Proposals for a New Business Corporations Law for Canada

Volume I

Proposals for a New Business Corporations Law for Canada

VOLUME I
Commentary

by

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PREFACE

The format of this report deserves a word of explanation. A report in the form of a draft statute with accompanying commentary, while perhaps novel in Canada, is not original, because the technique was used by Professor L. C. B. Gower in his report on the company law of Ghana. It seemed to me that readers of our report, most of whom will probably be lawyers, would find it easier to examine a report critically if that report was in statutory language. Additionally, if Parliament sees fit to implement our recommendations, action should be faster if an already overburdened Department of Justice does not first have to translate a report written in general language into legislation. The most important reason, however, was that I believed that the discipline of thinking always in terms of specific statutory language would force all who worked on the report to organize their ideas more thoroughly and express them more coherently. Sometimes all the implications of a problem do not become apparent when one writes in general terms, and side effects of proposed solutions can go unnoticed. The legal draftsman is much less likely to make these mistakes. Finally, the report in its present form is undoubtedly much shorter than it would have been otherwise. Contrary to popular belief, the language of the law, when properly used, should render ideas more concise as well as more complete.

The decision to write a statute made the task longer and certainly more difficult than it would otherwise have been and, no doubt, statutory drafting by amateurs has its hazards. I think that the advantages of the course we took outweight the disadvantages and that, whatever its shortcomings, the report is, I am sure, a better report than it would have been if written in general language.

A good deal of the raw material from which this report was compiled originated with a "Task Force" of professors of corporation law in Canadian universities and others. The impetus so badly needed to give a project of this kind a good start came from this group, and I am boundlessly grateful to Stanley M. Beck, Robert Bertrand, R. M. Bryden, Yves Caron, Bradley Crawford, J. Thomas English, Martin Friedland, Marc Giguère, Edwin C. Harris, David Huberman, Stuart MacKinnon, C. L. Mitchell, E. J. "Pete" Mockler, Douglas Sherbaniuk and Daniel A. Soberman. During the initial stages I also had the valuable assistance of Jeff Barnabe and Fred Blair. Stewart Angus, Stephen Gill, Warren Mueller, Stanley Newman, Jay Richardson, Norman Winton and Harvey Wortsman helped various members of the "Task Force" with research.

The literature on corporation law is extensive but, unfortunately, not always as useful as it might be. Legal writing has a tendency to be excessively analytical, whereas in law reform the goal is usually synthesis rather than analysis. As well as the standard legal textbooks and periodical articles, several investigations and studies of corporation law carried out by committees in other parts of the world have been carefully examined. Some of the most notable of these are the reports listed in the table of abbreviations following this preface.

Special thanks are owed to Mr. Robert S. Lesher, chief counsel to the New York Joint Legislative Committee, for making available to us the comprehensive studies underlying the major revision made in the corporation law of that state in 1963.

In a search for the most modern solutions to corporation law problems we paid particular attention to those statutes which have most recently undergone revision. The corporation law in the Australian states, New York, California, North Carolina and Ontario have all been amended substantially within the last decade, and we profited greatly from those precedents.

Other individuals who offered useful ideas on particular problems included Philip Anisman, Leonard Leigh, Peter Williamson and Jacob Ziegel. Ken Young, Harry Bray and Samuel Lavine explained many of the changes recently made in Ontario. G. B. Snider of Manitoba, James Warr of Alberta and J. M. LeBlanc of New Brunswick were particularly helpful in discussing the concept of inter-jurisdictional transfer of corporations. In Ottawa, Maurice Strong drew on his wide experience to offer valuable suggestions. From the Department of Consumer and Corporate Affairs J. F. Grandy, Roger Tassé, Louis Lesage, Digby Viets and the late Harry B. Parkinson gave me constant and encouraging support. From the Department of Justice, J. W. Ryan imparted a little of his vast knowledge of drafting.

Francis J. Nugan, J. B. Watson and David Hutton assisted me in the formidable task of digesting the mass of material from which I decided upon the basic form and content of the Draft Act.

The drafting was done almost entirely by John Howard and myself, with Leon Getz as a constant, perceptive and always constructive critic.

Finally, nothing can be produced without good secretaries, and I have been more fortunate than I deserve in this regard. The skill, patience, devotion and good humour of Norma McCarthy, Susan Telegdi, Linda Richards, Blanche Poirier and Thérèse Dupuis was at all times above and beyond what anyone could reasonabley have expected.

Although the report is the product of the ideas and scholarship of a great many gifted and stimulating people, I must accept the final responsibility for what it contains, and I do so willingly.

ROBERT W. V. DICKERSON
Director
Vancouver and Ottawa
April, 1971

CONTENTS

ABBREVIATIONS

Atlantic Acceptance Report	Report of the Royal Commission Appointed to Inquire into the Failure of Atlantic Acceptance Corporation Limited, Ontario, 1969
Bankruptcy Report	Report of the Study Committee on Bankruptcy and Insolvency Legislation, Canada, 1970
Cohen Report	Report of the Committee on Company Law Amendment, Cmd. 6659, United Kingdom, 1945
Ghana Report	Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana, 1961
Jenkins Report	Report of the Company Law Committee, Cmd. 1749, United Kingdom, 1962
Kimber Report	Report of the Attorney General's Committee on Securities Legislation in Ontario, 1965
Lawrence Report	Interim Report of the Select Committee on Company Law, Ontario, 1967

Mutual Funds Report	Report of the Canadian Committee on Mutual Funds and Investment Contracts, 1969
Ontario Act	The Business Corporations Act, 1970, Statutes of Ontario 1970, Chapter 25
Ontario Merger Study	Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements, 1970
Present Act	Canada Corporations Act, Revised Statutes of Canada 1952, Chapter 53
Wheat Report	Disclosure to Investors—a Reappraisal of Administrative Policies under the '33 and '34 Acts, United States, 1969

INTRODUCTION

1. There are a number of reasons why an introduction to a report of this kind can be useful. First, it affords a way of explaining the objectives of the report, the approach we took to the subject, and the principles upon which the recommended reforms in the law are based. Secondly, corporation law is a daunting subject and, no doubt, many people presented with a report on it (far less a draft statute) will open it with a sinking heart. This introduction may perhaps show that there are a number of points of interest and importance in the field of corporation law which even the non-specialist can examine with profit. We hope that we can tempt the reluctant or apprehensive reader to make a tentative foray or two into the body of the report.

2. For those who cannot manage even a dip into the main contents, the introduction will give a brief resume of some of the points covered in the report. Anyone can therefore learn something about what is afoot in the world of corporation law.

3. Finally, an introduction gives us a locus to discuss a number of things for which no convenient place can be found in the main report. This is particularly useful for explaining the absence of certain things or concepts which have been part of corporation law in the past but which, for one reason or another, we have abandoned.

THE NEED FOR REFORM

4. The importance of the corporation in the economic system can scarcely be exaggerated. It has been and remains the chief vehicle of economic advance, and its influence in the society in which we live is pervasive. This theme has been extensively developed by economists, sociologists and other writers, and no elaboration is needed here. The limited liability company, or corporation, through which so much has

been accomplished, is unquestionably one of the most significant concepts in our system of jurisprudence.

5. The general reader may therefore be surprised to learn that, in its essentials, the corporation and corporation law has not appreciably changed, in, say, the last hundred years. Furthermore, we do not in this report have anything to propose which would fundamentally alter or replace the corporation as we know it. Although we are critical of (and propose changes in) almost every corner of the field of corporation law, we have not invented a new legal creature. We believe that the corporation in broadly its present form will continue to be the entity through which most commercial activity will take place.

6. The stability of the corporate form as a legal device in a world of constant change reflects its flexibility and adaptability. Unfortunately, it also shows how the law can become irrelevant. When the law gets out of tune with reality the astute and well-advised can devise ways of avoiding the law. Those who cannot do this are left defenceless. The corporation law of Canada has been sadly neglected, the federal law perhaps most of all. The Canada Corporations Act, for example, has not been comprehensively amended since 1934.

7. Another consequence of out-of-date corporation law is expense and delay. Time-consuming and meaningless rituals have to be gone through, procedures and forms for doing things become embedded in administration and practice, and a mystique develops which is understood, if at all, only by a comparatively few legal specialists. When the law is silent in an important area those affected have to resort to expensive and unsatisfactory makeshifts. Perhaps the outstanding example of this is the failure to bring within a comprehensive federal scheme the regulation of the public issue of corporate securities. The Canada Corporations Act is woefully deficient in this area, a consequence of which is that people may have to comply with the legislation of several provinces. Again, the law governing the transfer of corporate shares in Canada is quite outmoded; so much so, in fact, that the securities industry largely ignores it.

THE LIMITATIONS OF REFORM

8. It is important not to overstate the case for corporate law reform. Corporation law is a pretty pedestrian thing and its reform should not be given a glamour which the subject does not possess. Ballantine explained the function of corporation law this way:

> "The primary purpose of corporation laws is not regulatory. They are enabling acts, to authorize businessmen to organize and to operate their business, large or small,

with the advantages of the corporate mechanism. They are drawn with a view to facilitate efficient management of business and adjustment to the needs of change. They provide the legal frame and financial structure of the intricate corporate device by which business can be carried on and in which the combined energies and the capital of the managers and of many investors may work together. They deal with the internal affairs of the organization, the content of the articles of incorporation, the rights of the shareholders, the powers and liabilities of directors, the authorized number and variety of the shares, the holding of meetings, restrictions on corporate finance, such as the withdrawal of funds by way of dividends and share purchases, the corporate records, the authorization of organic changes such as amendments, sale of entire assets, merger and consolidation, and dissolution and winding up. Some of these provisions are regulatory, seeking to prevent abuses of management and also of the majority and to protect minority shareholders and creditors."*

9. Unexciting though it may seem to some, we have kept Ballantine's precept in mind at all times. We have not come to think, for example, that the millennium can be achieved by reforming corporation law. A corporations Act will not solve problems of industrial relations, nor can the many vexing problems of taxation be cured through some alchemy in the corporation law. We have also resisted the idea that corporation law as such has anything to do with the question of foreign investment, control of the economy and Canadian sovereignty.

10. We have also rejected the argument made by some that "corporate democracy" should be improved by investing corporate shareholders with some of the powers now commonly exercised by directors. In our view, this idea is quite misconceived, not least because the analogy between democracy in a political context and the relationships between the shareholders and directors of a corporation is tortured and misleading. Nor can we see any practical way that, at least in the "public" corporation, shareholders could be involved in corporate administration. This is not to say, however, that directors should not be responsible for their actions and accountable to shareholders and others for what they do. We believe that they should be, and more so than they have been in the past. The Draft Act reflects this principle.

11. Those simple-minded people who are not comfortable until they can label a proposed change in the law (and those who recommend it) as either "tough" or "lax" will be disappointed; it is not legitimate to characterize the Draft Act in this way. We set out to design a scheme of law that was clear, workable and, above all, written for the businessmen who will operate under it, not for the corporation lawyer. Accordingly, the Act simplifies and codifies wherever possible. We have sought to eliminate the obsolete and anachronistic, and to remove the trivially

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*H. W. Ballantine, *Ballantine on Corporations*, Callaghan and Company, Chicago, 1946, pp. 41-42.

arcane. We have not shrunk from introducing new concepts, many of which we borrowed and adapted from other more modern, statutes. At the same time, we have rejected some ideas which, in our view, were misconceived or unsound.

12. Much of the simplicity which the Draft Act will bring to corporate administration will come about through the standard forms which will eventually be prescribed by regulation. Although we have not at this time prepared the models for those forms, we have their details reasonably well sketched out in our minds. We contemplate that there will be a prescribed form for all the standard steps from incorporation to dissolution. Each form will describe the information required, the further documents to be attached, and so on. It should therefore be relatively simple for any corporate solicitor to prepare the necessary documentation for whatever corporate change is being made.

ADMINISTRATIVE DISCRETION

13. The other theme which runs through the Draft Act is our attitude towards the place of administrative discretion in the administration of the law. We believe that there are few places where administrative discretion is needed in a corporations Act; there is certainly too much of it under the present Canada Corporations Act. Thus, wherever possible, we have set out the consequences which will follow the taking of certain steps, without requiring review or decision by the Registrar. The Registrar's function, for the most part, is to ensure that the law has been observed. Where an adjudication on conflicting rights is required, the adjudication should be made by a court, not a government official. The Draft Act therefore provides liberally for simple and speedy applications to court by interested or affected parties, and it gives the courts wide discretion to make appropriate remedial orders. For the same reason there are very few penalty provisions in the Draft Act.

14. The flexibility which, it is argued, can be achieved by granting wide administrative discretion is better achieved, we think, by allowing many of the detailed rules to be laid down by regulation. We have been liberal, in the Draft Act, in referring to matters to be prescribed by regulation. Delegated legislation can of course have most of the disadvantages of administrative discretion, but we have assumed that Parliament will pass legislation on statutory instruments; indeed, a Statutory Instruments Act is presently before Parliament in Bill C-182. Without better parliamentary controls on delegated legislation than presently exists, we would not argue for a wider use of regulations in the administration of corporation law.

CONSTITUTIONALITY

15. Some of the things recommended in the Draft Act touch upon questions of constitutional law. Few things in Canada do not. While none of the authors of this report can claim to be an authority in that lubricous field, we have, as Canadian lawyers, a reasonable understanding of the areas in which the Parliament of Canada can legislate. We believe, too, that there has been far too much attention paid in the past to the supposed differences between corporation legislation and securities legislation. We do not believe that there is a valid distinction, and that a good deal of what is found in provincial securities legislation could just as validly be enacted as corporation legislation. It is well settled that Parliament has power to legislate for the incorporation of corporate bodies. We are confident that the proposals in the Draft Act are necessary incidents of a modern corporation law and, as such, are properly recommended to Parliament for attention. The Draft Act would also contribute to more uniform securities, law and administration in Canada.

16. Quite apart from the merits of the various reforms we recommend, people will have different views as to which of them should be considered major, and which should be called minor. For convenience of discussion in this introduction we have classified our proposals into major and minor reforms. In a third category, we discuss some of the things we have not done, ideas which we have not adopted and concepts which we have abandoned.

MINOR REFORMS

17. We would include in this category incorporation by designating number. The idea is scarcely profound but it should be useful. The validity of pre-incorporation contracts is a simple and long-overdue reform which expedites corporate promotion and removes a trap into which the unwary often fall. By explicitly recognizing the "one-man corporation" we do away with a tiresome, unrealistic and easily avoided bit of legal dogma. In other areas, of which the law of dividends is a good example, our objective has not been to change the law so much as to clarify it by stating in one short section what must now be extracted from a mass of confusing case law. Some may regard as a fundamental change our provisions allowing corporations to purchase their own shares. We think that, in this area, we have done little more than relax a troublesome prohibition and one which is usually side-stepped anyway through such devices as redeemable shares and low capitalization.

18. Similarly, we don't think that the change in the method of incorporation from letters patent to registration is really a very basic one. The discretionary aspect of a grant of letters patent has long since ceased to exist in practice, and we don't see any reason why the law should pretend otherwise.

MAJOR REFORMS

19. The reforms under this heading are major in several different senses. In some areas, such as directors' duties and liabilities, our proposals are significant because they attempt to synthesize principles which have been more or less well developed in case law but which, in that form, are much less clear than we think they can and should be. In the field of corporate dissolution we have tried to rationalize and codify rules and principles now found in the Bankruptcy Act, the Winding-up Act and case law. The dissolution provisions are therefore partly old law, but they are also new in that comprehensive rules have never before been included in the Canada Corporations Act. Also, the procedural aspects of dissolution have been made to conform to the pattern established for incorporation and amendment. This, we hope, will assist efficient corporate administration.

20. We have designed provisions under which corporations can transfer their place of jurisdiction (continuance and discontinuance) which go beyond the parallel provisions which now exist in the legislation of some of the provinces. For one thing, we have not adopted the dog-in-the-manger attitude that a federally incorporated corporation should not be able to transfer to a jurisdiction unless that jurisdiction allows its corporations to move in the opposite direction. There is implicit in this policy a belief that corporation law belongs to the legislatures which enact it and to the officials who administer it. It does not. Also, the provisions in the Draft Act contemplate transfers to and from foreign jurisdictions, not just to and from the Canadian provinces. Finally, we propose that the transfer technique should be the means of bringing all federal corporations, including corporations incorporated under the Canada Corporations Act, under the new Act. This will permit a good deal of rationalization of federal corporation law, and it also solves a difficult transitional problem.

21. Part 6.00 of the Draft Act creates a wholly new regime (in Canada) for the transfer of corporate securities. In particular, the provisions authorizing the establishment of a central depository for corporate securities should eventually eliminate much of the expense and delay which now plagues the securities industry. Similarly, Part 15.00 replaces the very inadequate provisions of the present Canada Corporations Act and, in addition, brings federal law into line with the advances made recently in several of the provinces. Part 15.00 is a significant step towards uniformity of legislation governing the public issue of corporate securities in Canada.

22. The Draft Act also contains new rules governing the rights and duties of auditors. The provisions in the present Act are unclear in a number of important respects, and Part 13.00 substantially improves the law in this long neglected area.

23. In some ways the most significant and far-reaching proposals are found in Part 19.00, shareholders' remedies. The position of the minority shareholder has always been an exceptionally unenviable one. The provisions of Part 19.00 simplify enormously the procedure under which a shareholder can pursue justice when he believes he has been unfairly dealt with. Equally important, courts are given wide powers to make orders appropriate to the situation. We believe that these provisions will bring into corporate life a much better degree of both fairness and efficiency.

OTHER MATTERS

Shares and capital

24. In part 5.00 we have tried to take some of the mystery out of corporate finance by adopting some new terminology and by abandoning some concepts which have outlived their usefulness. The terms "authorized shares" and "stated capital" separate, first of all, the legal and the accounting aspects of corporate capital. Much confusion has been created in the past because these two concepts have been merged into something called "share capital", which the legal and accounting professions have tended to regard and define differently. Under the Draft Act it is not even mandatory for corporations to state in their articles of incorporation a fixed number of shares (i.e., "authorized shares") which can only be changed by amendment of the articles. Any corporation can impose this traditional ceiling on itself if it so wishes, but the Draft Act allows every corporation a choice. The abolition of the utterly useless idea of par value removes all kinds of difficulties, and so does the prohibition of the partly-paid share. Similarly, the new rules for redeemable shares remove a lot of complicated law. All these changes have been made without detracting from the flexibility of the corporate share as a commercial instrument. Indeed, we think that flexibility in corporate financing is improved under the Draft Act.

Non-voting shares

25. The non-voting share is something which has generated a good deal of discussion from time to time (see Lawrence Report, pp. 31-33). Most of the corporation Acts in Canada permit non-voting shares, although Ontario, since 1953, has provided that voting rights may only be restricted in "preference" shares ("special" shares in the new Ontario Act). Section 12(14) of the Canada Corporations Act is applied to require that even preferred shares must have the right to vote in certain circumstances.

26. The controversy over voting rights is largely confined to the question of whether "common" shares may be voteless; most writers do not object strongly to the elimination or restriction of voting rights on "preferred" shares. The argument therefore rests on the assumption that the terms "common" and "preferred" have a precise meaning, an assumption which we have rejected, along with the adjectives which we think are misleading. The Draft Act speaks only of "shares", although it recognizes that shares may be of different classes, with different terms and conditions attached to the shares in the different classes.

27. Ingenious corporate solicitors have not, of course, been defeated by those Acts which restrict the use of non-voting shares. The trick is simply to design a share which has voting rights in certain circumstances, but to ensure that, for practical purposes, those circumstances can almost never arise. The legal profession has been equal to the task, with the result that the protection given to shareholders by provisions such as those in the Ontario Act and in the Canada Corporations Act is largely illusory.

28. In the Draft Act, voting rights are not singled out for special attention. They are only one of the usual rights which shares will have unless, where there are two or more classes of shares, voting rights have been eliminated or restricted in some way. At least one class of shares in every corporation must always have unrestricted voting rights. Part 14.00 provides, however, that even shares which are normally non-voting can nevertheless be voted on matters which affect fundamentally the shares of that class. Moreover, the holder of a non-voting share has the same right as any other shareholder to invoke the "dissent" provisions which require the corporation to buy back his shares. In our view it is for the prospective shareholder to decide whether he wants to buy shares that don't carry a right to vote. If, knowing the circumstances, he elects to buy such shares, there seems no compelling reason why the law should prevent him from doing so. The law should ensure, however, that the shareholder is given a voice on any proposal that is made to change his rights subsequently, and a chance, if he disagrees with the proposal, to withdraw from the corporation.

Objects and powers

29. Another concept abandoned is that of corporate objects and powers. On this point, as on others, we have sought to make the law reflect commercial reality where, in practice, corporations are incorporated as a matter of course with virtually limitless objects. The learning on corporate objects (including the doctrines of ultra vires and constructive notice) has become little more than a playground for the legal scholar and, sometimes, a pitfall for the unadvised.

30. In our view the law should invest corporations with the legal *capacity* of a natural person, and leave it to the corporation itself to decide whether it wants to restrict itself in the business it may carry on or the powers it may exercise.

Creditors, employees and others as directors

31. Suggestions have been made from time to time that corporation law focuses too narrowly on shareholders, and ignores the reality that others, especially the corporation's employees and creditors, are affected by and concerned with what corporations do. It follows from this, so the argument goes, that these groups should have some voice in the choice of corporate directors. Moreover, it is said, there is a broad public interest in corporations, and this interest should also be represented in corporate boardrooms.

32. We are not disposed to quarrel here with the validity of the premise on which this argument is based, but we do not see any practical way, in the context of a corporations act, in which it can be implemented. The problem is one of establishing the electorate. How does one provide the machinery for giving notice of meetings to those who do not have a crystallized and identifiable interest in the corporation? How can votes be allocated fairly amongst those who do not have the kind of precise rights given by a share, and how could such voting rights be equitably balanced with those of the shareholders?

33. The Draft Act does not prohibit a corporation from making arrangements with its creditors, employees or others under which directors representing those groups could be elected. The influence of such outside groups would have to be brought upon the shareholders, however, for it is only the shareholders who can cast the necessary votes. It is inconceivable, for example, that if a major creditor demanded representation on a corporation's board of directors, he would not be accommodated, because, presumably, he would not extend credit unless the shareholders did accede to his wishes. In fact, such representation by creditors is not uncommon today. Management has no difficulty making the point known to the shareholders; in practice, of course, management usually controls sufficient proxies to guarantee the election of the creditor's representative anyway. There is no requirement in the Draft Act that directors hold qualifying shares, therefore this cannot be a barrier.

34. Similarly, with employees, representation on the board could be bargained for in the collective agreement if the employees thought the matter important. In fact, trade unions have not shown much interest in having representation on the boards of corporations, but this could change. It is extremely unlikely that such a provision in a collective agreement would not be honoured when the shareholders' votes were cast as, otherwise, the collective agreement would be broken.

35. The public interest must be reflected through government. It is highly unlikely that governments would ever be interested in having representation on the boards of more than a few highly important or significant corporations. If government policy develops in this direction there should be little practical difficulty in implementing it, but through special legislation, not in a general corporations Act.

Private corporations

36. We have not preserved the traditional private-public corporation dichotomy. Instead, we have defined "corporation" in different ways in different parts of the Draft Act where it seemed necessary or desirable to create a distinction. Corporations are therefore distinguished on functional rather than on doctrinal grounds. Thus, under Part 13.00, certain corporations will not have to make public their financial statements; in Part 12.00 some corporations will not have to solicit proxies from their shareholders, and so on. In each case, the corporations are differentiated according to criteria which are relevant in the circumstances.

37. It will still be possible for incorporators of corporations to set out in the articles of incorporation those features which have traditionally distinguished "private" corporations, such as restrictions on the transferability of shares. The realities are unchanged, only the label has been dropped.

38. At the same time, we have improved the position of those who may wish to have a truly "private" corporation. By expressly legitimating the device of a unanimous shareholder agreement in Part 11.00 we allow the closely-held corporation to avoid much of the formalism that is not appropriate to it, and to operate, in effect, as a partnership with limited liability. The provisions allowing signed resolutions in lieu of minutes of meetings, for example, have a similar effect.

Annual returns

39. The requirement in s. 125 of the present Act for annual summary reports has not been retained because we think that such a return would be a superfluous nuisance under the Draft Act. The return would show nothing that was not already disclosed in the articles, notice of registered office, notice of directors and, for those corporations affected, proxy circulars. If in future further data is required it may be collected through information returns prescribed under s. 20.09. See the commentary on that section.

Mortgage register

40. The Draft Act also does away with the scheme created by ss. 66 to 72 of the present Act under which corporations are required to file particulars of mortgages and the Department is required to maintain a public register of those mortgages. This register creates no rights and is therefore useless and, possibly, dangerously misleading. Particulars of a corporation's debts will be disclosed in its financial statements. More important, registration under the appropriate provincial legislation can and does create rights and it is upon those registers that people should rely.

Constrained shares

41. An amendment to the present Act in 1970 (s. 38A and Schedule) created "constrained share companies". The rationale of this provision is that other Canadian legislation, notably the Broadcasting Act, requires corporations in that industry to restrict the number of their shares which can be held by persons who are not Canadian citizens.

42. It is not for us to decide the extent to which nationalism should be a factor in the regulation of business, and we do not debate that general issue. We think we are entitled to say, however, that it has no place in a corporation act. The Draft Act *allows* corporations to restrict the transferability of their shares, but it does not set out the criteria by which any such restrictions should or should not be determined. If the Broadcasting Act, or any other legislation, requires certain corporations to restrict the kind of people who may be shareholders, then, under the Draft Act, the necessary restrictions can be embodied in the corporations' articles of incorporation. The regulatory Act can also set out the sanctions for non-compliance. Corporations which voluntarily decide to restrict the transferability of their shares will have no trouble doing so under the Draft Act. The point is that a corporations Act should not lay down the circumstances under which restrictions should obtain, nor the nature of the restrictions. It should merely provide machinery by which those restrictions, wherever or however decided, can be implemented.

43. We cannot leave this discussion of restricted share ownership without mentioning the corollary. There is nothing in the Draft Act to prevent a corporation from attaching the most illiberal restrictions to the transferability of its shares. A corporation may well decide to exclude shareholders on the basis of race or religion, for example. Again, we say that action to prevent this sort of thing should not be taken in a corporation Act, but (as it now is, in fact) in laws dealing with civil rights.

PART 1.00

Interpretation and Application

44. The Draft Act is intended to replace Part I of the present Canada Corporations Act. If the Draft Act is adopted by Parliament the present Act will have to remain in force until the corporations governed by Part I of that Act have been continued under ss. 14.14 and 20.15 of the Draft Act. In addition, the Draft Act makes no provision for non-profit corporations which can be incorporated under Part II of the present Act. Because the present Act cannot be immediately repealed, and because the Draft Act will only govern business corporations, we have adopted the name "Canada Business Corporations Act" as a short title. This name also corresponds to the phraseology used in the new Ontario Act.

45. The terms defined in s. 1.02 apply, of course, to the whole of the Draft Act. In addition, further definitions of more restricted application are contained in certain Parts and sections of the Act. The various terms defined will be discussed—where elaboration seems necessary or appropriate—throughout this report and in the context of the provisions in which they are used. It seemed to us that it would be less useful to discuss defined terms in isolation.

46. Section 1.03 reflects our belief that there should be a clear distinction between the creation of corporate bodies, including the internal rights of the members of them, and the regulation of the business carried on by those corporate bodies. In principle, the procedure to be followed in bringing a corporate body into existence should be the same whatever the business intended to be carried on by that corporation. Similarly, the rights and duties of shareholders, directors and others connected with a corporation should not vary with differences in the corporation's commercial activities. The nature and degree of regulation of business activity will, however, be very different. The banking or insurance business, for example, requires very different regulation from general manufacturing or retailing.

47. We have therefore attempted in the Draft Act to design provisions which could be of general application, contemplating that statutes such as the Bank Act and the Trust Companies Act will continue to apply to corporations engaged in the kind of business activity with which such special legislation is concerned. Many of the special Acts will no doubt themselves require amendment to remove provisions of the kind now found in the Draft Act. Once this reorganization has been completed, however, it should be possible to incorporate all new federal corporations under the Draft Act, with the special Acts applying only to the conduct of the business carried on by certain of those corporations. Sections 14.15 and 20.15 will permit corporate bodies already in existence under special legislation to be "transferred" into the Draft Act so that, eventually, there will be a common statute and body of case law governing the internal aspects of all business corporations incorporated under the authority of the Parliament of Canada.

PART 2.00
Incorporation

48. Section 2.01 makes two important changes in the present law. The minimum requirement of three incorporators (s.5 of the present Act) is reduced to one. This is consistent with legislation in other jurisdictions (eg. Ontario Act, s. 4). The legality of the "one-man" corporation has been acknowledged since the landmark decision in *Salamon* v. *Salamon & Co.* [1897] AC 22, and the formal requirements of the present Act are invariably met by the use of "dummy" incorporators, usually stenographers in lawyers' offices. The minimum membership requirement affords no significant protection to creditors, nor does it present any serious obstacle to irresponsible incorporation. Its abandonment will therefore expose creditors to no greater risks than those to which they are at present subject and, in accordance with a policy followed consistently in the Draft Act of dispensing with meaningless formalities, the requirement in the present Act of three incorporators is abolished.

49. Section 2.01 also removes the limitation contained in s. 7(1) of the present Act that the applicants for incorporation should be individuals. The Draft Act thus eliminates the artificiality of insisting upon human intermediaries in the formation of subsidiary corporations.

50. Under s. 2.03 incorporators must deliver "articles of incorporation", the contents of which are specified in s. 2.02, to the Registrar who issues a certificate of incorporation (s. 2.04). At that point the corporation comes into existence (s. 2.05). This procedure is new in an important respect. Under the present Act incorporation is by application for letters patent, the grant of which is an exercise of the prerogative powers of the Crown—*Bonanza Creek Mining Co. Ltd.* v. *R.* [1916] 1 AC 566—and, being discretionary in character, the manner of its exercise is in general not subject to scrutiny: *Poizer* v. *Ward* [1947] 2 WWR 193; *Re Cole's Sporting Goods Ltd.* [1965] 2 OR 243. The precise reasons for the persistence of this technique of incorporation in Canada are not clear, but historically the method seems to have been thought of as a device to control the character and quality of incorporations to protect the public interest. There is no evidence that the use of such broad discretionary powers has been noticeably more successful in achieving this objective than the technique of incorporation as a matter of right elsewhere, or that it is capable of doing so, and there is some evidence that the exercise of the power has caused delay and inconvenience. Moreover, the Departmental procedures involved seem excessively costly and in some respects futile. In any event, qualitative controls, to be effective, should be imposed upon the *conduct* of corporate enterprise rather than upon its creation, and the Draft Act contains a wide variety of techniques for ensuring this.

51. Accordingly, ss. 2.03 and 2.04 change the existing law by permitting incorporation as a matter of right, upon compliance with the provisions of the Act. It should be emphasised that this involves no abandonment of the idea that limited liability is a privilege—rather a recognition that that idea has more vitality in relation to post-incorporation conduct than to incorporation procedures.

52. The change in incorporation technique obviously involves a change in the powers of the incorporating officer—called, in the Draft Act, the Registrar—whose legal position under s. 2.04 becomes substantially identical to that of the Registrar in "memorandum" jurisdictions such as the United Kingdom and British Columbia. He has no discretion to refuse to file articles of incorporation if they comply with the Act: *Reuss* v. *Bos* (1871) LR 5 HL 176. Refusal by the Registrar to file articles of incorporation is appealable under s. 19.09.

53. The requirement in s. 2.04 that articles of incorporation be delivered to the Registrar is new only in the sense that the description of the document required is new. The contents of the document, set out in s. 2.02, correspond broadly to those required to be included in an application for letters patent under s. 7(2) of the present Act. The term "articles of incorporation" is commonly used in the United States and has been adopted in the new Ontario Act (s. 4).

54. Some provisions of s. 2.02 should be specially noticed. As explained in the commentary to Part 3.00, the concept of corporate objects has been done away with, so there is nothing corresponding to s. 7(2)(c) of the present Act. However, under s. 2.02(1)(h) of the Draft Act, incorporators may impose restrictions on the business which the corporation may carry on, or such restrictions may be added later by amendment of the articles.

55. Section 2.02(2)(a) reproduces the substance of s. 7(3) of the present Act. Incorporators may wish to entrench certain provisions that would normally appear in the by-laws by including them in the articles, thus subjecting them to the special protective procedures against casual change that are provided for in Part 14.00.

56. The function of a unanimous shareholder agreement, referred to in s. 2.02(2)(b), is discussed in the commentary to s. 11.14.

57. Section 2.06 makes one important change in existing law by authorizing the use of the word "incorporated" in addition to "limited" as part of a corporate name. This alternative description is available under the

Quebec Companies Act and the new Ontario Act (s. 6) and people in those provinces (or elsewhere) who prefer this term should, we think, have the same right if they incorporate federally. Under s. 22(1) of the present Act, every corporation must include "limited" either in full or abbreviated form, as part of its name. Historically, the word "limited" was used to distinguish between those incorporated associations the members of which enjoyed limited liability and those which involved no such privilege. The word "limited" was intended to act as a red flag warning the public of the dangers which they ran if they had dealings with limited liability corporations. Today, however, the number of corporations in which members do not enjoy limited liability must be insignificant and, in any case, the corporation has become such a commonplace form of organization that the need for this warning device seems much less compelling. Accordingly, the term "incorporated", in its full or abbreviated form is authorized by s. 2.06.

58. Although, therefore, the necessity for distinguishing between an incorporated business and one not incorporated is probably less important then it was, the practice is so well established that we can see no point in dispensing with it. However, we don't think that the requirement should be imposed upon corporations incorporated under another Act without the words "limited" or "incorporated" as part of their name. Such corporations could be put to great inconvenience and expense if, when they became continued under s. 14.14 of the Draft Act, they had to add the words to their name. For this reason, the Registrar is given an exempting power in s. 2.06(2).

59. Section 2.06(3) and (5) authorizes (as does s. 22(2) of the present Act) the use of either a French or an English form of corporate name. The policy of the Corporations Branch has been to refuse combined French and English forms of name, however, and subsection (5) expresses this policy.

60. Section 2.06(4) reproduces the substance of s. 22(3) of the present Act, but with one change. The requirement to post a corporation's name outside every office in which the corporation carries on business is an anachronism carried over from 1845 English legislation. It is little more than a nuisance provision which has never been enforced, and which has been abandoned almost everywhere. It is therefore omitted from the Draft Act.

61. Section 2.07(1) is entirely new. Although the present Act does not authorize the reservation of names for proposed corporations, the practice of the Corporations Branch is to agree unofficially to reserve a suitable name. Section 2.07(1) merely legitimates this practice, and in so doing brings the federal legislation into line with corporate legislation in other jurisdictions. This change will greatly assist incorporators outside Ottawa, and seems a desirable step towards facilitating the incorporation process.

