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Practice Material

Business: Company

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BUSINESS: COMPANY

CONTENTS

ORGANIZATION OF A BUSINESS

INCORPORATION PROCEDURES

SHARES

SHAREHOLDERS' RIGHTS AND REMEDIES

SHAREHOLDERS' AGREEMENTS

APPENDICES: *BCA* FORMS AND PRECEDENTS-- *NOT AVAILABLE IN ONLINE VERSION*

EXTRAPROVINCIAL COMPANIES

CANADA BUSINESS CORPORATIONS ACT

NOT-FOR-PROFIT ORGANIZATIONS

Chapter 1

Organization of a Business[1]

[§1.01] Introduction to These Materials

The *Practice Material: Business: Company* deals with corporate law, or the law that applies when you are creating, managing, holding shares in, or reorganizing, altering or dissolving a company. These materials provide entry-level practitioners with an overview of common issues and procedures in corporate law, but they do not cover advanced practice in this area.

The first chapter discusses different ways of organizing a business. It provides a broad overview of corporate structures, many of which are addressed in further detail in the later chapters. The second chapter covers procedures for incorporating a company in British Columbia. The next chapters cover key topics in operating a BC company: governance, shares, finance, ordinary and special procedures, and dissolution. Later chapters deal with shareholder issues that could arise, and cover remedies and shareholders agreements. The final chapters address federal companies and not-for-profit organizations.

The primary statute of note in dealing with BC companies is the *Business Corporations Act*, S.B.C. 2002, c. 57, as amended. These chapters refer to it as the "*BCA*," or the "*Business Corporations Act*," or simply the "Act." References to the "Regulation" are references to the *Business Corporations Regulation*, B.C. Reg. 65/2004, as amended. References to the "registrar" are to the Registrar of Companies under the *BCA*. References to the "*CBCA*" are to the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as amended.

This chapter and most of the following chapters of the *Practice Material: Business: Company* focus on the *BCA*. When it came into force in March 2004 it introduced some significant changes in corporate law in BC, which to that time had been governed by the *Company Act*, R.S.B.C. 1996, c. 62. These materials use some terms that recognize a history of transition in corporate law in BC. In these materials and in practice in this area there continue to be references to "pre-existing companies," which means companies incorporated under any of the BC corporate statutes that preceded the *BCA*. Also, several defined terms in the *BCA* reference or include terms from the former act (the *Company Act*). For example, the defined term "memorandum" in the *BCA*, s. 1 references a constating document that was required under the *Company Act* but is no longer used under the *BCA*. (A "constating document" is a document that forms part of the organization's constitution, brings it into existence, and defines its essential character. Such documents are sometimes called "charter" documents. They include, in respect of companies, articles and unanimous shareholder agreements, and in respect of partnerships, partnership agreements). In considering the governance of pre-existing companies that started operating before the *BCA* came into force, practitioners might need to refer to the company's memorandum, instead of its notice of articles, which is the comparable document under the *BCA*.

This *Practice Material: Business: Company* provides some precedents, including articles of incorporation and a sample shareholders agreement. For checklists on incorporation procedures, partnership agreements, shareholders' agreements, and other business law topics, refer to the *Practice Checklists Manual* on the Law Society's website (www.lawsociety.bc.ca). Also see the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC), and there is a list of further resources at the end of this chapter.

[§1.02] The Unstructured Business

Many people carry on a business without any formal legal organization. If a person carries on business alone without formal organization, the business is called a sole proprietorship.

If two or more people are carrying on a business but have not turned their minds to formal organization, they will probably be considered, at law, a general partnership. The *Partnership Act*, R.S.B.C. 1996, c. 348 (the "*Partnership Act*") defines partnership as "the relation which subsists between persons carrying on business in common with a view of profit" (s. 2). A general partnership, as defined in the *Partnership Act*, is "a partnership that (a) has British Columbia as its governing jurisdiction, and (b) is neither a limited partnership nor a limited liability partnership" (s. 1). People carrying on a business together may not be aware that they are doing so as a general partnership, and may have no formal agreement; nonetheless, the consequences of carrying on business in partnership with another person can be significant, as discussed further below.

There is a body of case law concerned with determining whether or not people are in partnership. Generally, the test is related to the law of agency. If individuals carry on a business as agent for, or on behalf of, one another, they will be partners (this test is reflected in s. 7 of the *Partnership Act*). Section 4 of the *Partnership Act* pro-

[1] **Darcy M. Toy** and **Chris Roine** (for Indigenous law content), Borden Ladner Gervais LLP, Vancouver, kindly revised this chapter in February 2023. Previously revised by Doug G. Copland (2021); Grant Foster (2019); Jennifer MacGregor-Greer (2016); Jason Harris (2011); Brock H. Smith (2004 and 2005); Darwin Hanna (for Indigenous law content, in 2003); Robert J. Fenton (1994); Jennifer A. McCarron (1996); and John D. Montgomery (1993).

vides guidelines for deciding whether or not there is a partnership. The most important guideline is that a person who receives a share of the profits of the business will be treated as a partner in the business, absent evidence to the contrary (s. 4(c)).

[§1.03] Choosing a Business Structure

Although a person may be a sole proprietor (or two or more people may be partners) without appreciating that fact, they may also deliberately select one of the many other forms of business organization. They may decide to form a business corporation, under either the federal or a provincial corporate statute; some may decide to form a limited partnership or a limited liability partnership.

Most clients are interested in achieving three objectives:

- limited liability;
- optimal tax position; and
- control of all major decisions.

In most cases, achieving one objective requires compromises to another objective.

[§1.04] Sole Proprietorship

Generally, the sole proprietorship is the simplest form of business organization. It is only suitable for someone who is the sole owner carrying on a business (perhaps alone, or perhaps with employees). It is not suitable if other people expect to participate in the ownership or governance of the business.

There are potential advantages of a sole proprietorship:

- it is inexpensive to set up;
- generally speaking, only the proprietor has the ability to bind the business (although in certain circumstances, employees and other individuals who act as agents of the proprietor can also bind the business); and
- the proprietor can write off business losses directly against personal income, which can be a notable benefit.

There are also potential disadvantages:

- there is no limited liability;
- only the proprietor can write off losses; and
- only the proprietor realizes profits or growth.

The only legal requirement for a sole proprietorship (apart from laws of general application, such as income tax and licensing provisions) is that if a person is doing business in trading, manufacturing or mining, and uses a business name other than the person's own, the person must register this name with the registrar.

[§1.05] Partnership

The *Partnership Act* contemplates three forms of partnerships: general partnerships, limited partnerships and limited liability partnerships. Limited partnerships and limited liability partnerships are creatures of statute and do not come into being until certain statutory requirements, including certain filings with the registrar, are fulfilled. In the absence of such filings and other requirements being met, any two or more people meeting the definition of a partnership as set out in s. 2 of the *Partnership Act* will be deemed, at law, to be a general partnership.

There are several advantages to carrying on business in partnership. In some cases, a partnership may provide tax advantages because business losses can be deducted against other personal income. So, if the business owners expect there will be losses in the first years of business operation, they may want to use a partnership to apply these losses as individuals against their other sources of income. This can be of significant financial benefit to the partners.

Although it is not essential to have a written partnership agreement, it is almost always a good idea to have one. A written agreement has obvious advantages over an oral one, particularly in the event of a dispute between the partners. In addition, the *Partnership Act* imposes a system of rights and duties upon partners, which they may want to vary. For example, under the *Partnership Act*, all of the partners are entitled to share equally in the profits of the business. The partners are free to change this by private agreement. A partnership agreement may be needed for many other reasons, such as to define management responsibilities, and to ensure the partnership's continued existence after a partner departs. Negotiating and drafting a partnership agreement can be complex and expensive depending upon the needs of the partners and the complexity of their business arrangement.

A partnership, unlike a corporation, is automatically dissolved in certain circumstances. For instance, a partnership is dissolved by any of the following:

- subject to any agreement among the partners, notice from any partner to the others of that partner's intention to dissolve the partnership (s. 35);
- subject to any agreement among the partners, the expiry of a set term, if the partnership was created only for a specific project or term (s. 35);
- the death or bankruptcy of one of the partners, if there are only two (s. 36); and
- any event which would make it unlawful for the partnership's business to continue (s. 37).

[§1.06] General Partnership

Two or more people going into business together might choose a general partnership for a variety of reasons:

- The organization of the partnership can be simple and inexpensive. There are very few legal requirements for forming a general partnership. If the partners are becoming partners for trading, manufacturing, or mining purposes, they are required under the *Partnership Act* to file a brief description of their partnership with the Registrar of Companies (s. 81). This is simpler and less costly than incorporating a company under the *BCA.*
- All partners are able to take part in the management of the business, unless they have a partnership agreement that states otherwise.
- The partners may be able to deduct business losses against other sources of personal income, as described above.

The major disadvantage in a general partnership is the liability it imposes upon the partners. Each partner is personally liable for all debts and obligations of the business incurred while that person is a partner, and may also be liable for the wrongful acts of other partners (and employees) if those acts are committed in connection with the partnership business. Consequently, the acts of one partner in conducting the business, even if those acts are not authorized by the others, may bring liability upon them all. Therefore, a general partnership is only suitable for a relatively small number of partners who place substantial trust and confidence in one another.

[§1.07] Limited Partnership

In some cases, parties may decide to form a limited partnership to carry on a business.

A limited partnership combines some advantages of a general partnership with some advantages of a corporation. It consists of two kinds of partners — "general" and "limited." General partners in a limited partnership have much the same liabilities, rights and duties as partners in a standard general partnership. Limited partners, however, are primarily investors and are unable to participate in the management of the limited partnership without losing their limited liability status – a limited partner that takes part in the management of the business, inadvertently or otherwise, becomes liable as a general partner. Otherwise, limited partners' liability for the business debts and obligations of the partnership is generally limited by the *Partnership Act* to the amount of capital they contribute or have agreed to contribute to it (s. 57).

This form of business organization gives investors some limits on their liability while allowing them the income-tax advantages of a partnership (that is, they can deduct losses against personal income). This makes the limited partnership, like the corporation, a way to raise capital for a business.

Usually, the general partner of a limited partnership will be the promoter (or a company owned or controlled by the promoter) and the manager of the business. The general partner itself will usually adopt a corporate form, thus ensuring limited liability for its own owners. The limited partners are usually investors seeking the tax advantages of limited partnership participation in the particular type of investment offered.

A limited partnership, though relatively simple to form, is in fact a complex and sophisticated form of business organization. A certificate of limited partnership must be filed with the registrar (*Partnership Act*, s. 51), and, in most cases, the partners will also enter into an extensive limited partnership agreement which governs their respective rights and obligations with respect to each other and the business of the partnership. This agreement is tailored to the particular business that is being undertaken by the limited partnership, and in practice often contains many provisions that are similar to those in a shareholders' agreement (see *Practice Material: Business: Company*, Chapter 9), including restrictions on the limited partners' right to transfer their ownership and other rights of the limited partners in relation to the partnership.

Limited partnerships have potential disadvantages, including the following:

- third parties, such as lenders, are sometimes reluctant to deal with limited partnerships;
- limited partners have no management control, while general partners have no limited liability (unless they incorporate);
- arguably, the *Partnership Act* does not have protections for limited partners equivalent to the legislated protections for minority shareholders; and
- limited partners who get involved in operations lose their limited liability protection and may be deemed to be general partners.

[§1.08] Limited Liability Partnership

A limited liability partnership ("LLP") is a modified form of general partnership. LLPs have been permitted in British Columbia since January 2005, following amendments to the *Partnership Act*. Like limited partnerships, LLPs are created by statute and do not come into existence until the statutory requirements have been fulfilled. Unlike a limited partner in a limited partnership (where the limited partner becomes liable as a general partner if the limited partner takes part in the management of the business), a partner in a LLP that takes part in the management of the business is not subject to the same liability exposure associated with limited partnerships. The reason is that the liability associated with be-

ing a partner in a LLP is significantly different from that of a limited partnership.

A partner in an LLP is not personally liable:

(a) for a partnership obligation merely because that person is a partner (a "partnership obligation" means any debt, obligation or liability of a partnership, other than debts, obligations or liabilities of partners as among themselves or as among themselves and the partnership);

(b) for an obligation under an agreement between the partnership and another person; or

(c) to the partnership or another partner for an obligation to which either (a) or (b) applies.

(*Partnership Act*, s. 104(1))

However, this does not relieve a partner in an LLP from personal liability for the partner's own negligent or wrongful act or omission, or for the negligent or wrongful act or omission of another partner or an employee of the partnership, if the partner seeking relief knew of the act or omission and did not take the actions that a reasonable person would take to prevent it (s. 104(2)). In addition, none of the above protects a partner's interest in the partnership property from claims against the partnership respecting a partnership obligation (s. 104(3)).

The partners of an LLP are personally liable for a partnership obligation if and to the same extent that they would be liable if the obligation was an obligation of a corporation and they were directors of that corporation (s. 105(1)). However, the partners are not subject to the duties imposed on directors of a corporation by common law or under s. 142 of the *BCA* (s. 105(2)). If a partner of an LLP is a corporation, each director of the corporation is also jointly and severally liable for any liability imposed on the corporation unless the director dissented to, or took the actions a reasonable person would take to prevent, the act or omission that resulted in the liability (s. 105(3)).

To form an LLP, a registration statement in the prescribed form must be filed with the registrar (s. 96(2)). In most cases, the partners will also enter into an extensive and sophisticated partnership agreement, which governs their respective rights and obligations with respect to each other and the business of the partnership.

Partners of an existing partnership, including the partners of a limited partnership, may apply to register an existing partnership as a limited liability partnership. If an existing partnership registers as an LLP, it must promptly take reasonable steps to notify all of its existing clients, in writing, that the registration has occurred and of the resulting changes in the liability of the partners (s. 107).

[§1.09] Corporation

Most businesses are carried on in the form of a corporation. A corporation is created by fulfilling the formal requirements of a federal or provincial statute. The result of incorporation is the creation of a separate, distinct legal entity having the capacity of a natural person. This means that the corporation can sue and be sued in its own name, enter into contracts (including contracts with its own shareholders), and hold property in its own name.

A corporation has been described as an "artificial being, invisible, intangible and existing only in contemplation of law," a separate legal entity from its shareholders—its liabilities being its own and generally not those of its shareholders. In British Columbia the terms "corporation" and "company" are frequently used interchangeably. Watch for specialized uses of the two words "company" and "corporation" in the statutes, and when preparing documents, be careful to use the statutorily correct term.

In general, the *BCA* refers to corporate entities formed or continued under the *BCA* as "companies," and corporate entities formed or continued in other jurisdictions as "corporations." Most (though not all) other business corporations statutes in Canada refer to corporate entities formed or continued under those statutes as "corporations." Specifically, in s. 1(1) of the *BCA*:

- "company" means a corporation that is recognized as a company under the *BCA* or a former *Companies Act* and that has not ceased to be a company;
- "corporation" means a company, body corporate, body politic and corporate, incorporated association or a society, however and wherever incorporated, but does not include a municipality or a corporation sole; and
- "British Columbia corporation" means (a) a company, or (b) a corporation, other than a company or a foreign corporation that is created in or continued into British Columbia.

In the *CBCA*, a "corporation" is simply defined as a body corporate incorporated or continued under the *CBCA* and not discontinued under it.

1. Public or Private

In general, when someone refers to a "public company," they mean a company having shares that are publicly traded on a stock exchange. Conversely, when someone refers to a "private company," they typically mean a company that has only a few shareholders (also called a "closely-held" company) or a company the shares of which are not traded on a stock exchange.

From a legal perspective, it is important to note that terms like "public company" and "private company" may have different meanings in different contexts and under different statutes.

Generally speaking, British Columbia companies fall into four categories:

- "Public company" as defined in s. 1(1) to include a company that is a "reporting issuer" under the securities legislation of any jurisdiction in Canada or a reporting company under United States securities legislation.
- "Closely held company" (also referred to as a "non-reporting company" or "private company"), a company with a small number of shareholders who invest together under circumstances that do not require them to have ongoing disclosure or reporting obligations under securities legislation.
- "Pre-existing company" as defined in s. 1(1), a company that was recognized as a company under a former statute. The many companies that already existed at the date the *BCA* came into force are pre-existing companies.
- "Pre-existing reporting company" (s. 1(1)), a company that was a "reporting company" under the *Company Act* but not a "reporting issuer" under applicable securities legislation. In practice it will be rare to deal with this type of company.

The *BCA* defines "private company" in specific contexts within the Act. For example, in s. 119.1 and in s. 192, "private company" is described as a company that is not a reporting issuer, is not listed on a stock exchange, and is not within a class of companies prescribed by regulation.

2. General Attributes

A corporation can be more expensive to set up and maintain than other types of business organizations. It does, however, have a number of attributes that may be advantageous to its shareholders. The following are some of the advantages:

(a) Immortality

A corporation is said to have potential immortality. It continues to exist even if all its shareholders change or even if, for a time, it has no shareholders. By contrast, a partnership is automatically dissolved in a number of circumstances, as noted earlier in this chapter.

(b) Limited Liability

Under all Canadian statutes providing for the incorporation of corporations, the parties who form the corporation and who become its shareholders are only required to contribute toward the debts of the corporation the amount that they have agreed to pay for their shares in the corporation, which may be a very small amount. For example, a corporation may have only one share issued to a single shareholder for $1. Technically, once the share price has been paid to the corporation, the shareholder has no further liability for that corporation's debts.

However, limited liability may provide less protection than is often supposed. For example, when a company is borrowing money or entering into a lease, the principal shareholders of the company are frequently required to give their personal guarantees of the company's obligations. Limited liability does provide some protection, particularly from general trade creditors, and in situations where the company becomes liable for wrongful acts (such as a company employee carelessly driving the company truck on company business and running down a member of the public).

(c) Transferability of Shares

In theory, a shareholder's interest in a company (which takes the form of shares) may be easily transferable. That said, in most small companies, the shareholders will enter into a shareholders' agreement that, among other things, restricts transfers of shares, such as by granting a right of first refusal to the other shareholders. The shareholders of a closely held company often are actively involved in the company and may not welcome new shareholders who do not share their interest or expertise. The transfer of shares is also subject to applicable securities law requirements.

(d) Separate Legal Entity

Corporations formed under the various Canadian corporation statutes typically have the ability to do anything a natural person who has full legal capacity can do. However, the types of business they may carry on may be restricted.

The articles of a British Columbia corporation might prohibit the company from carrying on certain businesses, although such a prohibition is rare. The articles of a British Columbia company set out the rules of conduct for the company and the relationships between its shareholders and the directors (for example, the power of the directors to manage the company). Although the *BCA* permits a company to include comprehensive rules in its articles, in some cases shareholders of small companies will enter into a separate shareholders' agreement to set out their respective rights and duties. One advantage of doing so is that, if the

needs of the company were to change, it is often easier for the parties to a shareholders' agreement to amend that agreement than for shareholders to amend the company's articles.

(e) Capital

The corporate form may also make raising capital for the business easier. One of the original purposes of a corporation was to bring together a large number of individuals to pool their capital and carry out enterprises that were too costly for a small partnership. Today a corporation may still raise money by selling its shares, which may be of various classes and series. A corporation may also borrow money and issue or grant debentures or other security to its creditors. This financing may be through lenders or by selling debt security to private individuals. The issuance and transfer of shares and other securities is governed by the *Securities Act*, R.S.B.C. 1996, c. 418.

(f) Tax Advantages

A company's separate legal personality also provides it with a number of possible tax advantages. Some companies can access preferential income tax treatment (for example, the small business deduction). Companies might be able to divide business income in tax-favourable ways. On the other hand, a company that suffers business losses but never earns a profit against which losses can be deducted does not realize any tax advantage in dealing with its losses.

(g) Rights and Remedies of Shareholders

Shareholders can participate in the management of the company to the extent they have control over the election of directors, or as the company's articles or a shareholders' agreement may otherwise provide. Shareholders have several other rights and remedies, such as legislated protection for minority shareholders. A shareholders' agreement may set out specific management, finance, share transfer and other rights and obligations of the shareholders, and there may be considerable cost involved in negotiating and drafting it. (See *Practice Material*: *Business: Company*, Chapter 9.)

3. Professional Corporation

A professional (such as a lawyer, dentist, medical doctor, realtor, etc) might find it useful to set up a professional corporation. In assisting a client to do so, consult the statutes and regulations that govern the professional's practice. It may be necessary to apply to the regulatory body that oversees that professional for approval.

For example, the *Legal Profession Act*, s. 82, sets out the distinguishing features of a law corporation. The Law Society's website has information about the procedure for incorporating a law practice, including considerations under the *Code of Professional Conduct for BC*. Also, the Law Society must approve the corporate name and must issue a permit before the law corporation can carry on business.

[§1.10] Unlimited Liability Company

In 2007, British Columbia became the third Canadian jurisdiction (after Nova Scotia and Alberta) to permit the incorporation and operation of unlimited liability corporations ("ULCs"). The primary advantage of this type of corporation is that the tax treatment in the United States makes it attractive to US firms seeking to move investment capital to an associated entity in Canada.

ULCs have the same powers as regular companies and are taxed in Canada identically to other corporations. In the US, however, the US *Income Tax Regulations* have historically given a Canadian ULC the opportunity to elect *not* to be treated as a corporation for US tax purposes, but to be treated instead as a partnership (if it has multiple owners) or a disregarded entity (if it has a single owner). This creates a tax advantage because the profits and losses of the Canadian ULC are allowed to flow through the US unlimited liability corporation directly to its US shareholders.

Given this primary advantage to unlimited liability companies, it is important to stay current with US tax regulations as well as tax treaties. When advising clients as to the potential use of ULCs, always obtain tax advice in the United States and Canada. The details and strategies for ULC use are beyond the scope of these materials. For further information, see the *BC Company Law Practice Manual* (Vancouver: CLEBC).

ULCs use similar incorporating procedures to other companies in BC. There are a few key differences, which are designed to give the public notice that they are dealing with this special type of company. For example, the words "Unlimited Liability Company" or "ULC" must appear in the name of the company (s. 51.21).

Existing BC companies may convert to an unlimited liability company by passing a unanimous shareholders' resolution. However, all shareholders, whether or not their shares carry a right to vote, must agree to the conversion (s. 51.31). BC companies may also amalgamate with other BC companies to create an unlimited liability company (s. 51.6), but amalgamations between foreign companies and BC companies to create an unlimited liability company are not permitted (s. 51.5).

[§1.11] Community Contribution Company

In 2012, the *BCA* was amended to permit the incorporation of a form of corporation called a "community contribution company" ("CCC"). Community contribution companies are corporations that have a "community purpose," which is defined in s. 51.91(1) to include purposes beneficial to (a) society at large, or (b) a segment of society that is broader than the group of persons who are related to the community contribution company. "Community purpose" includes providing health, social, environmental, cultural, educational or other services.

Community contribution companies can easily be identified by their name, which must include the words "Community Contribution Company" or "CCC."

As a corporation incorporated under the *BCA*, a CCC is organized in the same manner as any other corporation, but with a number of important differences. For example, the articles of a CCC must state that it is a CCC and, as such, has purposes beneficial to society. A CCC's articles must also set out its community purposes. There are also important financial differences between a regular corporation and a CCC, including restrictions on the ability of a CCC to sell its assets and pay dividends. As well, CCCs are required to have at least three directors (*BCA*, s. 51.93).

Pursuant to s. 51.951, shareholders of CCCs cannot waive the directors' obligation to produce and publish financial statements. CCC directors are also required under s. 51.96 to publish an annual report that discloses certain matters, including how the company's activities during that financial year served to benefit society.

[§1.12] Benefit Company

Amendments to the *BCA* allowing for the incorporation of a type of company called a "benefit company" came in to force on June 30, 2020.

Under Part 2.3 of the *BCA*, British Columbia companies are now able to incorporate as "benefit companies." Benefit companies are companies that, in addition to pursuing profit, commit to conducting business in a "responsible and sustainable manner" and to promoting one or more "public benefits." "Public benefits" mean positive effects for the benefit of either a class of persons (other than the company shareholders), communities, organizations, or the environment. Benefit companies will be required to include a benefit statement in their notice of articles and a benefit provision in their articles, and to publish an annual benefit report. Their directors will be required to balance their existing duties to act in the best interests of the company with new duties to conduct business in a responsible and sustainable manner and to promote the company's public benefits.

[§1.13] Indigenous Business Organizations

First Nations, which include over 600 Bands organized under the federal *Indian Act,* have unique legal rights recognized by Canada's Constitution, as well as specific rights and capacities under the *Indian Act* and other federal legislation. Canada holds title to about 3,100 reserves, generally on behalf of a specified First Nation. First Nations and other Indigenous groups often have Aboriginal or treaty rights outside their reserves and in their historical territories. *Indian Act* Bands are governed by a Chief and Council, elected by the membership. First Nations may have their own unique self-governing arrangements based on their history and traditions, sometimes recognized under modern treaties or self-government agreements that take them "out" of the *Indian Act*.

First Nations and other Indigenous entities will often create non-profit corporations or societies to conduct business on their behalf, or to deliver programs and services for the benefit of their members. Many Indigenous entities will also incorporate companies under the *BCA* or the *CBCA* for business or community purposes. In some cases, this is for the purposes of managing liability for similar reasons to non-Indigenous businesses. Often, Indigenous businesses are structured as limited partnerships or trusts, to take advantage of tax exemptions available under s. 87 of the *Indian Act* or s. 149(1)(c) of the *Income Tax Act.*

There has been historic uncertainty in the case law, and solicitors' practice, on the legal capacity of a Band to sue or be sued, or to own property in its own name. As a result, it was common practice to have property—including shares of a corporation—held by the Chief and/or members of Council in trust for the Band. Given recent advances in the case law (see e.g. *British Columbia v. New Westminster Indian Band No. 566*, 2022 BCCA 368 for a discussion of the legal personhood of Bands), and shifts in public policy, it is increasingly common to avoid this additional component in structuring Indigenous businesses. (For more on the legal capacity of a Band to sue or be sued, see *Practice Material: Civil*, Chapter 2.)

[§1.14] Jurisdiction

1. Jurisdiction of Incorporation

After the participants in a business have decided what form of organization to use, they must decide where to incorporate. In Canada, jurisdiction is either federal or provincial. Parliament is competent, by s. 91(2) of the *Constitution Act, 1867* (the "trade and commerce" power), to create corporate entities. Parliament also has the power to incorporate by royal prerogative. Section 92(11) of the *Constitution Act, 1867* provides that each province shall have the right to incorporate companies "with pro-

vincial objects." In addition, corporations incorporated outside Canada may be permitted under the laws of a province to be recognized as such and to carry on business in the province. For further discussion of this issue, see the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC).

2. Choice of Jurisdiction

The following matters should be considered when deciding whether to incorporate federally or provincially.

- A federal corporation has the capacity to carry out its purposes throughout Canada as of right. It need not change its name to do business in a province where there is a corporation with a similar name.
- A federal corporation is subject to provincial laws of general application, but provincial laws cannot discriminate against a federal corporation (*British Columbia Power Corporation v. British Columbia (Attorney General)*, 1963 CanLII 552 (B.C.S.C.)).
- In most provinces, a federal corporation carrying on business there must register as an extraprovincial corporation. This is an additional expense, particularly if it is carrying on business only in one province.
- A provincial company can carry on business within its own province as of right, but to carry on business in any other jurisdiction, it must receive the right by registering (or otherwise becoming qualified) as an extraprovincial corporation in that jurisdiction. Such registration can be refused by the other jurisdiction, though in practice any reason for such refusal is typically limited to the pre-existence of a corporation in that jurisdiction with the same or a confusingly similar corporate name.
- A provincial company is restricted to provincial objects, so its business must be within provincial legislative jurisdiction.
- Consider the local, national or international/cross-border nature of the business.
- Some provisions in the *BCA* are stricter or more complex than in the *CBCA*, and vice versa. It is essential to compare provisions concerning the liability and residence of directors, financial disclosure, meetings and records, continuance to/from other jurisdictions, and share transfer.
- If you must deal through Ottawa under the *CBCA*, there may be a greater delay than dealing through Victoria under the *BCA*. However, with electronic filing and messaging being used widely, it is likely that this factor will have little impact on the decision.

[§1.15] Federal Corporations

There are many federal statutes that permit incorporation of corporations, but the main one for general incorporation, suitable for almost all purposes, is the *CBCA*.

1. *CBCA*

On December 15, 1975, the *CBCA* superseded the *Canada Corporations Act* for incorporation of companies previously incorporated under Part I of the *Canada Corporations Act*. Companies that did not elect to "continue" under the *CBCA* before December 15, 1980 were automatically dissolved.

Like companies under the *BCA*, companies under the *CBCA* generally have the capacity and powers of natural persons, except that they may not carry on the businesses described in s. 3(4). In particular, a *CBCA* corporation may not carry on the business of a loan company.

See *Practice Material: Business: Company*, Chapter 11, for more on the *CBCA*.

2. Other Federal Corporations

There are other federal statues under which corporations may be incorporated, such as the *Bank Act* and the *Pension Fund Societies Act*. These Acts are for special purposes beyond the scope of these materials. There is also a federal statute for the incorporation of cooperative associations (the provincial statute is discussed below).

[§1.16] Provincial Corporations (British Columbia)

1. *BCA*

The *BCA* is the main statute dealing with the incorporation and regulation of companies in British Columbia.

2. *Societies Act*

The *Societies Act*, S.B.C. 2015, c. 18, came into force on November 28, 2016, replacing the older *Society Act*, R.S.B.C. 1996, c. 433. Societies that existed prior to this date had until November 28, 2022 to transition to the new Act. See also *Practice Material: Business: Company*, Chapter 12: "Not-for-profit Organizations."

The *Societies Act* provides for the incorporation of societies organized for agricultural, artistic, benevolent, charitable, educational, environmental, patriotic, philanthropic, political, professional, recreational, religious, scientific, social, sporting and other

similar purposes (see s. 2(1) of the *Societies Act*). A society must *not* have, as one of its purposes, the carrying on of a business for profit or gain, but it may carry on a business tangential to the purposes of the society to advance or support the purposes of the society. Subject to the approval of the Superintendent of Financial Institutions, a society may also be formed to provide for certain death, accident, sickness and disability benefits, pensions or annuities to its members. While a society is a legal entity with the capacity, rights, powers and privileges of an individual of full capacity, it must not carry on any activity that is contrary to the purposes stated in its constitution.

Societies have members rather than shareholders, and do not have share capital (see *Societies Act*, ss. 3 and 217).

3. Special Acts of the Legislative Assembly

From time to time, the Legislative Assembly incorporates companies by passing a private or public act. School boards, drainage and sewage disposal boards, park boards, religious orders, professional bodies, schools, unions, universities, and colleges are generally incorporated by public act.

A private business undertaking may be organized by a special act passed on a private bill. This is used where the *BCA* does not permit the undertaking to be incorporated under it: for example, an insurance company or trust company.

4. *Financial Institutions Act*

The *Financial Institutions Act*, R.S.B.C. 1996, c. 141 regulates the operations of trust companies, credit unions and insurance companies in British Columbia, and includes provisions respecting the incorporation of these financial institutions. One or more persons may submit a notice of articles and articles of a proposed trust or insurance company, file the prescribed form of application and pay the prescribed fees, to incorporate a trust or insurance company in British Columbia (see s. 13). After approval by the Superintendent of Financial Institutions and registration of the memorandum and articles, a certificate of incorporation is issued. Certain provisions of the *BCA* apply to a trust company so incorporated.

5. *Cooperative Association Act*

The *Cooperative Association Act*, S.B.C. 1999, c. 28 provides for the incorporation of cooperative associations. Like companies incorporated under the *BCA*, cooperative associations are corporations, and generally have the same powers and capacities as companies. However, in order to incorporate as a cooperative association, the incorporating documents must state that the cooperative association will operate on a "cooperative basis." Further, the cooperative association must in fact operate on that basis, failing which it may lose its status as a cooperative association.

There are a number of facets to operating on a cooperative basis, but the main requirement is that membership must be open in a non-discriminatory manner to persons who can use the services of the association and who are willing and able to accept the responsibilities of membership. Further, each member has one vote on matters to be decided by the membership, despite differences in the contributions of each member to the association or the number of shares owned in the association.

Cooperative associations have historically been found popular in agricultural businesses, and many fruit, vegetable, dairy and other agricultural businesses were incorporated as cooperative associations of the farmers and producers. Cooperative associations are also found in retail, housing and other contexts.

To create a cooperative association, the initial members subscribe to a memorandum and forward it to the registrar together with a set of rules, statement of incorporators, list of first directors and location of the registered office. If satisfied, the registrar issues a certificate of incorporation. The statute sets out the powers, administration and operational requirements of a cooperative association. Some provisions of the *BCA* apply to cooperative associations.

6. Others

There are many other statutes under which various forms of corporations are, or can be, created, such as the *Community Charter*, S.B.C. 2003, c. 26; *Vancouver Charter*, S.B.C. 1953, c. 55; *Railway Act*, R.S.B.C. 1996, c. 395, and *Strata Property Act*, S.B.C. 1998, c. 43.

[§1.17] Methods of Incorporation

There are a number of methods for incorporating corporations in Canada. The list below shows the most common methods, identifying the capabilities of these incorporated entities.

1. Registering Memorandum and Articles

Incorporation by registering a memorandum and articles is the method used in Nova Scotia. It was the method previously used in British Columbia under the *Company Act*.

A company incorporated under the *Companies Act* (Nova Scotia) on or after the first day of September 1982, or which has altered its memorandum of

association in accordance with that act, has the capacity, rights, powers and privileges of a natural person.

2. Incorporation Application

In British Columbia, one or more persons form a company by entering into an agreement and filing an incorporation application with the Registrar of Companies that complies with and contains the information prescribed by ss. 10(2) and (3) of the *BCA*. See Chapter 2 for a full discussion on incorporation procedures.

British Columbia corporations have only the powers given by their particular governing statute (which are quite general); acts exceeding those powers are *ultra vires* and a nullity so far as the company is concerned.

The *BCA*, however, expressly provides that a company has the rights, powers and privileges of an individual of full capacity (s. 30). In addition, a corporation is capable of acquiring and holding property, rights and interests in joint tenancy in the same manner as an individual (s. 31). Also, a British Columbia corporation has the right, subject to its charter and to other restrictions imposed by law, to carry on business in any jurisdiction outside of British Columbia (to the extent that the laws of the other jurisdiction permit it to do so), and to accept from any lawful authority outside British Columbia powers and rights concerning the corporation's business and powers (s. 32). If the memorandum (for a pre-existing company) or articles of a company restrict business that the company can carry on, or powers it can exercise, an act contravening these restrictions is not invalid by reason only that it contravenes those restrictions (s. 33(2)).

Section 421 provides that in proceedings by or against the company, there is no constructive notice of documents merely because they are filed with the Registrar or are available for examination at an office of the corporation.

If the company contravenes (or is about to contravene) restrictions on its business or power, certain persons (including shareholders) may apply to court for an order restraining the company from doing any act, or from transferring or receiving any property (s. 228). The court also may provide compensation and other forms of relief.

3. Filing Articles of Incorporation

Filing articles of incorporation is the incorporation method used in the *CBCA* and in provinces (including Alberta, Saskatchewan, Manitoba and Ontario) that have adopted Acts based on the *CBCA*.

The provincial acts governing this type of corporation state that an otherwise *ultra vires* act is not invalid, so the doctrine of *ultra vires* may not apply to acts by this type of corporation.

4. Statute or Special Act

A company incorporated under a particular statute or by a special act is subject to the doctrine of *ultra vires*. Such a company is not considered to have the capacity of a natural person unless specifically provided in the governing act; otherwise, it has only the capacity and powers described in the statute.

[§1.18] Further Reading

Several publications by the Continuing Legal Education Society of BC (CLEBC) are of interest to company law practitioners, including the following:

- *Advising British Columbia Businesses* (loose-leaf and online)
- *BC Company Law Practice Manual* (loose-leaf and online)
- *Charities and Not-for-profit Law Conference* (annual)
- *Company Law Deskbook* (updated loose-leaf and online for legal support staff and new lawyers)

Chapter 2

Incorporation Procedures[1]

This chapter deals with initial steps of incorporating a BC company. Many of the terms used in this chapter are technical terms defined in s. 1 of the *BCA*; refer to these definitions in order to fully understand the concepts discussed below. Further information can be found in Chapter 4 of the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC), the checklist for "Incorporation—Business Corporations Act Procedure" on the Law Society's website (www.lawsociety.bc.ca/), and "Incorporate a Company," on the BC government website (www. gov.bc.ca).

One of the first incorporation decisions is what to name the new company. This process is described at §2.01.

The persons incorporating the company prepare and file an incorporation application, including a notice of articles (s. 10(1) and (3)), with the Registrar of Companies (the "Registrar"). The incorporation application must be filed electronically. This process is described in §2.02 and the requirements for the notice of articles are described at §2.03.

Once the company has been incorporated, it must follow certain organizational procedures (described in §2.06).

[§2.01] Name Approval

A company's name must first be pre-approved by the Registrar. The following guidelines set out the procedures for companies to reserve names in British Columbia and the criteria the Registrar considers when deciding whether or not to approve the name.

If the proposed company name is the same name as a First Nations Band or an Indigenous community, the Registrar will require a Band Council resolution that authorizes using the name.

1. Reserving a Name

The Registrar may reserve a name for incorporation of a company under the *BCA* (i.e. an intended company) for a period of 56 days from the date of reservation (s. 22(2)). The name approval procedure is described in detail later in this chapter. Note that name reservations are also required for other corporate procedures such as company name changes, amalgamations, or the registration of a company in British Columbia from another jurisdiction.

2. Form of Name

Although a company may be incorporated as a "numbered company" without a descriptive name, most clients who want to use their companies to actively do business select a name. In British Columbia, that corporate name must meet certain legal requirements. Generally, names should have three components: a distinctive element, a descriptive element, and ending with the corporate designation. The name elements enable the public to distinguish one company from another so that the services or wares they offer are distinguishable.

The distinctive element helps to differentiate names having identical or similar descriptive elements. This requirement is satisfied if the name uses a personal name, a coined word or a geographic location.

The descriptive component indicates the nature of the company's business. It may be specific (such as "ABC **Muffler Service** Ltd.") or general (such as "ABC **Investments** Ltd."). The Registrar has published lists of similar descriptive words by category. If a name is requested with a similar descriptive word already in use, the name request will be rejected. For example, "Bella's Cosmetic Inc." would not be available as a corporate name if there already exists a company under the name "Bella's Day Spa Inc." The list of similar descriptive words is available on the Registrar's website under "Include a descriptive element" (www2.gov.bc.ca/gov/content/employment-business/business/managing-a-business/permits-licences/businesses-incorporated-companies/approval-business-name#rules).

A corporate designation shows the public that the entity is a corporation. Corporate designations include "Limited," "Incorporated" or "Corporation" and the abbreviated forms "Ltd.," "Inc." or "Corp." (s. 23(1)). An "unlimited liability company" must have the words "Unlimited Liability Company" or the abbreviation "ULC" at the end of its name (s. 51.21(1)). A community contribution company must have the words "Community Contribution Company" or the abbreviation "CCC" as part of its name (s. 51.921). Only one corporate designation may be used.

As noted earlier, a company may be incorporated as a "numbered company," for example, "0654321 B.C. Ltd." In that case, the incorporation number of the company is the distinctive element in the name. A name reservation is not necessary for a numbered company. The incorporation application states that the name under which the company is to be incorporated is the name created by adding "B.C. Ltd."

[1] **Dierk Ullrich**, Fasken, Vancouver, kindly revised this chapter in February 2023 and May 2019. Previously revised by Jennifer MacGregor-Greer (2016), Jason Harris (2011), and Brock H. Smith (2004 and 2005). Revised for Indigenous law content in 2003 by Darwin Hanna.

after the incorporation number of the company (ss. 10(3)(d)(ii) and s. 22), or in the case of an unlimited liability company "B.C. Unlimited Liability Company" (ss. 21(2) and 10(3)(ii)(B)). The Registrar will assign the next available incorporation number.

3. Registrar's Discretion as to Names

The Registrar must not reserve a company name unless that name complies with the requirements in the Regulation and in Part 2, Division 2 of the Act (s. 22(4)). These requirements give the Registrar some discretion on whether to accept a name.

Subsection 7(1) of the Regulation sets out the guiding principle for the Registrar's approval of a company name. This section provides that, to the extent it is likely to confuse or mislead, the name must not resemble:

(a) the name of an existing BC company;

(b) the name of any other corporation (including cooperative associations and societies) registered in BC;

(c) a name already reserved with the Registrar for a corporation; or

(d) the name of an extraprovincial company registered under the Act.

Section 7(1) does not apply to a corporation incorporated under the *CBCA* that wants to register as an extraprovincial company under the *BCA* (Regulation, s. 7(2)).

The name approval criteria apply before incorporation, registration, and change of name (s. 263(3)).

If the name of a foreign entity contravenes any of the name approval requirements, then the entity must reserve an assumed name in order to apply to be registered as an extraprovincial company in British Columbia (s. 26(1)). If the foreign entity reserves an assumed name, then the Registrar may register that entity as an extraprovincial company if the entity provides an undertaking to the Registrar that it will carry on all of its business in British Columbia under that assumed name (s. 26(2)). This section does not apply to a *CBCA* corporation.

If an extraprovincial company adopts an assumed name under the Act, then it must acquire all property, rights and interests in British Columbia under that name; it is entitled to all such property, rights and interests, and to all liabilities incurred, as if acquired and incurred under its own name; and it may sue or be sued in its own name, its assumed name or both (s. 26(3)). These rules also do not apply to *CBCA* corporations.

4. Name Approval Procedure

The applicant will typically fill out an online request through *Name Request* (www.bcregistry.ca/namerequest), a new online platform introduced by the Registrar in 2022. The applicant should submit a list of three names, in order of preference, along with the prescribed fees (check *Name Request* for current fees.) Presently, a name request can also still be submitted in paper form (by mail with payment by cheque), but with the introduction of the new *Name Request* online platform, the Registrar will be phasing out this option.

Before submitting a name, the applicant should consult resources that give insight into existing uses of the name or its variants. *Name Request* contains a research tool that allows you to compare your proposed name with existing names for registered British Columbia companies and organizations and performs a basic automated check for compliance with name requirements. However, the tool does not replace the Registrar's decision whether or not to approve a name. Other places to search include the Canadian Trademarks Database (to ensure the proposed name has not been trademarked) and NUANS, a database containing the names of existing corporate bodies and trademarks.

The registry staff checks the requested names against the corporate name register to determine if there is an identical (or similar) name that, in the opinion of the Registrar, would be likely to confuse or mislead. The name will not be approved if it is likely to confuse or mislead. One test is to place the names side by side and compare the sound, spelling, and appearance of the names.

Names such as "Tire Shop Ltd." or "Shoe Store Ltd." are not sufficiently distinctive because many companies are carrying on the tire or shoe business. These types of names would be acceptable if prefaced by a distinctive word such as a coined word (for example, "Xantrex Tire Company Ltd."), geographical location, or a person's name (for example, "Smith's Shoe Store Ltd"). One-word names are generally not acceptable as they are too general and would not be sufficiently distinguished from any other company name starting with the same word. For example, "International Ltd." is considered similar to "International Holdings Ltd."

When the first word in a company name is distinctive but it comes before a well-known existing name on the register, the proposed name would not be acceptable (for example, "Victoria Nordstrom Department Store Ltd.").

A coined word such as "Calvan" is not generally considered sufficiently distinctive in itself, as there may be many companies with the same first word in the name. However, if the coined word has been

trademarked and the Registrar receives a copy of the trademark and is satisfied that the name is very distinctive, a one-word name may be considered (for example, "Harmac Ltd." was incorporated). Coined words may be used for the distinctive element of the name (for example, "Altrex Holdings Ltd."), or along with a geographical location (for example, "Altrex Canada Ltd.").

A natural person's full name is an acceptable corporate name. Two surnames would also be acceptable. Examples include "Bill Brown Ltd.," "Green & White Ltd." and "Brown-Black Ltd." Initials are also permitted along with the surname (for example, "J.T. White Ltd."). Initials are also considered distinctive when followed by a descriptive word (for example, "A.D.E. Enterprises Ltd.").

Numerals may be used in a company name but only as the distinctive element. A year may be used in a name provided it is the year in which the company was incorporated, registered, amalgamated or a name change occurred.

Lawyers who are assisting clients with choosing a name should review the additional information provided by the Registrar on *Name Request* (see "How to Build Your Name") and "Request Approval for a Business Name" at www2.gov.bc.ca/gov/content/employment-business/business/managing-a-business/permits-licences/businesses-incorporated-companies/approval-business-name.

Most law firms maintain accounts with BC OnLine and the new corporate online platform to be introduced by the Registrar in the Spring of 2023. When the law firm submits a name for approval, the Registrar debits the account.

5. Extraprovincial Names

Provided there is no similar name already on the register, the Registrar sometimes gives special consideration to an extraprovincial company that has been incorporated in another jurisdiction for a considerable period of time, even if its name would not otherwise be sufficiently distinctive in British Columbia. An example is an established extraprovincial company with the name "Spray Painting Ltd." Before registration, the Registrar may require the company's written undertaking stating that it would not object if the Registrar later approved the registration of a company name including the words "Spray Painting" in the name (for example, "Victoria Spray Painting Corporation").

6. Name Not to Suggest Government Connection

The word "Government" in a name is not acceptable. Other words that may imply a connection with government require the government's consent—for instance, "provincial," "ministry," and "agency."

The prohibition against unauthorized representation of government authority is found in the *Provincial Symbols and Honours Act*, R.S.B.C. 1996, c. 380.

When the British Columbia government is implied in the name, written consent must be obtained from the Office of Protocol, Intergovernmental Relations Secretariat. The words "British Columbia" or "BC" as a *distinctive element* are considered to suggest connection or implied approval of the British Columbia government and therefore are not usually available other than as part of a numbered company name (for example, 123456 B.C. Ltd.).

If the name otherwise meets the guidelines, the words "British Columbia" or "BC" are permitted at the *end* of a company name, provided they precede the corporate designation (for example, "Pacific Storage Warehouse British Columbia Ltd.").

7. Name Not to Suggest Connection with Crown or Royal Family

The name of a company must not suggest or imply a connection with the Crown or any living member of the Royal Family, unless written consent from the appropriate authority is first obtained. Words such as "Crown," "Royal," "King," "Queen," titles of Royal Family members, and names of living Royal Family members are usually rejected, unless it can be shown that by reason of long *bona fide* usage the words do not suggest or imply connection with the Royal Family or Crown. An exception is the well-known and long-standing reference to New Westminster as the "Royal City" or words that form part of geographic locations such as "Prince George."

Any reference to "royal" or "vice regal" in a company name that could be taken as an endorsement of a product is prohibited by the *Trademarks Act*, R.S.C. 1985, c. T-13.

8. Name Not Objectionable on Public Grounds

If, in the opinion of the Registrar, a name is objectionable on public grounds, it will not be approved. A name will not be approved if it includes a vulgar expression; obscene words; or racial, physical or sexual slurs.

A name will also not be approved if it refers to a public figure in a way that could cause embarrassment, unless the person involved consents in writing and the name only affects that person and not the public generally. The name of a political party or leader is also prohibited without consent.

