses forcing the directors to resort to arbitration on the grounds that the arbitrator could not usurp their discretion.

¹⁸⁷² Alberta Report, *supra* note 223, pp. 28-29. Turgeon, *supra* note 9, p. 260, criticized this result as nothing less than the accidental abolition of limited liability.

¹⁸⁷³ Scavone, *supra* note 9, p.353.

¹⁸⁷⁴ *Ibid*, p. 353.

¹⁸⁷⁵ Dennis, *supra* note 9, p. 124.

¹⁸⁷⁶ Turgeon, *supra* note 9, p. 259.

¹⁸⁷⁷ *Ibid*, p. 260.

used.¹⁸⁷⁸ The merits of that justification aside, it would not extend to shareholders granted *de jure* power who decline to be active in its use. It would be preferable for agreements to empower only those investors prepared to accept the benefits and drawbacks of increased authority.

Given that policy goals require directors' duties and liabilities to affect the same individuals who have the powers they were meant to regulate, it is self-apparent that when a unanimous shareholder agreement only empowers a subset of shareholders, those individuals alone should bear the corresponding responsibilities.¹⁸⁷⁹ While there are arguments to be made that the other shareholders, who are also parties to the agreement, bear liabilities as a result, these are essentially the same points that one would use to attack shareholder limited liability generally, being at heart arguments that shareholders should be responsible for corporate debts and harms even when not in control because they have selected those who are. If one accepts that investors should normally be protected by limited liability when their ability to affect corporate decision-making is largely confined to electing directors,¹⁸⁸⁰ then the same logic would suggest protecting a shareholder who selected the corporate decision-maker by becoming a party to a unanimous shareholder agreement but who has no direct managerial power.

A variation of this occurs if a non-shareholder is granted the directors' authority through the terms of a unanimous shareholder agreement.¹⁸⁸¹ This must be distinguished from investors being granted power that they then attempt to delegate, a scenario that Hay and Smith found likely¹⁸⁸² and Disney argued should be permissible.¹⁸⁸³ The assumption that empowered shareholders might nominate agents, whether a subset of their number or someone else, to handle routine functions seems reasonable. It is, however, questionable whether, as Hay and Smith argue, these individuals should be considered directors for even limited legal purposes. They would seem more akin to employees, specifically senior officers, who have "administrative and managerial functions" subject to override. This was the conclusion arrived at in the trial judgement of *Allard c. Myhill*, when a corporation assumed direct control over a subsidiary and then placed individuals

¹⁸⁷⁸ Ibid, p. 260.

¹⁸⁷⁹ Or co-extensively with the directors, if they retain some power as well.

¹⁸⁸⁰ This can be debated, but that is beyond the scope of the current discussion.

¹⁸⁸¹ *Allard CQ*, *supra* note 1726, stated that this was at one time impossible and only shareholders could receive the powers of a director (par. 155), but that was explicitly based on the wording of the *Act* as it then was, which had since been changed to a more open-ended wording. The issue was not addressed in the successful appeal. *Indalex*, *supra* note 1775, mention such a scenario, as discussed below.

¹⁸⁸² Given that unanimous shareholder agreements may completely remove the powers of directors, Hay and Smith, *supra* note 319, discussed whether it should be permissible for corporations to dispense with the board of directors, arguing on p. 447 that "companies will always require parties who perform at least some of the administrative and managerial functions that directors currently discharge." Therefore, they warned that removing the board would simply result in the creation of a position with a similar role, which would not only make the move pointless but possibly require re-litigation of settled corporate law surrounding directors (p. 447). In their view, this outweighed the problems posed by directors retaining apparent authority, which they classify as a standard risk whenever agents of any sort are used (p. 447). See the discussion of this topic at note 1675.

¹⁸⁸³ Disney, *supra* note 9, p. 123.

in charge of it, although that decision was reversed on appeal.¹⁸⁸⁴

If, on the other hand, the unanimous shareholder agreement specifically grants the directors' powers to a non-shareholder (who apparently must still, under the current wording of the *C.B.C.A.*, be a party to the agreement), that would be analytically identical to a subset of investors receiving them. Duties and liabilities are included because that is what serves the social goals that underlie their existence; they must be imposed upon the individuals who have the corresponding powers and not upon those who do not.

Would be it possible for someone who was not a party to the unanimous shareholder agreement to receive the directors' powers? The section governing liability does not contemplate such an arrangement, but that is not the primary provision authorizing the agreements themselves. Since the section of the *C.B.C.A.* that allows for the creation and validity of unanimous shareholder agreements speaks only of "restricting" directors' powers, the same logic that expanded permissible "restrictions" to include the transfer of authority to shareholders could theoretically allow for the transfer of powers to anyone. A restriction that read, "The directors must follow any instructions¹⁸⁸⁵ given by (non-shareholder) John Smith," would arguably be valid even if John Smith was not a party to the agreement, but in that case, the provision governing the transfer of duties would not apply; any liability that John Smith faced would have to be derived from another source, such as a determination that he was a *de facto* director.¹⁸⁸⁶

In the trial judgment¹⁸⁸⁷ of *Allard*, De Michele J.C.Q found that "[t]he new version of subsection 146(5) stipulates and establishes that a director's normal duties and liabilities pass to the person who has a director's liability, [sic?] regardless of his or her title. The scope is much broader than the pre-2001 version."¹⁸⁸⁸ While not completely clear, this implies that in the current version of the *Act*, any individual may be granted the directors' powers and is then subject to the attendant liabilities, whether or not a shareholder. This becomes more obvious in the contrast with the judge's interpretation of the pre-2001 equivalent:

154 In addition, a literal interpretation of the former version of subsection 146(5) of the *CBCA* seems to indicate that the rights, powers and duties of a director may be transferred only for the sole benefit of the shareholders. The wording of the former version of subsection 146(5) clearly indicates that only the shareholders who are party to a unanimous shareholder agreement may assume such rights, powers and duties. [...]

155 Therefore, only shareholders may assume the rights, powers and duties taken away from directors [under the *Act* as it then was].

¹⁸⁸⁴ See discussion elsewhere in this chapter.

¹⁸⁸⁵ Alternatively, for a specified list of decisions, as described in previous sections.

¹⁸⁸⁶ See *C.B.C.A.* s. 2(1).

¹⁸⁸⁷ Whether a unanimous shareholder agreement could transfer the directors' powers to a third party was not addressed in the appeal judgment.

¹⁸⁸⁸ *Allard CQ*, *supra* note 1726, par. 149.

De Michele J.C.Q held that empowered shareholders could not delegate that authority, due to the rule of *delegatus non potest delegare*,¹⁸⁸⁹ discussed further below. In an apparent contradiction, however, the judge also stated that a unanimous shareholder agreement under the old *Act* could grant powers to third parties, but that the attendant liability would vest not in them but the shareholders who granted it:

150 Subsection 146(5) of the *CBCA*, as applicable in the period relevant to this dispute, does not state that the title of director applies to the person who performs the duties normally discharged by the person with this title, that is, the *de jure* director or the *de facto* director. Consequently, officers appointed under the unanimous shareholder agreement or the officer appointed under a declaration by the single shareholder are not subject to the liability of the directors set out in subsection 119(1), to the extent that the unanimous shareholder agreement or the declaration by the single shareholder gives these officers the powers that would otherwise be vested in the directors.

Although the past and present drafting of the acts have been imperfect, this issue is not complicated and a recommendation is easy. The directors' duties and liabilities should accompany their powers, wherever they are transferred.¹⁸⁹⁰ Only then can they serve the purposes for which they exist. To the extent that any legislation fails to adequately reflect this principle, some simple amendments can remedy the situation.

3.(e) Conclusion on Unusual Restrictions

Directors' duties and liabilities are supposed to accompany their powers, but the situations that unanimous shareholder agreements can create may lead to uncertain outcomes. The overly vague statutory provision that purported to govern such eventualities does not adequately address them. In analyzing four scenarios wherein directors' powers are not transferred in full to shareholders, recommendations were made as to how best to achieve the objectives that the board's responsibilities are intended to further.

The most straightforward is the transfer of power to third parties; it is they who should shoulder the corresponding duties and liabilities, not shareholders. The combination of, on the one hand, responsibilities relating to action, inaction, and position, and on the other, divisions of power by area or by the creation of a "supervisory" authority (which may or may not include the ability to originate actions) led to a variety of recommendations, but are all at least potentially resolvable. The result may not be simple, but it flows from the consistent premise that the duties and liabilities of directors should attach to the individuals who possess ultimate decision-making power in the corporation and/or the particular aspect of it that has given rise to difficulties.

What may not be solvable is the problem posed by pre-made decisions. It is unclear what party, if

¹⁸⁸⁹ Ibid, pars. 156-157.

any, should be held liable for specific decisions made in a unanimous shareholder agreement. There is no answer that adequately safeguards policy goals. It may simply be impossible to resolve this issue in a meaningful way. As useful as pre-made decisions could be, this is cause to reconsider whether they should be permitted in a unanimous shareholder agreement. The topic will be returned to in the following section, in the specific context of the duty of care.

The foregoing has proceeded with a necessary vagueness as to exactly what social purposes directors' myriad responsibilities serve; the explanations are varied and contested. But it has been assumed that they did serve some goals, and if they had legitimacy when imposed upon the normal ultimate power in the corporation, the directors, that suggested they should not be evaded or undermined by the transfer of that authority. The following sections challenge that axiom as it applies to the directors' duties to serve the interests of the corporation itself.

4. The Duties of Care and Loyalty

The preceding section dealt with various combinations of the transfer of duties and liabilities that occur when shareholders restrict the authority of directors. As the foundation of that discussion, it was assumed that the responsibilities that the board bears are attached to their powers in order to serve societal goals, which would be thwarted if either those who no longer managed the corporation were still made to shoulder those burdens or if those who had assumed control escaped them.

A specific subset of those duties and liabilities stands as a potential exception to this general principle. These are the duty of care and the duty of loyalty.¹⁸⁹¹ One conception of them is that they exist only to solve agency problems as between the directors and the shareholders (the latter implicitly monolithic); when investors represent themselves directly, this thinking runs, there is no longer any need

¹⁸⁹⁰ Turgeon, *supra* note 9, pp. 260-262, recommended the same.

¹⁸⁹¹ I avoid the term "fiduciary" here in order to prevent confusion. Per *B. (K.L.) v. British Columbia*, 2003 SCC 51, [2003] 2 S.C.R. 403, 230 D.L.R. (4th) 513, [2003] 11 W.W.R. 203, [2003] R.R.A. 1065, 187 B.C.A.C. 42, 309 N.R. 306, 2003 CarswellBC 2405, 2003 CarswellBC 2406, 19 C.C.L.T. (3d) 66, 2004 C.L.L.C. 210-014, 307 W.A.C. 42, 44 R.F.L. (5TH) 245, [2003] B.C.W.L.D. 790, J.E. 2003-1874, [2003] W.D.F.L. 374, 38 C.P.C. (5th) 199, [2003] S.C.J. No. 51, 18 B.C.L.R. (4th) 1, REJB 2003-48042 (S.C.C. Oct 02, 2003) and *Peoples*, *supra* note 809, in Canadian law the term "fiduciary" should be reserved for the duty of loyalty, not the duty of care, a usage roughly consistent with the term's meaning in law outside the corporate context (see Robert Flannigan, "Reshaping the Duties of Directors" (2005) 84 Can. B. Rev. 365, online: <http://ssrn.com/abstract=859628>, at pp. 366-373; Flannigan found some fault with the Supreme Court's analysis in *Peoples*, but accepted their description of the statutory duty of loyalty as "broadly congruent with the content of conventional fiduciary responsibility" (p. 369); Juzda, *supra* note 167, pp. 23-24 fn 68, attempted to address these concerns). However, the American tradition is to use the term "fiduciary duties" in the corporate context to refer collectively to both the directors' duty of loyalty and duty of care (and sometimes apparently even includes any other legal duty the directors owe or which a writer wishes to impose upon them); this wider usage is sometimes adopted by Canadians as well.

for duties whose only function is to police a relationship that no longer exists.

Before proceeding, it is useful to set out what the duties of care and loyalty are. According to the *C.B.C.A.*:¹⁸⁹²

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
(a) act honestly and in good faith with a view to the best interests of the corporation; and
(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.¹⁸⁹³

The first subsection corresponds to the duty of loyalty; this is the negative obligation¹⁸⁹⁴ which bars them from deriving direct or indirect unauthorized personal benefit from their position.¹⁸⁹⁵ The second corresponds to the duty of care; this is the positive obligation to demonstrate at least a minimum level of competence.

In a shareholder-primacy model of the corporation, both of these can be seen as primarily concerned with agency problems that prevent directors from maximizing corporate profits and therefore investor returns. The duty of loyalty prevents the diversion of assets and opportunities away from the

¹⁸⁹² This may be a codification of duties that would arise through common law regardless. (See note 1143.) Disney, *supra* note 9, p. 121, stated that in order for the unanimous shareholder agreement provisions of the Alberta statute to make sense, it must be presumed that the sections on directors' duties entirely displace the common law on that topic, since it allowed for a unanimous shareholder agreement to modify directors' statutory conflict of interest duties, but did not mention any common law conflict of interest duties they might have. The analysis in *M.E.N. Electric Co. v. Rumble*, 2005 CarswellOnt 4040 (Ont. S.C.J. Sep 06, 2005) (hereinafter "*M.E.N.*"), discussed later in this chapter, raises this issue as well.

¹⁸⁹³ *A.B.C.A.* s. 122(1), *M.C.A.* s. 117(1), *N.B.B.C.A.* s. 79(1), *N.L.C.A.* s. 203(1), *N.T.B.C.A.* s. 123(1), *N.B.C.A.* s. 123(1), *O.B.C.A.* s. 134(1), *S.B.C.A.* s. 117(1), and *Y.B.C.A.* s. 124(1) are substantially identical, although minor variations in wording are present. *Q.B.C.A.* s. 119 is loosely similar, but it has a significantly different wording and invokes obligations found in the *C.C.Q.* Except where noted, the discussion in this chapter of the directors' duties to the corporation assumes a common law framework and may not be entirely applicable in Quebec.

¹⁸⁹⁴ The duty of loyalty is inherently a negative obligation, in that it consists of refraining from prohibited behaviour, in this case refraining from using the position of corporate director for purposes other than advancing the corporation's interests. Under certain circumstances, this negative obligation may give rise to limited positive obligations, *e.g.* to disclose conflicts of interest, but the overall character of the obligation remains negative. Analysts (including judges) sometimes conflate this obligation not to use the position of director to benefit other interests ahead of the corporation with the directors' positive obligation to advance the corporation's own interests, but the latter is more properly categorized as part of the duty of care. See the discussion later this chapter, and Juzda, *supra* note 167, pp. 20-32.

¹⁸⁹⁵ Subject to certain limited exceptions, or to having their self-interested actions ratified by the shareholders. The legislation also imposes upon directors a specific obligation to disclose conflicts of interest and refrain from voting upon them (see *C.B.C.A.* s. 120, *A.B.C.A.* s. 120, *M.C.A.* s. 115, *N.B.B.C.A.* s. 77, *N.L.C.A.* s. 198, *N.T.B.C.A.* s. 121, *N.B.C.A.* s. 121, *Q.B.C.A.* s. 122 through s. 133, *O.B.C.A.* s. 132, *S.B.C.A.* s. 115, and *Y.B.C.A.* s. 122); although the procedures governing such situations are set out separately, the duty to avoid conflicts of interest is a subset of the duty of loyalty. (See *Peoples*, *supra* note 809, par. 35, whose definition of the directors' "statutory fiduciary duty" included that "[t]hey must avoid conflicts of interest with the corporation".)

corporation, and thus ensures that those assets and opportunities flow to the shareholders as profit. It might also occasionally prevent directors from taking advantage of opportunities that could not or would not have been available to the company, but that can be explained as an unfortunate yet necessary overreach to achieve the aforementioned goals. The duty of care is similarly designed to ensure that directors are not utterly incompetent in a manner that costs the company and therefore its shareholders money. Avoiding incompetence is not the same as guaranteeing success, and so the business judgment rule recognizes that financial failure does not prove that the board fell short of meeting their duty of care. This is fully compatible with maximizing shareholder returns. A duty to succeed would be implausible and counterproductive even from that perspective, penalizing competent individuals for factors beyond their control and thus discouraging them from becoming directors, and providing strong disincentives for risk-taking even when it might benefit investors (particularly diversified ones).

As will be discussed in a later part of this chapter, this view of the duties of care and loyalty has been at the very least complicated, if not outright discredited, by recent Supreme Court of Canada decisions. But it forms the basis, either explicitly or implicitly, of virtually all of the commentary to date on the interaction of these duties with unanimous shareholder agreements.

The next subsections discuss those analyses, which have intertwined the question of whether empowered shareholders inherit the duties of care and loyalty with whether or not they are permitted to "fetter their discretion" by pre-determining corporate decisions in the agreement. This is followed by my own analysis of the "fettering discretion" issue, which determines that it is best separated from the context of the duty of care and reconceived of as "pre-made decisions". Following that, case law concerning empowered shareholders and their potential duties is reviewed, and the section concludes with my argument that maintaining these responsibilities will be beneficial to the shareholders collectively.

4.(a) "Fettering Discretion" and the Debate on the Duties of Care and Loyalty

4.(a)(i) Before the *C.B.C.A.* Amendments

Few aspects of the unanimous shareholder agreement have interested commentators as much as the question of whether it might impose the directors' duties of care and loyalty (or some equivalent) upon shareholders. Prior to recent amendments to the *C.B.C.A.*, the *Act* did not specifically address this possibility; the discussion therefore centred around whether the provision that transferred "duties" in general included (or should be taken to include) them.

Much of the debate appears to have at its root the discussion of the unanimous shareholder

agreement in Bruce Welling's textbook *Corporate Law in Canada*. In the first edition,¹⁸⁹⁶ the general issue of whether the duties of care and loyalty might bind shareholders is not discussed beyond passing remarks that they would apply. Instead, one specific aspect was focussed upon, as part of Welling's analysis of what these agreements are and how they function:

The nature of the agreement is to specify certain endeavors concerning which the directors will be rendered powerless, rather than to express a shareholder consensus as to a particular course of action the corporation is to pursue. This does not appear to be what most practitioners currently think of as a unanimous shareholder agreement. However, it seems an inevitable conclusion when one recalls that the effect is to catapult each shareholder into a director's seat *vis-a-vis* certain defined subject matters. If each shareholder then owes the corporation the same types of equitable duties as a director would, then each shareholder *qua* acting director will be obliged to make up his mind afresh as he is confronted by each new problem within the scope of the agreement. He cannot agree in advance as to how he will decide because he will have inherited the director's obligation to decide each issue as *then* appears to be to the corporate advantage. Far from being free, as a shareholder, to contract, sell, or give away his precious vote, each shareholder *qua* acting director will be caught by the rule in *Motherwell v. Schoof*; he who owes a fiduciary duty (here, each shareholder, because of the unanimous shareholder agreement) cannot fetter his discretion; he is required to remain free to vary his opinion as seems to him to suit the occasion and the person (here, the corporation) to whom the duty is owed. In short, a unanimous shareholder agreement is an agreement by 100 per cent of the shareholders setting out certain areas of corporate endeavor in which the directors' power is to be limited; it is not a binding agreement as to how each of the shareholders will exercise his judgment in voting on corporate affairs.¹⁸⁹⁷

It is not just "most practitioners", but most judges as well, who have believed that unanimous shareholder agreements could set out specific decisions. As many of the examples discussed in previous chapters demonstrate, the courts have seldom hesitated in accepting that this fell within the scope of the tool. This may not have been consistent with the literal meaning of the statute, but it is almost undeniable that has it been the *de facto* state of Canadian law. Nor did judges view such clauses through the two-step transfer-then-fetter analysis, outlined below, that has underlain so much of the commentary. Instead, any ambiguity on their part about this practice has usually been expressed not through holding these terms invalid *per se* or in violation of the rule against fettering discretion, but through choices of enforcement mechanism that rendered the restrictions less than fully binding upon directors.¹⁸⁹⁸ Exceptions such as *9109* and *Couvre-Plancher* did conclude that terms other than transfers fell outside the statutory definition

¹⁸⁹⁶ Welling 1st ed., *supra* note 250.

¹⁸⁹⁷ *Ibid*, pp. 452-453. In the second edition, Bruce Welling, *Corporate Law in Canada: The Governing Principles*, Second Edition (Toronto: Butterworths, 1991) (hereinafter "Welling 2nd ed."), he retained the above-cited passage (pp. 483-484), but added additional discussion. Following upon the already established line of analysis, he asserted that if the agreement did purport to decide corporate matters, then such terms could not be enforced, because of the rule against fettering discretion (p. 486). He continued not to address wider questions of the duty of care and duty of loyalty.

¹⁸⁹⁸ See Chapter Four generally.

of the unanimous shareholder agreement, but not because they would limit empowered investors' freedom of choice. Only *Ming*, discussed below, considered the issue in that manner. One consequence is that while judges have permitted unanimous shareholder agreements to set out specific decisions, they have, unlike most commentators, done so in a manner that has no obvious implications for the duties that empowered shareholders owe to the corporation. It should therefore be understood that the debates covered over the following several subsections of this chapter have been, in more than one sense, academic.

Welling accepted that shareholders had the freedom *qua* (unempowered) shareholders to enter into a unanimous shareholder agreement that purported to fetter their discretion regarding the authority they were acquiring.¹⁸⁹⁹ But, in his analysis, that only prevented document with such a term from falling afoul of the statutory requirement that the contract be lawful; the term itself would be ineffectual once they had assumed power.

It is unfortunate that Welling framed this as he did. The prohibition against fettering discretion is a manifestation of the directors' duty of care; if they cannot consider each choice as it arises, bearing in mind all relevant factors, they cannot exercise reasonable care, diligence, and skill in their decision-making. But Welling was not questioning, really, whether shareholders who assumed power should owe a duty of care to the corporation; in general, he took as a given that they did. The issue he was truly concerned with was whether, under the wording of the statute, it was possible for the parties to a unanimous shareholder agreement to *make a specific corporate decision*, or only to transfer power to investors. Because the legislation at the time automatically passed all restricted powers to the shareholders, Welling's method for interpreting a specific decision in the agreement was to break it into two steps: it firstly transferred powers from the directors to the shareholders, and it secondly constituted an agreement amongst the shareholders as to how they would exercise that authority. The first step brought such contractual terms within the scope of the provision, but the second ran afoul of general corporate law.

Welling's comments regarding fettering discretion should not, therefore, be taken as generally applicable to the duties of care and loyalty. They were, instead, an examination of whether unanimous shareholder agreements were allowed to specifically set out corporate decisions, rather than transfer directors' powers. But by framing the issue in this manner, he set a troublesome foundation for analyzing both the duties of empowered shareholders and permissible terms in unanimous shareholder agreements.

One of the first commentators to follow him understood this correctly. Ratti quoted the same passage from Welling reproduced above,¹⁹⁰⁰ and identified the key point as being that only a transfer of authority was permissible, contrasting that with supervisory arrangements or the inclusion of specific

¹⁸⁹⁹ Welling 1st ed., *supra* note 250, p. 452. The passage was retained in Welling 2nd ed., *supra* note 1897, at p. 483, with an additional footnote that specifically emphasized that "this covers only the setting up of the unanimous shareholder agreement; once the agreement comes into existence and each shareholder becomes a fiduciary, each must manage with equitable obligations in mind" (p. 483 fn 66).

¹⁹⁰⁰ Plus a few additional sentences.

corporate decisions in the document.¹⁹⁰¹ Although he considered it logical that if an actual relocation of power was allowed, then a "lesser" change should be as well, Ratti concluded that the federal and Quebec legislation of the time were fully consistent with the former but did not explicitly permit the latter.¹⁹⁰² Both were contrasted with the Alberta version, whose wider criteria might permit such alternatives.¹⁹⁰³ He further concluded that, if under the *C.B.C.A. '74-'75* and *Q.C.A.* terms other than transfers of power were not properly the contents of unanimous shareholder agreements and were thus subject to the rules that normally governed contracts, they would be mostly ineffective at controlling directors.¹⁹⁰⁴

Unfortunately, Ratti was an exception in identifying Welling's real concern as the permissibility of including specific decisions in the document, an issue that is in most ways distinct from whether empowered shareholders are bound by the same duties that normally govern directors; Ratti himself dealt with the former as an independent issue, as just described, though he also revisited it in the context of those duties.¹⁹⁰⁵ Instead, Welling's framing, invoking the duty of care related phrase "fettering discretion" and setting out why he believed empowered shareholders were bound by this principle, has led to the debate about the sorts of clauses unanimous shareholder agreements might contain being tied to the question of whether empowered investors assume the directors' duties of care and loyalty, to the detriment of each.

Disney, for example, also connected the two topics, beginning his discussion of both of them by asking:

Does a shareholder thereby lose the relative freedom normally possessed by shareholders to act in their own interests, delegate their powers and otherwise behave in ways that would not necessarily satisfy the standard of care of directors? For example, would shareholders thereby become subject to the common law principle that the discretion of directors cannot be fettered, even though the entire purpose of creating unanimous shareholder agreements was to escape this principle?¹⁹⁰⁶

This attached arguments regarding the permissible content of unanimous shareholder agreements to questions regarding the investors' duties after they come into effect.

Disney considered the unanimous shareholder agreement to represent "a shareholder-chosen contractual model of corporate governance formerly absent from Canadian law".¹⁹⁰⁷ It is clear from what followed that he preferred this to a statutorily-determined one. His reasoning was that many close

¹⁹⁰¹ Ratti, *supra* note 16, pp. 106-108.

¹⁹⁰² *Ibid.*, p. 109, citing Welling 1st ed., *supra* note 250, pp. 452-453.

¹⁹⁰³ Ratti, *supra* note 16, pp. 109-110.

¹⁹⁰⁴ *Ibid.*, p. 110. At p. 119, for reasons discussed later in this chapter, Ratti did note that under his understanding of the Quebec legislation, while shareholders could not include specific decisions in a unanimous shareholder agreement *per se*, the same result could be achieved by transferring powers to themselves while simultaneously agreeing how they would exercise them.