62. One of the most awkward problems in the incorporation process is the choice of a suitable corporate name. The Corporations Branch, before accepting a proposed name, has to ensure that the name will not conflict with the name of an already existing corporation. This task is more difficult for the Director of the Corporations Branch in Ottawa than it is for his provincial counterparts because the Branch must have regard to all corporations in Canada. Substantial delays can occur while proposed names are being cleared. During this period the corporation is not in existence, it cannot execute enforceable contracts and the incorporators can miss valuable business opportunities. Delays in effecting the incorporation at this critical time reduce the utility of the Canada Corporations Act considerably; many lawyers advise clients not to incorporate federally for this reason. In some cases the problems of delay in incorporation can be sidestepped by the use of pre-incorporation contracts. Section 2.10 of the Draft Act authorizes such contracts.

63. In addition, we provide in s. 2.07(2) that a corporation may become incorporated with a designating number instead of a name. Through this device incorporators will be able to get a very speedy incorporation and the corporation, using the designating number as its name, will be able to execute contracts and do anything else required to get on with its business. The corporation could then, if it wished, submit a proposed name in the usual form to the Registrar for checking and approval in the ordinary way. Once the suggested new name had been accepted, the corporation, following the usual change of name procedure, could abandon its designating number and operate thereafter under the new name. Alternatively, the corporation could if it wished, retain the designating number as its name.

64. Section 2.08(1) reproduces the substance of s. 25(1) of the present Act, with two important changes. Under the present law a corporation may not be incorporated with a name that so nearly resembles an existing name "as to be calculated to deceive," which makes the question one of the intention of the incorporators rather than one of fact. The present Act was not always in this form—the current wording was introduced in 1934—though recent decisions have indicated that the courts interpret the phrase "calculated to deceive" as having substantially the same meaning as "likely to deceive": *Re F. P. Chappel Co. Ltd.* [1960] OR

531; *Re C. C. Chemicals Ltd.* [1967] 63 DLR (2d) 203. Section 2.08(1)(a) brings the language of the statute into line with its probable judicial interpretation.

65. Second, whereas the present Act uses the phrase "likely to deceive" s. 2.08(1)(a) uses the phrase "likely to mislead or confuse". This phraseology is designed to make it plain that the likelihood of confusion is a sufficient ground for barring the use of a name, whatever the motive may be of the person using it.

66. Section 2.08(1)(b) reproduces a condition now found in s. 25(1) of the present Act. It should be noted that ss. 19.09 and 19.11 permit a summary application to court to challenge the Registrar's decision to refuse a name. Section 2.08(1)(c) is new, and is a consequence of the right to reserve a name granted by s. 2.07(1).

67. The remaining subsections of s. 2.08, and s. 2.09, are essentially re-enactments of ss. 25 and 26 of the present Act, modified to permit the assigning of a designating number to a corporation where its name is later discovered to have been granted in contravention of the Act. Section 27 of the present Act has not been carried into the Draft Act because we think the provision is otiose.

68. Section 2.10 is new, and is designed to change what is widely acknowledged to be the unsatisfactory state of the common law. Under existing common law rules, a corporation cannot ratify a contract purportedly entered into on its behalf before its incorporation *Kelner* v. *Baxter* (1866) LR 2 CP 174; *Repetti Ltd.* v. *Oliver-Lee Ltd.* (1922) 52 OLR 315. Nor can it adopt such a contract; to become bound it must renegotiate a fresh contract after incorporation: *Natal Land Co.* v. *Pauline Colliery Syndicate* [1904] AC 120.

69. At common law, a person dealing with a promoter can find that not only does he not have a contract with the corporation, but he has none with the promoter, either because the latter expressly disclaimed liability, as in *Dairy Supplies Ltd.* v. *Fuchs* (1959) 28 WWR 1, or because the court concluded that it was not the intention of the parties that the promoter should become liable, as in *Black* v. *Smallwood* (1966) Austr. Argus Reports 744. The theory in such cases seems to be that the person dealing with the promoter intended to look to the corporation as his debtor and he cannot later turn round and select a more suitable alternative. In practice, this means that a great deal may turn upon the form of a contract, and minor differences in wording may be decisive of the rights and liabilities of the parties. And, with oral contracts, there are difficulties of proof and problems of conflicting testimony. Although the third party may sometimes have other remedies against the promoter—see *Wickberg* v. *Shatsky* (1969) 4 DLR (3d) 540—these are not always adequate substitutes for contractual remedies.

70. The general effect of s. 2.10 is to declare that the promoter is liable on a pre-incorporation contract unless he takes adequate steps to procure adoption by the corporation, or he makes an express disclaimer of liability, or a court makes an order relieving him of liability. The justification for this approach is that, as a matter of business reality, the promoter is usually in control of the pre-incorporation and immediate post-incorporation process and is able to protect himself.

71. If the promoter wishes to escape his obligations under the contract (and forfeit its benefits), he may, under subsection (2), procure the adoption of the contract by the corporation, if the contract is in writing. The reason for the provision that only written contracts are susceptible of adoption is simply that this seems the only way of ensuring full disclosure of the terms of the contract, which is an essential protection for the corporation. The corporation will have to make a deliberate decision to adopt the contract—surely the least that the shareholders are entitled to expect—and the onus will be placed squarely on the promoter to ensure that this is done.

72. If the corporation does adopt the contract pursuant to subsection (2)(a) then, by subsection (2)(b), the promoter ceases to be bound by or entitled to the benefits of the contract. It is obvious, however, that a promoter can evade liability by procuring the adoption of the contract by a shell corporation with insufficient assets to meet its obligations under the contract. Section 2.10(3) accordingly permits a third party to apply to court for an order that, in effect, renders the purported adoption either wholly or partially ineffectual, and authorizes the court to impose liability upon the promoter notwithstanding the adoption of the contract by the corporation. Section 2.10(3) also permits imposition of liability upon a corporation that has not adopted the pre-incorporation contract. The effect of this may well be to give the third party a choice of debtors where ordinarily there would at best be only one. Nevertheless, we think it is desirable to confer a wide discretion upon the court to make adjustments. The courts will clearly not impose liability upon the corporation where the promoter has no effective control over it and the other party's sole basis for seeking an order is that he is stuck with an unsubstantial promoter. On the other hand, a fraudulent promoter should not be allowed to evade his obligations by hiding behind a corporation that he in fact dominates.

73. But s. 2.10(3) does not authorize the imposition of liability upon a promoter who has expressly and in writing disclaimed liability, whether or not the corporation has adopted the contract. The inclusion of an express written disclaimer should make the third party fully aware of the kind of arrangement he is getting himself into, and there seems no case for allowing the court to override the provisions of the disclaimer. On the other hand, a valid disclaimer will not prevent the court from imposing liability upon the corporation in an appropriate case, even if it has not adopted the contract.

PART 3.00

Capacity and Powers

74. Part 3.00 of the Draft Act deals with three problems that have plagued Anglo-Canadian corporation law for over a century: (1) the ultra vires doctrine, (2) the constructive notice doctrine, and (3) the so-called Rule in *Royal British Bank* v. *Turquand* (1856) 119 ER 886.

75. In terms of the ultra vires doctrine a corporation has the legal capacity to do only such acts as are expressly or by reasonable implication authorised by its objects clause. Acts outside that range are totally void for want of legal capacity in the corporation, and cannot be set right even with the unanimous assent of all shareholders: *Ashbury Rly. Carriage & Iron Co.* v. *Riche* (1875) LR 7 HL 653.

76. The original purpose of the ultra vires doctrine was to place limits upon the scope of the activities open to a business corporation, in the interests of its shareholders and creditors and of the public generally. Its effectiveness in achieving that purpose has been largely frustrated, however, as ingenious corporate draftsmen included every conceivable type of business in the objects clause and, by using general phrases, authorised the corporation to carry on the widest possible range of activity—see, for example, *H & H Logging Co. Ltd.* v. *Random Series Corporation Ltd.* (1967) 63 DLR (2d) 6; *Bell Houses Ltd.* v. *City Wall Properties Ltd.* [1966] 2 All ER 674. The result has been that the protection afforded to those whom the doctrine was designed to protect have been minimal: See generally Getz, *Ultra Vires and Some Related Problems* (1969) 3 U.B.C. Law Rev. 30. On occasion the ultra vires doctrine works severe hardship, not only upon creditors—*Re Jan Beauforte* [1953] Ch. 131—but also in certain circumstances upon shareholders as well, because unauthorised transactions are void for want of legal capacity.

77. In any event, there has always been some doubt as to whether, and if so to what extent, the ultra vires doctrine applies to corporations incorporated by grant of letters patent under the Canada Corporations Act. The doubt is based upon a suggested analogy between letters patent corporations and corporations created by Royal Charter at common law. See *Bonanza Creek Gold Mining Co.* v. *R.* [1916] 1 AC 566; and generally, Mockler, *The Doctrine of Ultra Vires in Letters Patent Companies*, in Ziegel (ed.), *Studies in Canadian Company Law*, 1967, p. 231.

78. With the abandonment in the Draft Act of the letters patent technique of incorporation, and the substitution for it of incorporation by registration, most of the old learning will become redundant, and therefore it is not reviewed here.

79. We have addressed ourselves to three principal problems in relation to ultra vires. First, we have sought to make it clear beyond peradventure that a corporation incorporated under the Draft Act does not suffer from any limitations upon its legal capacity. That is accomplished by s. 3.01 (1) which declares that a corporation has and is deemed always to have had the legal capacity of a natural person of full legal capacity. This is admittedly a clumsy formulation but we think that, read together with s. 3.02(3) which declares that acts in violation of express restrictions in the articles of incorporation shall not be invalid except in the situations described in s. 3.03, this will effectively dispose of ultra vires.

80. The second problem to which we have addressed ourselves is the simplification of the articles of incorporation and, especially, the elimination of the "objects" clause, so as to eliminate practices whose sole effect is to mislead. This is accomplished by s. 3.01(1). Despite the apparently unlimited scope of the rule, it should be noticed that it does not significantly differ *in effect* from the multi-paragraph "objects" clauses so widely found in modern corporate constitutions. Its great merit, in our view, is that it is simple and not likely to mislead anyone. Account must also be taken here of s. 3.02 which makes it plain that every corporation has all the powers of a natural person unless there is some express restriction of power in the articles. This, in effect, achieves much more simply what is sought to be achieved by s. 14(1) of the present Act.

81. The combined effect of ss. 3.01 and 3.02 then, is to make the articles of incorporation much simpler, and far less likely to deceive. An incidental result will be that anyone reading articles of incorporation will immediately realise that they cannot be relied upon for information as to the business actually being carried on by the corporation, and that further inquiries will have to be made. This, in our view, is a positive advance.

82. The third problem with which we have been concerned in relation to ultra vires is that of conferring adequate protection upon shareholders against unauthorised transactions, while at the same time safeguarding the interests of creditors. We do not think that there is any practicable technique, through the medium of a corporation statute, for ensuring that only those businesses are described in an "objects" clause that the corporation actually intends to carry on. Experience has demonstrated this. Any such requirement can be readily evaded, either by suitable drafting or through the use of power to invest surplus funds. We see no difference in principle or practice between corporation A being authorised to carry on, and carrying on, the business of brewing beer and manufacturing shoes, and corporation B in the business of brewing beer itself but incorporating a wholly-owned subsidiary to manufacture shoes. Whatever one's views might be as to the merits of diversification, we do not think that an "objects" clause is a suitable vehicle for controlling commercial activity or protecting the relevant interests.

83. On the other hand, it makes a good deal of sense to us to ensure that if one invests in a corporation that by its articles is confined to carrying on the brewery business, one should be able to complain if it commences or proposes to commence the manufacture of shoes. Equally, we think it important to ensure that when a corporation abandons a line of business, that shareholders be fully consulted. We have provided for the latter situation in s. 14.16(4) of the Draft Act, and have sought to accomplish the former objective in s. 3.03.

84. Section 3.04, which is new, is designed to clarify a doubt that exists whether the so-called doctrine of constructive notice applies to the contents of all documents required to be filed in a public registry. Whether this doctrine applies to public documents under the present Act is not clear, although s. 9 appears to have this effect. See also *Re W. N. McEachren & Sons Ltd.* [1933] 2 DLR 558. The application of the doctrine to commercial transactions in the absence of express legislation has always been viewed with some reserve, and there seems wide agreement that the mere fact of filing in a public registry should not, per se, fix the public with notice of the contents of the register. Section 3.04 adopts this view, leaving it open to the court, in an appropriate case, to apply the doctrine of constructive notice if there is a good reason for so doing. It may be that prudent people do inspect public documents in their own interests. That, however, is a far cry from imposing upon them as a matter of course a legal duty to do so—and that is the effect of the doctrine of constructive notice.

85. Section 3.05 is new, and is based upon s. 142 of the Draft Ghana Companies Code. The purpose of the section is to attempt a statutory statement of the effect of the so-called rule in *Royal British Bank* v. *Turquand.* In terms of that decision, a person dealing with a corporation is entitled to assume that its internal procedures have been properly complied with. If a person dealing with a corporation was bound to satisfy himself that all formalities required by the corporate constitution had been properly satisfied, the efficient conduct of business would be difficult, if not impossible. The policy of the decision in *Turquand's* case is to relieve the outsider of any obligation to enquire whether there has been due compliance with internal procedures, and that policy is embodied in this section.

86. Of course, if a third person knows that there has been some internal irregularity or, in all the circumstances ought to know, he will not be entitled to claim the protection, and this is catered for by the proviso to s.

3.05. It should also be noted that the section is drafted to make it clear that *anyone* is entitled to its protection, a matter which was unclear at common law—see Prentice, *The Indoor Management Rule,* in Ziegel (ed.), *Studies in Canadian Company Law,* 1967, pp. 322-3.

87. The first part of s. 3.05 (d) merely restates the well established common law rule that the protection afforded by the decision in *Turquand's* case is not lost if the person with whom the outsider dealt was never properly appointed—*Mahoney* v. *East Holyford Mining Co.* (1875) LR 7 HL 869. The second part of the paragraph merely states a well known rule of agency law, namely, that a person dealing with an agent is entitled to assume that that agent has the authority usual to persons in his position.

88. Section 3.05 (e) modifies the common law rules. In *Ruben* v. *Great Fingall Consolidated* [1906] AC 439 Lord Loreburn stated that the decision in *Turquand's* case "applies only to irregularities that might otherwise affect a genuine transaction. It cannot apply to a forgery." The justification for this view was that the outsider had better means of protecting himself against the loss. This view has been strongly questioned by a number of commentators—see, for example, Prentice, *supra* at pp. 339-340—and is accordingly modified in s. 3.05 (e), by which if the dishonest officer has been given authority to issue genuine documents and warrant their genuineness, the outsider is protected if the officer abuses his authority by uttering a forgery. See, to the same effect, s. 6.11.

PART 4.00

Registered Office, Records and Seal

89. Section 4.01 reproduces, in part, the provisions of s. 21 of the present Act. Section 2.02 (1) (b) of the Draft Act requires the articles of incorporation to specify the place within Canada where the registered office of the corporation will be situated. Section 4.01(1) and (2) require the corporation to specify the address of the corporation within that place and to notify the Registrar in the prescribed form of this address and of any changes of address.

90. The place where the registered office is situated may be changed by an amendment to the articles of incorporation in accordance with the procedure for amendment specified in Part 14.00. The address itself, however, may be changed by a decision of the directors under subsection (3) and compliance with the formalities prescribed in subsection (4).

91. Section 4.02 is largely a consolidation of ss. 107, 110 and 115 of the present Act, except that the nimiety of s. 115(1) has been expunged.

92. Section 4.03(1) parallels s. 109(1) of the present Act with one change: There does not seem to be any good reason why a judgment creditor of a shareholder should enjoy the same rights of inspection and copying as shareholders and creditors of the corporation itself. Accordingly, such judgment creditors are treated in the same way as any other stranger to the corporation and may only inspect and make copies upon payment of a fee. It will be noticed that the inspection rights given here do not extend to directors' minutes or accounting records. This simply reflects the common law rule: *R.* v. *Mariquita* (1858) 120 ER 917.

93. Section 4.03(2) is new. It seems elementary that a shareholder should be entitled to receive an up-to-date copy of the constitution of the corporation in which he has invested, although he has no such right at present.

94. Section 4.03(3) is based upon s. 109A which was added to the present Act in 1970. It represents not only an important complement to the rights conferred by subsection (1) but, equally important, a valuable piece of ancillary machinery to the proxy provisions in Part 12.00 and to the right conferred upon shareholders to requisition meetings under s. 11.11, and to propose amendments to the articles and by-laws under ss. 9.02(5), 11.05 and 14.02. Under s. 4.03(3) any person wishing to communicate with the shareholders of a corporation for a proper purpose—as defined in paragraph (d)—may obtain a copy of a list of shareholders, upon payment of a reasonable fee and the filing of the affidavit required by paragraph (c). Comparable provisions exist in the legislation of other jurisdictions and the availability of the facility will considerably enhance the position of shareholders, especially in those corporations whose securities are widely distributed. It should be noted, however, that the right to a shareholders' list under this section is not confined to shareholders of the corporation, but is available to any person for any purpose permitted by s. 4.03(3)(d).

95. Section 4.04 has no counterpart in the present Act. It is based upon comparable provisions in the legislation of the United Kingdom and Ontario which were introduced to reverse the effect of the decision in *Hearts of Oak Assurance Co.* v. *Flower & Son* [1936] Ch. 76 that looseleaf ledgers were not "books" within the meaning of the Act, and inadmissible in evidence as such. There is no justification for retaining this rule, especially in view of modern record-keeping techniques, and s. 4.04(1) is drafted to recognise, subject to the qualification mentioned and to the protections required in subsection (2), modern techniques of data storage and retrieval.

96. At one point we considered abolishing the whole idea of the corporate seal, an anachronism carried over from a less literate age. The amount of money spent every year in buying and storing this redundant ironmongery must be substantial. In the end, however, we concluded that we would probably create more trouble than we would save by abolishing the seal. Many people, bank managers in particular, are devoted to the seal and would be very upset if its use was prohibited. The law need not deprive people of such simple and harmless pleasures. The Draft Act, in s. 4.05, therefore continues to recognise the seal; it even lays down a rule of evidence giving prima facie validity to a document which is impressed with a corporate seal. However, the Draft Act also makes it clear that the use of a seal is voluntary, and documents signed in the ordinary way by authorized corporate officers are completely valid.

PART 5.00
Corporate Finance

97. Section 5.01(1) is new and departs radically from the present Act as well as from the legislation of most other jurisdictions. Most corporation legislation permits the issue of both par value and no par value shares.

98. Section 5.01(1) prohibits the issue of shares with par value because par values are arbitrary and misleading. If an investor buys 1,000 shares of $1 par value in a corporation with an issued capital of 10,000 shares of $1 par value the true measure of his investment is not $1,000 but a 10% share in the business, the value of which must necessarily fluctuate as the fortunes of the business change. He is unlikely to have paid exactly $1,000 for his shares, nor will $1,000 represent their current market value or liquidation value. A share is simply a proportionate interest in the net worth of a business. Par values obscure this reality, while the concept of a share without par value precisely embodies it (though the words no par value are, strictly, redundant). What matters to an investor is the proportionate size of his investment in a corporation, not the arbitrary monetary denomination attributed to that investment. Par value may be especially misleading to an unsophisticated investor. A share with a par value of $5 might well appear to be a bargain at $2, even though the share is in fact worthless. The following illustration of the dangerously misleading use of the par value concept is taken from a piece of sales literature which recently came to our attention; this literature is apparently circulating in Quebec although, we are told, it would be prohibited by most securities commissions in Canada:

> "At this stage of development we are inviting you and a limited number of others to participate with us in what we believe will be an exciting modern-day gold strike. (Name omitted) shares have a par value of $1.00; to those who join us in this field operation, the price will be discounted by 75%. In other words you will be able to purchase 1,000 shares for $250; 1,500 for $375; 2,000 for $500 and so forth."

At a time when it appears to be the policy of both government and the business community to encourage wider ownership by Canadians of shares in Canadian corporations, we think everything possible should be done to eliminate practices likely to mislead.

99. No par shares also give greater flexibility in arranging a corporation's capital structure. A corporation with no par shares trading at so high a price as to hinder their marketability can easily split these shares into a larger number of shares, each of which will still be of no par value. Correspondingly, if the market price has fallen below the issue price, a corporation can raise additional capital by issuing additional shares at the current market price without running into obstacles against the issue of shares at a discount, such as those contained in s. 16(2) of the present Act.

100. Another reason for abolishing the concept of par value is our wish to eliminate the accounting and disclosure problems which result from it. Much confusion has been caused in the past by such terms as "paid-in surplus", "contributed surplus" and "distributable surplus" which have been used to reflect the amount in excess of par value received by a corporation upon the issue of its shares. Terms like these have cluttered and confused many a corporate balance sheet. Par value leads to a great deal more confusion when corporations are allowed to purchase their own shares. Each such purchase leads to problems of accounting for and reflecting the "profits" or "losses" arising when the shares are purchased at prices different from par. As will be seen later in this Part, we have relaxed the traditional prohibitions against corporations purchasing their own shares. We have decided that this progressive step should not be marred by the accounting confusion which would result from retaining the archaic and meaningless concept of par value.

101. Section 12(6) of the present Act permits all shares, except redeemable shares or those having a priority as to return of capital on liquidation, to be without par value. Normally, shares which are redeemable or which give the holders a priority in liquidation provide for the payment of a sum no greater than the arbitrary par value or, sometimes, par value plus an additional "premium" expressed as a percentage of par value. In fact, the concept of par value is not needed to create redeemable shares or shares having a preference in liquidation. What is paid to a holder of such shares is, after all, a sum of money, not a legal concept. There is no reason why shares without par value cannot be created with the same terms. It is merely necessary to specify in the articles of incorporation the redemption or liquidation price, or the manner in which that price will be determined, upon redemption or liquidation.

102. The remaining subsections of s. 5.01 do not require extended commentary. If a corporation has more than one class of shares, the rights, restrictions and conditions applying to the different classes must be set out in the articles. If there is only one class of shares they must carry a right to vote. If there is more than one class, the shares of each class have the right to vote unless the articles otherwise provide, but there must always be one class carrying the right to vote in an election of directors and auditor.

103. Section 5.02(1) substantially reproduces the provisions of ss. 12(10) and 32 of the present Act. The changes are necessitated by the provisions of s. 5.01 (no shares with par value) and 5.05 (pre-emptive rights) of the Draft Act. Apart from the application of s. 5.05, this section is largely declaratory of the equitable rules governing the exercise of directors' power to issue shares: *Harris* v. *Sumner* (1909) 39 NBR 204; *Hilder* v. *Dexter* [1902] AC 474.

104. Subsections (2) and (3) of s. 5.02 substantially reproduce the provisions of s. 12(10a), (11) and (12) of the present Act. The Draft Act goes further, however, in that it requires shares to be fully paid before they are issued. With this rule, the concepts of "subscribers", "partly-paid shares" and "calls" are abolished. There is no need to retain these complexities; normal practice where shares would have a high issue price is to effect a share split so as to make the shares more readily marketable. Most securities commissions in Canada will not in any event allow shares to be issued to the public if those shares are only partly paid at the time of issue. The reason for this, of course, is that shareholders owning partly-paid shares can become liable to make further payments when "called" or suffer forfeiture of their shares. By issuing partly-paid shares, a corporation could therefore avoid securities commission scrutiny on what, in reality, is a fresh solicitation of money from the public. The shareholder is put into the position where he can be forced to put up more money almost at the whim of the issuing corporation or suffer the loss of all or part of what he has already invested. We can see no point in retaining in the law complications created by commercial practices which are no longer followed and which are widely prohibited already by other legislation.

105. Section 5.03 accomplishes two things. First, it legislates what is already good accounting practice by requiring a separate capital account to be maintained for each class and series of shares issued. Second, it embodies the rule found in s. 12(7) of the present Act that the total consideration received by a corporation upon the issue of a share is capital. Before the 1964-65 amendments to the present Act it was possible to allocate some of the consideration received on an issue of no par shares to a "distributable surplus" account. It is still possible under the present Act to allocate to such an account any amount received in excess of par value when par value shares are issued. Such "distributable surplus" may be paid out in dividends: *Drown* v. *Gaumont British Picture Corporation* [1937] Ch. 402.

106. In our view (supported by the Canadian Institute of Chartered Accountants) it is wrong to use the term "surplus" in this way. It is also wrong, we think, to allow the distribution as dividends of moneys received by a corporation upon an issue of shares. There have been cases where shareholders have been misled by such payments into thinking that the corporation was more profitable than it in fact was. We believe that all moneys paid for shares should be treated as capital by the issuing corporation and, if any part of such money is later returned to the shareholders, it should only be by way of a redemption or reduction of capital.

107. The concept of a distributable surplus arising upon an issue of par value shares is of course made impossible in the Draft Act by the elimination of par value shares. It might be observed, however, that the United Kingdom long ago barred the payment of dividends out of such surplus: *Companies Act,* 1948, s. 56. The Draft Act is therefore in accord with the more modern thinking expressed in the United Kingdom Act and in s. 12(7) of the present Act.

108. Section 5.04, like subsections (1b), (2), (3) and (4) of s. 12 of the present Act, permits the issue of shares in series. A "series" is a subdivision of a class of shares: s. 1.02(1)(w). The Draft Act does not explicitly limit the right to issue in series to shares having a preferred dividend right although, in practice, it is only in this case that the need to issue in series will normally arise.

109. Subsection (1) permits the directors to determine the rights, privileges, restrictions and conditions to be attached to a series of shares. Naturally, the directors' discretion can only be exercised within the terms set out in the articles for the particular class of shares whose subdivision into series is authorized. When a class of shares is established, or when the terms of a class of shares are to be varied, the consent of the shareholders is required. The details of the procedure required are set out in Part 14.00. There may be occasions, however, when the time necessary to effect an amendment under Part 14.00 will frustrate the issue of shares. A class of shares may be established with a 6% preferred dividend rate, for example, but by the time the necessary formal steps are completed such a dividend rate may no longer be attractive to the market. If the directors had the power to revise the dividend rate the shares could still be marketed.

110. The major problem in allowing shares to be subdivided and issued in series is to determine how much power should be given to the directors to vary the terms without reference to the shareholders. If, to pursue the same example, some of the 6% preferred shares had been issued in the past but the directors were empowered to increase the dividend rate to 8% on a subsequent series of the same class, the original shareholders, it might be argued, have been prejudiced and have not had the opportunity to vote against the revision of the dividend rate. Although the power to vary the dividend rate of preferred shares is likely to be the power most often needed by the directors, there could be occasions when it would be necessary or advisable to have the power to vary other terms.

111. Some jurisdictions have, by law, attempted to set the boundaries within which the directors of a corporation may manœuvre without reference to the shareholders. In North Carolina, for example, directors may only vary the dividend rate, the amounts payable on redemption or liquidation, conversion privileges, and sinking fund provisions.

112. After careful consideration we have concluded that it is the shareholders and not the law which should set the limits on directors' discretion in this area. Subsection (1) does require, however, that where the issue of shares in series is permitted, the articles must also set out the limits imposed on the directors. We believe that shareholders themselves are the best judges of what protection they require. Referring again to the example used above, shareholders in the circumstances there portrayed could well require the terms of any shares of a class already issued to be revised at the same time that the terms of a fresh series issue were established. Subsections (2) and (3) ensure that, whatever other differences there may be, all shares of the same class are equal upon liquidation or when dividend payments are in arrears.

113. Subsections (4) to (6) require that, once the terms of a series are established by the directors, those terms must be crystallized by an appropriate amendment to the articles. Once issued, therefore, the terms of the shares cannot again be amended by the directors alone, but only by the shareholders in accordance with Part 14.00.

114. Section 5.05 is new and reverses s. 32 of the present Act under which there appears to be no shareholders' pre-emptive right in the absence of express provision therefor. Under s. 5.05 a pre-emptive right is presumed in the absence of express provision in the articles limiting or excluding it. If there is no such provision, this section limits the powers conferred upon directors under s. 5.02(1).

115. The change is doubtless a controversial one. It is obvious that in the absence of a pre-emptive right (the better view being that there is no such right at common law: *Harris* v. *Sumner* (1909) 39 NBR 204; but see *Martin* v. *Gibson* (1908) 15 OLR 623 and *Bonnisteel* v. *Collis Leather Co.* (1919) 45 OLR 195) the power of directors can be used to dilute not only the voting strength of existing shareholders but, to the extent that directors have control over the price at which new shares are issued, their interest in the net assets of the corporation. While few would deny that existing shareholders are entitled to protection against such dilution, there are differences of opinion as to how that protection should be achieved. One view is that existing rules as to the fiduciary obligations of directors in issuing shares—for example those statutorily declared in s. 5.02(1)—afford adequate protection. Moreover, it is argued, flexibility in financing decisions demands that there should be no such condition imposed upon the power to issue shares, and the doctrine of pre-emptive rights, while arguably appropriate in days of simple capital structures, is quite inappropriate to complex modern corporations. Accordingly, it is argued, there should only be a pre-emptive right if shareholders, having deliberately directed their minds to the problem, so decide. (See generally, Drinker, *The Pre-emptive Right to Subscribe to New Shares* (1930) 43 Harv. L. Rev. 586). Acceptance of this view would mean retaining the principle of s. 32 of the present Act.

116. The counter argument, which has motivated the adoption of the principle embodied in s. 5.05(1), is that the equitable restraints to which directors are subject are notoriously imprecise, as any attempt to reconcile the authorities on this question shows—see the authorities cited above and *Hogg* v. *Cramphorn* [1967] Ch. 254; *Bamford* v. *Bamford* [1969] 1 A11 ER 969—and the determination of their applicability is a costly and undertain process. If a shareholder is to abandon his conceded right to certain protection against direct dilution of his voting power, this should be by deliberate exclusion of that protection. It should be noted here that shareholders have some protection against indirect dilution by virtue of the provisions of s. 14.03.

117. Subsection (2) of s. 5.05 merely makes it clear that the right conferred by subsection (1) does not apply in the cases listed, in all of which, for obvious reasons, it would be quite inappropriate.

118. The present Act does not specifically authorize the issue by a corporation of certificates evidencing conversion privileges, options or rights to purchase, except in s. 35 which uses the term "share warrants" to describe a kind of bearer share. In practise the term "warrant" seems to be used somewhat loosely, most often in the sense of rights to purchase shares.

119. In part 6.00 of the Draft Act we have developed a wholly new scheme of legislation for share ownership and transfer. Bearers of shares who are not registered holders are given rights which they do not now have at law, but the bearer share as such is not recognized. There is therefore no equivalent of s. 35 of the present Act in the Draft Act. Similarly, we have not given the term "warrant" a specific statutory meaning, but have recognized, in s. 5.06(1), that it is a commercial term used to refer to such things as rights to purchase.

120. Subsection (2) of s. 5.06 is self-explanatory. Subsection (3) requires a corporation which has granted conversion privileges or other rights to acquire shares to keep available a sufficient number of its authorized shares so that the holders of the rights can obtain the shares to which they are entitled upon the exercise of their rights. Obviously, subsection (3) will not apply to a corporation that has not fixed a limit on the number of shares it may issue.

121. The principle that a corporation cannot own its own shares was established in *Trevor* v. *Whitworth* [1887] 12 App. Cas. 409. The rule is now embodied in s. 16A of the present Act, with the prohibition extended to the acquisition of the shares of a corporation's holding corporation. Section 16A also makes some exceptions to the general rule. Other exceptions are in ss. 12(1a) and 61 which authorize the redemption of shares in certain circumstances, s. 48(6) which permits a company to purchase fractional shares, and s. 12A dealing with mutual fund shares.

122. Section 5.07 repeats, with some simplification of language, what is now contained in s. 16A of the present Act. "Holding body corporate" and "subsidiary" are defined in s. 1.02(5) and (6). The exceptions to the general rule that a corporation may not hold shares in itself or in its holding body corporation are spelled out in ss. 5.08, 5.09 and 5.10.

123. Those who object to any relaxation of the rule prohibiting a corporation from purchasing its own shares say that the practice impairs the corporation's capital and thus prejudices the rights of creditors. Section 61 of the present Act meets this objection by providing that redeemable shares—the only kind (except for "mutual fund shares") which a corporation can legally acquire—can only be redeemed out of the proceeds of a fresh issue of shares or by "freezing" an equivalent amount of surplus otherwise available for dividends. Section 12(1a) allows redemption "out of capital" if the redemption would not cause insolvency. In our view the s. 61 test is too strict, and the s. 12(la) test, while better, is marred by the meaningless reference to capital. "Surplus" and "capital" as used in these sections are out-of-date and misunderstood accounting concepts which only confuse.

124. Another objection is that to allow a corporation to purchase its own shares is to permit the directors of the corporation and other insiders to fortify their own control, discriminate amongst shareholders and generally enhance their own shareholdings at the expense of other shareholders. To some degree this second objection can be met, as is done in the United States, by providing that re-acquired shares ("treasury" shares in U.S. parlance) have no voting rights.

125. Finally, where the shares of a corporation are publicly traded, there are possibilities of market manipulation. Indeed, there are documented cases in the United States where corporate directors, using the corporation's money, have "rigged" the market in the corporation's shares.

126. We are conscious of these problems, but believe that the rules we have designed will prevent abuses. The various safeguards will be described in the following paragraphs. In the first place, we have distinguished between a purchase or acquisition of shares and a redemption of redeemable shares. Any acquisition of shares beyond that permitted by ss. 5.08, 5.09 and 5.10 must be effected as a reduction of capital under s. 14.04.

127. Section 5.08 allows a corporation to purchase or acquire shares in any case where it could apply the same amount of money in paying a dividend. The solvency test set out in subsection (2) is the same as that in s. 5.14. Thus, a corporation may not acquire its shares under s. 5.08 (or pay a dividend under s. 5.14) if the payment would render the corporation insolvent. Similar (but not identical) solvency rules are applied elsewhere in Part 5.00 and in ss. 14.17 and 19.04 to other transactions involving payments to shareholders.

128. Subsection (3) of s. 5.08 contains a valuation rule which is made an inherent part of the solvency tests used in the Draft Act. We acknowledge that there are risks in allowing unrealized appreciation in the value of assets to be used in measuring solvency. At the same time, however, the general rise in price levels in recent years has made it obvious that it is absurdly conservative always to insist upon the use of historical cost in valuing assets. Nor do we think it is practical to stipulate in a statute the kinds of assets or the circumstances in which cost or current market value is most appropriate. Judgment has to be used in each case, and we think that corporate directors should be allowed to use their judgment as to whether unrealized increments in value should be taken account of. It has long been accepted accounting and business practice to take account of unrealized losses and we therefore do not think it is necessary for the statute to pronounce a rule on this. It should be remembered, also, that corporate directors can be made personally liable under s. 9.16 for payments made in contravention of s. 5.08 and the other sections governing payments to shareholders. This should ensure that a corporation's financial position receives close scrutiny whenever transactions of this kind are under consideration.