9. Well Known or Established Names

Some words, such as Exxon, Xerox and Coke, are so well known that it would be against policy to ap-

prove them in a name. The Registry does not maintain records of trade names and trademarks, and therefore must rely on public knowledge of well-known trademarks when deciding whether to approve a name. If the name otherwise meets the name approval requirements and the applicant has the consent of the holder of a trademark, the name may be available.

10. Identical or Similar Names Not Available

One of the most common reasons for rejecting a name is that it is identical, or very similar, to that of an existing company. The one exception is federal corporations registering extraprovincially in BC, which are not subject to name approval by the Registrar and are accepted even if the name is similar or identical to a company on the register.

If a company on the register has a similar —but not identical—name, and gives written consent to the name request, the name may be accepted for incorporation or registration.

The question of similarity or of being "likely to confuse or mislead" will normally be based on the wording of the name and not on the businesses actually being carried on by the similarly named companies.

The following is a sampling of *descriptive* words that are usually considered to be similar to one another, so that if the distinctive prefix is the same, the names are considered similar:

- hotel, motel, inn, resort, bed and breakfast
- financial, asset, acceptance, capital, credit, equity, fund, invest, load, mortgage, mutual, securities
- health, medical, practice, surgery, wellness
- coal, exploration, explore, drill, energy, fuel, gas, oil, petroleum, propane, resources, mine, mineral, placer, prospect
- heating, air conditioning, climate, comfort, furnace, HVAC, mechanical, pipe fit, plumbing
- restaurant, bistro, café, cantina, kitchen, cuisine, deli, dine, diner, dining, eats, eatery, gallery, grill, sandwich, takeout, taverna, trattoria
- storage, terminal, container, depot, warehouse

Such lists are not exhaustive. Each name is treated on the basis of its own peculiar circumstances when being checked for approval.

11. Statutory Restrictions on a Company's Name

Some statutes, both federal and provincial, restrict or prohibit the use of certain words; for example:

- "Architects"—*Architects Act (*British Columbia), requires proof that principal architect is a member in good standing with the Architectural Institute of BC.
- "Bank" or "Banking"—*Bank Act* (Canada).
- "Board of Trade" or "Chamber of Commerce" —*Boards of Trade Act* (Canada).
- "Co-operative" or "Co-op"—*Cooperative Association Act* (British Columbia).
- "Credit Union"—*Credit Union Incorporation Act* (British Columbia).
- "Professional Engineer"—*Professional Governance Act* (British Columbia) and its regulations.
- "Royal Canadian Mounted Police" or "R.C.M.P."—*Royal Canadian Mounted Police Act* (Canada).
- Names of universities, municipalities and words suggesting government patronage—*Trademarks Act* (Canada).
- "Trust," "Trustco," "Fiduciary," "Loan," "Loans," "Loanco," "Trustee," "Trusts"—*Trust and Loan Companies Act* (Canada).

12. Miscellaneous Restricted or Prohibited Words

Many words are prohibited, restricted or require consent or approval from some level of government or official tribunal before they are available for use in a company name. Some words are not available without a particular consent in any circumstances, and others are unavailable if they do not correctly describe the activities of the company and so mislead the public. If an element in a corporate name requires third party consent, the Registrar will typically identify as part of the name reservation process whose consent is needed. The following are examples from *Name Request* of words requiring consent:

- Engineering
- Doctor, DR , MD
- Registered Massage Therapist
- Chinese Medicine
- Lawyer, Law
- CPA
- Legion

13. Internet Names

A new company starting up a web-based business should consider both its corporate name and its domain name, if it wants the names to be similar (for example, ABCInvestments.com as the domain name for ABC Investments.com Ltd).

14. Trademarks

The Registrar does not consider the Canadian Trademarks Register, or the common law rights of the owners of unregistered trademarks, when granting consent to incorporate or register a company in British Columbia. The Registrar's consent, if given, indicates only that the Registrar will allow the applicant to incorporate or register a company in British Columbia, but it does not guarantee that the applicant will have the right to use that name in a particular business. If a BC company's name conflicts with the pre-existing rights of the owner of a registered or unregistered trademark, the company may be prevented from using that name and may be required to change its corporate name to another name that does not conflict with the trademark.

[§2.02] Forming a Company

Section 10(1) of the *BCA* provides that one or more persons (each an incorporator) may form a company by:

(a) entering into an incorporation agreement;

(b) filing with the Registrar an incorporation application; and

(c) complying with Part 2 of the Act.

1. Incorporators

An incorporator is a person who, before an incorporation application is submitted to the Registrar for filing, signs the incorporation agreement respecting the company (s. 1(1)). The incorporation agreement and articles must be signed by every incorporator (ss. 10(2)(c) and 12(3)(b)).

2. Incorporation Agreement

An incorporation agreement is a short agreement in which the incorporators agree to take shares of the company. The agreement must include the full name of each incorporator and the number of shares of each class and series of shares being taken by that incorporator (s. 10(2)(a) and (b)). Also the agreement must be signed and dated by each incorporator (s. 10(2)(b)(ii)(A) and s. 10(2)(c)). The incorporation agreement is held in the company's records office, not filed with the Registrar.

3. Incorporation Application

The *BCA* requires that certain information be included in the incorporation application, including the following (s. 10(3)):

(a) the completing party statement referred to in s. 15;

(b) the full names and mailing addresses of the incorporators;

(c) the name of the company (including the name reservation number); and

(d) a notice of articles that reflects the information that will apply to the company upon its incorporation.

A "completing party" is an individual who completes a record that is to be submitted to the Registrar for filing (s. 1(1)). The completing party may also provide the information necessary to complete an application document to an agent or employee of the government.

Section 15(1) of the *BCA* requires the completing party to examine the articles and incorporation agreement to ensure that they have been signed in accordance with s. 15(2). The completing party must also identify the incorporators in the incorporation application. The completing party must complete these steps before an incorporation application is submitted to the Registrar for filing.

Currently, many corporate documents that must be filed with the Registrar may be completed in paper form or electronic form, but an application for incorporation must be submitted in electronic form.

4. Form of Incorporation Application

The incorporation application must be in the form established by the Registrar (s. 10(3)(a)) (Form 1 for a limited company, Form 1U for an unlimited liability company, or Form 1C for a community contribution company). The form must be submitted to the Registrar for filing in an electronic format that is compatible with the technical requirements of the Registrar (s. 30(2) of the Regulation).

[§2.03] Notice of Articles

The notice of articles of a BC company forms part of its incorporation application (s. 10(3)(e)). It must be in the form established by the Registrar (s. 11(a)). Section 11 of the *BCA* sets out the requirements for a notice of articles, including the following:

(a) the name of the company including any translation that the company intends to use outside Canada (ss. 11(b) and (f));

(b) the full name of and the prescribed address for each of the directors (s. 11(c));

(c) the mailing and delivery address for the company's registered and records offices (ss. 11(d) and (e));

(d) a description of the authorized share structure of the company in accordance with s. 53 of the Act (s. 11(g)) (that is, the notice of articles must describe the name of each class or series and the kind of shares of which that class or series consists, set out the maximum number of shares of each class or series that the company is authorized to issue (or state that there is no maximum number), set out the par value of the shares (if applicable), and identify shares without par value); and

(e) whether there are or were any special rights and restrictions attached to any class or series of shares of the company and, if so, the date that each resolution altering those rights and restrictions was passed (s. 11(h)) (an example of special rights would be a right to dividends in priority to other share classes).

[§2.04] Articles

The company's articles must set out the rules for the company's conduct (s. 12(1)(a)). The articles remain and are held in the records office, not filed with the Registrar (s.42(2)(a)).

The articles must be mechanically or electronically reproduced (s. 12(1)(b)), divided into consecutively numbered or lettered paragraphs (s. 12(1)(c)) and signed by each incorporator (s. 12(3)).

Sections 12(1)(a) and (2) of the *BCA* set out the minimum requirements for the articles of a company. These requirements include rules for the conduct of a company; every restriction, if any, on the business that may be carried on or the powers that may be exercised by the company; the special rights and restrictions that are attached to each class or series of shares of the company; and the name and incorporation number of the company. If the company intends to use any translation of its name outside Canada, then that translation must also be included in the articles (s. 12(2)(c)(iii)).

The *BCA* provides for a standard form set of articles (see Regulation, Table 1) that may be adopted by a company in whole or in part (s. 12(4)). A company should carefully consider whether adopting the Table 1 articles is suitable. For one thing, the Table 1 articles, unaltered, will rarely "fit" a particular company. Moreover, unless the articles otherwise provide, if a company adopts the Table 1 articles, then any subsequent regulatory amendment to Table 1 will result in an amendment to the company's articles without the company passing a resolution to make that amendment (s. 261(2)) or without the company's knowledge. Therefore, if a company wants to retain control over the content of its articles, it should include a provision stating that no subsequent amendment to Table 1 will amend the company's articles until that amendment has been approved by the company in accordance with the procedure set out in the articles.

When drafting its articles, a company should consider how it will define its fundamental structure. The conventional structure under the *BCA* will be for the directors to have the power to manage or supervise the management of the affairs and business of the company (s. 136(1)). However, s. 137 makes it clear that the articles may restrict this conventional structure by transferring some or all of the directors' powers to one or more other persons. In most cases, the power would be transferred to one or more shareholders. Section 137 of the Act has a similar function as unanimous shareholder agreements under the *CBCA*. If the articles transfer some or all of that authority to another person, then the directors are relieved of their rights, powers, duties and liabilities to the same extent (s. 137(2)(b)). If the shareholders of a BC company wish to limit the directors' corporate powers and duties, then the mechanism of s. 137 must be followed. In that case, the articles could include "custom drafted" types of provisions that are commonly found in a shareholders' agreement. In practice, shareholders more commonly rely on the contractual arrangements in a shareholders' agreement, which can remain private, rather than on amending the articles, which can be inspected by the public (see ss.46(4) and (5)).

The following provisions are often included in articles:

- setting a quorum for meetings;
- defining special business at a general meeting;
- setting the special majority required to pass a special resolution (s. 1(1));
- setting special rights and restrictions for classes of shares (ss. 12(b)); and
- specifying the type of resolution required to change its authorized share structure, if other than a special resolution (s. 54(3)(c)).
- prohibiting the chair from voting to break a tie;
- designating who can vote at shareholder meetings;
- setting rules for proxy voting;
- establishing the method for setting the price for shares without par value (s. 63(1));
- authorizing additional directors (s. 122);
- authorizing removal of directors (ss. 128(3)(b) and 128(4)(b));
- transferring powers of directors (s. 137);

- setting procedures for directors' meetings, e.g. for providing notice and holding meetings by telephone or as electronic meetings (s. 140(1)(b));
- designating the officers (s. 141(1));
- setting voting procedure at directors' meetings;
- allowing or prohibiting an interested director to be counted in the quorum (s. 149(4)); and
- restricting share purchase, issuance or transfer.

If the company is using the Table 1 articles, the lawyer should carefully review the Table 1 provisions on the above topics to ensure that they are suitable for the needs of the particular company.

[§2.05] Incorporation

To effect the incorporation of a company, the incorporation application must be filed electronically with the Registrar (s. 10(1)(b)). The Registrar is in the process of introducing a new online filing system. At the time of writing, it is expected that the new platform will be implemented in the Spring of 2023. Upon submission to the Registrar and payment of the prescribed fees, the company will be incorporated on the date and time that its incorporation application is filed with the Registrar or on such later date as may be specified in the incorporation application (ss. 13(2), 410(1)(b) and Regulation, s. 31(a)). The incorporation date is the first date that the company is recognized under the Act (s. 3(1)(a)).

The Registrar must then issue a certificate of incorporation and must record in it the name and incorporation number of the company and the date and time of its incorporation (s. 13(2)). The Registrar will then provide the company with the certificate of incorporation and (if requested) certified copies of the incorporation application and the first notice of articles (s. 13(3)(a)). The Registrar will also provide a certified copy of the incorporation application to the completing party, if requested (s. 13(3)(b)). All these steps are automated functions of the Registrar's online filing system.

Once incorporation is effected, the notice of articles and the articles are considered binding contracts among the shareholders and the company (ss. 19(1) and (3)).

[§2.06] Post-Registration Procedures

The completing party must deliver or mail by registered mail to the records office the originally signed articles and the incorporation agreement (s. 15(1)(b)). As a practical matter, law firms often act as registered and records offices and the completing party is a paralegal of the firm.

Once a company is registered, it must be organized so as to carry on business. Post-incorporation, the company will do the following: acknowledge incorporation and the certificate of incorporation, the notice of articles and the articles; approve a seal (if any); approve the issue of a share certificate or non-transferable written acknowledgement for the share(s) taken by each incorporator (if the shares are not uncertificated (see s. 107), which has become more common with the adoption of electronic corporate records); and confirm the number of directors and the appointment of the directors listed in the notice of articles.

1. Initial Proceedings of Incorporators

The incorporators are the first shareholders of the company (s. 17). Consequently, they typically complete the rudimentary aspects of organizing the business, such as setting the number of directors, confirming or replacing the first directors, and waiving or appointing the company's auditors.

2. Initial Proceedings of Directors

The first directors of the company are the individuals designated as directors of the company in its notice of articles when it is recognized under the *BCA* (s. 1(1)).

The usual purposes of the initial meeting (or written consent resolutions) of the first directors are to allot and issue the share(s) that the incorporator(s) subscribed to in the incorporation agreement, allot and issue additional shares to the incorporator(s) or new shareholders, and, if applicable, to approve the transfer or repurchase the incorporators' shares. An incorporator's shares must be paid in full before they are issued (this rule applies to shares generally; see s. 64(2)). Shares in a company have been typically evidenced by share certificates, which are also approved by the directors. However, in recent years, with the adoption of electronic corporate records, uncertificated shares have become more common. The directors at this stage also appoint officers, fix a quorum for directors' meetings, determine a fiscal year end, and confirm the location for the records office and registered office as set out in the notice of articles. The directors may also pass other resolutions relating to maintaining corporate records, appointing bankers, and appointing auditors (if any) (ss. 203 and 204). As a practical matter, when a law firm acts as incorporator, post-incorporation resolutions are used to transfer the incorporator's shares to the persons on whose behalf the company was incorporated or to re-purchase the incorporator's shares and to issue new shares to the intended shareholders.

Other important documents that must be considered at this stage are a consent to act as director from each of the first directors, subscriptions for share allotments; the creation of a central securities register (s. 111(1)); an index of shareholders, if applicable (s. 112); a register of directors (s. 42(1)(e)); the minutes of the directors' meeting; and the cancella-

tion and issuance of share certificates (if any). Effective October 1, 2020, if the company is private, it must also establish and maintain a "transparency register" of "significant individuals." Individuals must be listed in the transparency register if they:

(a) own (as registered holder or beneficial owner) or indirectly control a significant number of shares (25% of the shares of the company, or shares having 25% of the voting rights in the company);

(b) have the right or ability to directly or indirectly elect, appoint, or remove the majority of the company's directors, by any (or any combination) of the following:

  (i) the right to elect, appoint, or remove one or more of the directors;

  (ii) indirect control of the right to elect, appoint, or remove one or more of the directors; or

  (iii) the ability to exercise direct and significant influence over an individual who has the right or indirect control described above.

In the case of companies incorporated by First Nations constituted as Bands under the *Indian Act* (Canada), often the Chief and the Council are the shareholders and directors of the company. The company may use a trust declaration for any of the following purposes:

(a) to describe Band Council control over the company;

(b) to state that the shares are issued in trust for the sole and beneficial use and ownership of the Band represented by Council;

(c) to require that shareholder decisions be authorized by a Band Council resolution; and

(d) to revoke shares if certain events occur (for example, a director leaves office).

Some Chiefs and Council members are appointed as directors as a matter of course following their election, because changes to directors typically coincide with Band elections. Once a person agrees to act as a director, that person must carry out the duties and responsibilities of a director, even if that person is a nominee director appointed by Band Council.

3. Initial Proceedings of Shareholders

A company may, by ordinary resolution of its shareholders, impose restrictions regarding the times during which a person (other than a current director) may inspect the company's records. However, those restrictions must permit inspection of those records during the times set out in the Regulations (s. 46(8)). Section 13 of the Regulation requires that a company's records be available for inspection for a period of at least two consecutive business hours per day within statutory business hours (9:00 a.m. to 4:00 p.m., Monday to Friday, excluding statutory holidays observed in British Columbia; see the definition of "statutory business hours" in s. 1(1) of the Act. This resolution can either be passed at a meeting or consented to in writing.

If there are to be no auditors, a written waiver of their appointment is required from the holders of all the issued shares (not just from the holders of shares having the right to vote at meetings) (s. 203(2)).

Finally, the corporate records must include the minutes of the meeting of the shareholders as described above, or the consent resolutions in lieu of that meeting approved in writing by all shareholders (as permitted by s. 180).

Chapter 3

Shares[1]

[§3.01] Securities Laws

Issuing or transferring shares must comply with applicable securities laws. For most private companies, a "private issuer" exemption from the registration and prospectus requirements is available; however, it is essential for lawyers to confirm the availability of an exemption each time a share is issued or transferred. A detailed discussion of requirements for public companies, or requirements under the BC *Securities Act* or the *Securities Transfer Act* is beyond the scope of these materials.

[§3.02] Registers and Certificates

1. Entitlement and Effect of Registering

The *BCA* combines the register of allotments, the register of transfers, and the register of shareholders into one register known as the central securities register, the contents of which are set forth in s. 111. The central securities register must be maintained at the records office of the company (s. 42(1)(d)) or in any other location in British Columbia designated by the directors (s. 111(4)).

While s. 194(3) provides that a share certificate is evidence of ownership of shares, it is entering the holder's name in the security register which, by definition, results in the person becoming a shareholder of the company, and which gives that person the rights that flow to shareholders under the *BCA* (see ss. 1(1), 194(3) and (4)).

Shares issued by a company may be represented by a share certificate or may be uncertificated (s. 107(2)). Unless a shareholder holds uncertificated shares, the shareholder is entitled, without charge, to a share certificate certifying the number of shares they own (s. 107(3)). If the company refuses to issue a certificate, an application may be made to court (under s. 230) for an order directing the company to comply.

2. Form of Share Certificates

It is good practice to review any form of pre-printed share certificate before using it to ensure that the requirements set out in s. 57 have been met. If there are rights and restrictions attached to the shares—such as restrictions on transfer or preference share rights—the certificates must state the rights and restrictions or they must be attached to the certificate or, as is most commonly done, the certificate must carry a "statement" or "legend", which indicates that there are special rights and restrictions and that a copy of the full text may be obtained at the registered office or records office of the company.

The certificate must state the date on which it is issued (s. 57(1)(d)). Use either the date in the resolution authorizing the issue of the certificate, or an "as of" date. The share certificate cannot be considered as issued until an appropriate director or officer has signed it (s. 110). In public companies, signatures are mechanically reproduced and a counter signature endorsed on the certificate by the transfer agent (s. 110(1)(b)).

3. Lost Share Certificate

Section 109 states that s. 92 of the *Securities Transfer Act* applies to lost or destroyed share certificates. Under s. 92 of the *Securities Transfer Act*, a company must issue a new share certificate to an owner who claims that a share certificate has been lost, destroyed or wrongfully taken, if the owner:

- makes the request for replacement before the company receives notice that the lost, destroyed or wrongfully taken share certificate has been acquired by a "protected purchaser" (as defined in the *Securities Transfer Act*, essentially a *bona fide* purchaser for value without notice of any adverse claim);
- provides the company with an indemnity sufficient in the company's judgment to protect the company from any loss that they may suffer by issuing a new certificate; and
- satisfies any other reasonable requirements imposed by the issuer.

The usual practice is to obtain a statutory declaration as well as an indemnity from the person who requests the replacement certificate.

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[1] Revised by **Sean Muggah** of Borden Ladner Gervais LLP, Vancouver, in April 2023. This chapter incorporates chapters previously revised by Sean Muggah in November 2021 and by Jennifer MacGregor-Greer in March 2020. Previously revised by Kathleen Keilty in 2011 and 2009, and Brock H. Smith. Parts of this chapter were based on an article prepared by Mary V. Newbury for the CLE publication (2005 and 2005). Parts of this chapter were contributed by John O.E. Lundell, KC, in January 2004 and updated by the author in 2004 and 2005.

[§3.03] Issue of Shares

1. Initial Proceedings

In incorporating a company, one of the lawyer's duties is to prepare the incorporation agreement, by which the incorporator agrees to subscribe for one or more shares of the company. The lawyer will also prepare the notice of articles, which sets out the names of the first directors of the company. Then, shares are typically allotted and issued through a directors' resolution, which is consented to in writing or at a meeting of the directors.

The process for issuing a share is as follows:

(a) The shareholder subscribes at a price determined by the directors.

(b) The company approves the issuance of shares at the specified price. Typically, it is the directors who have authority to issue shares and set the price for shares, but not always. The lawyer must check the company's charter documents, carefully read ss. 62 and 63, and check for any pre-emptive rights of existing shareholders contained in the articles, a shareholders' agreement, or, if applicable, the Pre-existing Company Provisions contained in Table 3 of the Business Corporations Regulation (the "PCPs") that preserve pre-emptive rights for pre-existing companies unless or until the company determines otherwise.

(c) The shareholder pays fully for the shares.

(d) The company creates a "paper trail" for the payment (e.g. by generating a document confirming the company's receipt of payment).

(e) The company issues the shares, entering the details in the Central Securities Register (s. 111).

(f) The company issues a share certificate representing the shares (s. 107).

2. Kinds of Shares

(a) What Is a Share

A share represents a proportionate interest in the net value of a company (that is, the value that would remain after all the company's liabilities to outside creditors were fully paid). A share also carries with it a bundle of contractual rights arising from the provisions of the company's articles and notice of articles (or letters patent or, in the case of a *CBCA* corporation, articles of incorporation), in addition to the statutory rights provided in the relevant incorporation statutes. When we say certain rights are contractual, it follows that the shareholder may sue the company, or any other person who breaches these rights, for breach of contract. It is therefore important to understand the meaning of the various special rights and restrictions of shares.

A company's authorized share structure is a bank of shares: it is the maximum number of shares the company may issue. A company must have at least one class of shares.

The company's notice of articles must describe the authorized share structure of a company (s. 11(g)); it sets out the name of each class or series of shares and the kind of shares of which that class or series consists (s. 53(a)). The notice of articles must also:

(i) set out the maximum number of shares of each class or series that the company is authorized to issue (or state that it is unlimited) (s. 53(b));

(ii) set out the par value of any shares having par value (s. 53(c) (see below for further discussion) of par value shares));

(iii) identify any shares without par value as being shares of that kind (s. 53(d)); and

(iv) set out any special rights and restrictions attached to shares of each class or series (s. 11(h)), but not what the special rights or restrictions are.

Share capital can be subdivided into many types of shares so that special share rights can be allocated to particular shareholders. Each class of shares, however, must consist of shares of the same kind (s. 52(2)).

(b) Series of Shares

A particular class of shares will have rights or restrictions attached to it, which could include a right of the company to issue more series of shares in that class.

By resolution, the directors can:

- determine the maximum number (or that there is no maximum number) of shares of the series, or alter any such determination, and authorize the alteration of the notice of articles accordingly (s. 60(1)(b)(i)); and
- alter the articles and authorize the alteration of the notice of articles to attach special rights or restrictions to the shares of the series, or alter any such special rights or restrictions (s. 60(1)(b)(iii)).

When a series of shares is created (as opposed to a class), s. 58(2)(a) can be used to create the special rights and restrictions for that series, but more often the directors do this under s. 60(1)(b). Series shares give flexibility by allowing the directors to set such matters as dividend rates or redemption rates for the series, without the time and expense of creating a new class of shares (which would involve calling an extraordinary general meeting of shareholders to create the new class, having particular special rights or restrictions). Changing series rights requires a directors' resolution.

Certain safeguards for shareholders are built into the series of shares concept, prohibiting one series from having priority over another series of the same class with respect to dividends and a return of capital (s. 60(6)).

Every share in a series of shares must have attached to it the same special rights or restrictions as are attached to every other share of that series. In addition, the special rights or restrictions attached to the shares of a series must be consistent with the special rights or restrictions attached to the shares of the class of shares of which the series is a part (s. 60(4)).

If shares of a particular series are issued, the maximum number (if any) of shares of the series which can be issued and the identifying name of and the special rights or restrictions attached to the series (and the concurrent alterations of the articles and notice of articles) may be altered, authorized or determined only by the type of shareholders' resolution specified by the articles or, if not so specified by the articles, by a special resolution. Such changes cannot be made by a directors' resolution (s. 60(3)). If none of the shares of the particular series created under s. 60(1)(b) are issued, the directors can make such changes (s. 60(1)(b)), as can the shareholders.

(c) Par Value and Without Par Value

Section 52(1)(a)(i) authorizes the company to create shares with par value and shares without par value (also called "non par value shares"). Most BC companies are incorporated having common shares without par value. A company might issue par value shares for particular purposes (such as estate planning or tax planning).

The "par value" is the minimum price for which par value shares may be allotted. If a company has more than one class of shares, some classes can have shares with par value and others can have shares without par value (s. 52(1)). The par value must be expressed in reference to a currency, but need not be expressed in Canadian currency (s. 52(3)). Shares without par value may, in theory, be issued for any price or consideration (the "issue price") that is properly determined at the time of issue.

If a company has par value shares, s. 54(1)(i) permits the company to decrease the par value of its shares, subject to s. 74 (reduction of capital; see §3.09).

Section 54(1)(i) also permits a company to increase the par value of its shares, provided that none of the shares of that class of shares are allotted or issued.

Unlike the *BCA,* the *CBCA* does not allow the issuance of par value shares (*CBCA* s. 24(1)).

3. Equality of Shares

If no special rights or restrictions explicitly attach to different classes of shares, they are presumed to be equal in all respects, no matter what they are called. For example, in *Birch v. Cropper* (1889), 14 App. Cas. 525 (H.L.), the holders of what were called "preference shares" had been given priority in the corporation's articles for the payment of dividends while the corporation was a going concern. The articles were silent, however, as to how the preference and common shareholders were to share in the distribution of the capital of the corporation upon a winding-up. The House of Lords held that, unless otherwise stated, the preference and common shares ranked equally on a winding-up. Indeed, the preference shareholders were entitled not only to the return of their paid-in capital, but also to share rateably with the common shareholders in respect of the capital surplus of the company.

It is prudent to avoid ambiguity by stating clearly in the articles the rights and restrictions (if any) that apply to shares.

[§3.04] Creating or Altering Special Rights or Restrictions

Often there is a distinction between "common" shares (or "ordinary" shares) and "shares with special rights or restrictions" (often called "preference shares" or "preferred shares"). The expressions "preference shares" and "preferred shares" are not required by the *BCA*. The common or ordinary shares can themselves be in various classes. If they are non-voting, they should be designated as such since each share carries the right to vote unless otherwise specified in a company's articles (s. 173(1)). Preference shares may specify that they will rank ahead of the common shares in some respects (for example, a

preference in receiving dividends, or in return of capital if the company is liquidated).

The special rights and restrictions set forth in a company's articles and notice of articles constitute an enforceable contract between a shareholder and the company.

Section 58 contemplates that different classes of shares may be created having special rights or restrictions, as set out in the company's articles. The definition of "special rights or restrictions" in s. 1(1) is an inclusive one, and thus many different characteristics can be given to shares.

Under s. 58, a company may create special rights or restrictions, or vary or delete special rights and restrictions, for any class or series of shares of the company, whether those shares have actually been issued yet or not (s. 58(2)(a) and (b)).

If special rights or restrictions are being created or deleted as part of the creation or elimination of a class or series of shares, the description of the company's authorized share structure must be altered in the notice of articles (ss. 11(g), 11(h) and 53).

Typically, the creation or alteration of special rights or restrictions must be approved by special resolution of the shareholders under s. 58(2), unless the articles specify a higher majority is required to approve the resolution (s. 55(2)). Special rights or restrictions may also be altered by court order.

The company must note on the resolution altering the articles that the alteration does not take effect until the notice of articles is altered to reflect the alteration to the articles. The company must deposit that resolution (with the notation on it) at the company's records office and then alter its notice of articles under s. 257 to reflect the alteration that was made to the articles.

Altering the notice of articles requires that a notice of alteration be filed with the registrar (s. 257(4)). The alteration to the articles takes effect when the alteration to the notice of articles takes effect (s. 257(5)). Also see §6.09 and §6.10.

If special rights or restrictions are to be altered under s. 58(2)(a) or (b), and the amendment will prejudice or interfere with any right or special right attached to issued shares of any class, then the consent, by a special separate resolution, of the holders of shares of that class or series will be required (s. 61).

Rights and restrictions attached to shares are sometimes agreed to outside the articles by way of contracts or shareholders' agreements, but those agreements are vulnerable to being overridden by *BCA* s. 12(2)(b), which requires that, for each class and series of a company's shares, all special rights and restrictions be set out in the company's articles.

[§3.05] Substance of Special Rights or Restrictions

The rights and restrictions attached to one or more specific classes of shares commonly relate to the following (described in more detail in the sections below):

(a) voting rights at general meetings (i.e. whether shares are voting, voting only in some circumstances, or non-voting);

(b) rights to participate in the profits of the company while it is a going concern by way of dividends;

(c) rights to participate in the capital assets of the company on a winding-up;

(d) pre-emptive rights on the allotment of shares;

(e) rights of redemption or retraction; and

(f) rights of conversion to other classes of shares (s. 76).

The same special rights and restrictions can be attached to shares of more than one class or series (s. 58(4)).

1. Voting Rights

Section 173 of the *BCA* codifies the common law principle that unless a company's charter documents state otherwise, there is a presumption of equality among the shares. Subject to the articles providing otherwise, all shareholders will normally be entitled to vote at general meetings of the company and to cast one vote per share. Depending on the terms of the articles of a company, shares may be voting or non-voting in all circumstances, or they may be voting only in some circumstances. Based on the "exclusionary principle", it seems likely that once a share is stated to be voting in some circumstances, those are the only circumstances in which it may be voted. However, it is prudent to avoid the chance of this question arising by stating clearly that those are the only circumstances in which the shares may be voted. It is also worth noting that in British Columbia, non-voting shares may be called "common" even though the concept of a common share might in the past have been taken to suggest full voting rights.

Even shares that are non-voting at general meetings are entitled to be voted at separate meetings of shareholders of the particular class of shareholders, if and when the applicable statute requires. For example, where a company proposes to amalgamate with another and the company has more than one class of shares, the amalgamation agreement must be approved either by a unanimous resolution of all shareholders (whether or not their shares otherwise carry the right to vote) or by a "special separate res-

olution" (s. 1(1)) of each class or series. Similarly, where a company proposes to waive the appointment of an auditor, the matter must be approved by unanimous resolution of all shareholders (whether or not their shares otherwise carry the right to vote) (s. 203(2)).

2. Participation as to Income

The right to share or participate by way of dividend in the income of a company while it is ongoing attaches automatically to a share unless this right is otherwise excluded. Dividend rights may be excluded totally or limited to a fixed return, as is the case with many preference shares. One variation on the fixed rate of return for preference shares has been to require that the fixed rate of return be adjusted in accordance with the cost of living.

Generally, dividends may be declared only by directors (*Burland v. Earle*, [1902] A.C. 83 (H.L.)). They are payable out of profits, capital, or otherwise, subject to the company's charter or an enactment (s. 70(1)). A record date may also be fixed in order to determine which shareholders are entitled to receive a dividend (s. 171(1)(a)).

As a protection for outside creditors, directors may not declare dividends if there are reasonable grounds for believing that payment of the dividends would render the company insolvent (i.e. unable to pay its debts as they become due in the ordinary course of business) or that the company is already insolvent (s. 70(2)). Directors who vote or consent to a resolution declaring a dividend in such circumstances may be exposed to civil liability (s. 154(1)(c)).

A shareholder's entitlement to dividends may be either cumulative or non-cumulative. If a dividend is cumulative, the directors must make up for "missed" dividends from previous fiscal periods before paying dividends to other lower-ranking classes of shareholders.

Dividend share rights are presumed to be cumulative (*Webb v. Earle* (1875), L.R. 20 Eq. 556). However, this presumption may be rebutted by any words indicating that a preferential dividend is to be payable only out of the profits of the particular year.

3. Participation on Winding Up

Share rights also often deal with participation in the capital assets of a company at the time it is wound up or dissolved. If the share rights and restrictions are silent on this point, all shareholders share rateably.

The most common limitation on preference shares is that the holders of those shares are entitled only to the return of the amount paid up on such shares. This limitation leaves the common shareholders (who have probably assumed more risk in the enterprise) to reap the rewards of capital appreciation of the company's net assets.

A company can set a record date for the purpose of determining which shareholders are entitled to participate in a return of capital upon a liquidation distribution (s. 171(1)(b)).

4. Pre-Emptive Rights

Shareholders sometimes want a right to purchase shares that are being offered by the company before those shares are offered to other prospective buyers. At common law, a shareholder was not entitled to insist on a right to purchase such shares first. In some cases, this meant that a shareholder who was disagreeing with the company might have their shareholding "watered down" or "diluted" by the directors issuing new shares to "drown out" the dissident.

Under s. 41 of the former *Company Act*, this situation was remedied. If the company was a non-reporting company, then the directors were required to offer the shares *pro rata* to the existing members before allotting new shares for issuance. This requirement still applies to pre-existing companies that have not removed the application of the PCPs. However, companies incorporated under or continued under the *BCA*, or pre-existing companies that have amended their articles to remove the PCPs, will not be subject to a statutory pre-emptive right on share allotments. They may, however, provide that right in their articles (ss. 62 and 442.1) or in a shareholders' agreement.

Likewise, there is no statutory pre-emptive right for share transfers. For this reason, shareholders' agreements in many private companies provide for a pre-emptive right, which a shareholder may exercise. Basically, this right gives shareholders a right of first refusal to acquire any shares that another shareholder proposes to transfer.

5. Redemption and Retraction

Rights of redemption (where a company forces a shareholder to redeem their shares by selling them back to the company) or retraction (where a shareholder forces the company to buy back the shares), or both, may be attached to shares, and a redemption or retraction price specified. The pre-agreed redemption or retraction price of a share usually is not less than the shareholder's original capital investment, but may be much higher. Indeed, preference shares that are redeemable or

retractable for a higher amount than their par value are often used for tax planning.

A proposed redemption might not be carried out if there are reasonable grounds for believing that the company is insolvent or if the redemption would render the company insolvent (ss. 77(a) and 79). Redemptions are also subject to any restrictions contained in a company's articles (or memorandum, if it is a pre-existing company) (s. 77(a)).

Under the former *Company Act*, redemptions had to be carried out rateably, or *pro rata*, among every shareholder of the subject class, unless its charter documents otherwise provided. In other words, if the board of directors resolved to redeem 50% of the issued and outstanding preference shares of the pre-existing company, 50% of the shares held by each shareholder normally had to be redeemed, so that some shareholders could not be favoured over others. This rateable redemption requirement continues for pre-existing companies that have not removed the application of the PCPs.

6. Rights of Conversion

Where no explicit right of redemption is provided for in the articles, a company at common law is prohibited from acquiring its own shares. However, both the *BCA* and the *CBCA* permit companies to repurchase their shares in certain circumstances. Under s. 77(b) of the *BCA*, the company only has authority to purchase its own shares if the articles (or memorandum, if it is a pre-existing company) provide authority to do so. Under the *CBCA*, the reverse is true: a corporation may acquire its own shares unless it is prohibited by its articles (*CBCA* s. 34). As is the case with redemptions, a repurchase may not be carried out under either statute if there are reasonable grounds for believing that the company is insolvent or that the repurchase would render the company insolvent (*BCA* s. 78; *CBCA* s. 34(2)).

As with redemptions, an offer to purchase made by a company under the former *Company Act* had to be made in most circumstances rateably to all shareholders of the subject class. This rateable repurchase requirement continues for some pre-existing companies (see Table 3, Part 4 to the Regulation).

Companies may also issue convertible shares. These are shares that may be converted at the option of the shareholder or the company into other classes of shares. Sometimes the right of conversion is triggered by a particular situation—for instance, the failure of the company to pay dividends to holders of preferred shares.

[§3.06] Subsequent Allotments

When allotting shares at any time following the initial issue of shares, the lawyer must ensure that all sections of the *BCA* (as well as the articles) respecting subsequent allotments are complied with.

Section 41(1) of the *Company Act* provided that, before allotting shares, the directors had to offer them *pro rata* to all members as a pre-emptive right. There is no similar requirement under the *BCA*; however, the *BCA* contemplates that the pre-emptive right will continue to apply to pre-existing companies unless the articles state otherwise.

The PCPs establish a minimum period of seven days within which shareholders can accept their entitlement. The usual practice for allotting shares in non-contentious situations is to provide for a waiver of the right to receive the *pro rata* entitlement every time shares are allotted. A general waiver is prohibited under P13 of the PCPs, but a specific waiver is permitted under P14, and the *pro rata* entitlement rules do not apply to public companies. A signed waiver referring to a specific allotment at a specific price and referring to ss. 40(1) and (4) of the *Company Act* has been judicially approved (*Milburn v. Copperbank Resources Ltd.* (1975), 58 D.L.R. (3d) 138 (B.C.S.C.)).

Many companies have provisions in their articles to ensure that shareholders will not suffer dilution of their percentage of equity without having the opportunity to preserve it by subscribing for more shares.

[§3.07] Transferring Shares

1. *Securities Transfer Act*

Common corporate transactions of private companies, including simple share issuances and share transfers, must comply with the relevant provisions of the *Securities Act* or the *Securities Transfer Act*. Lawyers representing private companies must become familiar with the exemptions from the registration and prospectus requirements available to private companies.

Section 17 of the *Securities Transfer Act* provides that a person acquires a security if they are a person to whom a security is delivered. Delivery of a certificated security to a purchaser occurs when:

(a) the purchaser acquires possession of the security certificate;

(b) another person acquires or acknowledges holding the security certificate on behalf of the purchaser; or

(c) a securities intermediary, such as a clearing agency or a brokerage, acquires possession of

the security certificate, in registered form, and the security certificate is registered in the name of the purchaser, payable to the order of the purchaser, or specially endorsed to the purchaser (*Securities Transfer Act*, s. 68(1)).

Delivery of an uncertificated security occurs when the company registers the purchaser as the registered owner, or another person either becomes the registered owner on behalf of the purchaser or, if previously registered as the owner, acknowledges that they hold the uncertificated security on behalf of the purchaser (*Securities Transfer Act*, s. 68(2)).

According to s. 86 of the *Securities Transfer Act*, a company must enter the name of the transferee in the company's securities register upon receiving a share certificate with a request to register a transfer, in the case of a certificated share, or upon the receipt of an instruction to register an uncertificated share, provided the conditions of s. 86(1) of the *Securities Transfer Act* have been met. If a company has a duty to register the transfer of a share under s. 86(1) of the *Securities Transfer Act*, the company is liable to the person presenting the certificated share or instruction for registration, or that person's principal, for any loss resulting from an unreasonable delay in registration or the failure or refusal to register the transfer (*Securities Transfer Act*, s. 86(2)).

2. Restricting Share Transfer and Transmission

The articles of most private companies prohibit the transfer of shares except with the approval of the directors. This restriction is required in order for the company to qualify as a "private issuer" and therefore be exempt from many securities laws. The restriction also ensures that those who own the company can limit shareholders to the people they choose to work with. Restrictions on transfer can effectively prevent a shareholder from selling their shares.

Shareholders' agreements might also require that the shares first be offered to existing shareholders, or that the consent of the parties to the shareholders' agreement be obtained prior to transferring the shares.

Usually, in non-contentious situations, an application to transfer is prepared by consent, waiving transfer restrictions.

The situation is different where there is an involuntary transfer, generally called a "transmission," such as occurs following the death or bankruptcy of a shareholder. Section 118 of the *BCA* sets out the items that the company must ask for when the shareholder's personal representative, such as the executor of a deceased shareholder's estate, requests a transmission of shares.

One practice is to transmit the shares into the name of the executor first, and later, once the estate is settled, transfer the shares to the beneficiary. Alternatively, it is possible for the company to transmit the shares to the executor and then immediately transfer the shares to the beneficiary, in one resolution. There are two important things to note:

- the company is bound to record the transmission in the share register if the requirements of s. 118 are met, but
- the transfer of the shares to the beneficiary is subject to all the usual procedures for, and the usual restrictions on, the transfer of shares of that company, including director approval.

Note that provisions in a shareholders' agreement might address the company buying back the shares instead of allowing them to be transferred (see Chapter 9).

[§3.08] Altering Share Structure

1. Alterations Under s. 54 Generally

The *BCA*, s. 54(1), sets out a long list of specifically permitted changes to the authorized share structure and the shares of a company. At the end of the list there is a catch-all provision permitting the company to otherwise alter its authorized share structure or shares when required or permitted to do so by the *BCA* (s. 54(1)(n)).

The procedure for a company to carry out any of the alterations under s. 54(1) depends on which of three categories the changes fit into.

(a) If the capital alteration will make information reflected in a company's notice of articles incorrect or incomplete, the notice of articles must be altered to reflect that change (s. 54(3)(a)).

(b) When only the notice of articles is being altered, ss. 257(2), (4), (5) and (6) apply (see §6.09). These subsections set out the type of resolution required, the filing requirements with the registrar, when the alteration takes effect, and the registrar's duties.

(c) When the effect of a change under s. 54(1) would render information in both the articles and the notice of articles incorrect or incomplete, then that change must be effected by altering both the notice of articles and the articles to reflect the change (s. 54(3)(b)).

2. Subdividing Shares

Under ss. 54(1)(e) and (f), a company may subdivide its shares.

Any unissued or fully paid issued shares *with par value* can be subdivided into a greater number of shares with a smaller par value (s. 54(1)(e)). The product of the number of shares multiplied by their par value must be the same before and after the subdivision (s. 54(2)). In other words, if there were 20 shares each having a par value of $100 ($2,000), then after subdivision there might be 40 shares each having a par value of $50 ($2,000).

Any unissued or fully paid issued shares *without par value* can be subdivided into any greater number of shares without par value (s. 54(1)(f)).

If not all the par value shares of a class are being subdivided, then two separate classes will be necessary (with different identifying names), because all par value shares in a class must have the same par value (s. 52(2)).

It is not possible to subdivide a series of par value shares without subdividing the whole class or turning the series into a separate class.

3. Consolidating Shares

The opposite of a subdivision of shares is a consolidation. Under ss. 54(1)(g) and (h), a company may consolidate its shares.

Any unissued or fully paid issued shares *with par value* can be consolidated into a smaller number of shares with a larger par value (s. 54(1)(g)) and, again, the product of the number of shares multiplied by the par value must be the same before and after the consolidation (s. 54(2)).

Any unissued or fully paid issued shares *without par value* can be consolidated into any smaller number of shares without par value (s. 54(1)(h)).

As with a subdivision, if not all the par value shares of a class are being consolidated, two classes will be necessary (with different designations), because all par value shares in a class must have the same par value (s. 52(2)).

It is not possible to consolidate a series of par value shares without consolidating the whole class, or turning the series into a separate class.

4. Altering the Name of the Shares

The identifying name of any shares, whether issued or unissued, may be altered (s. 54(1)(m)).

The identifying name of the shares should not misrepresent their characteristics. For example, if part of the name is the word "preferred," then the shares should actually be preferred over other classes of shares of the company in some respect.

Because s. 58(4) permits different classes and series of shares to have identical special rights or restrictions, the identifying names of classes (or series) might be the only distinction between them.

[§3.09] Reducing Share Capital

A company may reduce its capital in any way by a special resolution, provided that the capital is reduced to an amount that is not less than the realizable value of the company's assets less its liabilities (s. 74(1)(b)).

If it is reduced below that amount, the reduction of capital requires court approval (s. 74(1)(a)). Court approval is still an option even if the capital is not reduced below that amount (s. 74(1)(b)). Although the application for court approval might be authorized only by directors' resolution, it may be helpful, in some circumstances, to be able to advise the court that some level of shareholder approval had been obtained.

Section 75 permits certain reductions of capital and cancellations of shares without special resolution or court order. In addition, a company can perform these particular reductions and cancellations without having to change the company's authorized share structure (s. 75). These reductions include:

(a) redeeming or purchasing shares in the normal manner under s. 77, or under s. 227(3)(g) (the oppression remedy), or under Division 2 of Part 8 (the dissent remedy) or Division 5 of Part 9 (arrangements) (s. 75(a));

(b) accepting a surrender of shares as a gift, or for cancellation (s. 75(b)); and

(c) converting fractional shares into whole shares in accordance with s. 83, either on a subdivision or consolidation of shares under s. 54(4) (s. 75(c)(i)) or on a redemption, purchase or surrender (s. 75(c)(ii)).

Any of the enumerated acts in s. 75 may be performed whether or not there are any provisions relating to them in the articles of the company. However, if there are any such provisions, then the company can only do the acts on the terms and in the manner so provided (s. 75).

Section 75(c)(i) provides that a conversion of fractional shares into whole shares on a subdivision or consolidation under s. 54(4) does not require that the authorized share structure of the company be changed. However, it is possible that in limited circumstances a subdivision could push the number of issued shares over the maximum number of shares of the particular class or series that the company is authorized to issue. It would proba-

bly be necessary in this case to increase (or eliminate) that maximum number under s. 54(1)(c).

[§3.10] Interfering With or Prejudicing Class or Series Rights

Section 61 provides that a right or special right attached to issued shares must not be prejudiced or interfered with under the *BCA*, or under the notice of articles or articles, unless the holders of the particular class or series of shares consent. Such prejudice or interference may arise as a result of a resolution under s. 58 altering the rights attached to shares, but it could arise in some other way as well.

Section 61 refers to a "right or special right." The term "special rights or restrictions" is defined in s. 1(1). "Right" is not defined. Presumably it means a right attached to all shares by operation of the common law or the *BCA*, unless it is taken away by the articles. It would include such things as the right to attend and vote at general meetings (see s. 173(1)), the right to participate in the distribution of assets on dissolution of the company, and the right to receive dividends.

The meaning of the words "prejudice" and "interfere" in s. 61 is not clear, although the phrase "unfairly prejudicial" has received attention in cases decided under the former provision that is equivalent to the current s. 227(2)(b). The words "prejudice" and "interfere" might be held to have a wider meaning than simply a variation or deletion of special rights or restrictions under s. 58 that is detrimental to that particular class (or series) of shares. For example, it is not clear if creating a new class of shares that ranks ahead of an existing class with respect to dividends, or on a dissolution, would be prejudicial to the existing class of shares.

To add to the uncertainty surrounding the scope of s. 61, some English cases dealing with similar language have distinguished between a variation of a right (or special right) attached to a share and some act that is not such a variation but merely affects the enjoyment of that particular right. The courts have held that only the former situation gives remedies to an aggrieved shareholder. This distinction has been followed in at least one British Columbia case (*Re Trend Management Ltd.* (1977), 3 B.C.L.R. 186 (S.C.), following *Greenhalgh v. Arderne Cinemas Ltd.*, [1946] 1 All E.R. 521 (C.A.) and *White v. Bristol Aeroplane Co. Ltd.*, [1953] 1 All E.R. 40 (C.A.)).

If it is decided that a particular act (such as a resolution under s. 58) may prejudice or interfere with a right or special right attached to a class or series of issued shares, the consent of the shareholders of that class or series must be obtained under s. 61. This consent requires a special separate resolution (defined in s. 1(1)) of that particular class or series.