¹⁹⁰⁵ See the following subsection regarding that portion of Ratti's analysis.

¹⁹⁰⁶ Disney, *supra* note 9, p. 119.

¹⁹⁰⁷ *Ibid.*, p. 118.

corporations and their participants were not in compliance with the *Act*; in particular, directors behaved as if they were nominees for specific shareholders, rather than as if they owed a duty to the company itself.¹⁹⁰⁸ Disney saw the legitimization of this practice as a positive step.¹⁹⁰⁹ Consequently, he was opposed to the view that empowered shareholders should lose their freedom to pursue their own self-interest. He acknowledged that the statute (as it then was) passed without qualification the duties of the directors to investors who assumed their authority, but found the literal meaning problematic, because it might cause them to lose "the relative freedom normally possessed by shareholders to act in their own interests, delegate their powers and otherwise behave in ways that would not necessarily satisfy the standard of care of directors".¹⁹¹⁰

Disney put forth as an example the rule against fettering discretion, specifically in response to Welling's position on that topic.¹⁹¹¹ His view was that distinguishing the shareholders' freedom to enter into a contract that purports to govern their decision-making once they have assumed power from the (in)ability of that contract to actually bind them "does not represent the statutory intent and leads to an absurd result".¹⁹¹² He rejected Welling's interpretation of the legislative wording, instead finding it compatible with allowing for shareholders to place restrictions on their *own* powers as part of the agreement. Disney went so far as to argue that Welling's approach would make the unanimous shareholder agreement a useless tool.¹⁹¹³ Instead, there was "no apparent reason shareholders of a corporation should not be permitted to agree unanimously"¹⁹¹⁴ to include specific business decisions in the document, even if those arrangements might constitute self-dealing or otherwise deviate from the duty of loyalty a director would normally owe.¹⁹¹⁵

Turning to wider consideration of the directors' duties to the corporation, Disney's analysis remained similar. Of particular concern to him was the hypothetical stalemate caused by a potential corporate decision of benefit to some or all shareholders. The statutory and common law duties of directors prohibit them from voting on transactions if they have a conflict of interest, but the shareholders may be

¹⁹⁰⁸ Ibid, p. 118.

¹⁹⁰⁹ Ibid, p. 118.

¹⁹¹⁰ Ibid, p. 119.

¹⁹¹¹ He also reproduced portions of the same oft-quoted passage found above, at Disney, *supra* note 9, pp. 119-120.

¹⁹¹² Disney, *supra* note 9, p. 120.

¹⁹¹³ Ibid, p. 120. The passage is reproduced below in the discussion of *Ming*.

¹⁹¹⁴ Ibid, p. 120.

¹⁹¹⁵ The three examples Disney provided all involved committing the company to enter predetermined business dealings with specific shareholders (Disney, *supra* note 9, p. 120; the passage is reproduced below in the discussion of *Ming*). While it is possible that such arrangements would not violate the duty of loyalty, particularly given that the other shareholders could approve them, the choice of examples suggests a belief that placing these decision in a unanimous shareholder agreement itself might help circumvent that duty.

able to ratify such decisions.¹⁹¹⁶ The shareholders, in doing so, are permitted to vote in their *own* self-interest, so Disney found it "peculiar"¹⁹¹⁷ that they would not be allowed to behave in a self-interested manner if they themselves initiated events.¹⁹¹⁸ He considered it "ridiculous" that they might first be bound *qua* primary decision-makers¹⁹¹⁹ to disclose conflicts of interest before ratifying them *qua* shareholders.¹⁹²⁰ While this would undoubtedly be an artificial process, it actually is a feasible answer to any concerns about corporate paralysis that remains consistent with the statute.¹⁹²¹ His objection was that "such procedures are hardly conducive to the simplification of management of a closely-held corporation that unanimous shareholder agreements were designed to facilitate".¹⁹²² What this overlooked was that simplification, if such was indeed the legislative goal in creating this tool, should not outweigh all other concerns.

But Disney largely denied the validity, or even the existence, of any other concerns that might result from dispensing with these obligations to the company. He argued that the point of the unanimous shareholder agreement was to recognize that in small corporations, there is no meaningful distinction between directors who function as agents (and therefore must be bound by duties to their principals) and the shareholders who are principals (and free to act in their own interest),¹⁹²³ by which he apparently meant that there was no longer an agency relationship in place and therefore no need for the duties one would involve. To settle any remaining corporate governance problems that might arise after shareholders assumed power- he doesn't list any, but inter-investor conflicts are an obvious one- Disney speculated that courts might not bother attempting to precisely set out which of the directors' duties of care and loyalty bind empowered shareholders or how, instead resorting to the "common sense approach of evaluating the conduct of shareholders by the broad fairness standard of the oppression remedy",¹⁹²⁴ although this may make attempts at compliance more uncertain.¹⁹²⁵ What little reported case law exists on such situations

¹⁹¹⁶ Disney, *supra* note 9, p. 121. Disney used the example of *O.B.C.A.* 132(8) permitting shareholder ratification if the transaction is "reasonable and fair to the corporation". He noted that this was also possible at common law.

¹⁹¹⁷ *Ibid*, p. 121.

¹⁹¹⁸ Disney gave qualified support to the approach taken by the *A.B.C.A.*, which allowed for unanimous shareholder agreements to restructure or eliminate statutory rules governing directors' conflicts of interests (and their potential transfer to shareholders), but is critical of statutory drafting that suggests that, if the agreement is silent on this issue, shareholders might in some manner be bound to avoid conflicts of interest (Disney, *supra* note 9, p. 122).

¹⁹¹⁹ He refers to this capacity as "directors" (without quotation marks), but that's not necessarily an accurate term (Disney, *supra* note 9, p. 122).

¹⁹²⁰ Disney, *supra* note 9, p. 122.

¹⁹²¹ And, as discussed later in the chapter, actually might have genuine utility. Among other things, it is possible that the voting arrangement for *empowered* shareholders as primary decision makers would not be the same as for ratification.

¹⁹²² Disney, *supra* note 9, p. 122.

¹⁹²³ *Ibid*, p. 122. This description of the corporation does not accurately reflect the current state of Canadian law; see the discussion later in this chapter.

¹⁹²⁴ *Ibid*, p. 123.

¹⁹²⁵ *Ibid*, p. 123.

does not bear this out.¹⁹²⁶

Dennis' analysis was similar. In his view, the rule against fettering discretion should not apply to empowered shareholders, because it normally ensured that directors acted for the corporation and not for the benefit of specific investors only, but by contrast, the unanimous shareholder agreement was designed to "legitimate shareholder control" and therefore the rule against fettering had no basis in that context.¹⁹²⁷ He apparently interpreted the assumption of power by shareholders as dissolving the normal corporate law distinction between the "best interests of the corporation" and the interests of its investors, and it is on those grounds that the rule against fettering became meaningless. This ignored that the interests of the shareholders are individual, not monolithic. Dennis may even have endorsed empowered investors being able to further fetter their discretion outside the unanimous shareholder agreement.¹⁹²⁸ The problematic implications of that are examined below as part of the discussion of Welling's third edition.

Dennis recommended that empowered shareholders incur the duty of care but be excused from the duty of loyalty, and be allowed to act in their own interests.¹⁹²⁹ The justification was not elaborated upon beyond a statement that the purpose of the unanimous shareholder agreement was to "recognize the role of shareholders in the active management of the close corporation, by eliminating the requirement for directors".¹⁹³⁰ How exactly it follows that the duty of loyalty need not apply is unclear. Alternatively, depending upon one's premises, it might be unclear why the duty of care *would* apply, especially given his view that the prohibition on fettering discretion (a dereliction of that duty) did not. In combination, the result was nonsensical; empowered shareholders would be allowed to make decisions to the detriment of the corporation only if they could prove a self-interested motive, rather than simple lack of care.

Scavone came to the exact opposite conclusion, removing almost entirely the duty of care while leaving the duty of loyalty largely intact. This is at least defensible; the law tolerates the incompetent use of power more than its abuse. Like the preceding two authors, he began by considering fettering discretion as an example of the larger uncertainties surrounding whether shareholders inherit the directors' duty of care and duty of loyalty.¹⁹³¹ Regarding that particular issue, he argued that since unanimous shareholder agreements allowed investors to overcome the rule against fettering directors' discretion, preventing them from fettering their own would bind them with "the very rule from which the legislation was intended to provide relief".¹⁹³² Although he found such a prohibition more consistent with the then-current wording of

¹⁹²⁶ See a subsequent subsection of this chapter.

¹⁹²⁷ Dennis, *supra* note 9, p. 125.

¹⁹²⁸ *Ibid*, p. 125: "[T]he rule against fettering does not apply to directors to the extent that their powers have been restricted by unanimous shareholder agreement; nor does it apply to prevent shareholders having acquired powers of directors from fettering their own discretion."

¹⁹²⁹ Disney, *supra* note 9, p. 129.

¹⁹³⁰ *Ibid*, p. 129.

¹⁹³¹ Scavone, *supra* note 9, p. 344.

¹⁹³² *Ibid*, p. 344.

the statute, he argued that "it cannot be correct since it would too substantially undermine the very purpose of this section".¹⁹³³ This reference to the "purpose of the section" was ill-explained,¹⁹³⁴ although its subsequent amendment does give his assertion some retroactive credibility.¹⁹³⁵

More generally, Scavone wrote, "Among the 'duties' imposed on such shareholders [in the wording of the provision] are surely the primary duties of honesty and good faith and the duty of care[...]"¹⁹³⁶ They would therefore, when acting as primary decision-makers,¹⁹³⁷ not be free to vote for their own benefit and would have to look to the interests of the company.¹⁹³⁸ Scavone agreed with Disney's assertion¹⁹³⁹ that there was a certain ridiculousness to having shareholders vote twice, first with the duty and then without to ratify their own breach of it, but countered that it was only the procedure that was problematic; it was what the law appeared to require and did have practical benefits.¹⁹⁴⁰ A simple example was disclosure of conflicts of interest¹⁹⁴¹ but the duty of loyalty might also have advantages when shareholders' interests conflicted with creditors' or each other's.¹⁹⁴²

Scavone concluded with a proposal that investors be free, in drafting a unanimous shareholder agreement, to specify what duties, if any, they would be subject to under it.¹⁹⁴³ In the absence of such, he suggested the default rule be that:

shareholders to vote only once and in their capacity as shareholders subject to a limited core of fiduciary duties which would cover director-like duties of loyalty (avoiding conflicts of interest, not appropriating corporate opportunities and so on) but not director-like duties of care (acting in the best interests of the corporation). Such a compromise would allow shareholders to continue to generally vote in their own best interests, as opposed to the best interests of the corporation except in those situations that were most

¹⁹³³ Ibid, p. 345.

¹⁹³⁴ It is possible that the purpose of the original provision, at the time it was first enacted, was to allow for transfers of power to shareholders but not for specific corporate decision-making in the agreements.

¹⁹³⁵ The addition of the current *C.B.C.A.* s. 146(6) gives retroactive credibility to Scavone's view of the legislative intent in creating the unanimous shareholder agreement. Conversely, the existence of and thus presumptive need for that amendment might also suggest that he was mistaken in his argument that that purpose had been realized in the prior version of the federal statute and overrode any contrary indications in the wording. If, as Scavone argued, the *C.B.C.A.* had already allowed for shareholders to "fetter their discretion" before the amendment, the current s. 146(6) would have been unnecessary. That said, the issue was sufficiently ambiguous that the legislature could have simply been seeking to clarify, rather than change, the state of the law.

¹⁹³⁶ Scavone, *supra* note 9, p. 345.

¹⁹³⁷ Scavone uses the term "directors" in quotation marks for this role (Scavone, *supra* note 9, p. 345).

¹⁹³⁸ Scavone, *supra* note 9, p. 345.

¹⁹³⁹ He was explicitly responding to Disney.

¹⁹⁴⁰ Scavone, *supra* note 9, p. 345.

¹⁹⁴¹ Ibid, p. 346.

¹⁹⁴² Ibid, p. 346. He provided as examples contracts with a related corporation and sales of substantially all of the corporation's assets to a shareholder.

¹⁹⁴³ Ibid, p. 347.

susceptible to abuse.¹⁹⁴⁴

This is utterly self-contradictory, as inheriting the duty of loyalty, including specifically avoiding conflicts of interest, would seem the very definition of a prohibition on voting in one's own best interests (to the extent that those are in conflict with the company's). How are the situations "most susceptible to abuse" defined, if not as those where the shareholders might put themselves ahead of the company?¹⁹⁴⁵ Either the duty of loyalty is preserved or it is not. Scavone did not provide any justification for the offhand mention of removing the duty of care, except to the extent that the earlier discussion of fettering referred to a subset of that duty. It is possible that he erroneously believed that it was the duty of care, and not the duty of loyalty, that prevented self-interested voting.

Like both Dennis and Scavone, Ewasiuk contrasted a literal reading of the statute (as it then was) with the view that imposing the duties of care and loyalty upon empowered shareholders might "negate the essential purpose of a unanimous shareholder agreement".¹⁹⁴⁶ The latter perspective took this legal tool as a recognition that when shareholders are in agreement, it is artificial to maintain any distinction between their collective interests and those of the corporation, although he acknowledged this ignored creditors.¹⁹⁴⁷ Therefore, empowered investors should be free to "favou[r] their own interests over those of the company".¹⁹⁴⁸ In wording the conclusion thus, Ewasiuk inadvertently highlighted the inherent flaw in this argument. If the premises were correct, it would be impossible for shareholders to favour their own interests over those of the company because the distinction would no longer exist. Their own interests would *be* the interests of the company, and *vice versa*. Clearly, some distinction remains. If nothing else, the analysis makes the error of conflating unanimity in *enacting* a unanimous shareholder agreement with unanimity in *exercising powers* granted by one. Depending on the terms of the document, the latter need not be required, and therefore even if the unanimous will of the shareholders were equivalent to the best interests of the corporation, it does not follow that actions taken under the agreement represent either.

In *Ming Minerals Inc. v. Blagdon*,¹⁹⁴⁹ Mercer J. entered the debate. Unusually, he did so in order to determine whether specific business decisions in the document constituted restrictions upon the

¹⁹⁴⁴ Ibid, pp. 347-348.

¹⁹⁴⁵ The description of the "fiduciary duties" as "limited" in this proposal may be due to Scavone assuming the phrase to normally include both the duty of loyalty and the duty of care, such that excluding the latter is the limit. Due to focussing almost entirely on the duty of loyalty up until this point, his usage of the term "fiduciary duty" elsewhere is ambiguous as to whether the duty of care might also be included.

¹⁹⁴⁶ Ewasiuk, *supra* note 501, p. 15. Both perspectives were presented without explicitly favouring either. A third view he considered was that a distinction could be made between direct and supervisory powers; as discussed earlier, Ewasiuk was more directly critical of this third approach (p.16).

¹⁹⁴⁷ Ibid, p. 15.

¹⁹⁴⁸ Ibid, p. 16.

¹⁹⁴⁹ *Ming*, *supra* note 334.

directors, such that it would meet the criteria for a unanimous shareholder agreement;¹⁹⁵⁰ this has commonly (although not quite universally) been taken for granted by the judiciary. He began by quoting a passage from Disney setting out the question of whether empowered shareholders are subject to the duties of care and loyalty, and specifically the obligation not to fetter their discretion,¹⁹⁵¹ then noted that "Bruce Welling gives an affirmative answer to the latter question".¹⁹⁵² Yet again, the same influential passage from his book was reproduced.¹⁹⁵³ But Mercer J. rejected that view and instead adopted a passage from Disney:

24 I concur with Disney's view that the above analysis is not in accordance with the general view of legal practitioners, does not represent the statutory intent and leads to an absurd result:

Although the Dickerson Report did not discuss the subject at great length, it seems reasonably clear that it intended to change the law so as to permit shareholders to agree unanimously, as they frequently wish to do, that (for example), the corporation will lease space from one shareholder at an agreed rent, obtain services at an agreed remuneration from another, buy widgets from a third at an agreed price, and so on. Applying the principle against fettering of discretion to shareholders acting under a unanimous shareholder agreement would generally make the agreement virtually useless. Welling's interpretation is not required by the words of the *CBCA*. Section 146(2) could be read as validating an agreement restricting the exercise of the powers of management normally allocated to the directors, regardless of whether these powers are exercisable by the directors, as is usually the case under the *CBCA*, or by the shareholders under a unanimous shareholder agreement. The powers transferred to the shareholders pursuant to section 146(5) could be read as referring to such powers as restricted by the agreement. (Disney, p. 120)

Fitzwilliam cautioned that *Ming* was inconsistent with the Supreme Court of Canada's subsequent decision in *Duha* (albeit on a different matter) and was therefore, in his view, a weak precedent.¹⁹⁵⁴ After noting that *Ming* had preferred Disney's interpretation to Welling's, Fitzwilliam argued that the former was simply inconsistent with the wording of the statute and that no ambiguity was to be found; however absurd the results might arguably be, they could not be abandoned unless a secondary meaning actually existed, and in his view, here it did not.¹⁹⁵⁵ Under the then-current wording of the *C.B.C.A.*,¹⁹⁵⁶ "the shareholders,

¹⁹⁵⁰ Ibid, pars. 22-26.

¹⁹⁵¹ Ibid, par. 22, citing Disney, *supra* note 9, p. 119.

¹⁹⁵² *Ming*, *supra* note 334, par. 23.

¹⁹⁵³ Ibid, par. 23, quote from Welling 2nd ed., *supra* note 1897, p. 453.

¹⁹⁵⁴ Fitzwilliam, *supra* note 9, section 3.

¹⁹⁵⁵ Fitzwilliam, *supra* note 9, section 3.

¹⁹⁵⁶ Fitzwilliam was writing primarily about the importation of the unanimous shareholder agreement to Trinidad and Tobago, but this section was explicitly framed as referring to the success of the agreements

having inherited the directors' duties and liabilities, will now become fiduciaries and cannot validly agree among themselves (as is usually provided for in a shareholder agreement) in advance as to how each shareholder will exercise his judgment in the future when voting on the Restricted Matters".¹⁹⁵⁷ For that reason, he stated that the legislative provisions creating this tool fell short of fulfilling their assumed "rationale".¹⁹⁵⁸ He recommended that Trinidad and Tobago not follow this example.

Finally, the Industry Canada Discussion Paper also considered whether all of the common law and statutory duties which directors owe to the corporation would be transferred intact to empowered shareholders. Yet again, fettering discretion was presented as the leading example of this larger question.¹⁹⁵⁹ The duties of care and loyalty were described as a "related issue".¹⁹⁶⁰ The report considered that shareholders have traditionally been allowed to act in their own self-interest, but that this might be balanced by said self-interest only being given expression in the selection of directors¹⁹⁶¹ who were themselves bound to act for the *corporation's* benefit.¹⁹⁶² It therefore warned that investors assuming power without those obligations might result in them pursuing their own interests while leaving the company to bear the resultant liabilities.¹⁹⁶³

The commentary on the pre-amendment *C.B.C.A.* contains some disagreement over whether or not shareholders were permitted to "fetter their discretion", but there was a general consensus that they should be and that only then would the alleged legislative intention for the unanimous shareholder agreement be fully met. As discussed in the next subsection, the subsequent amendment to the *Act* has largely vindicated the last part of this position.

4.(a)(ii) After the *C.B.C.A.* Amendments

In 2001, one of the amendments to the *Canada Business Corporations Act*, likely as a result of the aforementioned debate, was the following addition:

146(6) Nothing in this section prevents shareholders from fettering their discretion when exercising the powers of directors under a unanimous shareholder agreement.¹⁹⁶⁴

in their native land, Canada.

¹⁹⁵⁷ Fitzwilliam, *supra* note 9, section 3.

¹⁹⁵⁸ *Ibid*, section 3.

¹⁹⁵⁹ Industry Canada Discussion Paper, *supra* note 9, pp. 32-33.

¹⁹⁶⁰ *Ibid*, p. 34.

¹⁹⁶¹ And voting on fundamental changes.

¹⁹⁶² Industry Canada Discussion Paper, *supra* note 9, p. 34.

¹⁹⁶³ *Ibid*, p. 34.

¹⁹⁶⁴ The same subsection was later included at *O.B.C.A.* s. 108(5.1), and a similarly worded section was added to the *Q.B.C.A.* s. 220. The remaining statutes do not contain an explicit reference to shareholders "fettering their discretion" while exercising powers conferred through a unanimous shareholder agreement.

As a result, when Welling produced his third edition of *Corporate Law in Canada: The Governing Principles*, he included an analysis of how the situation had changed, for the first time extending significant consideration to the wider questions of the directors' duties of care and loyalty. He believed that the responsibilities which are transferred "plainly includes the s. 122(1)(a) duty to make management decisions 'with a view to the best interests of the corporation.' Thus, each managing party owes fiduciary obligations to the corporation."¹⁹⁶⁵ These were unaffected by the new provision because:

Section 146(6) was added in 2001, presumably to resolve the ongoing debate about whether shareholders under a unanimous shareholder agreement owed a fiduciary duty to the corporation. It seems plain enough that the statutory answer is yes[....] It is clear that Parliament has statutorily authorized shareholders operating under a unanimous shareholder agreement to contract as to how they will manage. It is also clear that Parliament did nothing more than that.¹⁹⁶⁶

Welling warned that "lawyers' jargon"¹⁹⁶⁷ may mislead some people into thinking that the freedom to fetter discretion broadly relieved shareholders of the entire duty of care and/or loyalty, but that that interpretation would ignore both the roots of the phrase and that Parliament could have explicitly removed those duties, but did not.¹⁹⁶⁸

His objection that the statute's wording created a result that "doesn't work as planned"¹⁹⁶⁹ was unrelated. Curiously, even if one accepts his logic, he presented no evidence that this would be unplanned, and part of his argument was that the lawmakers specifically chose language that would have a narrow meaning, implying careful consideration of the results, although admittedly the consequences as Welling understood them are difficult to rationalize: the statute only authorizes investors to enter into binding contracts about the exercise of their new authority after the unanimous shareholder agreement is in force, rather than beforehand or in the agreement itself.¹⁹⁷⁰ Any restrictions the shareholders decided upon before the unanimous shareholder agreement was already in effect would not be binding upon them.¹⁹⁷¹ Welling stated that "the statute does not appear to have authorized them to contract away [managerial] powers before they acquire them".¹⁹⁷² In fact, the statute does not *authorize* shareholders to fetter their discretion at all; it instead explicitly does not *prevent* it. Unless this makes the subsection a nullity, their freedom to fetter must pre-exist it. Furthermore, the investors would not be contracting away powers, but rather

¹⁹⁶⁵ Welling 3rd ed., *supra* note 256, p. 468.

¹⁹⁶⁶ *Ibid*, pp. 467-468.

¹⁹⁶⁷ *Ibid*, p. 467.

¹⁹⁶⁸ *Ibid*, p. 468. The reference to the statute not working as planned on p. 465 is therefore presumably a reference to the second issue, not this one.

¹⁹⁶⁹ *Ibid*, p. 465.

¹⁹⁷⁰ *Ibid*, p. 468.

¹⁹⁷¹ *Ibid*, p. 468.

contracting with regard to how they will exercise them, a point Welling's own analysis emphasizes elsewhere. These errors aside, his interpretation may come down to having understood the latter part of the phrase "fettering their discretion when exercising the powers of directors" as modifying *when* investors may fetter, not *what*. This is a counterintuitive reading, and the statutory language does not require it. Alternatively, he may have been drawing a distinction between "restricting of the powers of directors" and "exercising the powers of directors", with the former occurring at the time the agreement is created and the latter only subsequently. The next subsection of this chapter explores how a restriction in a unanimous shareholder agreement can have identical effect to an exercise of the board's authority, which I refer to as a "pre-made decision". If, for the sake of argument, the inclusion of such a term is nonetheless not considered "exercising the powers of directors" for the purposes of s. 146(6), then it follows that it must have been the act of shareholders *qua* (unempowered) shareholders, and it was thus not subject to the directors' normal responsibilities regardless, including the prohibition against fettering discretion.¹⁹⁷³ For all these reasons, Welling's conclusion is unconvincing.

Commentary about the ability of shareholders to "fetter their discretion" has largely centred on the terms of the unanimous shareholder agreement itself and whether that legal tool can be used to make specific decisions or only to transfer powers.¹⁹⁷⁴ It was the latter question that had originally caused Welling to begin this debate. What he here concluded was that the opposite result had been achieved: the unanimous shareholder agreement *could not* set out specific decisions, but the empowered shareholders were subsequently free to fetter their discretion through additional contracts. The first part is debatable, but the second appears unfortunately true.

Welling insisted that the shareholders' new ability to "fetter their discretion" referred solely and specifically to entering into contracts whereby they decide in advance how they will vote, which directors are normally prohibited from doing.¹⁹⁷⁵ He noted that Parliament did not choose a wording to explicitly excuse shareholders from the general duty of care that directors owe, instead using this particular expression.¹⁹⁷⁶ "Fettering their discretion" may be the term developed to describe directors contracting about how they would vote,¹⁹⁷⁷ but whatever its historical roots, it is still perhaps debatable whether the

¹⁹⁷² Ibid, p. 468.

¹⁹⁷³ Earlier in Chapter Five, the question of whether directors' responsibilities in general can or should be imposed upon shareholders involved in the creation of "pre-made decisions" was considered at greater length. To address the present issue, it suffices to demonstrate that in restricting the directors, they are either acting *qua* empowered shareholders, in which case s. 146(6) applies, or *qua* (unempowered) shareholders, in which case the directors' duties do not apply. In both interpretations, they are free to fetter their discretion while placing restrictions into the unanimous shareholder agreement.

¹⁹⁷⁴ Only Dennis, *supra* note 9, as quoted earlier at note 1928, may have mentioned fettering discretion through subsequent contracts, and the reference was ambiguous.

¹⁹⁷⁵ Welling 3rd ed., *supra* note 256, pp. 467-468.

¹⁹⁷⁶ Ibid, p. 468.