129. The other aspect of s. 5.08(3) concerns depletion. Shortly stated, the reason why we say that depletion may be ignored is that it is usually not realistically measurable, and it is normally not taken into account in determining solvency. Section 83(4) of the present Act recognizes this, but the point is poorly expressed and is in any event confined to the determination of dividend paying capacity. It makes no sense to exempt mining corporations 75% or more of whose assets are wasting assets from the necessity of allowing for depletion. Other corporations, such as those extracting oil, natural gas or timber, also have depletable assets. Furthermore, the percentage of a corporation's assets which are of a wasting character is irrelevant. The point is that, because depletion is inherently such a problematical thing, it can safely be ignored in computing solvency by any corporation having any amount of depletable assets.

130. Section 5.09 allows a corporation which cannot satisfy the solvency test of s. 5.08(2) to acquire shares in certain narrowly prescribed circumstances if it can meet a slightly relaxed solvency test. Paragraphs (a) and (b) of subsection (1) correspond to s. 39(2) of the Ontario Act, and paragraph (c) covers another case in which a power to purchase shares will often be useful. Paragraph (d) and (e) empower a corporation to give effect to the remedies which are available to shareholders under ss. 14.17 and 19.04. The solvency test in s. 5.09(2) applies to payments falling under paragraphs (a) to (c) of subsection (1), but a still easier test is appropriate for payments made under paragraphs (d) and (e). That test is set out in ss. 14.17(26) and 19.04(6), respectively. Again, s. 5.09(3) states the valuation rule that applies to all these sections.

131. Section 5.10 recognizes the essential difference between the acquisition by a corporation of shares which were issued on the footing that they were redeemable and the acquisition of shares issued without that condition. In the case of redeemable shares the terms of the redemption have to be set out in the articles, and this information is available to all who deal with the corporation. There is therefore public notice of the fact that the corporation is empowered to reduce its capital by retiring redeemable shares. For this reason, it seems appropriate to say that only one condition should be attached to an acquisition of redeemable shares, and that is that the corporation should not thereby be made insolvent within the terms of subsection (2).

132. Under the scheme adopted in s. 5.10 it is no longer necessary to have special rules for "mutual fund shares", as in s. 12A of the present Act. The so-called mutual fund share is nothing more than a share that is redeemable upon the demand of a shareholder at a fluctuating redemption price. Such a share is embraced by s. 5.10 of the Draft Act. The solvency test in s. 5.10(2) should not impede the operations of sound mutual funds and will, we think, be a valuable regulatory measure in an area where concern has often been expressed. This is particularly true where a mutual fund operates partly on borrowed capital. Note that the valuation rule in subsection (3)—discussed above in the commentary to s. 5.08—is essential in s. 5.10 because mutual funds have to take account of unrealized appreciation in asset values when redeeming shares.

133. Section 5.11 provides, in subsections (1), (3) and (5), that upon an acquisition, redemption, conversion or alteration of shares, or a payment to a shareholder, stated capital in the corporation's accounts shall be reduced by an amount proportionate to what has been credited to stated capital upon the issue of shares of the same class or series. Section 5.03 requires that the entire proceeds of every issue of shares must be credited to stated capital, and s. 5.11 ensures that the stated capital account or accounts always represent what it is reasonable to consider the company has received and retained for its issued shares. The provision also lays down a clear and definite rule of accounting practice; this should prevent the confusion which has arisen in the United States over the proper accounting treatment of "treasury shares". The exceptions to this procedure specified in subsections (2) and (4) cover the cases where a purchase of shares has been made in circumstances where a dividend could have been paid instead. There seems no reason to require an adjustment of stated capital in these cases merely because the corporation has elected to characterize the payment as an acquisition of shares.

134. Further simplification is obtained by providing in subsection (6) that a corporation's re-acquired shares are cancelled or, if the corporation has an authorized number of shares, the re-acquired shares become, simply, authorized but unissued shares of the corporation. The shares so re-acquired may therefore not be sold, but the corporation may issue fresh shares in accordance with Part 15.00. These simple rules avoid the confusion that would result from the introduction of the U.S. concept of "treasury shares". This term is presently used in Canada (albeit loosely) to refer to authorized but unissued shares. In addition, the rule prevents the accounting and presentational problems of profits and losses arising from the re-sale of "treasury shares", and the multiplicity of surplus accounts found in the United States. Finally, s. 5.11(6) makes it unnecessary to specifically provide that re-acquired shares shall not have voting or dividend rights, and the re-issue of any shares which replace the re-acquired shares will automatically be within whatever provisions the corporation has adopted for shareholders' pre-emptive rights.

135. When shares are converted or altered so as to become shares of a different class or series there is a two-way effect. They cease to exist as shares of the old class or series and they become issued shares of a different class or series. Subsection (8) reflects this reality.

136. It is clear, we think, that there are ample safeguards against abuse of the right given to corporations to purchase their own shares, and, in addition, the system proposed is a logical and simple one. The carefully designed solvency rules meet one of the major problems. The rule requiring re-acquired shares to be cancelled eliminates the worry that directors can fortify their own positions by using the votes attached to those shares. It also reduces enormously the opportunity to manipulate the market in the corporation's shares because the re-acquired shares cannot simply be re-sold. Further, acquisitions of shares (except redeemable shares) are within the provisions of Part 11.00 governing insider trading. Re-acquired shares (or, more accurately, shares replacing the re-acquired shares) may be issued again, but this will be a fresh issue. Any provisions for pre-emptive rights will therefore apply to the new shares, as will all the rules of s. 5.02. Moreover, the issuing corporation may have to prepare a prospectus (or bring up to date an old one) under Part 15.00. Finally, a corporation is free to include in its articles of incorporation any additional restrictions or safeguards.

137. Section 5.11(9) re-enacts in a much shorter and, we hope, more intelligible form, s. 65 of the present Act. At common law, apparently, a corporation could not re-issue a debenture which it had previously redeemed: *In re George Routledge & Sons Ltd.* [1904] 2 Ch. 474. This is obviously not in accord with modern practice. Subsection (10) permits the common practice whereby corporations can acquire their own debentures and later pledge them as security for a fresh borrowing. In this way the new lender can be given, quickly and cheaply, the same security as the original lender.

138. Section 5.12 removes any doubt that may exist as to the enforceability of contracts providing for the purchase or redemption of shares by a corporation.

139. Section 5.13 is a very shortened version of s. 16 of the present Act. That provision requires that the corporate constitution not only authorize payment of commissions, but also specify the commission rate. This is unduly rigid since any alteration in commission rates would require an amendment to the articles, and it seems desirable to preserve a maximum of flexibility. Where a corporation issues its shares to the public the amount of the commission payable will, by regulation, have to be disclosed in a prospectus. Where corporations do not issue shares to the public it is unlikely that watering through excessive commission payments could be effectively concealed. Section 16(2) seems to be directed at preventing the issue of shares at a discount and other devious ways of avoiding the rules in subsection (1). We thought that the provision could safely be left out of the Draft Act because, for one thing, the question of discount does not arise with shares of no par value, the only kind permitted in the Draft Act. Moreover, ss. 5.02 and 5.13 both impose a standard on directors which should be capable of preventing improper share issues.

140. The law of dividends has been in a confused mess for years as a result of provisions like that of s. 83 of the present Act. Section 83(2), for example, uses a double test by saying that dividends should not be paid if the payment would render the company insolvent *or* if the company's capital would be impaired. There are at least two ways of viewing insolvency and the section does not say which is to be used. The concept of impairment of capital is singularly imprecise, particularly in view of case law saying that dividends can be paid out of current profits without first making up previous losses: *Ammonia Soda Co.* v. *Chamberlain* [1918] 1 Ch. 266.

141. Section 5.14(1) therefore sets out a straightforward formula for determining whether a corporation can pay a dividend. Again, it is a solvency test, the same as that in s. 5.08, that is propounded. The commentary to s. 5.08 is not repeated here.

142. The liability of directors for improper payment of dividends—s. 83(5), (6) and (7) of the present Act—is in s. 9.16 of the Draft Act, where it is combined with other aspects of directors' liability.

143. Section 5.15(1), like s. 83(2) of the present Act, authorizes share dividends and, in addition, the payment of dividends in kind. Subsection (2) is merely the accounting rule for the adjustment required to stated capital when a share dividend is paid.

144. In our opinion, it is implicit that dividends payable to a shareholder can be set off against debts owing to the corporation by the shareholder, and a provision like s. 83(8) of the present Act is not required.

145. Section 5.16 adopts the rule of s. 15 of the present Act that, except for the purposes described in subsection (5), a corporation shall not make or guarantee a loan to a shareholder or director, nor give financial assistance toward the purchase of its own shares. In addition, subsection (2) extends the prohibition to officers of the corporation and to "associates"—defined in s. 1.02(1)(c). The latter extension will frustrate a fraud that has been worked from time to time under which persons contrived to buy up a corporation's shares, financing the purchase through a nominee and using the corporation's money. A solvency test has also been introduced in subsection (3) to give a further safeguard.

146. The provisions of s. 15(4) of the present Act under which directors can be made personally liable for loans made in contravention of the section has been placed in s. 9.16 of the Draft Act.

147. Section 5.16(6) is new and is added to make it clear that the corporation and a bona fide lender will not be barred from enforcing a loan contract made in breach of s. 5.16.

148. Section 5.17(1) repeats the rule of s. 45(1) of the present Act. Subsection (2) of s. 45 becomes unnecessary because the concept of a partly paid share is abolished in the Draft Act.

149. Section 5.17(2) permits a corporation to secure a debt owing by a shareholder by a lien upon the shares of that shareholder. Under s. 43 of the present Act a shareholder who does not pay calls may forfeit his shares. In effect, the Draft Act extends this remedy to any debt owing by a shareholder to the corporation, if the existence of the lien is noted on the share certificate: see s. 6.02(8).

PART 6.00

Security Certificates, Registers and Transfers

150. The organization of the sections in this Part serves two purposes: to unite in one Part all the sections apposite to the registration and transfer of securities that are issued by a corporation under Part 5.00; and to maintain as far as possible the integrity of Article 8 of the U.S. Uniform Commercial Code—the origin of this Part—for convenience of cross reference. This structure can be seen more clearly in table form:

Topic	Sections	U.C.C.
Certificates, registers, and record dates	6.01 to 6.05	
General	6.06 to 6.08	8.101 to 8.107
Issue	6.09 to 6.13	8.201 to 8.208
Purchase	6.14 to 6.29	8.301 to 8.320
Registration	6.30 to 6.35	8.401 to 8.406

151. Section 6.01 sets out the definitions used in this Part, which are largely self-explanatory. Those definitions that offer some difficulty in the analysis of specific sections will be discussed in relation to those sections.

152. Sections 6.02 to 6.05 consolidate in one place the general rules relating to the form and effect of security certificates, the duty to maintain securities registers, the fixing of a record date, and the respective rights, duties and immunities of the corporation and its security holders in relation to securities. Although similar provisions are to be found in contemporary corporation laws, no existing law attempts to deal with all these problems in one integrated Part. In most statutes they are distributed at random throughout the Act. In those states that have adopted Article 8 of the Uniform Commercial Code, the provisions comparable with ss. 6.02 to 6.05 are contained in the corporation law, whereas the security transfer rules are contained in the commercial code, making it difficult to acquire an overview of the entire system in any one state. The consolidation in this Part attempts to overcome that problem.

153. Subsections (1) to (7) of s. 6.02 do not involve any radical departure from the present Act and are therefore largely self-explanatory. Subsection (2), however, empowering a corporation to charge a share transfer fee of $1, is new. Note that the fee is exigible only in respect of transfer and not original issue. The purpose of this provision is to discourage unnecessary transfers that require a large volume of handling and record keeping. Until a central depository is established to minimize these transfer problems, brokers and their customers will be inclined to deal in certificates endorsed in blank or registered in street form (in the name of a broker as owner) rather than pay the transfer fee. Clearly, if a substantial bloc of securities is involved, the transfer fee will represent only a nominal charge.

154. Subsection (8) of s. 6.02, consistent with the general concept of negotiability adopted in this Part, renders ineffective any purported restriction on the right to transfer the security unless the restriction is clearly set out on the security certificate.

155. Subsections (9) and (10) declare the shareholder's rights to obtain particulars of the rights, restrictions and conditions affecting his shares. To enable the shareholder to evaluate his position within the overall context of the capital structure of the corporation, these subsections require that he be furnished details both in respect of his shares as well as details concerning other classes and series of shares that the corporation is authorized to issue. Section 33 of the present Act limits this right to demand particulars to the class of shares held by the shareholder.

156. Subsections (11) to (13) set out provisions that permit the issue of fractional shares. These provisions are new. They are drawn to permit maximum flexibility, particularly in the case of amalgamations.

157. Section 6.03, which is similar to s. 108 of the present Act, sets out the duty of a corporation to maintain adequate records containing the details of each issue and transfer of a security. In subsection (1) the term "records" is used to ensure that a corporation may comply literally with the law. What is now called a stock transfer register (essentially a journal or book of original entry) is maintained according to the sequence of transactions, making alphabetical order impractical. On the other hand, the shareholder register (a subsidiary ledger relating to each security holder) is maintained alphabetically as a matter of course. The phrase "records" is thus broad enough to include both types of register. In any event the object of the Act must be met: the corporation must keep records setting out the required details.

158. The only novel provision in s. 6.03 is subsection (7), relating to the destruction of security certificates. The 6 year time period was selected for two reasons: first, because it corresponds to or exceeds the time limitation periods relating to contractual rights under provincial laws; second because it corresponds to the duty of the Registrar to produce certain documents under s. 20.14. The assumption behind this provision is that any ordinary claim will have arisen before the expiry of the 6 year period. In the event of an extraordinarily delayed claim, proof will have to be made by reference to the registers and to other evidence furnished by the parties to the dispute.

159. Adopting the pattern of the recently amended corporation laws of New York and Delaware, s. 6.04 abandons the archaic concept of closing the register and substitutes, instead, the technique of empowering the directors to fix a record date to determine which shareholders are entitled to receive dividends, to participate in liquidation distributions, and to receive notices of meetings. These provisions are quite straightforward, except in respect of notices of meetings, which can only be understood when related to other sections. Briefly, the rules operate as follows:

(a) The directors may fix a record date to determine the shareholders entitled to receive notice of a meeting, not more than 50 days nor less than 10 days before the date of the meeting: s. 6.04(2).

(b) A notice of meeting must be sent within these time periods to each registered shareholder included in the register on the record date, but whether or not he receives a notice the shareholder's right to vote is not affected: s. 11.03.

(c) A shareholder of a corporation that is required to solicit proxies under s. 12.03 is entitled to require the corporation to distribute a proposal he makes, if the proposal is submitted to the corporation before a record date relating to notices of the pertinent meeting has been fixed by the directors: s. 11.05(5).

(d) After fixing a record date for a notice of meeting the directors must prepare a list of the shareholders to whom the notice is sent. Each such shareholder is deemed entitled to vote his shares as shown on the register, unless he transfers the shares and the transferee notifies the corporation accordingly. Thus the corporation has no duty to seek out the transferee, but the transferee has the right to have his name added to the shareholder list (voter's list) at any time before the meeting: s. 11.06.

(e) A shareholder may revoke a proxy at any time before the pertinent meeting: s. 12.02(6).

(f) The directors may require that proxies be deposited at a time not exceeding 48 hours before the meeting: s. 12.02(7).

(g) A registrant (i.e. a broker holding shares for a customer) must forward a notice of meeting to the owner of the shares, requesting voting instructions. If no instructions are received more than 24 hours before the deadline for depositing proxies, the registrant may vote the shares at his discretion: s. 12.07(1).

(h) Finally, a corporation is required to send copies of its financial statements to each shareholder (and, in some cases, to the

Registrar) at least 10 days before the proposed meeting: ss. 13.05, 13.06.

160. Complementing s. 6.04, subsection (1) of s. 6.05 empowers a corporation to treat as the security holder the person who is recorded as such in the securities register. Subsection (1) is qualified by subsection (2), which requires a corporation to treat as a holder of record a person who furnishes proof that he is a fiduciary, a liquidator or trustee in bankruptcy. Because such a person is constructively entitled to exercise all the rights of a security holder, he may act in that capacity, notwithstanding that he has not been entered in the register as a security holder. The result is, where the articles of incorporation impose a restriction upon share transfers, even if registration has been held up pending the receipt of estate tax or succession duty consents or the consent of the directors to the transfer, a trustee in bankruptcy or a fiduciary may participate in the management of the affairs of the corporation. This prevents a gap in the continuity of legal administration of the corporation's business.

161. Subsection (3) allows a corporation to treat any other person as a security holder, notwithstanding that he is not the registered holder. Drafted in permissive terms, this subsection does not impose any duty upon the corporation to recognize such a person as a security holder. If, by doing so, it causes harm to a third person, it may be liable to compensate that person, since no immunity is provided in such a case.

162. Subsection (4) makes it absolutely clear that the corporation has no duty to see to the performance of any obligation of a security holder, particularly a fiduciary, owed to a beneficiary of a trust or other third person. Specific cases of this immunity are also set out in s. 6.37 in respect of securities transfers.

163. Subsections (5) and (6) are self-explanatory, empowering the corporation to deal with infants and joint holders of securities.

164. Subsection (7) is a modification of s. 39 of the present Act, setting out the mechanics for the transfer of corporate securities. When the applicant for registration of a security transfer fulfills the conditions of this section, the corporation has a clear duty to comply and to register the transfer. Subsection (8), drafted in terms of constructive authority, permits the corporation, with complete legal immunity, to register the security transfer and to treat the registered holder as the absolute owner of the security so transferred.

165. Section 6.05 is the last of the general provisions. Sections 6.06 to 6.35, following closely Article 8 of the Uniform Commercial Code, deal specifically with the issue and transfer of securities.

166. Starting from the fundamental premise that securities should be treated as negotiable instruments, the draftsmen of the Uniform Commercial Code scrutinized the Negotiable Instruments Law (based on the English Bills of Exchange Act as is the Canadian Bills of Exchange Act), to ascertain which provisions were applicable to securities transfers, omitting those not relevant, and adapting to the securities system those provisions that are pertinent. Like the Bills of Exchange Act, Article 8 of the Uniform Commercial Code is essentially a codification, that is, a closed system governing all aspects of securities transfers and registration. The U.C.C. provisions have two basic objectives: (a) to clarify the legal liability of all the parties to a securities transaction whether at the time of issue, transfer or registration; and (b) to expedite the registration process by clarifying and limiting the duty of the corporation and its agents to enquire into possible title deficiencies of the holder and possible adverse claims of third parties.

167. Article 8 of the Uniform Commercial Code does not attempt to set out any conceptual framework to explain the securities registration system. It cannot be equated with a deeds registration system, a Torrens title system, or a system governing the registration of security interests. It is unique. As a code, it purports to resolve all the ordinary problems of securities transfers by analogical extension of the Bills of Exchange Act, reconciling negotiability concepts, where essential, with the idea of a register. In effect, between registration dates a security, unlike a Torrens certificate of title, is a negotiable instrument, the bona fide purchaser in possession being the constructive owner who is entitled to become registered owner upon application.

168. Although Part 6.00 is relatively long, it is not especially difficult. Many of the provisions are an analogue of the Bills of Exchange Act, provisions that are familiar to all lawyers and to most registrars and transfer agents. This Part is, however, necessarily detailed because it is an ambitious attempt to clear up one of the murkiest areas of corporation law.

169. In the course of the preparation of this Part, questions were raised concerning the constitutionality of these provisions in a federal Act. Aside from the fact that securities are deemed to be negotiable instruments in this Part (and thus equated with bills of exchange,) it is clear that the security transfer rules are an integral, even an essential part, of any corporation law. Indeed, the use of transferable securities as a way to obtain capital is one of the three basic elements of the modern business corporation (limited liability, continuity, and transferable securities). Anyone preoccupied with static notions of encroaching on "property and civil rights" should bear in mind the admonition of Mr. Justice Rand in *A.G. of Canada* v. *C.P.R. and C.N.R.* [1958] SCR 285 at page 290:

> "Powers in relation to matters normally within the provincial field, especially of property and civil rights, are inseparable from a number of the specific heads of Section 91 under which scarcely a step could be taken that did not involve them. In each such case the question is primarily not how far Parliament can trench on Section 92 but rather to what extent are property and civil rights within the scope of the paramount power of Parliament. *Tennant* v. *Union Bank* [1894] AC 31, in which a provision under the Bank Act for taking securities for loans made by a bank in disregard of provincial forms of security and registration was upheld, is a characteristic example."

170. To describe in detail the provisions of Part 6.00 would require a very long commentary and might obscure the broad conceptual outline, therefore only the cornerstone sections are discussed. Two general comments warrant repetition: first, that these sections form part of a highly integrated, closed system; and second, that virtually every provision is an analogue of a provision in the Bills of Exchange Act.

171. As stated in the introduction to this comment, Article 8 of the Uniform Commercial Code (ss. 6.06 to 6.35 of the Draft Act) is divided analytically into four parts:

Sections	Topic
6.06 to 6.08	General
6.09 to 6.13	Relations between the issuer and the security holder.
6.14 to 6.29	Relations between a security holder and a subsequent holder (transferee).
6.30 to 6.35	The issuer's duty in respect of registration of security transfers.

The basic objectives of these provisions are:

(a) By adopting the concept of negotiability, possession of a duly endorsed security certificate is equated with ownership. Assuming there is no forgery, if a transferee of a certificate qualifies as a "bona fide purchaser" (a purchaser for value, in good faith, without notice of an adverse claim, who takes delivery of a bearer security or a security endorsed to him or in blank), he becomes owner of a negotiable instrument, free of any defences of the issuer, and free of any defect of title of a previous holder. In short, he is in the same position as a holder in due course of a promissory note.

(b) As a corollary, it follows that no charging order or notice of adverse claim presented to the corporation can detract from the unqualified ownership of the bona fide purchaser. He is absolute owner of the certificate and as such is entitled to demand registration of the transfer and issue of a new security in his name.

(c) The following sections distinguish clearly the conditions that might vitiate a holder's claim to ownership of a security:

   (i) A security is not "valid" if the corporation had no authority under its articles of incorporation or if it had not complied with the necessary corporate formalities to issue the security; but generally a defence of "invalidity" is not available to the corporation against a claim of a holder.
   (ii) An endorsement on a security is not "genuine" if it is forged. Forgery entitles the corporation to refuse to register a transfer, but if the corporation does register the transfer of a certificate presented by a purchaser for value without notice of an adverse claim, the corporation cannot recover the security or seek indemnity from the transferee.
   (iii) An endorsement on a security is not "effective" if made by an agent who acted beyond his actual authority. But the registered holder of the certificate cannot assert such ineffectiveness against a purchaser for value without notice of an adverse claim who received a new security on registration of transfer. If a purchaser—even a bona fide purchaser—does not apply for and obtain registration of transfer, his title may be impugned by the owner.

(d) By stating unambiguously who is an "appropriate person" to endorse a security, these sections limit narrowly the duty of a purchaser to make enquiries—even as to the power of a fiduciary—to acquire bona fide purchaser status. Of course, once the purchaser qualifies as a bona fide purchaser, he takes the security with all the rights of the seller, free of any adverse claim, but subject to s. 6.26(2).

(e) Consistent with this limitation upon the duty of a purchaser to enquire into the title of the seller, these provisions restrict the issuer's duty to investigate before registering a transfer to two cases:

   (i) where an adverse claimant has filed a stop transfer notice; and
   (ii) where the issuer has demanded excess documentation (e.g., an unnecessary partnership agreement or trust deed).

(f) Where an adverse claim does arise, the issuer does not have to make a judgment and hence is immune from liability. The duty of the issuer, instead, is to notify the applicant for registration of the adverse claim, leaving to the courts the problem of determining who is entitled to be registered holder.

172. Historically, the issuer has been compelled to scrutinize with great care all aspects of a security transfer—the capacity and authority of the transferor and the genuineness of each endorsement. This duty was further extended by the judicial doctrine of constructive notice, which enlarged considerably the purported knowledge of the issuer of an adverse claim. To protect itself the issuer was compelled to impose strict standards as conditions precedent to a transfer. Thus by these steps—declaring clearly when the issuer has a duty to register the transfer, specifying the assurances of proof the issuer may obtain, and limiting the issuer's duty to enquire into the internal administration of trusts, corporations and partnerships—these provisions aim at expediting the security transfer process. Under the Draft Act, the maximum delay, if an adverse claim arises, is the 30 day period during which an adverse claimant may take steps to establish his alleged prior rights.

173. To summarise, therefore, the share transfer provisions have the following general goals: (1), to minimize the defences the issuer might otherwise have against a holder; (2), to facilitate a transferee's becoming a bona fide purchaser (which limits the duty of the transferee to investigate the transferor's title, and which gives the transferee immunity from defects in the issue of the security or in the title of previous holders); and (3), to expedite the transfer process by limiting clearly the issuer's duty of enquiry and stipulating the issuer's duty to register transfers. A brief examination of the key sections show how these goals are reached:

s. 6.07 Securities are deemed to be negotiable instruments for the purposes of this Part.

s. 6.09 Except where a security is forged, once it has been issued the security must be honoured by the issuer when presented by a purchaser for value.

s. 6.11 Even an unauthorized signature by the issuer's agent cannot be invoked as a defence by the issuer. This section clearly abrogates *Toronto-Dominion Bank* v. *Consolidated Paper* (1963) 37 DLR (2d) 424.

s. 6.14 A bona fide purchaser (i.e., good faith, for value, certificate in proper form) acquires the security free of any adverse claim. This section gives to the bona fide purchaser the second of the two results of negotiability: he acquires absolute ownership, notwithstanding a defect in the title of his predecessor.

s. 6.17 A purchaser for value who presents a certificate and obtains registration of transfer becomes absolute owner of the new certificate, free of any claim by the issuer based on forgery of an endorsement (i.e., not genuine) on the certificate presented. The purchaser does warrant to the issuer, however, that he has no knowledge of an unauthorized endorsement. In addition, a transferor of a security warrants to the transferee that no endorsement on the security is forged (i.e., that it is genuine).

s. 6.19 This section serves two purposes: it states clearly who is an appropriate endorser and it declares how an endorsement may be made to render a certificate negotiable and, ultimately, registrable.

s. 6.20 Like a bill of exchange, transfer of a security certificate requires both proper endorsement and delivery.

s. 6.22 An owner of a security certificate may assert the ineffectiveness of a transfer on the ground of an unauthorized endorsement against the issuer or a transferee (other than a purchaser for value without notice of an adverse claim who applied for and obtained registration of transfer).

s. 6.23 This section, which declares specifically the duties of a signature guarantor, in effect provides the lubrication that keeps the wheels of the transfer system turning. Like an acknowledgment on a deed, it is assurance to the transferee and the issuer that the endorser is a real person who has the required capacity and authority to endorse.

s. 6.26 The owner of a security may recover a wrongfully transferred security from any holder except a bona fide purchaser. And even a bona fide purchaser—if he has not obtained a transfer—must give up a security that bears an unauthorized endorsement.

s. 6.28 This section is of strategic importance to the transfer system, making clear that no person can, by charging order or otherwise, obtain any priority over or charge against the interest of a security holder. To permit such execution would destroy the basic concept of negotiability between registration dates.

s. 6.29 This section, dealing with a central depository system is obviously too complex for analysis in this context. Its aim is to permit securities transfers by book entries, thus obviating the physical preparation and transfer of certificates. It goes, of course, one step beyond the clearing house, which still requires physical transfers of certificates to settle outstanding net balances.

s. 6.30 If the conditions stipulated in this section are fulfilled, the holder presenting a certificate is entitled to registration of transfer. Note that the issuer is not required to make any real value judgment; but he can refuse registration of transfer if the transfer is not rightful or if the presenting transferee is not a bona fide purchaser.

s. 6.31 Section 6.30 states, as one condition, that the applicant for registration of transfer must furnish reasonable assurance that such endorsement is genuine and effective. Section 6.31 limits the assurance that the issuer may require.

s. 6.32 Similarly, this section is integrated with s. 6.30, declaring what an issuer must do on receipt of an adverse claim. Note that again the issuer's function is to administer, not to make a value judgment. The issuer is required only to notify the interested parties of the claim, leaving to the courts the problem of deciding ownership. Some reservations have been expressed about this provision by transfer agents who fear that they may be flooded with spurious notices of adverse claims, for example, notices from judgment creditors. By definition a creditor does not have an "adverse claim". Indeed, he is even precluded by s. 6.28 from acquiring any interest in a security until he has acquired possession by execution. Subsection (4) of s. 6.32 is new. Designed to avoid clutter on the register, it requires that a continuing notice of adverse claim be renewed in each successive 12 month period.

s. 6.33 In very explicit terms this section states the liability and immunity of the issuer in respect of security transfers. From a practical point of view it is the immunity that is significant. If the issuer has not received notice of an adverse claim, and if the necessary endorsements were on the security (as verified by signature guarantees), the issuer cannot be held liable. In effect, the issuer is only liable where, through inadvertence, he registers a transfer on an endorsement of a fictitious person, a forged endorsement, or an unauthorized endorsement.

s. 6.34 The issuer may be exposed to liability for registration of a lost or stolen security, but this exposure is narrowly circumscribed by the requirement that the owner notify the issuer of the loss or theft within a reasonable time. Clearly, if bearer certificates or certificates endorsed in blank are stolen, a "reasonable time" is a very short time indeed. Consonant with this whole Part, the loss is to be borne by the person whose conduct made the loss possible.

174. Given the inherent complexity of security transfer problems—and the obvious need for uniform laws within the North American securities markets—it is unfortunate that the provisions of the recently enacted Ontario Business Corporations Act, 1970, ss. 63 to 97, depart in substance from the Uniform Commercial Code model which its draftsmen purported to adopt. Because it was designed as a tightly integrated system, any modification of the U.C.C. model not only detracts from but in effect destroys the system. By altering the concept of "bona fide purchaser", by deleting the provision that precludes charges on the register, and by amending drastically the latter provisions of U.C.C. Article 8 that set the issuer's duties in respect of registration of transfers, the new Ontario law in effect discarded the U.C.C. model and set out on a new course, adopting a variation of the present system of "quasi-negotiability" instead of the U.C.C. system of "negotiability". Clearly it would be preferable for all Canadian jurisdictions, acting in conjunction with the National Stock Transfer Committee of The Trust Companies Association of Canada, to adopt a uniform law that adheres as closely as possible to the U.C.C. model. Such co-operation on what is purely a technical as distinct from a policy problem would virtually eliminate very complex arguments based on constitutional powers or conflicts between local laws.

175. Some have deprecated the adoption of the U.C.C. model. For the above reasons we think that such adoption is obviously justified. And even if the language of the U.C.C. is frequently inelegant or the system sometimes lacks logical symmetry, U.C.C. Article 8 has two unassailable advantages: first, it is written in the language of transfer agents, reflecting business reality; second, it has worked for a considerable time in many jurisdictions without the need for substantial judicial interpretation. In the light of this experience, tampering with a demonstrably good model hardly appears warranted.

PART 7.00

Trust Indentures

176. Like Part 6.00 (Security Transfers), this Part and Part 8.00 (Receivers), raise basic constitutional problems, since the rights and duties referred to in these Parts are evidenced by contracts and certainly do affect civil rights. Again we refer to the comments of Mr. Justice Rand cited in the commentary to Part 6.00. It is self-evident that a corporation has the right to borrow funds by use of the legal institution of the trust indenture. Such a right is as vital to the existence of the corporation as the right to issue transferable shares.

177. It is clear that the federal Parliament is competent to enact laws providing for the incorporation of business corporations. It is also well established that where the federal Parliament has a general authority to legislate—for example, because the matter is within the federal jurisdiction as an interprovincial undertaking—it also has exclusive, specific authority to legislate in respect of any vital part of that undertaking: *Commission du Salaire Minimum* v. *The Bell Telephone Co. of Canada* [1966] SCR 767; (1966) 59 DLR (2d) 145. By analogical extension it follows that since an issue of debentures under a trust indenture is not only a necessary but a vital part of the issuing corporation's existence, the federal government has authority to legislate in respect of the terms of a pertinent trust indenture. And if it has authority to legislate in respect of a trust indenture, it also follows as a logical corollary that Parliament may enact legislation to regulate the conduct of a receiver appointed under a trust indenture. It would be an extraordinary proposition to assert that a provincial legislature could regulate all of the business and affairs of a federal corporation through the back door, simply because a trust deed provided for the appointment of a receiver in case of default and a default has actually occurred. If that was the case, innumerable conflicts of law would arise in determining the respective rights of the shareholders, the corporation, the trustee, the receiver and the security holders.

178. The Lawrence Committee, after describing briefly the contents of the U.S. Trust Indenture Act of 1939, concluded that similar provisions should be included in a contemporary corporation law. We concur. The objects of the U.S. federal law, set out on page 101 of the Lawrence Report are as follows:

> (a) To provide full and fair disclosure, not only at the time of original issue of bonds, notes, debentures, and similar securities, but throughout the life of such securities;
>
> (b) To provide machinery whereby such continuing disclosure may be made to the security holders, and whereby they may get together for the protection of their own interests; and

(c) To assure that the security holders will have the services of a disinterested indenture trustee, and that such trustee will conform to the high standards of conduct now observed by the more conscientious trust institutions.

179. The Ontario Act incorporates in ss. 57 to 62 the recommendations of the Lawrence Committee. While these provisions aim at the same goals as the U.S. Trust Indenture Act, they apply fundamentally different techniques. This draft also adopts some different techniques, therefore a brief overview of the key provisions of each Act is helpful.

Topic	U.S. Act	Ontario Act	Draft Act
(a) Qualification of trust indenture before S.E.C. required	Yes	No	No
(b) Qualification of trustee before S.E.C. required	Yes	No	No
(c) Conflict of interest prohibited	Yes	Yes	Yes
(d) Conflict of interest:			
(i) Expressly declared	Yes	No	No
(ii) Question of fact	No	Yes	Yes
(e) Court application to predetermine if conflict of interest	Yes (Rule 10b-3)	No	Yes
(f) Rights of security holder required to be set out in trust indenture	Yes	Yes	Yes
(g) Trustee's duty of care expressly declared	Yes (after default)	Yes	Yes
(h) Trustee precluded from exculpating self by contract	Yes	Yes	Yes
(i) Trustee barred from becoming receiver of same corporation		Yes	No (s. 8.01)

180. The Draft Act, like the Ontario Act, ignores the U.S. statute provisions requiring qualification of both the trust indenture and the trustee before the Securities and Exchange Commission, acting on the assumption that such provisions are unnecessary in the light of Canadian experience. If no distribution to the public is contemplated, then the creditor is sophisticated enough to protect himself. If there is to be a distribution to the public, the administrative body before whom the securities (that is, the prospectus) must be qualified will have adequate discretion to review both the qualifications of the trustee and the terms of the trust indenture.