In addition to the consents required under the *BCA*, the articles may require consents of holders of shares of a particular class or series if their special rights or restrictions are being altered or affected, or if preferential rights are being given to shares of a different class, or in other circumstances. The wording in the articles is usually different from that in s. 61, and can create a situation where no class or series consent is required under the *BCA*, but consent is still required under the articles.

Chapter 4

Governance[1]

[§4.01] Scope of This Chapter

This chapter deals with how companies are run and the duties and responsibilities of the people who run them.

Most of the provisions in the *BCA* dealing with "public companies" are restricted in scope to dealing with the initial structure and general management of the public company. The specific governance and financial reporting requirements that apply to public companies are set out in the *Securities Act* and related instruments, and in the applicable stock exchange rules.

Federal companies differ in some respects and are not dealt with comprehensively in this chapter; however, comparative provisions of the *CBCA* are mentioned in some sections. For more on *CBCA* companies, see Chapter 11.

[§4.02] Management of the Company

1. Control of the Company

While the articles may grant shareholders of a company, or any other person, extensive authority in connection with the management of the business of the company, the general practice is to entrust a board of directors with the exclusive power to manage the company and to grant that power free from interference from the shareholders (derived from s. 136(1)). Usually, the shareholders are left only with the power to change the directors at the annual general meeting or to remove them by special resolution (s. 128(3)(a)), or some other method or resolution as specified in the articles (s. 128(3)(b)).

2. Directors

(a) Election or Appointment of Directors

Under the *BCA*, the person or persons designated as directors in the notice of articles are the first directors. After that, the Act and the articles govern elections and appointments (s. 122(1) and see *Western Mines Ltd. v. The Shield Development Co. Ltd.*, [1976] 2 W.W.R. 300 (B.C.S.C.)).

Often the articles provide that the directors retire at each annual general meeting and the incoming directors are elected or appointed at that meeting, although this is not mandatory. Directors may appoint additional directors between annual general meetings, if authorized by the articles, provided that the number of directors added does not exceed 1/3 of the number of first directors (if any of them are still in their first term), or in any other case, 1/3 of the then current number of directors (s. 122(2) and (3)).

Subject to the articles, the remaining directors may fill a casual vacancy on the board (s. 131(b)) unless the articles provide otherwise (s. 130). Sections 131 to 135 set out the rules for filling vacancies, and these rules apply unless the articles provide otherwise.

To be a valid election or appointment, certain procedures must be followed. First, a director must consent to act as such. Consent can take the form of:

- the individual being present at the meeting at which they are elected or appointed as director, and not objecting to the election or appointment (s. 122(4)(b));
- written consent (before or after the appointment) (ss. 122(4) and 123(1)(a)); or
- performing functions of, or realizing benefits that are available to, a director, knowing (or when the person ought to have known) of the election, appointment or designation (s. 123(1)(b)).

The consent lasts until revoked, or the director's term ends and that director is not immediately re-appointed, or the director resigns or is removed (s. 123(3)).

The shareholders of private companies may elect directors by a resolution in writing instead of by election at a meeting.

A company must file a notice of change of directors with the registrar within 15 days of the change in its directors (or in the address of a director) (s. 127(1)). This change will affect the company's notice of articles (s. 127(2) and (3)).

(b) Number

Private companies must have at least one director, and public companies must have at least three directors (s. 120).

Commonly, the articles give the shareholders the power to change or fix the number of direc-

[1] **Jennifer MacGregor-Greer**, MEP Business Counsel, Vancouver, kindly revised this chapter in March 2023, March 2020 and January 2018. Previously revised by Jason Harris (2011) and revised with the assistance of Harris S. Wineberg in 1994. Based on an article prepared by Geoffrey Bird for the CLE publication, *Company Law* (November 1987) and revised annually by the author from 1995 to 2006.

tors. Always review the company's articles for the proper procedures and authorities.

(c) Residency Requirements

There are no residency or citizenship requirements for directors under the *BCA*.

(d) Qualifications of Directors

Under s. 124(2), those who are not qualified to become or act as directors include: people under the age of 18; people found to be incapable of managing their own affairs; undischarged bankrupts; and people who have been convicted of an offence in the past five years concerning the promotion, formation or management of a corporation or unincorporated business, or an offence involving fraud.

If a director ceases to meet the qualifications of s. 124 or the articles of the company, the director does not automatically cease to hold office but must resign immediately (s. 124(3)).

(e) Improper Election or Appointment

If a defect or irregularity in a director's appointment, election or qualification is discovered after the director has taken office and performed acts, those acts will not be invalid merely because of that defect (s. 143).

(f) Term of Office

The articles govern the length of a director's term of office and typically provide that the term extends only to the next annual general meeting (s. 128(1)(a)).

(g) Resignation

The resignation of a director must be in writing and delivered to the company or a lawyer for the company. It is only effective when it is received, or at the time, date or event specified in the resignation, if that time is later (s. 128(2)). The resignation need not be received at the company's registered office.

(h) Removal

Directors generally retire at each annual general meeting, but often stand for re-election at that meeting. If others are elected in their place, the term of the retiring directors ceases (if the articles so provide). Other than by voting a director out, a director may only be removed as specified in the articles, or by a special resolution of the shareholders (s. 128(3)).

If the holders of a class or series of shares have the exclusive right to elect or appoint one or more directors, then only those shareholders may remove those directors (s. 128(4)).

(i) Alternate Directors

Although it is common to appoint alternate directors in British Columbia (and most standard form articles provide a procedure for doing so), there is no statutory requirement for this practice. Section 137 of the *BCA* (which authorizes transferring powers from a director to another person, if authorized by the articles), seems to contemplate the complete transfer of authority away from the directors, which is not normally what a director intends by appointing an alternate. Section 137 does provide that an alternate director would be subject to the same duties, liabilities and protections as any director of the company, unless the alternate director performed functions as a director only under the direction and control of another director, shareholder or senior officer.

Provisions in articles permitting the appointment of alternate directors vary. Some provide that the alternate director can only perform limited functions, such as attending directors' meetings in the place of their appointer. Others purport to appoint alternate directors for all purposes, although some practitioners query how valid this practice is.

(j) Register of Directors

A company must maintain a register of its directors (s. 126). This register must contain the full names and prescribed addresses of the directors, the date on which each director was elected or appointed, and the date on which each former director became a director and ceased to hold office as a director.

The "prescribed address" for a director or officer is the delivery address of the office the director normally occupies during business hours (including, if different from the delivery address, its mailing address) or the address of the director's residence (Regulation, s. 2(2)).

Directors may avoid disclosing their home addresses if they also have office addresses where they can be served.

3. The Powers of Directors

Section 136(1) of the *BCA* states:

> The directors of a company must, subject to this Act, the regulations and the memorandum and articles of the company, manage or supervise the management of the business and affairs of the company.

When a person who is not a director (except those mentioned in s. 138(2)) performs the functions of a director, certain liabilities and obligations of directors will apply to that person (s. 138(1)).

No limitation or restriction on the powers or functions of the directors is effective against a person who does not have knowledge of these limitations or restrictions (s. 136(2)).

The standard form articles of British Columbia companies often contain provisions similar to those in the Act, as described above.

In practice, the directors establish sound business policies of the company and it is the officers of the company (appointed by the directors) who actually carry out those business policies on a daily basis. Because there is an active duty imposed on directors to manage the company, no distinction may be drawn between active and passive (or nominee) directors and their exposure to liability.

When the appropriate provisions are placed in the company's articles, the directors may transfer their powers to manage or supervise the management of the business, in whole or part, to others (who need not be shareholders or directors) (s. 137(1)). Consequently, some or all of the shareholders of a company (or other persons) can act as directors of the company if the shareholders want them to. To transfer powers effectively, the articles must clearly indicate (by referring to s. 137 or otherwise) the intention that such powers be transferred (s. 137(1.1)(b)).

When the powers are transferred, the persons to whom these powers are transferred are subject to the same duties and liabilities as any director who exercises these powers (s. 137(2)(a)). The "regular" directors are relieved from liabilities to the extent that other parties exercise these powers (s. 137(2)(b)).

Section 146(1) of the *CBCA* provides similarly. If all the shareholders (or all the shareholders and a third person) enter into a unanimous shareholder agreement, they may restrict in whole or in part the powers of the directors to manage, or supervise the management of the business and affairs of the corporation, as long as it is otherwise a lawful agreement (s. 146(1)). The shareholders who are party to a unanimous shareholder agreement are subject to the same duties and liabilities as any director who exercises these powers. Like under the *BCA*, the "regular" directors of the company are relieved from their duties and liabilities to the extent that other parties exercise powers under the unanimous shareholder agreement.

When a receiver-manager is appointed for a company, the powers of the directors and the officers cease to the extent of the appointment and during the period of the appointment (s. 105). The powers and duties of the directors and officers continue with respect to other corporate matters and assets not covered by the appointment of the receiver-manager. If the company is still viable after the receiver-manager has completed their job, the powers of the directors and officers then resume. If a liquidator is appointed, the powers of the directors and officers cease, except so far as the liquidator allows them to continue (s. 334(1)(a)).

4. Officers

The term "officer" is not defined in the *BCA*, although "senior officer" is defined in s. 1(1). "Senior officer" includes the chair and any vice chair of the board of directors, the president of the company, any vice president in charge of a principal business unit, and any officer who performs a policy-making function in respect of the company and who has the capacity to influence the direction of the company.

A company isn't required by the Act to have any particular officers, nor is any office with the company required to be filled by a director, unless the articles provide otherwise (ss. 141(1) and (2)).

The qualification criteria for officers are the same as those for directors under s. 124 (s. 141(3)). It is an offence for an unqualified person to act as an officer of a company (s. 426(4)). The election and appointment of officers is within the power of the directors, unless the articles specify otherwise (s. 141(1)). Even though there may be an irregularity or a defect in the election or appointment of an officer, their acts may still be valid (s. 143). If an officer is removed from office without cause, their contractual rights as an employee, if any, still survive, but the appointment as an officer does not of itself create any contractual rights (s. 141(5)).

Only "senior" officers (as defined in s. 1(1) and summarized above) must disclose possible conflicts of interest arising from offices or property held (ss. 147 to 153). The same rules for indemnification and insurance that apply to directors also apply to officers (ss. 159 to 160).

The duties of the officers are as directed by the articles and by the directors. Like directors, officers have a duty to act honestly and in good faith with a view to the best interests of the company (s. 142(1)(a)); must exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances (s. 142(1)(b)); and must comply with the *BCA*, its regulations, and the memorandum and articles of the company (s. 142(1)(c) and (d)).

5. Insiders

"Insider" in a "private company" means (s. 192(1)):

(a) a director or senior officer of the private company;

(b) a person who beneficially owns shares of the private company that carry, in aggregate, more than the prescribed fraction of the votes [currently set at 1/10th (Reg. s. 19)], that may be cast in an election or appointment of directors at a general meeting;

(c) an associate of a person referred to in paragraph (a) or (b);

(d) the private company itself;

(e) an affiliate of the private company;

(f) a person who is employed by the private company or who is retained by it on a professional or consulting basis; or

(g) a director or senior officer of another corporation if that other corporation is itself an insider of the private company.

Most of the provisions in the *BCA* dealing with "public companies" deal only with the initial structure and general management of the public company. The governance and financial reporting requirements of public companies are set out in the *Securities Act* and related instruments, and in the applicable stock exchange rules.

If an insider of a private company (as defined in s. 192) uses specific confidential information in a transaction involving any security of that company (not just its shares), and for the benefit of that insider or certain related parties, then the insider may be liable to compensate any person for any direct loss suffered by that person as a result, and may be accountable to the private company for any direct benefit or advantage received by the insider or certain related parties (s. 192(3)).

Parties to a transaction that involves a private company's securities may agree in writing that s. 192 does not apply to that transaction (s. 192(5)). (Note that provisions relating to insiders of reporting issuers are found in the *Securities Act*.)

Amendments to the *BCA*, in force as of October 1, 2020, require all private companies to establish and maintain a "transparency register" identifying all "significant individuals." "Significant individuals" are those holding 25% or more of the company's shares or their voting rights (s. 119.11).

6. Residual Powers of Shareholders

Directors generally have the exclusive right to manage the business of the company, although the shareholders are permitted a role in corporate governance in some respects:

(a) Pre-emptive Rights on Allotment of Shares

Section 41 of the former *Company Act* granted mandatory pre-emptive rights to existing shareholders of non-reporting companies for later allotments of shares. Each of the existing shareholders of a particular class had a right of first refusal to maintain their rateable interest in the company. Under the *BCA*, such rights only apply:

- to companies that are subject to the Pre-existing Company Provisions, (Table 3, Part 3 to the Regulation), (although the shareholders of a pre-existing company may remove them by altering its notice of articles by special resolution (Business Corporations Reg. s. 45)); or
- if provided for in a company's articles.

(b) Disposition of the Company's Undertaking

Section 301(1) of the *BCA* provides that a company must not sell, lease or otherwise dispose of all or substantially all of its undertaking, unless:

- it is authorized by special resolution to do so; or
- the sale is in the ordinary course of its business.

The "ordinary course of business" exception would apply when a company, in the course of carrying on its business, sells most of its assets all at once (such as an apartment building or a large piece of equipment) but is replacing them with similar assets and continuing the business. This prohibition does not apply to a disposition of the undertaking by way of security, or by a short-term (less than three years) lease, or to parent, subsidiary or sister corporations (in the wholly owned context), or to the sole shareholder of the company (s. 301(6)).

Although it appears directors of a company can avoid the effect of s. 301 by first transferring the undertaking to a wholly owned subsidiary of the company with the intent that the wholly owned subsidiary would then transfer it to a third party, such action may expose the directors who participated in such a scheme to liability for breach of their duty of good faith. There also is a risk that a court may determine that the

"undertaking" of a parent company includes the assets of its subsidiary.

Case law indicates that the meaning of the words "all or substantially all of its undertaking" must be interpreted in a qualitative (how important are the assets?) as well as a quantitative (what proportion of the company's assets?) manner. In particular, a court will examine whether the disposition in question was an unusual transaction or one made in the regular course of business (*Lindzon v. International Sterling Holdings Inc.* (1989), 45 B.L.R. 57 (B.C.S.C.)).

Section 301(5) provides that any shareholder of a company may send a notice of dissent to the company in respect of a special resolution to approve or ratify a disposition of substantially all of the company's undertaking. If a shareholder does so, Division 2 of Part 8 (ss. 237 to 247) applies, meaning that the shareholder can require that the shares that are the subject of the notice of dissent be purchased by the company at their fair value.

If a shareholder intends to dissent, the shareholder should not vote the subject shares in favour of the resolution approving the disposition or sign any consent resolution in writing approving the disposition.

When the special resolution is to approve a proposed disposition, the company should observe the timing requirements in Division 2 of Part 8. The company should ensure that it complies with ss. 240(1) and (2) regarding the sending of material advising all shareholders (voting and non-voting) of their dissent rights (whether or not there is an actual meeting), as the company may not want to continue with the disposition if there are too many dissents.

7. Directors' Meetings

In order to act, the directors must act together as a board. This does not mean that the directors must always hold a formal meeting.

A resolution of the directors may be passed without a meeting if each of the directors "entitled to vote on the resolution" consents to the resolution in writing, or in any other way permitted under the Act or by the company's articles (s. 140(3)). A director who is not entitled to vote on a particular resolution (for example, due to a conflict) does not need to sign the resolution for it to be valid.

If a company has only one director, a single director may constitute a meeting (s. 140(4)).

Unless the articles specifically forbid it, directors can hold a meeting by telephone or by any other device that allows the participants to communicate with each other at the same time (s. 140(1)(b)).

It is quite proper for a quorum of directors of a company to meet and settle the principles of the subject upon which they are making a decision and to prepare the formal minutes later. However, the courts in British Columbia (more so than elsewhere in Canada) require certain formalities to be observed. In *Re Associated Color Laboratories Ltd.* (1970), 12 D.L.R. (3d) 338 at 351 (B.C.S.C.), the court approved the statement of F.W. Wegenast in *The Law of Canadian Companies* (1931) at 215 in which he said:

> … So long as those in attendance are satisfied, the formalities may be reduced to a minimum. The only essentials are that the proper persons should be in attendance and that the minutes should represent their intention.

There must be a real meeting at which a quorum is present. A meeting cannot be held by polling the directors one by one, unless the articles specifically permit this as a way of holding directors' meetings (s. 140(3)(a)(ii)).

All directors must receive prior notice of the meeting (they cannot complain about not getting due notice if in fact they attend the meeting). The period of notice need only be what is reasonable in the circumstances, it may be given verbally, and it need not specify the nature of the business to be transacted, unless the articles provide otherwise. It is proper to hold a meeting and later obtain a waiver of notice of that meeting from any directors who did not receive due notice. If a director then refused to give their waiver, the meeting would not have been validly held and any resolutions purporting to be passed would be of no effect.

As a result of the wording of s. 140(3)(a)(i), resolutions in writing are only effective on the date the last director signs. Even though directors may properly ratify and confirm prior actions and therefore validate them, a resolution of the directors (whether in writing or passed at a meeting) speaks only from the date it is actually passed.

[§4.03] Duties and Liabilities of Directors and Officers

1. The Duties

The statutory duties of directors and officers are outlined in the *BCA*. Every director and officer must (s. 142(1)):

(a) act honestly and in good faith with a view to the best interests of the company;

(b) exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances;

(c) act in accordance with the Act and the regulations; and

(d) subject to paragraphs (a) to (c), act in accordance with the articles of the company.

These statutory duties are discussed in more detail below.

(a) Honesty

This duty includes being truthful, open and above-board with fellow directors. In particular, it prohibits any secret profits or any non-approved conflict of interest.

(b) Good Faith and the Company's Best Interests

This duty could more broadly be called the duty of loyalty or the fiduciary duty. The director must exercise their powers in the best interests of the company as a whole and not for any improper or collateral purpose, especially one that involves the director personally. The Supreme Court of Canada commented on the fiduciary duty in *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68. For a full discussion of fiduciary duty see the *Peoples* case and *BCE Inc. v. 1976 Debenture Holders*, 2008 SCC 69.

In determining whether or not there has been a breach of this duty, there is no general rule to apply. As Chief Justice Laskin said in *Canadian Aero Service Ltd. v. O'Malley*, [1974] S.C.R. 592 at 620:

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

And at 607:

> An examination of the case law … shows the persuasiveness of a strict ethic in this area of the law. In my opinion this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing.

A director must be especially careful if they have been appointed to the board to represent the interest of a third party such as a shareholder or creditor. A director has a fiduciary duty to disclose information to the company if it affects the company in an important way, even if such disclosure would harm the interests of the party who appointed them (*PWA Corp. v. Gemini Group Automated Distribution System Inc.* (1993), 103 D.L.R. (4th) 609 (Ont. C. A.), leave to appeal refused (1993), 104 D.L.R. (4th) vii (note) (S.C.C.)).

(c) Care, Diligence and Skill of a Reasonably Prudent Person

The duty of care requires prudence based on common sense. A director must act deliberately and cautiously and try to foresee the probable consequences of a proposed course of action.

The requisite level of "skill" likely varies in accordance with the director's duties and background, as well as the significance of the action, the time available to make the decision, and similar factors.

The duty of diligence involves making inquiries that a person of ordinary care in that position or in managing their own affairs would make. Some examples of the requisite standard of diligence are as follows:

(i) Attending Meetings

A director need not attend all directors' meetings, but should try to do so, since they may be held liable for prohibited matters that happened while they were absent.

If a director is not present at a meeting at which certain prohibited matters were approved (that is, carrying on restricted businesses, purchasing, redeeming or acquiring shares or paying dividends when the company is insolvent, paying improper indemnities, authorizing improper commissions or discounts or issuing shares without proper consideration), they must formally dissent within seven days of hearing about it or be deemed to have approved (s. 154(7)).

Section 123(3) of the *CBCA* is broader in that it does not restrict the application of the rule to certain kinds of resolutions. The director of a federal company must dissent with respect to any resolutions with which they do not want to be associated.

(ii) Relying on Other Directors

Subject to the duty of care mentioned earlier, the general rule is that a director is not liable for the misdeeds of their co-directors if they have not participated in the acts resulting in the damage and is not negligent. However, in some American cases, all of the directors of a company have been held equally liable for misinformation in a prospectus, even though all were not active participants in the misstatements.

(iii) Relying on Officers and Professionals

In being diligent, a director may rely on the officers of the company, although they should still be cautious in accepting information from them and should ensure that the officers and professionals have the requisite expertise and credentials.

Section 157(1) of the *BCA* permits a director (but not an officer) to rely in good faith on:

- financial statements of the company represented to the director by an officer of the corporation or in a written report of the auditor of the company to fairly reflect the financial condition of the company;
- a statement of fact represented to the director by an officer of the company to be correct;
- any record, information or representation that the court considers provides reasonable grounds for the actions of the director, whether or not that record was forged, fraudulently made or inaccurate; or
- a written report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement by that person.

That group of professionals ("lawyer, accountant, engineer…" from 157(1)(b)) is limited to true "professionals" and does not necessarily include experienced but non-professional officers of the company (see *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68 at paras. 73-78).

Section 157(2) provides:

> A director of a company is not liable under section 154 if the director did not know and could not reasonably have known that the act done by the director or authorized by the resolution voted for or consented to by the director was contrary to this Act.

Note that s. 157(2) applies only to a director, not to an officer. In practice, it would be difficult for a director to avoid liability by relying on s. 157(2).

A director should, as a minimum, examine the financial statements and review the general business activities of the company with the executive officers. However, a director is not required to go behind the financial statements to examine entries in the company's books.

The directors must be cognizant of the business as a whole. Directors have been found negligent where the actions by an officer of the company resulted in losses that could have been detected and prevented with proper supervision.

(iv) Relying on Outside Experts

Directors are not expected to be experts in all fields, and frequently must rely on the advice of specialists. They should obtain outside advice when circumstances require, but they must be reasonably assured that the outsider is truly qualified to give the advice sought. Directors may rely on the advice and opinions of an outside expert if the outsider is independent and appears qualified to give the advice and the directors continue to exercise their own judgment.

2. Duties to Whom?

It has long been a principle of common law that directors owe a fiduciary duty only to the company and not to its creditors or anyone else (*Percival v. Wright*, [1902] 2 Ch. 421). However, subsequent case law has eroded this position to the extent that now the directors may be held responsible to many different groups.

In addition to the fiduciary duties imposed by the *Societies Act* and the *BCA*, the council of a Band owe a fiduciary duty to members of the Band: *Assu v. Chickite*, [1999] 1 C.N.L.R. 14 at para. 23 (B.C.S.C.). Accordingly, members of the Band Council who sit as directors must act in the best interests of members of the Band when making decisions.

(a) Shareholders

The directors of a company may be liable to the shareholders for remedies sought under the oppression remedy or to the company under the derivative action remedy. The latter actions are commenced in order to right a wrong done to the company. The wrongdoers will normally be the directors and officers whose action has resulted in damage to the company. The directors could also be liable to the company for improper use of corporate assets that exist for the benefit of all shareholders or for favouring one group of shareholders over another in a takeover battle.

In *Redekop v. Robco Construction Ltd.* (1978), 7 B.C.L.R. 268 (S.C.), a director failed to disclose his interest in one of the company's con-

tracts. It was held that the company could recover the secret profits and a minority shareholder was entitled to an order that his shares be purchased either by the company or by the errant director.

In *Malcolm v. Trustee Holdings Ltd.*, 2001 BCCA 161, the court affirmed that, other than in exceptional circumstances (such as a family relationship or a special relationship of trust and dependency between the parties), the fiduciary duty of the directors is to the company and not to the individual shareholders.

Essentially, if there has been a "corporate mistake" in the conduct of the business or affairs of the company, any interested person may apply to court, under s. 229 of the *BCA* (*CBCA* s. 247), for an order to remedy that omission, defect, error or irregularity, and it is the directors and officers of the company who must provide the remedy.

(b) Creditors

Generally, directors owe no fiduciary obligation to creditors (*Western Finance Company Ltd. v. Tasker Enterprises Ltd.,* [1980] 1 W.W.R. 323 (Man. C.A.)). Some courts, however, have lifted the corporate veil in order to benefit creditors who have been the victims of unscrupulous conduct. In such cases directors and officers, as agents of the corporation, could be deprived of their immunity and held liable if their actions are tortious.

Under s. 301(2) of the *BCA*, if the appropriate requirements for the disposition of an undertaking of the company are not observed, a creditor may apply to the court to enjoin the proposed disposition or set aside the disposition or make any other order the court considers appropriate.

When funds administered by the company are impressed with trust conditions (even those contractually imposed, such as by an agreement with a creditor that funds received under certain conditions are to be held in trust for the creditor), directors have been held personally liable for participating in the breach of trust by the company when the subject funds were intermingled with those of the company (*Air Canada v. M & L Travel Ltd.*, [1993] 3 S.C.R 787).

The Supreme Court of Canada clarified the nature of the duty of care owed by directors of a company to its creditors in *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68. The trustee in bankruptcy of Peoples Department Stores had claimed that in attempting to remedy the financial difficulties of a parent company and its subsidiary, the directors had favoured the interests of one company over the other to the detriment of the creditors and had, therefore, breached their duty of care to the creditors.

The court held that although the directors of a company do owe a duty of care to a company's creditors (and other parties), such a duty is in the nature of a negligence standard of care (that is, to exercise the care, diligence and skill of a reasonably prudent individual) and is not comparable to the fiduciary duty that is owed by the directors to the company itself (that is, to act honestly and in good faith with a view to the best interests of the company). The court stated (at paragraph 67) that directors and officers will not be held to be in breach of their duty of care if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. Directors are not expected to be perfect and the courts will not second-guess their decisions, but the court will determine whether the directors in reaching their decision exercised an appropriate degree of prudence and diligence.

(c) Employees

Each of the directors and officers of a company may be liable for up to two months' unpaid wages and salaries of certain employees under s. 96(1) of the British Columbia *Employment Standards Act.* This liability includes unpaid commissions of employees. Despite s. 96(1), directors and officers are not personally liable for vacation pay accruing after the director or officer ceased to hold office, or for severance pay or termination pay payable under the *Employment Standards Act* if the company is in receivership or is subject to action under the *Bank Act* (Canada) or to a proceeding under an insolvency statute.

Directors and officers may also be liable under occupational health laws for injuries caused to employees by unsafe working conditions. Directors and officers should be especially careful if their company deals in toxic substances.

In one instance, the Ontario Court of Appeal allowed an employee to recover damages from the directors personally for breach of his employment contract by holding them liable for the tort of inducing the breach of the contract by the company (*Kepic v. Tecumseh Road Builders*, *supra*).

(d) Government

At least 135 provincial and federal statutes provide for liability of directors and officers in certain circumstances.

Many statutes (including the *Criminal Code*) provide that if the company has committed an offence under that act, every director and officer who authorized, directed, condoned or participated in the offence is liable to the same penalties as if they had personally committed the offence. Fines for such offences range from $50 to $25,000 with the possibility of up to one year of imprisonment.

Some examples of these statutes follow.

(i) Corporate Statutes

Section 427(2) of the *BCA* provides for a fine of up to $10,000 for directors and officers who authorize or condone the making of false or misleading statements.

Under the *CBCA*, failure to provide information to the Director under the *CBCA* relating to ownership and control, improper use of shareholder lists, failure to comply with proxy requirements, false reporting, and so on, all give rise to fines and/or imprisonment.

(ii) *Securities Act*

Directors, officers and employees who participate in insider trading activities by buying and selling securities of their company with knowledge of material facts or changes that have not been generally disclosed to the public are liable to very large fines and long terms of imprisonment. Such people are also liable if they advise other persons of inside information or do not provide full, true and plain disclosure in prospectuses and other disclosure documents.

There is also a statutory right of action against the company and its directors, officers and other "influential persons" by investors who purchased shares in the secondary (public) market and who have suffered damages from misleading information released by the company.

(iii) *Criminal Code*

A person may become a party to the offence of conspiracy (as opposed to being an actual participant) if they encouraged the conspirators to pursue their ends (*Criminal Code* ss. 463, 464 and 465).

(e) *Environmental Management Act*

The *Environmental Management Act*, S.B.C. 2003, c. 53 imposes liability on corporations but also on individuals, including directors, officers, agents and employees, for offences committed under that Act (s. 121). Further, a "person" is defined to include directors and officers for the purposes of responsibilities under the remediation provisions.

3. Avoiding the Duties

(a) Nominee Director

This term is used to describe a director who serves on the understanding that they are merely to obey orders given by someone else. Being a nominee, dummy, honorary, accommodation, or part-time director does not lessen a director's responsibility or duty unless (and only) where the powers to be exercised by the director have been transferred to another person.

There is no distinction between the duties and responsibilities of inside (active) directors and those of nominee or accommodation directors or of outside or part-time directors.

A person may not avoid the responsibilities of a corporate director by accepting the office as an accommodation with the understanding that they will not exercise any duties of a director.

(b) Doing Nothing

Even if a director has not participated in an illegal act, the director is not necessarily excused. A director must actively dissent within seven days of learning of certain prohibited acts taken by the other directors, or else they will be deemed to have consented to such acts (s. 154(8)).

While a director may not be liable for any improper act of which they are ignorant or which occurred before they became a director, upon learning of such a wrongful act, a director must take immediate and effective steps to absolve themselves and satisfy the duty to protect the company. If a causal connection can be shown between a director's inaction and a loss suffered by the company, the director may be held liable for the consequences of their inaction (*Bishopsgate Investment Management Ltd. v. Maxwell*, [1993] B.C.L.C. 814 (Ch. D.)).

American courts have also held that a director should take corrective action if they become aware of suspicious circumstances involving co-directors (*Newton v. Hornblower Inc.*, 585 P.2d 1136 (Kan. 1978)).

(c) Agreement

No provision in a contract or articles relieves a director from the duty to act in accordance with the *BCA*, nor from liability for breaches of duty, negligence, default or breach of trust (s. 142(3)). Any provision in the articles or a contract that would amount to such an exemption would be struck down by the courts, although articles that merely modify the scope of a director's duty to an extent that does not amount to relief from the duty will be permitted (*Rhyolite Resources Inc. v. CanQuest Resource Corp.* (1990), 50 B.L.R. 275 (B.C.S.C.)).

4. Prohibited Resolutions

Under s. 154, directors become jointly and severally liable for losses and damages suffered by the company if they vote for or consent to resolutions authorizing the company to take any of the following actions:

- do an act that contravenes the restrictions on the company's business or powers that are set out in the company's memorandum or articles, as a result of which the company pays compensation to any person (s. 154(1)(a));
- pay an unreasonable commission or allow an unreasonable discount to any person in consideration of that person procuring, agreeing to procure purchasers of, or purchasing or agreeing to purchase, shares of the company (s. 154(1)(b));
- pay certain (non-stock) dividends if the company is insolvent or if the payment renders the company insolvent (s. 154(1)(c));
- purchase, redeem, or otherwise acquire shares for consideration where the company is or is rendered insolvent (s. 154(1)(d));
- make a payment or give an indemnity to a director, officer or other eligible party contrary to s. 163 (s. 154(1)(e)); and
- issue shares for less than their par value or that are not fully paid (s. 154(2)).

Some of these prohibited resolutions involve a question of whether a company is insolvent or would be rendered insolvent by the action, so a director can apply to court to determine if a company is insolvent or would be rendered insolvent by the proposed action (s. 70(3)). This application would likely only be useful in extreme cases.

A director who attended a meeting but did not vote for the resolution or who did not attend the meeting may avoid liability when a prohibited resolution is passed by actively dissenting as set out in ss. 154(5) or 154(8). Since a director is deemed to have given consent unless a dissent is made, it is important to follow the procedures set out in these subsections.

A director may avoid liability for a prohibited resolution that has been passed by entering a dissent in the minutes, or by delivering a dissent in writing to the secretary during the meeting, or, more practically, by sending it by registered mail to the registered office promptly after the meeting (s. 154(5)). The company and the secretary of the subject meeting must certify the date and time the dissent is received (s. 155) and must place a copy with the company's records at its records office (s. 42(1)(o)).

A director cannot dissent if they voted for the resolution (s. 154(6)).

The joint and several liability under ss. 154(1) and (2) is in addition to, and not in derogation of, any liability imposed on a director by the *BCA* or any other act or rule of law (s. 154(3)). Anyone else who benefited from the resolution may also be joined as a party to a dissent proceeding (s. 156(2)(b)).

[§4.04] Directors' Conflict of Interest

Conflict of interest is the one area where directors and officers are most likely to get into trouble. Although the basic principles that relate to conflicts of interest are clear and although conflicts should be avoided where possible, applying those principles in practice permits a director some latitude. If the director moves carefully, the law may still permit a measure of conflict to co-exist between a director's own interest and that of the company.

For a director, a conflict may arise in many situations, including the following:

- The director personally contracts with or competes with the company, or acts as a director of two companies that contract with each other.
- The director does something not motivated by considerations of the "best interests of the company" but by some other goal. This is referred to as the "collateral purpose" doctrine. The leading cases relating to this doctrine are *Teck Corp. Ltd. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C.), and *Hogg v. Cramphorn Ltd.,* [1967] Ch. 254, in which the directors used their power to issue shares to themselves and others in trying to extinguish a contract and defeat a takeover bid.
- The director takes personal advantage of an opportunity for profit that should have gone to the company. This is called the "corporate opportunity" doctrine. The Supreme Court of Canada said that directors or officers cannot take mature corporate opportunities for themselves (*Canadian*

Aero Service v. O'Malley, [1974] S.C.R. 592; see also *3464920 Canada Inc. v. Strother*, 2005 BCCA 35).

The following is a discussion of how a director could run into conflict, a consideration of what conflicts are permissible, and if those conflicts are not permissible, what forms of protection are available to the director.

1. Personal Interest

The basic principle was set out in *Aberdeen Railway Co. v. Blaikie Brothers*, [1854] All E.R. Rep. 249 at 252 (H.L.), which states with respect to fiduciaries:

> … no one having such duties to discharge shall be allowed to enter engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict with the interest of those he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.

The meaning of these words was narrowed and clarified by the House of Lords in *Phipps v. Boardman*, [1967] 2 A.C. 46 (H.L.). The words "possibly may conflict" were interpreted to mean what the reasonable person, in looking at the situation, would think gives rise to a real, sensible possibility of conflict, not what one could imagine might arise out of a situation.

If there is an improper conflict (as opposed to a permissible conflict as discussed later), the errant director must account to the company for their profits (*Redekop v. Robco Construction Ltd.* (1978), 7 B.C.L.R. 268 (S.C.)). This obligation does not depend on bad faith or bad intent, or whether the profit would or should otherwise have gone to the company, or whether the opportunity may not even have been open to the company to take advantage of, or whether the company was in fact damaged, or whether the director had a duty to obtain the source of the profit for the company. The mere existence of the conflict gives rise to the obligation to account.

Things such as secret benefits, secret commissions and bribes are forbidden and will render the director or officer who took them liable to account, even if they were not gained at the expense of the company and even if the opportunity was not open to the company. A director who takes a bribe in any form, even if it appears to be a gift, is liable to account for it. A director must not accept any gift or remuneration from someone dealing with the company.

2. Disclosure and Ratification

At common law a person in a position of trust (such as a director or an officer of a company), could not benefit in any way from their position. About 100 years ago the courts began to relax this rule, provided that the shareholders ratified the director's action. If the interested director held voting shares, they were entitled to vote in such ratification proceedings (*North-West Transportation Co. v. Beatty* (1887), 12 A.C. 589 (P.C.)). Most jurisdictions have now codified these rules in their corporate statutes so that directors or officers may be allowed to keep profits or gains realized from a contract or transaction with the company in which they have a personal interest, provided that the director takes certain steps. These steps (canvassed below) are set out in ss. 147 to 153 of the *BCA* and in s. 120 of the *CBCA*.

Generally, all directors (but only "senior" officers, as defined in s. 1(1)) must disclose their personal interests in a contract or transaction (s. 148(1)) if it is material to the company and if the director or senior officer has a material interest in the contract or transaction (s. 147(1)).

Unless the director or senior officer properly discloses their interest and has the transaction properly approved, they must account to the company for any profit they make as a result of the transaction (s. 148(1)). If they do not take these steps, the director or senior officer may still be relieved of the obligation to account for profits by the court if the court finds that the transaction was fair and reasonable to the company (s. 150(1)).

A director or senior officer is *not* liable to account for any profits from the contract or transaction in which they had a disclosable interest in any of the following circumstances:

(a) the disclosable interest was disclosed under the former *Companies Act* and the contract or transaction is approved under s. 149, other than s. 149(3) (s. 148(2)(a));

(b) the directors who have no conflict approve the contract or transaction after the nature and extent of the interest have been disclosed to them (s. 148(2)(b));

(c) the shareholders approve the contract or transaction by a special resolution after the nature and extent of the interest have been disclosed to them (s. 148(2)(c)); or

(d) even if the contract or transaction is not approved in accordance with s. 149, if the contract or transaction was entered into before the person became a director or senior officer, the interest is disclosed to the directors or the shareholders, and the interested director or senior officer does not participate in any decisions or resolutions relating to the matter (s. 148(2)(d)).

There is no time specified for when the disclosure must be made, so the necessary approval may be given after the transaction has taken place.

No particular form is specified for the disclosure, but it must be in writing. This requirement could be satisfied by the disclosure being included in the consent resolution, or in the minutes of the meeting that approved the transaction, or in a written disclosure delivered to the company's records office (s. 148(3)). Copies of disclosures must be retained at the company's records office (s. 42(1)(n)(ii)), and shareholders may inspect the relevant portions of the minutes of meetings of directors or directors resolutions or other records that contain the disclosures (s. 148(5) to (7)).

If the company has entered into (or proposes to enter into) a material transaction or contract with a target company or firm where a director or senior officer of the first company is a director or senior officer or holds a material interest in the target, it is sufficient disclosure if a written statement is delivered to the first company declaring that the director has such an interest or holds such a position in the target company or firm (s. 148(4)).

Once the interested director or officer makes the appropriate disclosure, the transaction must be approved by a directors' resolution or a special resolution of the shareholders (s. 149(1)). An interested director cannot vote on the directors' resolution (but can vote their shares on a shareholders' resolution) to approve the matter (s. 149(2)), and is entitled to be counted in the quorum for the directors' meeting, unless the articles provide otherwise (s. 149(4)).

If all the directors are interested in a transaction, they are authorized by s. 149(3) to vote to approve it on behalf of the company and thereby put it into effect (for example, in the case of the issue of shares to all the directors). However, this does not mean that if all the directors are interested in the same transaction they may approve it and not be liable to account to the company for any profit. Section 148(2)(b) says that a director need not account for profits if the transaction is disclosed and approved by the directors, but the approval is only effective in situations other than s. 149(3). Consequently, if all the directors are interested, then they must properly disclose and have the transaction approved by special resolution of the shareholders under s. 148(2)(c), or else they may be liable to account for any profits.

There is no requirement that a transaction be reasonable and fair to the company before the directors and shareholders can approve it. However, if the contract or transaction was not properly approved under s. 148(2), the court may, if it determines that the contract or transaction is not reasonable and fair to the company, enjoin the company from entering into the transaction, and may order that the interested director or senior officer account for their profits, and may make any other order that the court considers appropriate (s. 150(2)).

A resolution in writing of the directors may still be used when a director is unable to vote because that director has a disclosable interest (s. 149(2)), since only those directors entitled to vote need sign a resolution in writing for it to be valid (s. 140(3)(a)(i)).

A director or senior officer need not disclose their interest in a contract or transaction merely because (s. 147(4)):

(a) the contract or transaction relates to security granted by the company for loans to or obligations undertaken by the director or senior officer;

(b) it relates to an indemnity or insurance for the director or senior officer under ss. 159 to 165;

(c) it relates to the remuneration of a director or senior officer in their capacity as a director, officer, agent or employee of the company or its affiliate;

(d) it relates to a loan to the company, and they (or a particular corporation or firm in which they have a material interest) have guaranteed or will guarantee the repayment of the loan; or

(e) it is with or for the benefit of an affiliated corporation (see s. 2(1) to (4)), and they are a director or senior officer of that affiliated corporation (although if the director has some other interest in the affiliated corporation, such as being a shareholder, then the exception does not apply).

Sometimes additional exceptions are included in the articles of a company. It is important to ensure that any provisions in the articles that make exceptions to the conflict provisions are no broader than those in s. 147(4). The provisions of the *BCA* take precedence in this area and must be observed (ss. 142(2) and (3)).

Although a director or senior officer may be liable to account for profits if the disclosures referred to in ss. 148 and 149 are not made or the approvals are not given, the fact that the director or senior officer was interested in the matter does not render the contract or transaction invalid (s. 151). In that event, the court, on the application of the company or any director, senior officer or shareholder may enjoin the company from entering into the proposed contract or transaction, order that the director or senior officer must account for any profit, or make any

other order that the court considers appropriate, but only if the court determines that the contract or transaction was not fair and reasonable to the company (s. 150(2)). A court will only set aside a contract or transaction if it is equitable to do so (*Ronbar Holdings Inc. v. Realcash Services Inc.,* [1991] B.C.W.L.D. 1875 (S.C.)).

Keep in mind that the courts impose a high standard of compliance on directors acting in conflict. Mere disclosure may not be sufficient in all cases. In *Levy-Russell v. Tecmotiv Inc.* (1994), 13 B.L.R. (2d) (Ont. Ct. (Gen. Div.)) the court said that even if a director has made full disclosure, the director must continue to place the interests of the company ahead of their own. If the conflict is serious and the stakes are high, the director might need to resign.

The directors should always go through the process of disclosure and ratification (that is, comply technically with the statutory rules) even if it may seem unnecessary at the time. If the company has only two or three directors who are the sole shareholders and are aware of the circumstances, one might say, "Who is to complain?"

Any director, senior officer, registered or beneficial shareholder, as well as the company, can complain if the proper steps of disclosure and ratification are not observed (s. 150(2)). In addition, the shareholders may change and the new group, upon discovering the profit formerly made by the directors, may claim for repayment. This is what happened in the case of *Abby Glen Property Corporation v. Stumborg* (1978), 85 D.L.R. (3d) 35 (Alta. C.A.). The previous directors sold their shares and later had to account for their former, undisclosed profits, even though this profit now amounted to a windfall for the new shareholders since the purchase price of the shares was negotiated without knowledge on either side of this potential claim. Similarly, in the case of *Redekop v. Robco Construction Ltd.* (1978), 7 B.C.L.R. 268 (S.C.), the court held that because a director did not properly disclose his interest and obtain the necessary approvals, he had to account, even though the director may have been acting in good faith or the business opportunity which the interested director took for himself was not open to the company.

Section 153 states that a director or senior officer who holds any office or possesses any property, right or interest by which, directly or indirectly, a duty or interest might be created in material conflict with their duty or interest as a director or senior officer of the company, must disclose the nature and extent of the conflict. The disclosure must be made to the directors promptly after they become a director or senior officer, or, if they are already a director or senior officer, promptly after they came to possess the property, right or interest or hold the office. However, this section seems to stand alone: sections 147 to 150 do not seem to apply to it. Consequently, even if disclosure has been made under s. 153, when a specific transaction or contract comes along in which a director or senior officer has an interest, that director or senior officer must still comply with ss. 148 and 149.

Canadian Aero Service Ltd. v. O'Malley, [1974] S.C.R. 592 expanded the potential liability of directors and officers in situations where they might be inclined to take a maturing business opportunity for themselves.

If a director or officer wishes to take a "business opportunity" that the company does not wish to pursue, they may be able to reduce (though probably not eliminate) exposure to liability by taking the following steps:

- disclose promptly their intent;
- resign from the board upon seeing the opportunity emerge;
- offer the opportunity to the company before leaving;
- delay making any profit from the venture for as long as possible;
- avoid taking any of the company's clients, at least not directly (any clients who wish to remain with the director should approach them, not vice versa);
- avoid luring away any officers or employees of the company; and
- receive from the board and the shareholders their blessing in the form of resolutions, which turn down the profitable opportunity and ratify their action.

These steps will not guarantee immunity, but they may help if the director or officer remains adamant in taking advantage of what might be a corporate opportunity.

It is also useful to obtain the unanimous ratification of the action by the shareholders. The case of *Canada Safeway Ltd. v. Thompson,* [1951] 3 D.L.R. 295 (B.C.S.C.) indicated that the conduct of the director may have been acceptable if the shareholders of the company had unanimously approved his actions after receiving full disclosure.

[§4.05] Directors' Protection From Liability

What can a director do to protect themselves against liability in a conflict of interest situation, and if found liable, to what extent may they be insured or indemnified?

1. Due Diligence

For directors to be able to properly defend themselves if their conduct is called into question, they must be able to show that they were duly diligent (that is, they took all reasonable care) in their conduct as a director. This requirement is particularly important in avoiding responsibility for the conduct of employees who may have caused the company to commit an offence. If directors are able to show on a balance of probabilities that they took all reasonable care, they may avoid liability (*R. v. Bata Industries Limited* (1992), 9 O.R. (3d) 329 at 362 (Prov. Ct.)).

Bata has been cited with approval and adopted in many subsequent cases, although none so far has reconsidered or reviewed the underlying principles.

The due diligence exercised by directors and officers of a corporation is one of the factors taken into account when assessing who is to be ordered to undertake or contribute to remediation under the *Environmental Management Act* (s. 46(1)).

2. Indemnification

At common law, a company was permitted to indemnify directors in certain circumstances. Most jurisdictions have now codified this ability in their corporate statutes, but it is still only applicable in limited circumstances.

Under the *BCA* a company may indemnify a director, officer or other parties, except regarding certain matters (see ss. 164(a) and (b) and 163(2)).

A company may indemnify a past or present director or officer or other persons who acted as a director or officer of affiliates or, at the request of the company, acted as a director or officer or equivalent of a partnership, trust, joint venture or other unincorporated entity (defined as an "eligible party") against "eligible penalties" (defined in s. 159) relating to their actions as directors and officers of the company (s. 160).

Subject to the prohibitions referred to below, a company must pay the net expenses of an eligible party, after the final disposition of the matter, if the party was substantially successful on the merits, or if they were wholly successful on the merits or otherwise (s. 161).

A company may also pay the expenses of an eligible party in advance, provided that the party undertakes to repay the advances if it is later determined that the company is prohibited from paying such expenses (s. 162).

A company cannot pay an indemnity if:

- the indemnity or payment is made under an earlier indemnity and at the time the agreement was made the company was prohibited from paying an indemnity by its memorandum or articles (ss. 163(1)(a) and (b));
- the party did not act honestly and in good faith with a view to the best interests of the company (s. 163(1)(c));
- the proceeding was not a civil proceeding and the party did not have reasonable grounds for believing that their conduct was lawful (s. 163(1)(d)); and
- the proceeding is brought against the party by the company or an associated corporation (s. 163(2)).

Notwithstanding any of the above limitations, the company or a director or officer may apply to court for an order that the company must indemnify the director or officer for any liability or expenses incurred by the party or for any other related obligations of the company (s. 164).

Although a company may enter into an agreement to indemnify a director or officer, because of the prohibitions the agreement cannot indemnify them in all circumstances. A director or officer would be wise to obtain an agreement of indemnity from the company requiring it to indemnify them when it is permissible to do so. Also, it is permissible and wise to obtain an agreement from a principal shareholder of the company or from some other outside party to protect against the other circumstances.

3. Insurance

Most corporate statutes allow the company to purchase insurance for directors and officers (e.g. *BCA* s. 165 and *CBCA* s. 124(4)). The *BCA* allows the company to take out insurance on behalf of a director or officer against any liabilities, even those against which the company is not entitled to indemnify them.