¹⁹⁷⁷ *820099 Ontario Inc. v. Harold E. Ballard Ltd.*, 3 B.L.R. (2d) 123, 1991 CarswellOnt 142, [1991]

phrase as used in the statute has that limited scope; Welling himself acknowledged that it is likely to be misunderstood. But even if the language is read in that way, the result of this new subsection in the amended *Act* is still in effect one where the duties of care and loyalty have been gutted, because it allows for the easy and arbitrary manipulation of the law. After a unanimous shareholder agreement has transferred the board of directors' powers to the shareholders, an individual cannot unilaterally decide in advance to vote in favour of a certain proposition, nor when the time comes vote arbitrarily without properly considering the issue.¹⁹⁷⁸ Either would be a violation of the duty of care. However, the same shareholders could enter into a contract wherein they promise to vote in favour or against, and apparently in so doing would free themselves from any duty of care. Furthermore, they are not prevented from binding themselves to courses of action that also violate the duty of loyalty, and the very fact that they receive compensation would itself be a violation of that duty under other circumstances.

Nothing in the law currently precludes the contract being with a disinterested party for only nominal consideration; this would still be fettering discretion, which is now permitted (or not prevented). It would therefore be prudent for shareholders who sought to exercise their power in a manner that would violate their duties to arrange to enter into such contracts for the specific purpose of avoiding liability. Even empowered investors who fully intended to meet those responsibilities would be prudent to do the same and enter into agreements confirming their votes, as they too would likely appreciate a liability shield. Even were this loophole closed and only "real" contracts- whatever that might mean- considered an acceptable excuse, it remains unclear what the policy rationale might be. It is highly anomalous for a group of people to be allowed to avoid a duty they normally owe only if they are receiving an inducement to abrogate it. It would be patently absurd, for example, to suggest a regime where corporate directors were excused from their duty of care¹⁹⁷⁹ if they were being bribed for their vote. And yet, this is exactly what the situation for empowered shareholders now appears to be.

This contradiction is inadvertently illustrated by Martel's recent positions on fettering discretion and the larger duties of care and loyalty.¹⁹⁸⁰ He asserted that those duties were for the public good; it is not just shareholders but creditors and society generally who benefit from them, and it would therefore be

O.J. No. 266 (Ont. Gen. Div. Mar 01, 1991) supports the use of this phrase to refer to directors contracting about how they intend to vote (pars. 101-105), while noting that unanimous shareholder agreements constitute an exception (par. 102).

¹⁹⁷⁸ Cannot in theory, at any rate. Enforcement is admittedly problematic.

¹⁹⁷⁹ The decision to which the directors were committing might, on the facts, be a violation of the duty of loyalty as well, but the very fact that they were committing to it in advance would, of itself, be a violation of the duty of care in all cases. That said, the fact that they were being compensated would always be a violation of the duty of loyalty.

¹⁹⁸⁰ Martel and Martel, *supra* note 16, p. 372 included a general citation to Welling 3rd., *supra* note 256, Disney *supra* note 9, and Ming, *supra* note 334, for further reading on this topic, without comment or explanation. One might therefore conclude that these earlier analyses influenced their thinking in some manner, and that their analysis falls into the tradition under discussion.

surprising if we allowed investors to, simply by agreeing amongst themselves, act in their own interest with impunity and to the detriment of others.¹⁹⁸¹ Curiously, he limited this objection to agreements transferring power, not agreements regarding the use of that power. On the one hand, he maintained that investors who assumed the directors' authority also took upon themselves obligations, including divulging conflicts of interest, refraining from voting upon them, and generally acting competently and in the best interest of the company.¹⁹⁸² Notwithstanding that, he did consider that investors might waive the duty of loyalty insofar as claims brought against each other were concerned, without affecting the rights of third parties such as creditors.¹⁹⁸³ Properly understood, his suggestion would not alter or limit the duty of loyalty itself- which is always owed to the company- only who could bring a derivative action to enforce it.¹⁹⁸⁴ However, Martel also acknowledged the recent statutory revision allowing shareholders to contract as to how they would exercise their new powers (fettering).¹⁹⁸⁵ Nor was that made grudgingly; he believed that this preserved the (alleged) benefit of the unanimous shareholder agreement, as without it, investors would have to act in the best interest of the company rather than their own.¹⁹⁸⁶ Paradoxically, that scenario was treated as a negative here. The contradiction between recognizing the need to protect third party and societal interests from the self-interested or incompetent actions of empowered shareholders and lauding those same investors' freedom to fetter their discretion in a manner that by definition could not meet either the duty of care or loyalty seems obvious.

*Simon v. Ramsay*¹⁹⁸⁷ touched upon this problematic new subsection, citing s. 146(6) as support for the proposition that "[a]s provided in section 122(2) *CBCA*, the directors are bound to act in accordance with the terms of a unanimous shareholders' agreement. In dealing with the effect of such an agreement, section 146 *CBCA* does provide that the shareholders, acting as directors, may so bind themselves."¹⁹⁸⁸ The exact consequences of this went unexplored- the principle did not apply in that case because there was no unanimous shareholder agreement¹⁹⁸⁹- but it suggests that empowered shareholders, like directors, are bound to follow the restrictions in such an agreement.¹⁹⁹⁰ This is at odds with Welling's interpretation, more similar to Martel's and my own (discussed below), but it is in accordance with all our prescriptive

¹⁹⁸¹ Martel and Martel, *supra* note 16, p. 372.

¹⁹⁸² *Ibid.*, p. 372. They elsewhere noted that empowered shareholders may not delegate their powers (p. 370).

¹⁹⁸³ *Ibid.*, p. 372.

¹⁹⁸⁴ Or possibly who could use their control to cause the corporation to bring an action itself.

¹⁹⁸⁵ Martel and Martel, *supra* note 16, p. 372. Martel implied that shareholders still have the ability to violate such agreements, subject only to contractual liability, and recommended the use of penalty clauses to help ensure compliance (p. 374).

¹⁹⁸⁶ *Ibid.*, p. 368.

¹⁹⁸⁷ *Simon*, *supra* note 451.

¹⁹⁸⁸ *Ibid.*, par. 26.

¹⁹⁸⁹ *Ibid.*, par. 28.

¹⁹⁹⁰ See Chapter Four for an extensive discussion of exactly what effect being bound by the restrictions might have.

goals. Perhaps whatever defects there may be in this subsection's wording, its judicial interpretation will solve them. Statutory reform should nonetheless occur, for greater certainty that shareholders are only permitted to fetter their discretion through clauses in the unanimous shareholder agreement itself, not subsequent contracts. However, for reasons set out in the next section, this part of the *C.B.C.A.* could also simply be eliminated, as another amendment to the statute has already allowed for what was desired.

4.(b) "Fettering Discretion" Versus "Pre-Made Decisions"

The current wording of the *C.B.C.A.* permits¹⁹⁹¹ a unanimous shareholder agreement to make a defined corporate decision or place a specific restriction upon the directors without in so doing transferring discretionary power to the shareholders. I refer to these as "pre-made decisions". But, contrary to what the commentary that preceded it might lead one to think, the crucial subsection that does so is *not* the one that now allows for shareholders to fetter their discretion. It is instead the rewording of section 146(5) in the 2001 amendment. What once read:

146(5) A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers and duties of a director of the corporation to which the agreement relates to the extent that the agreement restricts the powers of the directors to manage the business and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 119, to the same extent.

Now reads:

146(5) To the extent that a unanimous shareholder agreement restricts the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation, parties to the unanimous shareholder agreement who are given that power to manage or supervise the management of the business and affairs of the corporation have all the rights, powers, duties and liabilities of a director of the corporation, whether they arise under this Act or otherwise, including any defences available to the directors, and the directors are relieved of their rights, powers, duties and liabilities, including their liabilities under section 119, to the same extent.

The critical difference between these provisions is that the former version automatically grants to (all) shareholders the rights, powers, and duties of a director when they are restricted, whereas the latter separates the concepts of restricting directors' powers (and therefore liabilities) from giving them to other parties such as shareholders. The new wording therefore allows for the possibility that the board's powers will be restricted but said powers won't be given to anyone. The restriction will be just that, a *restriction*,

¹⁹⁹¹ On a literal reading of the wording.

rather than a transfer.¹⁹⁹² This is similar to the options available for inclusion in a corporation's articles and by-laws, but expanded to include any and every decision normally made by directors, arguably more effective at binding them, and significantly more entrenched if further changes also require unanimity. Such terms might take the form of either a specific decision or a general limitation on the board's authority.¹⁹⁹³ The difference between these two categories is often blurred; the naming of a particular individual to a corporate office is simultaneously a specific decision to appoint that person and a limitation of the directors' ongoing power to subsequently remove them. But in neither case do shareholders receive on an ongoing basis the authority they have removed from the board.¹⁹⁹⁴

The courts, with only isolated exceptions,¹⁹⁹⁵ had already adopted this perspective before the amendment and in jurisdictions without it. Both types of pre-made decisions in unanimous shareholder agreements have been upheld and enforced,¹⁹⁹⁶ without any indication they were being analyzed as if they transferred power to the investors (with the corresponding questions about fettering). This is not to say that the judiciary has wholeheartedly embraced pre-made decisions. It is no coincidence that virtually the entirety of the case law on directors breaching unanimous shareholder agreements concerns such terms. The contractual, directors' duties, and oppression models of enforcement can all be seen as ways to avoid placing a given power over the corporation into *no one's* hands. They respectively grant the board the ability to circumvent a unanimous shareholder agreement at the cost of paying damages, when it is in the best interests of the company, or when no reasonable expectations are violated. What the courts have not done is require that all restrictions be framed as transfers nor deem them as such.

It is clear in retrospect that the entire debate amongst commentators about the ability of shareholders to fetter their discretion was misguided, and unfortunately this error was not limited to textbooks and journal articles but has now manifested in an ill-advised change to the law itself. Fettering discretion was never the issue; the types of permissible restrictions in a unanimous shareholder agreement was.

There has been consensus amongst the commentators that the legislative intent was to allow for specific restrictions and/or decisions without transferring discretionary power to make those choices to the

¹⁹⁹² Contrary to the logic employed by Welling 3rd ed., *supra* note 256, p. 468, there is no need to first create a unanimous shareholder agreement that avoids any specific corporate decisions, in order to empower shareholders to subsequently make such choices. The creation of a unanimous shareholder agreement is not the origin of the shareholders' ability to restrict the powers of the directors; it is the *exercise* of their statutory ability to do so. A "pre-made decision" is conceptually a restriction upon the board that removes their authority to deviate from the position set out in the agreement. It is therefore suitable for inclusion in a unanimous shareholder agreement.

¹⁹⁹³ It is no longer controversial that the latter may be done, but there was some earlier debate in the commentary. See the discussion of Sohmer in the earlier subsection of this chapter on "Pre-Made Decisions".

¹⁹⁹⁴ See note 807 for a discussion of how this differs from the *ultra vires* doctrine.

¹⁹⁹⁵ 9109 CS, *supra* note 555; *Couvre-Plancher*, *supra* note 324; *Ming*, *supra* note 334.

shareholders. While often poorly justified at best, this inference as to statutory purpose (and recognition of common practice) has apparently been vindicated by the aforementioned amendment to the *Act*. Despite that, it is worth briefly questioning whether the assumption was actually correct. The old wording was conspicuously explicit that all restricted directorial powers and duties passed to the shareholders; there was no necessity for such a provision, as the amended *Act* demonstrates. It is plausible that the drafters of the original did indeed fear the possibility of a power vacuum or of decisions that were "locked in" and impossible to alter in the face of changing circumstances, and that they deliberately sought to avoid any outcome that would not allow someone to freely decide the best course of action for the company. That a later Parliament came to a different conclusion does not necessarily imply anything about what motivated a previous session, nor does it automatically speak to the intent of the provincial and territorial legislatures that maintain some variation of the earlier form.

It is unfortunate that commentators did not frame the issue in the manner outlined above. The reason was presumably that the wording of the old *Act* was clear: any restriction was automatically a transfer. To suggest the possibility of restrictions that were not transfers was a non-starter, legally, except perhaps as an idea for reform. (From a statutory perspective, at any rate; the case law was demonstrating otherwise.) So, instead, from Welling on, they engaged in a two-step analysis that first treated any such term in a unanimous shareholder agreement as a transfer of power to the shareholders and second as an agreement amongst the shareholders as to how that power would be used. If this analysis had successfully circumvented the problem, its popularity would be explicable. But because of the rule against fettering discretion, this path was almost as treacherous. Welling himself concluded that it was a dead-end; shareholders could not be bound by such a term, although its inclusion would not negate the validity of the agreement and hence the transfer of power. Subsequent commentators have not been as quick to accept that the rule against fettering discretion should apply to empowered investors, although this has largely required ignoring a strict reading of the statute in favour of its alleged purpose; notwithstanding that the subsection placed all the duties of directors upon shareholders, without exception, the logic ran that the rule against fettering discretion must be excepted to allow for arrangements that the legislature was assumed to surely have intended to permit.

And yet, if the legislature surely intended to permit such arrangements, despite the language used, why not suggest that they simply *permit such arrangements*? That is ultimately what has occurred in the recent amendments. Before then, or in the provinces,¹⁹⁹⁷ this line of reasoning could have been pursued

¹⁹⁹⁶ Or not, but on other grounds.

¹⁹⁹⁷ Currently, only *Q.B.C.A.*, s. 214 is similar to the amended *C.B.C.A.* in specifying "parties to the unanimous shareholder agreement who are given those powers"; the other statutes continue to assume that any and all shareholders who are parties (in some statutes, shareholders who are *deemed* parties are specifically included as well) assume the powers and responsibilities that have been removed from directors. See *A.B.C.A.*, s. 146(7); *M.C.A.*, s. 140(5); *N.B.C.A.*, s.148(7); *N.B.C.C.A.*, s. 99(5); *N.L.C.A.*,

either as a suggestion for reform or even as a particularly elastic reading of the statute, rather than engaging in the two-step analysis and facing the rule against fettering discretion. The unfortunate consequence of this tradition is s. 146(6), which allows empowered shareholders to freely fetter their discretion. It seems probable that this is the result, directly or indirectly, of the aforementioned academic obsession with this issue, which was referred to in the Industry Canada report.¹⁹⁹⁸ This problematically now allows for them to fetter their discretion any way they like, and not just via the terms of the unanimous shareholder agreement itself. Welling took this to the extreme position that investors may fetter their discretion *only* in separate contracts that are formed subsequent to the unanimous shareholder agreement; while that is a misreading, the statute *is* now permissive of such subsequent fettering, without a requirement of unanimity.

This misguided strand of analysis also tied the permissibility of pre-made decisions to the question of whether investors who assume directors' powers and liabilities should be subject to the duties of care and loyalty. The "fettering of discretion" has been treated by some authors as an example of the shareholders' duty of care, and specifically how it is more limited than the directors' usual one. No one has entirely conflated the two issues; the prohibition on fettering has been treated as a distinct sub-topic, and eliminating it not as necessarily synonymous with removing the rest of the obligations to the corporation. However, even if such an exception is treated as isolated and unique, it nonetheless requires that some distinction be made between the duties of directors and empowered shareholders, a distinction that the wording of the statute as it then was simply did not support. This made it easier to assume that the investors were not *really* supposed to take on all of the board's duties to the corporation, only some of them, only whichever ones were appropriate. Authors accordingly suggested some larger variation in the duties of empowered shareholders. They may have taken that position in any event, but the link in their logic seems clear. Replacing the concept of "fettering discretion" with one that directly permits pre-made decisions allows for consideration of the duties of care and loyalty on their own merits, rather than biased by the relatively uncontroversial utility of at least one reduction of their normal scope.

Before proceeding to that consideration, it should be determined whether there actually are any difficulties, from the perspective of the shareholders themselves, with allowing them to create pre-made decisions rather than receiving the directors' powers.¹⁹⁹⁹ Such restrictions might later impede actions that the investors would wish the corporation to take, presumably due to changing circumstances or new information.²⁰⁰⁰ That is the necessary trade-off for allowing them to impede actions they do *not* wish the corporation to take. The advantages of directors being free at any given moment to determine what is in the corporation's best interests must be weighed against the benefits of allowing shareholders to agree to

s.245(8); *N.T.B.C.A.*, s.148(7); *O.B.C.A.*, s.108(5); *S.B.C.A.*, s. 140(4); *Y.B.C.A.*, s. 148(7).

¹⁹⁹⁸ Industry Canada Discussion Paper, *supra* note 9, p.33.

¹⁹⁹⁹ The problems this poses for other parties are considered below.

²⁰⁰⁰ Or because they never actually supported the original restriction and agreed to it only as a result of negotiations with shareholders who did.

decisions that could then be relied upon as largely unalterable. Further, the use of unanimous shareholder agreements to determine issues in advance or to restrict the range of permissible options might serve as a form of minority protection; they could negotiate specific individual rights²⁰⁰¹ or generally applicable rights could be arranged at a time when it was unknown who might later need to make use of them. The utility of these tools might outweigh any lost flexibility, particularly given that such a bargain was one that all of the investors accepted.

This does rely upon accepting that the unanimous shareholder agreement signifies an increasingly contractual understanding of the corporation, a position whose merits and drawbacks are discussed throughout this work. Pre-made decisions allow not just for designating new decision-makers, but for using the company's "foundational documents" to place some choices beyond any decision-maker's discretion, in a manner that may require further unanimity to reverse. This goes beyond what can normally be achieved via the articles and by-laws. That may explain why, of all the unusual power structures the unanimous shareholder agreement renders possible, pre-made decisions are the most problematic for reassigning the directors' duties and liabilities; they assume a contractual corporation that can be freely rearranged, and those responsibilities rely upon something at least analogous to the statutorily-defined power structure. The degree to which pre-made decisions represent a rejection of the predefined entity model of the corporation may be why so many commentators have preferred the two-step method, although if so, it is a curious moment of traditionalism from analysts who largely favoured shareholder-driven "nexus of contracts" corporations.

4.(c) The Duties of Care and Loyalty Generally

Fettering discretion aside, larger questions about the duty of care and loyalty remain relevant. As discussed, the two issues have in recent years been heavily intertwined in the commentary. But this was not always the case. Several writers who preceded Welling's influential contribution demonstrated a different perspective.²⁰⁰² Instead, a separate complication was present in most of their analyses. Quebec's legislation formerly allowed empowered shareholders to retain their "voting rights" ("droit de vote").²⁰⁰³

²⁰⁰¹ Guaranteeing minority shareholders will hold certain jobs is a common example.

²⁰⁰² In addition to the French-language authors discussed in this subsection, another commentator who preceded the general "fettering discretion" phase of the debate, McCarthy, *supra* note 8, p. 471, stated that the then equally new statutory duties of directors and unanimous shareholder agreements might combine in such a way that "[t]he minority shareholder may be able to upset the decision of the majority under a unanimous shareholder agreement, simply on the ground that the majority did not vote in the best interests of the company, even though no oppression has been alleged, still less any violation of a more specific duty". Although possibly merely intended as descriptive, a criticism seems implicit.

²⁰⁰³ Quebec *Companies Act*, c-38 (hereinafter "*Q.C.A.*"), as amended 1979, c. 31, s. 27; 1980, c. 28, s.

This element, since replaced with a "fettering discretion" clause similar to the one found in the *C.B.C.A.*,²⁰⁰⁴ is now of only historical significance. At the time, however, it was an active part of the question of empowered shareholder's duties in Quebec, and it naturally attracted the attention of French-language commentators.

Martel, for example, did touch upon the "fettering discretion" issue,²⁰⁰⁵ but did so completely separately from his analysis of the imposition of directors' responsibilities upon investors, including it instead as part of his discussion of the procedures governing empowered shareholder management;²⁰⁰⁶ he argued that it was permissible because the fundamental advantage of a unanimous shareholder agreement was that it displaced the requirement for independent management.²⁰⁰⁷ With regard to the duties of care and loyalty generally, Martel confusingly both asserted that the directors' statutory obligations to the corporation would be included in the transfer of their legal responsibilities to shareholders, specifically mentioning the need to divulge conflicts of interest and refrain from voting upon them,²⁰⁰⁸ while also arguing that under the legislation, particularly the *Q.C.A.* that allowed them to retain their "voting rights", empowered shareholders still retained the right to vote as they wished, rather than being obliged to do so in the company's best interest.²⁰⁰⁹

The position of Smith on the latter issue was similar. He stated that empowered shareholders assumed the directors' duties to the company, among which he specifically included avoiding being placed in a conflict of interest, but he also took the position that since the *Q.C.A.* allowed them to retain their "voting rights", they still had the discretion they possessed as shareholders, rather than being obliged to act

123.92. The shareholders or the sole shareholder, as the case may be, shall then manage the affairs of the company as if they, or he, were its directors; they, or he, shall exercise the rights that have been withdrawn from the directors and assume the obligations from which the directors have been discharged. The shareholders may, however, govern the exercise of their voting rights.

²⁰⁰⁴ *Q.B.C.A.* s. 220.

²⁰⁰⁵ Although the French term he uses, "engagement de vote" translates as approximately "commitment to vote", which while apparently covering the same ground as "fettering discretion", may have different connotations.

²⁰⁰⁶ Martel, *supra* note 11, p. 27. Admittedly, elsewhere in that discussion of empowered shareholder management procedures, at p. 24, he did mention his view that shareholders would be able to exercise their vote freely, rather than subject to a duty to act in the best interest of the company as directors must, so the procedural discussion was not completely separated from duty of care analysis. Notwithstanding that, he did not link the "fettering discretion" question directly to the duty of care.

²⁰⁰⁷ *Ibid*, p. 27.

²⁰⁰⁸ *Ibid*, at pp. 38-39 considered it uncertain whether the wording of *C.B.C.A.* '74-'75 permitted shareholders to delegate the powers they received under a unanimous shareholder agreement to others or whether that would be barred by *delegatus non potest delegate*, but he considered it certain that the *Q.C.A.* as it then was would prohibit such delegation. See the discussion of *Allard* below.

²⁰⁰⁹ *Ibid*, pp. 24, 28.

independently in the best interest of the company.²⁰¹⁰ The obvious contradiction went largely unaddressed, but Smith did provide an example of a duty *not* covered by "voting rights": the prohibition against delegation.²⁰¹¹ The value of such an obligation is doubtful if it exists only to keep power in the hands of those who may abuse it at will.

Although Turgeon acknowledged that directors must act in the best interests of the company, which is distinct from that of shareholders,²⁰¹² he considered it "manifestly obvious" ("manifestment") that this derived from the mutability of shareholdings and served to protect future investors.²⁰¹³ He argued that this was not a concern for small enterprises, because new shareholders either buy in at prices reflective of the situation or are the heirs of the very individuals who created it for their own benefit.²⁰¹⁴ He did not address that, if this were true, it would seemingly also be true for public companies. Turgeon further insisted that the interests of the shareholders and the corporation did not have to conflict, since the company was created to serve the investors' common goals,²⁰¹⁵ but he accepted that there are situations when the majority and minority are opposed. So long as the results were not oppressive, he argued that the majority had the right to determine the best interest of the company.²⁰¹⁶ There was no clear explanation for the contradiction with his earlier admission that the two were distinct.

Having thus established a conception of the duties that served the interests of the majority of shareholders, what followed was unsurprising. Turgeon argued that assuming power did not remove their discretion when acting *qua* shareholder.²⁰¹⁷ Directors must abstain from voting if they have a conflict of interest, but shareholders can ratify the directors' self-interested acts, and they have no duty of independence of their own to satisfy when doing so.²⁰¹⁸ In order to remove what Turgeon called absurd results,²⁰¹⁹ the power of shareholder ratification must remain even when a unanimous shareholder agreement had transferred power to them.²⁰²⁰ His conclusion was that any decision normally capable of ratification should, if carried out by empowered investors, be automatically treated as if it had been so ratified.²⁰²¹ Every act they take is presumably one they would ratify.²⁰²² Ratification is a power of the

²⁰¹⁰ Smith, *supra* note 228, p. 311.

²⁰¹¹ Ibid, p. 311.

²⁰¹² Turgeon, *supra* note 9, p. 244.

²⁰¹³ Ibid, pp. 244-245.

²⁰¹⁴ Ibid, pp. 244-245.

²⁰¹⁵ Ibid, p. 245.

²⁰¹⁶ Ibid, pp. 245-246.

²⁰¹⁷ Ibid, p. 243.

²⁰¹⁸ Ibid, pp. 243-244.

²⁰¹⁹ He gave the example of a sole shareholder who was also the sole director entering into a self-interested contract after being empowered by a unanimous shareholder agreement, and subsequent transferees trying to annul it (Turgeon, *supra* note 9, p. 244).

²⁰²⁰ Turgeon, *supra* note 9, p. 244.

²⁰²¹ Ibid, p. 253. He added that having the shareholders perform an official ratification might still be beneficial in helping insulate their decisions from attack (p. 254).

shareholders *qua* shareholders.²⁰²³ He therefore concluded that absent oppression, the minority did not have the ability to challenge a decision of the majority on the basis that it had not been in the best interests of the company.²⁰²⁴

Despite granting empowered shareholders broad leeway to pursue their own benefit free of duties to an abstract conception of the corporate interest, Turgeon still found the "voting rights" in the *Q.C.A.* to be a poor addition to the statute, not on the basis that they were a bad idea, but because the wording was "ill-advised and equivocal".²⁰²⁵ Finding it ambiguous whether this section only applied to decisions normally within the shareholder's authority or whether it included powers taken from the directors, he unsurprisingly made the suggestion for legislative reform that, even when exercising the board's normal authority, investors be allowed to act in their own interests.²⁰²⁶

Finally, Ratti merged the "voting rights" and "fettering discretion" discussions, as the former was winding down and the latter was just getting started. His general position was that empowered shareholders would have the same duties as directors, including the prohibitions against delegation and against agreeing on their vote in advance; he quoted another extract from Welling on the latter point, although he did express some uncertainty regarding the earlier author's premise that directors themselves cannot make such contracts regarding their votes.²⁰²⁷ In the Quebec context, Ratti took the position that the retention of their "voting rights" reversed the situation, meaning that investors could agree in advance how they would use the powers taken from the board.²⁰²⁸

Despite this last-minute convergence with the English-language commentary and its intertwining of the "fettering discretion" rule with larger questions surrounding the duties of care and loyalty, the early French-language analyses provide an alternative perspective. Unfortunately, the presence of "voting rights" in the Quebec legislation of the time created its own complications, presenting at least a potential (if not definitive) justification for excusing empowered shareholders from the full duties directors normally owe to the company. Despite disagreement as to the exact meaning of these "voting rights", their inclusion at least explains why some commentators writing in that context found that only part of the duties of care and loyalty passed to empowered shareholders, not all of them.