181. Adopting a technique employed by the S.E.C. in Rule 10b-3 under the Trust Indenture Act, the Draft Act, instead of declaring specifically what is a conflict of interest (U.S. model) or setting out criteria that are subject to judicial interpretation (the Ontario Act refers in s. 58(2) to a "material" conflict of interest), enables a trustee to apply to a court either before or at any time after accepting a trust to determine whether a conflict of interest in fact exists. This procedure will be particularly useful, since the Draft Act, through the definition of "affiliate" and other related terms, could by construction create some rather tenuous conflict situations. An analogous provision is adopted in s. 13.10 to enable an auditor to establish whether or not he is "independent".

182. Like the U.S. Trust Indenture Act and the Ontario Act, the Draft Act contains a number of substantive provisions that must be set out in each trust indenture or that are deemed to be incorporated in the trust indenture. In general, these provisions are designed only to reflect what is now considered proper Canadian practice. In contrast to the U.S. law, however, the Draft Act provides for the prescription of further trust indenture contents by regulation, an approach that was considered undesirable by the U.S. Congress. See Loss, *Securities Regulation,* p. 735. We have concluded that such regulatory power is useful and at the same time is most unlikely to be abused. It is scarcely conceivable that a government would adopt regulations concerning such technical questions without having first discussed the issues fully with all parties concerned. See also the discussion of delegated legislation and the Statutory Instruments Act in the Introduction.

PART 8.00

Receivers and Receiver-Managers

183. Although not critically important in a corporations Act, we thought it was desirable for two reasons to adopt Part 8.00, which is roughly parallel to Part VI of the United Kingdom Companies Act, 1948. First, it clarifies the position of the receiver who is appointed by a court order or under a trust indenture to take over the assets of or to administer a corporation; and second, it makes uniform across Canada the law applying to receivers of corporations incorporated under the Act, particularly those appointed by virtue of a trust deed governing a debenture issue. Even in the Province of Quebec this should not pose any major problem, for although the term "receiver" is not used in Quebec law, the "sequestrator" referred to in the code of civil procedure (Art. 742 to 750) fulfils virtually the same function as a court-appointed receiver. If anything, this should clarify the law applicable to receivers appointed under the terms of trust deeds, which are very frequently employed in Quebec, and which almost invariably contain provisions referring to the right to appoint a receiver or receiver and manager in the event of default.

184. The sections in this Part are generally self-explanatory. Section 8.01, setting out the qualifications of a receiver, is parallel to s. 9.04 (quality standards to establish the eligibility of a director). In the first draft of s. 8.01 we disqualified a trustee under a trust indenture to which a corporation is a party from becoming a receiver in respect of that corporation. Influenced by the argument of Mr. Justice Hughes in the Atlantic Acceptance Report (pp. 1331 to 1342), we withdrew from that position and substituted instead a provision that permits a trustee to be appointed a receiver in relation to the same corporation, if the appointment is made or approved by a court.

185. Sections 8.02 to 8.06 clarify respectively the functions of a receiver as distinct from a receiver-manager and also state in general terms the rights and duties of a receiver or receiver-manager. These provisions are essentially declaratory of the common law.

186. Section 8.07 is novel, but it is consistent with the duties imposed by the Draft Act on directors (s. 9.19) and on trustees appointed under trust indentures (s. 7.09). Obviously, however, a receiver must be permitted to give special consideration to the interest of the persons on whose behalf he is appointed, who generally will be the creditors of the corporation, holding debentures issued under a trust deed. Section 8.07 makes it clear that, where there is no conflict of interest between the creditors the receiver represents and the shareholders, the receiver or receiver-manager has the same duty of care imposed upon him by law as a director would have in the same circumstances. Professor Gower added a similar provision in s. 240 of the Draft Ghana Corporations Code.

187. Section 8.08 is designed to make clear the personal liability of the receiver, a question that is not altogether clear under the common law. Consistent with the duties imposed upon promoters under the Draft Act, this section makes it clear that the receiver or receiver-manager is not personally liable if he discloses that he acts as agent of the corporation. Section 8.09 permits an application to a court for directions, following very closely the power of the court to give directions to a liquidator under s. 17.10(j).

188. Section 8.10 is a succinct variation of s. 375 of the United Kingdom Companies Act, 1948. Like s. 17.17(3) of the Draft Act, it enables an interested person to bring on an application compelling the receiver to expedite execution of the mandate conferred upon him.

189. Section 8.11 is also new. Recognizing the similarity in the functions of a receiver and a liquidator, it specifies in detail the duties of a receiver, which of course parallel closely the duties of a liquidator under s. 17.15. As a result, if a receiver ultimately becomes a liquidator there is a natural transition from the one function to the other, particularly in respect of his duty to render accounts.

190. In very general terms, the foregoing provisions are drawn to ensure that, in the event a receiver or receiver-manager is appointed on behalf of creditors, he will act in a way that will not be unfairly prejudicial to the other creditors and shareholders of the corporation. In theory, all the protective provisions of the Bankruptcy Act could be applied to govern a receiver appointed under a trust indenture, but that would require a very extensive reiteration of the Bankruptcy Act. We think that if the bankruptcy law is to apply to such cases, then the bankruptcy law itself should be amended to set out standards regulating the conduct of receivers or to empower a creditor of the corporation to apply under the Bankruptcy Act for administration under that Act. This recommendation is consistent with a similar recommendation in the recent Bankruptcy Report.

PART 9.00

Directors and Officers

191. Section 9.01(1) is a considerably simplified version of ss. 84(1) and 92 of the present Act. There is one important change. The wording of the present Act appears to lay down what might be called a statutory norm that complete power of management is vested in the directors and it would seem that in principle no departure from that norm is permissible—*Motherwell* v. *Schoof* [1949] 4 DLR 817—even if all shareholders agree to the departure: *Atlas Development Co. Ltd.* v. *Calof & Gold* (1963) 41 WWR 575. While there is authority to the contrary—*Ringuet* v. *Bergeron* [1960] SCR 672—the position is not entirely clear, and it seems desirable to clarify it. There seems no reason in principle or policy why shareholders should not be free to agree to a different structure of management, either by a provision in the articles, in the by-laws, or in a unanimous shareholder agreement. This more flexible arrangement is especially apt to the closely-held corporation, and is permitted by s. 9.01(1). If the statutory pattern is departed from in a shareholder agreement, the agreement will have to be unanimous, and will have to satisfy the requirements of s. 11.14.

192. It will be noticed that s. 9.01(1) by implication represents a change from the existing legislation, in that only one director is required, whereas the present Act (s. 84) requires a minimum of three directors. This change is a necessary consequence of the adoption, in s. 2.01 of the Draft Act, of the "one-man corporation".

193. Section 9.01(2) is designed to abolish the doctrine of constructive notice of limitations upon the authority of directors. There is some doubt whether that doctrine applies to limitations on the authority of directors of federally incorporated corporations. See Thompson, *Company Law Doctrines and Authority to Contract*, (1956) 11 U. of Toronto LJ 248; and Prentice, *The Indoor Management Rule*, in Ziegel (ed.), *Studies in Canadian Company Law*, 1967, pp. 310 to 313. Anyway, it is widely believed that the doctrine is commercially unrealistic, and accordingly it is abrogated by s. 9.01(2), which makes it plain that only actual knowledge of limitations on the apparent authority of directors will avail against persons dealing with them.

194. Section 9.02 is new, and is a significant departure from existing law. Under ss. 92 and 93 of the present Act, it appears that the directors alone may adopt or alter by-laws—*Kelly* v. *Electrical Construction Co.* (1908) 16 OLR 232; *Stephenson* v. *Vokes* (1896) 27 OR 691—subject only to confirmation by the shareholders. While it may be sensible to vest exclusive management powers in the directors, as the present Act does, there is nothing to be said for vesting in them the power to control the internal government of the corporation to the exclusion of shareholders.

195. Section 9.02 accordingly confers power upon shareholders not merely to sanction by-law changes proposed by the directors—subsection (2)—but also to initiate changes in the corporate structure: subsection (5). Where the directors do propose a change in the by-laws, they must submit the changes to the next meeting of shareholders, who may confirm, reject or amend any by-law proposed by the directors. If a shareholder wishes to propose a change in by-laws, he may if he wishes take advantage of the provisions of s. 11.05, which enable him to call upon the directors to circulate his proposal to the general membership. In the result, this scheme recognizes the realities of corporate management by placing residual control of internal government where it belongs—with the shareholders—but giving the directors power to administer the corporation from day to day.

196. Where the directors initiate a change in by-laws, the change will be effective until it is dealt with by the shareholders. If it is rejected, or amended, rights acquired under it are protected under subsection (3). If it is confirmed or amended, it continues to be effective as confirmed or amended from the date of confirmation or amendment: subsection (4). Subsection (4) also contains the salutary safeguard of s. 21(4) of the Ontario Act that prevents directors, if the shareholders reject a by-law, from immediately enacting another by-law substantially the same and thus circumventing the decision of the shareholders.

197. Section 9.03 is based upon an amalgam of the provisions of s. 52 of the Model Business Corporations Act and s. 404 of the New York Business Corporation Law of 1963. It introduces into Canadian law the entirely novel concept of an organization meeting of directors. In effect it obviates most of the elaborate and meaningless ritual, especially the fictitious series of organization meetings of first directors and shareholders, that characterizes organization procedure under the present Act.

198. Unlike s. 4.04 of the New York Business Corporation Law, which permits incorporators to hold an organization meeting whether or not they are directors, the Draft Act (like the Model Business Corporation Act, s. 52) empowers only the first directors to hold the organization meeting. If, therefore, the actual proposed shareholders are named as the first directors, then the organization meeting can reduce the clerical work surrounding organization to an absolute minimum. If, on the other hand, office incorporators are used, then after the organization meeting a further shareholders' meeting will have to be held to elect new directors. In addition, a new notice of directors will have to be filed in compliance with s. 9.12. Because of the novelty of the procedure in Canadian law, s. 9.03(1) lists the major items of business in the organization process in order to eliminate any doubt as to the breadth of the powers of the first directors.

199. Section 9.04 is largely self-explanatory. It does, however, make two important changes in the present law. The present Act does not specifically bar bodies corporate from acting as directors and, while there is no evidence of any widespread practice in Canada of having corporate directors, s. 9.04(1)(c) has been added to preclude this possibility. The case for such a provision is succinctly put by Professor Gower in his comment to s. 182 of the Draft Ghana Companies Code: "The objection to corporate directors is that, having 'no soul to be saved or body to be kicked', they should not be entrusted with any tasks involving personal duties of good faith and discretion." In any event, since corporate directors will always have to act through authorized human representatives, it seems more realistic to acknowledge this fact than to deny it.

200. Section 9.04(2)(a) abrogates the present statutory requirement that directors be shareholders, though the proposed provision does permit a share qualification to be imposed by the articles of incorporation. This approach is consistent with that now adopted in most Canadian provincial companies legislation, in the United Kingdom, and in many jurisdictions in the United States. Unless the share qualification is substantial, it is meaningless. In any event, this should be a matter for the incorporators to determine.

201. Canadian industry being what it is, it seems a futile gesture to impose a general requirement that directors of federally incorporated corporations should be citizens or residents of Canada. If, in a particular industry, it is thought desirable as a matter of government policy to insist upon such a qualification, this should be the subject of specific legislation.

202. Section 9.05 changes the law in several ways. Under s. 7(1)(k) of the present Act, the application for incorporation must set out the names of the proposed first directors, who are then named in the letters patent as the first directors and who, pursuant to s. 85, remain the directors until replaced. Section 9.05(1) of the Draft Act, read together with s. 2.02(1)(g), simplifies this procedure. Under the latter provision the articles of incorporation need only state the number (or minimum and maximum number) of directors, and under s. 9.05(1) a notice of directors in prescribed form is sent to the Registrar. The persons so named hold office until the first meeting of shareholders which, under s. 11.02 of the Draft Act, must be held within 18 months of the date of incorporation and may be called earlier. Generally, directors may only be elected at an annual meeting, although first directors can be replaced and other vacancies in the board may be filled at any time.

203. The present Act—s. 88(1)—imposes a maximum 2 year term on directors, except "class directors" who may hold office for 5 years. Subsections (2), (3) and (4) of s. 9.05 of the Draft Act permit 3 year terms and staggered terms so that continuity in the board can be assured. These provisions do not apply, however, where a corporation adopts cumulative voting.

204. Section 9.05(6) is designed to meet the situation in which one or more nominees for office named in an information circular pursuant to the proxy requirements in Part 12.00 cannot be elected because of subsequent disqualification, incapacity or death. In such cases the directors elected at the meeting, if a quorum, may act, but may not, under s. 9.10(1) fill the vacancy thus arising. This subsection is based upon the amendment made in 1970 to s. 84(4) of the present Act.

205. Section 9.06 has no counterpart in the present Act, although it has been Departmental practice to permit cumulative voting for directors where the applicants for incorporation so request. Section 9.06 makes express provision for cumulative voting as a matter of course, unless provisions excluding the right to cumulate are included in the articles of incorporation—see s. 2.02(1)(f).

206. The purpose of a cumulative voting system is to enable minority interests to obtain representation on the board of directors by permitting them to multiply the number of shares they control by the number of directors to be elected, and then to concentrate the total number of votes upon a single candidate or group of candidates, and thereby secure the election of their nominees. Since in the absence of a right to cumulate the votes of a simple majority will always be sufficient to elect, the efficient exercise of the right to cumulate may considerably enhance the protection available to minority interests. On the other hand, cumulative voting is somewhat controversial and may be thought more appropriate to small closely-held corporations where shareholder control is considered important than to large publicly-held corporations where stability and harmony in management is considered the dominant interest. For this reason, it is possible under s. 9.06 to exclude cumulative voting. Mathematical examples showing the effect of a cumulative voting system are given below in the commentary to s. 9.11.

207. The right to cumulate may be effectively defeated by a variety of devices such as rotating directorships and reduction in the number of directors. The former is precluded by paragraph (f) which requires the annual retirement of the entire body of directors, and the latter by paragraph (h) which limits the right to reduce the number of directors of corporations in which cumulation is permitted. Paragraphs (c) and (d) of s. 9.06 introduce a procedure for the election of directors that is novel in Canadian legislation. Under this provision, which is based upon comparable legislation in the United Kingdom—Companies Act, 1948, s. 183—and South Africa—Act 46 of 1926, s. 96—the election of every director must be the subject of a separate resolution, unless the shareholders first pass a resolution allowing more than one director to be elected by a single resolution. The purpose of this requirement is to prevent shareholders from being confronted wth the necessity to vote upon an entire slate of nominees for office, of only some of whom they may approve. This is a necessary part of the cumulative voting provisions. Paragraph (e) is designed to deal with a problem that may arise under this system if there is a greater number of candidates than there are offices to be filled. The procedure prescribed here is simply that the candidates receiving the lowest number of votes are eliminated, and the remaining candidates are declared elected.

208. Section 9.07 is self-explanatory. As to filling vacancies see s. 9.10.

209. Section 9.08 is new. It is based in part on s. 184 of the United Kingdom Act, and marks an important change in the law applying to federally incorporated corporations. At common law shareholders have no inherent right to remove directors before the expiration of their term of office; the power to remove must be expressly conferred, either by statute or by a provision in the by-laws: *Imperial Hydropathic Hotel Co.* v. *Hampson* (1882) 23 Ch. D 1; *London Finance Corporation Ltd.* v. *Banking Service Corpn. Ltd.* [1925] 1 DLR 319. Accordingly, unless specific provision authorizing removal is made, shareholders are powerless to remove a director with whom they have become dissatisfied. This was perhaps an appropriate rule in days when there was no clear distinction in fact or legal theory between managers and owners. In the conditions of modern business, however, and especially in large publicly-held corporations, the right of removal seems elementary and necessary, and should not depend upon fortuitous provision for removal in the corporate constitution. Section 9.08(1) accordingly provides for the right to remove by ordinary resolution. This right is, however, subject to two conditions..

210. It would clearly make nonsense of the right to cumulative voting conferred by s. 9.06 if, where this right exists, a simple majority of shareholders were able, by ordinary resolution, to remove a "minority" director elected through successful cumulation. Section 9.06(g) accordingly protects the right of cumulation against destruction by providing that the resolution to remove in such corporations will only be effective if fewer votes are cast against it than would be required to elect a single director at an election in which the full complement of directors were being elected, and the same total number of votes were cast.

211. Subsection (2) of s. 9.08 is designed to protect any class or series right to elect directors. It is self-explanatory. In practice, it will be possible to remove a director only at a special meeting, that is, a meeting other than the annual meeting—see s. 11.02. All business transacted at a special meeting is special business, the notice of which must state "the nature of that business"—s. 11.03(5), (6)—and must, by s. 9.09, be sent to any director in respect of whom a resolution to remove is proposed. Moreover, the director is entitled to attend and be heard at any such meeting (and at any meeting called to appoint or elect his replacement) and he may also require the corporation to send a statement of his to the shareholders: s. 9.09(1), (2), (3). This procedure is important not only in the interests of the director himself, so that he may have an adequate opportunity to state his case, but also in the interests of the shareholders generally, since the removal power can obviously be used for both legitimate and illegitimate purposes. Section 9.09(4) protects the corporation where a director's statement is defamatory.

212. Section 9.10 is a substantial elaboration of the provisions of s. 90(c) of the present Act. Unless, pursuant to subsection (4), the articles of incorporation provide that vacancies among the directors may only be filled by shareholder vote, the normal procedure for filling such vacancies will be that prescribed by subsections (1) and (3).

213. In the ordinary course of events a quorum of directors may fill a vacancy. If there is no quorum able to act then, by subsection (2), a special meeting of shareholders must be called for the purpose. This procedure will not apply, however, in three cases. The first is where the vacancy arises from an increase in the number or minimum number of directors. Since it is hardly possible to speak of a "vacancy" unless an office has been filled and vacated, this exception is possibly unnecessary. It has been included for the sake of completeness. In any event, since the power to increase the number of directors is specifically reserved to the shareholders under s. 9.11, it seems logical to reserve to them the right to fill the positions created by such an increase. The second is where the vacancy arises from a failure to elect a full slate of replacements for retiring directors. At common law, a vacancy arising in this way would not be regarded as one capable of being filled as a casual vacancy—*Munster* v. *Cammell Co.* (1882) 21 Ch. D 183—and this position is preserved under the Draft Act. If the directors were empowered to fill vacancies arising in this way there would be an obvious loophole in the system of elections to office. The exception in s. 9.10(1) is designed to block this avenue for manipulation, and protect the shareholders' right to elect directors. Moreover, without this exception, the requirements of s. 12.06(1)(e) as to disclosure in proxy circulars about candidates for office could readily be evaded. The third exception is where the vacancy arises among the directors elected pursuant to any special right to elect directors conferred upon the holders of some class of series of shares: s. 9.10(3).

214. Section 9.10(4) is self-explanatory. There is no reason why shareholders should not agree that they alone should have the power to fill vacancies among the directors, especially in small closely-held corporations, and subsection (4) permits this to be done. Subsection (5) reproduces the effect of s. 90(c) of the present Act.

215. Section 9.11 reproduces the effect of s. 87(1) of the present Act with some modifications. Since, under 2.02(1)(g), the articles are required to state the number or, where there is cumulative voting, the minimum and maximum number, of directors, any change in that number will require an amendment of the articles in accordance with s. 14.01. It should be remembered that directorships created as a result of an increase in the number of directors can only be filled by the shareholders; they are not "vacancies" under s. 9.10.

216. Section 9.11 is subject to paragraph (h) of s. 9.06. The proviso is necessary to protect the right to cumulative voting. It is obvious that the smaller the number of directors in a corporation, the greater the proportional shareholding required to elect one director. The formula for determining the number of votes required to elect a single director is:

$$\frac{\text{Total number of votes that can be cast}}{\text{Number of directors to be elected} \quad + 1} + 1 = \times$$

Thus, in a corporation in which there are 9 directorships to be filled and 30,000 shares, the number of votes required to elect a single director is:

$$\frac{9 \text{ x } 30{,}000}{9 + 1} + 1 = 27{,}001$$

which is approximately 10% of the votes. If, however, the number of directors is reduced to 5, the number of votes required to elect a single director would be:

$$\frac{5 \text{ x } 30{,}000}{5 + 1} + 1 = 25{,}001$$

which is 16%; and if the number of directors is reduced to 3, the number of votes required will be 22,501 out of 90,000, that is, about 25%. Mathematically, cumulative voting will not work unless there are at least 3 directors. Reducing the number of directors thus makes it much more difficult for a minority interest to employ the right to cumulate, and dilutes its value to them. They are entitled to protection against this, and the qualification to s. 9.11 gives that protection.

217. Section 9.12 does not require a great deal of explanation. It merely follows through the idea of s. 9.05(1), and ensures that there will always be public notice of who are the current directors of a corporation. By s. 20.01 an address shown in a notice of directors is an address for service.

218. Section 9.13 is new, but is largely self-explanatory. Subsection (3) reflects what is probably the common law rule: *La Compagnie de Mayville* v. *Whitely* [1896] 1 Ch. 788. Subsection (4) reverses the general common law rule that a director cannot waive his right to receive notice of a directors' meeting: *Young* v. *Ladies Imperial Club* [1920] 2 KB 523.

219. Section 9.14 is new. In the absence of express or implied authority, directors have no power to delegate the exercise of their powers: *Monarch Life Assurance Co.* v. *Brophy* (1907) 14 OLR 1. The present Act does authorize, in s. 94, delegation to an executive committee of directors if a corporation has more than six directors. This seems an entirely arbitrary and senseless condition, and is accordingly abandoned. Whether the present Act permits delegation in other circumstances—for example, s. 92(d)—is not clear, and we have therefore included a general authority to delegate.

220. Nevertheless, there are certain aspects of management that are sufficiently important to warrant the attention of all directors and s. 9.14(2) accordingly declares these to be non-delegable.

221. Section 9.14(3) is included to make it clear that directors cannot escape liability for negligence—see s. 9.19(1), for example—by relying upon the delegation of power to a managing director. This aspect of the leading case of *Re City Equitable Fire Insurance Co.* [1925] Ch. 407 is therefore abrogated.

222. Section 9.15, which gives statutory sanction to a provision frequently inserted in corporate by-laws, is new. It will be particularly useful to small corporations where formal meetings are usually unnecessary. A formal meeting will be required, however, where an auditor is to be appointed to fill a vancancy in the office of auditor, because the incumbent auditor is given a right by s. 13.14 to attend the meeting and make representations. Section 11.10 contains a similar provision to allow meetings of shareholders to be dispensed with.

223. Section 9.16 extends and elaborates the principle of s. 83(5) and (6) of the present Act. Under those provisions, directors who vote for a dividend when the corporation is insolvent, or the payment of which renders the corporation insolvent or impairs its capital, incur a statutory liability, as do those who are present when such action is taken, unless they take certain specified exculpatory measures. Section 15(4) contains a similar rule where improper loans are made. Subsection (1) and (2) of s. 9.16 of the Draft Act extend this principle to a number of other situations specified in the section, while subsection (3) prescribes the procedure to be followed by a director who dissents from any of the acts mentioned.

224. Section 9.16(5) is new. Gower, in *Modern Company Law*, 3rd. ed., 1969, at p. 551 remarks that "Though it is said that (directors) ought to attend these meetings (of the board) whenever they can, the cases suggest that this is little more than a pious hope. As in other walks of life, if anything is going wrong there are great advantages in 'not being there'". See also *Re Dominion Trust Co.* (1917) 32 DLR 63. Subsection (5) is designed to make it clear that absence from meetings at which important decisions affecting the corporate financial structure are made will not per se relieve the absent director of his statutory liability under this section.

225. The remaining subsections of s. 9.16 set out the right of a director to recover from the other directors or from the shareholders who received money to which they were not entitled, and the circumstances in which directors will not be liable under this section.

226. The common law, although it was very indulgent toward majority shareholders, was absolutely strict in its treatment of a director having an interest in a contract with the corporation of which he was a director. The common law rule was that a contract between an interested director and a corporation of which he was a director was void and the director had a duty to account to the corporation for any profits he received, irrespective of how fair the contract was to the corporation: *Aberdeen Railway* v.

Blaikie (1854) 2 Eq. 1281. But at the same time the common law recognized that there was no legal limitation upon what the parties could agree to in the articles of association, therefore draftsmen tended to employ articles which waived the obligation of the director to disclose his interest, permitted the director to vote in respect of a contract in which he had an interest, and absolved the director altogether from any duty to account for profits he made on the contract. Such articles had become so widespread before 1929 that the Companies Act was amended that year to include what is now s. 199 of the United Kingdom Companies Act, 1948. Section 199, when compared with other contemporary corporation Acts, really covers only one aspect of the problem: it focuses almost entirely upon disclosure of the interest in the contract, leaving to the common law the sanction to be imposed in the event of non-compliance by an interested director. Section 96 of the present Act is obviously based on s. 199 of the United Kingdom Act, but it has been expanded to limit the rights of an interested director to vote and to declare when a director is not accountable for profits he has made on the contract with the company.

227. Section 9.17 of the Draft Act also takes s. 199 of the United Kingdom Act as a point of departure. In fact, the Draft Act provision is a composite of the standards set out in the New York Business Corporation Law (s. 713) and the Delaware General Corporation Law (s. 144), both of which are adaptations of s. 820 of the California General Corporation Law, and the standards developed by the common law: *Gray v. New Augarita Porcupine Mines Ltd.* (1952) 3 DLR 1.

228. Section 9.17 has two objectives: first, to stipulate the conditions that must be fulfilled by a director having an interest in a contract with the corporation; and second, to declare that if the director does fulfil these conditions, the contract is not void and he has no liability to account for any profit he may make under the contract. Particularly noteworthy is the overriding criterion that the contract be "reasonable and fair to the corporation", which is necessary to preclude mutual "back-scratching" by directors who might otherwise tacitly agree to approve one another's contracts with the corporation. Of course directors who indulge in such conduct will be liable under the general provisions of s. 9.19 in any event. And any abuse by majority shareholders can be resolved by the remedies provided in Part 19.00. The "reasonable and fair" standard set out in subsection (3)(c) serves only to underline the director's specific duties in the circumstances.

229. Subsection (1) gives the particulars of the disclosure required. The subsection is broad in scope, requiring disclosure of both the nature and the extent of the director's interest in a contract, adopting the principle set out in *Gray* v. *New Augarita Porcupine Mines Ltd., supra.* The subsection is also broad in application, requiring disclosure both from a director who is himself a party to a contract or who has a material interest in a person who is or proposes to be a party to a contract with the corporation. The broad definition of "person" in s. 1.02(1)(p) extends the application of this section even further.

230. Subsection (2) is self-explanatory. Similar rovisions are contained in both s. 199 of the United Kingdom Act and s. 96 of the present Act.

231. Subsection (4) states clearly that a director may not be counted for the purpose of determining a quorum and he may not vote to sanction a proposed contract in which he has an interest, except in the specific cases enumerated in that subsection.

232. Subsection (5), following s. 96(3) of the present Act, permits an interested director to give a general notice to the corporation, rendering unnecessary a new notice each time a contract is entered into with a person in which the director has a material interest. This is a particularly useful provision because of the broad application of subsection (1) which includes both directors and officers.

233. Subsection (6), however, is new. In the absence of such statutory sanction, if a director fails to make the disclosure required under subsection (1), and thus fails to fulfil the conditions of subsection (3), he has no immunity from the harsh common law rules which render the contract void, and which impose upon the director the duty to account for any profit he has made irrespective of the "fairness" of the contract to the corporation. To ensure that a contract beneficial to the corporation will not be declared void because of the interest of a director, subsection (6) makes clear that such a contract is valid until the corporation or some interested person opts to set the contract aside. In short, the effect of subsections (3) and (6), although they allow contracts that might be void at common law to be valid, is to furnish a very strong incentive to a director to disclose his interest in a contract with the corporation of which he is a director before the contract is entered into.

234. Paragraph (a) of s. 9.18 is the counterpart of s. 92(d) of the present Act. The only significant change is that, in accordance with the policy adopted throughout the Draft Act, the power of the directors to appoint officers is made subject to variation under the articles, the by-laws or a shareholder agreement. See the commentary to s. 9.01.

235. Paragraph (b) of s. 9.18 is new, and is designed to make it clear that the common law doctrine of "incompatibility of offices"—*Iron Ship Coating Co.* v. *Blunt* (1868) LR 3 CP 484—does not apply to federally incorporated corporations. Paragraph (c) is also new. Many statutes provide that the offices of president and secretary may not be held by the same person. This provision appears originally to have been designed to ensure that where, for example, the by-laws required some act to be done on behalf of the corporation by the president and secretary, it should not, as a precaution, be done by the same person acting in both capacities. There is no reason why, if shareholders choose to simplify their operations, they should not be free to minimize formalities, and paragraph (c) permits this.

236. Section 9.19 is new and represents a general statutory formulation of the principles underlying the fiduciary relationship between corporations and their directors. The Jenkins Committee, while opposing an attempt at codification of directors' duties, took the view that some such general statement was desirable as possibly "useful to directors and others concerned with company management": Jenkins Report, para. 87. The Lawrence Committee, in one of the more opaque passages in its Report paras. (7.1.7, 7.2.1, 7.2.3.), took a similar view. Although the Jenkins Committee's recommendation has not been acted upon, the Lawrence Committee's proposal, which varies only slightly from s. 9.19(1), has been adopted in s. 144 of the Ontario Act.

237. In so far as the general duty of loyalty and good faith is concerned, this section is simply an attempt to distill the effect of a mass of case law illustrating the fiduciary principles governing the position of directors. Those principles have long since been accepted by courts in Canada: see, for example, *Sun Trust Co.* v. *Begin* [1937] SCR 305; *Peso Silver Mines Ltd.* v. *Copper* (1966) 58 DLR (2d) 1. Section 9.19 does not purport to answer in advance the manifold problems involved in assessing the facts of particular cases. Its purpose is simply, and perhaps gratuitously, to give statutory support to principles that are as difficult to apply as they are well understood.

238. There is one respect in which this formulation may work a change in the existing law, and that is in relation to the so-called "collateral purpose" or "abuse of power" doctrine. Briefly stated, this doctrine is that, "if directors exercise their powers for purposes other than those for which they were conferred, it may be said that they have exceeded their authority and are liable accordingly. . . .Thus directors will normally be authorized to issue further capital but they will be liable if they exercise this or any other power for the purpose of maintaining their control of the company, and this notwithstanding that they honestly believe that to be in the best interests of the company.": Gower, *Modern Company Law,* 3rd. ed., 1969, p. 524; see also *Hogg* v. *Cramphorn Ltd.* [1967] Ch. 254; *Bamford* v. *Bamford* [1969] 1 All ER 969.

239. Until recently the English courts seem to have taken the position that an exercise of power for a "collateral purpose" by the directors was a breach of duty, and any action taken pursuant to it was void. Thus, in the second edition of his book, Professor Gower took the view that such a breach of duty could not be ratified: *Modern Company Law* 2nd. ed., 1957 p. 476. Recently, however, the English courts have held such exercises of power for a collateral purpose to be ratifiable by the shareholders in general meeting: *Hogg* v. *Cramphorn*; *Bamford* v. *Bamford, supra*; and the latest edition of Professor Gower's book reflects that change. Without s. 9.19 Canadian courts would probably follow the English decisions.

240. While the new view on this matter may be satisfactory in result it seems to us analytically tortuous, and we have accordingly adopted in s. 9.19(1)(a) the simple test of whether the power was exercised "honestly and in good faith with a view to the best interests of the corporation". The effect and purpose of this more direct approach is, of course, to eliminate the "collateral purpose" doctrine, and to enable courts to deal with these cases on a more rational basis, giving due regard to all the relevant interests at stake. To this extent, therefore, the existing law is changed, not in result, but in approach. The Australian courts have already come to this position without the benefit of statutory intervention—see, for example, *Harlowe's Nominees* v. *Woodside Oil Co.* (1968) 42 ALJR 123—and provide a useful starting point for Canadian judicial approaches to these questions.

241. No attempt has been made in s. 9.19(1)(a) to give precision to the notion of "the best interests of the corporation". We agree with the view taken by Professor Gower in his Draft Ghana Companies Code, that "on the whole . . .it is probably better to leave the law to develop in the hands of the judges": Ghana Report, p. 146. The abandonment of the ultra vires and collateral purpose doctrines in that Code and the emphasis upon good faith in s. 9.19(1) (a) seem to leave the way free for directors to take into account whatever factors they consider relevant in determining corporate policies, and for the courts to escape from the constraints of what has somewhat charitably been described as the "anachronistic" view that has developed in the English courts: see Gower, *Modern Company Law,* 3rd. ed., 1969, p. 522.

242. The formulation of the duty of care, diligence and skill owed by directors represents an attempt to upgrade the standard presently required of them. The principal change here is that whereas at present the law seems to be that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him, having regard to his knowledge and experience—*Re City Equitable Fire Insurance Co.* [1925] Ch. 425—under s. 9.19(1)(b) he is required to conform to the standard of a reasonably prudent man. Recent experience has demonstrated how low the prevailing legal standard of care for directors is, and we have sought to raise it significantly. We are aware of the argument that raising the standard of conduct for directors may deter people from accepting directorships. The truth of that argument has not been demonstrated and we think it is specious. The duty of care imposed by s. 9.19(1)(b) is exactly the same as that which the common law imposes on every professional person, for example, and there is no evidence that this has dried up the supply of lawyers, accountants, architects, surgeons or anyone else. It is in any event cold comfort to a shareholder to know that there is a steady supply of marginally competent people available under present law to manage his investment.

243. Section 9.20, dealing with the indemnification of directors and officers of a corporation, raises one of the most complex and most controversial problems of contemporary corporation law. Reflecting this conflict of policies, there exists such a bewildering number of models in current statutes that no simple composite section is possible.

244. Probably the most comprehensive statutory provisions are those set out in ss. 721 and 726 of the New York Business Corporation Law. In addition to being far more detailed than English and Canadian law, they create an exclusive regime that applies to every New York business corporation irrespective of any other provisions contained in the corporation's articles or by-laws. Although much influenced by the New York model, s. 9.20 does not adopt its policy of setting up an exclusive statutory regime. Rather, this section represents a selection of the better provisions of the various contemporary laws, which are imposed by law upon every corporation to which the Draft Act applies. A corporation may, however, impose a stricter regime by its articles, by-laws or through a shareholder agreement. In fact, the specific policies reflected in s. 9.20 are very comprehensive: first, the provisions apply to former and present directors and officers and also nominee directors who represent a corporate shareholder; second, the provisions cover actions of all kinds—civil, criminal and administrative; third, the provisions distinguish between different procedures, individual actions against persons sued in their capacity as directors or officers, and derivative actions in the name of the corporation against their directors or officers; and fourth, except in respect of derivative actions, the provisions provide for indemnity not only for costs but also for amounts paid to settle an action or to satisfy a judgment.

245. The criteria that directors and officers must fulfil to qualify for indemnity varies with each statute. Some examples of these standards relating to indemnity are as follows:

(a) A corporation may indemnify if there is no wilful neglect or default (Canada Corporations Act, s. 91).

(b) A corporation may indemnify a director adjudged not liable of negligence or of a breach of his duty or if he has obtained a judgment in his favour. (U.K. Companies' Act 1948, s. 488 and Art. 136). But note that this same statute strictly limits the indemnity that the company may pay to an officer or auditor of the company (s. 205).