Although this option is very helpful for directors, it does not solve all their problems. Frequently there are restrictions contained in the insurance policies, which exclude claims for wilful or dishonest acts. Some policies also provide for a large deductible, which in effect prevents a complete avoidance of liability. Although policies used to be issued for up to three years, most now have a term of one year only.

Canadian companies are becoming increasingly interested in obtaining liability insurance for their directors and officers. There are two kinds of policies:

- The first type covers directors and officers for personal liability when the corporation chooses not to indemnify them or does not have the ability to do so.

- The second type insures the company itself, so that it may be reimbursed for the costs it incurs in indemnifying its own directors and officers.

Whether or not insurance is available and how much it costs depends on the individual case. Due to recent high-profile scandals and legal actions against directors and officers, the cost of this type of insurance has increased substantially in recent years, and insurance companies have stricter requirements for coverage. Some of the factors that the insurance companies consider when reviewing a potential client are as follows:

- the scope of the indemnification provisions;
- the amount of coverage desired;
- whether the company shares are widely or closely held;
- the profitability of the company;
- the type of business conducted or products manufactured by the company; and
- the company's past loss history.

The policies also have some broad exclusions. They generally do not apply to the following:

- fines and penalties imposed by statutes;
- libel or slander;
- personal gains that are found to be illegal;
- claims made by the company itself against the director;
- punitive damages;
- claims brought about or contributed to by the dishonesty of the director or officer; or
- liability for obtaining a secret profit or gaining a corporate opportunity.

In addition, some policies will totally or partially exclude environmental or pollution claims.

It is also possible to obtain policies for senior management personnel who are not otherwise directors or officers of the company but who play a major role in its corporate decisions.

4. Resignation

Although a director is probably wise to resign from the company as soon as they see that things are beginning to go wrong, resignation will not shield the director from liability for matters that have already occurred. Remember the previous comments about a director's duty to be diligent and the fact that some American cases have held that if a director discovers wrongdoing, they have an active duty to do something about it.

5. Trust Funds

Many statutes impose personal responsibility on the directors of companies that fail to observe the statutory rules. Recently, some companies have attempted to protect their directors from personal liability for unpaid wages, taxes, assessments, and so on, by establishing a fund to ensure that such obligations are actually paid by the company. This tactic has met with some limited success in British Columbia; see *Re Westar Mining Ltd.* (1992), 70 B.C.L.R. (2d) 6, in which the Supreme Court approved the establishment of a trust fund to pay the vacation pay of employees, although the court denied the use of such a fund to secure the unpaid severance pay of the employees.

The directors of an Ontario company tried to protect themselves by establishing a trust fund to pay statutory liens shortly before their company went bankrupt. The court set aside the fund as a preference and allowed a secured creditor to collect the money instead (*Central Guaranty Trust Co. v. 775843 Ontario Ltd.* (1993), 6 P.P.S.A.C. (2d) 121 (Ont. Ct. (Gen. Div.)). It has been suggested that if the directors establish such a fund far enough in advance of the company's insolvency, then they may be successful in retaining the fund to pay obligations for which they might otherwise be personally responsible.

6. Relief by Court

Where it appears to the court that in a proceeding against a director, officer, receiver, receiver-manager or liquidator of a company that the director (or such other person) is or may be liable for negligence, default, breach of duty or breach of trust, but they have acted honestly and reasonably and ought fairly to be excused, the court, after taking into consideration all the circumstances of the case, may relieve the director (or such other person), either wholly or partly, from liability, on the terms the court considers necessary (s. 234).

To be entitled to the relief, a director must have acted both honestly and reasonably and also ought fairly to be excused; see *Doncaster v. Smith* (1987), 15 B.C.L.R. (2d) 58 (C.A.) (a case involving a receiver manager) and *Island Realty Investments Ltd. v. Douglas* (1985), 19 E.T.R. 56 (B.C.S.C.) (a case involving a director). In general, a director should be excused if their default arises from a mere technical defect that would not ordinarily have caused any loss to the company (*Doncaster v. Smith*).

[§4.06] Lawyer's Conflict of Interest

Section 3.4 of the *BC Code* provides several principles to guide a lawyer's conduct when the lawyer is invited to act as legal advisor and investor, or as legal advisor and in some other role. Note that a lawyer may not act for a client when the lawyer has a direct or indirect financial interest in a matter, or a financial or membership interest in or with the client that would reasonably be expected to affect the lawyer's professional judgement. Also, a lawyer will be barred from acting if a relative or associate has a financial or membership interest, which would reasonably be expected to affect the lawyer's judgement (rule 3.4-26.1).

A director must not use confidential or sensitive information to benefit themselves or others. This principle applies with even greater force to a lawyer (whether a director or not) because they often have access to more sensitive, confidential information about clients than may be the case with other directors. If the lawyer/director should also happen to be a shareholder, they may be tempted to buy or sell shares in the client's company according to the nature of the information.

The discussion below deals with two situations:

(a) lawyers acting for a company but taking instructions from a director or major shareholder; and

(b) lawyers acting as directors of a company.

1. Lawyers Acting for the Company

Practitioners must be careful to keep in mind who is the client. For example, if a lawyer acting for the company is taking instructions from clients who are directors or majority shareholders, the lawyer should not act in such a way as to prejudice or oppress minority shareholders. Also, the best interests of the company are not always those of the directors or the majority shareholders, and the first duty of the company's lawyer is to the company.

In fulfilling this duty to the company, a lawyer must ensure that all the directors are properly advised as to whose interests the lawyer represents, so that they may make informed decisions. If the situation becomes litigious, the company's lawyer must be vigilant in acting only for the company; see *Mottershead v. Burdwood Bay Settlement Company Limited*, [1991] B.C.W.L.D. 2113 (S.C.).

On the question of conflicts of interest, refer to Chapters V, VI and VII of the Canadian Bar Association's *Code of Professional Conduct* (the "CBA Code") and section 3.4 of the *Code of Professional Conduct for British Columbia* (the "*BC Code*").

2. Lawyers as Directors

Generally, lawyers make good directors. Their training equips them to articulate their position well, to marshal facts required in making business decisions, and to explain the legal impact of the company's decisions. They have extensive experience because of their work with many business-related problems. Many lawyers participate in their own businesses separately from their legal practice. For these reasons, they are frequently asked to serve on the board of directors of companies, especially those of their clients.

For the lawyer who serves as director, serious problems may arise which are different from, and in addition to, all of the other problems that relate to directors in general.

The provisions in the CBA Code and *BC Code* do not forbid a lawyer from acting both as lawyer for a company and as a director, although they do point to the dual role as a likely source of problems. Normally, if two clients have mutual dealings, a lawyer is able to decline to act for either or both clients should a problem develop. However, if the lawyer is a director, they would also face the difficult decision of having to resign as director.

(a) Duty and Standard of Care

In satisfying the duty of care, a director must exercise that degree of skill that may be reasonably expected of a person of their knowledge and experience. In matters in which a lawyer is deemed to have a higher degree of skill than a layperson, the lawyer has a greater burden and responsibility. They must therefore take a greater interest in the affairs of the corporation and make more inquiries about its operations.

A leading case illustrating this situation is *Escott et al. v. BarChris Construction Corporation* (1968), 283 F. Supp. 643, a decision of the United States District Court of New York. This case involved a class action for damages sustained as a result of false statements and material omissions in a prospectus contained in a registration statement. One of the directors was a lawyer who was also counsel for the company. Even though there was an express finding that he honestly believed that the registration statement was true and complete, his "unique position" as the director most directly concerned with the statement could not be disregarded. The court said at 687:

> As a lawyer, he should have known his obligations under the statute. He should have known that he was required to make a reasonable investigation of the truth of all of the statements in the unexpertised portion of the document,

> which he signed. Having failed to make such an investigation, he did not have reasonable grounds to believe that all these statements were true. . . As the director most directly concerned with the registration statement and assuring its accuracy, more was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work.

In securities practice, there is a very high standard of care and diligence expected of lawyers when the company's prospectus is being prepared before shares are offered for sale. The lawyer who is also a director could be in the position of both advising the board and voting on whether to follow their own advice.

(b) Remarks Relied Upon as Legal Opinions

A lawyer/director is also unable to give an opinion that is free from their professional training. If they are asked (as every director is) for their view on the course of action proposed by the board, the reply will be taken as if it were a legal opinion, whether or not they are retained as the board's lawyer.

At common law, lawyers have been shielded from liability to parties other than clients by the doctrine of privity, but the trend now is to repudiate the doctrine of privity and permit non-clients to recover damages when the injured party had cause to rely on the lawyer who acted as director or officer of the company in which the injured party had some investment (see *Hedley, Byrne & Co. v. Heller & Partners Ltd.,* [1964] A.C. 465 (H.L.)).

(c) Privileged Information

How can the lawyer/director determine whether the information they receive is privileged? If the information is received in the lawyer's capacity as director, it is not privileged, but if it is received in the lawyer's capacity as lawyer, it is.

The best advice is that a lawyer should not serve on the board of a company for which they or any member of their firm acts as lawyer. Everything a lawyer is expected to do on the board can be done better if they are an independent legal consultant.

However, what if a lawyer has to (or wants to) serve on the board of directors of a client company? W.R. Miles suggested the following policy at the 1980 Canadian Bar Association mid-winter meeting, pages F-47 to F-50:

(i) there should be a process to screen the companies for which lawyers in the firm may act as directors;

(ii) the lawyer must be kept well informed of corporate affairs and insist upon financial information and regular meetings;

(iii) the lawyer should insist on an indemnity from the shareholders of the company;

(iv) the lawyer should always be sensitive to potential conflict situations;

(v) the lawyer should establish a close relationship with the auditor; and

(vi) in the case of public companies, the lawyer should only purchase or sell shares after publication of the financial statements.

Chapter 5

Finance[1]

[§5.01] Methods of Finance

There are three common methods of financing (also known as capitalizing) a corporation:

1. shareholder debt financing, typically referred to as shareholder loans;
2. share equity financing, by the sale of shares; and
3. borrowing from a bank or other third party lender.

These methods of capitalization are not exclusive. In almost all new corporations, the shareholders will provide the initial funding through both debt and equity financing. Similarly, established corporations will likely be financed through a combination of shareholder debt financing, share equity financing, and third-party debt. A company can also raise money by making profits, but that involves skills beyond the scope of this chapter.

[§5.02] Shareholder Loans (Debt Financing)

The simplest method of capitalizing a company is by shareholder loan. Typically, the principal shareholder or shareholders loan the bulk of the money needed to capitalize the company and subscribe for shares having only a nominal value. (There must be at least one common share subscribed for in every company.)

(a) Advantages

The investment is easily repaid to the shareholder as a repayment of debt, instead of requiring any reduction of share capital through redemption or repurchase of shares.

Another attraction of debt financing relates to corporate bankruptcy: a shareholder who has financed by way of a shareholder loan will rank at least equally with all other unsecured creditors, not below them as a common or preferred shareholder would do. Moreover, a shareholder who makes a loan to the shareholder's company can always take security from the company and thereby rank above unsecured creditors. However, if any third party loan or credit is extended to the company, the outside financier will likely want to rank above the shareholder in priority, and require a postponement (i.e. reduction in priority) of the shareholder's security.

(b) Disadvantages

There may be a detrimental tax consequence to a shareholder who invests in a company by way of a shareholder loan. In the initial phases of a company's activities, there are usually insufficient earnings to allow the company to pay any interest to the shareholder on the loan. Assuming the small business tax rate and that the shareholder pays personal income tax at a higher rate, if the company pays tax at approximately 13.5%, then receiving interest is not tax effective for the shareholder since the tax saving to the company is less than the tax cost to the shareholder.

When a shareholder borrows money from an outside lender and then lends it to the company at no interest, or at a rate of interest that is less than what the shareholder is paying to the outside lender, there is a risk that the interest paid on the outside loan may not be deductible by the shareholder for tax purposes. This is because s. 20(1)(c) of the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.) stipulates that only interest on borrowed money used for the purpose of earning income from a business is deductible. If the company is not paying interest to the shareholder, it is difficult to claim that the loan was obtained to earn income.

Despite the words of the *Income Tax Act*, the Canada Revenue Agency's Income Tax Folio S3-F6-C1, Interest Deductibility indicates that a deduction is permitted for the full interest expense incurred when a taxpayer/shareholder borrows money to loan it interest-free to a corporation that is wholly owned by that taxpayer (or if there are multiple shareholders, where shareholders make interest-free loans in proportion to their shareholdings), and where the loan proceeds improve the corporation's income-earning capacity, thereby increasing the potential dividend income for the taxpayer/shareholders.

Similarly, if a shareholder lends money at no interest to the shareholder's company, and the company cannot repay the loan, there is a danger that any resulting capital loss will be denied. This is because the shareholder did not make the loan for the purpose of gaining or producing income from a business or property (*Income Tax Act*, s. 40(2)(g)(ii)). However, the Canada Revenue Agency has said it will not deny the capital loss if a clear connection between the shareholder and the corporation's div-

[1] **Jennifer MacGregor-Greer**, MEP Business Counsel, Vancouver, kindly reviewed this chapter in March 2023 and updated it in March 2020 and June 2018. In June 2022, the Solicitors' Legal Opinions Committee of British Columbia reviewed parts of this chapter relating to solicitors' legal opinions and provided suggested edits. This chapter was previously revised by Kathleen Keilty (2011 and 2009). This chapter was based on an article prepared by Carl J. Pines for the CLE publication, *Company Law* (November 1987) and was revised annually by the author to January 2006.

idend income is demonstrated. See the Canada Revenue Agency's Income Tax Folio S4-F8-C1, Business Investment Losses.

[§5.03] Selling Shares (Equity Financing)

1. Share Capital

A second method of financing a company is the sale and issuance of shares. The buyers of the shares provide the capital to operate the company. In turn, they acquire shares having rights with respect to matters such as voting, dividends, and entitlement to capital, which translates into participation in the growth or decline in the company's value, to the extent that these rights are provided for in the company's articles (for more on shares, see Chapter 3).

(a) Advantages

Interest on money borrowed to purchase shares is generally deductible under s. 20(1)(c) of the *Income Tax Act*, since the purchase of shares is generally recognized as being "for the purpose of earning income from property." Anyone who does not qualify under the conditions set out in Income Tax Folio S3-F6-C1, Interest Deductibility to claim a deduction for interest paid on funds borrowed and then loaned to the company may prefer to finance by way of share purchase rather than by shareholder loan.

(b) Disadvantages

As mentioned earlier, funds loaned by a shareholder to a company are easily repaid to the contributor by repaying the loan. However, money paid for shares cannot be returned to the contributor so easily. One way to return the money is to have the articles of the company specifically permit the redemption or repurchase of the shares by the company. Tax consequences, however, may arise on the redemption or repurchase of shares, depending on their value and the attributes of the shares at the time of such redemption or repurchase. An alternative is to provide a return of capital to shareholders; however, both a return of capital and redemption or repurchase typically require corporate approval through a directors' resolution, a shareholders' resolution, or both.

The "paid-up capital" of the shares for tax purposes (which may or may not be the same as the paid-up capital for corporate purposes, depending on the applicability of certain adjustments under the *Income Tax Act*) is especially important on a share repurchase or redemption. For example, if the shareholder purchases common shares, and if those shares are repurchased or redeemed by the company, to the extent that the amount paid by the company for the shares on repurchase exceeds the paid-up capital, the shareholder will be deemed to receive a taxable dividend from the company. Once the shares have been redeemed or repurchased, there is a reduction of the paid-up capital in the company. This does not mean that the redemption or repurchase of shares cannot be performed, only that care must be taken at the outset when drafting the articles to provide for it (see s. 77 of the *BCA*).

The other main disadvantage to share purchase financing is that shareholders rank below unsecured creditors in the event of bankruptcy.

2. Price for Shares

Section 64(3) provides that a share is not fully paid for until the company has received full consideration for it in past services performed for the company, in property, or in money.

Under s. 63(2), par value shares must be issued at a price set by a directors' resolution, and shareholders pay that price (or more, but not less). Section 72(3) states than when par value shares are issued, an amount equal to the aggregate of their par value is added to the capital of that class or series.

Where shares are without par value, s. 63(1) requires that the issue price be set in the manner contemplated in the articles, or if not contemplated in the articles, by a directors' resolution (or a special resolution for pre-existing companies). Section 72(1) provides that on the issue of shares without par value, an amount equal to the issue price for those shares is added to the capital of a company, unless the shares were issued for property, in which case it is an amount not greater than the issue price for those shares.

3. Non-Cash Consideration for Shares

Where the number of shares issued by a company increases without a corresponding increase in the value of the company assets, the value of the existing shares will be diluted. Thus, where shares are to be paid for by way of property or past services, not money, s. 64(4) requires that the value of the property or past services be an amount set by resolution of the directors that is no greater than fair market value. It is sometimes difficult to determine the fair market value of non-cash consideration. Still, the problem that the section was intended to solve is far worse (e.g. allotting shares in exchange for property or past services that have no relation whatsoever to the value of the shares).

The language of the resolution authorizing the issue of shares for non-cash consideration should fully describe the nature of the property or past services

exchanged for the shares and must set out a determination by the directors of the money equivalent received by the company. The directors should fix the fair market value of the consideration at the actual fair market value, rather than at some other value, for both tax and business reasons.

In *Pioneer Distributors Ltd. v. Bank of Montreal* (1994), 97 B.C.L.R. (2d) 143 (S.C.), a complicated restructuring was challenged on the grounds (among others) that the fair market value of the property exchanged for the shares had been incorrectly determined by the board of directors. The judge held that it was nearly impossible to set an accurate amount as being fair market value within the normally accepted meaning of the concept, and agreed to a significant range of error. However, an important factor for valuation in the case was that no member of the public could become a shareholder or a creditor because the company had been established to assist in restructuring a corporation.

4. Limitation of Liability

Under s. 87(2), the liability of a shareholder for a share held is limited to the amount actually agreed to be paid for the share.

5. Payment for Shares

Section 64(2) requires that every share be fully paid for before it is issued. The Act provides that each director is jointly and severally liable to compensate the company and any shareholder for any loss sustained by reason of an allotment or issue in contravention of s. 63(2)(b) or s. 64 (s. 154(2)).

While s. 64 does not say that shares issued in contravention are a nullity (*Davidson v. Davidson Manufacturing Co.* (1977) *Ltd*. (31 August 1978), Vancouver C776454 (B.C.S.C.), endorsed in *Oakley v. McDougall* (1987), 37 B.L.R. 31 (C.A.)), non-payment for shares before they are issued may render the allotment and issue of the shares invalid. Consequently, it is good practice to provide a proper "paper trail" in the directors' resolution that allots and issues the shares: a written acknowledgment of receipt from or on behalf of the applicant for the shares, and of all consideration receivable by the company in full payment for the shares. It may help to prepare and sign an application for the shares indicating that a cheque in payment is attached and to remind the client to deposit the cheque that was drawn to pay for the shares into the company's bank account.

6. Partly Paid Shares

Before 1973, shares could be issued before the company received the full consideration for them. This resulted in what was known as partly paid shares upon which "calls" or "assessments" could be made. Sections 88 and 89 of the *BCA*, which preserve the concept of partly paid shares, only apply to companies incorporated before 1973.

7. Commissions and Discounts

Subsection 67(1) provides that the directors of a company may pay a reasonable commission or give a reasonable discount to someone who buys shares or assists in finding purchasers for shares.

Directors who vote for or consent to a resolution authorizing a commission or discount that is contrary to s. 67 (possibly allowing an unreasonably large payment or discount) are jointly and severally liable to the company to make good any loss or damage (s. 154(1)(b)).

[§5.04] Corporate Borrowing

One of the major reasons that businesses incorporate is to take advantage of the concept of limited liability. A company is a separate legal entity from its shareholders and the potential liability of the shareholders is, in the absence of an agreement to the contrary, limited to the amount they have agreed to pay for their shares. However, lenders typically will not make loans directly to small corporations, or to new corporations having minimal income, without personal guarantees of the shareholders.

The optimal financing source for any company is an outside lender who will loan money to the company directly without taking personal guarantees from the principal shareholders, therefore protecting the shareholders' limited liability.

Assuming that a lender is not willing to loan funds to capitalize a company without shareholder guarantees, the question then is which of the following methods of financing is best:

1. direct loan to the company with repayment assured by a shareholder guarantee; or
2. loan to the shareholder who in turn makes a shareholder's loan or purchases shares.

Often the lender dictates the terms of borrowing and the shareholder has no choice. If there is a choice, the best method depends on whether it is the individual or the company who can make the best use of being able to deduct the interest paid on the loan.

If the first option (above) is chosen, only the company is able to deduct the interest, and it is a benefit only if there are corporate profits from which to deduct the interest paid. If the second option is chosen, the individual deducts the interest from their other income.

1. Capacity to Borrow

Those lending money to companies usually retain a lawyer to assist in preparing the security documentation. The lender's lawyer should ensure that the company has the power and capacity to borrow, and should prepare proper security documents containing all of the necessary provisions to permit the lender to enforce its security. The borrower's lawyer is usually retained because the borrower wishes to ensure that the lender is not getting more security than was agreed upon.

Whether one is acting for a lender or a borrower, the subject of opinions becomes very important and will be discussed under a separate heading later.

Before the 1973 revisions to the *Company Act*, a company's memorandum set out elaborate objects and generally adopted all of the powers given to companies by s. 22 of the *Companies Act* then in force. The 1973 revisions to the *Companies Act* supposedly cured all problems pertaining to the power to borrow for the purpose of carrying out a company's objects because every company was (in theory) given the power and capacity of a natural person of full capacity. This concept was adopted in s. 30 of the *BCA*. However, under s. 33, restrictions may exist in a company's memorandum (if it is a pre-existing company) or articles regarding the business it may carry on and the powers it may exercise.

2. Searches by the Lender's Lawyer

Some procedures have evolved as being prudent practice in lending situations. The lender's lawyer will typically perform these steps:

- conduct searches at the Corporate Registry (that is, with the Registrar of Companies) and Personal Property Registry, and obtain certified copies of the articles and notice of articles;
- peruse the searches to note existing charges on those assets that the lawyer is planning to charge;
- obtain instructions as to whether any existing encumbrances are acceptable to the lender or whether the lender wants them to be discharged or postponed (reduced in priority) to the lender's charge;
- peruse the articles (and if the company is a pre-1973 company, the memorandum) for any restrictions on the capacity to borrow or any restrictions on the execution of documents and use of the company seal; and
- prepare an enabling resolution sanctioning the borrowing.

3. Opinions

The lender's lawyer will usually require that the borrower's lawyer provide an opinion. The borrower's lawyer's opinion is usually drafted by the lender's lawyer to include standard statements about the company and the transaction:

- that the company has been incorporated, validly exists and is in good standing with respect to the filing of annual reports with the Registrar of Companies;
- that the company has the corporate power and capacity to borrow and to enter into and perform its obligations under the applicable loan and security documents;
- that all necessary corporate action has been taken to authorize the borrowing and the entering into and performance by the company of its obligations under the applicable loan and security documents; and
- where standard form documents are not used in the transaction, that the security documents have been duly executed and delivered by the company and, in certain cases, that the security documents constitute the legal, valid and binding obligations of the company and are enforceable against the company in accordance with their terms.

The practice in Vancouver with regard to solicitors' legal opinions may not be uniform. Efforts at exploring best practices in solicitors' legal opinions have been undertaken by the Solicitors' Legal Opinions Committee ("SLOC"). The general practice is that, regardless of the amount, opinions from solicitors as to the validity, legality, binding effect or enforceability of standard form documents are neither requested nor given, except in unusual circumstances. "Standard form documents" is intended by SLOC to encompass all forms of documents that are developed and provided by one party to an agreement, are used by that party in substantially the same form for similar matters, and are not to be materially changed for use in a specific transaction. A model form of opinion to be given in the case of standard form documents is available on the SLOC website.

The same website also contains opinions for commercial transactions, *PPSA* transactions, real estate transactions, foreign law and limited partnerships. Recommended forms of opinion for other types of transactions or parties are under review by SLOC and will be posted to the internet from time to time. In addition, SLOC is also reviewing a "Due Diligence Checklist" for opinions, which will be posted to the internet when complete.

4. Registering Charges

Registration of charges in British Columbia is governed by the *Personal Property Security Act* (British Columbia) ("*PPSA*"), which is discussed in detail in *Practice Material: Business: Commercial*, Chapter 3.

Before the *PPSA* came into force, mortgages, debentures and other security instruments executed by companies were filed with the Registrar of Companies, unless the charge pertained solely to motor vehicles, in which case it was filed at the Central Registry. Since charges registered under the old system continue perfected under the *PPSA*, documents filed with the Registrar of Companies are still important to determine priorities and the capacity of a company to incur debt.

One of the most significant practice differences resulting from the *PPSA* is that the Personal Property Registry is a notice registry rather than a document registry. Thus, the document creating the security is not registered, but notice of the document and the collateral charged are registered.

Another important practice point resulting from the *PPSA* is the ability of a company to grant a purchase money security interest ("PMSI"). A PMSI creates a super priority over all charges previously granted over goods that are acquired by use of this security interest (for more, see *Practice Material: Business: Commercial*, Chapter 3). Thus, the PMSI concept permits borrowers to finance specific acquisitions despite previously granted security agreements, without seeking the security holder's permission. Note, however, that general security agreements may contain covenants by the company not to create indebtedness by granting a PMSI.

5. Debentures

Before the *PPSA*, it was the practice of lenders to require a corporate borrower to grant security over its assets using fixed and floating charge debentures. Since the *PPSA*, the practice has changed: at present, almost all lending institutions in British Columbia use general security agreements, rather than debentures, to obtain a fixed and floating charge on a borrower's assets. Debentures are still widely used in public offerings of secured debt and in other situations where there are multiple lenders. In these cases, the debentures are commonly issued under a trust deed that contemplates that the lenders will act in concert, through a trustee.

[§5.05] Restricted Transactions/Loan and Financial Assistance

1. Capacity to Give Assistance Under the *BCA*

Notwithstanding the natural person concept inherent in s. 30, a company can undertake a number of transactions only if certain qualifying tests have been met. While the *BCA* has eliminated many of the restrictions found in the *Company Act*, it helps to consider the former restrictions to understand where and if the case law in the area applies.

One of the most significant changes in the *BCA* is the elimination of many restrictions on a company providing financial assistance. The *Company Act* imposed a solvency test that prohibited a company from giving financial assistance if the company were insolvent or if giving the financial assistance would render it insolvent. These provisions also limited a company from giving assistance to someone to purchase shares of the company.

These provisions were not carried forward into the *BCA*, which permits a company to give financial assistance to any person for any purpose by means of a loan, guarantee, the provision of security or otherwise (s. 195(2)). Another major change in the *BCA* is the elimination of deemed statutory liability for directors if a company provides financial assistance at a time when it is insolvent.

The elimination of the *Company Act* provisions, however, does not mean that directors need not inquire as to the benefits to the company or its solvency before authorizing financial assistance. Directors still need to consider their obligations under s. 142 to act in the best interests of the company. For example, it is difficult to conceive of a circumstance where financial assistance would be in the interests of the company if giving it would render the company insolvent.

2. Reasons for Restrictions

The underlying reason for financing restrictions is that those lending money to or investing money in companies ought to be protected against the company embarking on transactions that are not undertaken for the purpose of earning profits. Under the *Companies Act* in force before 1973, companies were generally prohibited from purchasing or "trafficking" in their shares.

3. Authority to Purchase or Redeem Shares

A company may only purchase or redeem its shares if:

- the shares have a right of redemption attached to them (s. 77(a)), or the company is authorized by its articles to purchase its shares (s. 77(b)); and

- the applicable solvency test set out under ss. 78 or 79 is met (see the next section, which describes the test).

4. Solvency Test

Sections 78 and 79 prohibit the redemption, purchase or other acquisition of shares if the company is insolvent or if the transaction would render it so. "Insolvent" means unable to pay the company's debts as they become due in the ordinary course of its business (s. 1(1)).

The question can arise as to what specific date should be used in the insolvency test, if the date when the purchase is approved is not the date when the purchase is transacted. In *Nelson v. Rentown Enterprises Inc.*, 1992 CanLII 6183 (A.B. Q.B.), aff'd. 1994 ABCA 47, the court considered the solvency test under the equivalent sections of the *Canada Business Corporations Act* and held that the test must be applied at both dates; that is, when the agreement was made and also at the time of performance. The court reasoned that the limitation on a corporation's power to purchase its own shares was intended to protect creditors and other shareholders from share purchase arrangements that may prefer one or more shareholders in an insolvency situation.

The finding that the solvency test must be applied at both dates has been upheld in British Columbia in *Lin v. Lee*, [1996] B.C.W.L.D. 2010 (S.C.), which also held that a redemption agreement made at the time the company is insolvent (or which would render the company insolvent) is intrinsically illegal and cannot be interpreted in any other way, regardless of whether the parties are unaware of the contravention at the time. The finding in the *Lin* case as to illegality may have been reversed by the effect of s. 78(3), which says that a transaction is not rendered invalid on the basis that the company is insolvent, but since directors are obligated to act honestly and in good faith and in the best interest of the company (in s. 142), directors might be exposed to personal liability for transactions that offend the solvency test.

5. Lawyers' Obligations in Reviewing Security Documents

Lawyers should be vigilant in reviewing documentation submitted by legal counsel for a lender. When lenders are taking security that includes a guarantee by another company for the debt, lender's counsel will often prepare a resolution for the company giving the guarantee, which recites that the directors have determined that giving financial assistance is in the best interests of the guarantor.

When acting for a guarantor, one should understand the basis for the directors reaching this decision. When the companies are affiliated or associated, the connection is clear; in other cases it is not. The directors cannot conclude that giving financial assistance is in the best interests of the guarantor unless there are reasonable grounds for believing it. In deciding that there are reasonable grounds, the directors are potentially protected by the "business judgment rule"; in most cases, the courts will not look behind the business decisions of directors who have acted fairly and reasonably.

6. Disclosure Requirements of Section 195

The *BCA* provides that where a company has provided material financial assistance, the fact must be disclosed if the financial assistance is or was given to a shareholder, a director, an officer or an employee of the company or an affiliate or any of their associates, or to any person for the purpose of a purchase by that person of a share of the company or an affiliate (s. 195(3)).

The disclosure must be contained in a "written record" in the company's records office, and is to be made before or promptly after giving the financial assistance. The written record must be in a consent resolution of the directors, the minutes of a directors' meeting at which the giving is authorized, or the minutes of the directors' meeting that follows the act of giving financial assistance (s. 195(7)). The disclosure must include a brief description of the nature and extent of the assistance, together with the amount and the terms on which it was given (s. 195(6)).

Section 195(4) sets out exceptions to the requirement to make disclosure. A company need not make disclosure under subsection (3) in respect of financial assistance that is given:

(a) in the ordinary course of business, if the lending is part of the ordinary business of the company;

(b) on account of expenditures incurred on behalf of the company;

(c) to a parent by a wholly-owned subsidiary and vice versa and among certain other related companies;

(d) to employees to purchase or erect living accommodations; or

(e) to employees in accordance with an employee share purchase plan.

It would be prudent to keep a resolution approving financial assistance separate from other resolutions of the directors, to preserve the confidentiality of such other resolutions. A court can make an order dispensing with the requirement to make the disclosure where this might involve business details and information that could harm the company.

Chapter 6

Ordinary and Special Procedures[1]

[§6.01] Ordinary Procedures

Both shareholders and directors carry out ordinary corporate proceedings. In some cases the *BCA* provides that the proceedings can be handled quite informally, for example, by reaching an agreement or consensus, by convention, or by holding meetings in accordance with the company's articles. In other cases the proceedings are more stringently regulated.

When shareholders and directors of a company make decisions, those decisions are recorded by resolutions. The *BCA* provides for six different types of resolutions: ordinary, special, exceptional, unanimous, separate, and special separate. Each of these resolutions may be passed as a consent resolution. In general, the more significant the consequences are to a company, the more stringent the approval requirements.

[§6.02] Shareholders' Meetings

1. Definitions: "Shareholders" and "Resolutions"

A "shareholder" is defined as a person whose name is registered in a securities register of a company as owning a share of the company or, until such entry is made, a subscriber (in the case of a pre-existing company) or an incorporator (s. 1(1)).

The *BCA* defines the types of resolution in s. 1(1):

(a) An "ordinary resolution" is a resolution passed at a general meeting by a simple majority of the votes cast by shareholders who have the right to vote, or that is consented to in writing by at least a "special majority" of the votes entitled to be cast on the resolution at a general meeting, after the resolution has been submitted to all shareholders entitled to vote on it.

(b) A "special resolution" is a resolution passed at a general meeting by a "special majority" of the votes cast by shareholders, if the company gave advance notice of its intention to propose that resolution. Alternatively, it may be passed not at a general meeting but by being distributed and passed, in writing, by all shareholders entitled to vote.

(c) A "special majority" is the number of votes that a company's articles require for the company to pass a special resolution. It must be between 2/3 and 3/4 of the votes cast on the resolution. If the company's articles do not specify a number, the default is 2/3 of the votes cast.

(d) An "exceptional resolution" is a resolution passed at a general meeting by a number of votes specified in the company's articles that is greater than a "special majority", or that is consented to in writing by all of the shareholders entitled to vote on that resolution at a general meeting.

(e) A "unanimous resolution" is a resolution passed or consented to in writing by all of the shareholders entitled to vote on it.

(f) A "separate resolution" and a "special separate resolution" are resolutions on which only shareholders holding shares of a particular class or series of shares are entitled to vote. The *BCA*, s. 181, addresses the procedures for meetings involving separate resolutions.

In general, ordinary resolutions are required for matters that do not significantly affect the company or its value. Special resolutions are required to approve matters with significant consequences to a company. In some cases, the company may want to use an exceptional resolution to impose a specific threshold of approval that is higher than a special majority. Several provisions in the *BCA* require a unanimous resolution of the shareholders (one common example is the waiver of appointment of an auditor).

A "consent resolution" is any of the types of resolutions mentioned above (whether of shareholders or directors) that is consented to *in writing* by the requisite number of shareholders or directors. The approval threshold for consent resolutions is typically higher than for the same type of resolution if approved at a meeting. As noted earlier, ordinary resolutions of shareholders may be consented to in writing by at least a "special majority" of shareholders entitled to vote on the particular matter. All other types of shareholder resolutions require the consent of all the shareholders entitled to vote on the matter.

[1] **Jennifer MacGregor-Greer**, MEP Business Counsel, Vancouver, kindly updated this chapter in March 2023, September 2020 and 2018. Previously revised by Jason Harris (2011); Parts of this chapter were contributed by John O.E. Lundell, KC, in January 2004, and updated by the author in 2004 and 2005; other parts were updated by Brock H. Smith (2004–2005) and Jennifer A. McCarron (1996).

2. Annual General Meetings: Notice and Quorum

Every company must hold its first annual general meeting within 18 months after incorporation and, thereafter, at least once each calendar year and not more than 15 months after the last annual general meeting (s. 182(1)). However, the shareholders have the right to defer the date of an annual general meeting, to consent in writing to all of the business required to be transacted at that annual general meeting, or to altogether waive the holding of that meeting or any earlier annual general meeting that the company was required to hold (s. 182(2)). A unanimous resolution is required to effect any of these matters. Upon application by the company, the Registrar of Companies may allow the company to hold its annual general meeting on a date that is later than the required meeting date (s. 182(4)).

The articles of a company normally set out the procedures for calling a general meeting. Despite the articles, the directors of a company must call a general meeting on the request of one or more shareholders holding at least 1/20 of the issued voting shares (s. 167), unless the directors are excused from doing so by s. 167(7). A general meeting also may be called by the court if a company fails to hold a general meeting as required, or if it is impractical to hold or conduct a general meeting in the normal way as prescribed in the Act, the regulations or the articles (s. 186). The company auditor is entitled to attend any general meeting (s. 219(1)) and must attend a directors' meeting when asked to do so (s. 219(2)).

Every company must give its shareholders notice of any general meeting (s. 169(1)). The notice period is prescribed by regulation, but cannot be more than two months before the meeting. Shareholders (and any other persons entitled to notice) may waive or reduce the notice period for a particular meeting (s. 170(1)). The waiver or reduction of a notice period need not be in writing (s. 170(2)), and any person who attends at the meeting is deemed to have waived entitlement to notice, unless the attendance is for the express purpose of objecting that the meeting is not lawfully called (s. 170(3)). Notice is deemed to have been received on the day following the date of mailing, excluding Saturdays and holidays, unless the company's articles provide for a longer period (s. 6(2)). Always check the articles for notice provisions (s. 7(1)(b)).

A notice of general meeting should specify the time and place of the meeting, and provide a clear description of the business and matters to be discussed. The directors of the company may fix a "record date" for the meeting to determine the shareholders who are entitled to notice of, or to vote at, the meeting (ss. 171(c) and (d)). If no date is fixed, then the record date is 5:00 p.m. on the day immediately preceding the date on which the notice of meeting was mailed to the shareholders (or, if no notice was sent, the beginning of the meeting).

A meeting cannot proceed without a quorum. Unless otherwise provided for in the articles, the quorum for transaction of business at a general meeting is two persons entitled to vote at the meeting, whether present in person or by proxy (s. 172(1)(a) and (b)). However, if the number of shareholders entitled to vote at the meeting is less than the requisite quorum, then quorum for the meeting is all the shareholders entitled to vote at the meeting, whether present in person or by proxy (s. 172(1)(c)).

The following matters form part of the normal business at an annual general meeting (or they must be consented to in writing in lieu of the meeting):

(a) Presentation of Financial Statements: When a company holds an annual general meeting, the directors must place before the meeting the company's financial statements prepared in accordance with the *BCA*. See §6.03 below.

(b) Appointment of Auditor: Section 204 requires a company to appoint an auditor by each annual reference date (as defined in s. 1(1), but usually the date of the annual general meeting), unless all the shareholders (whether or not their shares normally carry the right to vote) waive this requirement by unanimous resolution under s. 203(2). See §6.07 for more.

(c) Election of Directors: Finally, the directors are elected at this meeting. Generally, directors retire at the annual general meeting and, subject to any limitations that might be in the company's articles, are eligible for re-election. Always check the articles for the rules governing the election process. See Chapter 4 for more on electing directors.

All general meetings must be held in British Columbia, unless the articles otherwise provide or unless the company obtains either the consent of the shareholders by ordinary resolution, or the consent of the registrar before the meeting is held (s. 166). However, as a result of the COVID-19 pandemic, the *BCA* now allows general meetings to be held partially or fully electronically. If a meeting is held by fully electronic means, the requirement that the meeting be held in British Columbia does not apply.

3. Voting

Always check the articles of the company for the voting procedures. Unless the articles otherwise provide, every registered shareholder has one vote for each share held by that shareholder (s. 173(1)).

At the annual general meeting, voting is generally by a show of hands except where a poll is demanded and except where a shareholder is participating in a meeting by telephone or other communications medium (s. 173(2)).

At any meeting at which a motion has been submitted, a shareholder or proxyholder who is entitled to attend the meeting may demand a poll. On a poll, every shareholder who votes in person or by proxy may cast the number of votes to which they are entitled. Every ballot cast on a poll and every proxy voted at a meeting must be held by the secretary for three months after the meeting, during which period they remain open to inspection at the records office of the company (ss. 173(5) and (6)).

A vote by show of hands includes votes by proxy, if proxies are permitted (see below under "Proxies").

If a motion is made at any meeting, the chair's declaration that the motion is carried by the requisite majority is, unless a poll is demanded, conclusive evidence of that fact, without proof of the votes recorded in favour or against the resolution (s. 173(3)).

A subsidiary cannot vote shares of a holding company (s. 177).

For meetings of shareholders of a particular class, check the company articles. If the articles are silent, s. 181 stipulates that the provisions governing general meetings apply.

4. Proxies

A "proxy" is defined in s. 1(1) of the *BCA* as "a record by which a shareholder appoints a person as the nominee of the shareholder to attend and act for and on behalf of the shareholder at a meeting of shareholders," and is recognized in s. 173. Essentially it means that a voter who cannot attend the meeting gives another person, who is attending, the right to cast a vote on behalf of the absent shareholder. Under the *BCA*, a shareholder may vote by proxy unless the articles or memorandum of the company provide otherwise.

[§6.03] Financial Statements

Section s. 185(1) of the *BCA* says the directors, in the annual general meeting, present the company's audited annual financial statements. In general, the financial statements must be presented and approved (ss. 198 and 199), unless the shareholders have waived this requirement by a unanimous resolution under s. 200 (and note that **all** shareholders must approve such a resolution, including those whose shares do not carry voting rights).

The financial statements presented must have been audited, unless a unanimous resolution under s. 203(2) was passed waiving the audit for the specific financial year (note again that **all** shareholders must approve such a resolution, including those whose shares do not carry voting rights).

Public companies are not excluded from these provisions in the *BCA* that allow waiving the financial statements and the audit. However, the practical requirements under the *Securities Act* as well as under other provisions of the *BCA* (including requirements of the audit committee under ss. 224 and 225, and limits on changing the auditors of a public company under s. 210) make it impossible for the shareholders of a public company to waive the audit or the presentation of financial statements.

A "qualifying debentureholder" may also demand to receive financial statements, in which case companies are required to provide the latest financial statement and a copy of the auditor's report (s. 201). A qualifying debentureholder is defined in s. 1(1) as a person who holds a debenture and who held that debenture prior to the coming into force of the *BCA*. In other words, persons who became debentureholders after the *BCA* came into force have no right under the *BCA* to receive this information.

Before a company issues or circulates a financial statement, the directors must approve it. One or more directors' signatures must evidence this approval (s. 199(1)). The form and contents of financial statements are prescribed by regulation (see Part 8 of the Regulation).

[§6.04] Annual Report

Every company must file with the Registrar of Companies an annual report in the prescribed form (Form 6 to the Regulation) within two months of each anniversary date of the company's recognition under the Act (s. 51). These reports must be filed electronically. The fee for filing annual reports is prescribed by regulation. Failure to file an annual report within this period may result in the registrar dissolving the company (s. 422(1)(a)).

[§6.05] Registrar of Companies

1. Records Maintained by the Registrar

The records maintained by the registrar include:

(a) Name Index and Register

The Index and Register contains the name of every British Columbia company, as well as private Act companies, extraprovincial and trust companies, cooperatives, and societies.

(b) Register of Dissolved Companies

A record is maintained for every company, extraprovincial company, society, cooperative and trust company that has ever been registered with the Registrar of Companies. The record shows when the company was dissolved

or ceased to be registered, and also shows the names of companies that changed their names.

(c) Company Files

Under the Act, few records are filed with the registrar and most filings must be submitted in electronic form. Copies of these records can be obtained from the registrar through BC OnLine. Generally, company records are maintained at the company's records office.

2. Filing Records

Most records that must be filed with the registrar must be filed in electronic form (see s. 30(2) of the Regulation and the *Registry Statutes Amendment Act*, S.B.C. 2002, c. 17).

Note the time limits for filing, and that some records are not effective until filed. The registrar has discretion to refuse filings under s. 408. The consequences of failing to file a record as required by the Act may include dissolution, as set out in s. 422(1). (For more on dissolution, see Chapter 7.)

[§6.06] Registered and Records Offices

1. Records Office Functions

Every company must have a records office and must provide both a delivery address and a mailing address for that office in its notice of articles (ss. 34 and 11(e)). A company must keep the company records listed in s. 42 at its records office. A company must make different records available for inspection and copying by certain classes of persons:

- current directors (s. 46(1)(a));
- former directors (ss. 46(2));
- shareholders (ss. 46(3)(a), 148(5), 195(8) and 46(1)(b)(i));
- former shareholders (ss. 46(3)(b), 148(6), 195(9) and 46(2));
- qualifying debentureholders (s. 43(3)(a)); and
- any other person (members of the public) (s. 46(4)–(5) and 46(1)(b)(ii)).

Members of the public are entitled to inspect more documents of pre-existing reporting companies or public companies(s. 46(4)).

Companies may, by ordinary resolution, impose restrictions on the times during which a person, other than a current director, may inspect their records, but those restrictions must comply with the inspection times prescribed by regulation. It is best to separate records according to who can inspect them.

2. Duty of Care

All companies and their agents have a duty of care to prepare and maintain records in a complete state, as required by the Act, and so as to avoid loss, mutilation or destruction and falsification of entries (s. 44(4)(a), (b) and (c)). Also, they have a duty to provide simple, reliable and prompt access to the records and registers required by the Act (s. 44(4)(d)).

3. Copies of Records

If a person entitled to inspect a company record requests a copy of that record, the company must provide to that person the requested copy promptly and, in any event, within 48 hours of the request, excluding Saturdays and holidays (s. 48(1)). The company may prescribe a fee for some, but not all, copies requested by such person (s. 48(1) and (2)).

A person is entitled to receive from the person who has custody or control of a company's central securities register a list setting out the names and addresses of shareholders of that company and the number of shares of each class or series held by that shareholder (s. 49(1)). There are certain procedural requirements that must be met in order for a person to receive this list (s. 49(2)) and, once the list has been received, there are limitations on the uses that can be made of the information in the list (s. 49(3)).

Section 44 deals with various forms of records. All records must be maintained in a bound or loose-leaf form or, for records that a company must maintain pursuant to s. 42, in the manner prescribed in that section.

4. Records Kept at Records Office

The Act identifies documents that companies must keep at their records office (s. 42), including these:

- the certificate of incorporation;
- a signed incorporation agreement;
- a copy of the company's articles;
- a copy of the company's central securities register (unless the directors designate another location under s. 111(4));
- a register of directors;
- minutes of general meetings, class meetings and every directors' meeting, and consent resolutions of shareholders or directors;
- a copy of every document filed and certificate issued by the registrar;
- a copy of written disclosure records; and
- financial statements.

Section 43 permits a company to store certain records at a different location, so long as the records can be produced for inspection within 48 hours.

Effective October 1, 2020, private companies must also keep a "transparency register" at the company's records office, or accessible electronically from the records office. The transparency register must include information about all "significant individuals" who (directly or indirectly) have substantial shareholdings in the private company or who can exercise control or significant influence over the company.

Records kept at the records office may be maintained in an electronic, microfilm or bound or loose-leaf form (Regulation 11). They are generally compiled into a "minute book" or corporate record book of the company. It has become more common in recent years to maintain "virtual minute books" rather than bound or loose-leaf minute books.

5. Examining Records

(a) Statutory Rights to Examine

Section 46 sets out a procedure for examining corporate records. Depending on the category of person inspecting the records, the company might be able to charge for providing copies.

Every current director of a company may "inspect" any records of that company, without charge. Former directors may inspect records relating to the time when they were directors (s. 46(1) and (2)).

Shareholders and qualifying debentureholders may inspect, without charge, most records, except those referenced in s. 46(3) (such as directors' resolutions and minutes of directors' meetings). Shareholders may access portions of records that disclose interests by directors or officers in transactions (s. 148(5)), or material financial assistance given by the company (s. 195(8)).

A member of the public ("any person") may inspect certain records, but this right is quite limited for most companies (s. 46(5)). The right broadens for records of public companies, pre-existing reporting companies, community contribution companies and financial institutions—in fact, a member of the public has the same right as a shareholder to inspect the records of these companies (s. 46(4)).

Finally, the articles of a company may also give wider access to shareholders, former shareholders, or members of the public (ss. 46(1)(b) and (2)). These same sections also give former shareholders limited access to records.