More recent commentary upon this issue has been intertwined with the "fettering discretion" question, but it is notable that while there was a general consensus with regard to that specific topic,²⁰²⁹ the conclusions reached about the general duties were more mixed, and they largely lacked clear explanation.

²⁰²² Ibid, p. 254.

²⁰²³ Ibid, p. 253.

²⁰²⁴ Ibid, p. 254.

²⁰²⁵ Ibid, p. 272, my translation of "malencontreuse et equivogue".

²⁰²⁶ Ibid, pp. 272-273.

²⁰²⁷ Ratti, *supra* note 16, pp. 117-119, citing Welling 1st ed., *supra* note 250, p. 453.

²⁰²⁸ Ratti, *supra* note 16, p. 119.

²⁰²⁹ At least, there was a general consensus upon what the law *should* be, if not what it was.

The ability to "fetter discretion" in the current legislation is technically a narrow exception, theoretically severed from the larger duties. Conversely, in practice, it can be abused to gut them entirely. Despite both these extremes, the impact of the "fettering discretion" debate upon the wider commentary might be as nothing more than one reason for the belief that the full duties of care and loyalty require reconsideration before being placed upon empowered shareholders. That is the closest one can come to a general consensus in the English-language literature. It is the same conclusion reached by the early French-language commentators. Without the justification of "voting rights", though, how and why empowered shareholders' general duties of care and loyalty should differ from directors' is unclear and seemingly contrary to the legislation.

This consensus, further, is opposed by the small amount of case law on the subject, including a decision of the Supreme Court of Canada. Judges have come to the conclusion that the responsibilities of directors are borne by investors when a unanimous shareholder agreement is in effect. The contents of those decisions and their implications are discussed in the next subsection. Following that, I will supply my own support for such a position, arguing that even in a shareholder primacy model of the corporation, the maintenance of these responsibilities will help achieve desired ends, an opinion that is only bolstered in the final part of this chapter when an expanded stakeholder approach is taken into account.

4.(c)(i) Cases on Transferring the Duties of Care and Loyalty

What little reported case law deals with whether investors who assume power under a unanimous shareholder agreement inherit the directors' duties of care and loyalty appears unanimous that they do. Four judgments directly take this position, although only one actually found a shareholder liable for violating those duties. In addition to these, the recent Supreme Court of Canada decision in *Indalex Ltd., Re*, while not addressing the topic directly, strongly implies further support when analyzed closely.

*M.E.N. Electric Co. v. Rumble*²⁰³⁰ actually held an empowered shareholder liable for violating his duty to the corporation. A key employee had left his job, also resigning his position as a director, but he still owned shares of the company he had departed.²⁰³¹ He subsequently began a competing business.²⁰³² The corporation sued him for breaching his fiduciary duty to it.

Perell J. determined that the respondent did owe an ongoing fiduciary duty to the company, in large part because he was a party to a unanimous shareholder agreement that gave him (in his capacity as a shareholder) the same duties to the corporation which a director would have, duties which were still in

²⁰³⁰ *M.E.N., supra* note 1892. This was actually a motion for an injunction. Despite finding that a "fiduciary duty" did exist- although not necessarily that it had been violated, which was technically left as a matter for trial (par. 39)- the motion was denied on the balance of convenience test (pars. 38-44).

²⁰³¹ *Ibid*, par. 20.

effect since he remained a shareholder. The document may have confirmed that the parties to it were under all the same duties as directors,²⁰³³ but Perell J. made clear that even aside from that, such responsibilities would have arisen under the common law or "in equity" and were also imposed by the sections of the *O.B.C.A.* dealing with unanimous shareholder agreements:

16 As will become clearer, more important than the non-competition clause, which, oddly, may not be operative when a shareholder competes against his own company, are the provisions in the agreement about the management of M.E.N. Electric. Under these provisions, the shareholders were to manage and were to be subject to the same duties and liabilities to which the directors of the corporation would have been had the shareholders' agreement not been made.

17 Pausing here, there is no doubt that based on the evidence presented on this motion for an interlocutory injunction that in January and February 2005, Mr. Rumble had a fiduciary duty to M.E.N. Electric. His fiduciary duties arose at common law or in equity under the line of authorities associated with the famous cases of *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592 (S.C.C.) and *Edgar T. Alberts Ltd. v. Mountjoy* (1977), 16 O.R. (2d) 682 (Ont. H.C.), and they arose because under his shareholders' agreement he had taken on the fiduciary responsibilities of a director under the Ontario *Business Corporations Act*, R.S.O. 1990, c. C.43, s. 134. [...]

21 Based on the evidence presented on this motion for an interlocutory injunction, Mr. Rumble's understanding that he had no ongoing responsibilities to M.E.N. Electric was from a legal perspective simply wrong. As famously demonstrated by the *Canadian Aero Service Ltd. v. O'Malley* case, *supra* a fiduciary does not shed his or fiduciary obligations by simply resigning from his or her post. And, in the immediate case, as noted several times, Mr. Rumble - to this day - remains a shareholder of M.E.N. Electric with a contractual obligation tied to the *Business Corporations Act* to act honestly and in good faith with a view to the best interests of M.E.N. Electric. See Ontario *Business Corporations Act*, s. 134.

The phrase "a contractual obligation tied to the *Business Corporations Act*" is awkward; while contractual obligations may have been imposed as well, those tied to the Ontario *Business Corporations Act* are themselves statutory, not contractual.

The most notable aspect is, of course, that the judgment found that the empowered shareholder was under a duty of loyalty to the corporation, as a result of both the provincial statute and common law and "equitable" principles. Perell J. determined without much analysis that the statutory duty of loyalty applied, simply because it was an obligation of the directors and therefore passed to the shareholders according to the legislation. As discussed, there was a general consensus among commentators that the actual wording of the statute meant that the duty of loyalty would apply to empowered shareholders, but equally common was that the analyst would immediately proceed to observe that this was self-evidently

²⁰³² Ibid, par. 22.

²⁰³³ Ibid, par. 16. The wording here was somewhat ambiguous as to whether this was explicit in the terms or simply part of their legal effect.

problematic, possibly even incorrect, because that would defeat some alleged purpose of the legal tool. In an actual case, the judge made that first step, but apparently did not find the result so obviously flawed as to necessitate a deeper inquiry. That is not to say what the results of such an inquiry might have been, but it does suggest that the *prima facie* meaning of the section may not be as troubling as has sometimes been thought.²⁰³⁴

The other striking aspect is the parallel drawn between the statutory duty of loyalty that is transferred from directors to shareholders when a unanimous shareholder agreement is involved and the common law fiduciary duty that would be imposed upon an empowered investor regardless. One might take this as a reminder that the directors' duty of loyalty is not just an arbitrary feature of the corporate statutes; it derives from a larger body of law that imposes such fiduciary duties when the situation warrants them. This, in turn, might be a principle to bear in mind when considering whether empowered shareholders should have similar duties.²⁰³⁵

The converse also holds; as with the directors' other responsibilities, they should not be imposed upon those who do not possess the corresponding powers. Thus, in *Piikani*,²⁰³⁶ McIntyre J. found that the

²⁰³⁴ It is also worth contrasting here Perell J.'s relative lack of explanation or justification for applying the *prima facie* meaning of the provision with the repeated tendency of commentators to assert an opposing legislative intent without explanation or justification. The former derived from the wording of the statute, whereas the latter has no clear basis.

²⁰³⁵ See also *Guinan v. Northwestel Inc.*, [1997] N.W.T.R. 149, 1997 CarswellNWT 9, 75 A.C.W.S. (3d) 651 (N.W.T. S.C. Jan 13, 1997). Two shareholders alleged that the other shareholders had committed acts that, according to the statement of claim, violated duties "arising as a result of Sections 5.09 and 6.05 of the USA and the Act, to act honestly and in good faith with a view to the best interests of NNCL and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances" (reproduced at par. 5). When the defendants argued that shareholders did not have such a duty under Canadian law (par. 9), the plaintiffs revised their position to allege a common law fiduciary duty arising from the specific relationship of the shareholders (par. 11) and they were ordered to so amend their statement of claim (18), since the evolving state of fiduciary law meant that such a claim could theoretically succeed (par 19). Since a unanimous shareholder agreement empowered the shareholders in some respects (par 4), this could have been an opportunity to consider whether that transferred the directors' statutory duties of care and loyalty to shareholders, but the possibility was left unaddressed. (Breaches of obligations in the agreement were alleged, but not of the restrictions upon the directors (par. 5).)

²⁰³⁶ *Piikani*, *supra* note 234. *Piikani* also included consideration of a related issue, whether there might be a conflict of interest for directors of the corporation who were also councillors of the Piikani Nation, which was the beneficial owner of the company and which received certain powers over it under the agreement. McIntyre J. determined at par. 215 that "[b]y ratifying the Settlement Agreement, the Piikani Nation has made it clear that it is in its best interests to allow PIC and the Piikani Trust to function and to further the purposes for which they were created. All Councillors are bound by this. To the extent that this is inconsistent with other interests of the Piikani Nation, the ongoing effectiveness of PIC and the Piikani Trust must take priority." Therefore, there was no irresolvable conflict of interest for councillors who were also directors, because their proper course of action was clear (par. 219). This included obligations to the corporation that were not the exercise of powers transferred via the agreement (par. 216). These obligations were derived from acceptance of the terms of the agreement, not the result of a transfer of directors' duties. McIntyre J. further stated that "[s]ince PIC, and necessarily its directors as well, must take direction from Council on certain matters outlined in Schedule 2 of the Trust Agreement, to the extent

shareholder-trustee did not owe fiduciary duties to the corporation, because while limits were imposed upon the board, the shareholder-trustee was not given any power to manage or supervise the company,²⁰³⁷ and thus he did not owe a duty to it.²⁰³⁸ McIntyre J. stated explicitly, if with inexact terminology, that "[u]nder the *CBCA*, a shareholder only owes a duty to the corporation if, by virtue of a USA, it steps into the shoes of a director".²⁰³⁹

In a pre-trial motion in *Morton v. Asper*,²⁰⁴⁰ the defendants sought, *inter alia*, an order that the company's president (one of the plaintiffs) be made to resign or, alternatively, an injunction barring various actions without their consent,²⁰⁴¹ due to alleged violations of fiduciary duties. The judge found that, "[h]ere, since the U.S.A. in effect delegates to the shareholders the responsibilities ordinarily those of directors, the shareholders become fiduciaries to each other".²⁰⁴² Since the purpose of this part of the motion was to obtain the resignation of the president, the reference to the unanimous shareholder agreement is puzzling; his duties arising from his office would suffice to ground such an approach and would be more immediately relevant; the fiduciary duty of a president was also specifically referred to.²⁰⁴³ It was also unclear how the powers of the shareholders were relevant to any of the impugned behaviour,²⁰⁴⁴ unless their mere existence was sufficient to create a wide-ranging duty not to act against the corporate interest. Also arguably incorrect was the reference to investors owing a duty to *each other*, rather than the corporation, although later in the judgment Scott A.C.J.Q.B. more accurately noted that in resolving these matters, it was appropriate to look to the interests of the corporation, not just the shareholder who complained of the other's violation.²⁰⁴⁵ It was determined that the fiduciary duty question would need to be settled at trial, so it was left unresolved.²⁰⁴⁶

that the director is acting in relation to these matters, no conflict arises" (par. 214). This did not explicitly address whether the Council's directives could be improper in that context, although it did make clear that the directors were obliged to follow them, so the two roles of a single individual wouldn't impose contradictory obligations; any conflict of interest would occur completely while the individual was in the role of "councillor" rather than arising as a result of multiple roles clashing.

²⁰³⁷ See discussion in Chapter Three on the status of this document as a unanimous shareholder agreement.

²⁰³⁸ *Piikani*, *supra* note 234, par. 190.

²⁰³⁹ *Ibid*, par. 185.

²⁰⁴⁰ *Morton v. Asper*, 1988 CarswellMan 229, 55 Man. R. (2d) 61, [1988] M.J. No. 424 (Man. Q.B. Sep 15, 1988) (hereinafter "*Morton* motion").

²⁰⁴¹ *Ibid*, par. 63.

²⁰⁴² *Ibid*, par. 54.

²⁰⁴³ *Ibid*, par. 60.

²⁰⁴⁴ The shareholders do not appear to have assumed direct management power under the agreement. The investors were instead granted specified rights to elect half the directors, their unequal shareholdings aside. The agreement also named corporate officers, which would presumably have satisfied the "restricting directors" requirement, although that was not made an issue in the judgment (*Morton* trial, *supra* note 323, par. 16).

²⁰⁴⁵ *Morton* motion, *supra* note 2040, par. 86.

²⁰⁴⁶ *Ibid*, pars. 81-83. When the issue was revisited at trial, it was without reference to the idea of

Another case that touched upon the possibility that empowered investors owe a duty of care is the trial judgment for *Allard c. Myhill*.²⁰⁴⁷ In analyzing the former version of the statute (already amended by that point, but still applicable to the case at hand), De Michele J.C.Q. determined that it only permitted directors' powers to be transferred to shareholders, not specified third parties.²⁰⁴⁸ Following from that, the judgment continued that general rules of corporate law would prevent any further delegation:

156 Should it be concluded that directors' rights and powers may not be legally transferred to officers by a unanimous shareholder agreement? Corporate law recognizes and applies the maxim *delegatus non potest delegare* (see Martel and Martel, *La compagnie au Québec*, Vol. 1, Les aspects juridiques, at page 25-1).

157 The *CBCA* allows shareholders to appropriate certain powers otherwise reserved for directors. However, the application of this maxim implies that shareholders are not allowed to delegate these powers to another party in turn.

The invocation of this particular rule is interesting, as it is not simply a prohibition on delegation of responsibilities, but specifically a prohibition against the *further* delegation of responsibilities that had already been delegated. The logic therefore rests upon the premise that investors empowered through a unanimous shareholder agreement have not in so doing removed delegation from the equation; they are the holders of delegated powers (*from whom* might be debatable, but possibly from each other or from themselves in another legal capacity) and therefore subject to responsibilities in how they discharge them. Insofar as the prohibition against delegation is a part of the directors' duty of care, this is further judicial confirmation that some or all aspects of it apply to investors who have been granted power through a unanimous shareholder agreement.

The question was not directly addressed by Dalphond J.C.A. in the appeal, but the finding there that when a shareholder corporation assumed power it would inevitably have to express that power through human actors, who would in turn be *de facto* directors and bear their responsibilities,²⁰⁴⁹ was an implicit rejection or limitation of *delegatus non potest delegare* in this context.

Finally, and perhaps most importantly, the Supreme Court of Canada's decision in *Indalex*

empowered shareholders; they were discussed either in terms of the actions of the president (*Morton* trial, *supra* note 323, par. 162) or simply in general terms, without reference to position (e.g. *Morton* trial, *supra* note 323, par. 159).

²⁰⁴⁷ *Allard* CQ, *supra* note 1726. The case dealt with whether officers of a corporation whose sole shareholder had assumed control through a unanimous shareholder agreement were liable for unpaid wages. They would be if they were operating as *de facto* directors. Whether it would be a violation of the shareholder's duty of care to appoint them as such was not directly relevant to the case, so these remarks might have been made *obiter*. Possibly, if delegation of the transferred powers and liabilities of directors were within the empowered shareholders' legal options, that might have helped the argument that the powers granted to the individuals in question were those of directors and not officers. On the facts, it was determined at trial that the powers being exercised were those of officers, but this was reversed on appeal.

²⁰⁴⁸ *Ibid*, pars. 154-155. See discussion earlier in this chapter.

suggested that empowered shareholders do, indeed, owe duties of care and/or loyalty to the corporation, albeit without addressing the question head-on. Late in the sequence of events that gave rise to the litigation, the directors of the corporation resigned and a unanimous shareholder agreement²⁰⁵⁰ was created that appointed a specific individual to manage the firm.²⁰⁵¹ The company brought a motion for an assignment in bankruptcy shortly thereafter.²⁰⁵²

A significant issue in *Indalex* was whether a conflict of interest existed due to the duties the corporation had assumed to pension beneficiaries being at odds with its other interests. The bulk of the disputed actions had occurred prior to the aforementioned unanimous shareholder agreement, but the assignment in bankruptcy itself was specifically addressed in two of the judgments. Deschamps J. did not mention it explicitly, but it was presumably covered in his general reference to "subsequent proceedings"²⁰⁵³ that did not, in his view, have a negative impact on the complainants' rights because they were predictable, typical, and subject to notice and representation.²⁰⁵⁴

Both Cromwell J. and LeBel J., the two who specifically discussed the motion to enter bankruptcy, did so in terms of the corporation's possible conflicts of interest between its obligations to the beneficiaries and its other corporate interests, *i.e.* its self-interest. Normally, of course, self-interest is not a legitimate consideration for a fiduciary. However, Cromwell J. had earlier established that the overall conflict of interest actually existed, in his view, at the level of the directors, stating, "As an employer-administrator, Indalex acted through its board of directors and so it was that body which owed fiduciary duties to the plan members. The board of directors also owed a fiduciary duty to the company to act in its best interests."²⁰⁵⁵ The conflict would therefore be one between two competing fiduciary duties, not between a fiduciary duty and self-interest.²⁰⁵⁶ Cromwell J. wrote with respect to the motion to enter bankruptcy:

221. It was certainly open to Indalex as an employer to bring a motion to voluntarily enter into bankruptcy. A pension plan administrator has no responsibility or authority in relation to that step. The problem here is not that the motion was brought, but that Indalex failed to meaningfully address the conflict between its corporate interests and its duties as plan administrator.

The reference to "Indalex" looking after "its" corporate interests could be understood as an imprecise description of Indalex's directors looking after their duty to the corporation, except that at that

²⁰⁴⁹ See discussion earlier in this chapter.

²⁰⁵⁰ Here called a "unanimous shareholders' declaration" due to the single shareholder.

²⁰⁵¹ *Indalex*, *supra* note 1775, par. 17.

²⁰⁵² *Ibid*, par. 18.

²⁰⁵³ *Ibid*, par. 74. "Subsequent" being relative to the events of April 8th.

²⁰⁵⁴ *Ibid*, par. 74.

²⁰⁵⁵ *Ibid*, par. 194.

²⁰⁵⁶ The distinction between these two conceptions of the situation is significant because the correct resolution of a conflict between a fiduciary duty and self-interest is well-established and uncontroversial;

point, *Indalex no longer had directors*. It had a manager appointed by a unanimous shareholder agreement. Therefore, if the judge's reference to Indalex and its corporate interests is understood in the context of his earlier remarks about the obligations of the board, the result is that that individual must have had a duty to the corporation that was at least loosely similar to that owed by the directors

LeBel J. put the issue in similar terms, framing it as a conflict faced by Indalex itself, between its duties to the beneficiaries and its corporate self-interest. Presumably, as with Cromwell J. and Deschamps J.,²⁰⁵⁷ the references to the company's self-interest as if it were a legal duty were intended to invoke the directors' duties to the corporation, although LeBel J. was not clear on that point. Assuming that to be the case, the analysis of the motion to enter bankruptcy in Lebel J.'s judgment carries similar implications:

274 I must also mention the failed attempt to assign Indalex in bankruptcy once the sale of its business had been approved. One of the purposes of this action was essentially to harm the interests of the members of the plans. At the time, Indalex was still wearing its two hats, at least from a legal perspective. But its duties as a fiduciary were clearly not at the forefront of its concerns. There were constant conflicts of interest throughout the process. Indalex did not attempt to resolve them; it brushed them aside. In so acting, it breached its duties as a fiduciary and its statutory obligations under s. 22(4) *PBA*.

One can see from how both Cromwell J. and Lebel J. treated the motion to enter bankruptcy that there must have been a presumption on each of their parts that the decision-maker at the time, the manager appointed by the unanimous shareholder agreement, was under a duty to the corporation that was at least similar to that normally owed by directors, which in turn formed the basis for imprecise references to the corporation having a legitimate need to look after its own interests even in the face of its fiduciary responsibilities to the beneficiaries. If the directors' duties had terminated when the unanimous shareholder agreement had been made, rather than being transferred, then there would have been no conflict, because the only surviving duty would have been that owed to the plan beneficiaries.

All three sets of reasons for judgment failed to maintain a rigorous distinction between directors and the corporation itself. Had they done so, they might have found that the board owed a duty to the company and it in turn owed a duty to the plan beneficiaries. With all due respect to the Supreme Court, that would have been the correct framing, and one in which there would actually have been no conflict of interest at all. Instead, the three judges conflated the parties and their obligations in various ways,²⁰⁵⁸

the former takes precedence. The resolution when two fiduciary duties are in conflict is less clear.

²⁰⁵⁷ Deschamps J. at *Indalex*, *supra* note 1775, pars. 64, 67, and 73 explicitly wrote that the duties the corporation owed to the beneficiaries were in conflict with the duties that the directors owed to the corporation to manage it in its best interests.

²⁰⁵⁸ For Deschamps J., a duty owed by the directors somehow conflicted with a duty owed by the corporation; for Cromwell J., the duty owed by the corporation to the beneficiary was explicitly transferred to the directors, who found it in conflict with their duty to the company, although the judgment was written at points as if the opposite had occurred; LeBel J. proceeded as if the corporation had a legal obligation to protect its self-interest, which was either a new doctrine or an imprecise way of referring to the directors'

which obscured that, by the time of the motion to enter bankruptcy, the directors had been replaced via a unanimous shareholder agreement, and any duties that they had been under only continued to exist if they had been transferred. That substitution went unremarked upon by two of the judges, who simply continued referring to the corporation itself when alluding to the duties owed by its decision-makers.

Whether the Court might have found it significant that the recipient of the board's powers was a designated manager, rather than the shareholder, is thus unfortunately unknown. (Some conceptions of directors' duties attribute these responsibilities to their being agents of the shareholders, and a designated manager would be in an analogous relationship.²⁰⁵⁹) On the one hand, no attention was drawn to this factor. On the other, the general lack in all three sets of reasons for judgment of a clear distinction between directors' duties to the corporation and the corporation's own self-interest makes *Indalex* a poor basis upon which to draw any conclusions about those responsibilities. There was no indication that either Cromwell J. or LeBel J. put any consideration toward the existence of a unanimous shareholder agreement at the time of the motion to enter bankruptcy, let alone its implications. That said, their mutual assumptions imply continuing duties on the part of the corporate decision-maker to protect the company's best interests, ones that survived the unanimous shareholder agreement and its transfer of power, to form the basis of their references to the corporation's self-interest.

Regardless of commentators' trepidation, what little reported case law exists seems overwhelmingly to support the view that shareholders who assume power face the same duties of care and loyalty to the corporation as directors normally do. Four cases discussed above explicitly confirm this, and the Supreme Court decision in *Indalex*, while more indirect, suggests further support.

4.(d) Conclusion on the Duties of Care and Loyalty Generally

According to the wording of the statute, shareholders who assume the powers of directors under the *C.B.C.A.* also assume all of their duties and liabilities, with the sole exception of the recent allowance for fettering discretion. The case law indicates that this should be taken literally to include the duties of care and loyalty, but commentators have suggested that this may be inappropriate. As a prescriptive matter, should these responsibilities pass to empowered shareholders? In the final section of this chapter, the full implications of this question with regard to the "stakeholder" component that has recently been attached to directors' duties will be considered. Before that, it is worth examining the issue in the context of the shareholder primacy²⁰⁶⁰ approach that underlay the commentary discussed above and that continues to have

duties to it.

²⁰⁵⁹ Recent Supreme Court rulings have clarified that this is not a correct understanding of the current state of corporate law in Canada. See the discussion later in this chapter.

²⁰⁶⁰ See note 1674.

a significant impact upon corporate law.²⁰⁶¹ In a shareholder primacy model, is it desirable for investors who have taken power to assume the directors' normal duties to the corporation? Such a framework assumes that the purpose of those responsibilities is actually to serve the interests of the shareholders, so one argument against imposing them is that it would be a duty which they owe to themselves, and thus redundant. This ignores the key point that unanimous shareholder agreements only require unanimity *at the time they are entered into*. If the agreement transfers authority to shareholders,²⁰⁶² then at the time power is actually exercised, unanimity may no longer be present.²⁰⁶³ Shareholders could therefore find that the corporation in which they have invested is subject to the decision-making of others and that their own ability to control the company is limited.²⁰⁶⁴ While the oppression remedy is one method whereby they can hold each other accountable, the directors' duties could also help fulfill this function.²⁰⁶⁵ It is self-evidently in the interests of any given shareholder for the *other* shareholders to be bound by duties of care and loyalty, or else the corporation runs the risk of having its crucial choices made in an incompetent or disloyal manner. The trade-off for this is that the investors would also allow *themselves* be bound.²⁰⁶⁶

The full duties of care and loyalty normally borne by directors should apply to empowered shareholders. The explanation for retaining the duty of loyalty will be addressed first, followed by the duty of care, and then the question of whether the duties could be waived by consent will be considered.

Removing the duty of loyalty eliminates one of the primary barriers to exploitation of the corporation by some of its decision-making shareholders at the expense of others.²⁰⁶⁷ Is allowing that in the best interest of shareholders? Only if they personally come out ahead, exploiting more value than is lost due to the exploitation of others.

The best case scenario would be that such exploitation reallocates value among shareholders without reducing the overall value available to them collectively. In other words, they would be fighting for larger slices of the pie without shrinking its total size. In that case, the presence or absence of a duty of loyalty would make no difference to the shareholders *collectively*, but would affect them individually.

²⁰⁶¹ See note 2166.