(c) A corporation may not indemnify a director or officer who has been adjudged liable for negligence or misconduct (Model Business Corporation Act, s. 4 (o)).

(d) A director has a right to demand indemnity from the corporation if he is successful in his defence (New York Business Corporation Law, s. 724).

246. Subsection (1) confers very broad powers on a corporation to indemnify a director or officer who is sued in his capacity as a director or officer by a person other than the corporation of which he is a director or officer. The only standards he must fulfil are, in a civil action, that he acted honestly and in good faith with a view to the best interests of the corporation and, in a criminal action or administrative proceeding, that he had reasonable grounds for believing that his conduct was lawful. The practical limitation upon any abuse of these powers of indemnity is the explicit provision that no indemnity can be paid until it has been approved by a court.

247. Subsection (2), which refers to a derivative action in the name of the corporation against its directors or officers, sets up several tests in addition to the general standards of subsection (1). Note that the indemnity here does not include amounts paid to settle an action or to satisfy a judgment. The implied premise of this subsection is that if a derivative action in the name of the corporation has been brought against a director or officer, he has probably not been acting in the interests of the corporation and therefore his conduct should be more closely scrutinized. This is particularly true in respect of settlements of actions where directors, having in their own interests profited from dealings that were prejudicial to the corporation, then seek indemnity from the corporation because they are compelled to settle a derivative action alleging that misconduct, a practice that has been appropriately castigated as "double looting" in some U.S. jurisdictions. Subsection (2) also requires court approval as a pre-condition to payment.

248. As another safeguard against abuse, subsections (6) and (7) allow the Registrar and, if the court thinks it appropriate, any other interested person, to appear and be heard upon an application for approval of an indemnity payment. Subsection (3) says that a director or officer may claim indemnity from a corporation as a matter of right where he has been wholly successful in his defence of an action brought against him in that status.

249. Certainly the most controversial provision in this section is subsection (4), permitting a corporation to purchase directors' and officers' liability insurance covering cases in respect of which the corporation itself could not have indemnified the directors or officers, because the misconduct constituted a breach of the standards set out in subsections (1) and (2). Similar provisions have been recommended by the draftsmen of the Model Business Corporation Act (s. 4A) and have been adopted in the Delaware General Corporation Law (s. 145). A version of this provision has also been adopted in the Ontario Act (s. 147), qualified to preclude coverage where the director or officer is in breach of the general duty of care specified in s. 144. This qualification appears to negate entirely the purpose of obtaining the insurance, for there is virtually no other conduct in respect of which a director or officer could be sued and could obtain indemnity under an insurance policy.

250. Some writers have severely censured these provisions, arguing that they not only conflict with but derogate seriously from the statutory standards. See, for example, Hornstein, *Corporation Law & Practice,* Supp., s. 733. These criticisms have validity if no account is taken of the insurance policies that are available. But they largely beg the question by assuming that insurers are in business only to shield directors and officers from liability for their own misconduct. In fact, the insurers are in the business to make a profit, and of course they must qualify the coverage they offer in order to achieve that goal. To limit abuse by directors and officers, the insurers, under both standard form policies now on the market, stipulate for a very large deductible (usually $20,000 for each loss) and for a form of co-insurance (the insured pays 5% of the loss). The most important limitation, however, is the exclusion of coverage where the director or officer obtains any personal profit from the alleged misconduct, an exclusion which bars coverage in the case of self-dealing by a director or officer. Until experience shows that this broad power to obtain indemnity insurance from commercial carriers has been abused by directors and officers, there appears to be no reason to limit the insurance coverage that may be obtained. As stated, the insurers themselves will be compelled to stipulate exclusions that will limit their exposure in cases of misconduct that cannot be characterized as in the interests of the corporation.

251. We think that one other safeguard would be useful. To bar any possible collusion between insurers and the directors and officers of a corporation to waive or qualify exclusions by special endorsement (which of course would require payment of a greater premium), the regulations under the Draft Act will require disclosure of all D & O insurance premiums paid. This can be effected by way of a note to the financial statements. In case of apparent abuse a shareholder has adequate remedies under the Draft Act effectively to state his objections.

252. Section 9.21 reproduces the substance of s. 92(c) and (d) of the present Act. Recall that s. 9.17 expressly permits directors to participate in the sanctioning of such contracts.

PART 10.00
Insider Trading

253. Part 10.00 of the Draft Act deals with "insider trading", described by the Kimber Committee as "purchases or sales of securities of a company effected by or on behalf of a person whose relationship to the company is such that he is likely to have access to relevant material information concerning the company not known to the general public" (Kimber Report, para. 2.01). The Kimber Committee thought that trading by "insiders" in such circumstances was improper, and should not be permitted by law. It also took the position that existing rules of law were inadequate to deal with the practice, and that legislation should be enacted. A similar view was taken by the Jenkins Committee. The Kimber Committee's recommendations were substantially adopted in the corporation and securities legislation enacted in various provinces from 1966 onwards, and the principle of this legislation was accepted by Parliament in 1970 in the most recent amendments to the Canada Corporations Act (ss. 98 to 98F). In the circumstances, it seems unnecessary to reargue the soundness of the principle here, and we have simply adopted it.

254. Broadly speaking, the provisions appearing in Part 10.00 parallel those to be found in the present Act, and in the insider trading legislation of the various provinces. The problem is attacked in two ways. First, s. 10.02 imposes an obligation upon all those classed as "insiders" to file reports with the Registrar detailing their interests in the shares of corporations of which they are insiders, and as well to report any changes in those interests. Second, s. 10.04 imposes civil liability upon insiders, and certain other persons standing in a defined relationship to a corporation, where they engage in "insider trading".

255. There are some important differences between the provisions of Part 10.00, however, and those of the present Act and the provincial statutes, and attention is drawn to these differences in what follows.

256. The principle behind the obligation of disclosure imposed upon insiders rests on what may be called the "goldfish bowl" theory, that improprieties are less likely to occur if those tempted to commit them are likely to be discovered and exposed to the glare of publicity. Consequently, provision is made not only for disclosure to the Registrar—s. 10.02—but, in addition, s. 10.03 requires the Registrar to publish periodic summaries of the information thus obtained. Further, by s. 20.13, the returns filed with the Registrar may be examined and copies made.

257. The obligation of disclosure is imposed upon insiders of public-issue corporations only—s. 10.02, read together with s. 10.01(1)(a). The definition of "insider" is wide. It includes not only directors and officers—s. 10.01(1)(b)(i)—but also any person who, directly or indirectly, owns or controls more than 10 per cent of the voting shares of a corporation—s. 10.01(1)(b)(iii) and (c). In addition, where one corporation is an insider of another, every director and officer of the former is deemed to be an insider of the latter—s. 10.01(2)(a)—and every director and officer of a subsidiary corporation is deemed to be an insider of that subsidiary's holding corporation. Furthermore, where corporation A acquires all or substantially all the property of corporation B, or corporations A and B amalgamate, then, notwithstanding that A has no shareholding in B, all the directors and officers of A are deemed to be insiders of corporation B—s. 10.01(3). This situation, referred to in the Draft Act as a "business combination" is included here in recognition of the fact that shareholding is not the only means of obtaining access to confidential corporate information.

258. The category of persons and corporations required to report under these provisions is very wide. It is justified on the ground that, if it was any narrower, the opportunities for evasion through nominees, controlled corporations and the like would be considerable, and the policy of disclosure could thus be severely undermined. It could be capable, however, of producing ludicrous results, not only because it will require disclosure from persons about whose activities there is no reasonable ground for concern, but also because it will require repetitive disclosure of substantially the same information from a multiplicity of sources. The result could be that the Registrar would become hopelessly over-burdened with paperwork, so that in the long run the cure would be worse than the disease. Accordingly, subsections (5) and (6) of s. 10.02 are designed to reduce pointless disclosure by eliminating repetitive disclosure of identical information and, under s. 10.02(8), the Registrar may also make an order exempting any person from compliance with the reporting requirements. By s. 10.03, details of any such exemption order, and the reasons therefor, must be included in the periodical published by the Registrar.

259. Section 10.04(1) imposes a civil liability for the use of undisclosed confidential information in connection with a transaction in a security of a corporation or any of its affiliates. The liability is imposed upon insiders, their associates and affiliates, and upon persons retained by the corporation. It is a liability to compensate any person for any direct loss suffered by such person as a result of the transaction.

260. Section 10.04 differs from its counterpart in the provincial legislation in a number of respects, and also from the provisions of section 98D of the present Act (as introduced in the 1970 amendments). S. 10.04(1) is broader than the provincial legislation in that it imposes liability upon "persons retained by a corporation", whereas the provincial legislation does not extend this far. The purpose of this provision is to extend the scope of the persons liable by including those who, in the course of their work with or relationship to the corporation, might obtain access to material confidential information about the corporation's affairs, even though they are not "insiders" within the meaning of s. 10.01(1)(b). It would thus impose liability upon solicitors, accountants and other professional advisers. The Kimber Committee decided against imposing liability upon such persons on the grounds that their professional associations would exercise appropriate supervisory jurisdiction in respect of conduct that was unethical, and the various provincial legislatures were evidently persuaded by this view. We have not adopted this approach, however, principally because it is cold comfort to an outside shareholder who suffers loss as a result of insider trading by, say, a lawyer, to know that that lawyer might be in breach of his ethical obligations and hence liable to discipline. It is not clear, in any event, that all the professional societies have responded to the suggestions in the Kimber Report, or that they will do so, and we prefer to make a firm rule on the point.

261. Section 10.04(1) is narrower in scope than both section 98D of the present Act and the corresponding provisions in the various provincial statutes. Under the latter provisions, the insider is liable both to the outsider and to the corporation. Under s. 10.04(1), however, provision is made for liability to the outsider alone. In this we have followed the recommendation of the Kimber Committee against double liability. Since, however, we are proposing a departure from what has become the standard pattern, and in particular a departure from a recently enacted amendent to the present Act, we think we should set out our reasons.

262. Under existing rules of common law and equity, the outsider is almost totally unprotected. This is largely the result of the decision in *Percival* v. *Wright* [1902] 2 Ch. 421, which declared that ordinarily a director is not in a fiduciary relationship with individual shareholders, and is therefore not bound to make any disclosure of information in his possession that affects the value of any shares that are the subject of a transaction between them. Even if the decision in that case was judicially overruled, however, the outside shareholder would have a remedy only against directors, and others having access to inside information who may deal with him would incur no liability to him for mere non-disclosure. Hence, overruling *Percival* v. *Wright*, we apply the new rule to a much broader category of persons than would be reached at common law.

263. The position of the corporation in relation to private use of confidential corporate information is not, in our view, nearly so exposed as that of the individual shareholder. Existing rules are perfectly well adaptable to cover the case of an insider, whether director or not, making use of confidential information for his own benefit or advantage. Well settled law about breaches of confidence, misappropriation of corporate assets, secret profits and conflicts of interest and duty are, in our view, adequate to the point, and their application to the case of insider trading, while not free of difficulty, does not present the same doctrinal problems as does their application to the relationship between insider and shareholder. Indeed, quite apart from the results on the facts, the decisions in a number of recent cases, such as *Peso Silver Mines Ltd.* v. *Cropper* (1966) 58 DLR (2d) 1 and *Boardman* v. *Phipps* [1967] 2 AC 46, amply demonstrates the flexibility of this body of law. It should also be said that, in most cases, improper share trading by an "insider" of a corporation will not in any event cause a loss to the corporation, however unfair it may be to individual shareholders of that corporation.

264. We have also been influenced by another consideration. Section 10.04(1) should be seen primarily as part of a scheme designed to secure reasonably prompt and widespread dissemination of corporate information. It is intended to advance the policy of timely disclosure to investors. In our view, the imposition of a second liability in favour of the corporation will not greatly advance that policy. The purpose of the rules governing the relationship between a corporation and those in a fiduciary relationship with it, and the imposition of liability for abusing or threatening that relationship, is quite different from the purpose of the new legislative rule permitting compensation for injured shareholders. We do not think that the two purposes are necessarily or even frequently advanced by the same principle of liability.

265. Section 10.05 is a simplified version of s. 98F of the present Act. There is nothing to be said in favour of allowing an insider to "sell short" the shares of a corporation in which he is an insider. The prohibition is enforced by a penalty provision because it is difficult, if not impossible, to create a practicable civil remedy.

PART 11.00
Shareholders

266. Section 11.01 is new. Section 88(1) of the present Act requires meetings to elect directors to be held within Canada, but makes no provision in respect of the location of meetings of shareholders. It has been thought wise to include a general provision dealing with this matter.

267. Section 11.02(a) reproduces the substance of s. 100(1) of the present Act, and s. 11.02(b), read together with s. 11.03(5) and (6), reproduces the substance of s. 101(6) of the present Act.

268. Subsection (1) of s. 11.03 reproduces the substance of s. 103(1) of the present Act. There are two changes. The minimum and maximum periods of notice are changed from 14 to 10 days, and 60 to 50 days, respectively. The result is that corporations with widely distributed shareholders, especially those with shareholders residing outside Canada, have a period of 40 days in which to mail notices of meeting.

269. Subsection (2) of s. 11.03 must be read together with s. 6.04(2). Under the latter section, the directors are authorized to fix a date, not more than 50 nor less than 10 days before the meeting, upon which the determination of those entitled to receive notice of the meeting may be made. By s. 11.03 (2), anyone entered upon the register of shareholders at that date is entitled to receive notice of meeting. By s. 11.06, anyone becoming a shareholder after the record date fixed under s. 6.04 is also entitled to attend and vote, though not entitled to receive notice of meeting.

270. Subsections (3) and (4) are new. At common law, an adjourned meeting is treated as a continuation of the meeting adjourned— *Jackson* v. *Hamlyn* [1953] Ch. 577—and fresh notice need not be given, unless any new business is to be transacted: *Christopher* v. *Mexon* (1883) 4 OR 672. Some corporations include a requirement that fresh notice must be given if the adjournment is over a longer period than prescribed, and this principle is adopted in the Draft Act.

271. Subsections (5) and (6) are new, but are merely statutory statements of provisions that are common in corporate by-laws, and do not call for extended explanation.

272. Section 11.04 has no counterpart in the present Act. The practice of waiving notice of meetings of shareholders is, in small closely-held corporations, a common one, and it seems desirable to legitimate this by an explicit statutory provision. There are comparable provisions for waiver of notice of directors' meetings in ss. 9.03(3) and 9.13(4).

273. Section 11.05 substantially reproduces the provisions of section 106H, an addition to the present Act made in 1970. There are some changes in wording. The source of the provision is Rule 14a-8 promulgated by the Securities and Exchange Commission in the United States pursuant to section 14 of the Securities and Exchange Act of 1934.

274. The purpose of the section is to provide a shareholder with machinery enabling him, at the expense of the corporation, to communicate with his fellow shareholders on matters of common concern. At common law, the management of a corporation is under no obligation to make any reference in any of the documents sent out by it to any non-management view of the matters to be discussed—*Campbell* v. *Australian Mutual Provident Society* (1908) 24 TLR 623—nor to include in a notice of meeting any proposals other than its own: Gower, *Modern Company Law*, 3rd. ed., 1969, p. 479. This places shareholders wishing to have a matter discussed at a meeting at a severe disadvantage because the meeting cannot effectively do anything not fairly comprehended by the notice of meeting.

275. The only alternative now open to dissident shareholders in such a situation is to requisition a meeting pursuant to s. 101 of the present Act (s. 11.11 of the Draft Act), which could be costly.

276. Section 11.05 accordingly seeks to provide a suitable alternative. It is based upon the proposition that shareholders are entitled to have an opportunity to discuss corporate affairs in general meeting, and that this is a right and not a privilege to be accorded at the pleasure of management. The machinery of the section permits a shareholder in a corporation to which the proxy provisions of this Act apply to have his proposal included in management's proxy circular: s. 11.05(2).

277. The shareholder is only entitled to have his proposal included if he gives adequate notice of it, and if it is an appropriate matter for action by the shareholders in general meeting: s. 11.05(5)(a) to (c). Subsection (5)(b) is designed to make it clear that the machinery of this section cannot be used to authorize the taking of decisions by the general meeting which the shareholders are not otherwise competent to make: *Re British International Finance (Canada) Ltd.* (1968) 68 DLR (2d) 578; *Automatic Self-Cleansing Filter Syndicate* v. *Cunninghame* [1906] 2 Ch. 34. Whether a proposal is a subject for action by shareholders must be determined by the Act, the articles, by-laws and any shareholder agreement.

278. Paragraphs (c) and (f) are designed to make it clear that the shareholders' meeting is not an appropriate forum for discussing personal grievances or life in general. Paragraphs (d) and (e) are intended to protect management and the shareholders generally from being harassed by repetitious discussion of stale matters.

279. Subsection (6), like s. 9.09(4), protects a corporation from the consequences of circulating a defamatory statement. Subsection (7) requires a corporation to notify any shareholder whose proposal it refuses to circulate, and subsections (8) and (9) allow either party to seek the court's assistance.

280. Section 11.07, which has no counterpart in the present Act, is designed to clarify the common law in a number of respects. At common law, there is authority for the view that as a general rule a meeting requires at least two persons: *Re Primary Distributors Ltd.* [1954] 2 DLR 438; *Re Cowichan Leader Ltd.,* (1963) 42 DLR (2d) 111. The only exception to this rule is that a single holder of all the shares of a class or series may constitute a meeting of that class or series: *Re Woodward* [1940] OR 387. In view of the legitimation by this Act of the "one-man corporation", it is necessary to provide that one person may constitute a meeting, and this is done by subsection (4).

281. While under the Draft Act one shareholder may constitute a meeting, it will be necessary, in the absence of contrary provision in the by-laws, that that person hold a majority of the shares: subsection (1). There is no reason why the by-laws should not provide for higher than majority quorum requirements, and this is quite a common practice in the by-laws of closely-held corporations. On the other hand, subsection (3) precludes the adoption of a practice that has become quite widespread—that of providing that if a quorum is not present at the opening of a meeting, the meeting shall stand adjourned to a fixed time, when the shareholders then present shall constitute a quorum and may proceed to business. Such a provision presents tempting opportunities for manipulation by unscrupulous persons and hence is prohibited.

282. At common law there is some doubt whether a quorum must be present throughout a meeting, or only at the opening. The better view, as reflected in the decision in *Re Hartley Baird* [1955] Ch. 143, is that a quorum is necessary only at the opening of a meeting, and this view is embodied in s. 11.07(2).

283. Subsection (1) of s. 11.08 reproduces with one important change the provisions of s. 102 of the present Act, as amended in 1970. The change is the deletion in this section of any reference to the voting rights of shareholders in arrears on calls, a point which becomes irrelevant with the abolition of partly-paid shares by s. 5.02(2) and (3) of the Draft Act.

284. Subsections (2) and (3) reproduce the substance of s. 105 of the present Act. Subsection (4) merely expresses in statutory form a provision commonly found in corporate by-laws.

285. Section 11.09 is new. Subsection (1) reflects the common law rule that voting takes place by show of hands, unless a ballot is demanded: In *Re Horbury Bridge, Coal, Iron & Wagon Co.* (1879) 11 Ch. D 109. It also clarifies the uncertainty existing at common law as to whether a proxy holder is entitled to demand a ballot: *Queen* v. *Government Stock Investment Co.* (1878) 3 QBD 443; *Re Haven Gold Mining Co.* (1882) 20 Ch. D 151. Under s. 11.09(1) it is clear that a proxyholder may demand a ballot.

286. Subsection (2) clarifies the doubt which exists at common law as to whether a vote by show of hands is an essential pre-condition to a call for a vote by ballot: *Carruth* v. *Imperial Chemical Industries Ltd.* [1937] AC 707; *Holmes* v. *Heyes* [1959] Ch. 199. Under s. 11.09(2) a ballot may be demanded at any time.

287. Section 11.10 is a new and useful provision, especially in the "one-man corporation". It seems pointless to require ritual meetings in such corporations and this section simply recognizes the realities of the situation. Moreover, it has long since been recognized that informal consent of all shareholders to an act intra vires the corporation is as effective as a formal resolution at a duly convened meeting: *Walton* v. *Bank of Nova Scotia* [1965] SCR 681. Comparable provision is made for written consents of directors in s. 9.15. The principle of the section applies, of course, to corporations with more than one shareholder.

288. Section 11.11 reproduces the substance of s. 101 of the present Act, with several changes. The section has been reworded to make it clear that a single shareholder holding the requisite proportion of shares can make a valid requisition. Although there is English authority to this effect—*Italian Rly. Construction Co. Ltd.* v. *Hooper* (1904) 48 Sol. Jo. 709—there is a dictum of Verchere J. in *Ingre* v. *Maxwell* (1964) 44 DLR (2d) 764 doubting whether this could be done under a comparable provision in the British Columbia Act. Section 11.11(1) makes the point clear.

289. The proportion of shares required for a valid requisition has been reduced from 10% to 5%. The change has been made in the interests of facilitating the requisitioning of meetings for legitimate corporate purposes.

290. Under the present Act the directors have 21 days from the receipt of the requisition to call the meeting. Under s. 11.11(4) the period is reduced to 10 days because there does not seem any good reason for giving such an extended period to the directors to consider the requisition.

291. Subsection (5) is included to make it clear that a meeting called pursuant to this section is subject to the proxy provisions of the Draft Act.

292. Subsection (6) adopts s. 101(5) of the present Act, but adds the provision that the shareholders may resolve that the corporation not reimburse the requisitionists. This addition seems desirable as a protection against harassment through requisitioned meetings.

293. Section 11.12 reproduces s. 104 of the present Act, but subsection (2) has been added to remove any doubt that the court has power to impose a different quorum rule, the usual reason why this section is resorted to.

294. Traditionally, the prerogative writ of quo warranto was the remedy invoked to review a contested election of a director of a business corporation. For many years, Quebec has permitted such review by special provisions in the code of civil procedure (Art. 838, 844). The use of prerogative writs in this context was abandoned in the common law jurisdictions in Canada because of the uncertainty arising from some 19th century cases that questioned the propriety of this procedure. See Fraser and Stewart, *Company Law of Canada*, 5th. ed., 1962, pp. 579 to 581. Apparently the proper form of action in the common law jurisdictions is a derivative action in the name of the corporation requesting a declaration that the election of a director is invalid: *Kelly* v. *Electrical Construction Co.* (1908) 16 OLR 232. This remedy, although useful if the majority of the shareholders contest the election, is procedurally difficult and in some circumstances practically ineffective because of the rules applicable to such actions: *Watt* v. *Commonwealth Petroleum Ltd.* (1938) 4 DLR 701.

295. But that is not to say that the present state of the common law is in any sense established. The procedure appears to vary from one jurisdiction to the next. In British Columbia, for example, a representative action by a shareholder on behalf of all the shareholders to contest an election is not permitted. Only a derivative action is proper: *Fraser River Mining & Dredging Co.* v. *Gallagher* (1896) 5 BCR 82. But, in the United Kingdom, a shareholder can apparently institute a representative action seeking an injunction to contest the validity of an election of directors: *Channel Collieries Trust* v. *St. Margaret's Co.* (1914) 2 Ch. 560.

296. In the United States the historical remedy of quo warranto continued to apply to enable a court to review the election of directors of a business corporation. By 1900, however, the use of the prerogative writs had become so encumbered by technical niceties and procedural formalities that they no longer provided an adequate solution to the problem. As a result, special provisions were embodied in the general corporation laws, giving to the corporation or an aggrieved shareholder the right to make a summary application to the court in respect of the disputed election, and conferring on the court broad discretion to deal with the problem. A useful model is s. 619 of the New York Business Corporation Law, which has been the focal point of a considerable body of case law. The object of s. 11.13, like s. 619 of the New York Business Corporation Law, is to furnish a remedy which, like the perogative writs, may be invoked by a summary application to the court, but which will be free of the conceptual and procedural difficulties that have long encumbered those writs. This remedy renders unnecessary any distinction among personal actions, representative actions by a shareholder on behalf of all shareholders, and derivative actions in the name of the corporation.

297. Under s. 11.13 the right to make a summary application to the court is straightforward. It will be as expedient as the rules of the court permit. In contrast to New York, where only an aggrieved shareholder may initiate an application, either a shareholder, a director or the corporation itself may make the application. The powers of the court in this section are broad and unequivocal. The provision is, of course, an analogue of the generic remedy set out in s. 28 of the Federal Court Act, which provides for a summary review of judicial or quasi-judicial decisions made by federal tribunals.

298. Section 11.14 is new. At common law it has long been recognized that agreements among shareholders as to the manner in which they will cast the votes attaching to their shares are lawful: *Ringuet* v. *Bergeron* [1960] SCR 472; *Motherwell* v. *Schoof* [1949] 4 DLR 812; *MNR* v. *Aaron's Ladies Apparel Ltd.* (1967) 60 DLR (2d) 448. Subsection (1) gives statutory form to the case law.

299. The common law rule is generally stated to be subject to the qualification that the agreements must be for a lawful purpose (*Motherwell* v. *Schoof, supra*), and this is generally tested by reference to whether the agreement purports to bind the parties to it not merely *qua* shareholders, but also *qua* directors. Thus, in *Motherwell* v. *Schoof,* part of such an agreement which purported to dictate the manner in which the parties would act in exercising their powers as directors was struck down as an invalid attempt to fetter the exercise of their discretion. This is doubtless a sound principle in a case where all shareholders are not parties to the agreement, but there is authority for the view that even an agreement to which all shareholders are parties is subject to the same limitation: *Atlas Development Co. Ltd.* v. *Calof & Gold* (1963) 41 WWR 575. This seems unnecessarily rigid, and accordingly s. 11.14(2) in effect reverses the decision in that case. Note that, under subsection (2), all the shareholders can enter into an agreement with a non-shareholder by which he has exclusive power to manage the affairs of the corporation. There is some doubt as to how far directors may go in divesting themselves of management powers under existing law, and this provision is designed to clarify the law on the point.

300. It is implicit in the definition of director in s. 1.02(1)(1) that where a person, though never elected a director, acts as one, he incurs the liability of a director. Section 11.14(5) merely makes this explicit where a shareholder agreement has been entered into, and is designed to prevent shareholders who have entered into such an agreement from relying upon it as a defence to an action based upon dereliction of duty as director. It also prevents shareholders who have unanimously entered into a total management contract with a stranger from relying on the agreement to escape any liability they may otherwise incur for failure to perform their duties of supervision.

301. It is probably the law that a transferee without notice of shares subject to restrictions is not bound by those restrictions: *Re Belleville Driving & Athletic Association* (1914) 31 OLR 79. Certainly that is true under the Draft Act: s. 6.02(8). Consequently, a transferee without notice would take shares free of any restrictions contained in a shareholder agreement. It is therefore good practice to ensure that the share certificate is endorsed with a statement of the existence of the agreement. Indeed, this is required by s. 11.14(3) as a condition of the validity of the agreement. Section 11.14(4) is self-explanatory.

302. Subsection (6) has been added in acknowledgment of the fact that, in any situation in which a unanimous shareholder agreement is appropriate, a pre-emptive right is also appropriate, if not essential, to maintain the integrity of the agreement. It seemed likely to us that, at least until the legal profession in Canada becomes accustomed to these agreements, the need for pre-emptive right provisions will often be overlooked. Therefore we have made pre-emptive rights a statutory condition in unanimous shareholder agreements unless the parties expressly say otherwise.

PART 12.00
Proxies

303. Part 12.00 substantially reproduces the provisions of sections 106A to 106G which were added to the present Act in 1970. Those provisions are in turn based upon the recommendations in the Kimber Report, and correspond closely to the proxy requirements in the legislation of several provinces. There are some changes in wording and organization from the present Act, but no changes of substance. The provisions of Part 12.00 lay down a simple regime for shareholders who wish to exercise their rights by proxy, and an elaborate one for managements and others who solicit proxies.

304. Section 12.01 reproduces section 106A of the present Act, and is simply an interpretation section. The only provision calling for special notice is paragraph (d), which defines the concept of "solicitation" upon which the entire system of proxy regulation rests. Subparagraphs (i) to (iii) of this definition are borrowed from Regulation 14a-1 issued by the Securities & Exchange Commission in the United States pursuant to the provisions of the Securities Exchange Act of 1934. For a discussion of the scope of the definition see Getz, *Alberta Proxy Legislation: Borrowed Variations on an Eighteenth Century Theme,* (1970) 8 Alta. L. Rev. 18.

305. Subparagraph (iv) is based upon comparable provisions enacted in provincial legislation following the recommendations of the Kimber Report, and must be read together with ss. 12.03 and 12.05. The combined effect of these provisions is that whenever the management of a corporation with 15 or more shareholders sends out a notice of meeting, it is deemed to solicit proxies, and must comply with all the rules in this Part, unless the Registrar makes an exemption order under s. 12.05. The most important consequence is that every notice of meeting sent out by management under these provisions must be accompanied by a proxy circular and form of proxy complying with the Act.

306. The exclusions from the definition of "solicitation" set out in s. 12.01(2) are straightforward. Paragraph (d) exempts from the solicitation rules the beneficial owners of shares registered in the name of a nominee, where the owner wishes to obtain a proxy so as to be able to attend a meeting himself or appoint someone other than the registered holder to represent him. Paragraph (c) is explained in the commentary to s. 12.07.

307. Section 12.02 reproduces the substance of s. 106B of the present Act. Subsection (1) confers upon every shareholder entitled to vote at a meeting of shareholders the right to appoint a proxyholder to cast his vote at the meeting, and that proxyholder need not be a shareholder.

308. Subsection (2) is self-explanatory. Subsection (3) ensures that proxies can be used only for the purpose of voting on the questions upon which the shareholder has been given the opportunity to make up his mind. If proxies could be used at subsequent meetings, perhaps to vote on entirely different matters, the whole purpose of the system would be lost.

309. Subsection (4) specifies the minimum requirements as to the content of every proxy form. A shareholder who wishes to give a proxy really has to do little more than name the proxyholder and make clear the particular meeting at which the proxyholder is to act. Where, however, a proxy is *solicited*—as defined in s. 12.01—the person making the solicitation must ensure that the form of proxy contains the additional information specified in s. 12.06.

310. Subsections (5), (6) and (7) are self-explanatory.

311. By s. 12.03(1) and (2), read together with s. 12.01(1)(d)(iv), the management of a corporation with 15 or more shareholders is deemed to solicit proxies whenever it sends out a notice of meeting. The consequence of this is that the corporation must send to each shareholder entitled to receive notice of the meeting—see s. 11.03(1)—a form of proxy complying with both ss. 12.02 and 12.06 and, in addition, a management proxy circular in prescribed form: s. 12.04(1)(a).

312. It should be noticed that, although by s. 12.02(1) every shareholder entitled to vote at a meeting of shareholders is entitled to vote by proxy, only those shareholders in corporations with 15 or more shareholders who are registered in the corporation's records on the record date are deemed to be solicited under s. 12.03.

313. Where the management of a corporation with fewer than 15 shareholders sends out a notice of meeting not accompanied by a form of proxy it is not deemed to solicit proxies, and therefore it need not comply with ss. 12.04 or 12.06 unless it *actually* engages in a solicitation. The category of corporations excluded from the deemed solicitation provisions of s. 12.03(1), namely, those with fewer than 15 shareholders, differs from the category excluded in section 106E(1) of the present Act, that is, a "private company" or a "public company that has fewer than fifteen shareholders". The distinction between private and public corporations is abandoned in the Draft Act, for reasons explained in the Introduction.

314. Where a non-management group engages in a solicitation s. 12.04(1)(b) requires that it send out a document called a "dissident's proxy circular". In the Draft Act we have used the expressions "management proxy circular" and "dissident's proxy circular" because they are more descriptive than the terms "information circular" and "explanatory memorandum" used in the present Act. There is no requirement that a form of proxy be sent out since, in practice, a non-management group would be likely to solicit shareholders to fill out proxies received from management in a particular way, rather than send its own proxy forms. The person or group soliciting could of course send its own form of proxy and, if it did so, the form of proxy used would have to comply with ss. 12.02(4) and 12.06.

315. Section 106D(2) of the present Act has been omitted. Section 106D(2)(a) is borrowed from a provision in the S.E.C. Regulations in the United States, the purpose of which is far from clear. It has been suggested that the purpose of the S.E.C. regulation is to facilitate the formation of shareholders' protective committees—Aranow & Einhorn, *Proxy Contests for Corporate Control*, 2nd. ed., 1968, pp. 110 to 111—though it is not easy to see why the process of formation should necessarily involve a solicitation. Paragraphs (b) and (c) of s. 106D(2) are redundant in view of s. 12.01(2)(c) and (d) of the Draft Act, and are accordingly omitted. This does not represent any change of substance.

316. Section 12.05(1) reproduces with some changes in wording the substance of s. 106E(2) of the present Act. There are no doubt some cases which would be solicitations under the Act but in which it would be unduly burdensome to apply all the statutory rules. An exemption procedure should therefore be useful.

317. Section 12.06 reproduces the substance of s. 106F of the present Act and specifies the form of proxy that must be supplied where a solicitation takes place. The general purposes of the provision are, first, to ensure that the shareholder is given adequate warning of the rights that he has in respect of proxy voting; second, to give him adequate information about the persons for whom and the proposals for which his support is solicited; and third, to give the shareholder the greatest freedom of choice possible in determining how his votes are to be cast.

318. Section 12.06(1)(a) requires the identity of those making the solicitation to be clearly indicated on the face of the proxy form. The shareholder must be advised of his right to appoint a proxyholder of his own choice to act on his behalf at the meeting, together with space for the substitution of his own proxyholder in place of any person named and instructions as to how the substitution is to be made: subsection (1)(b) and (c).

319. The proxy form must be in what is called "two-way" form; that is, the shareholder must be given an opportunity to specify that his votes be cast either for or against a particular proposal or related group of proposals: s. 12.06(1)(d). If the shareholder fails to give any indication of how he wishes his votes to be cast, the proxyholder will have a discretionary authority only if the proxy form itself clearly indicates how the votes will be cast if no directions are given. The proxy form must also clearly indicate that the shares will be voted on a ballot, and that they will be voted in accordance with any directions given by the shareholder: subsection (3).

320. Special provision is made in subsection (1)(e) for voting in elections for directors and auditors. The opportunity to vote for or against a particular proposal does not extend to elections. There is no problem where the only matter to be acted upon at the meeting is an election of directors and auditor, for a shareholder can simply decline to return the proxy form if he does not wish to vote for the candidates whom he is asked to support. Where, however, there are other matters to be voted upon, it may be unsatisfactory if the shareholder wishes to vote on those matters, but not to support the management nominees for office, and there is no proxy contest presenting him with an electoral alternative. In such a case, he is forced to vote for the management nominee, or forfeit his franchise completely. Accordingly, subsection (1)(e) requires that a shareholder be provided with an opportunity to direct that his votes be withheld from any election. The provision is based upon S.E.C. Regulation 14a-4(b)(2). Subsection (1)(e) also provides that a proxy only confers authority to vote for the election of a person as director or auditor if the proxy circular identifies that person as a bona fide candidate for the position: see *Charlebois* v. *Bienvenue* (1967) 64 DLR (2d) 683.