(b) Minute Book Review

The records of a company that are required to be maintained at its records office are generally kept in a "minute book" or corporate record book.

Lawyers often physically review a company's minute book as part of their due diligence generally, in preparing for litigation, or in a particular transaction. The minute book provides a record of all the company's major decisions and resolutions. The minute book also contains the certificate of incorporation and of any amalgamations, the company's notice of articles and articles, the central securities register (unless the company has decided to keep it in a different location pursuant to ss. 42(1)(d) and 111(4)), the register of directors, and any court orders made involving the company,. As mentioned above, for some public and reporting companies, the available records can be much broader.

In examining the minute book, the lawyer is typically looking for evidence relevant to the transaction they are involved with, but might be looking for any of the following:

- restrictions on the company's powers set out in the articles;
- the company's authority to do something that it is purporting to do;
- relevant resolutions passed in proper form by the appropriate majority;
- the company's financial position;
- the current shareholders and directors; and
- any court orders of note.

For more details of searches and inquiries, see §5.04(2) on searches by a lender's lawyer and the *Practice Material: Business: Commercial* on buying and selling a business.

6. Time Coverage of Records

For companies incorporated or transitioned under the Act, records must be maintained from the date of incorporation or transition, although some records of a transitioned company must be kept longer. Pre-existing companies must also maintain records required by s. 42(2)(e), subject to the exceptions in s. 42(3). After seven years, it is possible to move certain records to a location other than the records office, so long as they can be produced for inspection within 48 hours of a request.

7. Share Certificates, Seals and Accounts

Every share certificate issued by a company must clearly state the name of the company and words indicating that it is a British Columbia company (s. 57(1)(a)). The share certificate must also include the name of the person to whom the certificate is issued, the number, class and kind of shares (and the amount of the par value shares, if applicable), the date of issue, the certificate number, and a statement outlining any restrictions on transfers (s. 57(1)(b) to (f)). If the share certificate is only partly paid, it must state the amount that has been paid (s. 57(2)). Special rights or restrictions must be noted in the text (ss. 57(3) and 51(4)). A share certificate must have one manual signature (s. 110(1)). Any other signatures required may be printed or mechanically reproduced on the share certificate.

A seal is not required in British Columbia to make, vary or discharge a contract (s. 193(1) and (4)). Companies without a seal may encounter problems with some land title offices and lending institutions, but otherwise, the lack of a seal rarely creates issues. If a company does have a seal, its name must be engraved in legible characters upon it (s. 27(2)). The company's articles govern how to execute documents under seal.

Every company must keep proper accounting records of all financial and other transactions of the company (s. 196(1)), stored in a place determined by the directors (s. 196(2)). If permitted by the articles, a company must allow a shareholder to inspect and obtain a copy of its accounting records (s. 196(4)). The directors may, subject to the provisions of the company's articles, permit a shareholder to inspect and receive copies of a company's accounting records (s. 196(5)).

[§6.07] Auditors

The directors of a company must appoint the first auditor to hold office until the annual reference date following the recognition of the company, and must appoint an auditor to fill any casual vacancy (s. 204(1) and (4)). Otherwise, by each annual reference date the shareholders must appoint (by ordinary resolution) an auditor to hold office until the next annual reference date (s. 204(3)). If no auditor is appointed, the court may, on application of a shareholder or creditor, appoint an auditor (s. 204(5)). Prompt notice to an auditor of their appointment is required in writing (s. 204(6)).

Under s. 203(2) of the Act, a company need not appoint an auditor if all shareholders (voting and non-voting) resolve unanimously to waive the appointment, but the requirements of the *Securities Act* make such a waiver by a public company all but impossible.

The shareholders must set the remuneration of the auditor, but this power falls to the directors if the shareholders so authorize by ordinary resolution, the articles so provide, or the directors appoint the auditor (s. 207).

The qualifications and duties of an auditor are set out in ss. 205 to 211.

[§6.08] Special Procedures: Majority

1. Conflict as to Majority Required

The majority required to pass a particular resolution might be specified in the *BCA*, or in the articles.

If a company is required to pass a resolution to make a particular change, and there is a conflict between the *BCA* and the articles as to what majority is required for the resolution, the resolution must be passed by the greatest majority required (s. 265).

2. Changing the Majority Generally

A company may alter its articles to specify or to change the majority of votes required to pass a special resolution at a general meeting, provided that that majority is at least two-thirds and not more than three-quarters of the votes cast on the resolution (s. 259(2)). In effect, the company can set a different "special majority" than the default under the Act, which is two-thirds of the votes cast; see the definition of "special majority" in s. 1(1).

The majority so determined will apply to all special resolutions of the company. It will not be possible to have different majorities for different special resolutions covering different matters.

The resolution that specifies or changes the special majority under s. 259(2) must, itself, be a special resolution, passed (if at a general meeting) by whatever special majority applies to the company at that time (s. 259(2)).

A special resolution can also be consented to in writing by the holders of all shares entitled to vote at general meetings (s. 1(1)).

3. Exceptional Resolution

The articles of a company can contain an exceptional resolution provision. This provision may specify that a particular provision of the notice of articles or of the articles of the company may not be altered or that the company or the directors may not take an action unless the resolution to authorize the alteration or the action is passed as an exceptional resolution (s. 264(1)).

An exceptional resolution, if to be passed at a general meeting, must be passed by a specified majority set out in the articles, and that majority must be greater than a special majority and, if to be consent-

ed to in writing, must be consented to in writing by all the shareholders holding shares that carry the right to vote at general meetings (see the definition of "exceptional resolution" in s. 1(1)).

An exceptional resolution provision in the articles cannot be varied or deleted unless the variation or deletion is itself authorized by an exceptional resolution (s. 264(2)).

4. Special Separate Resolution

When a company has different classes or series of shares, the company might want to set or change the particular majority required to pass resolutions affecting only those separate shares. Again that majority must be at least two-thirds and not more than three-quarters of the votes cast on a special separate resolution by shareholders holding those shares. See the definition of "special separate resolution" in s. 1(1).

Whatever majority is chosen will apply to all special separate resolutions of that class or series of shares. There is no ability to have different majorities for different kinds of special separate resolutions dealing with different matters affecting the same class or series.

To make this alteration, first, there must be a special resolution of the shareholders (s. 259(3)(a)).

In addition, if any shares of the particular class or series are issued and outstanding, then a special separate resolution of the shareholders holding those shares is required (s. 259(3)(b)), and must be passed by whatever majority applies at the time.

A special separate resolution can also be consented to in writing by the holders of all the shares of a class or series (s. 1(1)).

[§6.09] Special Procedures: Altering Notice of Articles

1. When Permitted

The word "alter" includes "create, add to, vary and delete" (s. 1(1)).

The notice of articles of a company can only be altered in the manner required or permitted by the Act (s. 257(2)(a)).

The Act requires the notice of articles to be altered if there are certain changes to the company, such as changes under s. 54(3)(a) and (b) dealing with alterations to the authorized share structure, or s. 263(1) dealing with changing a company's name. (An example illustrating the procedures in changing a company's name is set out below at §6.13.)

In addition to the restrictions in the Act, other restrictions on altering the notice of articles may exist in the articles, or in special rights and restrictions attached to classes or series of shares. There could also be restrictions in various agreements to which the company is a party (e.g. bank loan agreements).

Altering the notice of articles must be authorized by a court order or by a resolution (s. 257(2)(b)). The only exception to this requirement is if an alteration to the articles of a company has been approved under s. 259(1) or has been made by court order, and the alteration of the articles renders incomplete or incorrect any information in the notice of articles, or where special rights or restrictions are created, added to, varied or deleted (see s. 11(h)).

In such a case, the company may alter the notice of articles to reflect the alteration to the articles without obtaining a further court order or resolution (s. 257(3)). In effect, the resolution or court order altering the articles is sufficient authorization.

2. Types of Resolutions

The approval threshold required for a resolution altering the notice of articles depends on three things:

- the type of resolution required for the particular change might be specified in the Act (s. 257(2)(b)(i));
- if not specified by the Act, the type of resolution might be specified by the articles (s. 257(2)(b)(ii)); or
- if neither of the above applies, a special resolution is required (s. 257(2)(b)(iii)).

The types of shareholders' resolutions that could be specified (either in the Act itself or in the articles) include ordinary resolutions, special resolutions, exceptional resolutions and special separate resolutions.

An alteration of the notice of articles could also be done by directors' resolution if so specified by the Act (see s. 263(2)) or by the articles.

3. Filing Alteration

If the notice of articles is being altered under s. 257, the company must file a notice of alteration with the registrar (s. 257(4)). A notice of alteration must be filed electronically (s. 407(a) and Reg. s. 30(2)(e)).

If the company is not in good standing, the registrar may refuse to accept any filing relating to the company (s. 411(1)(a)). A company will not be in good standing if its annual report filings are not up-to-date or if the information in the corporate register shows that there is no director of the company.

After an alteration of the notice of articles takes effect under s. 257, the registrar must give to the company a certified copy of the notice of articles, as altered, if requested to do so (s. 257(6)).

4. When Effective

An alteration of the notice of articles under s. 257 is effective:

(a) on the date and time that the notice of alteration is filed with the registrar; or

(b) subject to a withdrawal of the notice of alteration, if the notice of alteration specifies a date, or a date and time, on which the alteration to the notice of articles is to take effect that is later than the date and time on which the notice of alteration is filed with the registrar (which cannot be more than 10 days later) (s. 410 and Reg. s. 31(b)),

(i) on the date and time specified in the notice of alteration; or

(ii) if a date but no time is specified in the notice of alteration, then at the beginning of the specified date (s. 257(5)).

The alteration of the notice of articles takes effect as set out above, whether or not there actually has been a court order or a resolution referred to in s. 257(2) (s. 257(5)).

5. Withdrawing Notice of Alteration

Section 258 provides that between the time that a notice of alteration is filed with the registrar and the effective time of the alteration (as set out in s. 257(5)), the company or any person who appears to the registrar to be an appropriate person to do so, may withdraw the notice of alteration by filing a notice of withdrawal with the registrar.

[§6.10] Special Procedures: Altering Articles

1. When Permitted

Subject to s. 256, there are no restrictions in the Act on when the articles can be altered.

Section 256(1) prohibits pre-existing companies from altering their articles, with very narrow exceptions (s. 256(2)(a) and (c)), which deal with transition matters or restoration matters and with certain minor alterations mentioned below. However, once a pre-existing company has complied with the relevant transition rollover provisions in s. 370(1)(a) and (b) or 436(1)(a) and (b), it can then alter its articles at any time (s. 256(2)(b)).

There is a general rule at common law that an alteration of the articles must be *bona fide* and in the best interests of the company as a whole.

Restrictions on altering the articles may be contained in the special rights or restrictions attached to classes or series of shares, or may be elsewhere in the articles. In addition, there could be restrictions in various agreements to which the company is a party (e.g. bank loan agreements).

While most alterations of the articles will require a resolution of some kind (or a court order), any individual may insert in the articles the incorporation number of the company and the name (and any translation of the name) of the company, regardless of whether there has been a resolution directing or authorizing that insertion (s. 12(5)). These insertions will not constitute a breach of or default under, any security agreement or other record, and are deemed not to be an alteration of the company's charter for the purposes of such security agreement or other record (s. 12(6)).

While most of this section deals with resolutions altering the articles, court orders could also alter the articles. Section 259, which deals with alterations of articles generally, does not specifically deal with an alteration of the articles of a company by court order, but does refer to such an alteration generally in s. 259(8). A court order is contemplated in s. 257(3) if the alteration of the articles will alter information in the notice of articles. Presumably, such a court order (with the exception of one under an arrangement, where solvency is in issue) would take effect at the time of pronouncement of the order, or any later date and time specified in the order (see s. 259(8)).

2. Types of Resolutions

Generally, the process required to alter the articles starts with the same considerations in altering the notice of articles, namely:

- is the type of resolution specified by the Act (s. 259(1)(a));
- if not specified by the Act, is the type of resolution specified by the articles (s. 259(1)(b)); or
- if neither of the above applies, a special resolution is required (s. 259(1)(c)).

Some of the sections in the Act dealing with alteration of the articles, in effect, refer to s. 259 (for example, see s. 54(3)(b) dealing with alterations to the authorized share structure) or specifically refer to s. 259 (for example, see s. 261(3) dealing with an alteration to Table 1 articles). Some sections specifically require a special resolution (for example, s. 259(2)) or a special separate resolution (for example, s. 259(3)), both dealing with altering required majorities for those resolutions.

In some cases, the Act may require a shareholders' resolution (as opposed to a directors' resolution) without specifying the type of shareholders' resolution (ordinary or special), for example, creating, varying or deleting special rights or restrictions attached to shares; in this case, if there is nothing in the articles, a special resolution would be required (s. 58(2)). See also s. 60(3), which deals with alterations relating to a series of shares.

The types of shareholders' resolutions that could be specified (either in the Act itself or in the articles) could include ordinary resolutions, special resolutions, exceptional resolutions and special separate resolutions.

An alteration of the articles could be done by directors' resolution, if so specified by the articles or the Act (for example, see s. 60(1)(b) relating to series of shares), and assuming that the Act does not require some kind of shareholders' resolution.

3. Alteration of Articles Affecting Notice of Articles

Section 259(4) deals with the situation in which an alteration of the articles would render incorrect or incomplete any information in the notice of articles or would alter special rights or restrictions attached to shares (because of s. 11(h)).

In such a case, the company must:

- note on the resolution altering the articles that the alteration does not take effect until the notice of articles is altered to reflect the alteration of the articles;
- deposit the resolution altering the articles at the company's records office; and
- after complying with the above, alter the notice of articles (under s. 257) to reflect the alteration to be made to the articles (s. 259(4)).

The alteration of the notice of articles does not need a separate authorizing resolution.

4. When Effective

An alteration of the articles that affects the notice of articles as described above is effective only when the alteration of the notice of articles takes effect under s. 257(5), as set out above (s. 259(5)).

Any other alteration of the articles is effective:

(a) on the date and time that the resolution altering the articles is received for deposit at the company's records office; or

(b) on the date and time specified in the resolution (or on the beginning of the specified date, if no time is specified), if the alteration to the articles is to take effect later than when the resolution is received at the company's records office (s. 259(6)).

5. Subsequent Copies

When the articles of a company are altered, every copy of the articles issued after the date when the alteration takes effect must either reflect that alteration or have attached to it a copy of the resolution, court order or other record by which the articles were altered (s. 262).

Any company that contravenes this requirement commits an offence (s. 426(1)(a)).

[§6.11] Special Procedures: When to Alter the Articles

1. Altering Table 1 Articles

If a company has Table 1 as its articles, or if a provision of Table 1 is adopted by a reference in the articles of a company, any regulation that amends Table 1 or that provision will automatically effect a corresponding alteration to the articles of the company at the time the regulation comes into force, without the necessity for a resolution to make that alteration, unless the articles provide otherwise (s. 261(2)). It is not clear what the phrase "unless the articles provide otherwise" means, aside from an express statement in the articles that all or some of the Table 1 provisions are not altered automatically when Table 1 is altered by regulation.

If one of the provisions in Table 1 is altered by the company (that is, by a resolution under s. 259), which is specifically permitted by s. 261(3), then any subsequent amendments to Table 1 will not affect that altered provision (s. 261(4)).

2. Altering Restrictions on Business and Powers

If a company has restrictions on the businesses it can carry on or on the powers it can exercise, these restrictions must be contained in the articles of the company (s. 12(2)(a)). When the intention is to change, remove or create such restrictions, the articles of the company are altered.

The alteration (within the extended meaning of "alter" in s. 1(1)) of any restriction on the businesses carried on or to be carried on by a company, or on its powers, is not specifically provided for in the Act, and simply falls into the general provisions relating to altering the articles of a company. The required resolution will be determined under s. 259(1).

Section 260 provides that any shareholder may send a notice of dissent to the company in respect of a resolution to alter any restriction on the powers of the company or the business it can carry on.

[§6.12] Special Procedures: Unalterable Provisions

The articles of a pre-existing company that has transitioned to the *BCA* might include one or more provisions that are declared to be "unalterable." Where a pre-existing company has such a provision in its articles (after its transition), the provision cannot be altered except by a court or by a unanimous resolution signed by all the shareholders of the company, whether or not their shares carry voting rights (s. 264(3) and (4)).

Under the *BCA*, a provision might require an exceptional resolution to change it (s. 264), but the *BCA* does not permit unalterable provisions.

[§6.13] Illustrating Special Procedures: Name Change

1. Changing the Notice of Articles

Section 263 contains the requirements of the Act relating to the voluntary change of the name of a company and to the adoption of, and the change of, any translation of the name of a company. This change will involve, primarily, an alteration of the notice of articles.

A translation of a company's name is for use outside Canada only (s. 11(f)). The English form or French form (or a combined form) must be used for the actual name of the company (s. 25(1) and (2)) and it must be set out in the notice of articles (s. 11(b)) and the articles (s. 12(2)(c)(ii)). A translation of a company name must also be set out in the notice of articles in letters from the English alphabet (s. 12(2)(c)(iii) and Reg. s. 10).

2. Resolutions

Section 257 specifies the resolution (and other procedures) that is required in order to authorize an alteration to the notice of articles of a company to change its name or adopt or change any translation of its name (see s. 263(1)).

In the case of a change of the name of a company, the type of resolution is the type specified in the articles (s. 257(2)(b)(ii)) or, if none is specified in the articles, a special resolution (s. 257(2)(b)(iii)).

In the case of the adoption of or change to a translation of a company's name, the approval may be by way of a directors' resolution or an ordinary resolution (ss. 257(2)(b)(i) and 263(2)).

3. Reserving Name and Registrar Filings

Unless the new company name is to be the name created by adding "B.C. Ltd." after the incorporation number of the company, it must be reserved under s. 22 (see ss. 263(3)(a) and (b)).

To change the name, the company must file with the registrar a notice of alteration (s. 257(4)). If there is no name reservation existing at the date the change of name is to take effect, the notice of alteration is deemed to be withdrawn on that date and is deemed not to have made any change to the name in the notice of articles (s. 263(4)). It is also possible to voluntarily withdraw the notice of alteration (s. 258). There is no requirement to reserve a *translation* of a company name.

If the company is not in good standing, the registrar may refuse to accept any filing relating to the company (s. 411(1)). A company will not be in good standing if its annual reports are not filed up-to-date or if the information in the Corporate Registry shows that there is no director of the company.

After the alteration to the notice of articles takes effect, the registrar must give the company a certified copy of the notice of articles as altered, if requested to do so (ss. 257(6), 263(5)(a)(ii) and 263(6)(a)).

In addition, the registrar must issue and give the company a certificate of change of name showing the change of name and the date and time the change took effect (s. 263(5)(a)(i)). The registrar does not issue a certificate for adopting or changing a translation of a company's name.

When the company's name has been changed, the certificate of change of name issued by the registrar must be filed by the company in its records office (s. 42(1)(a)).

After changing a company's name (but again, not after a translation), the registrar must publish a notice of the change of name on a government website (s. 263(5)(a)(iii) and Reg. s. 6).

4. Altering Articles

After an alteration to the notice of articles has taken effect under s. 257(5) to change the name of a company, the company must promptly alter its articles to reflect that change of name (and any translation of the new name) (s. 263(5)(b)). Any such alteration to the articles does not require a resolution (s. 263(7)). See also ss. 12(5)(b) and (6).

5. Effect of Change of Name

A change of name, whether voluntary or involuntary, does not affect any of the rights or obligations of the company, nor does it render defective any legal proceedings by or against the company and any legal proceedings that may have been continued or commenced against the company under its former name may be continued or commenced against the company under its new name (s. 263(8)). The same comments apply to translated names.

Chapter 7

Dissolution and Restoration[1]

For further information on this topic, see Chapter 15 of the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC).

[§7.01] Dissolution by Registrar

1. Grounds for Dissolution by Registrar

Section 422(1) of the *BCA* allows the registrar to dissolve a company or cancel the registration of an extraprovincial company on various grounds, including these:

(a) the company has for two consecutive years failed to file with the registrar its annual report or any other record as required by the *BCA* or any predecessor act;

(b) the company fails to comply with an order of the registrar, including an order to change its name;

(c) the company tenders a cheque for fees under s. 431 that is dishonoured; or

(d) a pre-existing company fails to observe transition provisions as required by s. 370 or s. 436.

2. Procedure

The registrar first sends a letter informing the company of its failure to comply with the *BCA* and of the registrar's powers. If the company is a BC company, the registrar has the power to dissolve it. If the company is an extraprovincial company, the registrar has the power to cancel its registration (s. 422(1)). (For more on extraprovincial companies, see Chapter 10.)

If the registrar does not receive a satisfactory response within one month indicating that the company has resolved (or is resolving) the failure, the registrar may publish a notice on a government website (s. 422(3), Reg. s. 6). The notice must state that the company will be dissolved (or, in the case of an extraprovincial company, that its registration will be cancelled) unless, within one month of the date the notice is published, the registrar's concerns are satisfied in one of these ways:

(a) the company establishes why it should be allowed to continue (s. 422(4)(b)(i));

(b) the company satisfies the registrar that it is not in default, that the default has been remedied or that reasonable steps are being taken to remedy the default (s. 422(4)(b)(ii)); or

(c) a copy of an entered court order favouring the company's position is filed with the registrar (s. 422(4)(b)(iii)).

If the company cannot satisfy one of those three exceptions, the registrar may dissolve the company (or cancel the registration of the extraprovincial company) at any time after one month from the date of publication of the notice (s. 422(5)). At that point, the company is dissolved (or, in the case of an extraprovincial company, its registration is cancelled). Another notice is then published indicating that the company has been dissolved (s. 424 and Reg. s. 6).

3. "Letting It Die"

Having the company dissolved for failing to comply with the *BCA* is often used as an inexpensive form of dissolution when the company has no assets or liabilities. The company simply fails to file annual reports, and then at any time after two years, two months and one day after the effective date of the last filed annual report, the company can be dissolved as set out above.

The registrar will cancel the registration in British Columbia of an extraprovincial company for failure to file annual reports in the same situation (s. 422(1)(a)). However, an extraprovincial company can achieve the same result by simply sending a notice to the registrar that the company has ceased to carry on business in British Columbia (s. 397(b)).

When a client is seeking dissolution, it may be inappropriate to counsel that client not to file annual reports, because that is counselling the client to disobey a statute. Nevertheless, it is fairly common for a lawyer to point out the option of letting the company die, and informing them that doing so will breach the *BCA*, giving rise to certain penalties.

Further, if a company has assets at the time of its dissolution, those assets will vest in the government in accordance with s. 4(1) of the *Escheat Act* (in the case of land) or s. 344(2) of the *BCA* (in the case of other assets).

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[1] Revised by **Chat Ortved**, Lawson Lundell LLP, in March 2023, March 2020 and March 2018. John O.E. Lundell, KC, using Chapter 12 of the *British Columbia Company Law Practice Manual*, 2nd edition (Vancouver: CLEBC), contributed this chapter in January 2004 and reviewed it in November 2004 and November 2005.

If a company is to be "allowed to die," it may be prudent to use a simple form of conveyance to transfer all assets to the shareholders with a power of attorney that will survive the dissolution.

[§7.02] Voluntary Dissolution ("Short-Form Dissolution")

1. Short- or Long-Form

Also known as "short-form dissolution", a voluntary dissolution without liquidation under Division 2 of Part 10 of the *BCA* is generally used when all the company's debts and liabilities have been paid (or discharged, or adequately provided for) or when the assets of a subsidiary have been transferred to its parent. A company that has significant assets or liabilities, or has an active business, may need to use the liquidation provisions of ss. 319 to 343, also called "long-form dissolution."

Under s. 313, only solvent companies may engage in dissolution and liquidation proceedings. As a result, the directors of a company seeking to dissolve must adequately provide for the payment of each of the company's liabilities (see §7.02(2)(b)); if that is not possible, it may be necessary to proceed under insolvency legislation such as the *Bankruptcy and Insolvency Act*. If a company is found to be "insolvent" for the purposes of the *Bankruptcy and Insolvency Act*, any dissolution proceedings under the *BCA* must be stayed (s. 313). After the assets of a company have been liquidated and distributed under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, the company will still exist, and can only be dissolved by action taken in accordance with the procedures of the *BCA*.

2. Procedure

(a) Required Steps

A company can be dissolved in a short-form dissolution if it complies with these steps:

(i) it passes an ordinary resolution authorizing it to be dissolved (s. 314(1)(a)) and

(ii) it files with the registrar an application for dissolution containing a statement that an affidavit complying with s. 316(2) and sworn by a director has been obtained and deposited in the company's records office (s. 316(1)(b)).

Section 314(2) permits a company that has not issued any shares to be dissolved if it is authorized to do so by a directors' resolution, rather than an ordinary resolution.

Special resolutions authorizing the dissolution are also acceptable (since a special resolution, by definition, meets and exceeds the criteria for an ordinary resolution).

When the company has remaining assets to be distributed, a special resolution should be passed because of s. 301 (which requires that a company not dispose of all or substantially all of its undertaking unless it does so in the ordinary course of its business or has been authorized to do so by a special resolution). Some exceptions to the requirement of a special resolution are set out in s. 301(6), including that it is unnecessary if the company is disposing of its assets to a wholly owned subsidiary, or if the company is a wholly owned subsidiary of the company that is purchasing the assets. Note that this special resolution gives rise to a right of dissent (s. 301(5)) and note the requirements of s. 240 with respect to notice.

The company must be in good standing at the time the application for dissolution is filed.

Upon filing the application for dissolution, the registrar publishes a notice on a government website (Reg. s. 6), issues a certificate of dissolution showing the date and time of dissolution (s. 345(a)), and furnishes a copy of the certificate to the applicant and to the person selected (under s. 351) to retain the company records.

(b) The Affidavit

The person swearing the affidavit must be a current director of the company (s. 316(1)(a)).

The wording of the affidavit must comply with s. 316(2) and must state:

- the company's dissolution has been duly authorized in accordance with s. 314(1)(a) or (2), as the case may be;
- the company has no assets; and
- the company has no liabilities as a result of s. 315(6) or otherwise, or has made adequate provision for the payment of each of its liabilities.

When a director cannot swear such an affidavit, the long-form dissolution procedures described in §7.03 should be followed.

(c) Documentation

Various instruments are required to transfer assets when registration is required, such as a Form A Freehold Transfer for real property, a bill of sale for goods not in possession, transfer forms for motor vehicles, and so on. In addition, there should be an assignment and assumption agreement or general conveyance agreement transferring the assets of the compa-

ny to the shareholder or shareholders. The party assuming liabilities should be careful to specify with as much accuracy as possible the liabilities that are being assumed.

(d) Surviving Power of Attorney

Using an agreement with general assignment language will avoid the problem of unknown or forgotten assets being forfeited to the government. One of the most important provisions in such an agreement is the grant of an irrevocable power of attorney coupled with an interest from the dissolving company to its parent (or, if the dissolving company is not a subsidiary, to a shareholder) to file all necessary tax returns and elections and to do and execute all acts and transfers necessary to complete the assignment of the assets to the recipient. Otherwise, the company cannot execute documentation because the company does not exist. Note the requirements of the *Power of Attorney Act*.

(e) Indemnifying Directors and Officers

If it has the power and capacity, it is normally desirable to have the parent company of a dissolving subsidiary agree to indemnify the officers or directors of the subsidiary for liabilities related to their acting to dissolve the company, including with respect to income taxes.

3. Extraprovincial Companies

A foreign entity that wants to have its registration as an extraprovincial company cancelled can simply file with the registrar a notice of ceasing to carry on business in British Columbia (s. 397(b)).

Alternatively, the extraprovincial company may simply stop filing annual reports, in which case its registration will eventually be cancelled by the registrar under s. 422(1)(a) (but see §7.01(3) with respect to counselling this).

The registrar will also cancel the registration of an extraprovincial company if they receive notice from the registrar (or equivalent authority) in the foreign entity's jurisdiction that the foreign entity has ceased to exist (s. 397(a)). The registrar cannot dissolve an entity that has been incorporated in another jurisdiction; it can only cancel the registration of the extraprovincial company in British Columbia.

For more on extraprovincial companies generally, see Chapter 10, and for more on *CBCA* companies, see Chapter 11.

[§7.03] Voluntary and Court-Ordered Liquidation

1. Liquidation Generally

Liquidation is the process by which a company with assets and liabilities is "wound up", as its debts and liabilities are satisfied, and any remaining assets distributed to the shareholders, following which the company is dissolved.

The liquidation process can be voluntary or under a court order. The shareholders of the company initiate a voluntary liquidation; a court may order liquidation on application of any one of a number of "appropriate" persons.

For the most part, the process of liquidation is the same regardless of whether the liquidation is voluntary or ordered by the court. The same powers and responsibilities are attached to the role of the liquidator, for instance.

Insolvent companies cannot engage in liquidation proceedings under the *BCA* (s. 313). (See §7.02(1) with respect to insolvent companies.)

2. Voluntary Liquidation

(a) Company Having Extensive Debts

Voluntary liquidation under Division 3 of Part 10 of the *BCA* is used when the company to be dissolved has extensive debts and liabilities, not all of which may be known at the commencement of proceedings. In contrast to short-form dissolution under Division 2, a company can be fully "wound up" under Division 3 even if it has assets that have not been distributed or debts that have not been paid.

(b) Special Resolution and Shareholders' Meeting

A voluntary liquidation begins with a special resolution resolving to liquidate the company (s. 319(1)). For a voluntary liquidation, "commencement of the liquidation" is defined in s. 312 as when the special resolution is passed, unless the resolution specifies a later date.

(c) Appointment of Liquidator

At the shareholders' meeting or in a written consent resolution, the shareholders also appoint (by ordinary resolution) a liquidator to liquidate the company and distribute the company's assets (s. 319(2)).

The liquidator must be someone who is qualified as a receiver under s. 64(2) of the *Personal Property Security Act*; however, if all the shareholders give written consent, a person mentioned in s. 64(2)(e) of the *Personal Property Security Act* (an insider or auditor of the

company or of an affiliate) is qualified to be the liquidator (s. 327(1)).

No act of a liquidator is invalid merely because of any defect in the liquidator's appointment or qualifications (s. 328).

Promptly after the resolutions to liquidate and appoint a liquidator are passed, the company must file with the registrar a statement of intent to liquidate (s. 321(1)). Unless the liquidator's appointment is reflected in a filed statement of intent to liquidate, the liquidator must file with the registrar a notice of appointment within 10 days of the commencement of the liquidation (s. 329(1)(a)), or "promptly" if appointed after commencement (s. 329(1)(b)).

(d) Notices

Promptly after the commencement of the liquidation, the liquidator must publish a notice in the *Gazette*, and in a newspaper that is distributed generally where the company has its registered office, that the company is in liquidation (s. 330(a) and s. 331(1)(a)). The notice must require:

- any person indebted to the company to pay the amount owing to the liquidator (s. 331(2)(a));
- any person having custody or control of any property, rights or interests of the company to deliver them, or provide control of them, to the liquidator (s. 331(2)(b)); and
- any person with a claim against the company to provide particulars to the liquidator within two months after the date of publication in the *Gazette* (s. 331(2)(c)).

The liquidator must also, promptly after publishing the notice of liquidation, send a separate notice to the last-known address of each known creditor (s. 331(1)(b)) and to any creditor the liquidator becomes aware of within two months after the date on which the notice was published in the *Gazette* (s. 331(4)).

The notice must disclose that the company is in liquidation and must include the following:

- a statement of the amount, if any, that the liquidator in good faith accepts is owing by the company to the particular creditor;
- a statement that the liquidator will provide to that recipient a list of all the company's known creditors and amounts the liquidator accepts are owing to them; and
- a statement that the recipient of the notice has four months from the date of publication of the notice in the *Gazette* to pursue any claim for money owed by the company in excess of the amount stated in the notice (s. 331(3)).

(e) Limits on Claimants

Section 332(1) limits those who may claim against a company in liquidation or against its liquidator, to the following persons (unless the court orders otherwise) (s. 332(1)(d)):

- those in receipt of notices;
- those to whom the liquidator refused or neglected to send a notice; or
- those who provide written notice of their claim to the liquidator within two months of the notice published in the *Gazette* and to whom the liquidator refuses or neglects to send a notice under s. 331(4).

Creditors who receive notices cannot claim amounts greater than what is specified in the notice, unless the court or the liquidator agrees they are owed more in one of these ways:

- within four months after the publication of the *Gazette* notice, the creditor brings legal proceedings to dispute the specified amount or persuades the liquidator that a greater amount is owing to them; or
- the court orders otherwise (s. 332(2)).

(f) Powers and Duties of Liquidator

(i) General

The liquidator takes custody or control of the company's property, rights and interests (s. 330(b)) and must:

- dispose of the assets of the company other than assets to be distributed in kind to the shareholders (s. 330(l));
- invest money in investments approved for trustees pending distribution to creditors and shareholders (s. 330(h)); and
- after paying or providing for all liabilities, distribute the remaining assets in money or in kind among the shareholders according to their rights and interests in the company (s. 330(m)).

(ii) Keeping Records

The liquidator must keep proper records of all matters relating to the liquidation (s. 330(e)). The liquidator must indicate that the company is in liquidation on every invoice, order for goods, and business letter issued by the liquidator or on which the

name of the company appears (s. 330(f)), and use the designation of "liquidator" on any record on which the liquidator's name appears (s. 330(g)).

The liquidator must file with the registrar an annual liquidation report instead of a regular annual report for the company (s. 330(k)).

The liquidator must take custody or control of the company's records (s. 330(b)), and ensure that the corporate records are maintained and made available as required under Part 2, Division 5 (s. 330(c)) and Part 4.1 (s. 330(c.01)).

The liquidator must establish a liquidation records office (s. 333(1)) in British Columbia (s. 333(2)) where certain records relating to the liquidation will be retained and where access to such records may be made available during statutory business hours.

(iii) Managing the Company

The liquidator has very broad powers to manage or supervise the management of the company and to exercise the powers of the company that are not reserved for the shareholders (s. 334(1)(a) and (b)). The powers of the directors and officers cease on appointment of the liquidator, except to the extent that the liquidator approves their continuation (s. 334(1)(a)).

(iv) Cease Carrying on Business

The company must cease carrying on business after liquidation commences, except to the extent that the liquidator considers it necessary or advisable for the liquidation (s. 340(2)). When the company is carrying on business during the liquidation, the liquidator must produce financial statements for the company at least every 12 months (s. 330(j)).

(v) Recovery of Property

Any past or present director, receiver, receiver-manager, officer, employee, banker, auditor, shareholder, beneficial owner of shares or agent of a company in liquidation, or of any its affiliates, must deliver any property, rights and interests of the company in that person's custody or control to the liquidator and must also provide full disclosure to the liquidator with respect to any such property, rights and interests, or property which has been disposed of by the company, except any disposed of in the ordinary course of business of the company (s. 335 (1)).

(vi) Distributing Assets

A liquidator may distribute assets of the company to the shareholders in kind, or may exchange all or substantially all those assets for securities of another corporation, which the liquidator will then distribute to the shareholders (s. 336(1)).

(vii) Preparing Accounts

Accounts of the liquidation, showing how it has been conducted and the disposition made of the company's assets, must be prepared at least once in every 12-month period after the appointment of the liquidator, and whenever directed by the court or (in a voluntary liquidation) an ordinary resolution. They must also be prepared at two stages of the liquidation: before the liquidator pays or makes provision for the liabilities of the company, and promptly after making such payment or provision but before distributing the assets of the company to shareholders (s. 338(1)).

(viii) If Creditor or Shareholder Not Located

When the whereabouts of a creditor or a shareholder are unknown, s. 337 provides a mechanism whereby the liquidator may, after making reasonable efforts to determine the whereabouts of the creditor or a shareholder, pay or deliver amounts or property due to that party to the administrator under the *Unclaimed Property Act*, S.B.C. 1999, c. 48.

(g) Powers of Shareholders in Voluntary Liquidations

The shareholders can restrict the power of the liquidator by requiring shareholder approval of certain matters (s. 320(1)).

The shareholders also have the power to remove the liquidator by a special resolution passed at a general meeting, if notice has been given to the liquidator and to each creditor whose unpaid claim exceeds $1,000 (s. 322(1)(b) and Reg. s. 24). Given the language of this provision, a consent resolution is probably insufficient.

(h) Reversing a Voluntary Liquidation

At any time after a statement of intent to liquidate is filed and before the company is dissolved, the company, or any other person who appears to the registrar to be an appropriate person to do so, may file a notice of withdrawal,

which effectively withdraws the statement of intent to liquidate (s. 323).

(i) Completion of Liquidation

Within three months after all the assets of the company have been distributed to the shareholders, the liquidator prepares final accounts showing how the liquidation has been conducted and how the assets of the company have been disposed of (s. 341(1)(a)). The liquidator must deposit those accounts in the liquidation records office and send a notice to the shareholders informing them that they may receive a copy of the final accounts and inspect them for a period of at least three months from the date of the notice (ss. 341(1)(b) and (c)). The liquidator cannot apply to dissolve the company until that three-month period expires (s. 341(3)).

Before distributing assets to shareholders, the liquidator should obtain customary statutory clearance certificates (e.g. under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) and the *Provincial Sales Tax Act*, S.B.C. 2012, c. 35).

Promptly after the expiry of the three-month period during which shareholders may inspect the final accounts, the liquidator must file with the registrar an application for dissolution stating that the final accounts have been prepared and deposited in the liquidation records office and, in the case of a court-ordered liquidation, that a copy of an entered order under s. 342 approving the dissolution of the company has also been deposited in the liquidation records office (s. 343).

In the case of voluntary liquidation, the company will be dissolved on the beginning of the day that is one month after the date on which the application for dissolution is filed with the registrar (s. 343(2)(b)). In contrast, for a court-ordered liquidation, the company will be dissolved when the application is filed, or on any later date (and time, if any) specified in the application (s. 343(2)(a)). The court may defer this date (s. 343(3)).

(j) Remunerating the Liquidator

The shareholders may by ordinary resolution either set or authorize the directors to set the remuneration for each liquidator appointed in a voluntary liquidation (ss. 319(2)(b) and 322(5)).

Section 326 provides that the court must set the remuneration of a liquidator appointed by the court.

3. Court-Ordered Liquidation

A court-ordered liquidation may be initiated by an application made by the company, a registered or beneficial shareholder, a director, or any other person (including a creditor of the company) whom the court considers an appropriate person to make such an application (s. 324(1)).

The court may order that a company be liquidated and dissolved if an event occurs which triggers liquidation according to the articles of the company (or its memorandum, if it is a pre-existing company), or if the court otherwise considers it "just and equitable" to order the liquidation and dissolution of the company (s. 324(1)(a) and (b)).

When the court makes such an order, it must, in that order, appoint one or more liquidators (s. 324(4)). The appointment of the liquidator takes effect on the commencement of the liquidation (s. 324(5)), which is the date of the liquidation court order, or such later date (and time, if any) specified in the order (s. 312).

The liquidator's responsibilities under a court-ordered liquidation are substantially the same as under a voluntary liquidation. Many of the provisions of the *BCA* governing liquidation (and most of the above comments) apply to both a court-ordered and a voluntary liquidation. Some of the differences have been mentioned above; others are as follows:

- a court-ordered liquidation cannot be discontinued without a court order under s. 325(3)(v);
- if a court-appointed liquidator is not qualified to act, the liquidator is not required to resign but instead must seek directions from the court (s. 327(2)(b)); and
- a court-appointed liquidator must obtain a court order approving the dissolution (s. 342(1)).

4. Dissolution Following Liquidation

As mentioned, a liquidator appointed by the court must, before applying for dissolution of the company, obtain a court order approving that dissolution (s. 342). No court approval is required for dissolution in a voluntary liquidation.

In addition, s. 342(3)(c) specifies that the court may order that the liquidator be discharged effective on the dissolution of the company or at any other time the court orders. A liquidator in a voluntary liquidation can be discharged by a court order under s. 350(1). The order discharges the liquidator from all liability in respect of any act or default of the liquidator (ss. 342(3)(c) and 350(3)). If the liquidator's liabilities are not discharged by the order, the liquidator's liabilities, if any, will survive the dissolution (s. 347).

After dissolution, the registrar must issue a certificate of dissolution, furnish a copy to each liquidator, and publish a notice of the dissolution (s. 345).

[§7.04] Post-Dissolution Matters

1. Survival of Liabilities

Proceedings may be continued against a company after its dissolution or brought against a company within two years after its dissolution as if the company had not been dissolved (s. 346(1)).

Section 347 provides that, subject to ss. 348(2) and (4) and 350(3), the liability of every director, officer, liquidator and shareholder of a dissolved company shall continue and may be enforced as if the company had not dissolved.

When assets of the company are distributed to a shareholder in anticipation of, during, or as a result of the company's liquidation or dissolution, the court may add the shareholder as a party to litigation, determine the amount for which the shareholder is liable and the amount the shareholder must contribute to satisfy the plaintiff's claim and direct payment of those amounts (s. 348(1)), provided that the shareholder is not liable unless added as a party within two years after the date of dissolution (s. 348(2)). The shareholder's liability is limited to the value of the assets they received, as at the date of distribution (s. 348(4)).

It is usually advisable for all the officers and directors to resign well in advance of dissolution. When a company is restored and persons have not resigned, they are also reinstated in their respective roles as officers and directors.

2. Record Keeping

Sections 351 to 353 describe how to maintain and access records of a dissolved company (as required under s. 42), or of a liquidation (as required under s. 333(1)).

The person responsible for the records will be the person shown in the application for dissolution as having custody of the records (s. 351(2)(a)(i) and (b)), or if there was no application for dissolution, the person responsible will be whoever had custody of the records at the time of dissolution (s. 351(2)(a)(ii)).

The records must be retained for two years or until the expiration of any shorter period the court orders (s. 351(2) and Reg. s. 25).

The obligation to retain the records includes the requirement that the records be made available for inspection during statutory business hours by any person who would have been entitled to inspect the company's records before dissolution (s. 352). A party entitled to inspect the records is also entitled to a copy of any of them.

[§7.05] Restoration and Reinstatement

1. Restoration by Registrar or Court

The registrar can restore a dissolved company or reinstate the registration of an extraprovincial company whose registration has been cancelled (ss. 356 and 364.1). In addition, the court can order that a dissolved company be restored (s. 360).

A "related person" may apply for a full restoration or reinstatement (see below under the heading "Who Can Apply"); any person can apply for a restoration or reinstatement for a limited period (ss. 356(2), 360(2) and 364.1(1)). After that period expires, the company is again dissolved, or the extraprovincial company's registration is again cancelled (ss. 359(1), 361(1) and 364.3(1)), unless the restoration or reinstatement period is extended. Alternatively, a "related person" may apply for a limited restoration to be converted to a full restoration (ss. 359(2)(a) and 361(2)(a)).

2. Assets of Dissolved Company

When a company ceases to exist while it still has assets, those assets will become the property of the government through the doctrine of escheat (in the case of land) or under s. 344(2) of the *BCA* (in the case of all other assets). Assets held in joint tenancy vest in the other joint tenant at the date of dissolution (s. 344(2)(a)).

When a corporation holding land in British Columbia is dissolved, the land immediately escheats under the *Escheat Act*, R.S.B.C. 1996, c. 120. Land held by a British Columbia company in a federal territory or another province will escheat under the common law Crown prerogative (which is regulated by the *Escheats Act*, R.S.C. 1985, c. E-13) or a provincial statute. The British Columbia *Escheat Act* and the *BCA* work in tandem to return land located in British Columbia to a restored company in a reasonably convenient way.

If a company is restored within two years after its dissolution, any land in British Columbia that had escheated to the government vests in the company, subject to the terms of any court order, as though the company had not been dissolved. In the case of a restoration after that two-year period, the return of the escheated land requires an order of the court, with prior notice to the government of the application for that order.

In the case of assets other than land, their title passes immediately to the government on the dissolu-

tion of a company (s. 344(2)). If money or other assets of a dissolved company have vested in the government as a result of its dissolution, upon restoration of the company any such assets not disposed of by the government vest in the company automatically (s. 368(1)(a)). The government must return to the company any assets in its custody, and pay to the company the amount of any money it received and the amount of any money realized from the disposition of any of the assets (s. 368(1)(b)).

Conflicts of laws principles provide that title to assets is governed by the laws of the jurisdiction in which they are situated, so other assets located outside British Columbia will be governed by local laws, which will determine what happens to ownership of them when the company is dissolved.

3. Restoration or Reinstatement Discretion

The registrar has no discretion to deny restoration if an application is filed under s. 356 or reinstatement if an application is filed under s. 364.1, unless a court order to the contrary is filed with the registrar (ss. 358(1) and 364.2). The court has discretion to order a restoration if it is satisfied that a restoration is appropriate (s. 360(5)).

4. Who Can Apply

Any person can apply for a limited restoration or reinstatement, but only a "related person" can apply for a full restoration or reinstatement (ss. 356(2), 359(2), 360(2), 361(2), and 364.1(1)).

In the case of a dissolved company, a "related person" means a director, officer or shareholder at the time of dissolution, or the heir or personal or other legal representative of a deceased shareholder of the company (ss. 354(2)(a)(i) and (ii)).

In an application to the court (but not to the registrar) for a full restoration of a dissolved company, or conversion of a limited restoration to a full restoration, "related person" also includes any person the court orders an appropriate person to make the application (s. 354(2)(a)(iii)).

In the case of an extraprovincial company that has had its registration cancelled, a "related person" means the foreign entity itself or a director, officer or shareholder of the foreign entity (or, for a limited liability company, a manager or member of the limited liability company) (ss. 354(2)(b)(i) and (ii)).

Any person may apply to extend the period of a limited restoration or limited reinstatement (ss. 359(2)(b), 361(2)(b), and 364.3(1)(b)).

5. Reasons for Applying

As noted in §7.01(3), assets of a dissolved company vest in the government. As a result, the company must be restored for the assets to be reacquired. A dissolved company is also incapable of paying debts and discharging liabilities. A dissolved company's assets, other than land in British Columbia, that vested in and were received by the government, are available to judgment creditors who apply to the minister for recovery against those assets within two years of the date of dissolution (s. 349). Creditors may, therefore, seek to restore the company in order to realize against assets, or otherwise collect, after the two-year period.

Legal action can only be taken against a dissolved company within two years of dissolution (s. 346(1)(b)). Therefore, a party wishing to proceed against a company after that two-year period must have the company restored.

6. Time Limits

In the case of a company that was dissolved before the *BCA* came into force, an application for restoration cannot be made to the registrar more than ten years after the dissolution (s. 356(4)). In such a case, the application must be made to the court under s. 360. There are no other time limits on restoration.

[§7.06] Procedures for Restoration or Reinstatement

1. Publication and Mailing of Notice

Before applying for restoration or reinstatement, the applicant must publish notice of the application in the *Gazette* (ss. 355(2)(a) and 364.1(2)(a)).

The applicant must also mail notice of the application to the last address or mailing address of the registered office of the dissolved company or, in the case of an extraprovincial company, of its attorney (or, if none, to the last address in British Columbia of its head office), all as shown in the corporate register (ss. 355(2)(b) and 364.1(2)(b)).

When a restoration is as a result of an application to the registrar under ss. 356 and 364.1, the restoration cannot take place until 21 days after the later of publication in the *Gazette* or mailing of notice to the last address shown in the corporate register (ss. 363 and 364.4).