²⁰⁶² Restrictions that do not transfer powers were covered in the previous subsection.

²⁰⁶³ An agreement may require unanimity before some corporate action is taken, but that does nothing to solve the problem that dissent may exist; it simply alters the necessary victory conditions for each side, perhaps allowing a minority to veto the desire of the majority.

²⁰⁶⁴ Unless the corporation has only one shareholder.

²⁰⁶⁵ This assumes that the oppression remedy cannot be removed by a unanimous shareholder agreement, or at least that it has not been. See note 1207.

²⁰⁶⁶ With regard to the duty of loyalty, Flannigan's "limited access" model of fiduciary duty only applies if it can be established that shareholders (here assumed for the sake of argument to be the beneficiaries) should grant each other power for such limited purposes, rather than agreeing to open and self-interested access. See generally Robert Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] J.B.L. 277.

²⁰⁶⁷ The oppression remedy remains in place. However, it is not a perfect substitute for the duty of loyalty. Some of the differences between them were discussed in Chapter Four, albeit in another context.

Removing it would benefit those who had both the *desire* and the *ability*²⁰⁶⁸ to exploit the corporation (more than others) and harm those who did not. As between these two groups, the role of the law has traditionally been to protect those vulnerable to exploitation from those who would exploit them, not to ensure that the latter are free from fear of punishment.

The alternative scenario²⁰⁶⁹ would be that widespread exploitation weakens the corporate entity to the point where its activities are compromised, harming all shareholders collectively²⁰⁷⁰ through a loss of profit-generation. Individuals might still be able to exploit sufficiently to achieve a net personal benefit, but the logic for retaining a duty of loyalty is even stronger in such a case.

This does not mean that there can be no corporate activity that benefits an investor personally once a unanimous shareholder agreement is in place. The corporation would still be able to, for example, enter into a contract with a company controlled by one of its shareholders. But such arrangements would be subject to the same approval process as they normally are when the personal interests of a director are implicated in a decision, as set out in s. 120 of the *C.B.C.A.*; generally speaking, the shareholder must disclose the conflict and refrain from voting on the matter. That would prevent shareholders from abusing their power for individual gain, while allowing for fair transactions in which they had an additional stake.

The *Act* also contains a section allowing, under certain conditions, for shareholder approval or confirmation of contracts in which directors have material interests;²⁰⁷¹ it could similarly be used when empowered investors have the same. Disney was critical of a two-step process, shareholders first voting on matters using the powers they acquired from the directors and then ratifying their own decisions. While there is a certain artificiality to that procedure, it does not seem unreasonable to allow for the criteria outlined in s. 120(7.1) to serve as a second standard for votes on matters in which some shareholders have an interest; if the vote met the criteria set therein, it should be binding, without the need for a two-step

²⁰⁶⁸ Majority shareholders would have an advantage, but not necessarily a definitive one.

²⁰⁶⁹ I would suggest that there is no plausible scenario in which allowing for exploitation of the corporation by empowered shareholders would strengthen it overall.

²⁰⁷⁰ Although, if the exploitation is particularly bad, only some shareholders might still be in a position to benefit from corporate profitability.

²⁰⁷¹ *C.B.C.A.* s. 120(7.1): Even if the conditions of subsection (7) are not met, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit realized from a contract or transaction for which disclosure is required under subsection (1), and the contract or transaction is not invalid by reason only of the interest of the director or officer in the contract or transaction, if (a) the contract or transaction is approved or confirmed by special resolution at a meeting of the shareholders; (b) disclosure of the interest was made to the shareholders in a manner sufficient to indicate its nature before the contract or transaction was approved or confirmed; and (c) the contract or transaction was reasonable and fair to the corporation when it was approved or confirmed.

The provincial provisions allowing for shareholder approval of transactions in which the directors have a conflict of interest contain some variation. See *A.B.C.A.* s. 120(8) and s. 120(8.1), *M.C.A.* s. 115(5) and s. 115(7), *N.L.C.A.* s. 200, *N.B.B.C.A.* s. 77(7) and s. 77(9), *N.T.B.C.A.* s. 121(8), *N.B.C.A.* s. 121(8), *O.B.C.A.* s. 132(8), *Q.B.C.A.* s. 129 and s. 133, *S.B.C.A.* s. 115(7) and s. 115(8.1), and *Y.B.C.A.* s. 122(7).

process.²⁰⁷² This approach could supersede the obligation shareholders would otherwise inherit from directors to refrain from voting if they faced a conflict.²⁰⁷³ This allows for additional flexibility and could, in particular, be useful for decisions in which *all* shareholders had some sort of personal interest.

A final possibility is that investors might wish to use a unanimous shareholder agreement to cause the corporation to enter into transactions that are *not* reasonable and fair in the legal sense. For example, part of their deal might be that one of them would receive external contracts at rates far above the commercial norm.²⁰⁷⁴ It is best to explicitly cover those matters in the agreement as pre-made decisions, which would both ensure that *all* shareholders found the terms acceptable and thus avoid anyone being taken advantage of²⁰⁷⁵ and would remove these arrangements from the powers (and thus decision-making) to which the duty of loyalty and other statutory requirements applied. Removing that duty in its entirety is overbroad for those purposes. It could easily lead to unintended exploitation happening alongside whatever was anticipated, or for the anticipated exploitation to spiral beyond what was foreseen.

Whether it is in the investors' own interest to retain the duty of care when they assume power lends itself to a similar analysis. Once again, it benefits any individual shareholder if the *other* shareholders discharge their duty of care by making decisions in a minimally competent manner, and this can be weighed against the disadvantage to those same shareholders of finding *themselves* subject to that duty. Given the traditionally very low bar for the duty of care, it is easier to justify allowing them to hold each other even slightly accountable than to free them of any responsibility whatsoever. The primary interest which the law has traditionally recognized shareholders as having in the corporation is its profitability. Retaining the duty of care would align with that expectation, while dispensing with it would allow for extremely incompetent behaviour on the part of decision-makers that could harm the corporation's ability to function at even a minimum level of efficiency.

This obligation does have some key differences from the duty of loyalty that further strengthen the argument. The first is that failing to meet it does not directly transfer value from the corporation to the offending shareholder;²⁰⁷⁶ there is, in other words, no direct benefit to one who fails to satisfy that responsibility.²⁰⁷⁷ Since a failure to meet this duty would not give rise to an action if it did not cause a harm, the inevitable conclusion is that a shareholder who has failed to meet the duty of care in an

²⁰⁷² The votes might also have to be re-counted, since shareholders *qua* shareholders have their votes counted *by share*, while empowered shareholders might have their votes counted some other way, such as *by shareholder*, depending upon the terms of their agreement.

²⁰⁷³ *C.B.C.A.* s. 120(5).

²⁰⁷⁴ Either as an act of goodwill or as part of some network of *quid pro quo* arrangements worked out between the shareholders (and possibly the corporation) that would prove difficult to justify in court as valid consideration for the increased rates.

²⁰⁷⁵ Assuming that consent prevents exploitation.

²⁰⁷⁶ If it did, it would be a violation of the duty of loyalty instead.

²⁰⁷⁷ That said, shareholders who shirk their duty of care obtain at least notional value from the effort they saved, and possibly actual value if they redirected that energy to some other profitable pursuit.

actionable sense has caused the company some measure of harm. Since the losses of the corporation caused by a failure to meet the duty of care are not received by any shareholder, they are net losses of the shareholders collectively. The duty can therefore be said to serve investors, even when it is they themselves who are making the decisions, because it provides additional incentive to put at least minimal effort into safeguarding their collective interests, in case their personal stake was not motivation enough.²⁰⁷⁸ Alternatively, it provides a reason to decline authority if they do not believe they will be able to discharge it with at least some skill and diligence; again, this likely serves shareholders well, by avoiding incompetent management of the company in which they have invested.

Because whoever fails to meet the duty of care shares proportionally in that loss, with no accompanying benefit, they have already harmed not just the investors collectively, but their own interests as well, before any issue of liability arises. If the duty of care functions well, even those who would have shirked in its absence may benefit from their own efforts to comply.

It might be argued that the unanimous shareholder agreement should nonetheless allow investors to agree to waive these duties. Currently, the *C.B.C.A.* does not permit this. The logic behind such a suggestion is that the freedom of shareholders to make their own arrangements should trump any attempt to enforce predetermined rules upon them, no matter how logical and justifiable those predetermined rules might be. This is the variant of the "nexus of contracts" theory where to the greatest extent possible, rules should be defaults and not mandatory. It might be beneficial to the shareholders to allow for *specific* exceptions to the duty of loyalty or duty of care to be agreed upon through this method. These would receive the consent of all the other investors, who could both price the concessions and take appropriate steps to limit or counteract the harm they might cause. It is doubtful, however, whether a shareholder can meaningfully consent to unknown, unlimited self-interested or incompetent behaviour by others who control the corporation in which they have invested.²⁰⁷⁹ Obviously, I would recommend that they not enter such arrangements voluntarily, and at the risk of paternalism, the law should step in to prevent this.

The duties of care and loyalty therefore continue to serve a function when shareholders assume direct control over a corporation, even if one believes that the sole purpose of those responsibilities is to serve the interests of the investors themselves. Because the shareholders are not a unified group, they have a need to hold each other accountable for the decisions they are now in a position to make; the duties of care and loyalty continue to serve that function. These benefits outweigh the drawback of that same accountability. And, as discussed in the next section, shareholders may not be the only beneficiaries.

²⁰⁷⁸ There is the danger of economic inefficiency here, if the value of the collective interest is less than the total cost of all shareholders individually meeting the requirements of the duty of care.

²⁰⁷⁹ The oppression remedy might still offer them some protection, but it is not a perfect substitute, particularly if the very fact that they have waived these duties is taken into account as part of their reasonable expectations.

5. Stakeholder Theory and the Duties of Care and Loyalty

The analysis up to this point of the duties of care and loyalty has assumed that they were an internal corporate matter, meant to protect shareholders rather than wider societal interests. It was for that reason that they were treated separately from the other responsibilities which directors possess, because if the only goals they served were those of the investors themselves, then it was at least possible that they need not bind empowered shareholders, although that argument was rejected. But if the duties of care and loyalty serve wider societal purposes too, such a distinction does not exist; there is no basis for not having them accompany the powers of directors, no matter who holds them. Recent developments in the law have indicated that the duties of care and loyalty may be defined in just such a fashion, thanks to stakeholder theory.

The view that the interests of the corporation are synonymous with shareholder profit-maximization has been challenged in recent years by stakeholder theory, an approach whose basic tenet is that there are groups other than shareholders who each have a "stake" (*i.e.* the capacity to be either helped or hurt) in corporate decisions and that this interest should receive some form of legal recognition.²⁰⁸⁰ It is impossible to define the larger theory much more precisely than that; which groups should qualify as "stakeholders" in this sense, which of their interests should receive legal recognition, and what form that recognition should take are far from settled questions even amongst supporters of stakeholder-centred reform. But it is possible to be more precise when dealing with its influence on recent Supreme Court of Canada decisions and thus its role in contemporary Canadian corporate law. Three judgments within the past decade have made clear that the duties of care and loyalty which directors must meet are *not* framed solely in terms of the interests and desires of shareholders, but instead include other stakeholder groups. In the next subsection, those three cases are examined in depth.

Although this theory is now a part of the directors' duties, there are a variety of different ways that it can be integrated, including permitting but not mandating consideration of stakeholder interests, having an enforceable obligation to stakeholders, creating a duty to stakeholders but not granting them standing to enforce it, and subsuming the obligation to meet statutory requirements into the directors' duties to the corporation. Each of these, and the ways in which they would interact with unanimous shareholder agreements, are considered in turn, with the conclusion that they are all problematic.

This leads to a wider theoretical discussion of stakeholder theory and the unanimous shareholder agreement, two elements of corporate law that proceed from different basic premises, whose co-existence is uneasy at best. But the dilemma this poses is not unique to the implications of this statutory tool; the unanimous shareholder agreement is simply the most obvious manifestation of the shareholder primacy

²⁰⁸⁰ Although some definitions of "stakeholders", including this one, include shareholders, for convenience the term "stakeholders" in the following discussion will sometimes be used to refer to *other*

model of the corporation that underlies much of our law.

5.(a) Stakeholder Theory in the Supreme Court

To understand the importance of the stakeholder model in the Canadian context, one should begin with three judgments of our Supreme Court: *Peoples*, *BCE*, and *Indalex*. It was these decisions that not only established stakeholder theory as having a role in our nation's corporate law, but specifically confirmed that the duties of care and loyalty were obligations owed to the corporation, not the shareholders. However, the protection they actually granted to stakeholders was limited at best.

The first of them, *Peoples v. Wise*,²⁰⁸¹ established that when directors were determining the "best interests of the corporation" in the context of their duty of loyalty,²⁰⁸² they were permitted, but not required, to look to interests other than maximizing shareholder value:

We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.²⁰⁸³

The court made clear that the best interests of the corporation were not synonymous with the interest of *any* single group of stakeholders, implicitly including shareholders.²⁰⁸⁴ Unfortunately, little guidance was given as to how directors should deal with situations where the interests of various stakeholder groups were opposed:

In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders. If the stakeholders cannot avail themselves of the statutory fiduciary duty (the duty of loyalty, *supra*) to sue the directors for failing to take care of their interests, they have other means at their disposal.²⁰⁸⁵

This instruction that the board should not favour any group's interests but should instead work to

stakeholder groups, in contrast to shareholders.

²⁰⁸¹ *Peoples*, *supra* note 809.

²⁰⁸² Called by the Court their "statutory fiduciary duty" (*Peoples*, *supra* note 809, par. 32).

²⁰⁸³ *Peoples*, *supra* note 809, par. 42. A slight variation of this list appears in *BCE* as "*inter alia*, shareholders, employees, creditors, consumers, governments and the environment" (*BCE*, *supra* note 1143, par. 40).

²⁰⁸⁴ *Peoples*, *supra* note 809, par. 43.

create a "better" corporation is simply rephrasing the question. What is a "better" corporation? What factors go into determining that?²⁰⁸⁶ From the stakeholder perspective, then, this first half of the *Peoples* analysis is only a half-measure. It confirms that directors who, in a given situation, take a course of action that is (relatively) favourable to one stakeholder group but perhaps (relatively) unfavourable to another, *including the shareholders*, are not in so doing placing the interests of a third party ahead of the corporation, which would be a violation of the duty of loyalty.²⁰⁸⁷ On the other hand, there is no particular obligation to safeguard the interests of any given group, merely permission to do so.

The next stage of *Peoples* turned to the duty of care, which was a similarly mixed bag for both sides of the stakeholder debate. Major and Deschamps JJ. found that, based on the wording of the *C.B.C.A.*, the duty of loyalty was specifically owed to the corporation, but the duty of care was a general one for which the list of potential beneficiaries "is much more open-ended, and it appears obvious that it must include creditors".²⁰⁸⁸ While the Court went no further explicitly, the logic certainly leaves open the possibility that other stakeholders might also be the beneficiaries of this duty.²⁰⁸⁹

Obstacles remain. First, notwithstanding that Major and Deschamps JJ. found that, on the wording of the *C.B.C.A.*, the duty of care is owed to a potentially wide-ranging list of beneficiaries, those groups do not have standing under the *Act* to bring a suit against the directors. In Quebec, they can ground such standing in the *C.C.Q.*;²⁰⁹⁰ possibly some other provincial laws might have similar effect, but failing that, the Supreme Court has for the rest of the country seemingly recognized a duty that cannot be enforced. Second, even when it can be, the business judgment rule remains in effect,²⁰⁹¹ realistically blocking almost any possibility that directors would actually be found liable.

In *Peoples*, the Supreme Court imported stakeholder theory into the directors' duties in three different ways: as a permitted but not mandatory element of the duty of loyalty, as a (technically)

²⁰⁸⁵ Ibid, par. 47.

²⁰⁸⁶ Darcy L. MacPherson, "The Supreme Court Restates Directors' Fiduciary Duty- A Comment on *Peoples Department Stores v. Wise*" (2005) 43 Alta. L. Rev. 383, at p. 402 noted that *Peoples* contains "no meaningful guidance to allow directors to structure their decision making".

²⁰⁸⁷ See *Peoples*, *supra* note 809, par. 36, which invoked the idea of placing *someone's* interests ahead of the beneficiaries as a violation of the duty of loyalty; the relevance to the later analysis was not explicit, but would seem to be the logical reason why any of this was part of the duty of loyalty discussion.

²⁰⁸⁸ Ibid, par. 57.

²⁰⁸⁹ Jeffrey G. MacIntosh, "BCE and the Peoples' Corporate Law: Learning to Live on Quicksand" (2009) 48 Can. Bus. L.J. 255, at pp. 267-268 criticized this position for being in conflict with the history of the duty of care and the legislative intent, but he also interpreted it as meaning that the corporation itself was not the beneficiary of the duty, and thus could not bring suit to enforce it, leaving it unenforceable. While the decision was not totally without precedent, its interpretation of the duty of care was undoubtedly a shift in direction for Canadian law, but it nonetheless seems clear that the Supreme Court still intended for the corporation itself to be among the beneficiaries of the duty, and for it, at least, to always have standing to enforce it.

²⁰⁹⁰ *Peoples*, *supra* note 809, pars. 54-56.

²⁰⁹¹ Ibid, par. 64.

enforceable part of the duty of care within Quebec, and as a part of the duty of care outside Quebec for which otherwise-potential claimants lack the standing to bring a suit. In their next case to deal with the issue, they further complicated this model.

In *BCE*, the claim was not for breach of the duty of loyalty or care *per se*, but the analysis of the oppression remedy involved an examination of what those duties entailed.²⁰⁹² The Supreme Court found that the duty of loyalty included a "fair treatment" component for stakeholders.²⁰⁹³ For applicable groups such as creditors, this in turn formed part of the reasonable expectations that ground the oppression remedy.²⁰⁹⁴ The Court restated the conclusions of *Peoples*:

37 The fiduciary duty of the directors to the corporation originated in the common law. It is a duty to act in the best interests of the corporation. Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear - it is to the corporation: *Peoples Department Stores*.

38 The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.

39 In *Peoples Department Stores*, this Court found that although directors must consider the best interests of the corporation, it may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders.

There is some elaboration here as to what constitutes the best interests of the corporation that

²⁰⁹² J. Anthony Vanduzer, "*BCE v. 1976 Debentureholders*: The Supreme Court's Hits and Misses in its Most Important Corporate Law Decision Since *Peoples*" (2010-2011) 43 U.B.C.L. Rev. 205, at p. 212, set out the following succinct summary of how the Supreme Court of Canada related the two areas (with which I agree): "[T]he Court confirmed that the oppression remedy is intended to protect reasonable expectations of shareholders and it is reasonable to expect compliance with the fiduciary duty." Vanduzer elaborated at pp. 230-234. MacIntosh, *supra* note 2089, pp. 261-264, was critical of the Supreme Court's combination of the duty of loyalty with the oppression remedy, but his understanding of exactly what occurred differed from the above, involving a greater and more bilateral conflation.

²⁰⁹³ *BCE*, *supra* note 1143, par. 36. Vanduzer, *supra* note 2092, p. 213 fn 25, noted that while this discussion of "fairness" occurred in the context of the oppression remedy, the Court described it as a component of the duty of loyalty. MacIntosh, *supra* note 2089, p. 264 noted that a fairness element required a determination beyond what the "best interests" of the corporation itself was, because it required weighing the treatment of shareholders. The inclusion of such a factor within the duty of loyalty is puzzling, given that this obligation is designed to prevent self-interest. One explanation could be that directors must not benefit themselves at the expense of any other stakeholders, even when shareholder interests were unaffected; this would fall under the umbrella of restraining self-interest, the subject of this responsibility.

underlie the duty of loyalty,²⁰⁹⁵ but the reference to statutory obligations as their minimum core is potentially problematic, depending upon how the passage is interpreted. If the Court was intending to impose upon directors what their wording literally describes, an obligation to ensure that the corporation meets its statutory requirements, then that would have been more appropriately classified as part of the duty of care, which imposes actual standards of competence. The duty of loyalty, instead, per *Peoples* and the overall history of the fiduciary duty from which it derives,²⁰⁹⁶ is designed to prevent directors from placing other interests- primarily, but not exclusively, their own- before those of the corporation. It is possible to harmonize the two concepts, however, if one interprets *BCE* to mean that directors who cause their corporation to adhere to statutory requirements even when doing so would harm other corporate interests and/or stakeholders are not thereby placing a third party before the corporation, *i.e.* are not in violation of the duty of loyalty. Alternatively, and more strongly, the passage could be read to mean that when statutory compliance is involved, the best interests of the corporation are defined as being said compliance, and placing any other considerations ahead of that would therefore be a violation of the duty of loyalty, even if the result would otherwise have been within the company's interests.

The Court also found that:

66 The fact that the conduct of the directors is often at the centre of oppression actions might seem to suggest that directors are under a direct duty to individual stakeholders who may be affected by a corporate decision. Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.

²⁰⁹⁴ *BCE, supra* note 1143, par. 36.

²⁰⁹⁵ This and other passages in *BCE* have oft been criticized for their vagueness regarding exactly what the interests of the corporation are and how the interests of stakeholders should be balanced. See *e.g.* Poonam Puri, "The Future of Stakeholder Interests in Corporate Governance" (2009) 48 Can. Bus. L.J. 427, at pp. 431-432; MacIntosh, *supra* note 2089, p. 256; Vanduzer, *supra* note 2092, pp. 236-237. Mohammed Fadel, "*BCE* and the Long Shadow of American Corporate Law" (2009) 48 Can. Bus. L.J. 190, at pp. 201-204 offered a different critique; he considered the Court's conclusion against the debentureholders to be at odds with the standards it was allegedly following, with the implication that it was actually more sympathetic to an American-influenced shareholder primacy in the context of takeovers, but was nonetheless constrained to pay lip service to the principles it set forth in *Peoples*.

²⁰⁹⁶ See Flannigan, *supra* note 1891, pp. 366-373. As discussed at note 1891, Flannigan was critical

Amidst the restatement of the distinction between the interests of any group of stakeholders and those of the corporation, the Court made the point that the duty may include an obligation to "consider the impact of their decisions on corporate stakeholders". As in *Peoples*, this was framed permissively, rather than obligatorily.²⁰⁹⁷ However, as part of the oppression remedy analysis- one heavily tied to the duty of loyalty- it was found that "[t]he evidence, objectively viewed, supports a reasonable expectation that the directors would consider the position of the debentureholders in making their decisions on the various offers under consideration".²⁰⁹⁸ This must be understood in the context of this particular decision; the Supreme Court does not appear to have sought to translate either the oppression remedy or the duty of loyalty (or care) into a general requirement to consider creditor interests. It instead found that, on the facts of this case, certain non-binding assurances by the directors had led to a reasonable expectation on the part of the creditors that their interests would be protected.²⁰⁹⁹ This was entitled to some legal recognition. The Court chose to limit that recognition to a duty to consider the creditors' interests, but not a duty to protect them.²¹⁰⁰

of aspects of the analysis in *Peoples*.

²⁰⁹⁷ Edward Iacobucci, "Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties" (2009) 48 Can. Bus. L.J. 232, at pp. 234-236 criticized the duty as described in the above passage on the basis that the corporation itself had no interests, only the various stakeholders. He rejected, at p. 237, the view that the Court meant by the corporation the aggregate of all stakeholders, because while he found that a coherent position, it was not a plausible interpretation of the judgment. Although the Supreme Court took pains to disassociate the interests of the corporation from those of any given stakeholder group, the judgment was equally clear that the two were related. While Iacobucci is correct that it is difficult to read *BCE* as defining the best interests of the corporation as those of the stakeholders in the aggregate, it seems plausible that the former term refers to some ever-shifting (and thus admittedly indeterminate) mix of stakeholder interests that, at any given moment, stand in for the corporation's.

²⁰⁹⁸ *BCE*, *supra* note 1143, par. 102.

²⁰⁹⁹ The judgment did not suggest that the representations that gave rise to this obligation were themselves promises to consider creditor interests; they appear to have been non-binding statements that the corporation would protect creditor interests within certain unspecified limits. They were described as a statement of "commitment to retaining investment grade ratings [...] accompanied by warnings, repeated in the prospectuses pursuant to which the debentures were issued, that negated any expectation that this policy would be maintained indefinitely" (*BCE*, *supra* note 1143, par. 25). That the Court would translate this into an obligation to consider suggests that such a duty is legally different in degree rather than kind from an obligation to act. It could be a general response to scenarios where the relationship between a corporation and its creditors (and possibly other stakeholders, although at present not via the oppression remedy) is such that the interests involved are entitled to some legal recognition but not full enforcement, even if the idea of "considering" the interests was never discussed by the parties. It remains as yet unknown whether *BCE* represents a relatively unique situation or whether it will set a pattern for widespread future findings that stakeholders had a sufficient relationship with the corporation that they were owed a duty of consideration but nothing more.

²¹⁰⁰ The reason the Supreme Court did not extend the obligation in *BCE* beyond a duty to consider was also partly based on the facts of the case, those being "that there is no evidence that it was reasonable to suppose it [a deal that protected the creditors' interests while also profiting the shareholders] could have been achieved" (*BCE*, *supra* note 1143, par. 106). If there had been such evidence, a greater duty might have existed (or, depending on how one frames it, the same duty might have had a different standard): one where the actual results achieved would be scrutinized. This will be discussed in the next subsection.

Most recently, in *Indalex Ltd., Re*, the Court was split into three judgments. Those of both Deschamps J. and Cromwell J. confirmed that the duty of directors was to make management decisions in the best interests of the corporation,²¹⁰¹ while the dissent of LeBel J. referred more vaguely to "business obligations",²¹⁰² "corporate duties",²¹⁰³ and similar language, without explicitly confirming the content of those duties or their beneficiaries, beyond that they were in conflict with obligations owed as pension administrator. Cromwell J. restated the *Peoples* position that the directors' duty to the corporation is permissive of, but does not require, consideration of the interests of various stakeholder groups:

194 This was the case for Indalex. As an employer-administrator, Indalex acted through its board of directors and so it was that body which owed fiduciary duties to the plan members. The board of directors also owed a fiduciary duty to the company to act in its best interests: *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 122(1)(a); *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 S.C.R. 560, at para. 36. In deciding what is in the best interests of the corporation, a board may look to the interests of shareholders, employees, creditors and others. But where those interests are not aligned or may conflict, it is for the directors, acting lawfully and through the exercise of business judgment, to decide what is in the overall best interests of the corporation. Thus, the board of Indalex, as an employer-administrator, could not always act exclusively in the interests of the plan beneficiaries; it also owed duties to Indalex as a corporation.