321. Subsection (4) is new. There is some doubt whether a proxyholder is bound to act in accordance with his instructions or, indeed, whether he is bound to cast his principal's vote at all. The better view is that there is a duty on him to cast the vote in accordance with his instructions, at least where he is a director—*Oliver* v. *Dalgleish* [1963] 3 All ER 330; *Second Consolidated Trust* v. *Ceylon Amalgamated Estates* [1943] 2 All ER 567—and to that extent subsection (4) is merely declaratory.

322. Section 12.07 repeats, with minor drafting changes, s. 106G of the present Act. The purpose of the provision, of course, is to ensure that "registrants"—defined by section 12.01(c) as, in effect, brokers and dealers in securities—do not vote shares which they hold as nominees without, at any rate, seeking voting instructions from their principals.

323. Section 12.08 provides the kind of remedy which, in our opinion, is most appropriate if the proxy solicitation rules of Part 12.00 are not complied with. If the information upon which proxies are given is wrong, then the votes cast thereby are not an accurate representation of what the shareholders wish to accomplish. When this occurs, it should be possible to stop the solicitation, and this is what s. 12.08 does.

PART 13.00

Financial Disclosure

324. There are major differences between the provisions in Part 13.00 and the corresponding sections (ss. 116 to 124) in the present Act. The duty to keep accounts (presently s. 115) has been placed in Part 4.00.

325. The Draft Act does not specify the kind of financial statements a corporation has to prepare and, of course, it does not contain the kind of rules found in ss. 116 to 121C of the present Act detailing the particular items of information required to be disclosed in financial statements. This kind of legislation, in our opinion, should be prescribed in regulations. This proposal is sufficiently novel to require a word of explanation.

326. In recent years there has been an increasing awareness of the need to improve the quantity and quality of financial disclosure required of corporations. The question of corporate financial disclosure has been prominent in studies such as the Kimber and Lawrence Reports, and the need for improved disclosure was also stressed by Mr. Justice Hughes in the Atlantic Acceptance Report (see, for example, p. 1442). Recent amendments to corporation and securities legislation in Canada have embodied many of the recommendations contained in those reports. History indicates, however, that legislation on matters such as financial disclosure is changed only infrequently, sporadically and usually because some dramatic financial catastrophe or fraud revealed how outmoded the law had become.

327. In addition, accounting practices and financing techniques are always evolving and they have usually been well in advance of the law. The state of current financial reporting is as good as it is because in large measure the accountng profession—spurred to some extent by the demands of the financial community—has been willing to go beyond the demands of the law. It should not be left to the persuasive powers of the accounting profession to see to the implementation of improved financial reporting practices, because the unscrupulous will tend to observe only the minimum legal requirements.

328. Another reason why we believe that a more flexible and responsive form of legislation is required in the area of financial disclosure is that the Draft Act contemplates that many different kinds of corporations will be governed by it. Even under the present Act there is reason to doubt that the provisions of ss. 116 to 121D are entirely suitable for all the corporations affected by them. This is recognized, to a degree, in ss. 116(4), and 121I which grant exemptions from some of the rules in certain circumstances. If the concept of the Draft Act, that all federal corporations should be incorporated or continued under it, is accepted, the range of corporate activity covered by the Act will be much wider and the required financial statements will be much more diverse.

329. For all these reasons, we believe that the time has come to put the rules governing the form and content of financial statements in regulations instead of in the Act. Initially, at any rate, ss. 117 to 120B of the present Act would probably be enacted almost verbatim in the regulations. We are conscious of the disadvantages of delegated legislation but we believe that those drawbacks can be met. For one thing, it is unrealistic to suppose that regulations in the area of financial disclosure would be enacted without previous consultation with the accounting profession and other interested groups. The Dominion Bureau of Statistics, for example, has been working closely with the accounting profession in areas of common concern. We hope, indeed, that a standing committee of Departmental officials and interested outsiders will be established to keep such regulations under continuous review. In addition, we have assumed that the Statutory Instruments Act now before Parliament as Bill C-182 will be implemented, or at least that the principles enunciated in that Bill will be adopted in one way or another before the Draft Act is enacted. Finally, we provide in s. 13.02 a right to apply to a court for an exemption from any of the rules which may be laid down in the regulations. The right to apply for an exemption is much wider than that given in s. 121I of the present Act. Note, however, that the Draft Act does not retain the exemption provisions of s. 121H of the present Act, because we do not think that those exemptions are either necessary or desirable.

330. Except for this major departure on the matter of the form and content of financial statements, many of the provisions in Part 13.00 are so similar to their counterparts in the present Act that detailed comment is unnecessary. The table below shows the correlation:

Topic	Draft Act	Present Act
Financial statements for annual meeting	s. 13.01	s. 116
Exemption from disclosure	s. 13.02	s. 121H, 121I
Consolidated financial statements	s. 13.03	s. 121
Approval of financial statements	s. 13.04	s. 121D
Circulation of financial statements	s. 13.05	s. 121E
Public filing of financial statements	s. 13.06, 20.13	s. 121E, 121F, 121G

331. Section 13.07 deals comprehensively with the vexing question of auditors' independence. In the past, corporations legislation has commonly provided that, except with the unanimous consent of the shareholders in a "private" corporation, an auditor could not be a director, officer or employee of the corporation for which he was auditor, or any of its affiliated companies (see s. 123 of the present Act). Recently some Acts have also barred or limited the right of an auditor to own shares in the corporation, or to act as a receiver or liquidator (see, for example, Ontario Act, s. 170).

332. Once again good practice has long been in advance of the law. Although it is only recently that the Institutes of Chartered Accountants have, in their codes of ethics, adopted a similar rule regarding shareholdings in client corporations, the better accounting firms have for years prohibited such shareholdings by their partners and employees.

333. Shareholdings and directorships in client corporations are only the more obvious manifestations of a (possible) lack of independence on the part of an auditor. We believe that it is the fact of independence which must be stressed and safeguarded. We therefore state this plainly in s. 13.07(1). Subsection (2) emphasizes, in paragraph (a), that independence must always be a question of fact in each particular case, and we hope that this will encourage auditors to examine all aspects of their relationships with their clients. Paragraph (b) of subsection (2) then lists the cases under which an auditor will be deemed not to be independent, and thus not qualified to accept an audit engagement.

334. Subsection (4) of s. 13.10 should be referred to in this context. The independence principle, as formulated in s. 13.07, can obviously give rise to uncertainty. After anxious consideration, we concluded that it was preferable to allow borderline cases to be resolved by a court, instead of attempting to foresee and specify a limitless number of fact situations in the statute itself. We took this same approach to the analogous problem with trustees' conflicts of interest in s. 7.02.

335. Section 13.09 describes the circumstances in which some corporations, namely those not required to make their financial statements public, may dispense with an auditor altogether. We think that the distinction drawn in the present Act, that every corporation must have an auditor but that "private" corporations may choose one who is not independent, is unsound. We agree that some corporations should, if their shareholders wish, be able to forgo the benefits of an audit but, if a corporation does have an auditor, that auditor should be independent. The distinction, in short, should be between a good audit or none at all; not between a good audit and one which is open to question.

336. Sections 13.08 and 13.10 to 13.14 govern the appointment, removal and replacement of auditors. The thrust of those provisions is to strengthen the position of the auditor vis-a-vis the management of the corporation. By making the removal of an auditor comparatively difficult (at least if the incumbent auditor has valid grounds for disputing his removal) greater shareholder control in this important area is enhanced. The rules in s. 13.14 parallel those in s. 9.09, dealing with directors.

337. Section 13.15 deals with the auditor's duty to report. The irrelevancies contained in s. 124(3) of the present Act have been eliminated. More important, the auditor's duty in cases where he is unable to give an unqualified report is clarified. He is explicitly required to state his opinion and, if his opinion is qualified or if he is unable to express an opinion or only an unfavourable opinion, he must also explain the reasons why: subsections (2), (3), (4).

338. We have not, however, accepted the principle which we think the Ontario Act tries to expound in s. 171(7), a singularly murky provision which Mr. Justice Hughes reviled in the Atlantic Acceptance Report (see p. 1451). We do not think that an auditor of a holding corporation should be liable, ipso facto, for the work of an auditor of a subsidiary body corporate. If such a liability is automatically imposed, it will inevitably increase the concentration of auditing work in the large national and international accounting firms, and this would not be healthy for either the profession or the public. If different firms were still retained to perform the audits of constituent corporations, auditors of parent corporations would feel obliged to check that work very closely, thus increasing over-all audit costs. Furthermore, there will be situations, especially with foreign subsidiaries, where it will be impractical or impossible for the auditor of a holding corporation to make the detailed examination of the subsidiary which a provision like s. 171(7) of the Ontario Act will make virtually obligatory. These difficulties are not met, as Mr. Justice Hughes seems to think, by saying that the auditor of the holding corporation can qualify his report or refuse to express an opinion.

339. It is preferable, in our opinion, to formally acknowledge that an auditor of a holding corporation may reasonably rely on the work of another auditor, if the extent of that reliance is declared in the report of the auditor of the holding corporation, and s. 13.15(5) of the Draft Act so provides. The holding corporation's auditor must be able to show that it was reasonable for him to so rely, however, and subsection (6) says that reasonableness is a question of fact. The result therefore is that, in each case, a holding corporation auditor will have to make a professional judgment as to the competence of his professional colleague, and it is for him to decide how he will satisfy himself on the matter. Put in this way, a holding corporation auditor is in the same position relative to another auditor that an auditor is in relation to any other expert upon whose work or opinion he must rely. In these circumstances, the question for the person doing the relying is not the adequacy of the other person's work, as such, but the degree to which that other person can be depended upon to have done his work properly.

340. By statutorily equating the position of "other auditors" vis-à-vis a holding corporation auditor with the legal relationships between an auditor and any other expert, we preserve a legal standard for determining whether an auditor is or is not negligent when relying upon another person. Nevertheless, auditors should be aware that the courts may apply the standards differently, reasoning that a subsidiary auditor is not merely another expert possessing knowledge not available to the auditor of the holding corporation, and upon whom he can rely in the same way. The auditor of a holding corporation will frequently not be as dependent upon a subsidiary auditor as he will be upon another kind of expert. On the face of it, the auditor of the holding corporation is just as expert as the subsidiary auditor because their fields of professional competence are the same. The courts might well expect an auditor of a holding corporation to go deeper into the evidence behind a subsidiary auditor's opinion than would be expected with the report of an expert in a field in which the holding corporation's auditor had no qualification. Also, while a holding corporation auditor who has not been formally appointed or elected as auditor of a subsidiary corporation has no legal right to demand access to the records of a subsidiary, s. 13.16(1)(c)—s. 124(4)(c) of the present Act—gives him that right indirectly.

341. Section 13.16(1) parallels s. 124(4) of the present Act (as amended in 1970), but subsection (2) is new. The section is designed to ensure that the auditor of a corporation has the power to demand, both in terms of quantity and quality, the information he needs to perform his duties.

342. Section 13.17 is the other notable addition to this Part. It embodies (more comprehensively, we think) the ideas advanced by the Lawrence Committee and implemented in ss. 182 and 171(4) and (5) of the Ontario Act.

343. Section 13.18, finally, gives qualified privilege to statements made by an auditor, whether the statement is one made in his report to the shareholders or a statement made under section 13.14. In this latter respect the section parallels s. 9.09(4). The idea, of course, is to encourage full and frank statements by auditors. Such statements (provided always that there is no malice) probably have qualified privilege now at common law, but we think it is desirable to make the point clear, particularly to auditors who may not be aware of the common law position. See also s. 15.10(14).

PART 14.00

Fundamental Changes

344. At common law, in the absence of specific statutory authority, a corporate charter could only be amended by the unanimous consent of the shareholders, a rule which was analoguous to the rule relating to the amendment of a partnership agreement. In those circumstances, a shareholder could be said to have a "vested right" from which the majority of shareholders could not derogate. Gradually the company laws were made more flexible so that in the United Kingdom a company could amend its articles of association and even, in certain cases, its memorandum of association. Implicit in these more flexible amendment rules was an abandonment of the vested rights doctrine, for it was clear that any rights acquired by a shareholder under the contract evidenced by the share certificate could be modified. The focus of attention then shifted away from the doctrine of "vested rights" to a determination of "equitable rights" of which a shareholder could not be deprived by the majority shareholders, irrespective of compliance with corporate law formalities.

345. After a century of considerable uncertainty, apparently only the common law of New Jersey has developed and applied equitable standards of "fairness" that protect the rights of a minority shareholder from encroachment in favour of majority interests. See *Ballantine on Corporations*, p. 656 and Hornstein, *Corporation Law and Practice*, s. 363. When considering cases where a shareholder alleges that his rights have been unfairly prejudiced, most common law jurisdictions refuse to consider the fairness of the amendment or other fundamental change in the corporation's business or affairs. Normally the court will intervene only where the plaintiff establishes fraud or bad faith. Jurisdictions as widely separated in philosophy as England and Delaware apply these general standards.

346. In this context, the courts in the United Kingdom have struggled in vain to refine this general policy and to arrive at a workable standard to govern the conduct of majority shareholders. The law is ambiguous. The current rule is that majority shareholders cannot derogate from the rights of the minority shareholder, unless the proposed modification is "bona fide for the benefit of the corporation as a whole". In this context "corporation" means all the shareholders, implying that the majority shareholders cannot make fundamental changes that discriminate against minority shareholders. In addition, a further judicial qualification has been added to the rule: it is for the shareholders acting in good faith, not the court, to determine what is for the benefit of the corporation as a whole. In spite of these judicial refinements, the application of such a standard is very difficult. Judging from the reported cases, the present state of the common law is at best unsatisfactory, at worst downright unjust. See the discussion on the leading cases in Gower, *the Principles of Modern Company Law*, 3rd. ed., 1969, p. 561 ff.

347. For these reasons a basic change of policy is recommended in Part 14.00. Instead of relying on common law standards to restrict the conduct of majority shareholders who propose to make a fundamental change, the provisions in this Part confer upon a shareholder who dissents from the fundamental change the privilege of opting out of the corporation and demanding fair compensation for his shares. In short, if the majority seeks to change fundamentally the nature of the business in which the shareholder invested, and if the shareholder dissents from the change, he may demand that the corporation pay him the fair value of his shares as determined by an outside appraiser. Of course, if enough shareholders dissent, creating a heavy drain on the corporation's cash resources, the proposed change will be effectively blocked. Thus the general policy of the common law is not only changed but in fact reversed. Instead of placing the minority shareholder at the mercy of the majority, these provisions permit the minority shareholder to withdraw from the enterprise and, if enough minority shareholders are affected, to bar the proposed change. Nevertheless, the majority shareholders can, if they go through the proper formalities, and if they pay any dissenting shareholders, effect almost any fundamental change with impunity. The result is a resolution of the problem that protects minority shareholders from discrimination and at the same time preserves flexibility within the enterprise, permitting it to adapt to changing business conditions. Although the provisions vary substantially from one state to another, every state in the United States other than West Virginia gives a minority shareholder a statutory right to dissent and to demand the appraised value of his shares. See Hornstein, *Corporation Law and Practice*, s. 630.

348. While the right to dissent from a proposed fundamental change is the keystone, Part 14.00 also achieves several ancillary policy objectives. First, all the usual amendments to the articles of incorporation are consolidated in one section, providing a convenient although not exclusive checklist for the practitioner. Second, class rights are given specific protection. Third, this Part deals with all variations of fundamental change in one place, applying consistent rules to each. And fourth, uniform formalities are adopted, parallel with the formalities required to be complied with at the time of incorporation.

349. The provisions of this Part are technically too complex to be dealt with summarily, but the following table provides an overview of the system that makes clear its objectives:

	Fundamental change	Only voting shares entitled to vote	All shares have right to vote	Separate Class or Series vote	Right to dissent instead of voting (s. 14.17)
14.03	Amendment of articles	Yes (if no class vote)	Yes (if class vote)	Yes (if specially affected)	Yes (if specially affected)
14.07	Restatement of articles	No	No	No	No
14.10	Amalgamation	No	Yes (each corp.)	Yes (if specially affected)	Yes
14.11	Vertical amalgamation of wholly-owned subsidiary	No	No	No	No
14.11	Horizontal amalgamation of wholly-owned subsidiaries	No	No	No	No
14.14	Continuance (import)	(Determined by law of place of incorporation)			
14.15	Continuance (export)	No	Yes	No	Yes
14.16	Extraordinary sale, lease or exchange of property	No	Yes	Yes (if specially affected)	Yes
14.18	Reorganization (e.g., bankruptcy)	No	No	No	No

350. Section 14.01 consolidates in one place a uniform regime, governing all kinds of amendments to articles of incorporation. The list is not exclusive, however, since paragraph (p) permits amendment of any extraordinary provision that may be set out in the articles. Section 14.01 includes all the provisions that are scattered throughout the present Act: general amendment (s. 17), change of registered office (s. 21), change of name (s. 26), and amendment of capital structure (s. 48). Because of the special problems posed by a reduction of capital, that topic is treated separately in s. 14.04, just as it is separately dealt with in s. 49 of the present Act.

351. It is implicit in s. 14.01 that a corporation may amend its articles as of right, just as incorporators may incorporate as of right under s. 2.01.

In other words, the Registrar has no discretion to bar a lawful amendment. The only legal qualifications on the right to amend are the class vote under s. 14.03, the special conditions applicable to a reduction of capital set out in s. 14.04, and the general equitable restraints such as the doctrine of "fraud on the minority". See, for example, *Dafen Tinplate Co. Ltd.* v. *Llanelly Steel Co. Ltd.* [1920] 2 Ch. 124; *Greenhalgh* v. *Arderne Cinemas Ltd.* [1951] Ch. 286. In addition, the right of a shareholder to dissent may impose a practical limitation, as mentioned above.

352. Under the present Act, the procedure to amend letters patent involves the enactment of a by-law by the directors under s. 93, the sanctioning of that by-law by two-thirds or three-quarters of the shareholders present at a special general meeting (e.g. s. 17), and delivery of a copy of the by-law to the Department either with or incorporated in an application for supplementary letters patent. The procedure set out in ss. 14.01 to 14.06 is not substantially different from the routine under the present Act, except for the following. No directors' by-law is required. Under s. 14.02 either a director or a shareholder may propose an amendment and, in either case, the proposed amendment is simply put forward by way of a motion at a meeting of shareholders. No special meeting of the shareholders is required to consider the amendment, but of course notice of the proposed amendment must be stated in the notice of the meeting as special business in accordance with s. 11.03. The one traditional safeguard that has been maintained in this section is the requirement of a two-thirds vote (i.e., a special resolution) in respect of fundamental changes, whether by way of amendment, amalgamation, continuance (export), or extraordinary sale or lease of assets.

353. Subsection (1) of s. 14.02 effects a major change of the present law by conferring on a shareholder the right to propose an amendment to the articles, a right that was previously reserved to the directors. This corresponds to the right of a shareholder to propose an amendment to the by-laws under s. 9.02. The mechanics of making the proposal are set out in s. 11.05. Subsection (2) underlines the fact that a proposal to amend is special business that is required to be set out in the notice of meeting of shareholders that is sent pursuant to s. 11.03. The notice to shareholders must also set out the shareholders' right to dissent, but failure to give notice of that right does not render the amendment invalid. If proper notice of a proposed amendment is not given, a shareholder will have grounds to apply under s. 19.10 to restrain the meeting until proper notice is given to all shareholders.

354. As stated above, the contractual rights acquired by a shareholder through ownership of a share are not vested rights but are, rather, rights that are alterable by a special resolution of the shareholders. Although the corporate share is thus a unique legal institution, where only one class of shareholders exists there is no great injustice involved in such amendment, since every shareholder is aware of this peculiar qualification of his rights. But where a corporation issues, in addition to one class of voting shares, other classes to which particular rights, privileges, restrictions and conditions are attached, an obvious injustice may arise if the voting shareholders are permitted to abrogate, vary or derogate from these rights, privileges, restrictions and conditions. Indeed, generally such changes are demonstrably unfair.

355. The United Kingdom Companies Act, 1948 does not deal clearly with this problem, but it does appear to offer considerable protection to class shareholders. See Gower, *Modern Company Law,* 3rd. ed., 1969, pp. 506 to 514. Subsection (3) and (5) of s. 48 of the Canada Corporations Act, added in 1964-65, expressly protect the holder of a particular class of shares: but if anything those provisions go too far, apparently giving class shareholders veto power over a proposed amendment even if the class of shares is only remotely affected by it. Section 14.03 attempts to arrive at a compromise which confers very broad protection upon class shareholders, and which at the same time does not unduly restrict management from amending the corporate structure in order to achieve desirable business goals. It is modelled, in part, on the corresponding provisions of the North Carolina Business Corporations Act, which has been described as expressing "...a unique concern for the preferred shareholder". See Hornstein, *Company Law and Practice,* s. 630.

356. The substantive provisions of s. 14.03 are straightforward. A shareholder of a class whose rights are affected has a right to vote whether or not voting rights are attached to the shares he holds in case of any proposed amendment that falls within subsection (1). The cases set out in subsection (1) confer as broad or broader protection than any other Act we have examined. A proposed amendment which does or might derogate from the rights of a class shareholder is sanctioned only if the class approves of the amendment by special resolution (two-thirds majority). Where, on the other hand, the proposed amendment does not affect class rights, if the class has no voting rights attached to its shares, the class does not vote on the issue.

357. Note that where shares of a special class do vote, they vote separately. In short, a separate special resolution is required from each class of shareholders voting. In some cases, there may even be separate votes by the holders of a series of shares: s. 14.03(2). Thus, it is conceivable that one class could veto an amendment agreed to by other classes. But no *shareholder* has veto power. The circumstances described in s. 14.17(1) and (2) are those in which we considered that even a single shareholder should not be compelled to go along with the majority. In those cases the shareholder is not given power to block the amendment agreed to by the other shareholders, but he is given an opportunity to withdraw from the corporation altogether. The machinery for this is more fully described below in the commentary to s. 14.17.

358. One subtlety in subsection (1) of s. 14.03 merits further discussion. By this provision a class is entitled to the protection of a separate class vote not only where their rights are altered directly, but also where there is an indirect effect upon those rights as the result of action in relation to the shares of another class, for example upstream conversion into the class or leap-frogging of one class over another. Subsection (1) is drafted to exclude the effect of a line of English decisions such as *Greenhalgh* v. *Arderne Cinemas Ltd.* [1946] 1 All ER 512; *White* v. *Bristol Aeroplane Co.* [1953] Ch. 65; and *Re John Smith's Tadcaster Brewery Co.* [1953] Ch. 308, which seem to hold that under the "variation of rights" provisions of the United Kingdom Companies Act, 1948, class rights are only affected if they are directly altered. Thus, in the first-mentioned case, the fact that a subdivision of the shares in one class materially diluted the voting strength of another class was held insufficient to entitle the latter to protection. Section 14.03 abrogates the principles stated in these cases.

359. Sections 14.04 to 14.06 are self-explanatory, setting out the administrative procedures relating to an amendment of the articles, which procedures parallel the incorporation routine. In place of the Byzantine provisions governing the reduction of capital in the present Act (ss. 49 to 58), s. 14.04 deals with the reduction of capital in the same manner as any other amendment of the articles, except that three additional conditions must be fulfilled to the satisfaction of the Registrar: (a) the corporation is not or would not thereby be rendered insolvent; (b) adequate notice of the proposed reduction of capital has been given to all creditors of the corporation; and (c) no creditor objects to the amendment. The most difficult standard is the solvency test which is a standard parallel to the insolvency standards applicable to an acquisition by the corporation of its own shares under s. 5.08 and the payment of dividends under s. 5.14. Otherwise the reduction of capital provisions are brief and explicit, relegating to proper perspective something which has long been overemphasized in corporations Acts as a structural technique to protect creditors. In widely-held corporations, a reduction of capital is a rare event. In closely-held corporations a substantial amount of capital is rarely invested by way of shares, causing reduction of capital safeguards to be largely illusory.

360. Section 14.07 is new. It permits the directors of a corporation (or the Registrar to require the directors) to consolidate the corporation's original articles and all amendments thereto in one document to be known as restated articles. This provision is based on s. 59 of the Model Business Corporations Act. In addition to encouraging better corporate housekeeping, by simplifying the format of the articles it will facilitate the shareholder's right of access to corporate records under s. 4.03.

361. Sections 14.08 to 14.13 deal with corporate amalgamations. Although influenced by both the substantive and administrative provisions of the New York and Delaware Laws, these sections continue substantially the policy of s. 128A of the present Canada Corporations Act, modified in respect of formalities and in respect of amalgamations of or with subsidiary corporations. Particularly noteworthy is reduction of the required vote of approval of shareholders in each constituent corporation from a three-quarters majority to a two-thirds majority. As stated in the introduction to this commentary, the policy of Part 14.00 is not to lock management in by rigid structural design but rather to permit a dissenting shareholder to opt out under s. 14.17 if he objects strongly to a proposed change.

362. Section 14.09 sets out in broad terms the required contents of the amalgamation agreement that must be sent to all shareholders for consideration. Except for subsection (2), the section is self-explanatory. Subsection (2), borrowed from s. 196(3) of the Ontario Act, merely reflects proper accounting procedure. If, for example, one amalgamating corporation owns shares in another amalgamating corporation, and if the shares are not cancelled pursuant to the amalgamation agreement, then one of the assets of the amalgamated corporation will be shares in itself. Thus, in the absence of this provision, the amalgamation would have effected an oblique reduction of the apparent capital of the amalgamated corporation, achieved by an indirect acquisition of its own shares.

363. Section 14.10 sets out the mechanics of amalgamation. Note that all shareholders of the corporation have the right to vote in respect of an amalgamation even if all classes of shares do not ordinarily have a right to vote; but a class of shareholders has a right to vote *separately* as a class only if the amalgamation agreement in some way derogates from the rights of the class: subsection (4). This is a slight variation of the policy relating to amendment of the articles of incorporation. Subsection (2), which is an analogue of s. 14.02(2), requires that adequate notice of the proposed amalgamation be sent to the shareholders along with a copy of the amalgamation agreement. Subsection (7) permits the directors of a constituent corporation to terminate an amalgamation agreement at any time before the amalgamation is perfected. Similar provisions are set out in s. 67 of the Model Business Corporations Act and in s. 251 of the Delaware Law. Such immunity from contractual liability is necessary in case many shareholders of a constituent corporation dissent, making extraordinary demands on the cash resources of the corporation and thus rendering the amalgamation impracticable.

364. Although it is novel in Canadian statutes, s. 14.11 is self-explanatory. It permits the directors (without any sanction by the shareholders) to amalgamate a subsidiary corporation with a holding corporation or to amalgamate one wholly-owned subsidiary corporation with another. Similar provisions are commonplace in U.S. state laws, but considerable difficulty has arisen in respect of these provisions because they are not limited to amalgamations of wholly-owned subsidiaries. The result is that they have been used as a technique to squeeze out minority shareholders. See Hornstein, *Corporate Law and Practice,* s. 362. The United States federal law, in particular Rule 10b-5 under the Securities Exchange Act, 1934, has been successfully invoked to prevent such squeeze-outs: *Vine* v. *Beneficial Finance Co.* 374 F 2d. 627; *Voege* v. *American Sumatra Tobacco Corp.* 241 F Supp. 369. Since the short-form amalgamations contemplated by s. 14.11 can affect only wholly-owned subsidiaries, the problems revealed in the United States cannot arise when a short-form amalgamation is effected under the Draft Act.

365. Sections 14.14 and 14.15 are new, permitting a corporation that was incorporated under the laws of one jurisdiction to continue its existence under the laws of another jurisdiction. Similar provisions are commonplace in U.S. statutes but are generally characterized as interstate mergers or consolidations. A similar regime could have been adopted here, but that would have entailed adoption of a whole body of complex rules governing inter-jurisdictional amalgamations. Instead these sections permit simple continuance. If inter-jurisdictional amalgamation is desired, it can be effected in two steps: first, continuance under the laws of the desired jurisdiction; and second, an amalgamation under the laws of that jurisdiction which will then apply to all the constituent corporations.

366. Of the two provisions, s. 14.14 relating to imports is the easier provision to draft, since in this case the corporation becomes subject to the Draft Act which we know offers broad protection to shareholders, and most of the pre-conditions to the transfer will be spelled out in the law of the place out of which the corporation wishes to transfer.

367. Section 14.15, dealing with the export of corporations by continuance under the laws of another jurisdiction (i.e., discontinuance under the

Draft Act) is an inherently hard case, defying the application of fixed rules or even general standards of fairness, for there is always the possibility that unscrupulous management will recommend export to a jurisdiction with easier standards to evade their duties under the Draft Act. For this reason broad discretion is given to the Registrar to block a proposed export. Note, too, that a shareholder has the right to vote in respect of continuance under the laws of another jurisdiction (export) whether or not he is otherwise entitled to vote. In addition, in such case a dissenting shareholder has the right to opt out and to claim the appraised value of his shares under s. 14.17.

368. Subsection (1) of s. 14.16 largely reiterates s. 63 of the present Act, but it completely reverses the emphasis of that section. Here the directors of the corporation are presumed to have broad borrowing powers unless they are restricted by the articles or by-laws of the corporation or by a unanimous shareholder agreement. Under s. 63 of the present Act, these powers must be expressly authorized by by-law. This has caused unnecessary difficulty in Quebec, where pursuant to s. 22 of the Special Corporate Powers Act, a corporation is able to borrow by way of a trust deed of hypothec, mortgage and pledge only if the corporation is so empowered by its "charter or its letters patent". Section 14.16 should make clear that a corporation incorporated under the Draft Act has such power. Usually a borrowing by-law is perfunctorily adopted by the directors of a corporation and sanctioned by its shareholders. It is not just in Quebec, however, where difficulties have arisen because a corporation overlooked adoption of such a by-law. See Fraser & Stewart, *Company Law of Canada* 5th. ed., 1962, pp. 362 to 368.

369. Subsection (2) is new. Under s. 14(1)(d) of the present Act every corporation has incidental to its objects the power to "guarantee the contracts of, or otherwise assist" any other corporation carrying on a business that the guarantor corporation is authorized to carry on, or that is "capable of being conducted so as directly or indirectly to benefit" the guarantor corporation. It also has the incidental power to act as guarantor for any other corporation with which it may have business relations or in which it has an investment: s. 14(1)(q). It seems to be the law, however, that the guarantee will only be valid if it can be shown to be for the benefit of the guarantor. See Fraser & Stewart, *Company Law of Canada* 5th. ed., 1962, p. 64. Subsection (2) is essentially declaratory of the present law, except that the directors' authority to give a guarantee is characterized by a standard of reasonableness instead of as an aspect of corporate capacity. The shareholders may in any case authorize a guarantee by special resolution.

370. Subsections (3) to (11) of s. 14.16 are new, being based substantially upon ss. 71 and 72 of the Model Business Corporations Act. The common law position appears to be that directors have complete powers to dispose of the entire undertaking of a corporation without consulting the shareholders: *Wilson* v. *Miers* (1861) 142 ER 486; *Daniel* v. *Gold Hill Mining Co.* (1899) 6 BCR 495. Apparently no distinction is drawn between sales in the ordinary course of business and sales of assets that constitute a sale of the whole or a substantial part of the business enterprise. Subsection (3) confirms the common law position in respect of a sale, lease or exchange of property in the ordinary course of business, but in respect of extraordinary disposition of assets subsection (4) requires shareholder approval. The procedural rules and the formalities are parallel to those relating to amalgamation and discontinuance, therefore it is unnecessary to describe those provisions in detail in this commentary.

371. It will sometimes be difficult to decide whether a guarantee will further the business of a corporation or whether a sale, lease or exchange is of substantially all the corporation's undertaking. Where there is doubt (and probably even where there is none) prudent third parties to such transactions will demand shareholder approval. This is common practice today.

372. A dissenting shareholder has the right to claim the appraised value of his shares under s. 14.17 if he objects to a proposed sale, lease or exchange of all or substantially all the property of the corporation. In several U.S. jurisdictions, where no right to dissent is granted in respect of the sale of assets but is granted in respect of an amalgamation, management has frequently characterized an acquisition as a purchase of assets instead of an amalgamation to avoid any possible right of dissent. In some states, the common law developed a "de facto merger" doctrine which compelled a corporation to grant appraisal rights even in the case of a sale of assets. By specifically covering the extraordinary sale, lease or exchange of assets in this section, we include what are considered to be the fairer common law precedents.

373. Section 14.17 has been referred to several times in the preceding commentary. Subsection (1) sets out the four basic cases where the right to dissent arises: (a) an amendment of the articles that restricts the transfer of shares; (b) amalgamation with another corporation, except a short-form amalgamation: (c) continuance under the laws of another jurisdiction (export); and (d), a sale, lease or exchange of all or substantially all the corporation's property. In addition, subsection (2) confers upon the holders of a class of shares to which particular rights, privileges, restrictions or conditions are attached the right to dissent from any amendment to the articles that derogates from the rights of holders of that class of shares. Subsection (3) sets out the substantive right to dissent. Subsections (4) to (27) of this section are largely self-explanatory. They set out in detail the procedure to be followed by a shareholder to obtain the appraised value of his shares. Although very long, these provisions are necessary to render the substantive right to dissent meaningful. They are an adaptation of similar provisions contained in s. 623 of the New York Business Corporation Law.

374. To clear up the obscure meaning of "reorganization", subsection (1) of s. 14.18 states that the term includes a court order made under the Bankruptcy Act, s. 19.04 and any other federal law. The object of the section is to enable the court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with all the formalities of the Draft Act, particularly shareholder approval of the proposed amendment. For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders; second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured note holders or preferred shareholders. Presumably then the corporation will be in a position to borrow further upon the security of its assets. In addition, the court will have power to reconstitute the board of directors, thus permitting representatives of the creditors of the corporation to take over the administration of the corporation until the corporation is once again solvent.

375. The procedure and formalities relating to the perfection of reorganization are parallel to the earlier provisions and therefore do not require commentary.

PART 15.00

Prospectus Qualification

376. Although the common law systems of England, Canada and the United States have a common origin, the statute law of each jurisdiction developed independently and thus the substantive rules often diverge widely. But in the area of securities regulation there has been a surprising degree of homogeneity, since both the United States and Canada have adopted—at least in principle—the basic disclosure philosophy advocated by Gladstone as President of the Board of Trade and first enacted in the United Kingdom Companies Act of 1844. See the history of these laws in Gower, *Modern Company Law*, 3rd. ed., 1969, pp. 40 to 43; Loss, *Securities Regulation*, p. 6; Loss & Cowett, *Blue Sky Law*, p. 17; Williamson, *Securities Regulation in Canada*, pp. 4 to 34.