2. Application to Restore or Reinstate

The requirements for a restoration or reinstatement application made to the registrar are largely set out in ss. 357 and 364.1(4) and (5). All restoration and reinstatement applications must list the date when

notice was published in the *Gazette* (ss. 357(a) and 364.1(4)(a)) and the date when the notice required under s. 355(2)(b) or s. 364.1(2)(b) was mailed (ss. 357(b) and 364.1(4)(b)).

An application for restoration of a company must identify the reserved name (or say that the name will be the incorporation number plus "B.C. Ltd.") (s. 357(c)). It must also, in the case of a full restoration, explain the applicant's status as a related person and the addresses of the proposed registered and records offices of the company (s. 357(e)).

A reinstatement application for an extraprovincial company must identify the name reserved (or, in the case of a federal corporation, the name of the corporation). A full reinstatement application also requires a statement explaining the applicant's status as a related person (s. 364.1(4)(d)). An application for a full reinstatement must also include an address for the post-reinstatement head office of the foreign entity (s. 364.1(4)(e)).

If the required application is filed, the registrar has no discretion to deny restoration or reinstatement (ss. 358 and 364.2). However, the registrar has a very broadly worded power to require an applicant for restoration or reinstatement to submit any records and information the registrar may require (ss. 356(3)(b) and 364.1(3)). This power is expected to be used to require applicants to file missing annual reports and similar records.

3. Consent of the Registrar

Sections 360(3) and 361(3) require that notice and a copy of any documents filed in the court for the application for a restoration or for the conversion of a limited restoration to a full restoration be sent to the registrar, and that the registrar must consent to the restoration. The consent must be provided to the court (ss. 360(4)(b) and 361(3)(d)(ii)). The registrar may make such consent subject to any terms and conditions the registrar considers appropriate.

In the case of an extraprovincial company, the registrar may also require a certificate of status from the home jurisdiction of the extraprovincial company confirming its continued existence.

4. Limited Restorations and Reinstatements

Section 354(1) defines "limited restoration" to mean a restoration of a company for a limited period (up to two years). Sections 364.1(1) and (5) and s. 364.3 refer to the reinstatement of an extraprovincial company for a limited period. When the limited period of restoration or reinstatement expires, the company is dissolved (or the registration of the extraprovincial company is cancelled) (ss. 359(1), 361(1) and 364.3(1)). The registrar will then publish notice of the dissolution or cancellation of registration on a government website (ss. 359(4), 364.3(2) and Reg. s. 6).

When there has been a limited restoration by the registrar, a related person may apply to the registrar within the limited period of restoration to convert it to a full restoration (s. 359(2)(a)). Any person may apply to extend the limited period of a limited restoration or limited reinstatement to any later date the registrar considers appropriate (ss. 359(2)(b) and 364.3(1)(b)).

The court may similarly extend or convert a limited restoration, whether the limited restoration was by the court or the registrar (s. 361(2)). In the case of conversion of a limited restoration to a full restoration, the applicant must be a related person (s. 361(2)(a)), must provide the registrar with notice of the court application and copies of the records filed with the court (s. 361(3)(b)) and must obtain the registrar's consent to the conversion (s. 361(3)(c)).

5. Court Order

Section 360(5) provides that the court can make an order restoring a company subject to the conditions and on the terms the court considers appropriate.

Unless the order states otherwise, the restoration of the company will be without prejudice to the rights of any third party who has acquired any rights before the company's restoration (see s. 360(7)). The same applies to a restoration by the registrar (s. 358(2)).

Promptly after a court order is made under s. 360 or 361, the applicant must file with the registrar a restoration application, including a statement that an entered court order has been obtained under s. 360(5) or 361(2)(a) or (b), as the case may be, and any other records the registrar may require (s. 362(1)). Upon receipt of that application, the registrar must restore the company, extend the restoration, or convert a limited to a full restoration, as applicable, unless an entered court order to the contrary has been filed with the registrar (s. 362(2)).

Section 360(6) says that the court may give directions and make provisions it considers appropriate for placing the company and every other person in the same position, as nearly as possible, as if the company had not been dissolved.

[§7.07] Effect of Restoration or Reinstatement

Upon completion of a restoration, the company is deemed to have continued in existence as if it had not been dissolved, and proceedings may be taken as if it

had not been dissolved (s. 364(4)). Similarly, if the registration of an extraprovincial company is reinstated, the registration is deemed not to have been cancelled and proceedings may be taken as if the registration had not been cancelled (s. 365(3)).

After the restoration or reinstatement, the registrar publishes a notice on a government website and issues a certificate of restoration (s. 367(1) and Reg. s. 6). The restoration or reinstatement is effective at the time and date shown in the corporate register (ss. 364(1) and 365(1)).

Chapter 8

Shareholders' Rights and Remedies[1]

For further information on this topic, see Chapter 17 of the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC).

[§8.01] Remedies Under Statute

Shareholder disputes are more common than most people realize. Frequently, shareholders embark on some business venture as "partners" without any formal agreement; they may have little understanding of the financing and conduct of the business, and only a "standard" set of company articles. This pattern leads to trouble. Even where a shareholder agreement exists, conflict may arise in various situations:

- the shareholder agreement contains remedies, but fails to deal with some unforeseen issues;
- equal "partners" in a business reach a deadlock on the future of the venture; or
- "partners" lose confidence in their colleagues but are unable or unwilling to execute a "buy-out" under a shareholder agreement.

Consequently, even if a shareholder agreement exists, the remedies under the *BCA* may be required to resolve a dispute. These remedies are explored in this chapter.

[§8.02] Court Proceedings

1. General Provisions

All applications to "court" under the Act must be made to the Supreme Court of British Columbia (s. 1(1)). Under the Supreme Court Civil Rules, B.C. Reg. 168/2009 (the "SCCR"), such applications must be made by petition (see SCCR 2-1(1), (2) and 16-1). The "application" itself is normally the hearing of the petition. In some circumstances, the court has the power to convert a proceeding commenced by a petition to a civil claim.

Unless notice is explicitly required, an application may be brought without notice (s. 235). If an order is obtained without notice, any person affected by the order has the right to apply to set it aside or vary it (SCCR 8-5(8)), on the grounds of material misrepresentation, that an application without notice was inappropriate, or on its merits. In most cases a company's shareholders will be persons affected by an order that was obtained without notice.

Documents may be served on a company at its registered office or personally on a director, senior officer, liquidator, or receiver manager of the company (s. 9).

2. Rectification of Irregularities

The court may, either on its own motion or on the application of any interested person, make an order to rectify or modify the consequence of any omission, defect, error or irregularity in the conduct of the business or affairs of a company, which causes a breach of the Act or the company's memorandum, notice of articles or articles, or which renders proceedings at a meeting or on a consent resolution ineffective (s. 229).

On application by a company, a shareholder, or an "aggrieved person", the court may also correct the company's articles, notice of articles or memorandum, minutes of any shareholders or directors' meeting or resolution, or any of the company's registers. The court has the power to correct information wrongly entered or retained in or wrongly deleted or omitted from these records, and to compensate anyone who suffered a loss as a result of the incorrect information (s. 230).

3. Relief From Oppression

A shareholder of a company may apply for a court order under s. 227 on the following grounds:

- the affairs of the company are being or have been conducted, or the powers of the directors are being or have been exercised, in an **oppressive** manner; or
- some act of the company has been done (or is threatened) or some resolution of the shareholders has been passed (or has been proposed) that is **unfairly prejudicial** to one or more of the shareholders.

Such applications are commonly referred to as "oppression" proceedings.

For the purposes of s. 227, a shareholder includes a beneficial owner of a share of the company and any other person who, in the court's discretion, is a proper person to make an application under s. 227.

[1] **Steve Warnett** of Borden Ladner Gervais LLP, Vancouver, kindly reviewed this section in January 2023, and revised it in 2021, 2019, and 2017. It was previously revised by Stephen Antle (1994–2005).

The shareholder must be able to point to conduct affecting them as a shareholder, not just as a director, officer or employee.

The court is concerned with fairness in deciding oppression applications. The expectation of fair treatment is a fundamental reasonable expectation. Has the majority been dealing honestly and fairly with the minority shareholders? This will depend on the factual circumstances.

According to the Supreme Court of Canada's decision in *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, there is a two-part test for whether there has been oppression. The shareholder must prove:

1. that the shareholder's reasonable expectations have been violated; and
2. that violation amounts to oppression or unfairly prejudicial conduct.

There must be evidence to verify that the shareholder actually held the reasonable expectations that the shareholder claims have been violated, and that the conduct complained of is "oppressive" or "unfairly prejudicial."

Conduct that is burdensome, harsh and wrongful is oppressive (*Scottish Co-operative Wholesale Society v. Meyer*, [1958] 3 All E.R. 66 (H.L.)). According to the Supreme Court of Canada in *BCE*, *supra*, oppressive conduct means conduct that is coercive, an abuse of power or suggestive of bad faith.

Conduct that has satisfied the court as oppressive in the circumstances includes majority shareholders appointing themselves to paid offices of the company, and majority shareholders paying themselves excessive salaries or bonuses and thereby absorbing profits that would otherwise be paid to shareholders as dividends.

Generally, it is not necessary for a shareholder to prove an element of bad faith on the part of those conducting the company's affairs, but the shareholder must demonstrate a lack of probity and a failure to deal honestly and fairly with the majority. What is important is the effect of the conduct complained of (*Juno Europe LP v. PresiNet Systems Corp.*, 2008 BCSC 587; *Collins Barrow Vancouver v. Collins Barrow National Cooperative Inc.*, 2015 BCSC 510 at para. 247, affirmed 2016 BCCA 60).

Conduct that is not oppressive may be unfairly prejudicial, since the threshold is lower (*Elliott v. Opticom Technologies Inc.*, 2005 BCSC 529). One basis for successfully proving unfairly prejudicial conduct is for a shareholder to satisfy the court that the shareholder had a legitimate expectation, such as participating in the direction of the company's business, that was denied.

Breaches of the company's obligations under the Act or its articles can also be oppressive or unfairly prejudicial.

The case law is divided on the effect of a shareholder agreement on a shareholder's ability to seek remedies under s. 227. The courts generally have held that where the shareholder agreement contains remedies for the conduct complained of that are similar to those sought under s. 227, the shareholder should pursue rights under the agreement. But breaches of a shareholder agreement can be evidence of oppression or unfairly prejudicial conduct.

The court may order interim or final relief. Available remedies are listed in s. 227(3). These are the most common types of relief:

- orders that remedy the specific conduct complained of;
- orders that require the company or other shareholders to purchase the wronged shareholder's shares;
- orders that appoint a receiver or receiver manager; and
- orders for liquidation and dissolution.

If the court makes a payment order and the company is insolvent or payment would make it insolvent, it must pay as much as possible without becoming insolvent (s. 227(5) and (6)).

A shareholder may seek to hold a company's directors or officers personally liable for oppression or unfairly prejudicial conduct. To succeed, the shareholder must establish that specific directors or officers did specific things that amounted to oppression. The shareholder must also show that the imposition of personal liability would be a fit remedy for the oppression under the circumstances. Personal liability may be appropriate if the directors or officers personally benefited from the oppressive conduct.

It is important to note that the provisions of s. 227 differ from the analogous provisions of the Federal, Ontario and Alberta Acts. For example, under those statutes, shareholders, creditors and directors can all bring oppression proceedings. Under s. 227, shareholders alone can bring oppression proceedings. Under the other statutes, complainants can bring proceedings where corporate conduct "unfairly disregards" their interests. Relief is unavailable under s. 227 in these circumstances.

4. Derivative Actions

As distinguished from oppression proceedings, a shareholder or director brings a derivative action in the name and on behalf of the company (s. 232(2)). Derivative actions are brought to enforce rights,

duties or obligations enforceable by the company, or to recover damages for any breach of those rights, duties or obligations (s. 232(2)). A shareholder or director of the company may also, with leave of the court, defend an action brought against the company (s. 232(2) and (4)).

Section 233(1) requires that, before bringing a derivative action to the court, a shareholder or director must have made reasonable efforts to cause the directors to prosecute or defend an action. The shareholder or director must notify the company, and any other person the court may order, of the application. The section also requires that the shareholder or director act in good faith and in what appears to be the best interests of the company. In addition, if the party bringing the derivative action is a shareholder, the shareholder must have been a shareholder at the time of the transaction that gave rise to the cause of action.

In *2538520 Ontario Ltd. v. Eastern Platinum Limited*, 2020 BCCA 313, the Court held that "appearing to be in the best interests of the company" means that the proposed action must be have a reasonable prospect of success and litigating it will, if successful, maximize the value of the company.

The derivative action may not be discontinued, settled or dismissed without the court's approval (s. 233(5)). The court may issue interim and final orders regarding the conduct of the action and costs for the action (s. 233(3) and (4)).

Section 233(6) states that no derivative action is to be stayed or dismissed by reason only that it can be shown that an alleged breach of a right, duty or obligation owed to the company has been or might be approved by the shareholders of that company. However, evidence of that approval or possible approval may be taken into account by the court when making an order under s. 232.

5. Order for Liquidation and Dissolution

A company may be liquidated and dissolved by court order under s. 324 of the Act, if the court thinks it just and equitable to do so. Such an order is a drastic remedy. Consequently, a heavy onus rests on the applicant to persuade the court to grant the order. The essential consideration is whether the relationship between the company's shareholders has deteriorated to such an extent that they have neither trust nor confidence in each other's ability to manage the company's affairs.

The courts are particularly likely to order a liquidation where it appears that the basis of the company was mutual confidence among the shareholders, where the shareholders agreed all were to participate in management, or where a shareholder agreement restricts shareholders' ability to liquidate their investment.

In the case of a family company, the courts have held it is appropriate to take a more liberal approach to liquidation. The courts have found it would be just and equitable to liquidate a family company where one family member after working in the business for many years was excluded from management, even though he was never a director and there was no wrongdoing by the other family members; see *Safarik v. Ocean Fisheries Ltd.* (1996), 12 B.C.L.R. (3d) 342.

Once the court is satisfied it would be just and equitable to liquidate the company, it is not limited to making a liquidation order. Under s. 324(3), the court may make any of the orders available under s. 227, which include removing directors, directing that the company take certain actions, setting aside resolutions or ordering trial on any issue.

While a liquidation order is a drastic remedy, the test to show that it is just and equitable that the company be liquidated may be easier to meet than the test for finding that the shareholder is being oppressed. This may enable a shareholder to access "oppression" remedies in s. 227 indirectly through the liquidation provisions of s. 324.

[§8.03] Dissent Proceedings

1. General Information

In certain circumstances, a registered shareholder who disagrees with a proposed corporate action can require the company to purchase their shares for their "fair value" (s. 237(1)).

These actions give rise to a right of dissent:

(a) altering the articles of a company:

  (i) altering the restrictions on the powers of the company or the business the company is permitted to carry on (s. 260(a)), or

  (ii) in the case of a community contribution company, without limiting s. 260(a), altering any of the company's community contribution purposes within the meaning of s. 51.91 (s. 260);

(b) proposing an amalgamation (ss. 272, 287);

(c) approving an arrangement (where permitted);

(d) proposing disposition of all or substantially all of its undertaking (s. 301(5));

(e) proposing continuance outside of BC (s. 309); or

(f) actions in respect of any resolution or court order or arrangement permitting dissent.

Under similar provisions in the Alberta *Business Corporations Act*, the Alberta Court of Queen's Bench held that, despite a clear statement that only registered shareholders may exercise dissent rights, the company had so conducted itself as to be estopped from denying a beneficial shareholder the right: *Lay v. Genevest Inc.*, 2005 ABQB 140.

2. Waiver

Shareholders may waive their right to dissent with respect to a particular corporate action (s. 239(1)), by providing a waiver to the company setting out specified information (s. 239(2)). In that event, the shareholder's right of dissent with respect to that action terminates (s. 239(3) and (4)). Shareholders may not waive their right to dissent generally (s. 239(1)).

3. Notice of Corporate Action

The company must notify each of its shareholders of corporate actions from which they have a right to dissent. If shareholders are entitled to dissent from a resolution that is to be considered at a shareholders' meeting, the company must notify them before the meeting concerning the resolution and their right of dissent (s. 240(1)). The notice period depends on the company's situation. If the shareholders are entitled to dissent from a resolution, the company may notify them of the resolution and their right to dissent at least 21 days before the specified date (s. 240(2)). If the company does not notify the shareholders, and the resolution is passed, or if a court order provides for a right of dissent, the company must notify any shareholders who did not vote in favour of the resolution, and send them a copy of the resolution and a statement of their right to dissent, within 14 days after the resolution is passed (ss. 240(3) and 241).

4. Notice of Dissent

A shareholder who intends to dissent from corporate action must send the company a written notice of dissent within a specified time. The notice must specify the shares in respect of which the shareholder is dissenting, and whether the shareholder is a registered or beneficial owner of the shares or both (s. 242(1) to (4)). If the notice does not comply with s. 242, the shareholders' right of dissent terminates (s. 242(5)).

5. Notice of Intention to Proceed

If a company that receives a notice of dissent intends to continue with the corporate action, it must send the dissenting shareholder a notice stating its intention to proceed and advising the shareholder how to complete that dissent (s. 243).

6. Completion of Dissent

A dissenting shareholder who receives a notice of intention to proceed must, if they still want to dissent, send the company or its transfer agent, within one month, their share certificates and a written statement that they require the company to purchase their shares (s. 244(1)). The shareholder is then deemed to have sold the shares, and the company to have purchased them (s. 244(3)). Once the shareholder has done this, the shareholder may not vote or exercise any shareholder rights in respect of the shares (s. 244(6)). Again, if the shareholder fails to comply with this requirement, their right to dissent terminates (s. 244(4)).

7. Payment

The dissenting shareholder and the company may agree on the value of the shares to be paid out (s. 245(1)). If they cannot agree, either may apply to the court to determine the fair value of the shares or for an order that value be established by arbitration, or by the registrar or a referee (s. 245(2)).

This "payout value" is defined by s. 237(1)(a) as the "fair value" of the shares, as distinguished from "fair market value". A determination of the fair value of shares does not typically focus on the shareholders; rather, it involves a contextual inquiry into the "assets, liabilities and business operations of the *company*" (*Nixon v. Trace*, 2012 BCCA 48 at para. 56 (emphasis in original)).

Following the determination of the fair value of the shares, the company must then promptly pay that amount to the shareholders (s. 245(1) and (3)), unless the company is insolvent, or payment of the fair value would make it insolvent, in which case the company must notify the shareholders of that and not pay (s. 245(5)). The dissenting shareholder may then either withdraw the notice of dissent within 30 days, or claim against the company for the unpaid amount (s. 245(4)).

8. Loss of Right to Dissent

As set out earlier in this section, a shareholder can lose the right of dissent by failing to comply with the requirements in the Act. In addition, a shareholder loses a right of dissent if the company abandons the corporate action that gave rise to the right of dissent, if a court permanently enjoins the action, or if the shareholder votes in favour of the action or withdraws the notice of dissent with the company's consent (s. 246). When these events occur, the company must return the share certificates to the shareholder and the shareholder regains the ability to vote the shares and exercise shareholder rights (s. 247).

Chapter 9

Shareholders' Agreements[1]

[§9.01] Defining Rights and Obligations

Two or more companies or individuals may decide to carry on business together as partners, co-owners or shareholders of a company. They should define their relationship in advance and set out their obligations to the business and each other. It might be difficult to convince some parties that an agreement is needed, but as soon as a dispute arises they will see the need for it.

This chapter deals specifically with shareholders' agreements, but many of the same principles apply to co-ownership agreements and partnership agreements. Whether the parties choose to be shareholders, partners or co-owners depends on tax and other considerations.

The *Company Law Practice Manual* from CLEBC contains a comprehensive shareholders' agreement to use as a precedent. A shareholders' agreement will address standard concerns as well as matters specific to the company. The following discussion reviews the model shareholders' agreement at §9.12 and the relevant matters in such an agreement for a British Columbia company that is a private or closely held company (not a public company or reporting issuer).

[§9.02] *BCA*

A shareholders' agreement is just one tool available to a lawyer to implement the business agreement between the shareholders and the company. It is an instrument that supplements the company's constating documents and the applicable corporate statute.

To determine which matters to address in a shareholders' agreement, consider what protections and benefits already exist in the legislation, in a company's articles, or in its notice of articles. When conducting such a review, it is essential to distinguish between companies incorporated under the *BCA* and those pre-existing companies incorporated under the *Company Act*. For companies incorporated under the *Company Act*, determine how the company has dealt with the *BCA*'s Pre-existing Company Provisions ("PCPs") under s. 442.1(1). The PCPs apply to a pre-existing company unless and until the company alters its notice of articles to remove them or adopt other provisions in their place.

The following paragraphs discuss a few of the provisions in the *BCA* that may benefit a shareholder.

1. Allotment

For a pre-existing company, before allotting new shares, the PCPs require that those shares must be offered rateably to the current shareholders, unless the company has amended its notice of articles to remove the application of the PCPs to the company. "Rateably" means in proportion to the shareholder's current holdings. For example, if three shareholders held 20%, 30% and 50% of the shares, respectively, their entitlement to the new shares would be in those proportions. Companies incorporated under the *BCA*, or pre-existing companies that have altered their notice of articles to remove the application of the PCPs to the company, are not bound by this requirement, and may address this issue in a shareholders' agreement.

2. Purchase or Redemption

When a pre-existing company proposes to purchase or redeem its own shares, the PCPs generally require that the offer to purchase or redeem be made rateably to every shareholder of the class or series to be purchased or redeemed, unless the company has amended its notice of articles to remove the application of the PCPs to the company. Companies incorporated under the *BCA*, or pre-existing companies that have revised their notice of articles to remove the application of the PCPs to the company, need not make this offer. They may need to address this issue in a shareholders' agreement.

3. Approval by Special Resolution or Exceptional Resolution

The *BCA* contains many provisions that require the company to obtain the approval of the shareholders by special resolution. A special resolution is the approval of shareholders by a special majority (between two-thirds and three-quarters of the votes cast, depending upon the articles and whether the company is a pre-existing company to which the PCPs apply). Absent a specific provision in the articles, a three-quarters majority will be required for any pre-existing company with a notice of articles that reflects that the PCPs apply to the company, and a two-thirds majority will be required for any company incorporated under the *BCA* or any pre-existing company that has revised its notice of articles to remove the application of the PCPs to the company. A company may specify its special majority to be any amount not less than two-thirds and not more than three-quarters.

[1] **Robert G. Owen** of Borden Ladner Gervais LLP, Vancouver, kindly revised this chapter in February 2023 and November 2021. Previously revised by Kathleen Keilty (2009 and 2011) and Douglas G. Shields (1996–2005). This chapter is based on a paper prepared originally by H. Laing Brown for Continuing Legal Education.

Matters requiring a special resolution under the *BCA* include the following: continuation out of British Columbia (s. 308(2)); removal of directors (s. 128(3)); power to alter the notice of articles and articles (Part 9—Company Alterations); approval of amalgamation (s. 271); disposing of all or substantially all of its undertaking (s. 301); and voluntary liquidation and the appointment of a liquidator (s. 319).

Under the *BCA*, the articles can identify matters that must be approved by *exceptional* resolution, which is a majority specified to be in excess of the *special* majority required to pass a special resolution.

[§9.03] Notice of Articles and Articles

The next tools for documenting the business agreement between the shareholders are the notice of articles and articles of the company. These "charter documents" of the company might contain protections for shareholders, including the following as described in the *BCA*:

(a) *BCA* s. 33(1)—the articles may restrict the business that the company can carry on, or its powers. These restrictions could be used, for example, to limit the company's ability to give guarantees.

(b) *BCA* ss. 58 and 61—special rights or restrictions may be attached to share classes.

(c) *BCA* s. 264—the articles may restrict the company or the directors from taking certain actions, or from altering certain provisions of the articles or notice of articles, without first passing an exceptional resolution. This requirement could be used, for example, to limit the ability of the directors to make capital expenditures over a certain amount without an exceptional resolution.

The above matters are most appropriately contained in the articles. There are many other topics that might be contained in the shareholders' agreement or the articles of the company. There are a number of factors to consider when determining whether portions of the business agreement between the shareholders should be placed in the company's charter documents or in a separate shareholders' agreement:

(a) The notice of articles and articles can be amended by a special resolution of the shareholders. As a result, the notice of articles and the articles may not help protect the interests of minority shareholders who hold less than the number of votes required to defeat a special resolution. While it may be possible to get around this problem by attaching special rights and restrictions to separate classes of shares, this can be cumbersome. On the other hand, provisions in a shareholders' agreement, unless it says otherwise, could be amended only with the unanimous approval of the parties.

(b) It is usually easier to amend a shareholders' agreement (even one that requires unanimous approval) than to amend the notice of articles or the articles. Amending the notice of articles or the articles requires compliance with the relevant statutory provisions, including holding meetings, passing required resolutions and making the necessary filings with the office of the Registrar of Companies.

(c) The articles must be maintained at the records office of the company and, together with certain other documents, may be made available for inspection by the public. Shareholders' agreements are not available for inspection, so shareholders can keep their agreement private.

(d) Section 137 of the *BCA* provides that the articles may restrict the power of the directors to manage or supervise the business and affairs of the company, or may transfer that power to other persons. Such a term in a shareholders' agreement might be invalid, due to the common law rule against fettering a director's discretion. Transferring powers using s. 137 of the *BCA* should be approached with caution, because the person to whom directors' powers are transferred also takes on the duties and liabilities of a director with respect to the exercise of those powers. For example, shareholders are normally allowed to act in their own interests, but if they take on the powers of directors, they must act in the best interests of the company in exercising those powers (see ss. 137(2) and 138).

Other considerations or understandings among shareholders might be more appropriately set out in a shareholders' agreement. These are discussed in more detail later in this chapter, and include the following:

(a) the shareholders' right or duty to participate in the management of the company, or "Conduct of the Affairs of the Company";

(b) funding the company and distributing its profits, or "Financing, Shareholders' Contributions, and Distribution of Net Profit";

(c) control over who is entitled to hold shares in the company, or "Restrictions on the Transfer of Shares or Right of First Refusal or Offer";

(d) dispute resolution and liquidating a shareholder's investment, or "Compulsory Buy-Out";

(e) what happens on the death of a shareholder, or "Investment Sale on Death"; and

(f) how to deal with a shareholder who defaults on obligations, or "Default."

The parties should discuss with a lawyer how they see the business agreement amongst themselves with respect to the conduct of the affairs of the company. It gives the

shareholders the opportunity to set out their understanding of the business agreement, and it gives the lawyer the opportunity to identify topics to be addressed in a shareholders' agreement, including topics that the shareholders might not have considered.

The model agreement and this chapter are based on the following fact pattern:

- the company has just been incorporated under the *BCA*;
- there are three individual shareholders who each own one-third of the issued and outstanding common shares of the company;
- each shareholder will contribute equally by way of loan;
- each shareholder will be actively involved with the company through a separate employment contract;
- a shareholder may unilaterally transfer that shareholder's interest in the company to another company that the shareholder controls without the approval of the other shareholders or any substantial amendment to the agreement; and
- where there is a corporate shareholder, an individual will be appointed as that corporate shareholder's representative.

The rest of this chapter deals with concerns that may arise among shareholders. The chapter breaks down these concerns into topics that might be addressed in a shareholders' agreement.

[§9.04] Parties

The parties to a shareholders' agreement are each of the shareholders and, usually, the company. The company must be a party if it is providing covenants under the agreement, such as agreeing to purchase shares from a shareholder. If a shareholder is a corporation that has obligations under the agreement, it may be advisable to have its shareholders sign as parties.

The lawyer must be careful to determine who the client is. Conflicts may arise in negotiating a shareholders' agreement, as shareholders often have competing interests. The lawyer should determine at the outset who the client is and inform all parties in writing, explaining the significance of that party being represented and advising the unrepresented parties to obtain independent legal advice before executing the agreement.

[§9.05] Conduct of the Affairs of the Company

The shareholders' agreement should set out how the affairs of the company will be managed and who will make the decisions. These provisions relate to the control of the company and the protection of any minority shareholders.

Without the benefit of provisions in a shareholders' agreement dealing with the conduct of the company, the affairs of the company will simply be carried out pursuant to the *BCA* and the company's articles. Consequently, a majority of the shareholders will be able to elect a board of directors, who in turn will appoint the officers of the company. Subject to various provisions in the *BCA* (including s. 142 of the *BCA*), the directors will be free to manage and conduct the affairs of the company as they see fit.

1. Management of the Company

A shareholders' agreement usually contains covenants relating to management of the company, including the following:

(a) Directors: the number of directors, and who may appoint and remove directors. The agreement may say that each shareholder may appoint one director, or may describe circumstances where a shareholder can appoint more than one director or where the parties may appoint an independent director to break deadlocks.

(b) Quorum: the quorum for the transaction of business by the directors. The quorum may require a director appointed by each shareholder to be present or may provide that a smaller number can transact business.

(c) Meetings: where meetings are held, who can call them and the notice required.

(d) Powers: decisions the directors can make.

2. Major Decisions

In any business, certain important decisions require the unanimous or special approval of the directors or the shareholders. Examples might include making major expenditures, borrowing or granting security for capital expenditures, conducting non-arm's-length transactions, approving budgets, entering into major contracts, buying or selling property, and issuing dividends or additional shares.

3. Employment Contracts

If shareholders will be running the business, the parties may wish to have separate employment or management contracts between the company and those shareholders. Cross-default provisions should be used to ensure that a default by a shareholder under an employment contract will trigger a default under the shareholders' agreement.

4. Non-Competition, Non-Solicitation and Confidentiality Agreements

Often it is important that the shareholders agree not to be involved in competing businesses within the market area of the company's business, either while they are shareholders or for a certain period of time afterwards. The clauses must be reasonable as to scope of activity, geographic area, and duration, or they risk being found unenforceable as contrary to public policy. In the absence of any non-competition covenants, employee shareholders may also be subject to fiduciary obligations that would prevent them from competing with the company. Similar covenants or agreements may be appropriate to control use of confidential information and prohibit solicitation of employees, customers or suppliers.

5. Model Agreement

As each of the three shareholders in our assumed fact situation is a "minority" shareholder, two of the three could, in the absence of a shareholders' agreement, act together to elect only themselves to be board members, and they in turn could be appointed the only officers of the company. Arguably, they could also ensure that the company does not employ, or distribute dividends or make other distributions to, the other shareholder (although this would also mean dividends are not paid on the shares of that class held by any other shareholder since shares of the same class are generally entitled to an equal amount per share of any dividends that are declared and paid on shares of that class). As none of the shareholders knows at the outset who may be the one left out, it is in the best interest of each to resolve this situation fairly. The model agreement allows for each shareholder to be a director or to nominate a director to a three-person board. This ratio maintains the same relative voting power on the board as at a meeting of shareholders.

The model agreement also provides for a quorum of three at a board meeting (paragraph 3.03). This provision is consistent with the shareholders' desire that a board meeting not be held without all the directors being present. Paragraph 3.03 also allows for a possible quorum of two, to ensure that no one director is able, through continued non-attendance, to stalemate the directors' ability to manage and conduct the affairs of the company.

Regulating the conduct of the affairs of the company in a shareholders' agreement balances protecting the interests of minority shareholders with freeing the company to manage the business efficiently. Finding that balance depends on the goals of the particular shareholders and the company.

The model agreement contains an extensive list of the major decisions that can only be made with a 75% majority vote of the directors. Where there are three directors, this effectively requires unanimous agreement. The list of major decisions considered in paragraph 3.04 of the model agreement leans heavily to the side of protecting the interests of minority shareholders, possibly constricting the efficient operation of the company. A lawyer drafting an agreement for particular shareholders might include fewer major decisions in that list, depending on the shareholders' concerns.

Note that the shareholders' agreement does not contain details of the employment or management agreements between the company and its shareholders. It is usually more appropriate to separate these agreements from the shareholders' agreement, although amendments to employment or management agreements by the company are major decisions subject to the restrictions contained in paragraph 3.04 of the model agreement.

The model agreement also contains an attempt at preventing competition by the shareholders with the company, both while the shareholder is involved with the company (in paragraph 3.06) and also after the shareholder has ceased being involved with the company. The model agreement also seeks to prevent such competition after the agreement is at an end (in paragraph 3.07). How a company protects itself against competition will depend on the situation, and the lawyer must ensure that these important clauses are properly suited for the particular company and its reasonable needs for protection. If the clause is unreasonable in the particular circumstances, the courts may determine that it is not enforceable.

One matter that is not contained in Part 3 of the model agreement is which shareholders will be officers of the company, and the functions of those offices. The lawyer should consider whether such provisions are necessary or enforceable, as they might suggest fettering of the directors' discretion.

[§9.06] Financing, Shareholders' Contributions, and Distribution of Net Profit

Part 4 of the model agreement says that the shareholders initially contribute to the company by means of subscribed share capital and loans. The company will obtain additional funds it requires, as far as possible, by borrowing from a bank or other lending institution.

Unless the shareholders unanimously agree, no shareholders are required by the model agreement to guarantee the indebtedness of the company.

The model agreement further provides that where the company is unable to obtain funds by borrowing, a majority of the board can require that shareholders lend additional funds to the company. These loans will be made rateably in proportion to a shareholder's common shareholdings in the company and will be repaid rateably. The company might consider securing shareholder loans, to give shareholders priority over other third-party creditors the company may have.

Part 10 of the model agreement provides remedies against a shareholder who defaults on an obligation to lend the company money. There may be other remedies available in such a case, including the following:

- diluting the defaulting shareholder's interest in the company; or
- paying a high rate of interest to those shareholders who do loan the company money.

Simply diluting the defaulting shareholder's position may be possible through offering shares in the company for sale to the shareholders. However, in most closely held companies (as well as in our assumed fact situation), a shareholder's investment in the company consists not only of shares, but also of shareholders' loans. Consequently, it may be difficult to achieve the desired degree of dilution of the equity of a shareholder, and also maintain the desired mix of loans and shares. A further difficulty is in determining the appropriate price for shares that are proposed to be allotted and issued.

Paying a high rate of interest to shareholders who do lend the company money may work; however, as with all means of attempting to require shareholders to inject more money, this method also has the potential for abuse where the shareholders have unequal financial means.

Distributing profits of the company is a complex subject, which must be resolved after carefully reviewing the business, operations and financial structure of the company. Most companies retain part of their earnings to reinvest in the company, while paying part of their earnings out to the shareholders. The shareholders will be concerned about how much money is paid out to them and when and how it is paid. Absent any written agreement or specific rights and restrictions attached to the shares, the directors will have the authority to make all decisions associated with distributing profits.

Money can be paid out in the form of salary, dividends, interest on or repayment of shareholders' loans, or return of capital. The best mix for each company will depend partly on tax considerations and partly on the nature of the contributions made by the shareholders. Accordingly, it is difficult to predetermine a mix that will always be in the best interests of all concerned.

It may be possible to achieve a desired formula for distributing profit to the shareholders by using a mixture of shares (preferred and common) and by having interest-bearing shareholders' loans. It also is possible to have only one class of shares and a dividend policy with respect to those shares. These policies may include various terms:

- a fixed return on investment;
- a percentage of net profits;
- a percentage of net profits subject to a working capital ratio, a veto by certain shareholders, or the surplus exceeding a particular figure; or
- a combination of the above.

It is critical that any policy regarding distributing profit to shareholders be realistic in protecting the company's need to retain funds to further its business interests.

The model agreement brings this subject to the attention of the shareholders in paragraph 4.05, by providing that after retaining profits for expenses anticipated by the board, the company will pay out the net profits: first, by way of repayment of shareholder loans on a rateable basis, and second, by way of dividend. This is a somewhat simplistic provision, intended to encourage the shareholders to discuss this important matter and arrive at a mutually satisfactory solution based on all of the circumstances.

[§9.07] Restrictions on the Transfer of Shares or Right of First Refusal or Offer

In a closely held company, the shareholders are usually actively involved in the management of the company and are guarded about working with newcomers they did not originally agree to partner with. Consequently, the shareholders' agreement should restrict the transfer of shares by shareholders, both *inter vivos* and upon the death of a shareholder. An absolute prohibition on share transfers will be invalid, and restrictions on transfers will likely be narrowly construed.

There are typical provisions to give some control over the admission of new shareholders:

- requiring the approval of the directors or shareholders of all transfers of shares;
- giving the shareholders the pre-emptive right to purchase shares before the sale of the shares to a third party; and
- providing tag-along or drag-along rights (discussed below).

The first control mechanism governing the transfer—unanimous consent of shareholders or of directors and shareholders—may be too restrictive and may be subject to abuse. Such a provision may make it virtually impossible for shareholders to dispose of their interests in the company. While the aim may be to ensure that the present shareholders are not forced to deal with a share-

holder they do not approve of, the liquidity of each shareholder's investment must also be considered.

Pre-emptive rights can be a relatively simple method of accomplishing the goals noted above. The selling shareholder can set the sale price and the terms and conditions of sale. The shareholders' agreement may also set guidelines for valid offers, which might include price as well as terms and conditions.

There are basically two different kinds of pre-emptive rights. The first, a right of first refusal, requires that the selling shareholder obtain an offer from a particular buyer before offering the shares to the other shareholders. With proper disclosure clauses, this procedure has the advantage of informing the remaining shareholders about the prospective buyer, thereby enabling them to determine whether or not they wish that person to be a shareholder with them in the company. The obvious disadvantage of this scheme is that a prospective buyer would rarely be willing to go to the trouble and expense of making an offer and negotiating a deal if the offer were subject to a right of first refusal by the remaining shareholders.

The second pre-emptive right is a right of first offer (used in Part 5 of the model agreement). This right allows selling shareholders to offer their shares to the remaining shareholders without first having entered into any agreement with a third party. If this offer is not accepted by the time set by the shareholders' agreement, the selling shareholder has a further period of time to find a prospective third-party buyer and sell to that person (on no better terms and conditions than were offered to the remaining shareholders). In fact, the selling shareholder might already have reached an agreement with a third party before offering the shares under the pre-emptive rights set forth in the shareholders' agreement.

Either one or both of the above methods could be used. Regardless, it can be a hardship or an inconvenience for the remaining shareholders to pay a substantial amount of money in a relatively short period of time, or to be joined by a third-party shareholder of whom they may not approve. This problem can be mitigated in several ways, including by adding the following terms, which have been used in the model agreement:

- extend the pre-emptive rights to the company itself so that the company can use its assets to finance the payment of the purchase price (this may have significant income tax consequences for the selling shareholder);
- restrict the price to some agreed-upon formula for valuation; or
- provide that the purchase price may be paid by a buyer using a promissory note, or over a period of time while the shares are held in escrow.

These provisions benefit the remaining shareholders, by helping them finance the share purchase and protecting them from having to make large capital outlays.

Where the company is to be the buyer of shares, review the company's articles to confirm whether the company must make an offer to every shareholder of that class of shares to purchase those shares rateably from all applicable shareholders.

Paragraph 5.01 of the model agreement requires that each share certificate representing shares of the company will have endorsed on it a notice that the shares represented by the certificate are transferable only in compliance with the shareholders' agreement. This notice alerts any potential buyers as to the restrictions on transfer contained in the shareholders' agreement. Further, the provision of this notice is consistent with s. 57(1)(e) of the *BCA*, which requires that restrictions on the transfer of shares be noted in a conspicuous statement on the face of the certificate. While this section of the *BCA* may more particularly refer to restrictions contained in the articles of the company, the practice contemplated in paragraph 5.01 of the model agreement is a good one.

Some forms of articles may restrict the transfer of shares. If these restrictions conflict with or create ambiguities as to the procedure set out in the shareholders' agreement, the articles may have to be amended accordingly.

Finally, pre-emptive rights may be enhanced by adding "drag-along" or "tag-along" provisions. Drag-along rights (also called "draw-along" rights) usually require that if a shareholder or group of shareholders holding a certain majority of the outstanding shares receives a *bona fide* arm's-length offer to purchase their shares, they can require that all other shareholders of the company sell their shares to the same buyer on the same terms, including price per share.

In most cases, drag-along rights are granted by minority shareholders to majority shareholders (and not vice versa) and are intended for situations where a buyer wants to acquire all of the issued shares of a company that is controlled by the majority shareholder. This permits the majority to control negotiations for the sale of the company to a third-party purchaser, and makes the company considerably more attractive to the third-party purchaser, who need not worry that a minority shareholder could prevent the sale of 100% of the company.

Conversely, "tag-along" rights (also called "piggy-back" rights) offer a degree of protection to minority shareholders. Under a tag-along right, minority shareholders are entitled to require that, before the transferor (in most cases a controlling shareholder) is entitled to accept an arm's-length third-party offer, the buyer must make the same offer to the minority shareholders.

Part 6 of the model agreement uses drag-along and tag-along rights for buyers seeking an aggregate of 60% of the issued and outstanding shares in a company.

[§9.08] Compulsory Buy-Out

When minority shareholders of closely held corporations elect to withdraw from ownership, they may have difficulty finding a ready market for their shares. The question as to whether minority shareholders should be entitled to compel the company or the other shareholders to purchase their shares is a difficult one. The biggest problem with any option to compel the purchase of shares is arriving at a fair value. There are various means of establishing a price:

- providing that the price be set by a third party (for example, the company's auditors or some independent arbitrator);
- providing a formula (for example, book value, fair market value, or using past or current earnings);
- using a combination of the above; or
- requiring the parties to agree each year among themselves as to the value of the shares, where this value will be in force for the ensuing year.

If a third party sets the price, the third party should be totally independent. Although there may be some advantage in having the value of the shares assessed by someone already familiar with the company, there is a danger of bias. However, shareholders sometimes think that the advantages of having the company's auditors or accountants determine the value outweighs the potential bias.

Determining an appropriate formula for valuation is typically beyond a lawyer's expertise. The auditors or accountants for the company and the shareholders themselves are likely to be far better judges of what is an appropriate method for evaluating the investment in the company. Alternatively, the company may wish to engage the services of a chartered business valuator to determine the most appropriate method.

While it might be advantageous to provide that the members will agree in each year as to the fair value of the shares, this should not be the only method of valuation. There is a good chance that the shareholders will fail to determine the value, thereby having any earlier agreement quickly become stale-dated. Certainly, where one of the shareholders may be planning on selling and the others are aware that they may need to buy those shares, a conflict results.

Part 7 of the model agreement uses a "shotgun" or "roulette" clause in an attempt to solve the problem of an otherwise illiquid investment. It also is useful as the ultimate remedy (and threat) for dispute resolution, whether or not either side of the dispute is in default or breach of its obligations. The dispute may simply be as to the future direction of the company. However, it is often inappropriate to use a shotgun clause in shareholders' agreements, particularly when there are inequities in the relative financial capabilities of the shareholders.

The model agreement enables shareholders desiring to offer all, but not less than all, of their investment in the company to give notice to the remaining shareholders requiring that they either sell their investment to the instigating shareholder or purchase the instigator's investment. This can be a simple and very effective clause where there are only two shareholders or two groups of shareholders in the company. However, in the facts assumed in this chapter and the model agreement, there are three shareholders. If all of the offerees elect to take the same action, there is no problem; however, if one of the remaining shareholders elects to sell to the instigator and the other elects to buy from the instigator, a rather complex vicious triangle could result. In drafting a shareholders' agreement, consider whether this problem could arise and determine how the shareholders prefer to address it, and whether it would be prudent to include wording to address this problem.

As an alternative to a "shotgun" provision, consider a clause allowing a shareholder to require that the other shareholders either purchase that shareholder's shares or agree to sell 100% of their shares in the company to a third party. For such a clause to be used, there would need to be a third party willing to buy all the company shares. The logic behind the clause is that it is easier to sell all of the company than a fraction of it. This is certainly true where that fraction is less than half.

[§9.09] Investment Sale on Death

The concerns regarding the transfer of shares on the death of a shareholder, or the representative of a shareholder where that shareholder is a company, are essentially similar to those where there is an *inter vivos* transfer. On one hand, the remaining shareholders will want to ensure that the shares do not go to the heirs of the deceased shareholder. Alternatively, the estate of the deceased shareholder will probably want to ensure that the deceased shareholder's investment in the company is sold at a fair price, and on terms and conditions that will free the estate from any obligations to the company.

Where the value of the deceased shareholder's investment in the company is substantial, requiring the surviving shareholders to buy the shares might cause hardship and inconvenience, or even threaten their ability to continue in the company. There are several ways in which this additional burden of having to purchase the investment of the deceased shareholder can be lightened, including:

- payment of the purchase price could be spread over a period of time;

- the company could become involved in the purchase of the investment, thereby enabling it to use its financial resources and assets to finance the payment of the purchase price; and
- the company could take out life insurance on each of the shareholders, so the proceeds would be available for the company to use to buy the deceased's investment from the estate.

The model agreement anticipates that the remaining shareholders will purchase the deceased's investment in the company. In order to lessen the hardship of the purchase for the shareholders, Part 8 of the model agreement requires that the company maintain life insurance policies on the lives of each of the shareholders, in amounts proportional to the estimated value of each shareholder's investment in the company.

If any of the shareholders is uninsurable, all of the provisions in the model agreement relating to the investment sale on death should be reconsidered.

Having the company purchase life insurance on the lives of its shareholders may have advantages:

- since the premiums on the insurance are paid by the company, if the marginal tax rate of the company is lower than that of the shareholders, the cost of funding the insurance is less than if the premiums were paid by the shareholders;
- the company's payment of premiums may be a deductible expense if the life insurance policy is assigned to a financial institution as collateral for a loan, as provided in Interpretation Bulletin IT-309R2; and
- it is less complicated to have the company purchase life insurance on the lives of its shareholders than to have all the shareholders purchase insurance.

However, the tax consequences of life-insured corporate buy/sell arrangements in private companies must be considered. Before the April 1995 amendments to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), it was possible to structure buy/sell arrangements in a shareholders' agreement so that any taxable capital gain to the deceased shareholder on death would be offset against a capital loss to the deceased's estate on a redemption of the deceased's shares. However, amendments to the "stop-loss" rule in s. 112 of the *Income Tax Act* have since limited this possibility. Now that the amendments are in effect, it is advisable to consult a tax practitioner before drafting a life-insured buy/sell arrangement. In particular, Part 9 of the model agreement addresses a capital dividend, where a lawyer should consult the client's accountant or a tax practitioner to determine whether this is appropriate in the particular tax situation of the company and its shareholders.

[§9.10] Default

Default under the shareholders' agreement can take the following forms:

- a shareholder may fail to advance additional monies to the company on terms set by the agreement; or
- a shareholder may fail to satisfy other obligations owed under the shareholders' agreement.

In a shareholders' agreement, it may also be necessary to address the circumstances in which a shareholder ceases to be employed by the company. Part 10 of the model agreement does this by providing it is a default if a shareholder ceases to be employed by the company or to have a representative who is employed by the company (except as a result of death), and allowing the non-defaulting shareholders to cause the forced sale by the defaulting shareholder of that shareholder's investment in the company. Lesser remedies are also available.

The threat of a forced sale of the investment, perhaps at a slightly reduced price, may encourage each of the shareholders to be good corporate and contractual citizens. This Part, together with the compulsory buy-out in Part 7 of the model agreement, works not only as a means of curing a default or providing liquidity to the investment of a shareholder, but acts also as a "big stick" encouraging each of the shareholders to find some alternative and less drastic solution to the problems that may develop between the shareholders.