Because the company was in the midst of insolvency, the discussion of its interests directly invoked stakeholder groups other than shareholders. All three sets of reasons for judgment were clear that there was, on some level, a conflict of interest between the plan beneficiaries and the corporation's other interests; given the facts, those cannot have been limited to shareholder value maximization. Cromwell J. noted that the directors had not created a conflict between their duty to the plan beneficiaries and their duty to the corporation "when protective action was taken for the purpose of preserving the status quo for the benefit of all stakeholders",²¹⁰⁴ and Deschamps J. referred to the board's decision to take action to avoid "a creditor start[ing] bankruptcy proceedings and in so doing jeopardiz[ing] ongoing operations and jobs".²¹⁰⁵ In both those passages, the directors were described as considering groups other than shareholders in determinations of the company's interests.²¹⁰⁶

The stakeholder theory of the corporation has sometimes been referred to as "multi-fiduciary".²¹⁰⁷

²¹⁰¹ For example, at *Indalex*, *supra* note 1775, par. 67 and par. 194, respectively.

²¹⁰² *Indalex*, *supra* note 1775, par. 269.

²¹⁰³ *Ibid*, par. 271.

²¹⁰⁴ *Ibid*, par. 206.

²¹⁰⁵ *Ibid*, par. 70.

²¹⁰⁶ There are a number of other references in the judgment to stakeholder interests, but they are in the context of the goal of the legal proceedings being the protection of stakeholder interests, not the beneficiaries of the directors' duties.

²¹⁰⁷ Joseph William Singer, "Jobs and Justice: Rethinking the Stakeholder Debate" (1993) 43 U. Toronto. L.J. 475, at p. 505 did not use that term but discussed the concept of directors owing fiduciary

Indalex illustrates why this terminology is not an accurate representation of current Canadian law, and moreover, why it would not be a viable development. All three judgments held that due to the company's position as pension administrator, fiduciary duties were owed to the plan beneficiaries, and these created a conflict of interest with the normal obligations of corporate law, although the scope of that conflict was the subject of disagreement.²¹⁰⁸ They also all agreed that when a conflict between two different duties of this nature arose, the correct solution was not to attempt to balance the interests, but to take steps to remove the conflict, such as transferring some responsibilities to another party.²¹⁰⁹ *Peoples*, *BCE*, and *Indalex* are all unequivocal that the directors' duty of loyalty is owed to the corporation and only to the corporation, but that in determining the interests of the company, stakeholders might be taken into account. While it might be possible to strengthen that protection, it must be done in a manner that avoids the sorts of conflict of interest that occurred in *Indalex*.

These three cases have made it clear that the duty of loyalty cannot be equated to an obligation to advance shareholders' interests alone. Directors have the discretion to consider other stakeholder groups, but such consideration is not mandatory, merely permitted; the language in *Peoples*, *BCE*, and *Indalex* is consistent that directors "may" do so, not that they must. That is relatively straightforward, if problematic, but it is not the whole picture. *Peoples* went further with the duty of care, ruling that its beneficiaries are open ended and include stakeholders; the duty cannot be enforced, however, except in jurisdictions that specifically grant standing. *BCE* subsequently added some complications of its own, placing within the duty of loyalty an obligation to obey statutes. The following subsections will examine the practical difficulties of these four approaches, after which, the general conflict between the stakeholder theory of the corporation and the presumptions inherent in the unanimous shareholder agreement will be examined.

5.(b) Permission to Consider Stakeholder Interests

All three decisions of the Supreme Court of Canada are clear that the duty of loyalty is owed to the corporation, not to any given stakeholder group, not even to shareholders. Furthermore, they are consistent that the directors *may* look to any stakeholder(s) in determining the corporate interest, but there is no requirement that they consider the interests of any group, let alone safeguard them.²¹¹⁰ This can be labelled

duties to multiple stakeholder groups. Marleen A. O'Connor, "Restructuring the Corporation's Nexus of Contracts: Recognizing A Fiduciary Duty to Protect Displaced Workers" (1990-1991) 69 N.C.L. Rev. 1189, at p. 1251 referred to these as "dual or conflicting fiduciary duties", classifying the directors' duty to majority and minority shareholders as an example (this is not the Canadian position) and noting that while generally forbidden, such conflicts are acceptable in agency law if both principals agree.

²¹⁰⁸ *Indalex*, *supra* note 1775, pars. 61-75, 184-222, 267-276.

²¹⁰⁹ *Ibid*, pars. 66, 218, 272.

²¹¹⁰ MacIntosh, *supra* note 2089, p. 259, expressed confusion as to whether *BCE* generally presented a permissive ("may") standard or a stronger one, but that was because of his view that the court had totally

the "permissive" approach to incorporating stakeholders into the duty of loyalty.

Defining the duty of directors in a manner that permits them to take into account various groups without making them responsible to any of them raises a danger that opponents of stakeholder theory have long cited.²¹¹¹ In a situation where the board have no defined obligation to any one group,²¹¹² but license to consider a host of competing interests, they could end up accountable to no one but themselves.²¹¹³ It is no answer to say that their obligation is to the corporation itself, because without an established referent, they would be free to define the corporation's interests however they wished. While it has been suggested that that might actually be desirable, freeing directors to behave in a socially beneficial manner,²¹¹⁴ it seems just as likely that it will encourage them to pursue their own self-interest in the guise of helping others.²¹¹⁵

There are at least two rejoinders to this concern, the first cynical and the second optimistic. The cynical reply is that directors are *already* often accountable to no one but themselves. Legal mechanisms are historically ineffective at reviewing the board's decisions due to the business judgment rule, barring the most blatant corruption, since it is generally possible to portray any course as at least potentially in the corporation's best interests. In some firms, accountability may exist through the threat of replacement, rather than the enforcement of legal duties; in others, where replacement is unlikely, directors might have almost no accountability at all. Such a line of reasoning suggests that freeing the board to consider stakeholder interests does no additional harm, because their legal duties would have been unlikely to

conflated the duty of loyalty and the oppression remedy, and included reasonable expectations in the former. Vanduzer, *supra* note 2092, pp.244-245, also argued that the inclusion of fairness within the duty of loyalty imported a mandatory element.

²¹¹¹ At least going back as far as A. A. Berle, Jr., "For Whom Corporate Managers Are Trustees: A Note" (1931-1932) 45 Harv. L. Rev. 1365.

²¹¹² Directors potentially face other incentives to favour shareholder interests, which will be considered below.

²¹¹³ This possibility is frequently discussed by those on both sides of the debate. *e.g.* MacIntosh, *supra* note 2089, p. 256; Singer, *supra* note 2107, p. 500-501; Hart, *supra* note 108, pp. 304-305; O'Connor, *supra* note 2107, p. 1233; Puri, *supra* note 2095, p. 432-433; James C. Tory, "A Comment on *BCE Inc.*" (2009) 48 Can. Bus. L.J. 285, p. 286; Vanduzer, *supra* note 2092, pp. 227-228, 247-248, 252, and even conceded by E. Merrick Dodd, Jr., "Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?" (1934-1935) 2 U. Chi. L. Rev. 194, at pp. 206-207.

²¹¹⁴ *e.g.* E. Merrick Dodd, Jr., "For Whom Are Corporate Managers Trustees?" (1931-1932) 45 Harv. L. Rev. 1145 generally; Einer Elhauge, "Sacrificing Corporate Profits in the Public Interest" (2005) 80 N.Y.U. L. Rev. 733 generally; Tuvia Borok, "A Modern Approach to Redefining 'In The Best Interests of the Corporation'" (2003) 15 W.R.L.S.I. 113 at the Conclusion; Bruce Chapman, "Trust, Economic Rationality, and the Corporate Fiduciary Obligation" (1993) 43 U. Toronto L.J. 547, at pp. 582-583 discussed how managers (insulated from shareholder control) may feel more sympathetic to other long-term stakeholders than to shareholders.

²¹¹⁵ Discussed by *e.g.* Vanduzer, *supra* note 2092, pp.207-208; Singer, *supra* note 2107, pp. 500-501, 503-504; Ruth O. Kuras, "Corporate Social Responsibility: A Canada - U.S. Comparative Analysis" (2000-2001) 28 Man. L.J. 303, at p. 310; Wai Shun Wilson Leung, "The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests" (1996-1997) 30 Colum. J.L. & Soc. Probs. 587; O'Connor, *supra* note 2107, p. 1233; MacIntosh, *supra* note 2089, p. 256.

meaningfully prevent such consideration in any event.²¹¹⁶

The optimistic reply is that directors are already experienced at balancing diverse interests, as shareholders may be divided in many ways: majority and minority, short-term and long-term, risk-prone and risk-averse, insiders and outsiders, *et cetera*.²¹¹⁷ But this likewise illustrates how competing beneficiaries make the directors' duties almost unenforceable and largely irrelevant. The interests of shareholders that the law recognizes as legitimate are limited, and short of oppressive or self-interested conduct, it is difficult to conceive of, for example, a group of long-term shareholders convincing a court that the board had inappropriately favoured short-term shareholder interests to the degree that the duty of loyalty was violated. Whatever balancing of competing shareholder interests is occurring, legal duties play little role in its outcome; either other incentives are motivating directors, or it is simply their discretion and hopefully good faith that determines whose agenda prevails.

Now the Supreme Court of Canada has ruled that the board are permitted to take into account not just various shareholders interests, but stakeholders as well. At the very least, this has created a "shield" so that any directors who happened to decide, for whatever reason, to favour the interests of other groups would not be penalized for doing so, except by subsequent replacement. By defining the duty of loyalty in this permissive manner, the Court may have been attempting to encourage a re-conception of directors' roles that would result in more attention actually being paid to stakeholder interests, notwithstanding the lack of any legal obligation to do so.

The unanimous shareholder agreement stands in opposition to such efforts. In a regime where directors are not required to consider stakeholders but are legally protected should they choose to do so, a unanimous shareholder agreement has a very significant impact. It can completely circumvent this move away from shareholder primacy.

If investors assume power, then by law they are subject to all the corresponding responsibilities. But in the scenario under consideration, directors have no duties to stakeholders; they only have permission to consider those interests, at their discretion. The shareholders would inherit that discretion,²¹¹⁸ but its significance in their hands would be changed.

Corporate directors are often in a position of relative immunity from accountability to

²¹¹⁶ Jonathan R. Macey and Geoffrey P. Miller, "Corporate Stakeholders: A Contractual Perspective" (1993) 43 U. Toronto L.J. 401, at p. 403; Iacobucci, *supra* note 2097, p. 242; Elhauge, *supra* note 2114, generally argued that this has been the current state of American law.

²¹¹⁷ Iman Anabtawi, "Some Skepticism About Increasing Shareholder Power" UCLA School of Law, Law-Econ Research Paper No. 05-16, online: <http://ssrn.com/abstract=783044>, generally; Macey and Miller, *supra* note 2116, pp. 403, 413; Hart, *supra* note 108, pp. 307-308. Geoffrey G. MacIntosh, "Designing an Efficient Fiduciary Law" (1993) 43 U. Toronto L.J. 425, at pp. 458-460 argued that this balancing act among investor interests was already problematic and that directors should only owe duties to the interests of non-preferred shareholders. Dodd, *supra* note 2113, at p. 201 noted that if shareholders have divergent interests, corporate activity cannot necessarily profit all of them.

²¹¹⁸ Possibly further protected by their ability to fetter it.

shareholders. It has been argued that, beyond negative effects such as agency costs and self-interest, this freedom may have positive aspects.²¹¹⁹ The board might be more likely to make decisions that benefit stakeholders or society generally (*i.e.* corporate social responsibility) because they have a hands-on understanding of the business, they have more direct exposure to the needs of other stakeholders, and they experience reputational costs and gains.²¹²⁰ They therefore might look past profit maximization and pursue other goals. This is not necessarily magnanimous of them; generosity is easy if someone else pays the price.²¹²¹ Further, were they truly insulated from oversight, it is entirely possible that they would primarily seek to benefit themselves, even granting that they might make some efforts to help other groups along the way; the two are not mutually exclusive.²¹²² Nonetheless, if directors have the freedom to advance stakeholder interests, they probably will do so at least occasionally even if there is no personal benefit. To the extent that they are insulated from shareholder reprisals (and assuming that the difference in returns from whatever shares they own would be minimal), there is really no reason for them to always make decisions in the investors' interests; this is the very essence of the "agency costs" that shareholder advocates warn against.

It would be arbitrary and inconsistent to assume that, on the one hand, directors relieved from accountability would use that freedom to help stakeholders, and on the other, that were shareholders to take the reins of power for themselves, they would behave entirely selfishly. There is plenty of evidence that some portion of shareholders do not solely consider their own profit and would prefer corporations to recognize stakeholder interests and/or corporate social responsibility. So-called "ethical investment" is a growing field.²¹²³

To better understand the potential effects of a unanimous shareholder agreement, one therefore should consider the relative costs and benefits that directors and empowered investors face if they are permitted, but not required, to favour stakeholder interests at the cost of diminished profits. This sort of

²¹¹⁹ See note 2114.

²¹²⁰ Elhauge, *supra* note 2114, pp. 743, 797, 838.

²¹²¹ David L. Engel, "An Approach to Corporate Social Responsibility" (1979-1980) 32 *Stan. L. Rev.* 1, at p. 22 noted that it is managers, not shareholders, who feel personal gratification from corporate charity, and even suggested, at pp. 22-23 fn 65, that this may be part of their compensation. Elhauge, *supra* note 2114, raised this objection and provided a number of counterarguments to the effect that the concern, while not completely unfounded, is overstated: managers receive more immediate benefits from profitability, such generosity must take the place of self-interested behaviour (pp. 740-741, 805-807, 835-836), other forces constrain managers (p. 808-810, 840), and any choice they make will please some shareholders and disappoint others, either those who prefer profits alone or those who have other considerations (785). Elhauge nonetheless advocated legal limits (pp. 841-857).

²¹²² Particularly given that the board may identify some stakeholders whose interests happen to align with theirs and use that group as "cover". Macey and Miller, *supra* note 2116, p. 412, gave the example of blocking a take-over by referring to the employees' desire not to relocate.

²¹²³ Protecting stakeholder interests will sometimes also result in financial benefit for the shareholders. MacPherson, *supra* note 2086, pp. 393-398, referred to this as "enlightened shareholder value", a term borrowed from the United Kingdom. The present discussion refers to situations where these goals conflict.

economic analysis is a simplification; there is a disconnect between the abstract rational actor and real human behaviour. But it makes a useful starting point.

Corporate net income directly increases the value of shareholders' investments.²¹²⁴ Directors participate in such increases if they are also shareholders, and they additionally may benefit in other ways: bonuses, empire-building, and increased status in the market for management.²¹²⁵ Despite those qualifiers, it seems likely that, unless directors are particularly skilled at diverting profits into their own pockets, the bulk of any increase in value would fall to the shareholders collectively. It therefore becomes relevant how many shareholders there are and their proportions of the gain.²¹²⁶ The higher that is, the greater their incentive to favour profits over stakeholders.

The "costs" of ignoring (unprofitable) stakeholder interests are moral and reputational.²¹²⁷ The moral objections would be the same for either empowered investors or directors, assuming similarly sized and informed groups. If the shareholders are a significantly larger group, they may face lesser moral costs if they can convince themselves that their individual votes don't make a difference,²¹²⁸ or if they vote without informing themselves about the issue, in order to avoid unpleasant truths (something that might be permissible if they are not bound to the same duty of care as directors).²¹²⁹ Similarly, the reputational costs might differ between the groups, depending upon whether empowered investors remained more anonymous than the directors they replaced and whether they had more or less use for a reputation for treating stakeholders well.²¹³⁰

It is therefore impossible to make a general determination regarding the relative levels of incentive that directors and shareholders have to favour corporate profitability. It is of course possible that shareholders would have the greater one, *e.g.* where the directors were nominees with no direct investment in the company. It is also possible that they would have not, *e.g.* when their shareholdings were minimal. Perhaps the directors would be investors themselves with about average holdings, which would align their incentives quite closely with those of the general shareholders, or even that the directors and shareholders

²¹²⁴ Unless they are diverted.

²¹²⁵ Including renegotiation with the firm that already employs them.

²¹²⁶ Also relevant is what the decision-making procedure for the empowered shareholders is; voting by shareholding, for example, could lead to a different outcome than a system that allowed each investor an equal vote regardless of shareholdings.

²¹²⁷ Elhauge, *supra* note 2114, pp. 752-756 referred to these as "moral" and "social", and included in the latter category the general unpleasant experience of social sanctions, beyond the utilitarian cost of reputation loss.

²¹²⁸ Elhauge, *supra* note 2114, p. 742 raised this specifically in the context of tendering during a takeover despite objecting to the proposed purchaser's anti-stakeholder practices.

²¹²⁹ *Ibid.*, pp. 758-759, 798-799.

²¹³⁰ Stone, *supra* note 153, p. 371, noted that the importance of intra-firm reputation for managers is lessened in situations where they experience high turnover, as the newcomers are granted a "clean slate". This observation has applicability to the current discussion; the relative reputational costs faced by directors and empowered shareholders for mistreating stakeholders are tied to their respective rates of

might be co-extensive groups, literally identical and therefore possessing identical interests.²¹³¹

Regardless, the presumed logic of the Supreme Court was that the board are not automatically inclined to prioritize shareholder interests over other stakeholders, and the aforementioned judgments ensure that there is no legal requirement that they do so. To the extent that the shareholders themselves prefer their own interests, if they assumed power, they would be free to benefit other groups but would not do so to their own detriment. Indeed, if the directors were commonly exercising their discretion in favour of stakeholders, that could lead to increasingly dissatisfied investors using unanimous shareholder agreements precisely to assert the centrality of their interests. This legal tool thus represents an obstacle to using the "permissive" approach to stakeholder rights as a means, however tepid, of making them a larger factor in corporate decision-making.

Investors could also use a unanimous shareholder agreement to restrict the board from considering any interests other than theirs. The theoretical permissibility of such a term rests upon the precise scope of the legal endorsement for consideration of stakeholders. The approach in *Peoples*- incorporating a permissive view of stakeholder interests within a mandatory duty to the corporation- possibly prevents this. But when the principle was later restated in *BCE*, it was as follows: "[T]his Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders."²¹³² Consideration of stakeholders was there listed as separate from consideration of the best interests of the corporation, rather than subsumed into it; the following paragraph, however, once again placed the former within the context of the latter. Hypothetically, if the existing duty did not preclude taking stakeholders into account, but also did not directly include consideration of their interests within a larger mandatory obligation, then there would appear to be no reason why a unanimous shareholder agreement could not eliminate that permission. In other words, if the extent of the legal protection of stakeholder interests could be summed up as "by default, the duties imposed by law do not prevent directors from taking stakeholders into account", it might be possible to create a unanimous shareholder agreement that did just that; the entire point of the tool, after all, is restricting directors' powers by placing limitations upon their decision-making that otherwise do not exist.

turnover.

²¹³¹ Directors might also belong to some other stakeholder group, such as creditors or employees, or even to multiple groups simultaneously, and that might also affect their interests. Given that the board are elected by shareholders, however, it appears most likely that their interests would reflect shareholder interests, absent circumstances that would pose their own difficulties. Shareholders have obvious reasons to elect directors who they believe will favour them and to replace those who do not; directors, already having been selected for their perceived inclination to favour the shareholders, will be further motivated by the desire to retain their position. If board members who belong to other stakeholder groups favour their interests over shareholders, it indicates a possible failure of the director election and removal processes as mechanisms for holding them accountable. The potential problems that poses are discussed in this chapter.

²¹³² *BCE*, *supra* note 1133, par. 39, emphasis in original.

Even if stakeholder interests were included within those of the company itself, it might still be possible to create a unanimous shareholder agreement designed to mitigate that, by drafting something to the effect of "where multiple options are all within the corporation's best interests, the one most beneficial to shareholders must be chosen".²¹³³ If this tactic was permitted, it would place pressure on the board to favour investors above other groups, lest they be forced to justify why not doing so was the *only* option in the corporation's best interests.²¹³⁴ Enforcing such clauses could penalize directors who deviated from shareholder profit maximization, the very thing that *Peoples* allowed. Of course, it might be determined that such agreements were contrary to public policy, but prior to the law²¹³⁵ closing this hole, it would seem to be logically permissible.

A restriction upon the directors designed to force them to prioritize shareholder interests need not be so explicit in its rejection of stakeholder theory. A "pre-made decision" might be included in a unanimous shareholder agreement that benefited equity investors at the expense of other groups. For example, a term requiring the payment of dividends would leave fewer funds available for wage increases, environmentally-friendly technologies, *et cetera*. Where the law only permits, but does not require, consideration of stakeholder interests, pre-made decisions favouring the shareholders are apparently valid,²¹³⁶ even though their effect is to render that permission ineffective. It would be difficult, perhaps impossible, to prevent pre-made decisions from undermining the board's permission to consider various stakeholder groups, unless such terms were forbidden entirely.

The fundamental assumptions of the unanimous shareholder agreement and stakeholder theory are at odds. The "permissive" approach to the duty of loyalty, which the Supreme Court of Canada has endorsed in three recent decisions, allows for a particularly easy illustration of this conflict, and one in which the unanimous shareholder agreement, with its implicit endorsement of investor-centrality, emerges the practical victor. Put simply, if on one side there is only permission granted to the board that they "may" consider stakeholder interests, and on the other shareholders have a tool that allows them to directly control corporate decision-making either by restricting directors' options or assuming power themselves, then the fight is hardly fair. The continued centrality of shareholder interests is assured.²¹³⁷

²¹³³ Elhauge, *supra* note 2114, pp. 862-863, pointed out that, in American states where directors were permitted to consider stakeholder interests, he was unaware of any company attempting to use a charter to force the board to prioritize profit-maximization. The danger may therefore be theoretical.

²¹³⁴ Or, more precisely, that all options within the corporation's best interests would have had similar impact.

²¹³⁵ Either through precedent or statutory reform.

²¹³⁶ Assuming that "pre-made decisions" are acceptable otherwise.

²¹³⁷ A half-step above a merely permissive regime is one where the corporation, in the form of its directors, is legally required to consider the interests of some group(s) of stakeholders in its decision-making, but the actual decisions themselves are not subject to any standard. In other words, the directors have fulfilled their duty if they can present evidence that they took into account that their decisions would harm the relevant stakeholder group, even if they then proceeded to do exactly that.

In *BCE*, the Court concluded that the directors were under such an obligation. Jeremy D. Fraiberg, "Fiduciary Outs and Maximizing Shareholder Value Following *BCE*" (2009) 48 Can. Bus. L.J. 213, at p. 217 declared that following *BCE*, it will now be important for directors to keep records showing they considered stakeholder interests and expectations. Iacobucci, *supra* note 2097, p. 243, concluded that, "[i]t is not entirely clear [from *BCE*] whether directors have an obligation to consider as a procedural matter the interests of stakeholders even if there is no substantive obligation to act in their interests", and he argued that a simple permissive approach would be preferable, because considering all stakeholders is unfeasible (p. 244). MacIntosh, *supra* note 2117, pp. 444-445 criticized a duty-to-consider standard for its incoherence and uncertainty. My own view is that, while certainly problematic (as discussed below) this obligation arose in *BCE* both "on the facts" and in the context of reasonable expectations under the oppression remedy, and thus was not made a part of the directors' duties to the corporation.

For analytic completeness, however, it is worth considering as a variation of the "permissive" approach, one where the *consideration* of stakeholder interests is mandatory but actually *protecting* them is merely permitted. (This must be distinguished from models including both a procedural duty to consider *and* some substantive standard for the outcome, *e.g.* the proposal of Poonam Puri and Tuvia Borok, "Employees as Corporate Stakeholders" (2002) 8 Journal of Corporate Citizenship 49.) When there is a legal duty to consider the interests of stakeholders, then shareholders who take power through a unanimous shareholder agreement would be bound by that duty. As with the permissive model, shareholders arguably have a greater incentive than directors to put investor interests (their own) ahead of those of other groups. If a duty to consider stakeholder interests is intended not simply as a *pro forma* acknowledgment of their stake before a contrary decision is reached, but instead to result in such interests occasionally winning out in whole or part, then this might be even less effective if shareholders have assumed power. The treatment in *BCE* implied the former, so it would make little difference if this passing acknowledgment of the interests being harmed was made by directors or shareholders. Even if the duty to consider is nothing more than a hollow procedural requirement, it can still pose problems for shareholders who have assumed power. If the onus is upon them to prove that they have discharged it, they will have to be careful to keep evidence to that effect. That applies to directors as well, but investors may be dispersed enough, informal enough, or otherwise have a strange enough procedural system for exerting control that it is difficult or impossible to prove what they did or did not consider. In order to protect themselves, they would need to ensure that they kept records they otherwise might not have. Shareholders who assume power in a corporation have the ability to "fetter their discretion"; it is unknown how this might interact with any duty to consider stakeholder interests. Even reading this ability as only applicable to shareholders entering into contractual agreements with regard to how they will vote, it would create a conflict. Since the "fettering of discretion" through contract by definition precludes further consideration, it would seem to always prevent the satisfaction of any duty to consider stakeholder interests. One doctrine or the other must triumph, but the two cannot be reconciled. If investors use a unanimous shareholder agreement to issue a specific order to the corporation, then they are restricting the powers of the directors with respect to that decision. The wording of the statute suggests that in doing so, shareholders bear all responsibilities the board would with respect to that order, including any duty to consider stakeholder interests. If the pre-made decision restricted directors' powers on an ongoing basis, a duty to consider would prove difficult to apply. At the time of the unanimous shareholder agreement's formation, stakeholder interests that would ultimately be affected by the restriction might be unknown, making it impossible for the shareholders to consider them. But once the agreement is in place, directors bound by it cannot *meaningfully* consider interests they no longer have the power to affect. This assumes that the duty to consider should be meaningful, *i.e.* those doing the considering must have the power to influence the outcome. If the duty to consider was seen instead as an act of acknowledgment and recognition rather than a true decision-making process, possibly to serve some abstract moral purpose, then directors might still "consider" harms they had no power to avert. Indeed, it would then be possible to construct a unanimous shareholder agreement that permitted (even instructed) directors to *consider* the interests of other stakeholders but to nonetheless always

5.(c) Enforceable Duties to Stakeholders

While *Peoples* established that the duty of loyalty was owed only to the corporation, the duty of care was found to have a wider range of potential beneficiaries, albeit subject to some standing issues. The contents of the latter obligation, however, apparently did not include safeguarding stakeholder interests *per se*; the Court found that it had been discharged in that case because the steps taken were legitimate business decisions for the company, and they thus fell within the business judgment rule, despite the harm they caused to creditors.²¹³⁸ The apparent result is that, if directors have acted in a manner that fails to meet their standard of care as it pertains to the corporation's interests, and if they have also thereby done harm to stakeholder interests, then in jurisdictions such as Quebec where standing is allowed, the stakeholders could sue for compensation.