377. Generally, all jurisdictions in the common law world have adopted the basic disclosure concept of the English statutes. At the state level in the United States and the provincial level in Canada, however, numerous other standards have been engrafted to raise the duty of the issuer somewhat above the level of mere disclosure. In addition, many jurisdictions give the securities administrator broad discretion to impose further conditions upon the issuer for the protection of investors. See Loss & Cowett, *Blue Sky Law*, p. 77. The conditions in s. 15.23 of the Draft Act are typical. While the laws in the United Kingdom have dominated the substantive concepts of the securities statutes, the U.S. Securities Act of 1933 has led the way in the development of techniques to administer these laws through an independent regulatory commission, a pattern that has been adopted in Ontario and in the jurisdictions in Canada that have adopted the Ontario Securities Act as a model. There are, therefore, many parallels between the Canadian securities laws and the U.S. Securities Act of 1933.

378. Specifically, Part 15.00 is an adaptation of Part VII of the Ontario Securities Act, varied to add the sections incorporated by reference in that Part from other Parts of the Ontario Securities Act, to make the style conform to the drafting of the Draft Act and, to a limited extent, to pick up some of the suggestions in respect of mechanics set out in the recent Ontario Merger Study. The broad substantive changes recommended in that study are not embodied in this Draft. That is not to say, however, that we do not agree with those suggestions. In fact, we do. But in the interests of uniformity, we think that such changes should be made at the same time, preferably after a joint study by the federal and provincial authorities. We have not attempted therefore to make any critical analysis of the present Ontario law.

379. To describe in detail all the provisions of Part 15.00 would require a very extensive commentary. Indeed, the matter dealt with in this part is the subject of very lengthy legal texts. In this commentary, therefore, we are proceeding on the assumption that most of the pertinent provisions of the Ontario Securities Act are well enough known to permit us to deal with them rather perfunctorily. Where we have made changes, we comment in detail on them.

380. Because we have not included the provisions of the Ontario Securities Act dealing with the registration of brokers and dealers, we have been able to abridge considerably the number of definitions required to be set out in s. 15.01. Except for the definition of "primary distribution to the public" (s. 15.01(b) of the Draft Act) the definitions are parallel in substance to those in the Ontario Securities Act. Adopting the recommendation contained in the Ontario Merger Study (p. 46) we have deleted the word "primary" from this particular concept, leaving the phrase "distribution to the public". That study also recommended deletion of the word "public". We concluded that deletion of the term "public" would be premature.

381. The provincial securities Acts use three basic techniques to regulate the securities markets: (a) qualification by registration (upon compliance with specified standards) of the principal actors in the market—security issuers, dealers, salesmen, underwriters, and investment advisers; (b) qualification of securities proposed to be distributed to the public by the registration of a prospectus, again subject to compliance with the statutory standards; and (c), anti-fraud provisions that are enforceable by civil action, making the Acts largely self-enforcing. Part 15.00 is concerned principally with the regulation of the anti-fraud of securities to the public, reinforced by the general distribution provisions of s. 15.28.

382. The foundation of this entire Part is s. 15.02, which bars any distribution of securities to the public until a prospectus has been qualified in accordance with the broad disclosure standards of ss. 15.08 and 15.09, and the more rigorous discretionary standards of s. 15.23, which originated in the "blue sky laws" of the U.S. states and later spread into the securities Acts of the Canadian provinces. The use of the defined term "distribution to the public"—s. 15.01(b)—extends the scope of Part 15.00 to include both primary distributions by the issuer corporation and secondary distribution by one who holds a controlling bloc of those securities. Because it is impossible to define explicitly the terms "distribution to the public" and "control", just what constitutes such a distribution remains somewhat unclear, particularly where securities are issued directly to an exempt institution or pursuant to an exempt trade (for example, a "private placement") and subsequently leaked into the marketplace without any prospectus disclosure at either stage. These administrative problems are dealt with more fully in the comments to ss. 15.20 and 15.21.

383. As we have said, the administrative techniques employed in this Part parallel closely the provisions of the U.S. Securities Act of 1933 and operate briefly as follows:

(a) No distribution of a security to the public is permitted until a prospectus has been filed with and a receipt issued by the Registrar: ss. 15.02, 15.05;
(b) During the waiting period, that is between the date of the receipt for the preliminary prospectus and the issue of a receipt for the final prospectus, the issuer or its agents may give public notice of the proposed distribution of securities to the public by "tombstone ads", distribution of a preliminary prospectus containing all the material facts except the auditor's report, underwriter's commission and final offering price, and the issuer or its agents may also solicit expressions of interest. But no firm contracts for the sale of the securities may be made during this waiting period: ss. 15.03 to 15.06;
(c) Upon the issue of a receipt for a prospectus by the Registrar the effective period of the prospectus commences. Each sale of a security must be accompanied or followed with two days by the delivery of a prospectus: s. 15.26. To ensure that the qualified prospectus is the principal source of sales literature, the use of supplementary selling literature is regulated: ss. 15.03, 15.19.
(d) Any material change affecting the issuer corporation during either the waiting period or the effective period must be disclosed by an amendment to the preliminary prospectus during the waiting period or to the prospectus during the effective period: ss. 15.07, 15.17.
(e) If the effective period of the qualified prospectus, that is the distribution period, lasts longer than 12 months, then the original prospectus is presumed to be stale and a new "12 month prospectus" must be filed and qualified: s. 15.18.
(f) Finally, on the suspension or termination of a distribution of securities to the public, each person involved must notify the Registrar accordingly: s.15.16.

384. By legitimating the process of soliciting expressions of interest during the waiting period, s. 15.03 circumvents one aspect of the problem of "jumping the gun" that plagued the administration of the U.S. Securities Act before 1954, at which time that Act was amended to permit similar solicitations. Obviously, during the waiting period, the issuer is under great pressure to promote interest in the proposed offering, therefore to bar selling efforts completely during this period would invite the use of avoidance techniques. The rules contained in this section largely resolve this problem, reconciling the practical needs of the issuer with the need to regulate, at least to a limited extent, sales effort before the final prospectus is qualified. The other aspect of the problem, the conditioning of the market by press releases before or during the waiting period, is not easily solved. The difficulty is to distinguish between giving normal information to shareholders and the public and extraordinary sales effort. No special regulations govern this aspect in any jurisdiction, although some clarification has been recommended in the Wheat Report (pp. 127 to 148).

385. Consistent with the policy of regulating sales efforts during the waiting period, s. 15.04 requires that a person making a distribution of securities to the public must maintain a record of the name and address of each person to whom a preliminary prospectus has been sent. This enables the prompt despatch of an amended preliminary prospectus under subsection (3) of s. 15.07, if a material adverse change occurs during the waiting period.

386. Following the U.S. model, s. 15.03 stipulates a waiting period or "cooling off period" of at least 10 days during which all parties involved in a securities distribution—the issuer, managing underwriter, members of the underwriting group or syndicate, and dealers—may consider the terms of the issue. The concept of a "cooling off period" was one of the major provisions added to the United Kingdom model by the U.S. Securities Act of 1933 (see Loss, *Securities Regulation,* p. 268). The mandatory waiting period gives rise to two problems. First, it is impossible to determine what is a reasonable offering price until the prospectus has been qualified and the receipt issued, at which time the securities may be offered to the public. Indeed, it is general underwriting practice for the underwriter to stipulate for a "market out" clause, that enables him to withdraw in the case of collapse or even substantial decline of the market during the waiting period. Second, it is essential that the parties to the distribution be permitted to generate some interest in the proposed offering by advertising and contacting prospective investors. Recognizing these practical needs, s. 15.03 permits distribution or publication of a "tombstone ad", distribution of a preliminary prospectus, and the solicitation of expressions of interest, if the solicitation is accompanied or followed by delivery of the preliminary prospectus.

387. To reconcile the conflicting policies of complete disclosure to the prospective investor and careful scrutiny of the proposed distribution during the waiting period, s. 15.05 permits omission from the preliminary prospectus of auditors' reports and particulars of the underwriters commission and the offering price. Whether or not the preliminary prospectus is complete, the parties involved in the distribution must at the time of sale of a security deliver a prospectus under s. 15.26, which prospectus must be congruent with the preliminary prospectus and must contain the "price amendment" and other particulars that had been omitted from the preliminary prospectus.

388. Section 15.06 is the analogue of Rule 433, a regulation adopted by the U.S. Securities and Exchange Commmission pursuant to powers vested in that body by the Securities Act of 1933. The purpose of this section, of course, is to underline that the preliminary prospectus may be used only to generate interest in the proposed securities distribution and not as a basis for a firm contract of purchase and sale of a security. In addition, this section states explicitly the basic substantive rule that no firm contract for the purchase and sale of a security may be made during the waiting period, telescoping into one section what is contained in s. 5 and Rule 433 of the Securities Act of 1933, and what is stated indirectly in ss. 15.02 and 15.26 of the Draft Act.

389. To ensure that the preliminary prospectus is a true statement of the particulars of the proposed securities offering, and that it will be used only for the purpose of generating interest in that offering, s. 15.07 stipulates that where the preliminary prospectus is defective (failure to comply with the Act) or where some material adverse change in the business of affairs of the corporation has occurred during the waiting period, the preliminary prospectus must be amended accordingly. As a corollary, a copy of the preliminary prospectus as amended must be sent to each person who received the preliminary prospectus and who is therefore shown on the list maintained under s. 15.04. Section 15.17 imposes a similar rule in respect of material changes that take place after the effective date.

390. Section 15.08 sets out the basic disclosure standard, which originated in the United Kingdom Companies Act of 1844 and which was later introduced into the Canada Corporations Act, the U.S. Securities Act of 1933, and also the Ontario Securities Act (see Loss & Cowett, *Blue Sky Law*, p. 18). This broad standard is buttressed by the more specific provisions of ss. 15.09 and 15.23. The latter section superimposes on the basic disclosure philosophy of this section the "blue sky" philosophy of the U.S. state jurisdictions, giving to the regulatory authority quite wide discretion to qualify or to impose conditions on a prospectus, and therefore to determine whether the securities may be distributed to the public. These quality standards are of critical importance in Part 15.00, for a breach of these standards may give rise to the purchaser's right of civil action under s. 15.28, the sanction that makes this law largely self-enforcing. Moreover, the Registrar may restrain the distribution under s. 15.24 where the quality standards of s. 15.23 are not fulfilled.

391. Paraphrasing the language of para. (d) of s. 8 of the U.S. Securities Act of 1933, s. 15.09 requires additional disclosure where any statement would otherwise be misleading, even if the Act does not specifically require that such fact be disclosed in the prospectus. The language of this section is reiterated in s. 15.23, permitting the Registrar to enforce compliance with such quality standards by issuing a restraining or stop trading order under s. 15.24.

392. Wherever feasible, we have omitted from the Draft Act accounting rules that we think are better set out in the proposed regulations. Consistent with this view we have left out of the Draft Act the following sections of the Ontario Securities Act:

s. 43 Financial statements required in prospectus.
s. 44 Pro forma balance sheet showing effect of issue may be required in propectus.
s. 45 Financial statements required in case of acquisition of a business.
s. 48 Designation of financial statements required in a prospectus.
s. 49 Separate financial statements of a subsidiary may be required in a prospectus.

This policy accords with the accounting rules made in the United States under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Companies Act of 1940. These rules, called Regulation S-X to reflect that they apply to all the above mentioned Acts, were first adopted in 1940. They have stirred much controversy, but the fact that they are set out in regulations instead of in the Act has caused no problem (see Loss, *Securities Regulation*, pp. 326 to 340).

393. Although long, s. 15.10 is largely self-explanatory, dealing with the eligibility of an auditor whose report is to be used in the prospectus, the qualifications that the auditor may make in his report, and requirements for certain special reports. Consent to the use of such a report must be filed under s. 15.12. As in the U.S. system (Reg. S-X, Art. 2), the independence of the auditor is a keystone of Part 15.00. Section 15.10 varies substantially from the Ontario model; it is an analogue of s. 13.15 of the Draft Act. The significance of s. 15.10 in the context of this Part is that if a material, untrue statement is embodied in a prospectus, the purchaser of a security offered by the prospectus may obtain rescission of the purchase and sale contract within 90 days after the date of the purchase: s. 15.27. In contrast, s. 11 of the U.S. Securities Act of 1933 imposes civil liability upon an accountant, unless he can establish that, after a reasonable investigation, he had reasonable grounds to believe that the statements were true, or unless he can invoke some other statutory defence set out in s. 11. Section 11 of the U.S. Act is itself an analogue of s. 43 of the U.K. Companies Act, 1948.

394. In a recent U.S. case, *Escott* v. *Barchris Construction Corp.* 283 F. Supp. 643, a federal court, relying on s. 11, imposed liability upon auditors for misstatements contained in a prospectus report. In imposing liability, the court applied the analogous rule concerning directors liability established in the English case of *Adams* v. *Thrift* [1915] 2 Ch. 21. That case would be applicable to determine the civil liability under s. 15.28 of directors and promoters who sign the certificate required by s. 15.14. It would not apply to auditors, who have no corresponding duty to certify the prospectus. That is not to say, however, that an auditor, expert or underwriter who consents to the inclusion of his report in or who certifies a prospectus is not exposed to liability. Unlike the U.S. Securities Act of 1933, this Part does not impose civil liability upon such persons. But they must always consider the possibility of liability for negligent misstatements contained in a prospectus upon which an investor relies when he purchases a security. See *Hedley, Byrne & Co. Ltd.* v. *Heller & Partners Ltd.* [1967] 2 All ER 575 and the subsequent decisions applying the rule established in that case.

395. Section 15.11 underlines the liability of directors for the contents of the prospectus. In addition to the general certification under s. 15.14, under this section they, in effect, specifically certify the contents of the financial statements that are embodied in the prospectus.

396. To preclude misuse of experts' opinions, s. 15.12 requires that each expert named in subsection (1) must expressly consent to the inclusion of his report or opinion in a prospectus. Subsection (3) supplements s. 15.10, requiring the auditor to accompany his report under that section with a declaration to the effect that any inference drawn from the financial statements and set out in a prospectus is not misleading. Subsections (4) and (5), consistent with the disclosure philosophy of Part 15.00, compel full disclosure of any conflict of interest of an expert that may detract from the objectivity of his opinion or report that is embodied in the prospectus. Subsection (6), repeating in part subsection (1) of s. 15.10, confers unlimited discretion on the Registrar to refuse to issue a receipt for a prospectus if he does not approve of any expert referred to in subsection (1).

397. Section 15.13 is a logical corollary of s. 15.12, enabling the Registrar to require a further express consent from an expert as described in subsection (1) of s. 15.12, if an amendment to a preliminary prospectus or prospectus materially affects the original consent.

398. Section 15.14 is a simplified version of s. 11 of the U.S. Securities Act of 1933. Both provisions are derived from the United Kingdom Directors' Liability Act of 1890, which was enacted to abrogate the decision in *Derry* v. *Peek* (1889) 14 App. Cas. 337, where the House of Lords concluded that the common law deceit action did not apply to a non-fraudulent misstatement contained in a prospectus. The successor provision is now set out in s. 43 of the U.K. Companies Act, 1948. Its counterpart is s. 78 of the Canada Corporations Act. Technically, the effect of this section is to give the purchaser of a security a right of action for damages against a director or promoter named in the section, without having to invoke the common law action based on deceit: that requires proof that there was an untrue statement of a material fact, knowingly made with the intention that the plaintiff should rely on it, actual reliance upon the statement by the plaintiff, and injury to the plaintiff because of such reliance. In a securities context, the action was framed in tort because there was frequently no contractual privity between the person who made the misstatement and the person who purchased the security, relying on that misstatement. In effect, s. 15.14 abrogates most of the technical difficulties of the deceit action, requiring only that the plaintiff purchaser of the security establish that there was an untrue statement of a material fact in the prospectus and that he suffered some loss as a result. The statement need not be made knowingly with the intention that the plaintiff should rely on it. Moreover, the plaintiff is presumed to rely upon the misstatement in the prospectus, even if he had not read the prospectus before entering the contract of purchase and sale of the security. The section only sets out the duty of the promoters, directors and officers to certify the prospectus. Section 15.28 creates the civil right of action and the correlative liability of the persons named in subsection (1) of s. 15.14.

399. Section 15.15 sets out the details of the mandatory certification by underwriters which must be included in a prospectus. The wording, of course, is taken from s. 15.08, which stipulates the general quality standards of disclosure required in a prospectus—". . . full, true and plain disclosure . . .". In contrast to s. 11 of the U.S. Securities Act of 1933, no statutory right of action against an underwriter is given under s. 15.28 to the purchaser of a security offered under a prospectus containing such certification, even if the certificate itself contains a misstatement. But the Draft Act does not confer any immunity on the underwriter with respect to a civil action for damages for negligent misstatements.

400. Section 79 of the Canada Corporations Act, based on Rule 462 of the U.S. Securities Act of 1933, strictly regulates delayed or suspended distributions requiring a bona fide intent to distribute at once after qualification, and stipulating that immediate notice be given to the regulatory authority of a delay or suspension. The time periods set out in the two Acts vary considerably, but the substance is essentially the same. Section 15.16 of the Draft Act, based on s. 54 of the Ontario Securities Act, is considerably less stringent. No declaration of intent is required. No express time limits are stipulated. Nevertheless, the issuer must give notice to the Registrar of the commencement and of the termination of his participation in the distribution. Notice of a substantial delay or precipitate withdrawal by an underwriter will alert the Registrar, and enable him to ascertain the reasons for the delay or termination. If satisfied that something is amiss or that the prospectus is "stale" or otherwise misleading, the Registrar may restrain the distribution under s. 15.24.

401. In addition, s. 15.16 supplements s. 15.02, declaring that no distribution to the public may be made until after the Registrar has been notified. This provision, in close cases, may bring s. 15.21 into play, requiring that the Registrar determine whether or not a "distribution to the public" is involved. What s. 79 of the Canada Corporations Act does directly, s. 15.16 achieves only obliquely. The emphasis in this section on the parties to the distribution is more readily enforced in the Ontario context, where the principal market actors must qualify and register ("registrants") and must maintain records of their transactions. If any question arises, the Ontario Securities Commission can quickly ascertain which registrants participated in the distribution, check their records, and so determine the time duration and the breadth of the distribution. For the sake of uniformity, the Ontario provision is left unchanged. Experience may establish that a reversion to more stringent regulation under a provision like the present s. 79 is necessary.

402. Section 15.17 is largely self-explanatory, requiring an amendment to a qualified prospectus where a material change occurs during the period of distribution of the securities offered by the prospectus. A preliminary prospectus used during the pre-effective period must be similarly amended under subsection (2) of s. 15.07. Since such amendment provisions are an integral part of any system of prospectus qualification, parallels are to be found in s. 80 of the Canada Corporations Act and s. 10 of the U.S. Securities Act of 1933.

403. The objective of s. 15.18 is to ensure that the information contained in a prospectus, particularly the financial data, does not become stale. The regulations, corresponding to s. 43 of the Ontario Securities

Act will stipulate that the financial statements included in the prospectus must not be dated more than 120 days before the issue of the receipt for the preliminary prospectus, thus permitting the information contained in the financial statements to be, at most, 16 months old. Section 15.18 therefore requires that a new "12 month" prospectus be prepared for distribution if the distribution has not been completed within that 12 month period. These limits correspond quite closely to the time periods stated in the U.S. Securities Act of 1933. See Loss, *Securities Regulation,* p. 294. The problem of the stale prospectus is also dealt with in ss. 79 and 80 of the Canada Corporations Act.

404. Following s. 57 of the Ontario Securities Act, s. 15.19 declares the policy of Part 15.00 that the prospectus shall serve as the basic source of information in respect of a securities sale. This section also legitimates the use of the "tombstone ad" literature that is permitted under subsection (2) of s. 15.03. The section is, however, open-ended, impliedly permitting the use of supplementary selling literature that is not prohibited by the regulations. Apparently no regulations in this regard have been made under the Ontario Securities Act. The U.S. Securities Act of 1933 permits the use of supplementary selling literature after the effective date, if the supplementary selling literature either follows or accompanies the delivery of the prospectus. In the absence of regulations, s. 15.19 would condone at least that kind of supplementary selling literature. See Loss, *Securities Regulation,* p. 249. See also the discussion of the related "gun jumping" problem in chapter 5 of the Wheat Report.

405. Section 15.20 brings into sharp focus one of the most intransigent problems in the regulation of securities distributions: to chart a navigable course between two not wholly satisfactory techniques of administration. The first involves regulation of every securities distribution (by the issuer or by a control person), however small, other than those transactions expressly excepted by the Act. The second, starting from the opposite end of the spectrum, involves regulation of only those transactions, whether primary or secondary distributions of controlling blocs, that are in fact distributions to the public. In the second system, interpretation of the words "public" and "control" are of strategic importance to determine what is or is not a lawful transaction. It is this problem, among others, that was analysed in the recent Ontario Merger Study.

406. The present Ontario system—and hence the system set out in this Part—follows generally the second approach. Sections 15.02 and 15.21 in effect require that a distribution of securities must be preceded by qualification of a prospectus, unless the distribution is not a distribution to the public (s. 15.02), or the distribution is exempted from prospectus qualification under s. 15.20. In addition, ss. 15.02 and 15.20, because of the broad definition of "distribution to the public", similarly govern a secondary distribution by a control person, who must also qualify a prospectus before distribution unless he can invoke one of the foregoing exemptions. But if the issuer or control person makes an exempt distribution to one or more purchasers, each such purchaser may, if he is not in turn a "control person", resell the securities without previous qualification of a prospectus. The only limitations on this general rule are the requirement of "investment intent" added to subsection (1) of s. 15.20 and the limit on further distribution to the public in paragraphs (d) and (e) of subsection (3). The qualification of investment intent is not contained in s. 19 of the Ontario Securities Act: it was included because of the conclusion reached in the Ontario Merger Study (p. 68).

407. Paragraph (d) of s. 15.20(2) covers a case where an exemption is appropriate, but one which is not explicit in the Ontario Securities Act.

408. Subsection (1) of s. 15.21 gives broad discretion to the Registrar to determine whether a proposed or intended trade constitutes a "distribution to the public". When hearing applications under the counterpart of the Ontario Securities Act (s. 59), the Ontario Securities Commission applies a "need to know" test, which is apparently a variation on the "investor's ability to fend for himself" concept that is based on the standards established by the U.S. Supreme Court in *S.E.C.* v. *Ralston Purina Co.* 346 U.S. 119 (1953) and reiterated in SEC Release No. 4552 (1962). See Loss, *Securities Regulation,* p. 653; and also the Ontario Merger Study, p. 38. The Ontario Merger Study says this section provides a residual discretion, enabling the regulatory authority to determine whether there is a "distribution to the public" where there is no clear exemption from qualification of a prospectus. The problem is discussed extensively in that study at pp. 38, 47, 54 and 75.

409. The definition of "distribution to the public" includes secondary distributions by control persons. The concept of "control" is a matter of fact in each case as it has been under the analogous provisions of the U.S. Securities Act of 1933 (see Loss, *Securities Regulation*, ch. 5). As a result of this broad meaning of "control", a control person may be in a position where he is required to qualify a prospectus before he can make a secondary distribution to the public of his bloc of shares at a time when he has not sufficient voting control to be able to compel the issuer corporation to provide him with the information that is essential to prepare the prospectus. Section 15.22 resolves this impasse, empowering the Registrar to compel the issuer corporation to provide such information to the control person, or to waive the inclusion of information concerning the corporation that would otherwise be required in the prospectus.

410. As stated in the comment to s. 15.02, Part 15.00 imposes two different sets of standards of quality respecting prospectus disclosure. The first standard is the general declaration that a prospectus must provide full, true and plain disclosure (ss. 15.08 and 15.09). This implies that prospectus disclosure must not only be complete but also readable, meaning that the truth should not be obscured by unnecessary detail. The problem of the readable prospectus is discussed at length in the Wheat Report, pp. 80 to 95. The second set of standards are the discretionary or "blue sky" standards set out in s. 15.23, which have their origin in the U.S. state laws (see Loss & Cowett, *Blue Sky Law*, p. 67).

411. The Ontario Merger Study points out that this latter section creates a residual power in the Commission. Indeed, the criteria are so broad that the section virtually creates a "just and equitable" standard. The very broad discretion given to the Registrar is ameliorated by the following provisions:

(1) Subsection (2) requires that the Registrar give written reasons for his decision to refuse the issue of a receipt for the prospectus;
(2) Section 19.08 repeats the duty to give written reasons and further stipulates that the reasons must be given within 10 days and, if not, are deemed to be given within 20 days; and
(3) Section 19.09 affords a complainant a right of appeal to a court.

The right of appeal under s. 19.09 may be somewhat illusory, since the standards of s. 15.23 are very broad. But the right right of appeal will at least ensure that these broad standards are not applied in a discriminatory way.

412. Section 15.24 ensures that the Registrar is not rendered helpless by the issue of a receipt where he has overlooked a failure to comply with the standards, or where some non-compliance with the prospectus. arises after the issue of a receipt for the prospectus. In effect, this section empowers the Registrar to enjoin further distribution of securities without having to apply to a court for an injunction. Like many of the administrative provisions of this Part, the provision parallels the U.S. Securities Act of 1933, s. 8(d).

413. Section 15.25 complements ss. 15.23 and 15.24, conferring upon the Registrar wide discretionary authority to stop the distribution of securities of a finance corporation where there is a failure to comply with the standards set out therein. This section applies explicitly to the effective period of the prospectus, reflecting the more stringent regulatory control that is required over the volatile issues of finance corporations.

414. Consonant with the philosophy of this Part, subsection (1) of s. 15.26 requires that a current prospectus be used as the basis of the selling literature used to sell a security. More specifically, the delivery of a prospectus to the buyer must precede, be contemporaneous with, or follow within two days after the sale of the security. Recognizing that securities are particularly "sensitive goods", subsection (2) grants an option to the buyer to rescind the sale within two days after receiving a prospectus, a privilege which accords with the general protection given to purchasers of goods from door-to-door salesmen under s. 18 of the Ontario Consumer Protection Act, 1966. The remaining subsections set out the rules that make this system workable. The protection given to the buyer of a security by this section is considerably greater than the protection given under s. 12 of the U.S. Securities Act of 1933, which permits rescission only if the buyer establishes that no prospectus was delivered as required by law or that the prospectus contains a material false statement.

415. Section 15.27 is the counterpart of subsection (2) of s. 12 of the U.S. Securities Act of 1933, giving the buyer of a security the privilege to demand rescission within 90 days after he receives the prospectus, if the prospectus contains a material false statement or omits a material statement necessary to ensure that the prospectus is not misleading as required by ss. 15.08 and 15.09.

416. Section 15.28 declares the right of a purchaser of a security to recover damages from the persons specified in s. 15.14 (promoters, directors and officers), where the prospectus contains a material false statement. This provision, like its analogue, s. 11 of the U.S. Securities Act of 1933, is based on what is now s. 43 of the U.K. Companies Act, 1948, the successor of the substantive rules set out in the U.K. Directors' Liability Act of 1890, which had been enacted to abrogate the effect of the House of Lords decision in *Derry* v. *Peek* (1889) 14 App. Cas. 337 (see the comment above on s. 15.14).

417. Section 15.28 adheres more to the original United Kingdom model than does s. 11 of the U.S. Securities Act of 1933, which is somewhat wider in scope (like s. 15.27 it refers to omissions as well as untrue statements) and much wider in application (in addition to the promoters, directors and officers referred to in s. 15.14, it applies expressly to a security issuer, every accountant or other expert who consented to use of his report or opinion in the prospectus, and every underwriter). Note, however, that s. 43 of the United Kingdom Act does apply to experts, therefore its application, too, is somewhat wider than this section. The qualifications to the almost strict liability declared in this section are roughly parallel to those contained in the U.K. and U.S. laws, except that the U.K. and U.S. statutes, because they apply to experts, include additional exculpatory provisions that refer only to those experts.

418. Section 15.29 supplements the rescission remedy provided in s. 15.27: it prohibits a salesman from soliciting an order for the sale of securities by telephoning or by calling at a residence, and thus it protects the consumer from harassment and from high pressure sales techniques. In addition, this provision, enforced by a penalty, discourages unlawful distribution of Canadian securities to buyers in the United States who are solicited by telephone from Canada to make purchases through their U.S. brokers, a technique that has been used to evade the securities Acts of both the United States and the Canadian provinces (see Loss, *Securities Regulation,* p. 706). Section 15.29 is modelled after a provision that was added to the United Kingdom Companies Act in 1928 as an alternative to qualifying and licensing securities salesmen (see Mutual Funds Report, p. 552). Its counterpart now appears in the Canada Corporations Act (s. 82) and, in varying form, in the provincial securities Acts.

419. The Uniform Securities Act permits the registration of securities to be effected in three ways:

(a) *Registration by notification:* issuers that are large, established corporations with a respectable history of earning and dividend distributions may distribute shares to the public simply upon filing notification of the proposed distribution with the regulatory authority. Federal law in the United States, although it does not permit this type of registration, is moving in this direction as a result of the Wheat Report. See, for example, SEC release 4996 of September 15, 1969 in respect of short-form registrations, and see also the Ontario Merger Study, p. 18. Distribution of listed securities through an exchange under s. 15.20(3)(h) of the Draft Act is an analogous technique.

(b) *Registration by co-ordination:* this permits registration of securities by notice where the securities proposed to be distributed to the public are qualified contemporaneously in another jurisdiction having comparable regulatory laws and, of course, similar standards.

(c) *Registration by qualification:* this, of course, means registration by compliance with the quality standards imposed by a securities Act.

These techniques are discussed in Loss & Cowett, *Blue Sky Law,* p. 241.

420. Section 15.30, an adaptation of s. 76A of the present Act, permits registration by co-ordination, supplementing the rules regarding registration by qualification set out in this Part. The operation of this section can best be seen by an illustration. Where a corporation that is incorporated under this Act proposes to distribute its securities to the public, if the proposed distribution is qualified under a provincial securities Act—or even under a foreign law—that imposes similar quality standards, the Registrar may in his discretion waive the obligation to qualify the offering under this Part. This Part does not contain any express provisions with respect to registration by notification. Both the Wheat Report and the Ontario Merger Study recommend that where a corporation qualifies as a "reporting corporation" (meaning that it is required by law to file frequent reports with a regulatory body and to make timely disclosure of material changes in the corporation's business and affairs), the corporation may register a proposed distribution of securities to the public simply by notification and distribution of a short information circular in lieu of a prospectus. We agree, for we think that this is a necessary first step to establishing a system of continuous disclosure by corporations as distinct from disclosure related to specific issues of securities.

421. As stated in the introduction to this commentary, although we are aware of the changes in the system of securities regulation recommended in the Wheat Report and in the Ontario Merger Study, we consciously avoided any major amendment of the present Ontario model. This we did for three reasons, all closely related: first, the Ontario provisions are familiar both in Ontario and the western provinces; second, for the sake of uniformity, unilateral changes should be avoided; and third, if the statutory system is to be varied, it should take into account all the current issues—a uniform securities code for all jurisdictions in Canada that covers all aspects of the securities market, including investment companies, creation of a national securities commission, and finally the creation of a national data centre for corporate filings.

422. Although there are some differences in policy from one jurisdiction to another in Canada, in fact no jurisdiction seriously questions the substantive rules and administrative procedures set out in the Ontario Securities Act. The distinctions that do exist—for example, local requirements of certain financial statement captions—are so subtle that they constitute more a nuisance to the issuer than an added protection for the investor. Irrespective of the question of a national securities commission, it is most desirable that all jurisdictions uniform in Canada should co-operate to develop and adopt a uniform securities code. Such a code would minimize conflicts, simplify national distributions, and furnish greater access to the capital market to issuers all over Canada. Tentative but nevertheless positive steps are being taken toward such a codification in the United States under the auspices of the American Law Institute: See Loss, *ALI Federal Securities Code Project*, (1970) 26 Business Lawyer 555.

423. A corollary of a uniform, national securities law would be a national commission to recommend policy and to adjudicate in respect of the regulatory system. Whether a national commission should be established by the provinces alone, the provinces in conjunction with the federal government, or the federal government alone is an issue outside our terms of reference. But the advantages of such an agency are clear. It would eliminate much duplication of effort at the provincial level. It would make possible the accumulation and development of the expertise that is essential to regulate a sophisticated securities market. And, most important, it would be a nucleus around which a truly national capital market could be built. These problems have already been analysed extensively in respect of the many U.S. jurisdictions: Loss & Cowett, *Blue Sky Law*. The subject is also mentioned in the Mutual Funds Report at p. 715.

424. If a national commission was set up, it could also serve as the administrator of a national data bank on Canadian corporations and enterprises that issue securities to the public. If not the central theme, at least the most recurrent idea in the Wheat Report and the Ontario Merger Study is that continuous disclosure by corporations that distribute securities to the public should be substituted for the present, "one-shot" disclosure philosophy that is implicit in the emphasis upon propectus contents. Indeed, on the assumption that the present reporting rules already require continuous disclosure—although somewhat haphazardly—the Ontario Merger Study recommended a new system that would relegate the prospectus to its originally intended role, a brief, understandable description of the issuer's history and prospects. Very briefly those aspects of the study can be summarized as follows:

(a) Corporations that distribute their securities to the public are to be subject to continuous disclosure rules (regular reports and timely disclosure of material changes)—these are "reporting corporations".

(b) The term "primary distribution to the public" should be replaced by the term "distribution", "public" being redundant because s. 15.02 of the Draft Act applies to every trade, and "primary" is simply superfluous. It will continue to include a distribution out of a controlling bloc.

(c) When making a "distribution", instead of using prospectuses, reporting companies will distribute only a brief "offering circular", a policy based on the assumption that the corporation's file contains all material information, and that it is always open to public inspection.

(d) The general prospectus exemptions (basically accorded to exempt purchasers and private placements) will be available to reporting corporations (subject to immediate disclosure) and resale by such purchasers will be regulated (minimum holding period of 28 days, report of trade and, if a control person, no special selling efforts).

(e) The prospectus exemptions most frequently invoked in "two-step" transactions to avoid disclosure—exempt purchasers, private placements (Draft Act s. 15.20(1)—will not be available to non-reporting corporations.

(f) Other exemptions, such as trades by a corporation with an underwriter or to its security holders or employees would be available, but such purchasers will *not* be permitted to resell these securities until disclosure has been made, barring leakage into the market of securities distributed without disclosure at any stage.

(g) To obviate administrative scrutiny of share issues in closely held corporations a new exemption for "promoters" will be vital. But this, of course, gives rise to a new definitional problem—in close cases the problem will be interpretation of "promoter" instead of "public". In any event resale by promoters also will *not* be permitted until disclosure has been made.

425. The system proposed would clearly be an improvement over the present regulatory scheme. But it would be demonstrably better if administered by a national commission backed by national resources and a very comprehensive data bank. The real problem, which is inherent in every federal system, is to reconcile national policy making with regional administration. Although difficult, the problem is not formidable. And the goal is obviously worthwhile. In the meantime, we think that the federal government should proceed to qualify the prospectuses of federal corporations under Part 15.00: first, to acquire the expertise that is necessary to administer a contemporary corporation law; and second, to make easier the transition to a national system.