[§9.11] Tax Considerations

Practitioners should keep certain income tax issues in mind when drafting shareholders' agreements. What follows is not a complete catalogue of these issues, and it is prudent to seek advice from tax professionals.

A corporation that is controlled by shareholders who are non-residents or public companies will not qualify as a Canadian-controlled private corporation ("CCPC") under the *Income Tax Act* and, as such, will not qualify for some important tax benefits, including the lowest corporate tax rate. Accordingly, consider drafting shareholders' agreements so that non-resident or public company shareholders do not hold sufficient voting shares to elect a majority of the board.

Income tax issues also can have an impact on financing and shareholder contribution or distribution issues. For example, how a shareholder finances the corporation, whether by buying shares or by giving loans or guarantees, affects that shareholder's ability to claim a tax loss if the corporation fails. In particular, losses realized on bad loans, or on payments made to honour guarantees, can only be deducted for income tax purposes where the loan or the guarantee was given for the purpose of earning income.

The buyout provisions of a shareholders' agreement can have tax implications as well. For example, a right to purchase shares or to cause the corporation to repurchase shares may be exercisable if some event occurs. If the corporation has non-resident or public company shareholders, the existence of such buyout rights could change the corporate control and render the corporation ineligible for CCPC status. Clauses which the CRA does not consider problematic include shotgun and right-of-first refusal clauses. Tax considerations that arise in buyout scenarios should, of course, be discussed with the appropriate tax advisors.

Chapter 10

Extraprovincial Companies[1]

For further information on extraprovincial companies, see Chapter 16 of the *British Columbia Company Law Practice Manual* (Vancouver: CLEBC).

[§10.01] The Registration Requirement

British Columbia recognizes foreign entities incorporated or organized under the laws of other provinces, under federal law, and under the laws of other countries, so long as they register under Part 11 of the *BCA*.

Section 375(1) requires every foreign entity (with the exceptions below) to register as an extraprovincial company under the *BCA* within two months after the foreign entity begins to carry on business in BC.

1. Foreign Entities Exempted From Registration

The extraprovincial company provisions of the *BCA* do not apply to a foreign entity if it is a bank or if its only business in the province is constructing and operating a railway (s. 375(3)(a) and (b)).

A foreign entity whose principal business consists of operating one or more ships is not required to register under the *BCA* if it does not maintain in BC a warehouse, office or place of business under its own control or under the control of a person acting on its behalf (s. 375(4)). Every resident agent or representative of such an entity must file a notice containing the information required by s. 375(5).

2. Provincially Registered Corporations From Other Western Provinces

The New West Partnership Trade Agreement (the "NWPTA") is a trade agreement between British Columbia, Alberta, Saskatchewan and Manitoba to reduce obstacles to trade, investment and labour mobility among the participating provinces.

Under the NWPTA, an Alberta, Saskatchewan, or Manitoba company that is registered under provincial legislation in its home province and fulfills its registration and reporting requirements in that province will be deemed to have met the applicable registration and reporting requirements in BC. Such companies may carry on business in BC without any condition that the company maintain a representative office or enterprise in, or be a resident of, British Columbia. These companies are also exempt from filing annual reports in BC and from most fees payable by extraprovincial companies. The NWPTA does not apply to federally registered companies.

3. Carrying on Business

Section 375(2) of the *BCA* states that a foreign entity is deemed to carry on business in BC in all of the following circumstances:

(a) its name, or any name under which it carries on business, is listed in a telephone directory

  (i) for any part of BC; and

  (ii) with an address or telephone number in BC for the foreign entity;

(b) its name, or any name under which it carries on business, appears or is announced in any advertisement in which an address or telephone number in BC is given for the foreign entity;

(c) it has, in BC,

  (i) a resident agent; or

  (ii) a warehouse, office or place of business; or

(d) it otherwise carries on business in BC.

Even if clauses (a), (b) and (c) do not apply, clause (d) acts as a residual "catch-all" that requires consideration of the extensive jurisprudence relating to the common law tests of "carrying on business". Because it is not always clear whether a foreign entity's activities constitute "carrying on business" in BC, and because failure to register is an offence under s. 426(1)(b), if there is any doubt, it is normally prudent to register.

Section 375(3)(c) provides that a foreign entity is not deemed to carry on business in the province merely because it has an interest as a limited partner in a limited partnership carrying on business in the province. By implication, if a corporation is a general partner of a limited partnership or is a partner of a general partnership, and the partnership carries on business in the province, then the foreign entity is subject to the extraprovincial company provisions of the *BCA*.

[1] Revised by **Chat Ortved**, Lawson Lundell LLP, in March 2023, March 2020 and March 2018. John O.E. Lundell, KC, using Chapter 13 of the *British Columbia Company Law Practice Manual*, 2nd edition (Vancouver: CLE), kindly contributed this chapter in January 2004 and updated it in November 2004 and November 2005.

4. Effect of Registration

Section 378(1) provides that a notation in the corporate register that a foreign entity has been registered as an extraprovincial company is conclusive evidence that it has been duly registered on the date and time shown.

No act of a foreign entity, including any transfer of property to, or by, the foreign entity, is invalid by reason only that the foreign entity was not, at the time of that act, registered as an extraprovincial company (s. 378(4)(b)).

Registration will protect the name of the foreign entity to the extent that other corporations with the same or similar names will not be able to incorporate or register extraprovincially in BC (except for federal corporations).

5. Limited Liability Companies

Many American states provide for the formation of limited liability companies (often referred to as LLCs). These are statutory unincorporated associations that combine certain elements of corporations, such as limited liability of owners, and certain elements of partnerships.

The definition of "foreign entity" expressly includes a limited liability company or a foreign corporation (s. 1(1)). Accordingly, limited liability companies are subject to the same rights, restrictions and obligations as foreign corporations under the *BCA*.

[§10.02] Registration Procedure

1. Name

Reserve a name before submitting the registration statement. An extraprovincial company will not be registered by a name that does not comply with the Regulation and with the other requirements of the *BCA* (s. 22(4)). There is an exception for a federal corporation seeking extraprovincial registration in British Columbia.

2. Assumed Name

If the name of a foreign entity contravenes the Regulation or any of the requirements under the *BCA*, but that foreign entity wants to be registered as an extraprovincial company, it must reserve an assumed name (s. 26(1)). This rule does not apply to federal corporations (s. 26(5)).

The foreign entity must provide an undertaking to the registrar that the foreign entity will carry on all of its business in BC under that assumed name. On registration, the extraprovincial company is deemed to have adopted the assumed name (s. 26(2)).

An extraprovincial company that has adopted an assumed name under the *BCA* must acquire all property, rights and interests in BC under its assumed name; is entitled to all property, rights and interests acquired, and is subject to all liabilities incurred, under its assumed name as if the property, rights and interests and the liabilities had been acquired and incurred under its own name; and may sue or be sued in its own name, its assumed name or both (s. 26(3)).

No act of an extraprovincial company, including transferring or acquiring property or rights, is invalid merely because the extraprovincial company did not do so under its assumed name (s. 26(4)).

3. Registration Requirements

Every extraprovincial company that requires registration under the *BCA* must:

(a) complete and file with the registrar a registration statement (s. 376(1)(c)(i)); and

(b) submit to the registrar any other records the registrar may require (s. 376(1)(c)(ii)), including a certificate of status (or other proof of existence) for foreign entities incorporated or organized outside Canada.

An extraprovincial company failing to register as required by the *BCA* commits an offence (s. 426(1)(b)) and is liable to a fine up to $100 for each day the offence continues (s. 428(3) and Reg. s. 35).

4. Registration

When the foreign entity has filed the registration statement and other records as required by s. 376 in satisfactory form and paid the necessary fees, the registrar must, if the foreign entity is a federal corporation (and may, in any other case) register the foreign entity (s. 377(1)). Then, the registrar must issue a certificate of registration showing that the foreign entity is registered as an extraprovincial company under the *BCA* (s. 377(2)).

The certificate will show the date and time of registration in BC. The registrar must also publish a notice on the government website (s. 377(2)(d) and Reg. s. 6).

[§10.03] Duties of an Extraprovincial Company

1. Attorneys

An extraprovincial company is required to have an attorney, unless under the company's charter its head office is within the province (s. 386(1)). The attorney must be either an individual who is resi-

dent in BC or a BC company (s. 386(2)). Each attorney is deemed to be authorized by the extraprovincial company to accept service of process on its behalf in each legal proceeding by or against it in BC, and to receive each notice to it (s. 388). See also s. 9(2).

The initial attorney or attorneys for an extraprovincial company are those specified in its registration statement (s. 387). Thereafter, an extraprovincial company may appoint one or more persons to be attorneys by filing a notice of appointment of attorney (s. 389(1)). The attorney's address may be changed, and the attorney's appointment revoked, by filing a notice (ss. 391(1) and 393(1)).

A revocation of the appointment of an attorney does not take effect until the extraprovincial company has appointed one or more replacement attorneys (unless under its charter its head office is in British Columbia, in which case it does not need to appoint an attorney) (s. 393(3)).

An attorney of an extraprovincial company who intends to resign must provide a written resignation to the extraprovincial company at its head office at least two months before the date on which the resignation is to take effect (s. 395(1)(a)). Promptly after complying with this obligation, the attorney must file with the registrar a notice of resignation of attorney (s. 395(1)(b)).

2. Annual Reports

Every extraprovincial company registered under the *BCA* is required to file an annual report within two months after each anniversary of the date of its registration (s. 380(1)(a)), unless another date has been prescribed, in which case it must be filed within two months after each anniversary of that prescribed date (s. 380(1)(b)).

3. Amalgamations

Under s. 379(1), if a foreign entity that is registered as an extraprovincial company is party to an amalgamation (or similar process), the extraprovincial company must provide to the registrar the records and information the registrar may require and must file with the registrar, within two months after the effective date of the amalgamation, a notice of amalgamation of extraprovincial company.

From the time of the amalgamation (or similar process), the amalgamated extraprovincial company is seized of and holds and possesses all land of the amalgamating entities that is located in BC (s. 379(4)).

The requirement under s. 379(1) does not apply if the amalgamation (or similar process) results in a BC company (for example, the amalgamation of an extraprovincial company with a BC company to create a BC company under s. 269(b)).

4. Change of Name

If an extraprovincial company changes its name, the extraprovincial company must file with the registrar a notice of change of name of extraprovincial company and any other records the registrar may require (s. 382(1)(a)). Before filing the records, the extraprovincial company must either reserve its new name under s. 22, or adopt an assumed name if its new name contravenes any of the requirements of the Regulation or of the *BCA* and the extraprovincial company does not have an assumed name under which it intends to continue to carry on business in British Columbia (s. 382(1)(b)). The requirement to obtain a name reservation or to use an assumed name does not apply to a federal corporation (s. 382(4)).

Chapter 11

Canada Business Corporations Act[1]

All section references in this chapter are to the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("*CBCA*") unless otherwise indicated.

[§11.01] Scope of This Chapter

This chapter briefly reviews the law relating to *CBCA* corporations. It covers matters that lawyers practising in British Columbia should know about corporations incorporated under the *CBCA* ("*CBCA* corporations"), and problems that practitioners face in dealing with them.

This chapter also refers to the *Business Corporations Act* (S.B.C. 2002, c. 57) ("*BCA*"), and to companies incorporated under the *BCA* ("*BCA* companies"). It assumes that the reader is reasonably knowledgeable about *BCA* companies, and mentions some important ways in which *CBCA* corporations differ from *BCA* companies.

Practitioners should be aware of recent changes to the *CBCA* due to the coming into force of parts of *An Act to Amend the Canada Business Corporations Act,* the *Canada Cooperatives Act,* the *Canada Not-for-profit Corporations Act* and the *Competition Act*, S.C. 2018, c. 8. Since August 31, 2022 these amendments have affected the election of directors and the permitted length of director terms for *CBCA* corporations that are distributing corporations (i.e. "public" companies). Many of these amendments introduce requirements that are similar to those that Canadian stock exchanges impose on their listed companies. See §11.09 for a more detailed discussion.

Practitioners should also be aware of recent changes to the *CBCA* due to the recent coming into force of parts of the *Budget Implementation Act, 2018, No. 2,* S.C. 2018, c. 27. Due to these amendments, since June 13, 2019, non-distributing *CBCA* corporations (i.e. "private" or closely held companies) have been required to maintain a register of individuals with "significant control" over the corporation, as defined in s. 2.1(1) of the amended legislation. The amendments are intended to provide increased transparency as to the beneficial ownership of *CBCA* corporations. This new register is not available to the public, but is available to shareholders and creditors of the corporation.

As well, sections of the *Budget Implementation Act, 2019, No. 1*, S.C. 2019, c. 29 regarding disclosure of the register to investigative bodies came into force on June 21, 2019. Under these amendments, an investigative body (including the police, the Canada Revenue Agency, or any other prescribed body) may request, and a *CBCA* corporation must provide, copies of its register of individuals who have significant corporate control.

Similarly, recent amendments to the *BCA* under the *Business Corporations Amendment Act, 2019,* S.B.C. 2019, c. 15, require private *BCA* companies, as of October 1, 2020, to maintain a "transparency register" with information about shareholders who qualify as "significant individuals." However, unlike under the *CBCA,* the information in this register will only be available to directors of the company and certain tax, regulatory, and law-enforcement officials, rather than the company's shareholders and creditors.

[§11.02] Capacity and Powers of *CBCA* Corporations

Section 15 states that a *CBCA* corporation has the capacity and powers of a natural person, subject to restrictions in the *CBCA*. Note that a *CBCA* corporation may not carry on the business of a bank, cooperative credit association, insurance company, trust company or loan company (s. 3(4)). It also may not carry on the business of a degree-granting institution, unless expressly authorized to do so by the applicable regulatory authorities governing educational institutions (s. 3(5)). Restrictions on a *CBCA* corporation's capacity may be provided for in a corporation's articles, although s. 16(3) states that no act of a corporation is invalid by reason only that it is contrary to its articles or the *CBCA*.

[§11.03] Comparing a *CBCA* Corporation to a *BCA* Company

This section compares some key provisions of the *CBCA* with those of the *BCA*. This discussion emphasizes the differences between the two statutes and summarizes their effects in order to highlight these differences. When giving advice on specific issues arising under either the *CBCA* or *BCA*, refer directly to the statutes.

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[1] **Riley O. Lalonde and Lauren E. Frederick**, of Edwards, Kenny & Bray LLP, kindly revised this chapter in November 2022 and November 2021. Previously revised by W. Fraser Hartley and Riley O. Lalonde (2019 and 2018); Peter J. Brown, W. Fraser Hartley and Riley O. Lalonde (2016); Peter J. Brown and Diane E. Campbell (2010 and 2012); Peter J. Brown (2005, 2006 and 2008); Lawrence W. Talbot (1997, 1999 and 2001); and Gregory D. Lewis (1995). The chapter was originally based on a paper prepared by E.F. Horsey, KC, for a Continuing Legal Education Seminar in 1983. William R. Miles, KC, contributed §11.03 in April 2004.

1. Differences

(a) Out-of-Province Shareholders and Out-of-Province Contractors

Lawyers and businesses use the *CBCA* because it is understood throughout Canada. While it is federal legislation, many provinces have adopted acts that are virtual copies of the *CBCA*. To a certain extent, the *CBCA* has become the national standard. British Columbia, on the other hand, has chosen to adopt an act that is unique. Companies with shareholders or contractors in other provinces may find it easier to deal with those people if the company operates as a *CBCA* corporation under a statute that is understood across Canada, rather than under the unique *BCA*.

(b) Name Protection

Most provinces have legislation that requires a company incorporated elsewhere to be extraprovincially registered in the province if the company carries on business in the province. Provincially incorporated companies must extraprovincially register under a name that is acceptable to the registrar of the province concerned. In some provinces, this can create difficulties if another company that has incorporated or extraprovincially registered in the province in question is already using the company's name. *CBCA* corporations, on the other hand, are permitted to use their corporate name anywhere in Canada, even where another company has already registered under the same name, subject to trademark rights.

(c) Disability if Not Registered

Most provinces impose a penalty on extraprovincial companies that do not register as required by their legislation. This penalty normally takes the effect of an inability to commence an action with respect to a contract formed in the jurisdiction unless and until the company completes the registration requirements. For constitutional reasons, this disability cannot apply to a *CBCA* corporation, but can apply to a *BCA* company.

(d) Drafting Style

The *CBCA* deals with most issues in simpler and more general terms than the *BCA*. The *BCA* uses a more complex drafting style. While it is more complex, it is more precise.

(e) Residence of Directors

The *CBCA* requires that 25% of the directors of a *CBCA* corporation be "resident Canadians" as defined in the *CBCA*. If a corporation has fewer than four directors, at least one must be a resident Canadian (s. 105(3)). In certain cases, including where a corporation participates in a prescribed business sector or is required by law to maintain a specified level of Canadian ownership, a majority of directors must be resident Canadians (s. 105(3.1)). (See §11.09(3) for more, including exceptions.)

The *BCA* has no residency requirements for directors, so it can be useful for foreign parties wishing to incorporate in Canada.

(f) Due Diligence Defence for Directors

The due diligence defence available to directors under ss. 123(4) and (5) of the *CBCA* is slightly broader than the comparable defence under the *BCA* (s. 157(1)). The *CBCA* recognizes any means of exercising the "care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances." The *BCA*, on the other hand, lists specific items on which a director can rely. However, in practice, the distinction may not be very great.

(g) Transferring Directors' Powers

The *BCA* allows powers normally reserved to directors, and the liability which goes along with those powers, to be transferred to the shareholders, including, for example, paying a dividend, hiring a new chief executive officer, and starting a new line of business. Under the *CBCA*, the same transfer of powers can be achieved by a unanimous shareholders' agreement (s. 102(1)). However, under the *BCA*, a clear provision to this effect must be put in the articles themselves (s. 137). Putting the provision in the articles makes it available to the public but does not necessarily make it binding on third parties, unless the third parties have knowledge of the provision (see ss. 33, 42, 46, 136, 137 and 146 of the *BCA*).

(h) Altering Charter Documents

The *BCA* provides a great deal of flexibility in the level of approval required to alter the charter documents. For example:

- The definitions of "special resolution" and "special majority" in the *BCA* provide that a special resolution can require anything between a 2/3 majority and a 3/4 majority, as the articles provide. Without a provision in the articles, a special resolution requires 2/3 of the votes cast in the case of a company incorporated under the *BCA*, and 3/4 of the votes cast in the case of a pre-existing company that is subject to the Pre-existing Company Provisions of the Regulation to the *BCA* (s. 1(1)).

- The *BCA* states that, subject to the minimum requirements of the *BCA*, the articles can allow provisions of the charter documents to be altered by whatever level of resolution is provided for in the articles, in some cases including even a directors' resolution (s. 259). The *BCA* also states that a company may specify in its articles that a provision of its notice of articles or its articles may not be altered unless the resolution is passed as an exceptional resolution, which is a resolution passed by a majority greater than the 2/3 or 3/4 majority referred to above (ss. 1(1) and 264).

In contrast, a *CBCA* corporation's articles of incorporation may be amended by special resolution of its shareholders (s. 173). A "special resolution" is defined in the *CBCA* to mean a resolution passed by 2/3 of the votes cast by shareholders at a meeting or signed by all the shareholders entitled to vote on the resolution (s. 2(1)). The bylaws of a *CBCA* corporation may be amended by the directors of the *CBCA* corporation, subject to approval by the shareholders by ordinary resolution at the next meeting of shareholders (s. 103).

(i) Share Rights

Under the *BCA*, special rights or restrictions applicable to shares may apply differently to some shareholders (s. 59(5)). This section appears to permit, for example, a provision in the rights and restrictions attached to a class of shares that shares owned by the founder may have ten votes per share but if owned by anyone else have only one vote per share. This would likely not be a valid provision under the *CBCA* (*McClurg v. Canada*, 1990 CanLII 28 (S.C.C.) and *Bowater Canadian Ltd. v. R.L. Crain Inc.*, 1987 CanLII 4037 (Ont. C.A.)).

(j) Records

The record-keeping responsibilities of people who maintain records of *BCA* companies are greater than the responsibilities of people who maintain records of *CBCA* corporations. For example, under the *BCA*, the company's records are the only source for the rights and restrictions attached to shares, whereas under the *CBCA*, the share characteristics can be verified by checking filings made with the Director. The *BCA* also contains a more extensive list of the records to be kept and who can see those records (ss. 42 and 46). Under the *BCA*, many documents, including all minutes and resolutions of shareholders and directors, must be date- and time-stamped when received in the records office (s. 44(3)). There is no similar provision under the *CBCA*.

As noted earlier, recent amendments to the *CBCA* introduced new record-keeping requirements with respect to the beneficial ownership of non-distributing companies. Amendments to the *BCA* introduced similar requirements for private companies.

(k) Financial Issues

(i) Paying Dividends

The *CBCA* has two rules governing the payment of dividends (s. 42):

- The corporation must be able, both before and after paying the dividend, to pay debts as they become due.
- The realizable value of the corporation's assets must, after payment of the dividend, not be less than the aggregate of its liabilities and stated capital of all classes.

The *BCA* contains the first rule (s. 70(2)) but not the second. The omission from the *BCA* of the second rule makes it easier to pay dividends in certain circumstances under the *BCA*. Of course, under both statutes, the directors must be satisfied that the payment of dividends complies with their duty to act prudently and in the best interest of the company.

(ii) Waiving Financial Statements and Annual General Meetings

The *CBCA* requires that an annual general meeting of shareholders be held annually and that financial statements be placed before the shareholders at that meeting (ss. 133(1) and 155(1)). The *BCA* contains similar provisions, but allows the shareholders to waive the production and publication of financial statements by unanimous resolution of all shareholders (including non-voting shareholders) (s. 200(1)). As well, the *BCA* allows shareholders to waive the requirement to hold an annual general meeting by a unanimous resolution of all voting shareholders (s. 182(2)). Shareholders of *CBCA* corporations may not waive the holding of an annual general meeting. However, a *CBCA* corporation can satisfy the requirement to hold an annual general meeting by passing a resolution in writing, signed by all the shareholders entitled to vote at that meeting, and dealing with all matters required

to be dealt with at a meeting of shareholders (s. 142(1)).

(iii) Par Value Shares

The *BCA* allows companies to have par value shares (s. 52(1)), while the *CBCA*, in common with most other corporate legislation in Canada, has abolished par value shares (s. 24(1)).

(l) Liability for Wages

Section 119 of the *CBCA* makes directors liable to employees of the corporation for all debts not exceeding six months' wages. The comparable provision in British Columbia is in the *Employment Standards Act*, s. 96, where the liability is limited to two months' wages, but applies to officers as well as directors.

(m) Holding Shares of Parent

The *BCA* permits a company to hold shares of its parent corporation (s. 85), while the *CBCA* prohibits a corporation from owning shares of its parent except in limited circumstances (s. 30).

2. Similarities

(a) Pre-Emptive Rights on New Share Issues

Neither the *CBCA* nor the *BCA* have mandatory pre-emptive rights for issuing new shares.

(b) Indemnification of Directors

The *BCA* has removed the requirement to obtain court approval before indemnifying a director and also permits a company to advance defence costs. Both these provisions are similar to the *CBCA*.

(c) Amalgamations

The *BCA* provides, like the *CBCA*, that amalgamations can be accomplished without a court order. The *BCA* also provides for short-form vertical amalgamations (amalgamations of a subsidiary with its parent corporation) (s. 273) and short-form horizontal amalgamations (amalgamations of two wholly-owned subsidiary corporations of the same parent corporation) (s. 274). But, unlike the *CBCA*, the *BCA* also provides for interjurisdictional amalgamations (s. 275), if the other jurisdiction also provides for them (*CBCA* amalgamations are discussed further in §11.12(5)).

(d) Electronic Meetings

The *CBCA* provides for electronic meetings of shareholders and directors (ss. 114(9) and 132). Similarly, the recent coming into force of the *Finance Statutes Amendment Act (No. 2), 2021*, S.B.C. 2021, c. 14, introduced provisions to the *BCA*, allowing meetings to be held by fully or partially electronic means, provided that all participants are able to communicate with each other and the company's articles do not prohibit electronic meetings (s. 174).

(e) Financial Assistance

The *BCA*, like the *CBCA*, has removed the prohibition against a company giving financial assistance in connection with the purchase of its shares. However, to comply with their fiduciary duty, directors must be of the opinion that giving financial assistance is in the best interests of the company.

(f) Unlimited Number of Authorized Shares

The *BCA* provides, as does the *CBCA*, for a company to have an unlimited number of authorized shares.

(g) Transparency Registers

The information that must be collected for the "transparency registers" is very similar under the recent amendments to the *CBCA* and the *BCA*. The register must contain the following information about each individual with significant control over the corporation: full name, date of birth, last known address, jurisdiction of residence for tax purposes, the date the individual became or ceased to be an individual with significant control, and a description of how the individual meets the definition of an individual with significant control. *CBCA* corporations must also include a description of steps taken to keep the information current.

[§11.04] Words With Special Meanings Under the *CBCA*

Under the *CBCA*, certain terms are used:

- "**articles**" or "**articles of incorporation**" correspond to parts of the "incorporation application" and "notice of articles" of a *BCA* company;
- "**body corporate**" includes a company or other body corporate wherever or however incorporated;
- "**bylaws**" correspond generally to the articles of a *BCA* company;
- "**Director**" means the Director appointed under the *CBCA*;
- "**distributing corporation**" is defined in the *Canada Business Corporations Regulations*, s. 2. The definition means a "reporting issuer" or "distributing corporation" as defined under any provincial securities or business legislation. A "distributing

corporation" therefore corresponds to a "reporting issuer" under the *BCA* and to a "reporting issuer" under the *Securities Act* (British Columbia);

- "**incorporator**" means a person who signs the articles of incorporation under the *CBCA*;
- "**security**" means a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation;
- "**special resolution**" means a resolution passed by a majority of not less than 2/3 of votes cast by shareholders who voted in respect of that resolution or signed by all the shareholders entitled to vote on the resolution; and
- "**shareholder**" is an undefined term, but as used in the *CBCA* it simply means the holder of a share.

[§11.05] Incorporation Procedures

1. Name Selection and Reservation

(a) General Rules

The same general rules apply when selecting a name for a *CBCA* corporation as for a *BCA* company. Each name generally must contain a distinctive element (perhaps a surname or other unique term), a descriptive element (e.g. Manufacturing, Consulting, Trading) and a mandatory legal element (e.g. Corp., Inc., Ltd.). For a *CBCA* corporation a descriptive element is not absolutely required, but a name will not be approved if the Director believes that it could cause confusion with other businesses or mislead the public. These rules are located in Part 2 of the *Canada Business Corporations Regulations* (the "Regulations").

Corporations Canada has a publicly available name-granting policy that provides guidelines for interpreting the name regulations. For a name to be accepted, you must have a Newly Upgraded Automated Name Search ("NUANS"), a search that compares a proposed corporate name or trademark with databases of existing corporate bodies and trademarks. Order a NUANS report from the Innovation, Science and Economic Development Canada website (www.ic.gc.ca/eic/site/icgc.nsf/eng/home).

If you want to ensure that a name is available before you file your Form 1 – Articles of Incorporation, you may ask the Director to approve the proposed name in advance, by submitting the applicable NUANS search and a Corporate Name Information Form. This approval, if granted, is valid for the life of the NUANS search report (90 days from the date when the report is requested).

Because finding an appropriate name can be time-consuming and it may be important to incorporate the company quickly, many corporations incorporate with a number name (e.g. 123456 Canada Ltd.). Corporations Canada issues the number. The name is left blank in the articles when filed.

The corporation may change its name later, when a name has been accepted. The NUANS database has the names of all corporations incorporated in all jurisdictions in Canada, all business names used in Canada, and also all trademarks and trade names. A NUANS search report must be filed with the articles where a name (other than a number name) is used, unless the name has been pre-approved, in which case you must file a copy of the name approval document.

(b) Special Rules as to Names

Often, both an English and a French form of the name will be used. The name must end with the words "Limited," "Incorporated" or "Corporation," their abbreviations, or the French version of those words (s. 10).

2. Documents

Under the *CBCA*, bylaws are not a public document and need not be filed. The articles of incorporation are a public document, so they must be filed.

In order to incorporate a *CBCA* corporation, certain documents and a fee must be sent to Corporations Canada. The documents and fees are as follows:

- Form 1 – Articles of Incorporation;
- Form 2 – Initial Registered Office Address and First Board of Directors;
- if you requested prior approval of the name of the corporation, the letter from the Director approving the name (with a copy of the NUANS report);
- if you did not request prior approval of the name, a NUANS report not more than 90 days old and a Corporate Name Information Form (unless you are requesting a number name, in which case a NUANS report is not usually required); and
- incorporation fee as prescribed (at print time, $250 for email or postal mail filing, and $200 for online filing).

Copies of Form 1 and Form 2 are attached to this chapter as Appendix 5 and 6. See the website for Innovation, Science and Economic Development of

Canada at www.ic.gc.ca under the tab "Federal corporations" for details on completing these documents.

Corporations may transmit notices and documents to the Director in electronic form (s. 258.1). Electronic filing may be done through www.ic.gc.ca under the tab "Federal corporations." All "key" *CBCA* applications are available online. Payment of any prescribed fees may be made by credit card or debit card (online filings) or by credit card or cheque payable to the Receiver General for Canada (paper filings). The use of the electronic filing methods is voluntary, and paper-based filing remains available.

3. Articles of Incorporation

The following are some of the features and effects of the articles of incorporation of a *CBCA* corporation.

- The articles of incorporation must state the province or territory in Canada where the registered office is to be situated. The actual address must be set out in the Form 2 – Initial Registered Office Address and First Board of Directors.
- The articles of incorporation must state the restrictions (if any) on share transfers.
- The articles of incorporation must state the number of directors, or the minimum and maximum number.
- The articles of incorporation may state any provisions permitted by the *CBCA* or law to be set out in the bylaws of the corporation (s. 6(2)).
- The articles of incorporation do not constitute an agreement of an incorporator to be a shareholder of the corporation. In fact, the incorporator does not automatically become a shareholder of the corporation. The *CBCA* articles of incorporation merely constitute an application by incorporator(s) to form a corporation.
- The incorporators do not become the first directors of the corporation under the *CBCA*. The directors of the corporation are those individuals listed in the Form 2 – Initial Registered Office Address and First Board of Directors.
- A corporation comes into existence when a certificate of incorporation is issued.
- At the time of incorporation, a *CBCA* corporation has no bylaws.
- A *CBCA* corporation may have the benefit of, and be bound by, a pre-incorporation contract entered into on its behalf before it came into existence. However, to do so, it must, by action or conduct signifying its intention to be bound by the pre-incorporation contract, adopt it within a reasonable time after the corporation comes into existence (s. 14(2)).

4. Organizational Meetings

The organizational meeting of the directors of a *CBCA* corporation is similar to the organizational meeting of a *BCA* company, except as follows:

- The directors of a *CBCA* corporation may pass bylaws at an organizational meeting (s. 104(1)). *CBCA* corporation bylaws are effective when made by the board of directors. The bylaws are effective only until the next shareholders' meeting (s. 103(2)), and accordingly, it is common to have the shareholders approve the bylaws immediately after the organizational meeting of the directors (by contrast, a *BCA* company must have articles on its incorporation, and any amendments to a *BCA* company's articles must receive prior approval by a special resolution of the shareholders). Resolutions in writing of both the directors and shareholders are effective in the same way as they are under the *BCA* (sample bylaws are attached to this chapter as Appendix 7).
- At the organizational meeting, the directors should approve subscriptions for and authorize the issuance of shares, because before the actual allotment and issuance, the *CBCA* corporation has no issued or outstanding shares or shareholders.

5. Registered Office

A *CBCA* corporation must at all times have a registered office in the Canadian province specified in its articles (s. 19). Its corporate records must be maintained at its registered office or at any other place in Canada designated by its directors (s. 20). These records will contain the following:

- the articles and bylaws, and all amendments thereto, and a copy of any unanimous shareholders' agreement;
- minutes of meetings and resolutions of shareholders;
- copies of all notices of directors and notices of change of directors or a director's address; and
- a securities register that complies with s. 50.

In addition, the corporation is obliged to prepare and maintain adequate accounting records, minutes of meetings, and resolutions of directors and committees of directors (s. 20(2)).

As noted earlier, non-distributing corporations are now required to also maintain a register containing information about individuals who have "significant control" of the corporation. This change came into force June 13, 2019.

6. Rights to Examine Corporate Records

If the corporation is a non-distributing corporation (i.e. a private or closely held corporation), then shareholders and creditors of the corporation, their personal representatives and the Director may examine the articles, bylaws, copies of any unanimous shareholders' agreement, minutes of meetings and resolutions of shareholders, copies of directors' notices, and the securities register (s. 21(1)). On the other hand, if the corporation is a distributing corporation (i.e. a publicly held corporation), any person may examine such records (subject to some other requirements as described below).

Any person who wants to examine the securities register of a distributing corporation must make a request to the corporation or its agent and provide an affidavit with the request (s. 21(1.1)). The affidavit must confirm that if the requestor obtains any list of shareholders or information from the securities register it will not be used, except in connection with the following:

- an effort to influence a voting shareholder;
- an offer to acquire corporate securities; or
- any other matter relating to the affairs of the corporation.

Under the *CBCA*, it is difficult for a member of the public to inspect the records of a *CBCA* non-distributing corporation. However, effective June 13, 2019, shareholders and creditors (or their personal representatives) can request access to the register of individuals who have "significant control" over a non-distributing corporation, provided they comply with the affidavit requirements (s. 21.3(3)).

[§11.06] Shares

The *CBCA* does not contain the concept of "private" corporations or "reporting issuers" but does contain provisions applicable to "distributing corporations" (such as the requirement for not fewer than three directors, under s. 102(2)). Note that many of the changes enacted in 2018 under *An Act to Amend the Canada Business Corporations Act* …, S.C. 2018, c. 8 apply only to distributing corporations.

1. Non Par Value Shares Only

Shares of a *CBCA* corporation must be non par value shares. If rights, privileges, restrictions or conditions are attached to shares, they must be set out in the articles (s. 24).

2. Unlimited Number of Shares Permitted

It is not necessary for a *CBCA* corporation to have a limited number of authorized shares or capital. It is common for the articles to provide that the corporation may issue an unlimited number of shares.

3. Shares Fully Paid

A share may not be issued until the consideration for the share is fully paid in money or in property or past services that are not less in value than the fair equivalent of money that the corporation would have received if the share had been issued for money (s. 25(3)). "Property" does not include a promissory note, or a promise to pay, that is made by a person to whom a share is issued, or a person who does not deal at arm's length (within the meaning of that expression in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)), with a person to whom a share is issued (s. 25(5)).

4. Stated Capital

The *CBCA* corporation must maintain a separate "stated capital account" for each class and series of shares that it issues. The corporation must add to the appropriate stated capital account the full amount of any consideration it receives for any shares it issues, except in certain specific circumstances where it may choose to add less (s. 26).

5. Shares in Series

Section 27(1) provides that the articles may authorize the issue of any class of shares in one or more series, and may fix or authorize the directors to fix the number of shares in, and determine the designation, rights, privileges, restrictions and conditions attaching to shares of, each series, subject to limitations set out in the articles. This can be a useful provision: for example, it permits a distributing corporation, which may have many shareholders, to fix the terms of a preferred share issue by simply filing the required articles of amendment, without having to call a shareholders' meeting to approve the rate of dividend that is payable (which often will be fixed immediately before a public issue).

6. Trafficking in Shares

Except in certain circumstances, a *CBCA* corporation may not hold shares in its parent corporation (s. 30(1)); by contrast, a *BCA* company may, although it is not entitled to vote such shares (*BCA*, s. 177). A *CBCA* corporation may purchase its own shares if it is solvent (s. 34). A *CBCA* corporation that holds its own shares is not entitled

to vote those shares, except in limited circumstances (s. 33).

[§11.07] Shareholders

Many of the provisions of the *CBCA* relating to shareholders are similar to those of the *BCA*.

1. Meetings

Under the *CBCA*, the first annual meeting of shareholders must be held not more than 18 months after the date of incorporation, and thereafter, not more than 15 months after the last annual meeting (s. 133). However, financial statements not more than six months old must be presented to the annual meeting (or to the shareholders signing resolutions in lieu of the meeting, which is permitted under both the *BCA* and the *CBCA*) (s. 155(1)).

Meetings must be held at the place within Canada that is named in the bylaws, or if the bylaws do not name a place, then a place within Canada that the directors determine (s. 132(1)). If the articles specify a meeting place outside Canada, or if all shareholders entitled to vote agree, meetings can be held in that place (s. 132(2)). In addition, meetings can be held by electronic means (ss. 132(4) and (5)).

2. Record Dates

The *CBCA* has specific provisions permitting directors to fix a date for determining which shareholders are entitled to receive notice of meetings. Under the *CBCA*, the Regulations prescribe these time periods (s. 134 and Regulations, s. 43).

3. Form of Notice of Meeting

The *CBCA* provides that the notice of a meeting of the shareholders at which special business is to be transacted shall state the nature of that business in sufficient detail to permit the shareholder to form a reasoned judgment on it, and shall state the text of any special resolution to be submitted to the meeting (s. 135(6)).

Unless the corporation is not a distributing corporation and its bylaws provide for a shorter notice period, the notice given to shareholders must comply with the prescribed time periods: not less than 21 days, nor more than 60 days, before the meeting (ss. 135(1) and 135(1.1), Regulations, s. 44).

4. Right to Vote

The corporation must prepare a list of shareholders entitled to vote as of the record date for a meeting of shareholders. The list must show the number of shares held by each shareholder (s. 138). A shareholder whose name appears on such list of shareholders is entitled to vote the shares shown opposite their name at the meeting to which the list relates. Note with respect to voting that the *CBCA* provides that "unless the articles otherwise provide, each share of a corporation entitles the holder thereof to one vote at a meeting of shareholders" (s. 140).

5. Cumulative Voting

Under s. 107 of the *CBCA*, the articles may provide for cumulative voting in respect of an election of directors. This provision is not often used. Note that the changes in *An Act to Amend the Canada Business Corporations Act …,* S.C. 2018, c. 8 that were brought into force on August 31, 2022 require distributing corporations to receive separate votes for each nominee, so that each director must be individually elected by a majority of votes cast.

[§11.08] Security Certificates, Registers and Transfers

Part VII of the *CBCA* governs security certificates, registers and transfers of securities.

1. Negotiable Instruments

If transfer restrictions are not noted on a security certificate of a *CBCA* corporation, the certificate becomes a negotiable instrument (s. 48(3)). Therefore, it is valid in the hands of a *bona fide* purchaser without knowledge of any defect in title.

A *CBCA* corporation has a duty to register a transfer of shares and is liable if it issues a security certificate to a person not entitled to it. However, if, after the issue of a new security certificate to an owner who claims that their security certificate has been lost, destroyed or wrongfully taken, a *bona fide* purchaser presents the original security for registration of a transfer, the corporation is not required to register it if registration would result in "overissue" (i.e. issuance of shares beyond its authorized capital). In such circumstances, the corporation must purchase a security for the person entitled to the validation or issuance of that security if it is reasonably available. If a security is not reasonably available, the corporation must pay to that person an amount equal to the price the last purchaser for value paid for the invalid security (s. 52(1)).

In view of the "negotiability" provisions of the *CBCA*, it can be quite dangerous to issue replacement security certificates for a lost or stolen security. Consequently, most *CBCA* corporations' bylaws require that a bond be put up if a fresh security certificate is issued and the old security certificate has not been produced.

Part VII of the *CBCA* contains provisions that persons who present securities for the recording of a transfer or who issue securities warrant title and validity of the securities (see e.g. ss. 55 and 63).

2. Registers

The provisions relating to registration of securities (for example, for registrations of allotments and transfers of shares and of security holders) are set out at s. 50. The date of issue of each security must be noted in the securities register (s. 50).

[§11.09] Directors and Officers

Provisions regarding directors and officers are found under Part X of the *CBCA*. Directors of a *CBCA* corporation fulfill the same role as the directors of a *BCA* company. Under the *CBCA*, "the directors shall manage, or supervise the management of, the business and affairs of a corporation" (s. 102(1)).

1. Restraints on Directors' Powers

In considering restraints on directors as to their management of the business and affairs of a corporation, under the *CBCA*, the rights and obligations of the directors are subject only to any unanimous shareholder agreement (s. 102(1)). A unanimous shareholder agreement may validly restrict, in whole or in part, the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation (s. 146(1)). A unanimous shareholders' agreement is binding on the directors (s. 102(1)). Further, the *CBCA* provides that the shareholders have the rights, powers, duties and liabilities of a director to the extent that the unanimous shareholder agreement restricts the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation (s. 146(5)).

2. Shareholder Democracy

Under the *CBCA*, the directors are to be elected by ordinary resolution at the first meeting of shareholders and at each succeeding annual meeting at which an election of directors is required. This requirement is subject to the right of the directors, if provided for in the articles, to appoint additional directors between annual meetings, provided they do not appoint more than one-third of the number of directors elected at the previous annual meeting (s. 106(8)).

For non-distributing corporations, directors are to be elected to hold office for a term ending no later than the close of the third annual meeting of the shareholders following that election (s. 106(3)). The amendments brought into force on August 31, 2022 set a one-year term limit for directors of distributing corporations (s. 106(3.1)). Accordingly, directors must be elected by the shareholders (subject to the directors' right under s. 106(8) to appoint directors between annual meetings), and they must be elected for a term not exceeding three years for non-distributing corporations and one year for distributing corporations.

Under the *CBCA*, directors generally may be removed by ordinary resolution (s. 109).

As noted earlier, directors' powers also may be limited by unanimous shareholders' agreements.

3. Residence

At least 25% of the directors of a *CBCA* corporation must be "resident Canadians" (s. 105(3)). However, if a corporation has less than four directors, at least one must be a resident Canadian. Section 114(3) requires that at least 25% of directors present at any directors' meeting be resident Canadians.

If a *CBCA* corporation engages in an activity in Canada that is in a prescribed business sector (see Part 1, s. 16 of the Regulations), then a majority of the directors must be resident Canadians. Similarly, corporations that are subject to ownership restrictions as specified in the Regulations, and corporations that individually are subject to ownership restrictions, are to have a majority of Canadian residents on their boards (s. 105(3.1)). However, if a corporation that is subject to restricted ownership has only one or two directors, that director or one of the two directors must be a resident Canadian (s. 105(3.3)). Section 114(3) requires that a majority of directors of these specified corporations at any directors' meeting be resident Canadians.

Notwithstanding the majority director requirements for specified corporations described in s. 105(3.1), if the corporation is of the type described in s. 105(3.1) and is also a holding corporation and earns 95% of its revenues offshore, then only one-third of its directors must be resident Canadians (s. 105(4)).

4. Bylaws

The directors may make, amend or repeal bylaws, effective immediately. However, shareholders must approve the changes by ordinary resolution at the next meeting of shareholders or the bylaw ceases to be effective (s. 103(3)).

At an annual meeting of a *CBCA* corporation, a shareholder entitled to vote at the meeting may make a proposal to make, amend or repeal a bylaw (s. 103(5)). The proposal and a statement in support must not exceed 500 words in total, and must be included in a management proxy circular sent out in

respect of that meeting (s. 137 and Part 6, s. 48 of the Regulations).

5. Delegation of Directors' Powers

The *CBCA* specifically permits directors of a corporation to appoint from their number a managing director (who is a resident Canadian) or a committee of directors, and to delegate to such managing director or committee any of the powers of the directors (with certain exceptions, including the ability to declare dividends; repurchase or redeem shares issued by the corporation; adopt, amend or repeal bylaws; or issue securities except as authorized by the directors) (s. 115).

6. Standard for Directors' Duties

Directors and officers in exercising their powers and discharging their duties must act honestly and in good faith with a view to the best interests of the corporation, and must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (s. 122). The standard is essentially the same as under the *BCA*. Amendments under the *Budget Implementation Act, 2019, No. 1* provide that, when acting in the best interests of the corporation, directors and officers may consider factors including (but not limited to) the interests of shareholders, employees, retirees and pensioners, creditors, consumers and governments; the environment; and the long-term interests of the corporation (this change came into force June 21, 2019 and codifies elements of the Supreme Court of Canada's decision in *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69).

Like the *BCA,* the *CBCA* requires a director (and officers who are not also directors) to disclose conflicts of interest. If a director or officer is a party to a material contract or a material transaction (whether made or proposed) with the corporation, that director or officer must disclose, in writing or by requesting to have it entered in the minutes of meetings of directors, the nature and extent of such interest (s. 120). The same obligation arises if the director or officer:

- is a director or an officer, or an individual acting in a similar capacity, of a party to the contract; or
- has a material interest in a party to the contract or transaction.

If a director or officer discloses their interest as required, and does not vote on the approval of the contract or transaction, and the contract or transaction is subsequently approved by the directors or shareholders, the contract or transaction is not invalid and the director or officer will not be accountable to the corporation or its shareholders for any profits realized, provided that the transaction was reasonable and fair to the corporation when it was approved (s. 120(7)).

Transactions not approved by the other directors in the above manner may instead be confirmed by shareholders 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 (s. 120(7.1)).

If the director or officer did not disclose the interest and receive director or shareholder approval, a court may, upon application of the corporation or any of its shareholders, set aside the contract or transaction on any terms that it thinks fit, or may require the director or officer to account for any profits or gain realized, or both (s. 120(8)).

There is a specific provision under the *CBCA* for indemnity and also for the maintenance of insurance for the benefit of a director against liability incurred by the individual as a director (s. 124).

7. Officers

Under the *CBCA*, there is no specific provision requiring that certain officers be elected or appointed. Nor does the *CBCA* require that the president be a director. Appointment of officers is under the control of the directors, subject to the articles, bylaws, and any unanimous shareholder agreement (s. 121). It is common for the bylaws of a *CBCA* corporation to set forth specifically the duties of officers of the corporation. Officers of a *CBCA* corporation have the same duty of care and obligation to disclose conflicts of interest as directors (ss. 120 and 122).

8. Recent Changes

An Act to Amend the Canada Business Corporations Act …, S.C. 2018, c. 8 introduced a number of changes to the *CBCA*, including the following:

- requiring that each director of a *CBCA* distributing corporation (i.e. public corporation) stand for re-election annually (s. 106(3.1));
- implementing changes to the way in which directors of certain *CBCA* corporations are elected (e.g. requiring that each director nominated in an uncontested election be elected by a majority of votes cast) (s. 106(3.4)); and

- requiring certain *CBCA* corporations to make annual disclosures respecting diversity among directors and members of senior management (s. 172.1).

The diversity disclosure requirements came into force on January 1, 2020. The director term and election provisions came into force on August 31, 2022. A lawyer whose practice involves advising *CBCA* corporations should be aware of these rules.

[§11.10] Going Private, Insider Trading, and Squeeze-Out Transactions

Under the *CBCA* those Parts of the Act that prescribe particular treatment for distributing corporations essentially "harmonize" the procedures for dealing with transactions and dealings of distributing corporations and their officers or directors with provincial securities legislation.

1. Going Private

Part XVI, s. 193, expressly permits "going-private transactions" ("GPTs"), as defined by the Regulations (see s. 3(1) of the Regulations). Essentially, the definition refers to amalgamations, arrangements, consolidations or any other transaction that would result in the termination of a shareholder's interest with compensation, but without consent and without a replacement of equivalent value in a participating security. Consequently, it covers the situation where a distributing corporation becomes a private corporation without the consent of each of its shareholders. The definition is broad and intended to cover all transactions, whether or not a related party is involved. While these transactions are permitted, it is clear that a corporation may not carry out a GPT unless it complies with any applicable provincial securities laws.