If the duties owed to the company can, for virtually all purposes, be satisfied by courses of action that are in the interests of the shareholders, then this responsibility is not of much concern to empowered investors; assuming they are motivated to act in their own interests, the only drawback would be being held to a legal standard in so doing. Some investors might balk at that, even one as lax as the duty of care, preferring to avoid any responsibility.²¹³⁹

If, on the other hand, the corporation's interests are sufficiently distinguishable from shareholders' that actions taken to advantage the latter could fail to meet the directors' duties, then the situation is more complicated. This goes a step further than the judges in *Peoples* and *BCE* were willing, but it is consistent with their logic and worth exploring, particularly as it is possible that that is the direction that the law is heading.²¹⁴⁰ To make such a proposal realistically enforceable presents difficulties due to the diverse and often conflicting interests of stakeholders. Some method would need to be used to synthesize the

completely *prioritize* the interests of shareholders.

²¹³⁸ *Peoples*, *supra* note 809, pars. 70-71.

²¹³⁹ Unanimous shareholder agreements that only restricted the board without empowering shareholders create more interesting technical problems. Directors might be limited to options which would ordinarily not satisfy the duty of care, with one(s) that would meet it "off-limits". In such a circumstance, it would be unfair to hold them liable for failing to take that option, which would suggest that the shareholders should be accountable under a transferred duty of care. But if the decisions that created the restrictions were evaluated to see whether they met the duty of care when they occurred, then they might be found to have been acceptable or even beneficial at the time. This is a specific instance of the dilemma that pre-made decisions pose for the transfer of directors' responsibilities.

²¹⁴⁰ Singer, *supra* note 2107, p. 501 argued that, absent a belief that managers are sincerely motivated to protect stakeholders, statutes designed to recognize the interests of those groups cannot have been intended to be merely permissive and thus ineffectual, but should instead be taken to have created enforceable rights. The origin of this particular strain of stakeholder rights in Canada, however, was judicial, not legislative, albeit based in expansive readings of existing statutes, and thus Singer's logic would be largely inapplicable.

"corporate" interests (in order to determine if the directors' actions were in line with them), although perhaps one might, for example, instruct the board to consider Kaldor-Hicks efficiency, where the foreseeable harm done to any group of stakeholders would need to be outweighed by the benefit to another.²¹⁴¹ This would be difficult to apply to many business decisions, where the gains and losses of various stakeholders are difficult to estimate, but for more easily quantifiable situations such as the one in *BCE*, it could serve as a method for determining which group's agenda should prevail. Or one might create a hierarchy of interests to guide the directors,²¹⁴² or simply leave finding the best balance to their reviewable judgment.²¹⁴³ Whatever form it took, such an obligation would not necessarily achieve much in practice, due to the difficulties of bringing a successful action. At present, shareholders have a difficult enough time enforcing the duty of care, due to the business judgment rule, and the board would find it even easier to hide behind such discretion if they had multiple constituencies' interests to balance.

Whether or not it could be made to work as intended, such a legal regime would designate directors as essentially mediators among competing stakeholder interests.²¹⁴⁴ As discussed in the previous subsection, a variety of factors might encourage them to favour shareholders,²¹⁴⁵ including their own investments and the nature of their elected positions,²¹⁴⁶ but the assumption of the Supreme Court appears

²¹⁴¹ A Kaldor-Hicks standard (and the similar Pareto one) was considered by MacIntosh, *supra* note 2117, pp. 440-442; Edward S. Adams and John H. Matheson "A Statutory Model for Corporate Constituency Concerns" (2000) 49 *Emory L. J.* 1085, at pp. 1113-1114; Leung, *supra* note 2115, pp. 605-608.

²¹⁴² Puri and Borok, *supra* note 2137, proposed that directors should look first to the interests of shareholders and employees, and only thereafter to those of other stakeholder groups. MacPherson, *supra* note 2086, pp. 394-395, discussed (but rejected) the position that certain harms (such as loss of life) are unquantifiable and that avoiding them should have first priority in corporate decision-making before any cost-benefit analysis.

²¹⁴³ This would not be the same as creating separate obligations owed to each stakeholder group. As *Indalex* demonstrated, that would simply create conflicts of interest, rather than putting directors in a position to mediate conflicting interests.

²¹⁴⁴ See generally Margaret M. Blair and Lynn A. Stout, *supra* note 68; Adams and Matheson, *supra* note 2141, p. 1106; Leung, *supra* note 2115, pp. 603-605; Elliott J. Weiss, "Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse" (2000) 49 *Emory L. J.* 1085, at pp. 426-427 provided a (partly prescriptive) analogy between directors and judges.

²¹⁴⁵ Directors might also, in some cases, belong to *other* stakeholder groups, such as creditors or employees, and might therefore have incentive to favour those interests.

²¹⁴⁶ Contrast certain European jurisdictions, where employees elect some directors. Obviously, such a system would be difficult to reconcile with the nature and function of unanimous shareholder agreements, absent heavy revision to them. The presumptive purpose of additional constituencies participating in the selection of directors is to allow them to have an influence over the ultimate decision-making authority in the corporation. This goal would be undermined if the shareholders could use a unanimous shareholder agreement to override the board's normal authority. One possible solution would be to require that all the members of any stakeholder group entitled to select directors would also have to be parties to any agreement restricting the board. Another would be to limit the effectiveness of the restrictions imposed by a unanimous shareholder agreement, so that rather than restricting the collective powers of the board to manage the corporation, they instead restricted the votes that the specific directors elected by the shareholders were able to cast; this would be in contrast to the current state of the law regarding unanimous

to have been that these would not necessarily prove conclusive and that directors could have sufficient impartiality that they might consider other stakeholders. Nonetheless, the reasons for these judgments were clear that the board could not consider their own benefit *qua* directors as part of the best interests of the company, as that would constitute a violation of the duty of loyalty;²¹⁴⁷ only if their interests "innocently and genuinely coincide with those of the corporation",²¹⁴⁸ such as because they were also shareholders or because they were being paid a *reasonable* salary for their work,²¹⁴⁹ are they permitted to profit from their decision-making.²¹⁵⁰ Directors as a class are conspicuously absent from the lists of possible stakeholders in *Peoples*, *BCE*, and *Indalex*,²¹⁵¹ although in a technical sense, they are stakeholders too. The expansion of their duties to allow for stakeholder interests was not intended to include self-interested behaviour; assumptions of impartiality, however naive, can only go so far. Especially given the lack of a clear standard for how competing agendas should be balanced, letting directors favour *directors* as a class when calculating the corporate interest would open the door to impermissible abuse.²¹⁵²

When shareholders assume direct control, then they are in that very position of mediating amongst stakeholders while their own interests constitute valid factors in the decision-making. To favour themselves would thus not be a violation of the duty of loyalty. Only the duty of care would constrain them; they could be judged as to whether they were serving the overall corporation sufficiently well. As *Peoples* illustrated, it is relatively easy to take courses of action that both meet the duty of care by being "a reasonable business decision"²¹⁵³ and that primarily end up serving shareholder interests to the detriment of other groups. Barring a complete, clear, and enforceable overhaul of the system to guarantee that, in some determinable circumstances, other stakeholders prevail, forcing directors to balance various interests rather than merely permitting them to consider those factors might have limited effect. Letting investors take direct control of the corporation through unanimous shareholder agreements exacerbates (or at least brings out into the open) those problems by allowing for self-interest as a valid consideration.²¹⁵⁴

Limiting the board's powers without transferring them also conflicts with placing directors in the

shareholder agreements in companies with multiple share classes.

²¹⁴⁷ *Peoples*, *supra* note 809, pars. 34-39.

²¹⁴⁸ *Ibid*, par. 39.

²¹⁴⁹ *Ibid*, par. 39.

²¹⁵⁰ MacIntosh, *supra* note 2089, p. 266, argued that, if acting in the shareholder's interests was not automatically required of directors, then since the board are elected by them, making decisions that favour shareholders can be seen as self-interested, and thus would violate the duty of loyalty.

²¹⁵¹ See discussion earlier.

²¹⁵² Query, however, abuse of *whom*? The corporation, legally, but if the corporation's interests actually do include the directors', then advancing their interests may be acceptable and no abuse occurring.

²¹⁵³ *Peoples*, *supra* note 809, par. 68.

²¹⁵⁴ Allowing shareholders to fetter their discretion, as they currently can, makes this even more difficult. They could use that ability to bind themselves against any course of action that might harm their interests but benefit other stakeholders. This freedom would therefore have to either be qualified or removed.

role of mediators between stakeholder interests. It would again likely be impermissible for shareholders to explicitly prevent directors from favouring the interests of other groups; a unanimous shareholder agreement might still be able to contain a general restriction that forced the board to choose from amongst any set of equally valid options the one that most favoured investors. If the legal protection of stakeholder interests was sufficiently great, such a clause might nonetheless be seen as an attempt to circumvent the directors' statutory duties and thus impermissible. What remains viable are restrictions that do not explicitly refer to favouring shareholder interests, but have the same effect.²¹⁵⁵ As previously discussed, it would be difficult to enforce the duty of care against restrictions created before any problems arose, unless such restrictions automatically violate it. Any limitation on directors' powers has the potential to affect the interests of stakeholders, so one cannot prohibit restrictions on that basis alone unless one discards pre-made decisions entirely, but one could create a doctrine that restrictions on the board's authority whose intention or primary purpose was defeating stakeholder interests (in favour of shareholders) were impermissible attempts to negate the directors' legal duties.

5.(d) Duty Without Standing

One of the more peculiar applications of stakeholder theory is imposing upon corporations (and/or their directors) a duty to some group(s) of stakeholders, but not granting that particular group legal standing to bring suits.²¹⁵⁶ According to *Peoples*, this actually is the case with regard to the directors' *C.B.C.A.* duty of care, at least outside of Quebec.

In practice, identifying stakeholders as the beneficiaries of a duty that they lack the ability to enforce seems rather similar to a regime that is merely permissive of granting their interests consideration. Where the unanimous shareholder agreement is concerned, however, there is a minor difference. A permissive regime might allow for such discretion, depending upon how it was conceived, to be narrowed or erased. By contrast, if stakeholders are owed a statutory duty, even an unenforceable one, then presumably such a duty could not be superseded by a unanimous shareholder agreement, as discussed in the preceding subsection.

If shareholders transfer power to themselves, they are subject to the same duties that directors face, including the unenforceable ones. While it is doubtful that it was the legislative intent, a possible *ex*

²¹⁵⁵ For example, forcing the company to pay out retained earnings as dividends. This would prevent those funds being used to raise wages, improve environmental standards, *et cetera*.

²¹⁵⁶ Vanduzer, *supra* note 2092, pp. 248-252, was critical of the Supreme Court's position on standing to enforce the directors' duties, in part because the Court's proposed supplement of the oppression remedy had its own statutory limits on who may bring claims, but ultimately he concluded that standing to bring claims without an enforceable standard to base them on would be of little use.

post justification for this situation is similar to that of a permissive model;²¹⁵⁷ it might influence the corporation toward considering stakeholders without mandating it. The earlier discussion about the incentives shareholders and directors face in balancing the profitability of the corporation against other interests would apply.

5.(e) Statutory Compliance

In *BCE*, the Supreme Court of Canada established that ensuring statutory compliance was part of the duty of loyalty.²¹⁵⁸ The general principle behind that duty is that it identifies for whose benefit the directors must work; to prioritize the benefit of any other party instead, including but not limited to themselves, would be a violation of it. Thus, while the passage in *BCE* was ambiguous in some respects, its implication is that directors must prioritize statutory compliance over competing interests. Given that a derivative action to enforce the duty of loyalty would be a highly unlikely path for statutory enforcement, this would in practice be more likely to serve as a "shield" than a "sword", but it represents nonetheless an important principle: directors are expected to ensure statutory compliance first and foremost. Since legislation is, in at least some cases, designed to protect the interests of stakeholders, this is another avenue whereby the directors' duties are indirectly to them, not to profit-maximization for the shareholders' benefit.

This joins any number of statutory provisions that seek to hold the board directly accountable for the company's misdeeds, including the criminal law. Even one of the foremost advocates of the shareholder primacy, profit-seeking model of the corporation, Milton Friedman, acknowledged that there was a limitation on that goal: legal compliance.²¹⁵⁹ Despite this, firms do sometimes break the law and incur fines as if they view these penalties to be nothing more than the price of doing business. It is "rational" to violate statutes if the profits earned in so doing outweigh the costs. However distasteful this behaviour is, there are arguments to support it, much like there are in favour of "efficient" breaches of contracts. Firstly, if the penalties are correctly priced and the gains still outweigh them, then it actually is socially beneficial to violate the law, because the net benefit for all parties combined is positive.²¹⁶⁰ If the result is genuinely a net detriment to society, then the penalties were incorrectly priced and should have

²¹⁵⁷ Or a duty-to-consider one. See note 2137.

²¹⁵⁸ Iacobucci, *supra* note 2097, pp. 238-239, warned this could lead to overdeterrence, a critique based upon the possibility that a statute might conflict with the best interests of the corporation. My own analysis herein avoids that problem by making the two synonymous by definition.

²¹⁵⁹ In the famous quote, "So the question is, do corporate executives, provided they stay within the law, have responsibilities in their business activities other than to make as much money for their stockholders as possible? And my answer to that is, no they do not." (Milton Friedman, interview with John McClaughry, "Milton Friedman Responds" *Chemtech* (February 1974), at p. 72.)

²¹⁶⁰ Engel, *supra* note 2121, pp. 51-52, and generally.

been higher.²¹⁶¹ The counter-argument is that legal penalties cannot be made arbitrarily large, and further that the intent behind them is often not to create a precisely calculated offsetting cost but to actually prevent undesirable behaviour.²¹⁶² A second argument in favour of allowing companies to break the law if they are willing to pay the penalty is that an individual faced with such a choice would do so (were they the theoretical rationally self-interested actor), and thus corporations should not be prohibited from doing what a natural person could. The counter-argument is that the difficulties of achieving perfect legal compliance do not mean that no steps should be taken to encourage what compliance is possible; just because a human *might* break the law is no reason to allow a corporation to do so.

If the shareholders have transferred control to themselves, would they be more likely than directors to cause the company to violate statutes? They would face the same potential personal liabilities, which can be significant for some breaches but are minimal or nonexistent for others, yet these penalties may not be greater than the potential gains.²¹⁶³ Thus, if statutory compliance was truly made primary in the duty of loyalty and that duty were somehow enforced, it leads to a significant consequence. Failing to meet it would not be a permissible exercise of business judgment, nor even a demonstration of unacceptably poor decision-making (*i.e.* a violation of the duty of care); it would be the favouring of another interest over that of the corporation, in contravention of the duty of loyalty, and thus subject to one established element of that particular obligation, *the disgorgement of any profit realized in its violation*. That would lessen the financial incentive shareholders have to disregard statutes, although given imperfect enforcement, it would not eliminate it entirely. This might even place empowered investors into a worse position than the directors, although technically it shouldn't, since favouring *self-interest* could be easier to see as a violation of the duty of loyalty than placing third-party interests (as the shareholders technically are to the board) ahead of the beneficiary (the corporation, whose deemed interest here would be statutory compliance).

The question of whether profit-maximization would be more likely to motivate shareholders or directors to violate statutes is otherwise essentially the same as the earlier one about which group would be more prone to ignoring stakeholders in favour of revenue.²¹⁶⁴

²¹⁶¹ Ibid, pp. 44-47, dismissed the idea that the criminal law was intended to absolutely eliminate acts regardless of cost, but at p. 43 fn 141 he acknowledged a variety of reasons for legislative reluctance to set high fines.

²¹⁶² For contracts, such counter-arguments are not as readily made. The assumption of proponents of "efficient breach" that damages are an adequate substitute for performance can be better justified since they are, at least in theory, specifically set by a court to achieve that result. Even putting aside the judicial inability to achieve perfect outcomes at all times, there remains a problem when the contractual terms breached were ones designed to keep the corporation from engaging in risky endeavours, the violation of which have caused the company to become insolvent and therefore unable to pay damages.

²¹⁶³ And are always nonexistent for the corporation's contractual breaches, unless they have provided personal guarantees.

²¹⁶⁴ Moral and reputational costs for violating statutes might be seen as higher than for harming stakeholder interests, perhaps, but that applies to both directors and empowered shareholders. Regardless, the analysis of shareholder and director incentives for profitability is the same.

5.(f) Conclusion on Specific Stakeholder Models of the Directors' Duties

Stakeholder interests are included in the notional "corporation" to which directors owe their duties, as has become clear from recent Supreme Court cases. This does not cease to be true when a unanimous shareholder agreement empowers investors, and it is then the shareholders who bear responsibilities that at least permit, and possibly require, consideration of those groups. But there are reasons to be wary of such a scenario. If those duties permit consideration of stakeholders without mandating it, mandate it without granting them standing, or mandate it in a manner that will still *de facto* leave the outcome to the empowered shareholders' discretion, the outcome is likely to be the same: the shareholders will have greater incentive to prioritize their own interests.

It is not necessary to caricature investors as ruthlessly single-minded in the pursuit of their own profit for this to raise concerns. Indeed, it is likely that moral and reputational factors will occasionally lead them to behave well toward other groups. But they cannot be said to be anything resembling neutral mediators of the corporate interest, when among the groups whose potential gains and losses constitute valid considerations are they themselves.

The only interest which the law is currently effective at elevating above profit-maximization is statutory compliance. Incorporating this into the duty of loyalty, while initially counter-intuitive, makes it a component of the corporate interest that must take priority over competing considerations. Because this method has the virtues of both clarity and certainty, it would still be effective should shareholders assume control, at least to the extent that the statutes themselves are clear. Unfortunately, it would be difficult to extend this to any further protection of stakeholders, unless *specific* interests could be identified that should *always* take priority. So long as some degree of ambiguity or discretion remains as to what interests must be prioritized in what circumstances, and so long as there is judicial reluctance to second-guess corporate decision-making (the "business judgment rule"), empowered shareholders would remain free in practice to disregard agendas other than their own.

It is worth querying, however, whether directors themselves are any different. Unlike empowered investors, they are not allowed to pursue their collective self-interest (*qua* directors), but they are elected by shareholders, are frequently shareholders themselves, and are allowed to favour the interests of shareholders. Indeed, there is a legal tradition that they are *expected* to do so,²¹⁶⁵ from which stakeholder theory is a departure. By exploring the practical problems of asking empowered investors to consider other interests in addition to their own, we are also exposing the limitations of asking directors to consider

²¹⁶⁵ See *e.g.* MacPherson, *supra* note 2086, who at pp. 388-389 cited various authorities in support of the proposition that, prior to *Peoples*, "the weight of Canadian authority on the subject equated 'the best interests of the corporation' with 'the best interests of the shareholders collectively'" (p. 389).

stakeholders as well as shareholders. The next subsection expands upon this, going beyond the drawbacks of specific stakeholder-inclusive models of the duties of care and loyalty to the general conflict between the assumptions of stakeholder theory on the one hand and the unanimous shareholder agreement on the other.

5.(g) Stakeholder Theory Versus Unanimous Shareholder Agreements

The unanimous shareholder agreement does not mesh well with the Supreme Court's tentative steps toward including stakeholder theory in Canadian corporate law. The previous subsections illustrated how the specific stakeholder-driven elements of the Court's model of directors' duties might be rendered (even more) ineffective by the use of this tool. But the problems run deeper than the practical difficulties of reconciling two specific legal mechanisms; the unanimous shareholder agreement derives from an entire way of thinking about the corporation that is directly at odds with stakeholder theory. Nor is it unique in that; many facets of our law are based on a tacit assumption that the corporation exists to serve shareholders,²¹⁶⁶ not a conception of corporate interests that includes a variety of stakeholder concerns. The obviousness of the incentive empowered investors have to maximize profits regardless of the consequences for others only serves to bring out into the open the underlying conflicts between the legal recognition of stakeholder theory and the law's continuing tendencies toward shareholder primacy, conflicts which exist even for companies where no such agreements are in place.

The apparent justification for the unanimous shareholder agreement is the view that the corporation exists to serve investors. As such, the election of directors to run it is merely a convenient method whereby shareholders select agents to manage on their behalf, and such delegation is unnecessary if they (unanimously) agree to retain the power for themselves. Similarly, proceeding from the premise that directors' powers are delegated from them, when the shareholders wish to set specific limits to those powers, they may do so, and when they wish to provide a specific order to the directors, they may do so, and when they wish to retain some powers but delegate others, they may do so, and so on and so forth.

By contrast, in the strongest form of stakeholder theory, the shareholders' place in the corporation is not an especially central one; they are merely one constituency whose interests must be balanced against those of others. The list of potential stakeholder groups is quite large.²¹⁶⁷ One definition of stakeholder is

²¹⁶⁶ It is shareholders who have the power to elect and remove the board, confirm directors' self-interested acts, amend the articles, approve "fundamental changes", *et cetera*.

²¹⁶⁷ There has been criticism (*e.g.* Alan Hyde, "Ownership, Contract, and Politics in the Protection of Employees Against Risk" (1993) 43 U. Toronto L.J. 721, at pp. 721-722, 726-728) that, while the interests of these groups might separately warrant legal recognition, tying them together into one general "stakeholder" class rather than analyzing each claim separately is of relatively little utility. If the rights each group are entitled to are distinct and presumably arise from the natures of their respective relationships with the corporation, then the term "stakeholder" has no practical legal significance and may result in confusion. It potentially also creates a sense of equivalence that could be objectionable if one

anyone the corporation can affect, anyone who has a proximate interest in its decisions, who is either likely or certain to draw a benefit from the company or be harmed by it.²¹⁶⁸ Another definition emphasizes groups who have contributed to the corporation in some way,²¹⁶⁹ and their status is therefore based not on a gratuitous moral obligation but on the fairness of some *quid pro quo*.

Using either definition, shareholders are simply one group of stakeholders among many. They supplied capital on equity terms,²¹⁷⁰ just as others supplied debt capital, labour, tax breaks, clientele, *et cetera*. They look to it for dividends and capital gains, just as others do for wages, repayment with interest, goods and services, the avoidance of pollution, *et cetera*. Shareholders should therefore have no special ability to assume further powers nor otherwise limit the authority of the directors who run the corporation on behalf of all its stakeholders. There is no provision, after all, for a "unanimous employee agreement" nor a "unanimous creditor agreement". But this objection raises a parallel consideration; if one accepts stakeholder theory, why are shareholders the only group who elect the board? If they are but one constituency and the duties of directors are not owed to them, why should shareholders have the unique ability to select those who wield ultimate power in the corporation?

There is an argument that, even accepting that other groups have a legitimate "stake" in corporate governance, nevertheless the aims of all stakeholders are best achieved when the corporation is successful

believes that some would-be stakeholders are entitled to greater protection than others. Nonetheless, there is utility in a general term for groups who may have rights against the corporation, even if such rights are varied and thus the term does not represent a single coherent doctrine, but a collection of separate ones.

²¹⁶⁸ The terminology for this definition is variable. *e.g.* Puri and Borok, *supra* note 2137, referred to this as a general definition of "stakeholder"; Vanduzer, *supra* note 2092, pp. 240-241, appears to have treated this as the implicit definition of stakeholder. Jeffrey Bone, "Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?" (2011) 24 *Can. J. L. & Jurisprudence* 277, at pp. 290-293 called this "communitarian" theory, which he considered a contrast to stakeholder theory; Ronald Daniels, "Stakeholders and Takeovers: Can Contractarianism Be Compassionate?" (1993) 43 *U. Toronto L.J.* 721, at pp. 329-331 called it "communitarian protectionism"; Kuras, *supra* note 2115, p. 306 defined "communitarian" corporate social responsibility in essentially this way. Adams and Matheson, *supra* note 2141, pp. 1108-1109 referred to this as the "ethical responsibility" of the corporation.

²¹⁶⁹ Again, while this concept is in common usage, terminology or the lack thereof is not entirely standardized. *e.g.* Bone, *supra* note 2168, at pp. 287-288 defined stakeholders in this manner, saying that "stakeholder theory" is a less shareholder-focussed offshoot of contractarian models of the corporation; Adams and Matheson, *supra* note 2141, p. 1110 referred to this; Roy Jones, "The Stakeholder Approach to Corporate Governance: A Wider Perspective" (1999), OECD, USAID and World Bank Joint Conference on Corporate Governance in Russia, online: www.corp-gov.ru/projects/1/jones.pdf, at p. 3 defined stakeholders as "those who have contributed firm specific risk-bearing investments" of any sort; Leung, *supra* note 2115, p. 589 defined stakeholders as those who have contributed to corporations in a manner that is not legally recognized. Puri and Borok, *supra* note 2137, described employees as "investors" of human capital, ones who are especially undiversified compared to other stakeholders. Daniels, *supra* note 2168, pp. 331-340 called these "implicit contracts", a phrase that other authors have used more narrowly to refer to the expectations inherent in a long-term employment relationship; he challenged the position that such "implicit contracts" should be honoured in the takeover context by pointing out that they can be violated during normal operations, but the obvious answer to this critique would be to protect them elsewhere as well.

in some generic sense, which in turn is often taken to mean that its profits are maximized.²¹⁷¹ In general, shareholders are the only group with a theoretically unlimited interest in maximizing the corporation's wealth, and according to the simplistic but useful assumptions of economic rationality, they are thus the most industrious in the pursuit of profitability. Therefore, it would make sense that directors be accountable to shareholders, both through the election process and the enforcement of their duties, because that group has the strongest incentive to monitor their performance towards that end.²¹⁷² For the same reason, allowing investors to affect corporate decision-making or even assume complete control of the company through a unanimous shareholder agreement would be even more efficient at maximizing wealth, since the party with the greatest incentive would be making the decisions with no agency costs. This helps insure that all parties with claims ahead of the shareholders, *i.e.* all creditors, are paid off to the greatest degree possible, that shareholders themselves profit to the greatest degree possible, and that the business is as economically productive as possible, bringing the most benefits at the least cost to society at large through mutually beneficial transactions with external parties.²¹⁷³ Assuming one accepts this line of reasoning,²¹⁷⁴ it explains why, even if stakeholder interests are recognized, directors should still be primarily accountable to shareholders and why investors should be able to take power through a unanimous shareholder agreement.

But that treats profit maximization as the sole or at least primary goal of corporations. Stakeholder theory offers several critiques of this premise.²¹⁷⁵ One is that the argument that increasing residual wealth is a rising tide to lift all stakeholder boats relies upon the simplistic belief that they can all be treated as "creditors" who desire only to be repaid for existing debts. The harms that many stakeholders

²¹⁷⁰ See the explanation in Chapter Two comparing equity and debt financing.

²¹⁷¹ *e.g.* Vanduzer, *supra* note 2092, p. 239.

²¹⁷² Macey and Miller, *supra* note 2116, pp. 416-419, argued that shareholders, being residual claimants, are the group least able (in a theoretical sense) to negotiate complete contracts to protect their rights, and it is for that reason that they instead are the beneficiaries of the directors' duties.

²¹⁷³ The last item invokes some further contested ideas about the benefits of the free market that may fail in practice for a variety of reasons.

²¹⁷⁴ It is, of course, a highly contested claim; *e.g.* Leung, *supra* note 2115, p. 599 summarized but rejected this logic.

²¹⁷⁵ Even accepting profit maximization for the residual beneficiary as the primary goal of corporate activity, or at least as an efficient proxy for the goal of productive economic activity that is assumed to benefit all stakeholders, one must consider that it is arbitrary that shareholders receive the unlimited surplus wealth of the corporation. This was, of course, their understanding when they invested, and- assuming no redistributive goals- it would be problematic and unfair to change it without compensation. But, as a hypothetical, one could limit equity investors' share of the increased wealth to perhaps a fivefold increase over their original investment every year, with any surplus beyond that to be divided evenly amongst the employees of the company. It would then be the employees who would have the incentive to foster unlimited corporate wealth. This is a radical notion, and no doubt some would object that no one would invest under such onerous conditions and the entire capitalist system would shortly collapse. But if the *only* reason for shareholder primacy were to insure that there existed a group with unlimited profit potential whose interests could stand in for those of the corporation, then such an alternative arrangement would

seek to avert are not unpaid debts. They might, for example, want to avoid the severance or radical restructuring of their relationship with the corporation.²¹⁷⁶ Granted, a company with extra funds is in a better position to continue affording the costs of its existing relationships, but the two goals are not always compatible; the increased profitability may be the result of just such a severance or restructuring. Similarly, the corporation may be deriving profits at the direct expense of stakeholders, by causing harms for which it will not be fully compensating the aggrieved parties. Even *if* the company's profits are greater than the harm done,²¹⁷⁷ of which there is no guarantee, there might be no legal avenue for redress or the transaction costs of obtaining it might be too great.²¹⁷⁸ Further, even if compensated, not everyone finds money an adequate answer for the wrongs they have suffered.²¹⁷⁹

Maximizing residual wealth may also encourage courses of actions with high risks but high potential rewards. Diversified shareholders would favour that, but individuals with less diversified interests would not. Unless the corporation is already causing inadequately compensated harm, *no* other stakeholder group receives an obvious benefit from a course of action likely to cause the company to go bankrupt or drastically curtail its operations if a risk fails to pan out; it renders the business unable either to maintain its existing relationships or to pay for harms it causes, ensuring the same two problems previously discussed in the context of solvent companies.²¹⁸⁰ Even a "diversified" stakeholder- say, a creditor who has loaned funds to multiple companies or a customer who regularly purchases substitutable products from multiple sellers- appears to have more to lose than to gain from half the corporations with which they associate doing extremely well and the other half going broke.²¹⁸¹ But a shareholder with multiple investments would rather that half become worthless and half triple in size than that all remain stable.

There are, of course, many potential benefits to the pursuit of profit. Truly wasteful activities can be eliminated and socially beneficial ones discovered to take their place, all because of it. At best, innovation and prosperity are the result. But it is a mistake to confuse maximizing residual wealth in general with its more positive side effects. The result is often courses of action which are "efficient" only in that they are cheaper. Even aside from the most obvious harms- pollution, unsafe products, exploitation of labour, *et cetera*- the smallest effects might be pernicious to stakeholders. Cutting back a customer

present no difficulty.

²¹⁷⁶ A common example is workers, whose interest in continued employment extends beyond their current contract, let alone unpaid wages owing, and may include implicit promises of a long-term wage arc. See *e.g.* Singer, *supra* note 2107, pp. 480-481 and generally; Stone, *supra* note 153, pp.364-369 and generally; Robert Howse and Michael J. Trebilcock, "Protecting the Employment Bargain" (1993) 43 U. Toronto L.J. 751, at p. 755 and generally.

²¹⁷⁷ *i.e.* it is Kaldor-Hicks efficient.

²¹⁷⁸ See generally Coase, *supra* note 1137.

²¹⁷⁹ A problem not unique to this corner of the legal system, of course.

²¹⁸⁰ Howse and Trebilcock, *supra* note 2176, pp. 756-757; Macey and Miller, *supra* note 2116, pp. 408-409 worked through some mathematical examples illustrating how the risks and returns of a given corporate act create conflicting preferences for shareholders and creditors.

service department could have no appreciable effect on sales, harming both customers and (former) employees while raising returns for shareholders.

Incentives for the corporation to harm stakeholder groups in the pursuit of profit exist even when no unanimous shareholder agreement is in place. Directors are elected by shareholders, after all, and on that basis alone are likely to look out for their interests.²¹⁸² But the position of the Supreme Court of Canada is that nonetheless the board might have sufficient impartiality to consider other stakeholders. The unanimous shareholder agreement, however, makes it that much more difficult to believe that the interests of the corporation might be held distinct from those of its investors. In practice, of course, empowered shareholders will not behave with ruthless greed at every turn. But it strains credibility that they are anything resembling unbiased arbiters as between *their own self-interest* and the interests of other stakeholders, absent far more compelling legal protections for those groups than currently found in Canadian law. The unanimous shareholder agreement is essentially legislative recognition that shareholders have the right to cause the corporation to promote their own agenda ahead of other stakeholders if they so choose.²¹⁸³

A unanimous shareholder agreement is, for practical reasons, likely to be found only in a small corporation.²¹⁸⁴ But the *C.B.C.A.*, all territorial, and most provincial equivalents place no such limitation. Assuming the statutes can be taken at face value, the possibility of entering into a unanimous shareholder agreement *and the theory of the corporation it represents* apply to all federal and territorial and most provincial corporations. The existence of this tool is a legislative endorsement for the understanding that corporate power derives from the shareholders. This is incompatible with stakeholder theory, where equity investors are just one constituency.

When courts consider granting recognition to stakeholder interests, they usually do not make

²¹⁸¹ Unless the creditor can put in place exaggerated risk premiums.

²¹⁸² Singer, *supra* note 2107, p. 502; Leung, *supra* note 2115, pp. 617-618; MacIntosh, *supra* note 2089, p. 256. Borok, *supra* note 2114, advocating a stakeholder-friendly definition of "best interests of the corporation", pointed out that that the shareholders' ability to elect directors would allow them to retain a "priority position", although curiously framed that as a defence of his proposal rather than a flaw in it. O'Connor, *supra* note 2107, p. 1234 made a similar point, that large amounts of unprofitable stakeholder-friendly activity render a firm vulnerable to takeover, which in turn usually leads to replacement of the board, thus motivating them to limit such behaviour in favour of profitability.

²¹⁸³ Furthermore, why should shareholders be free to fetter their discretion if directors are not? As discussed earlier, this may have been intended to allow for the creation of pre-made decisions, following the commentators' debate, but the actual provision went substantially beyond that and could effectively allow empowered shareholders to avoid the duties of care and loyalty. Arguably, imposing lesser duties on them than directors suggests a legislative perception that there is less need for them, which in turn might imply that those were duties designed to protect investors and thus they are not as necessary when shareholders are directly empowered, despite the Supreme Court's decisions to the contrary.

²¹⁸⁴ More precisely, a corporation with a small number of shareholders. Even a private company with few shareholders can still be a large firm, involving many individuals, numerous assets, and significant operations.

reference to the theoretical basis of the unanimous shareholder agreement, a facet of corporate law that likely seems irrelevant without such an agreement in place, nor *vice versa*.²¹⁸⁵ There are some limited exceptions to this. In *J.L. Deslières et Fils inc. c. Colabor inc.*,²¹⁸⁶ Trahan J.C.S. stated:

48 Il est clair, à la lecture des articles 102 et 146(2) de la *Loi*, qu'une telle convention restreint les pouvoirs des administrateurs de gérer les affaires de la société. Par une convention unanime d'actionnaires, ceux-ci "se protègent" pour l'avenir en limitant le droit des administrateurs d'agir dans le seul intérêt de la société: ils doivent aussi tenir compte de l'intérêt de tous les actionnaires. De telles conventions obligent donc les administrateurs et les actionnaires de reconnaître le droit à la dissidence d'un ou de plusieurs des actionnaires.²¹⁸⁷

The unanimous shareholder agreement was here openly described as a means of forcing directors to look beyond the interests of the company, to those of the shareholders. In context, that was probably only meant as an affirmation that that method could be used to protect the rights of minority investors, not to assert the primacy of shareholders over other stakeholders. Nonetheless, the line is easily blurred. Terms meant to protect the minority from the majority might easily have secondary costs upon other groups. If unanimous shareholder agreements had the effect Trahan J.C.S. set out, superseding the best interests of the corporation as a whole, they could supplant consideration of stakeholders.

The reported case that comes the closest to directly placing a unanimous shareholder agreement into conflict with stakeholder rights is *Casurina Ltd. Partnership v. Rio Algom Ltd.*²¹⁸⁸ A parent company created an agreement governing a subsidiary in order to shift assets from it to elsewhere in the corporate group; the directors of the subsidiary insisted upon that mechanism in order ensure that any liability rested with the parent company and not them personally.²¹⁸⁹ This act was found to be oppressive of the owners of convertible debentures issued by the subsidiary.²¹⁹⁰ Although not the determinative factor, Spence J. stated

²¹⁸⁵ In *Indalex*, *supra* note 1775, where such an agreement actually did exist at one point, nothing was made of it by any of the judges.

²¹⁸⁶ *J.L. Deslières & Fils inc. c. Colabor inc.*, 2003 CarswellQue 1703, J.E. 2003-1458, REJB 2003-45273 (C.S. Que. Jul 07, 2003) concerned whether a shareholder had, as part of purchasing additional shares, agreed to be party to an agreement to terminate the existing unanimous shareholder agreement; it was found that he hadn't.

²¹⁸⁷ My translation: "It is clear, from reading sections 102 and 146(2), that such an agreement restricts the powers of the directors to manage the affairs of the company. Through a unanimous shareholder agreement, the shareholders protect themselves by limiting the right of the directors to act in the sole interest of the company: they must also bear in mind the interests of all the shareholders. Such agreements therefore oblige the directors and the shareholders to remember the right to dissent of one or more shareholders."

²¹⁸⁸ *Casurina*, *supra* note 1209. The document was referred to as a "unanimous shareholder resolution". These issues were not dealt with in the appeal, *Casurina Ltd. Partnership v. Rio Algom Ltd.*, 181 O.A.C. 19, 2004 CarswellOnt 180, 40 B.L.R. (3d) 112, [2004] O.J. No. 177 (Ont. C.A. Jan 21, 2004).

²¹⁸⁹ *Casurina*, *supra* note 1209, par. 83.

²¹⁹⁰ *Ibid*, par. 213. Despite this conclusion, due to the terms of the debenture agreement, they were found to have waived the right to bring the claim (par. 239).

that the use of a unanimous shareholder agreement rather than obtaining board approval (which might have required alleviating the directors' concerns about the transaction) was among the elements that raised questions as to whether the parent company was disregarding the interests of the debenture-holders.²¹⁹¹

Both of these cases alluded to, and *Casurina* in particular demonstrated, the tension that exists in Canadian corporate law between the unanimous shareholder agreement and the role of directors as guardians of the corporation's own interests. The former allows shareholders (and shareholders alone²¹⁹²) to impose their will upon the company, while the latter increasingly assumes some element of stakeholder theory. Even in corporations without such an agreement in place, the theoretical implications of this legal tool cast a shadow. Although the existence of unanimous shareholder agreements does not preclude some legal recognition for stakeholders- the law already includes contractual rights, labour law rights, oppression remedy rights, *et cetera*, and additional protections could easily be added to this list- it does affirm the centrality of investors as the source of corporate power, which is incompatible with the strong form of stakeholder theory that equalizes shareholders and other groups.

6. Conclusion

At first glance, allowing investors to restrict directors' powers through a unanimous shareholder agreement, even transferring those powers to themselves, might seem straightforward. They, after all, elect the board, and so already exert indirect power over the company. But directors are not merely a means through which shareholders control the corporation. They are bound by a complex set of legal duties and liabilities that serve a variety of purposes, and these must be given at least as much respect as empowering shareholders. Legislative bodies have recognized this by providing that the duties of directors would be transferred along with their powers. This too might initially seem straightforward; it is anything but. It is an attempt to combine legal principles that were developed in the context of the statutory default corporate power structure with a tool designed to rearrange that structure.

The sheer versatility of the unanimous shareholder agreement's ability to restrict directors has many advantages, but attempting to reconcile that flexibility with the transfer of responsibilities is no easy task, and the statute provides little guidance. On the one hand, possible arrangements include the splitting of powers between shareholders and directors, the establishment of a "supervisory" relationship between the two, or making specific decisions or placing restrictions upon the board that do not transfer ongoing authority. On the other, directors can face liabilities arising from their actions, their failure to act, or simply

²¹⁹¹ Ibid, pars. 198-201.

²¹⁹² Non-shareholders may be parties to the creation of a unanimous shareholder agreement, but their participation is not required, and no other constituency has the ability to create such an instrument without the participation of all of the shareholders.

by virtue of their offices. The outcomes from combining the possible factors are uncertain at best, and while the reported case law does not indicate that this is causing widespread problems, it is a deeply unsatisfactory situation for the theorist.

Applying the principle that liability only serves its purpose when attached to the relevant decision-maker, I analyzed a variety of scenarios and made recommendations as to how they might be handled. Whatever merits or flaws my specific suggestions have, the result is both complex and imperfect. What this illustrates, more than anything, is that directors' liability and unanimous shareholder agreements are both *complicated*, and the provision that currently attempts to merge them borders on the glib in its failure to engage with that.

Pre-made decisions in the unanimous shareholder agreement are particularly problematic. While these have been the source of a lengthy, and possibly misguided, discussion in the literature centring on the prohibition on "fettering discretion", that can easily be solved by re-conceiving of them simply as restrictions on the directors with no corresponding empowerment of shareholders. That does, however, mean promoting a contractual model of the corporation (wherein such decisions can be included in the very essence of the company) over anything even remotely resembling the default model found in the statute (which assumes identifiable decision-makers). This in turn leaves almost unsolvable certain questions of liability, as neither the directors, the original shareholders, nor the current shareholders seem good candidates for those responsibilities.

The related controversy on whether empowered shareholders should inherit the duties of care and loyalty seems quite easily solved by recognizing that these obligations have a continuing function in ensuring that the investors manage the company for, at the very least, their collective benefit. That conclusion is only strengthened by the inclusion of stakeholder theory into these responsibilities, as the Supreme Court of Canada has recently, if tepidly, done. But analysis reveals that such an obligation to consider stakeholders might amount to little in the face of shareholders' *de facto* freedom to favour themselves over other groups. Only a form of stakeholder rights far stronger than has been adopted to date could overcome that, but that would require a scrutiny of corporate decisions that is not only a departure from tradition, it would likely prove unworkable unless these groups' interests were granted a priority akin to the various statutes that currently set the boundaries within which directors exercise their business judgment. The difficulties of combining unanimous shareholder agreements with stakeholder theory only serve to highlight an underlying issue: the problem of reconciling this theory with the rest of Canadian corporate law, which still largely rests upon implied notions of shareholder primacy, manifested among other ways in their unique ability to elect directors.

While unanimous shareholder agreements are a niche topic, restricted in practice to only a tiny subset of companies, this is perhaps their greatest significance to our understanding of the law generally: they represent a "stress test" of sorts for it. They illustrate the ways in which shareholder primacy

continues to be a significant theme, one which comes into conflict with stakeholder theory or even general notions of corporate accountability. They demonstrate that a contractual model that freely rearranges corporate decision-making powers would be problematic for the controls that society has imposed upon companies, particularly through the placement of duties and liabilities upon directors, but also through the statutory obligations placed upon the firm itself to which the board are tasked with making the company adhere. To solve these problems, if indeed they can be solved, requires a thorough consideration of the general bases of directors' liability, the function that their duties serve in safeguarding shareholders, the role that stakeholder theory should play in corporate decisions, and the purpose of unanimous shareholder agreements themselves. Just as a clear understanding of the underlying principles is necessary to answer questions about the transfer of directors' responsibilities when their powers are restricted, so too can understanding the way that unanimous shareholder agreements work (or should work) tell us much about the larger principles they reflect.

Chapter 6: Conclusion

The unanimous shareholder agreement is a formidable tool. It allows shareholders to restrict or assume the authority of the directors, potentially enabling them to exert direct control over corporate decision-making. This stands in contrast to the traditional power structure of the corporation, a form of representative democracy wherein the board are entrusted with ultimate authority over the business and affairs of the company, subject to legal duties and the threat of replacement, but not to limitation or override by investors.

For such a major innovation, the statutory provisions creating the unanimous shareholder agreement are notoriously vague in key respects. Throughout this dissertation, issues arising from that ambiguity have been considered, ranging from whether amendments must be unanimous to how the responsibilities of directors should be relocated when their powers are reconfigured in complex ways. Confronting these uncertainties has often required a fresh examination of the larger legal principles underlying them. This is not a one-way process; the interaction between the unanimous shareholder agreement and other aspects of corporate law can tell us as much about the latter as the former. The new situations this tool can create and the questions it raises form a sort of "stress test", exposing new dimensions in everything from the definition of "shareholder" to the purpose of the oppression remedy to the obstacles facing stakeholder theory. One cannot understand how the unanimous shareholder agreement fits into corporate law without understanding the corporation itself. And perhaps one cannot understand the corporation without understanding the unanimous shareholder agreement.²¹⁹³

Nowhere is this more apparent than in the one question that has recurred most often throughout this dissertation, seeming to underlie or affect almost every other dilemma encountered. Does the inclusion of the unanimous shareholder agreement in Canadian law represent a shift away from the corporation as an entity whose existence is derived from and defined by a statutory framework, toward the "nexus of contracts" theory that equates the company with a web of voluntary agreements? The unanimous shareholder agreement obviously adds another level of customizability to the corporation. However significant that option is, it is hardly unprecedented. The statute is full of ways that the corporation can be tailored. But there is clearly something about this legal tool- whether it is the contractual mechanism through which it is enacted or the fundamental importance of rearranging the corporate power structure itself- that has seen it both lauded and resisted as exceptional, *sui generis* in its capabilities and potential. It has been claimed that the unanimous shareholder agreement represents "a shareholder-chosen contractual

²¹⁹³ In the jurisdictions where it exists.

model of corporate governance formerly absent from Canadian law".²¹⁹⁴ If true, this would have significance reaching far beyond the relatively small portion of companies that have such a document actually in place. Our understanding of what a corporation *is* would have to change to accommodate this development.

The "nexus of contracts" is a way of understanding corporations in the abstract, not a suggestion that they are literally composed of contracts. Despite the claims of its proponents, the theory fails to adequately explain all of the entity's quintessential features, in particular limited liability. The statutes do not merely facilitate a complex web of notional contracts; they grant, by concession, a fundamental element not otherwise available. Unless that trait is removed, the corporation can never truly be reducible to contracts, even hypothetical ones. Notwithstanding the flaws in their metaphor, some advocates of the theory argue that this allegedly "contractual" nature means that the corporate structure should be far more malleable than it traditionally has been. It is this prescriptive vision of an almost entirely renegotiable "contractual" corporation that is in conflict with the interpretation of it as an entity defined by an often rigid statutory framework.

Does the unanimous shareholder agreement represent a radical change in Canadian corporate law, an embrace of that "nexus of contracts" paradigm?

No.

The creation of the unanimous shareholder agreement is obviously a shift toward a corporation *more* based upon the common preferences of its specific investors and less upon a mandatory form set out in advance by the legislature. The original justification for this tool also does seem to have been influenced by a conception of the corporation roughly in line with the axioms of the "nexus of contracts" theory, and it can legitimately be seen as having moved the law a step in that direction. But the unanimous shareholder agreement, as it currently exists, is a far cry from allowing investors to freely negotiate the corporate arrangement. These documents can do more than just restrict the powers of directors, but they can only deviate from the default corporate structure in limited ways. The recommendations of some commentators that this tool be expanded far beyond its current capabilities remain nothing more than dreams.

The reception that these agreements have had in the courts further emphasizes that Canadian law is far from accepting of the "nexus of contracts" theory. Although judges have often strictly interpreted the distinctly contractual (and anomalous for corporate law) unanimity requirement, the effect has been to avoid facilitating the alteration of the corporate structure. This is reflected in the similar inclination among the judiciary- including the Supreme Court of Canada- to enforce the statutory criterion that a unanimous shareholder agreement must restrict the directors in order to be valid, and in extreme cases to narrowly define what restrictions are acceptable. That is consistent with it being a tool included in the legislative framework for a specific purpose, but runs counter to treating it as the manifestation of a freely

²¹⁹⁴ Disney, *supra* note 9, p. 118.

renegotiable corporation.

The enforcement of unanimous shareholder agreements further demonstrates a collective ambivalence in the judiciary toward them. Some cases do apply the "corporate constitutional" model, wherein the agreement truly reshapes the company's power structure and removes authority from the directors. While this method does not require a "nexus of contracts" understanding to function, it is compatible with that theory. It co-exists, however, with three other approaches, which reject or ignore the possibility that the unanimous shareholder agreement can cause a fundamental rearrangement of the corporation. The contractual model of enforcement externalizes the agreement, classifying it as a contract existing alongside the entity, while the directors' duties and oppression remedy methods integrate unanimous shareholder agreements into pre-existing corporate rights and remedies. Despite the wording of the legislation, then, there is not even legal consensus that the restrictions in these documents genuinely remove power from the board. This, more than anything, indicates the entrenched judicial resistance to the idea that a Canadian corporation is nothing but a "nexus of contracts", its fundamental terms renegotiable.

The transfer of responsibilities that accompanies a unanimous shareholder agreement also reveals the problems that arise when these documents interact with a legal framework that remains largely premised on the default corporate form. Unusual power arrangements create unclear and sometimes unsolvable questions of liability. Although a shareholder primacy conception of the directors' duties of care and loyalty indicates that it would be beneficial if they continued to bind empowered shareholders- a further refutation of the totally renegotiable corporation- the inclusion of stakeholder interests complicates matters considerably. This recent trend in Canadian law, supported by the Supreme Court, is fundamentally at odds with a tool designed to let investors exert direct control over a company in pursuit of their own ends. (Realistically, however, this might be no more problematic than expecting shareholder-elected directors to give any real consideration to the interests of other groups.) The law is already being stretched, perhaps past the breaking point, to accommodate even this degree of corporate flexibility.

The unanimous shareholder agreement allows investors to affect various aspects of the company's structure, most notably by restricting the power of the directors. But the ability of these instruments to alter the corporation is limited, has faced resistance from the judiciary, and has caused as yet unresolved problems in its interaction with other legal principles. While some positions consistent with a "nexus of contracts" interpretation of the unanimous shareholder agreement have merit- I endorsed the corporate constitutional approach to enforcement on other grounds, and the unanimity requirement may also be justifiable- on the whole, the unanimous shareholder agreement can and should be treated as a tool within the statutory entity framework. Its inclusion in the *C.B.C.A.* and various provincial and territorial equivalents does not indicate that Canadian corporate law now runs on "nexus of contracts" principles.

The unanimous shareholder agreement has significant potential to affect corporate decision-making in this country. It can allow for myriad variations of companies' default power structures:

transferring authority totally to investors, giving them only partial or supervisory power, or allowing them to set out specific pre-made decisions. The goals that empowered shareholders could then pursue range from increased profitability to greater corporate social responsibility. To an extent, this is already occurring; the cases discussed in earlier chapters illustrate some of the ways that this tool is currently being used. Unfortunately, legal confusion still surrounds the unanimous shareholder agreement and may be preventing its possibilities from being fully realized. It is hoped that this dissertation has helped shed light on the many uncertainties plaguing these agreements. In time, the law may evolve, to clarify their technical workings and guiding principles. Only then will the unanimous shareholder agreement achieve its full maturity as a component of Canadian corporate law.

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