2. Insider Trading

The *CBCA* provisions relating to insider trading (Part XI, ss. 126–131) also harmonize with provincial securities legislation. The definition of "insider" covers most persons who could be expected to be in a position to receive confidential information about a distributing corporation and includes directors, officers and affiliates. The Regulations also deem persons who hold more than a prescribed percentage of shares to be "insiders" (Regulations, ss. 39 and 40). Also, the civil liability provisions define "security" for insider trading purposes expansively in order to help deter insider trading by allowing civil actions to be brought based on that broader definition. Finally, provisions of the *CBCA* impose civil liability on persons—"tippers"—who communicate undisclosed confidential information to others—"tippees"—that allows them to trade on such information (ss. 131(6) and (7)).

3. Squeeze-Outs

Part XVI, s. 194 expressly permits "squeeze-out transactions," as defined in s. 2(1) of the *CBCA*. A "squeeze-out" is a transaction by a **non-distributing** corporation that would "require an amendment to its articles and would, directly or indirectly, result in the interest of a holder of shares of a class of the corporation being terminated without the consent of the holder, and without substituting an interest of equivalent value in shares issued by the corporation, which shares have equal or greater rights and privileges than the shares of the affected class." Section 194 expressly permits a squeeze-out transaction if it is approved by an ordinary resolution of each class of shares affected by the transaction, whether or not the shares otherwise carry the right to vote.

[§11.11] Financial Disclosure

1. Report of Directors

Under the *CBCA* it is not necessary to place a report of the directors before the annual meeting.

2. Approval of Financial Statements

Distributing corporations are required to prepare their financial statements in accordance with the International Financial Reporting Standards ("IFRS"). Non-distributing corporations have the choice to use either IFRS or the Accounting Standards for Private Enterprises ("ASPE").

The *CBCA* specifically provides that the directors must approve the annual financial statements. The manual signature of one or more directors or a facsimile of the signatures reproduced in the statements evidences director approval. The corporation shall not issue, publish or circulate copies of the financial statements unless they are so signed and are accompanied by the report of the auditor of the corporation, if any (s. 158). The *CBCA* does not require the directors to approve and sign any interim financial statements.

A corporation must, not less than 21 days before each annual meeting, send a copy of the financial statements and auditor's report, if any, to each shareholder, except shareholders who have informed the corporation in writing that they do not want a copy of those documents (s. 159(1)).

3. Filing Annual Financial Statements

A distributing corporation under the *CBCA* that has any outstanding issue of securities that are held by

more than one person must send a copy of its annual financial statements to the Director (s. 160).

However, under the "Exemption from the filing of certain documents (single filing exemption) – *Canada Business Corporations Act*" (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02164.html), a corporation that is required to file its annual financial statements with a provincial securities commission or regulator under a provincial securities act is exempted from filing them with Corporations Canada. This is because the financial statements are publicly available online through the System for Electronic Document Analysis and Retrieval ("SEDAR"). SEDAR is used for electronically filing most securities-related information with the Canadian securities regulatory authorities. SEDAR filing is mandatory for most reporting issuers in Canada.

4. Waiver of Auditor

A corporation that is not required to file its annual financial statements with the Director may, by unanimous resolution of its shareholders (including the shareholders not otherwise entitled to vote), waive the appointment of an auditor until the next annual meeting of the shareholders (s. 163).

5. Independent Auditor

The *CBCA* does not require that an auditor be a member of the Chartered Professional Accountants of Canada. A person is disqualified from being an auditor of a corporation if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or its affiliates. Under the *CBCA* independence is a question of fact, but the Act prescribes certain relationships in respect of which a person is deemed not to be independent (s. 161).

6. Resignation or Removal of Auditor

The *CBCA* contains detailed provisions for removal or resignation of auditors and for replacing them. For example, an auditor must attend a meeting of the corporation if a shareholder gives notice to the auditor or former auditor that that auditor should attend and answer questions relating to their duty as an auditor (s. 168(2)). In addition, no person may accept an appointment replacing an auditor who has resigned, or has been removed, or whose term of office has expired, until the person has requested and received from the auditor a written statement of the circumstances and the reasons, in that auditor's opinion, for their replacement (s. 168(7)). Also, if a corporation proposes to replace an auditor, the corporation must issue a statement as to why (a copy must go to each shareholder), and the proposed replacement auditor may make a statement commenting on the reasons referred to in the corporate statement (s. 168(5.1) and (6)).

[§11.12] Fundamental Change

1. Meaning of "Fundamental Change"

The concept of "fundamental change" is essentially the same under the *CBCA* and the *BCA*. The term "fundamental change" is not defined in the *CBCA*. However, Part XV of the *CBCA* is entitled "Fundamental Changes" and describes various types of corporate transactions that can potentially impact the corporation or its business in such a fundamental way that shareholder protections are required. In a *CBCA* corporation, that change may be as simple as a corporate name change, or may be as severe as an amalgamation with another corporation, changing the business and its capital structure.

2. Special Resolution

The definition of "special resolution" under the *CBCA* means "a resolution passed by a majority of not less than two-thirds of the vote" (s. 2(1)). Most fundamental changes are authorized by special resolution. Under the *CBCA*, the notice of a meeting of shareholders must contain the text of any special resolution (s. 135(6)) and notice must be given within the prescribed time (s. 135(1)). Consequently, there is effectively a minimum 21-day notice period for a *CBCA* special resolution, unless all shareholders consent to waive notice of the meeting, or, for non-distributing corporations, the bylaws allow for a shorter notice period.

3. Dissent Proceedings

Under the *CBCA*, if the change is a fundamental change it may trigger the provisions for dissent proceedings. A shareholder may require that the corporation purchase the shareholder's shares for their fair value, if the fundamental change is made. The *CBCA* provision permitting dissent proceedings (s. 190) is available if the corporation resolves to:

- amend its articles to add, change or remove provisions restricting or constraining the issue, transfer or ownership of shares of that class;
- amend its articles to add, change or remove any restriction on the business or businesses that the corporation may carry out;
- amalgamate with another corporation, otherwise than under s. 184;
- be continued under the laws of another jurisdiction;

- lease, sell or exchange all or substantially all of its property other than in the ordinary course of business; or
- carry out a going-private transaction or a squeeze-out transaction.

The *CBCA* permits the dissenting shareholder to have their shares purchased by the corporation.

There is no right of dissent in these situations:

- where an oppression remedy effects an amendment of the articles (s. 241(5)); or
- if an amendment to the articles is effected under the reorganization provisions of the *CBCA* (s. 191(7)).

Pursuant to subsection 190(26), the corporation may not purchase the shares from a dissenting shareholder if there are reasonable grounds for believing that:

- the corporation is or would after the payment be unable to pay its liabilities as they become due; or
- the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities.

4. Procedure

Once a special resolution authorizing a fundamental change has been passed, articles of amendment are sent to Corporations Canada, in duplicate, on the printed form, together with a cheque for the fee (or filed electronically), after which the Director is obliged to issue the certificate of amendment.

If the amendments become complicated, the directors may restate the articles of incorporation, file the restated articles with Corporations Canada, and the Director will issue a restated certificate of incorporation, which will supersede the original articles of incorporation and all amendments (s. 180). This is an easy method for keeping the articles of a *CBCA* corporation accurate and clear.

5. Amalgamation

The *CBCA* provides for amalgamations of *CBCA* corporations with other *CBCA* corporations (s. 181).

If a *CBCA* corporation is to be amalgamated with a body corporate subsisting under the laws of another jurisdiction, there will have to be a "continuance" so that both corporations are governed by the laws of the same jurisdiction before the amalgamation can proceed.

Under the *CBCA*, court approval is not required to amalgamate. The Director is obliged to be satisfied, on statutory declaration evidence, that creditors will not be prejudiced by the amalgamation (this procedure can be more onerous than if court approval were required—see the requirements of s. 185 of the *CBCA*). The Director then issues the certificate of amalgamation.

There is provision under the *CBCA* for a "short-form amalgamation," which saves time when a subsidiary corporation is amalgamating with its parent corporation ("vertical short-form amalgamation"), or when two or more wholly-owned subsidiary corporations of the same parent corporation are amalgamating ("horizontal short-form amalgamation"). In these instances, the amalgamation is approved by a resolution of the directors of each amalgamating corporation, and certain other conditions must be met (ss. 184(1) and (2)). This short form of amalgamation can save a great deal of time and does not require shareholder approval or an artificial non-arm's length amalgamation agreement.

In situations where a short-form amalgamation is not available, the amalgamating *CBCA* corporations are required to enter into an agreement setting out the terms and means of effecting the amalgamation (s. 182). The directors must submit the amalgamation agreement for approval to a meeting of the holders of shares of the amalgamating corporation of which they are directors (s. 183). It should also be noted that when an amalgamation takes place under the *CBCA*, it is not necessary that shares of the amalgamated corporation be issued to shareholders. Shares of a parent or other corporation can be issued instead, making for some interesting planning and acquisition possibilities.

A *CBCA* corporation may amalgamate with one or more bodies corporate under certain other federal statutes—the *Bank Act*, the *Canada Cooperatives Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act*, or the *Trust and Loan Companies Act*. For these types of amalgamations, the application must be made to the Office of the Superintendent of Financial Institutions, and the *CBCA* will not apply to the amalgamated corporation.

For more information on *CBCA* amalgamations, see the "Guide on amalgamating business corporations" on the Corporations Canada website (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02719.html).

6. Arrangements

A *CBCA* corporation may carry out a procedure referred to as an "arrangement." The arrangement procedure is generally intended to provide a mechanism for a corporation in financial difficulties to reorganize its affairs with the consent of its shareholders and creditors, but can also be used to ac-

complish a number of corporate transactions that would not otherwise be possible.

The *CBCA* provides a list of the type of transactions included within the definition of an "arrangement" (s. 192). The definition contemplates transactions involving a corporation and its shareholders and creditors and transactions involving another corporate entity (which may not be a *CBCA* corporation). Section 192 of the *CBCA* requires a corporation wishing to carry out an arrangement not be "insolvent" and that there not be any other "practicable" way to carry out the transaction. In addition, the Director must be notified, and will often participate in the court hearings.

For more information on *CBCA* arrangements, see "Policy on Arrangements—*Canada Business Corporations Act*, Section 192" on the Corporations Canada website (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01073.html).

7. Extraordinary Sale, Lease or Exchange

Pursuant to s. 189(3) of the *CBCA*, a sale, lease or exchange of "all or substantially all" of the property of a corporation other than in the ordinary course of business requires the approval of the shareholders by special resolution. In order to obtain shareholder approval, the notice of meeting must include a copy or summary of the agreement of sale, lease or exchange, and state that a dissenting shareholder is entitled to be paid the fair value of the holder's shares by the corporation.

The meaning of "all or substantially all" has been examined in the case law and involves a combined qualitative and quantitative analysis of the transaction in question. The underlying rationale behind the requirement in s. 189(3) is to protect shareholders from a fundamental change in the corporation that strikes at the heart of the corporate purpose and existence of the corporation.

[§11.13] Continuances (Export and Import)

Bodies corporate subsisting under the laws of other jurisdictions may be continued as corporations under the *CBCA* (import). As well, *CBCA* corporations may be continued as bodies corporate under the laws of another jurisdiction (export). See ss. 187 and 188 of the *CBCA*. This procedure is commonly used in the following kinds of circumstances:

- If, for example, a company that is incorporated under the *BCA* moves its head office to Toronto and wishes to be governed by a statute with which its officers and lawyers resident in Toronto are more familiar, it may be continued as a *CBCA* corporation.
- If an amalgamation is desired between a *CBCA* corporation and a company incorporated in another jurisdiction, it may be necessary for the other company to continue as a *CBCA* corporation or, alternatively, for the *CBCA* corporation to continue as a company under the laws of the other jurisdiction.

1. Export

A special resolution of the shareholders is required to export a *CBCA* corporation. Also, the Director must be satisfied that the continuance will not adversely affect the creditors or shareholders of the corporation. Under the "Policy on Continuance (Export)—Legislation Pre-approved by Corporations Canada Under the *Canada Business Corporations Act*" (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs05236.html), the Director considers the listed legislation as allowing for continuance from a *CBCA* corporation and containing rights for shareholders and creditors similar to those under the *CBCA*. To export to a jurisdiction recognized under this Policy, the Director requires only a letter from the corporation stating that a special resolution of the shareholders authorizing the continuance has been passed, plus the applicable filing fee. To export into any other jurisdiction, the corporation must provide certain documentation to the Director to satisfy the Director that the continuance will not adversely affect the creditors or shareholders of the corporation.

For further information on the steps required, see "Policy on Continuance (Export) of a Federal Corporation" on the Corporations Canada website (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01052.html).

2. Import

In order for a body corporate to import itself under the *CBCA*, it must be authorized to do so under the laws of the jurisdiction that applies to it (s. 187(1)). In addition, it must comply with the requirements of such jurisdiction with respect to its export from that jurisdiction and file evidence of authorization from the exporting jurisdiction with the Director, together with the same documents as are required for incorporation under the *CBCA* (except that the articles of incorporation are replaced by articles of continuance in the form that the Director fixes). All rights and obligations of the importing body corporate are preserved under the *CBCA* (s. 187(7)). For further information, see "Policy on Continuance (Import) of a Body Corporate into the Canada Business Corporations Act" on the Corporations Canada website (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02720.html).

[§11.14] Compulsory and Compelled Acquisitions

In BC, the *Securities Act* (BC) governs takeover bids. A takeover bid under the *Securities Act* means the acquisition of 20% or more of the issued shares of a company.

In addition, Part XVII of the *CBCA* deals with Compulsory and Compelled Acquisitions. Under s. 206(1), these provisions govern takeover bids for shares of distributing corporations. The provisions assist persons (or companies) offering to acquire all the shares of a class, whether or not the shares are voting, by forcing any holdout shareholders to sell their shares, in certain circumstances.

The *CBCA* provides for compulsory acquisition of the shares of holdout shareholders where the offeror receives more than 90% acceptance of the offeror's bid within 120 days of the bid being made (s. 206). The *CBCA* gives the holdout shareholder (the "dissenting offeree") the alternate right to demand an independent valuation of their shares. See ss. 206(9)–(18).

[§11.15] Dissolution, Liquidation, Revival

1. Dissolution

Sections 210 and 211 of the *CBCA* govern dissolution procedures. A corporation cannot apply to dissolve under the *CBCA* until it has distributed its property and discharged its liabilities.

Where the corporation has no property or liabilities, and no shareholders, the directors can authorize its dissolution by passing a directors' resolution. Where the corporation has no property or liabilities, but does have shareholders, each class of shareholders must pass a special resolution to authorize the dissolution.

A corporation with property or liabilities must first distribute that property and discharge those liabilities. The corporation can start the liquidation process before starting the dissolution process, or can start the dissolution process before the liquidation process. Particular rules apply to the process chosen. For further information, see the "Guide on Dissolving a Business Corporation" on the Corporations Canada website (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs07074.html).

2. Revival

Section 209 of the *CBCA* provides for the revival of a dissolved corporation in a manner similar to the restoration provisions of the *BCA*. An "interested person" may apply for revival of a dissolved corporation. The *CBCA* defines "interested person" in s. 209(6) as including, among other persons, a shareholder, director, officer, employee, creditor, person who has a contractual relationship with the corporation, and a trustee in bankruptcy for the corporation. The most common reasons for applying for revival include attempts to reclaim property that had not been disposed of prior to the corporation's dissolution, or to bring an action against the corporation.

[§11.16] Investigation and Remedies

1. Investigation

The provisions for investigation under Part XIX of the *CBCA* provide for essentially the same rights as those under the *BCA*. On an application from a security holder or the Director, a court having jurisdiction where the corporation has its registered office may order an investigation to be made of the corporation and any of its affiliated corporations on the grounds and subject to the provisions stated in Part XIX (s. 229).

2. Derivative Actions

Under the *CBCA* a complainant may apply to the court to commence or defend an action on behalf of a corporation or to intervene in any action to which any such body corporate is a party (s. 239).

3. Oppression Remedy

A complainant may apply to court under s. 241 of the *CBCA* for relief from conduct that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer. The remedy granted to a complainant under s. 241 is often referred to as the "oppression remedy." The court may make any order it thinks fit, including a restraining order, an award of damages, appointment of a receiver or receiver-manager, the dissolution of the corporation, the forced acquisition of securities, and the amendment of the corporation's articles or bylaws or of a unanimous shareholder agreement.

[§11.17] General Provisions

A *CBCA* corporation is obliged to file an annual return with Corporations Canada in the form prescribed (s. 263), which is Form 22 and is available online. This return must be filed within 60 days after the anniversary date of incorporation of the corporation. This deadline was previously set out in s. 5 of the Regulations (which was repealed in March 2022). However, the "Policy on filing of annual returns – *Canada Business Corporations Act*" (ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02544.html) confirms this deadline. Failure to file the annual return within one year of the due date can lead to dissolution of the

corporation, although Corporation Canada's current practice is to target corporations that have failed to file their returns for two consecutive years (s. 212). The corporation must also file an annual return in each provincial jurisdiction where it is extraprovincially registered.

Section 254 provides that a notice or document required to be sent to or served on a corporation may be sent by registered mail to the registered office of the corporation shown in the last notice filed under s. 19.

Chapter 12

Not-for-profit Organizations[1]

[§12.01] Scope of This Chapter

Not-for-profit organizations and their volunteers play an important role in our society, providing services and activities that might not otherwise be available. These organizations take various forms, including social clubs, associations, trusts, foundations, societies, cooperatives and corporations without share capital.

While some not-for-profit organizations are unincorporated, many of them *are* incorporated, provincially under the *Societies Act*, S.B.C. 2015, c. 18, or federally under the *Canada Not-for-profit Corporations Act*, S.C. 2009, c. 23. Many not-for-profit organizations are also registered charities under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

This chapter begins with an overview of incorporation as a not-for-profit organization, including an overview of the *Canada Not-for-profit Corporations Act*, the *Societies Act*, and the differences between the two (§12.02–12.06).

§12.07 to §12.12 focus on societies governed by the *Societies Act.* All section references in those sections are to the *Societies Act*, unless otherwise stated.

§12.13, §12.14 and §12.15 address cooperative associations, foundations, and charitable status, respectively.

§12.16 and §12.17 address issues with respect to lawyers acting as directors for not-for-profit organizations or providing pro bono legal services to them.

[1] **Riley O. Lalonde and Lauren E. Frederick**, of Edwards, Kenny & Bray LLP, kindly revised this chapter in November 2022. Edited by PLTC in 2023 following the coming into force of amendments under the *Societies Amendment Act*, *2021*. Previously revised by Riley O. Lalonde and Lauren E. Frederick (November 2021); W. Fraser Hartley and Riley O. Lalonde (2019 and 2018); Peter J. Brown, W. Fraser Hartley and Riley O. Lalonde (2016); and Peter J. Brown and Diane E. Campbell (2010 and 2011). Peter J. Brown substantially rewrote this chapter in 2005 and reviewed it in 2008. Reviewed annually from 1997 to 2003 by Val Proctor.

[§12.02] Advantage of Incorporation

The most common reason to incorporate a not-for-profit organization is to take advantage of limited liability. Many not-for-profit organizations host activities where harm or damage could occur, and individual members could face liability if the organization was not incorporated.

[§12.03] Differences Between an Incorporated Not-for-profit Organization and a Company

A company incorporated provincially or federally carries on a business, divides its capital into shares, and pursues profit as its main objective. In contrast, an incorporated not-for-profit organization operates for the purposes and objects stated in its governing statute and constitution, *without profit or gain to its members*.

Neither a society nor a not-for-profit corporation has capital divided into shares.

[§12.04] *Canada Not-for-profit Corporations Act* – Overview

The *Canada Not-for-profit Corporations Act* came into force on October 17, 2011, replacing Part II of the *Canada Corporations Act*, R.S.C. 1970, c. C-32.

The purpose of the *Canada Not-for-profit Corporations Act* is to provide a modern framework for the regulation of federally incorporated not-for-profit organizations. The statute is modeled on the *Canada Business Corporations Act* and provides a more attractive federal option than the previous legislation.

[§12.05] *Societies Act* – Overview

Societies governed by the *Societies Act* are the most common type of not-for-profit organization in BC.

The *Societies Act* came into force on November 28, 2016, repealing and replacing the former *Society Act*, R.S.B.C. 1996, c. 433. The former *Society Act* was brought into force in 1977 and remained largely unchanged until 2016. The *Societies Act* contains significant changes designed to update processes and allow societies more flexibility in how they operate, while still protecting the public interest.

Societies incorporated under the former *Society Act* had until November 28, 2022 to "transition" to the new legislation, failing which they could be dissolved by the registrar. Transitioning required that a society file an electronic copy of its constitution and bylaws with the corporate registry. Most pre-existing societies also needed to amend these core documents to comply with the *Societies Act*.

As well, practitioners should be aware of the *Societies Amendment Act*, *2021*, S.B.C. 2021, c. 24. The *Societies Amendment Act, 2021* introduced a number of changes to the *Societies Act*, including new rules relating to record keeping and limitations on the information included in a society's register of members. There are also new rules setting a new default term of office for directors, and making other changes affecting senior officers and directors of a society. The stated purpose of the changes is to provide societies with greater adaptability in their internal governance, while ensuring transparency and accountability. Some of the amendments came into force on Royal Assent on October 28, 2021, and the rest came into force in May and July 2023. Lawyers who advise societies should be aware of these new rules.

Effective July 15, 2019, certain disputes under the *Societies Act* fall within the jurisdiction of the Civil Resolution Tribunal, including disputes about the interpretation of the *Societies Act* or a society's constitution or bylaws, and disputes about decisions or actions of a society pertaining to its members.

[§12.06] Comparing the *Societies Act* and the *Canada Not-for-profit Corporations Act*

Currently in BC there are far more provincially incorporated societies than federally incorporated not-for-profit organizations. A comparison of the relative advantages and disadvantages of incorporating under either the provincial *Societies Act* or the federal *Canada Not-for-profit Corporations Act* follows.

1. *Societies Act* Advantages

- The registry and officials overseeing BC societies are located in BC and can be easier to communicate with than federal officials in Ottawa.
- There is no requirement under the *Societies Act* to file financial statements with the Registrar of Companies, whereas the *Canada Not-for-profit Corporations Act* requires that if an organization is a "soliciting corporation," (i.e. a corporation receiving more than $10,000 in income from public sources in a single financial year) then it must send copies of its financial statements to Corporations Canada (s. 176(1)).
- Non-voting members need not vote as a separate class in respect of certain proposals and transactions (e.g. dissolution).
- Certain societies qualify as "member-funded societies" exempt from specific requirements set out in the *Societies Act*, such as the requirements to report remuneration of directors and to provide copies of financial statements upon request. Member-funded societies can be converted to *Business Corporations Act* companies.

2. *Canada Not-for-profit Corporations Act* Advantages

- It authorizes a not-for-profit corporation to operate and use its approved name in any Canadian province as of right.
- It provides flexibility regarding the province or territory where a not-for-profit corporation has its head office, maintains corporate records or holds meetings.
- It authorizes members of non-soliciting corporations to create unanimous member agreements through which they may agree to restrict the powers of the directors to manage and supervise the activities and affairs of the corporation.

[§12.07] Purposes and Characteristics Under the *Societies Act*

An organization may be incorporated as a society for certain purposes set out in the *Societies Act*. Under s. 2(1), a society can be formed for lawful purposes that include, but are not limited to, agricultural, artistic, benevolent, charitable, educational, environmental, patriotic, philanthropic, political, professional, recreational, religious, social or sporting purposes.

A society cannot have as one of its purposes the carrying on of a business for profit or gain. However, carrying on a business to advance or support the purposes of the society is not prohibited (s. 2(2)).

[§12.08] Registrar Under the *Societies Act*

The person appointed as the Registrar of Companies under the *Business Corporations Act* is also the "registrar" under s. 1 of the *Societies Act*.

[§12.09] Incorporation Procedure Under the *Societies Act*

1. Name Approval and Reservation

The first step to incorporation under the *Societies Act* is to ensure the proposed name of the society is available for approval by applying to the registrar to have the name reserved (s. 9(1)).

Section 9(4)(a) of the *Societies Act* states that the registrar must not approve a name unless it complies with the requirements prescribed by regulation. Similar to the process for approving names of companies under the *Business Corporations Act*, for a name to be available for a society, the name must not resemble the name of an existing society or company to such an extent that, in the registrar's

opinion, approving the name is likely to confuse or mislead (s. 2 of the *Societies Regulation*, B.C. Reg. 216/2015).

The registrar also has the discretion to refuse to reserve a name for a society if the registrar disapproves of the name for good and valid reasons (s. 9(4)(b)).

2. Incorporation Application

One or more persons may incorporate a society under the *Societies Act* by filing an application with the registrar that contains the following (s. 13):

- the name reserved for the society, and the reservation number given for that name;
- the constitution, bylaws and statement of directors and registered office of the society; and
- the full name and contact information of the applicants for incorporation.

3. Constitution and Bylaws

The constitution and bylaws are the core documents that govern the purposes and internal governance of a society.

The constitution of a society must set out the name and purposes of the society (s. 10(1)). The constitution must not contain any provisions other than the name and purposes—all other provisions must be in the society's bylaws (s. 10(2)). The only exception is for "member-funded societies," discussed later in this chapter.

Bylaws are analogous to the articles of a company and contain the provisions respecting the internal affairs and governance of the society. A society cannot carry on any activity or exercise any power that is restricted by its bylaws or contrary to its purposes (s. 7(1)).

Societies may adopt all or any of the "Model Bylaws" prescribed by regulation (s. 11(2)). The Model Bylaws are Schedule 1 to the *Societies Regulation*.

The Model Bylaws are often adequate, especially for relatively small societies, but they are rarely ideal. Rather than simply adopting the Model Bylaws, it is best to ensure that the bylaws are tailored to the society from the start, especially since it can be difficult to amend the bylaws once they are put in place (see s. 17).

The bylaws adopted by the society must comply with the *Societies Act* and, if the society seeks status as a registered charity for income-tax purposes, the bylaws must be approved by the Charities Directorate of the Canada Revenue Agency.

Section 11(1) of the *Societies Act* requires that a society's bylaws contain provisions respecting the internal affairs of the society, including provisions respecting the following matters:

- **membership in the society**, including the admission of members, their rights and obligations as members, if there is more than one class of members, a description of each class, and, if members may cease to be in good standing, the conditions under which that may occur;
- **directors of the society**, including the manner in which directors are elected or appointed, and the expiry of a director's term of office if the term ends other than at the close of the next annual general meeting following the director's designation, election or appointment;
- **general meetings of the society**, including the quorum for such meetings, whether proxy voting is permitted, if the members may vote by mail, fax, email or other electronic means; and the rules respecting how that voting is to occur; and
- **restrictions on the society**, including limits on activities the society may carry on or the powers the society may exercise.

Corporate registry staff do not examine bylaws at the time of incorporation or when bylaws are changed. The registry is just the repository of bylaws for public access. Consequently, it is up to each society to ensure its bylaws comply with s. 11.

A society can alter its bylaws by passing a special resolution authorizing the alteration and then filing a bylaw alteration application with the registrar (s. 17).

A "special resolution" is defined as follows (s. 1):

(a) a resolution consented to in writing by all voting members of a society;

(b) a resolution passed by at least 2/3 of votes cast at a general meeting, whether in person or by proxy; or

(c) a resolution passed by at least 2/3 of votes cast by indirect, delegate, mail-in or electronic ballot, if the bylaws of a society authorize members to vote by such means.

The bylaws of a society can set a higher voting threshold than the threshold set out in the s. 1 definition of a "special resolution" to effect any action that requires a special resolution under the *Societies Act* (s. 11(4)). The voting threshold could be set as high as requiring unanimous consent of the members to effect certain actions.

The former *Society Act* contained a concept of "unalterable provisions" that could be included in a society's constitution. One of the changes required when an existing society "transitions" to the *Societies Act* is that it must move any unalterable provisions from its constitution to its bylaws and identify those provisions as "previously unalterable."

The *Societies Act* does not provide for the inclusion of unalterable provisions in either the constitution or bylaws of a society, and even bylaw provisions identified as previously unalterable can be altered by special resolution (s. 17(5)). If a society has provisions in its bylaws that members consider important and do not want to be easily changed, the members may consider setting the voting threshold for a special resolution higher than the 2/3 vote required by the *Societies Act*.

4. Additional Filings

In addition to the constitution and bylaws, an incorporation application for a society must contain a statement of directors and registered office setting out the full names and addresses of the directors of the society and the delivery and mailing addresses of the society's registered office (s. 12(1)).

Incorporation applications must be accompanied by the fee prescribed by the *Societies Act*, which is currently $100 (see s. 212 of the *Societies Act* and s. 14 and Schedule 2 of the *Societies Regulation*).

If the registrar refuses an application to incorporate a society, the affected person can appeal the refusal to the BC Supreme Court (s. 406 of the *Business Corporations Act*).

Societies Act forms may be obtained online from Societies Online (www.bcregistry.ca/societies).

[§12.10] Organizational Matters Under the *Societies Act*

1. General Meetings

Societies must hold an annual general meeting of their members in every calendar year, except for the year in which the society is first incorporated (s. 71(1)). If a meeting cannot be held in a particular calendar year, a society can apply to the registrar for authorization to hold the meeting before March 31 of the following year, and if such authorization is granted, the meeting is deemed to be held in the preceding calendar year (s. 71(3)).

If all the voting members of a society consent in writing to a resolution dealing with the matters that must be dealt with at an annual general meeting, the meeting will be deemed to have been held, and the requirements for calling, giving notice of and holding the meeting will be deemed to have been met (s. 72). Societies with just a few members may opt to pass written consent resolutions to avoid the time and expense of calling and holding an annual general meeting.

At any time, the directors of a society may choose to call a general meeting (s. 74).

Written notice containing the date, time, and, if applicable, location of the general meeting, and the text of any special resolution to be submitted to the meeting, must be sent to every member of a society at least 14 days, and not more than 60 days, before the meeting (s. 77(1), 78(1)). A society can adopt a notice period shorter than 14 days in its bylaws but the notice period must be at least 7 days (s. 77(1)(a)(ii)). If a general meeting is an electronic meeting, the notice of the meeting must also include instructions for attending and participating in the meeting by telephone or other communications medium, including, if applicable, instructions for voting at the meeting (s. 78(2)).

If permitted in its bylaws, a society with more than 100 members can give notice of a general meeting by emailing the notice to members and publishing the notice in a newspaper at least once in each of the three weeks leading up to the meeting, or posting the notice on the society's website for the 21 days leading up to the meeting (s. 77(2)).

Members of a society can participate in general meetings by telephone or other communications medium, unless the society's bylaws provide otherwise (s. 83(1)).

If a society's bylaws allow members to vote electronically, the bylaws must set out how that voting is to occur (s. 84(6)).

2. Annual Filings

Pursuant to s. 73(1) of the *Societies Act*, within 30 days after each annual general meeting, a society must file with the registrar an annual report that includes the date on which the meeting was held. If a society fails to file annual reports for two consecutive years, the registrar may notify the society that it will be dissolved unless it holds an annual general meeting and makes the required annual filings (see ss. 73(4) and 214).

Promptly after a change of its directors or the address of any of its directors, a society must file a notice of change of directors with the registrar (s. 51(1)). If the change occurs at an annual general meeting, the society can give notice of the change in its annual report rather than filing a notice of change of directors (s. 51(2)). If a society becomes aware that its statement of directors and registered office contains an error, it must promptly file a notice of correction with the registrar (s. 51(2.1)).

Also, a society must file a notice of every change to the address of its registered office either by filing a notice of change of address of registered office or noting the change in an annual report (s. 19(1)).

3. Financial Statements

Section 35 of the *Societies Act* requires that the directors of a society present the society's financial statements and auditor's report, if any, to the members at each annual general meeting. All financial statements presented at an annual general meeting must be approved and signed by the directors of the society (s. 38(1)(a)).

The *Societies Act* also requires that a society's financial statements include a note providing information in respect of remuneration paid by the society to employees and contractors of the society who receive remuneration above an amount set by the *Societies Regulation*. The financial statements must also set out the remuneration paid to directors (s. 36(1)(a)). Note that these reporting requirements do not apply to member-funded societies (s. 196).

The amount currently set by the *Societies Regulation* is $75,000 received by the employee or contractor in the period for which the financial statements are prepared (s. 9(2)).

Section 9(2) of the *Societies Regulation* sets out what information must be included in the financial statements concerning remuneration paid to employees and contractors meeting the prescribed criteria under s. 36(1)(b) of the Act. The information required is either of the following:

(a) a list of those persons, including:

  (i) the remuneration paid to each person;

  (ii) in the case of employees, each employee's title or position;

  (iii) in the case of contractors, the nature of the services provided; and

  (iv) if the society chooses, the names of the persons; or

(b) the total number of those persons and the remuneration paid to those persons.

A society (other than a member-funded society) must provide any person a copy of its financial statements on request by the person (ss. 28(2) and 195). The society may charge a reasonable fee for providing its financial statements, which may not exceed any fee set by regulation (s. 28(4)). In addition, if a society has a subsidiary, a member or security holder of the society is entitled to a copy of the subsidiary's most recent financial statements on request and payment of the required fee (s. 39).

4. Audit Requirements

Many societies do not appoint an auditor to audit their financial statements. However, a society must have an auditor if the society's bylaws or the *Societies Regulation* require it (s. 111(1)(a)). In some cases, a lender or regulator may also require that a society appoint an auditor.

If a society is required to have an auditor, the first auditor must be appointed either by the directors of the society or by ordinary resolution of its members, and subsequent auditors must be appointed at each annual general meeting by an ordinary resolution of the members (s. 111(2) and (3)).

The auditor must be qualified (s. 112) and independent of the society (s. 113), and must prepare a report on the financial statements to be presented at an annual general meeting (s. 117(1)(a)). That report must state whether, in the auditor's opinion, the society's financial statements (s. 117(1)(b)):

(a) fairly reflect in all material respects the financial position of the society and the results of its operations for the period under review;

(b) were prepared in accordance with generally accepted accounting principles; and

(c) were prepared consistently with how financial statements from the preceding period were prepared.

A society may remove an auditor before the auditor's term ends by calling a general meeting for that purpose and passing an ordinary resolution (s. 115(1)(a)), but the society must also pass an ordinary resolution (at that same meeting) appointing a replacement auditor for the remainder of the outgoing auditor's term (s. 115(1)(b)).

5. Society Records

Section 20 of the *Societies Act* requires that a society keep certain records, including the following:

(a) the society's certificate of incorporation;

(b) certified copies of the constitution and bylaws of the society, and the statement of directors and registered office;

(c) the society's register of directors, including contact information for each director, the date each director was designated, elected or appointed, and the date each director ceased to hold office;

(d) subject to the regulations, the society's register of members, organized by different classes of members (if applicable), and only the name and contact information provided by each member (new s. 20(1.1) prohibits including any other information about members);

(e) court orders made in respect of the society;

(f) the society's financial statements;

(g) the minutes of general meetings of members and the minutes of meetings of directors of the society, including the text of each resolution voted on at the meeting; and

(h) the consent resolutions passed by members and directors of the society.

The records of a society must be kept at the society's registered office, in the case of physical records, or made available for inspection on a computer terminal located at the society's registered office, in the case of records in electronic form (s. 22(1)).

The directors can, by resolution, permit some of the records to be kept somewhere other than the society's registered office, although in that case the registered office must contain a written notice listing the records kept off-site and identifying where those records are kept (ss. 22(2) and 22(3)).

While the directors of the society may inspect all the records a society is required to keep under s. 20 of the *Societies Act*, access to some records by members and other people will depend on what records are being sought and on the provisions contained in the society's bylaws (s. 24).

Members of a society are entitled to inspect the society's records; however, the bylaws may restrict members' rights to inspect minutes of directors' meetings, consent resolutions passed by directors, and the accounting records of the society (ss. 24(1) and 24(2)). The directors may also restrict the members' rights to inspect the register of members, if they believe the inspection would harm the society or the interests of any members (s. 25(1)).

If permitted by the society's bylaws, a person other than a member or director may inspect the records of a society (except the register of members) and the society may charge a reasonable fee for the inspection, not to exceed the maximum fee set by regulation (ss. 24(4) and 24(5)).

[§12.11] Operational Matters Under the *Societies Act*

1. Directors and Officers

Directors and officers of a society are subject to a number of duties and liabilities under various statutes and the common law. There is little distinction between the duties, liabilities and qualifications of directors and officers of a society and of a company, even though the individuals involved with a society may be volunteers.

Societies must have at least three directors, at least one of whom must be ordinarily resident in BC (s. 40). An exception is for "member-funded societies", which need only one director and none of the directors need to be ordinarily resident in BC (s. 197(1)).

Directors must either provide written consent to act as directors or be present at the meeting where they are appointed and consent to the appointment (s. 42(4)).

Individuals must meet certain qualifications to be directors of a society (s. 44). Also, a society (other than a member-funded society) must ensure that a majority of its directors are not employees or contractors of the society (s. 41).

Unless the bylaws specify otherwise, a director's term of office ends at the end of the first annual general meeting after becoming a director (s. 11(1)).

The *Societies Act* lists specific duties of directors (s. 53(1)). These duties include the following:

(a) to act honestly and in good faith with a view to the best interests of the society;

(b) to exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstance;

(c) to act in accordance with the *Societies Act* and the *Societies Regulation*; and

(d) subject to the first and third duties above, to act in accordance with the society's bylaws.

These duties are in addition to any rules concerning the liabilities and duties applicable to directors under other statutes or the common law (s. 53(3)).

A society's directors and officers can be exposed to personal liability in a range of situations, including where the society fails to remit taxes or neglects to pay employee wages. The *Societies Act* provides that, in some circumstances, a director is liable for authorizing a society to either make distributions of money or other property contrary to the *Societies Act* or the society's bylaws (s. 59) or to enter into contracts or transactions where the director has an undisclosed conflict of interest (s. 57).

Many societies have honorary directors appointed to lend prestige to the society or to reward faithful volunteer service. These honorary directors often play no role in the governance of the society. However, they are not relieved from liability due to lack of involvement in the organization's affairs and, in fact, could be exposed to increased liability for failing to fulfil their duties in an appropriate manner. Individuals who are not officially appointed as directors, but who perform the functions of directors,

should be aware that many sections of the *Societies Act*, including those relating to the duties and liabilities of directors, will apply to them as if they were directors (s. 55).

Directors of a society may choose to appoint one or more senior managers to exercise the directors' authority to manage the activities and internal affairs of the society (s. 61(1)).

Directors can only be paid for being directors if the bylaws authorize remuneration (s. 46). As noted earlier, a society (other than a member-funded society) must include a note on its financial statements setting out remuneration paid to directors (s. 36).

Unless the bylaws of a society provide otherwise, a society's directors may meet at any location, or electronically, on any notice and in any manner convenient to the directors (s. 54(1)). The directors may pass a director's resolution without a meeting if (a) a copy of the resolution is sent to all the directors and (b) all the directors (or a lesser number if provided for in the bylaws) consent to the resolution in writing or any other manner permitted by the bylaws (s. 52(2)). A director may not vote by proxy at a meeting of directors (s. 52(3)).

2. Investing and Borrowing

Section 33 of the *Societies Act* provides that a society may only invest its funds either in accordance with its bylaws or in an investment in which a prudent investor might invest, unless the bylaws prohibit that investment.

Section 34(1) of the *Societies Act* authorizes a society to borrow money or issue bonds, debentures or notes on terms determined by the directors. The general authorization for borrowing and issuing evidence of a society's debt obligations is subject to any restrictions or prohibitions contained in the society's bylaws (s. 34(2)).

3. Corporate Status

Many small societies do not keep the records required by the *Societies Act*. In the event of litigation, borrowing, or purchasing a major asset, it is prudent to review the records in detail to determine whether the society is in a legal position to do what it proposes. These problems are common:

- failure to file an annual report, with the result of either not being in good standing with the registrar or of being struck from the register; and
- failure to have a proper register of members and directors.

If the society's records are not current, it becomes difficult to provide a legal opinion on whether voting was properly conducted or resolutions were validly passed.

4. Capacity

The *Societies Act* states that a society has the capacity, rights, powers and privileges of an individual of full capacity (s. 6).

While the activities and powers of a society will be limited by the society's purposes and any limitations contained in its bylaws, s. 7(2) of the *Societies Act* provides that an act of a society is not invalid merely because it is contrary to the society's bylaws or purposes. This section clarifies some ambiguity about the validity of a society's actions in the event of litigation, borrowing, or a significant transaction where it is imperative to ensure that the society has the capacity to do what is proposed.

[§12.12] Member-Funded Societies Under the *Societies Act*

The *Societies Act* designates "member-funded societies" as those societies that do not receive a significant amount of public funding and operate primarily for the benefit of their members, as opposed to the public.

Member-funded societies are exempt from some of the public transparency provisions in the *Societies Act* (ss. 195 and 196). Member-funded societies may also have a single director (s. 197(1)), distribute property to their members on dissolution (if permitted by their bylaws or by resolution, s. 199), and convert into *Business Corporations Act* companies (s. 198).

The constitutions of member-funded societies must identify the societies as member-funded and state that they are funded primarily by members to carry on activities for the benefit of members (s. 191(1)).

Certain societies cannot be member-funded societies (s. 191(2)):

(a) societies that receive public donations, government funding, or a combination thereof in excess of either $20,000 or 10% of the society's gross income, over a period of two years (see s. 12 of the *Societies Regulation*);

(b) registered charities (defined in the *Income Tax Act*, s. 248(1));

(c) societies that are a designated recipients under the *Provincial Sales Tax Act* or are otherwise entitled to receive taxes, fees, or other revenue received by the government as an agent of the society;

(d) student societies (defined in the *College and Institute Act*, s. 1, or the *University Act*, s. 1); and

(e) hospital societies (defined in the *Hospital Act*, s. 42.1).

[§12.13] Cooperative Associations

A cooperative is an organization owned by its members who use its products or services on a community-owned and cooperative basis. Cooperatives can provide a broad range of products or services, and can be either not-for-profit organizations or for-profit enterprises. Housing cooperatives are by far the most common type of co-operatives in BC.

A cooperative can be incorporated provincially under the *Cooperative Association Act*, S.B.C. 1999, c. 28 or federally under the *Canada Cooperatives Act,* S.C. 1998, c. 1.

Effective July 15, 2019, certain disputes under the *Cooperative Association Act* fall within the jurisdiction of the Civil Resolution Tribunal.

[§12.14] Public and Private Foundations

A foundation is a registered charity whose primary purpose is to make grants to other charities and to organizations recognized by the federal government as "qualified donees."

The difference between a private foundation and a public foundation is that a private foundation obtains more than 50% of its capital from one donor or a small group of donors. Private foundations often have family or other non-arm's length directors. On the other hand, a public foundation obtains its capital from a variety of donors and has an arm's length board. A private foundation is not permitted to engage in any business activity.

A foundation must meet the requirements prescribed by the *Income Tax Act*, which include being constituted and operated exclusively for charitable purposes. A foundation may be structured as either a trust (formed pursuant to a trust document and managed by trustees) or corporation (incorporated under the *Societies Act* or the *Canada Not-for-profit Corporations Act*).

[§12.15] Applying for Charitable Status

Many not-for-profit organizations apply to become registered charitable organizations under the federal *Income Tax Act*. To be a registered charity, the society or not-for-profit organization must have charitable purposes that fall into one or more of the following categories:

(a) the relief of poverty;

(b) the advancement of education;

(c) the advancement of religion; or

(d) other purposes that benefit the community in a way the courts have identified as charitable.

There are advantages to being a registered charity:

(a) Registration allows an organization to issue charitable donation tax receipts for gifts received.

(b) Once the organization is registered, it is exempt from paying income tax (under Part I of the federal *Income Tax Act*).

(c) Many goods and services provided by registered charities are exempt from GST.

(d) A registered charity may receive grants from other registered charities.

(e) Charitable status may benefit the organization in terms of public perception.

Limitations are imposed on registered charities:

(a) Reporting requirements for registered charities are onerous, so the organization must keep detailed records, file annual returns, and meet disbursement quotas.

(b) The activities of the organization must be exclusively charitable.

(c) There are significant limitations on what political activities the organization may be involved in.

(d) There are restrictions on *when* and *where* the organization may disburse donations it receives.

An application by a society to become a registered charity is more likely to succeed if the constitution and bylaws were originally drafted with a view to the organization becoming a registered charity (for example, the constitution should set out charitable purposes).

[§12.16] Lawyer as Director of a Not-for-profit Organization

1. General Comments

Being asked to serve as a director for a not-for-profit organization is an honour and may be an excellent opportunity to contribute to the community. It is also a significant responsibility. A lawyer should only accept a directorship after careful consideration of the nature of the commitment and a due-diligence review of the organization itself.

2. Insurance

The BC Lawyers Compulsory Professional Liability Indemnification Policy does not cover lawyers for any claims arising from or in any way connected to their acting as directors or officers. A lawyer who acts as a director or officer of a not-for-profit organization should ensure that the organization's bylaws

require it to indemnify directors and officers. The lawyer should also ensure that the organization has and maintains appropriate Directors and Officers Liability Insurance, and that it has the authority and capacity to do so. Alternatively, the lawyer may arrange for private insurance coverage.

See *Practice Material: Professionalism: Ethics* for more on the BC Lawyers Compulsory Professional Liability Indemnification Policy.

3. Duties

In matters in which a lawyer is deemed to have a higher degree of skill than a lay person, the lawyer has a greater responsibility to exercise care.

4. Other Considerations

Many not-for-profit organizations ask a lawyer to become a director as a way of obtaining free legal advice. A lawyer considering becoming a director should clarify those expectations. A lawyer who is not prepared to provide legal advice should properly advise the applicable board, council, or committee of the organization and ask them to confirm they understand the lawyer's role.

The lawyer who acts as a director of a not-for-profit organization while providing legal advice to the organization must also consider the potential for conflicts.

[§12.17] Pro Bono Legal Services

1. Definition

Lawyers have a general professional responsibility to contribute to their community by providing pro bono legal assistance. The legal profession has an obligation and responsibility to facilitate the administration of justice by providing legal assistance.

2. Indemnity Coverage

The BC Lawyers Compulsory Professional Liability Indemnity Policy provides indemnity coverage to lawyers who purchase the policy (generally lawyers in private practice) for their pro bono legal services.

In addition, coverage is extended to lawyers in good standing who do not purchase the policy (such as exempt, non-practising, in-house and retired lawyers), for claims arising out of pro bono services defined in the policy as "sanctioned services." Services are sanctioned services if:

- they are provided by a lawyer to an individual solely through a pro bono legal services program;
- they are not for the benefit of a person previously known to the lawyer, including a family member, friend or acquaintance; and
- both the services and the program are approved by the Law Society.

If a claim arises against a lawyer providing approved services, the usual financial consequences of a paid claim are waived (e.g. deductibles and surcharges). For more information on approved programs and services, see Access Pro Bono's website: accessprobono.ca/.

For more information on indemnity coverage for pro bono legal services, see *Practice Material: Professionalism: Ethics*, and refer to the "Information Sheet: Pro Bono Services" on the Law Society's website (lawsociety.bc.ca/support-and-resources-for-lawyers/member-services/forms/).