PART 16.00

Take-over Bids

426. Continuing the policy which, in 1970, carried into the Canada Corporations Act the Ontario law relating to financial disclosure, insider trading, proxies and take-over bids, Part 16.00 adheres closely to the principles set out in Part IX of the Ontario Securities Act. A few substantive changes are made in the Draft Act, but again we concluded that it would be better, for the sake of uniformity, to resist the temptation to make major modifications to the Ontario law. Otherwise we would have adopted most of the recommendations in Chapter 7 of the Ontario Merger Study. Instead, as in Part 15.00, we included only the recommendations that we thought were immediately useful to clarify the present law.

427. Most of the provisions in Part IX of the Ontario Securities Act are derived from the United Kingdom "City Code on Take-overs and Mergers" of March 27, 1968 and its predecessors. Recently, by amendments to ss. 12 and 14 of the Securities Exchange Act of 1934, the U.S. Congress also enacted into law some of these regulatory provisions governing take-over bids. A brief history and comparative analysis of these laws is contained in (1969) 24 Business Lawyer 1275.

428. Although there are some changes in the drafting style, the definitions in s. 16.01 correspond closely to the Ontario model. There are however three changes worth noting. First, subparagraph (i) of paragraph (b) limits exempt offers by separate agreements to agreements with not more than 15 shareholders, following the recommendation in the Ontario Merger Study. Second, in paragraph (f), instead of using the phrase "offeror's presently-owned shares" we have substituted a definition of "shares" which is not only much more concise but in fact broader in scope. It is the same as the definition used in ss. 1.02(1)(c)(i) and 10.01(1)(c). Third, the definition of "take-over bid" is amended to substitute the defined term "shares" and to include shares held by an "associate" of the offeror, to clarify further the meaning of the phrase "direct or indirect". In addition, in paragraph (g), continuing the policy in the Canada Corporations Act—s. 127A(g)—we have reduced from 20% to 10% the bloc of shares that qualifies an offer as a "take-over bid".

429. The U.S. Securities and Exchange Act is somewhat broader in its application. In effect, it goes back one step further to require disclosure whenever any person acquires 5% of the voting shares of a corporation. A similar policy recommending that a special insider report be required whenever an individual acquires ownership of 20% of the voting shares of a corporation was contained in the Ontario Merger Study. In 1970 the U.S. Congress passed an act reducing the bloc of shares requiring such special disclosure from 10% to 5%, indicating that Congress thought that more disclosure was required in respect of creeping acquisitions. Although the 10% base adopted in the present Act was adopted before the U.S. law was amended, it appears to be a reasonable compromise between the Ontario law and the U.S. law, which reflect very different policies. Although admittedly it requires broader disclosure, the U.S. law also gives very considerable advantages to entrenched management, enabling them to take measures at a very early stage to fend off a take-over bid.

430. Sections 16.02 and 16.03 set out the general rules that are applicable to all take-over bids. Although we adopt generally the principles set out in the Ontario Securities Act, there are differences in the specified time limits, in the order of the subsections, and in some of the substantive rules. We hope, when Ontario and the western provinces consider adoption of the changes suggested in the Ontario Merger Study, that it will be possible for all the jurisdictions involved to agree on a uniform set of rules and to draft parallel laws, thus minimizing conflicts of laws in interjurisdictional bids.

431. Section 16.04, although it modifies the wording of the Ontario provisions, restates the substantive rules set out in ss. 82 and 85 of the Ontario Securities Act. The major change is to make it clear that a take-over bid circular will be in the form prescribed by regulations, obviating detailed provisions in the Act. Subsection (3) makes it clear that Part 16.00 has no extraterritorial application but that offers can be sent to foreign nationals who have a Canadian address.

432. Section 16.05, dealing with the duty of bidders to make arrangements for funds to finance a cash bid, is self-explanatory. Similar provisions are contained in the Ontario Securities Act (s. 84) and in the U.S. Securities Exchange Act of 1934 (s. 13(d)).

433. Section 16.06 equates a share-for-share bid with a distribution to the public by the corporation the shares of which are offered in exchange for the shares held by the offerees. The standard of disclosure is exactly parallel to the standard required to qualify a prospectus for distribution to the public. Instead of adopting ss. 85(3) and 94 of the Ontario Securities Act, we simply require compliance with Part 15.00 of the Draft Act. Thus, we don't create a separate set of prospectus rules in relation to take-over bids.

434. Section 16.07, which follows s. 86 of the Ontario Securities Act, is self-explanatory, stating the duty of directors to send a directors' circular where they recommend acceptance or rejection of a bid and providing a sanction for breach of that duty. Again, consistent with s. 16.04, the form of the directors' circular will be prescribed by the regulations.

435. Like the Ontario Securities Act (s. 87), s. 16.08 requires that each expert must consent to the use of his statement or report in a take-over bid circular or directors' circular. The regulations will of course stipulate that the consent be set out in the circular, a rule that is in s. 93 of the Ontario Securities Act. This provision is an analogue of s. 15.12, relating to the consent of an expert that is contained in a prospectus.

436. Section 16.09 restates in abridged form s. 88 of the Ontario Securities Act, requiring that a take-over bid circular be approved by the directors of a corporation that makes a bid. Again, the disclosure requirement of s. 92 of the Ontario Securities Act, stipulating that the directors' approval shall be set out in a take-over bid circular, will be contained in the regulations that govern the contents of take-over bid circulars.

437. Section 16.10 is an adaptation of s. 89 of the Ontario Securities Act, modified to make the language parallel to other exemption order provisions in the Draft Act (for example, s. 10.02(8) concerning insider trading reports and s. 12.05 concerning proxies), and to require publication of the exemption orders granted.

438. The offences in subsection (1) of s. 16.11 are clear. They are roughly parallel to s. 99 of the Ontario Securities Act, and the penalties (see s. 19.14) are the same. Subsection (2) is new. It enables an interested person to seek a restraining order to block a take-over bid where a take-over bid circular or a directors' circular is misleading. This provision closely parallels s. 12.08 which deals with a misleading proxy circular. In our opinion this is a more effective remedy than very large penalties, for it is available to block the bid where breach of the standards of the Act is established, notwithstanding that no grounds are available to justify an injunction order.

PART 17.00

Liquidation and Dissolution

439. The law of corporate dissolution is in a chaotic state. Sections 28 to 30 of the present Act permit voluntary dissolution, and ss. 5(4), 125 and 140A authorize the dissolution or winding up of companies which have acted outside the scope of their objects or powers or which have failed to comply with certain provisions of the Act. Where a company is insolvent the Bankruptcy Act and, sometimes, the Companies Creditors Arrangement Act, will apply. Worse, the Winding-up Act applies to federally incorporated companies, in situations both of solvency and insolvency, although, under the 1966 amendments to the Bankruptcy Act, that Act can be used to oust the jurisdiction of the Winding-up Act where the corporation concerned is insolvent. Finally, several doctrines and principles applying to corporate dissolution have been developed in case law and are not found in any statute.

440. Part 17.00 is a clarification of the rules which we think should apply to corporate dissolution, except where the corporation is insolvent. In our view, insolvency should be dealt with in the Bankruptcy Act. This is also the view of the committee which has been studying the Bankruptcy Act (see Bankruptcy Report, p. 24). If the Draft Act is adopted the Winding-up Act, an astonishingly archaic statute, will no longer apply to federal corporations. Furthermore, the machinery in ss. 14.15 and 20.15 under which all corporations incorporated federally can be "transferred" into the Draft Act will permit the repeal of the Winding-up Act.

441. Because Part 17.00 is such a thorough reorganization of the law of corporate dissolution it is not possible to compare it, section by section, with the present law. Its closest model in Canada is probably the dissolution provisions in provincial corporations Acts. A better example, and one in which we found many useful ideas, is the New York Business Corporation Law. Procedurally, Part 17.00 is straightforward, the terminology is consistent with that used throughout the Draft Act, and the steps in a dissolution follow the pattern established in other Parts. Thus, "articles" are sent to the Registrar, he issues a certificate of dissolution, and so on.

442. Generally, under the Draft Act, applications may be made or actions brought in any Canadian superior court—defined in s. 1.02(1)(j). One exception is in Part 17.00 and others are in Parts 14.00 and 18.00 (see ss. 17.01, 14.17(17) and 18.01) where the only courts with jurisdiction will be those in the place where the corporation has its registered office. It seemed to us that the convenience of the corporation was paramount when the question was liquidation and dissolution, the paying of shareholders who dissent from a fundamental change in the corporation, or the ordering of an inspection.

443. Section 17.02 describes the jurisdiction of this Part. Liquidation and dissolution provisions in a corporations Act should apply only when the corporation in question is solvent, and should yield to a comprehensive bankruptcy statute if the corporation is insolvent. Our policy is therefore consistent with the recommendations in the recent Bankruptcy Report. If a corporation in process of liquidation under Part 17.00 is found to be insolvent, s. 17.02 prevents a conflict of legislation by stating explicitly that the proceedings shall be stayed, at which point the machinery in the Bankruptcy Act would take over.

444. Under s. 17.03(1) the incorporators or first directors of a corporation which has not commenced business and which has not yet issued any shares may dissolve the corporation by simply filing articles of dissolution. If the corporation has shareholders but no property, the same simple procedure is available under subsection (2), except that the decision to dissolve must be made, unanimously, by the shareholders.

445. Section 17.04 deals with the next level of complexity, the voluntary dissolution of a corporation which has property. Under subsection (2) any director or shareholder may propose dissolution, but a special resolution of each class of shareholders is required to authorize it: subsection (3). Obviously, the notice of meeting must refer to the proposed dissolution: subsection (2).

446. Under s. 17.04 the first document filed is a statement of intent to dissolve—subsection (4)—after which the corporation must cease to carry on business: subsection (6). Subsection (7) describes the steps to be followed in carrying out the liquidation and dissolution. Normally, in a dissolution under s. 17.04, the shareholders will themselves appoint a liquidator, but an application may be made under subsection (8) to have the liquidation supervised by a court.

447. Unless the decision to dissolve is revoked—subsections (9), (10) and (11)—the corporation, after clearing its debts and distributing its property—subsection (12)—will file articles of dissolution: subsection (13). The Registrar then certifies the dissolution, at which time, as under s. 17.03(5), the corporation ceases to exist: subsections (14), (15).

448. Under s. 17.05(1) the Registrar may either cancel a corporation's certificate of incorporation or apply to a court for a dissolution order. This procedure is open to the Registrar when the corporation has not commenced or has ceased to carry on business. Corporations are sometimes incorporated merely to tie up a desirable name. The Registrar should have power to prevent this abuse of the Act, and also to clear his files of dead corporations. Failure to file documents required under the Act is also a ground for action under this section: subsection (1)(c). This provision parallels ss. 125(12) and 140A(1)(c) of the present Act, and is designed to encourage compliance.

449. Subsection (2)—like s. 125(10) of the present Act—requires notice to be given, although the notice period is considerably shortened.

450. Where a corporation has property the Registrar will usually apply for a dissolution order, in which event s. 17.10 will apply. If, on the other hand, the Registrar has elected simply to cancel the certificate of incorporation, he will effect that cancellation by issuing a certificate of dissolution at the end of the notice period: s. 17.05(3), (4). Subsection (5) permits any interested person to revive the corporation within 2 years of its dissolution.

451. Section 17.06 is another provision allowing the Registrar to apply for dissolution of a corporation. This section would normally be used against an operating corporation, and thus it is not a case where simple cancellation of the certificate of incorporation would be appropriate. The grounds set out in subsection (1) include those now found in s. 140A(1)(a) and (b) of the present Act, and the section thus encourages compliance with important provisions of the Act.

452. The order made by the court under subsection (2) depends upon whether the corporation has assets to liquidate and distribute. If not, it may be dissolved straightaway. If a liquidation is necessary, the court has the powers conferred on it by s. 17.10: subsection (5). Subsection (3) of s. 17.06 specifies what the Registrar has to do following the court's order.

453. Section 17.07(1) sets out the court's power to order a liquidation and dissolution. Paragraph (a) of that subsection takes account of the strict limits which the courts have imposed on the "just and equitable" rule in paragraph (b)(ii). It is unlikely that the courts will be able to free themselves from the weight of the established precedents without statutory assistance. Paragraph (a) therefore contains a set of more relaxed criteria which, we hope, the courts may find useful in those cases where dissolution appears to be the most equitable solution, but which would be excluded under the "just and equitable" rule.

454. Paragraph (b)(i) of 17.07(1) is new, and gives a means of enforcing something which may be stipulated for in a unanimous shareholder agreement.

455. There should be no need, in this commentary, to explain fully the "just and equitable" concept. At the risk of over-simplifying, it may be said that there are broadly two kinds of situations in which a dissolution will be ordered on this ground. One is where there is a deadlock in voting power, leaving the court no option but to put the parties asunder. The other is where there is such a degree of over-reaching by directors or controlling shareholders that it almost amounts to fraud. As long as the "just and equitable" rule is not the only basis upon which dissolution may be sought—and the other criteria in s. 17.07(1) prevent this—then the established precedents are worth keeping. Paragraph (b)(ii) of s. 17.07(1) is therefore a residual provision, retained so that a useful fund of case law is not discarded.

456. Paragraphs (c) and (d) of s. 17.07(1) give a court power to intervene (upon application) in any dissolution, a power which can be useful to prevent a "squeeze-out" of shareholders in a voluntary liquidation.

457. Section (2) forges a link between s. 17.07 and s. 19.04 which will facilitate the resolution of intra-corporate disputes. An applicant for a dissolution order can apply in the alternative for an order under s. 19.04, a section which, as will be described later, gives courts broad discretionary powers to make remedial orders falling short of corporate dissolution. A court could make such an order even if it was not specifically applied for—see s. 17.10—but it seems to us wise to highlight the alternative remedy. As will be seen, the inter-action of ss. 17.07 and 19.04 is reinforced by the fact that ss. 17.07(1)(a) and 19.04(1) are very similarly phrased. Section 17.07(3) brings into an application for dissolution certain procedural rules which assist the applicant.

458. Since, under the Draft Act, corporations will have the capacity of a natural person it is not appropriate to have a provision like s. 5(4) of the present Act providing for the dissolution of a corporation which has acted outside its declared objects or powers. If the articles of a corporation incorporated under the Draft Act do contain limitations on the business which the corporation may carry on, or if the corporation has contracted to limit its activities, s. 3.03 gives a shareholder or creditor a right to apply for a restraining order or to have an improper contract set aside. This, we believe, is an adequate remedy. In a flagrant case, it might be possible to show that the improper action was so oppressive or prejudicial that it would justify dissolution under s. 17.07(1)(a).

459. Sections 17.08 and 17.09 are procedural and require no comment. Section 17.10 lists the powers of the court which, deliberately, are very broad. Sections 17.11 to 17.14 are self-explanatory.

460. Sections 17.15, 17.16 and 17.17 set out in detail the duties and powers of a liquidator. Although the list is extensive, each item is self-explanatory. Again, the final step in a court-supervised liquidation is the issue of a certificate of dissolution by the Registrar: s. 17.17(7).

461. Section 17.18 is very important. Dissolution has sometimes been used as a way of accomplishing a reorganization or other fundamental change in the constitution of a corporation and, in the United States, to prevent shareholders from invoking their appraisal rights. Section 17.18 allows a court to defeat this manoeuver, either by requiring all the corporation's assets to be converted into cash, or by making applicable the appraisal provisions of s. 14.17 to require payment in cash to shareholders who dissent.

462. Sections 17.19, 17.20, 17.21 and 17.22 are concerned with matters arising after a dissolution has been completed. Records must be kept for a reasonable period—s. 17.19—and, under s. 17.20, actions may be continued or brought. Subsections (4) and (5) of s. 17.20 expand slightly on the provisions of s. 30 of the present Act. Sections 17.21 and 17.22 direct the disposition of unclaimed property.

PART 18.00
Investigation

463. Part 18.00 of the Draft Act deals with investigations of the affairs of corporations, either at the instance of shareholders, or of the Registrar. The principle involved is not new, for provisions authorizing investigations may be found in s. 112 of the present Act and in almost all provincial corporation legislation. The investigation provisions of the present Act were greatly amplified in 1970, and some of the changes made there have been incorporated into the Draft Act.

464. The system of inspection is designed to serve two purposes. First, it is a valuable weapon in the armoury available to shareholders as a protection against mismanagement. Although Part 19.00 of the Draft Act greatly extends and improves the means of redress open to individual shareholders in the courts, it will almost certainly be true in many cases that even the most sophisticated litigative weapons will be valueless for lack of information as to the details of suspected mismanagement. That information is, by its very nature, likely to be known by the suspected wrongdoers and unlikely to be known or voluntarily disclosed to those seeking to complain of the suspected wrongdoing. Accordingly, we have provided in s. 18.01(2) that if an applicant can satisfy the court that there are circumstances suggesting wrongdoing, an investigation order may be made in aid of litigation.

465. Moreover, there is a public interest in the proper conduct of corporate affairs, and while the protection of the public interest may be a by-product of the protection of shareholder interests, we are not persuaded that it is a necessary by-product. Accordingly, s. 18.01(1) provides for an application by the Registrar.

466. The requirement that the shareholder application be made by the holders of not less than 5% of the issued shares, or issued shares of a class, has been imposed in recognition of the possibility that the threat of an investigation could be used for purposes of harassing management. Note that the section does not require a minimum number of shareholders. One shareholder may apply if he owns at least 5% of the shares of a class. If his interest is smaller it does not seem unreasonable to ask him to convince a sufficient number of additional shareholders, aggregating a 5% interest. Failing that, the shareholder could ask the Registrar to make the application. If the application is by a shareholder, subsection (3) requires notice to be given to the Registrar. Either way, there is a screen to keep out nuisance applications, but one which should not prevent valid ones.

467. In practice, applications for investigations are unlikely to be made by anyone but the Registrar although, probably, the Registrar will almost always act because a shareholder has brought a suspected irregularity to his attention. Section 112D(3) of the present Act provides that applicants for an investigation may be required to give security for costs. This, we think, is a highly undesirable provision because it is almost guaranteed to deter complainants. Section 18.01(4) of the Draft Act therefore states the opposite.

468. The most significant difference between the Draft Act and the provisions in the present Act is that we have left investigations to be supervised by the courts. The present Act puts them under the supervision of the Restrictive Trade Practices Commission. There are two reasons for this change. For one thing, Part 19.00 of the Draft Act gives shareholders realistic civil remedies for virtually any kind of corporate wrong. The law today—substantive and procedural—is so hopelessly inadequate that, for practical purposes, shareholders are often remediless. Under the present Act, therefore, we agree that there is a strong case for a body like the Restrictive Trade Practices Commission to do what shareholders are unable to do for themselves. Under the Draft Act, however, civil justice should be much more accessible, and investigations, already rare, will be rarer still. There will be no need for a specialist tribunal.

469. The second reason for giving the supervision of investigations to the courts instead to a tribunal is that the civil rights of persons affected by or concerned in the investigations are better assured. The matters spelled out at great length in the 1970 amendments to s. 112 of the present Act are unnecessary in the Draft Act. It should be remembered that the function of the court is not to conduct the investigation, a task requiring a certain expertise and for which a court is possibly not well suited. If this was to be the task of the court there would be a strong case for establishing an expert tribunal. But the court's function is to oversee the conduct of the investigation, to lend the court's authority to the inspector, and to ensure that those affected by the investigation are justly treated. These are things which courts already do and do well. There is therefore no need to create a new tribunal.

470. Section 18.01 also permits an application for an investigation of the affairs of an "affiliated corporation", as defined in s. 1.01(2) of the Draft Act. In *Re H. Flagal Holdings Ltd.* (1966) 52 DLR (2d) 385, it was held that the Ontario Act, which at that time did not include any such reference, was not broad enough to permit the investigation of a wholly-owned subsidiary. Such a limited investigation may in many cases give an incomplete or misleading picture of the position of a business organization, and thereby prevent proper steps being taken to remedy any abuses disclosed. For this reason the Draft Act includes the wider power.

471. The criteria spelled out in subsection (2) of s. 18.01 (with some refinement of wording) are those adopted in 1970 and are, in turn, based upon s. 165 of the United Kingdom Act. Although there is authority to say that the "affairs" of a corporation in this context include its investment in a subsidiary—*R.* v. *Board of Trade Ex. parte St. Martin Preserving Co. Ltd.* [1964] 2 All ER 561—we have used the term "affiliates" throughout subsection (2), both to put the point beyond doubt and to allow the court to consider facts not strictly within a parent and subsidiary relationship. The difference between "affiliated corporation" and "affiliate" in s. 18.01—and also in ss. 17.07(1)(a) and 19.04(2)—is very important. Although in considering whether circumstances exist which would justify an investigation, the court may consider the dealings between the corporation and any of its affiliates, it can only order an investigation of the corporation and affiliated *corporations*, that is, those which are governed by the Draft Act.

472. Sections 18.02 to 18.06 are self-explanatory, dealing with procedural matters incidental to the conduct of an investigation.

473. Section 18.07 adopts s. 112A of the present Act. The section gives the Registrar the power to obtain information to determine the true owner of the securities of a corporation. The power is limited to disclosure of ownership and control for the purposes of enforcing the insider trading and take-over bid provisions of the Draft Act. Although those provisions do contain their own enforcement devices, the power authorized by s. 18.07 should prove an important residuary power, and has been included for that reason.

PART 19.00

Remedies, Offences and Penalties

474. Although many of the substantive provisions of the Draft Act are complemented by specific remedies to enforce compliance with discrete rules, we think that for two reasons these specific remedies must be buttressed by other remedies having much wider application. First, the Draft Act is extraordinarily permissive, for it omits altogether the traditional—and we think largely formalistic—safeguards such as minimum capital contributions, limited and clearly specified objects, statutory restrictions on conditions attached to shares and so on, allowing considerable scope for misconduct, and therefore requiring fast, effective remedies to prevent abuse of the rights of persons having an interest in a business corporation. Second, given the protean quality of the business corporation as a legal institution and the seemingly inexhaustible ingenuity of the unscrupulous to exploit this quality to further their own ends, it is impossible for the draftsman to anticipate all the possibilities of misuse. That is not to say, however, that the general remedies set out in Part 19.00 have been tacked on as an afterthought. Impliedly, at least, the proposed remedies reflect three fundamental policies.

475. First, the structuring of a business corporation as an ideal "democratic" polity, while desirable, is not at all a complete answer to the problem of satisfactorily resolving corporate disputes. Throughout the Draft Act structuring techniques such as pre-emptive rights and cumulative voting are not only legitimated but positively encouraged. Nevertheless they are deliberately not made mandatory, a policy which would, in our opinion, over-emphasize their most useful function—i.e., as close corporation planning tools—and thus distract attention from the real problem of providing effective remedies to prevent or at least to furnish compensation for demonstrable wrongs.

476. Second, we think that the best means of enforcing a corporation law is to confer reasonable power upon the allegedly aggrieved party to initiate legal action to resolve his problem, making the Draft Act largely self-enforcing, obviating the need for sweeping administrative discretion and harsh penal sanctions, and, at the same time, forcing resolution of the issues before the courts, which have the procedures, the machinery and the experience that enable them better than any other institution to deal with such problems. Included within this concept, of course, is the "appraisal" right conferred upon each shareholder by s. 14.17, which entitles a shareholder to withdraw his investment at an objectively appraised price in the event of a fundamental change in the business or affairs of the corporation.

477. Third, the remedies provided in the Draft Act recognize that corporation law—and particularly the duties of officers, directors and dominating shareholders of corporations—is in a very fluid state, reflecting the uncertain role or identity of the business corporation in contemporary society. For this reason we have frequently established only very broad quality standards of conduct (e.g., s. 9.19 referring to duties of directors and officers and s. 19.04 relating to "oppressive or unfairly prejudicial" conduct of management or dominant shareholders), permitting the courts to determine whether there has been failure to comply with those standards, that is, to continue to develop the common law of responsibility of corporate management unhampered by the legal fetters created at a time when courts were preoccupied with enforcing "democratic" structures—particularly voting power—as the one real object of the law. Investigation by a government agency is also provided for, but it is essentially a residual remedy, available to resolve problems that cannot be adequately dealt with by ordinary litigation.

478. The remedial techniques employed in the Draft Act fall, analytically, into six categories that can be best explained by concrete illustrations.

(1) *Disclosure:* access to corporate records and lists of shareholders under s. 4.03, publication of insider reports under s. 10.03, and disclosure of financial statements under s. 13.01, 13.03, 13.05 and 13.06.

(2) *Structural techniques:* pre-emptive rights referred to in s. 5.05, cumulative voting referred to in s. 9.06, and shareholder proposals under s. 11.05.

(3) *Civil action:* improper insider trading under s. 10.04, court review of an election of directors under s. 11.13, and a restraining order in respect of an untrue statement made in the course of a proxy solicitation under s. 12.08.

(4) *Administrative proceedings:* revocation of corporate name under s. 2.08, cancellation of certificate of incorporation under s. 17.03, or investigation under Part 18.00.

(5) *Director's personal liability:* improper purchase or redemption of a corporation's shares, improper payment of a commission in respect of the sale of shares, improper payment of a dividend, or making an improper loan or guarantee, etc., all of which are referred in s. 9.16.

(6) *Penalties:* failure to maintain records under s. 4.02, refusal to permit access to corporate records under s. 4.03, failure to file an insider report under s. 10.02, or failure to distribute financial statements under s. 13.06.

The foregoing examples are of course not complete. They have been selected only for illustrative purposes.

479. The major premise of this Part is that a corporations Act should be largely self-enforcing by civil action initiated by the aggrieved party, not by severe penal sanctions or sweeping investigatory powers. If this policy is not adopted, it is our opinion, given the state of the common law, that we must continue to rely on ever broader powers of investigation as a means to remedy corporate ills, which become increasingly complex as businesses become more and more sophisticated. Bearing in mind this continually implied policy, we shall review Part 19.00 section by section.

480. Although only two defined terms are used in Part 19.00, we think them sufficiently important to be set out in a separate section, thus underlining their very broad scope. The term "action" is largely self-explanatory: it extends the application of these provisions to any legal action to which a corporation is a party, whether or not the right of action was created by the Draft Act. The term "complainant", following one of the recommendations of the Jenkins Report (paras. 119 to 212) is broadened to encompass the persons who clearly might be interested—a shareholder, a security holder or the Registrar—and, in addition, to include any other person the court thinks is a proper person to participate in the litigation. No specific reference is made in the definition of "complainant" to legal representatives of a deceased shareholder, notwithstanding the express recommendation to that effect by the Jenkins Committee, since we think it better, rather than attempt to list all the persons who might acquire ownership of shares by operation of law, to give the court discretion to determine who is a proper person to make an application. See subparagraph (iv) of paragraph (b) of s. 19.01.

481. Subsection (1) of s. 19.02 confers upon a complainant the right to apply to a court for consent to bring or intervene in a derivative action in the name and on behalf of the corporation or one of its subsidiaries to enforce a right of the corporation. This provision is largely self-explanatory, but two points merit special emphasis. First, it is most important to keep in mind that this provision relates only to the enforcement of rights of the corporation. It is not available as a remedy to enforce rights of an individual shareholder or even a group of shareholders, although a group of shareholders may bring, in representative form, a derivative action in the name of the corporation if they can characterize the issue as the enforcement of a right of the corporation. Typical examples of cases where a derivative action may be invoked are actions against directors or officers for a breach of duty under s. 9.19 alleging self-dealing or negligence, an action for an injunction to preclude a threatened injury to a corporation, or an action to restrain an act outside the scope of the authority of the corporation, its directors or officers. Second, by including the reference to a subsidiary of the corporation, this provision contemplates and permits the "double derivative" action, that is, it confers on a shareholder of a holding corporation the right to initiate a derivative action in the name of a subsidiary of that holding corporation, notwithstanding that the shareholder does not own a share of the subsidiary.

482. Subsection (2) of s. 19.02, which adopts in principle a recommendation of the Jenkins Committee (para. 206), and which follows the model adopted in s. 99 of the Ontario Act, requires a shareholder who seeks to bring a derivative action to obtain a court order before commencing legal proceedings. At one stroke this provision circumvents most of the procedural barriers that surround the present right to bring a derivative action and, incidentally, minimizes the possible abuse of "strike suits" that might otherwise be instituted as a device to blackmail management into a costly settlement at the expense of the corporation. Although it confers extraordinarily wide discretion upon the court, subsection (2) does state the conditions that must be met before a derivative action may be commenced. By requiring good faith on the part of the complainant this provision precludes private vendettas. And by requiring the complainant to establish that the action is "prima facie in the interest of the corporation" it blocks actions to recover small amounts, particularly actions really instituted to harass or to embarass directors or officers who have committed an act which, although unwise, is not material. In effect, this provision abrogates the notorious rule in *Foss* v. *Harbottle* and substitutes for that rule a new regime to govern the conduct of derivative actions. In the preface (page v) to the second edition of his text, *Modern Company Law*, Professor Gower states that ". . . an attempt has been made to elucidate the mysteries of the rule in *Foss* v. *Harbottle;* I believe that I now understand this rule, but have little confidence that readers will share this belief". We have been so persuaded by Professor Gower's elucidation of these "mysteries" that we have relegated the rule to legal limbo without compunction, convinced that the alternative system recommended is preferable to the uncertainties—and obvious injustices—engendered by that infamous doctrine.

483. Section 19.03 is designed to give very broad discretion to the court to supervise generally the conduct of a derivative action, providing maximum flexibility in respect of interim financing of the litigation and the control over the conduct of the action in a way that obviates a multiplicity of actions. Moreover, in certain cases, e.g., where a corporation has redeemed or purchased its own shares or has been liquidated or dissolved, a court can order payment directly to shareholders and former shareholders of the amount recovered, thus resolving a technical problem that has resulted in obvious injustice in some U.S. cases. In addition, it enables the court to permit the amount recovered to flow directly through to shareholders, precluding the wrongdoers from sharing in the recovery by the corporation.

484. Section 19.02 in broadly permissive terms—but always subject to court supervision—legitimates the shareholder's derivative action that is brought in the name of the corporation to enforce a right of the corporation, e.g., where the directors divert to themselves the profits from a transaction that they had a duty to effect in the name and on behalf of the corporation. The object of s. 19.02 is to remedy a wrong done to the corporation, therefore it applies to all corporations irrespective of size or distribution of shares. Section 19.04, on the other hand, will be invoked most frequently—but not always—in respect of a corporation the shares of which are held by only a relatively small number of persons, a so-called "close corporation", since its usual object is to remedy any wrong done to minority shareholders. Examples of such cases are commonplace. The most frequent cases are mentioned in the Jenkins Report (para. 205): e.g., where dominant shareholders appoint themselves to paid offices of the corporation, absorbing any profits that might otherwise be available for dividends; the issue of shares to dominant shareholders on advantageous terms; or the repeated passing of dividends on shares held by a minority group. Generally, the purpose of these tactics is to squeeze out minority shareholders. Another illustration is the liquidation "freeze-out" that succeeeded in *Fallis and Deacon* v. *United Fuel Investments Ltd.* [1963] SCR 397. Scrutiny of these examples shows that there is no clear dividing line between the cases. Diversion of corporate profits is clearly a wrong to a corporation that normally would be remedied by a derivative action under s. 19.02. A refusal to declare dividends in order to squeeze out minority shareholders would call for an application under s. 19.04. But the payment of excessive salaries to dominant shareholders who appoint themselves officers is a borderline case: it may constitute a wrong to the corporation and, at the same time, may have as its specific goal the squeezing out of minority shareholders (at a low price reflecting the small dividends paid) whose investment is no longer required. In such a case the aggrieved person may select the remedy that will best resolve his problem. And if neither of these remedies is adequate in the circumstances the aggrieved person may request the ultimate solution—liquidation and dissolution under s. 17.07. In sum, we think that the courts should have very broad discretion, applying general standards of fairness, to decide these cases on their merits.

485. Derived from s. 210 of the U.K. Companies Act, 1948, s. 19.04 is drafted in language which aims at the same goal as the original model, but which has been modified in accordance with the recommendations of the Jenkins Report (para. 212) to strip away the self-imposed judicial qualifications that have limited the application of s. 210 and that have therefore cast considerable doubt upon the effectiveness of the original provision. The conceptual differences between the original model (s. 210) and s. 19.04 of the Draft Act are subtle, but in general terms the changes are as follows:

(a) The standard based on just and equitable grounds to wind up the corporation has been deleted, abrogating the effect of those cases that interpreted s. 210 to mean that grounds to wind up the corporation must always be established.
(b) The section applies not just to a continuing course of oppressive conduct but also to isolated acts of any corporate body that is affiliated with the corporation or any of its affiliated corporations.
(c) To the basic criterion "oppressive" is added the phrase "unfairly prejudicial to or in disregard of the interests of", which makes abundantly clear that s. 19.04 applies where the impugned conduct is wrongful, even if it is not actually unlawful.
(d) The Jenkins Report also recommends that the right to invoke s. 19.04 be conferred upon legal representatives and that the court be empowered, in connection with a s. 19.04 application, to make a restraining order. The former has been effected by paragraph (b) of s. 19.01 which gives wide discretion to the court to determine who is a proper person to make an application under s. 19.04, the latter by subsection (3) of s. 19.04.

In addition s. 19.04 is made applicable to all cases of conduct that are "oppressive or unfairly prejudicial to or in disregard of the interests of" any security holder, creditor, director or officer and not just to the narrow case where a shareholder is oppressed in his capacity as a shareholder. See the discussion in Gower, *Modern Company Law* s. 3rd. ed., pp. 598 to 604. Note, too, that s. 19.04 may be invoked in respect of an affiliate as well as the principal corporation. On summing up the standards set out in s. 19.04, it is difficult to improve on the frequently quoted interpretation of the meaning of s. 210 made by Lord Cooper in *Elder* v. *Elder and Watson Ltd.* [1952] SC 49 at p. 55: " . . . the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely".

486. Corresponding to s. 19.03, which relates to the powers of the court in respect of a derivative action, subsection (3) ensures that the court has broad powers to carry out its very comprehensive mandate under subsection (2). Some of these powers are novel. But they have one common object: to enable the court to apply a remedy that will offer continuing relief or indemnity to the complainant and, at the same time, render unnecessary the liquidation and dissolution of the corporation, which in practice often constitutes a pyrrhic victory for the complainant. Subsection (4) is also novel. If the court orders some change of a corporation's constitution by amendment of its articles or by-laws, those rules become static, creating vested rights that may be amended only with the consent of the court. The need for this provision could arise frequently, for under the Draft Act close corporations are, under s. 11.14, equated with incorporated partnerships, which suggests that the court should impose rules requiring that the business be continued, if practicable, in accordance with what are essentially partnership rules, including the arbitration of disputes. This furnishes a technique to continue a business that has been plagued by internal conflict until a dissident can be bought out or the business sold as a going concern.

487. Section 19.05 sets out several rules that apply both to derivative actions and "oppression" applications. Subsection (1) abrogates that aspect of the rule in *Foss* v. *Harbottle* that bars a shareholder from complaining of alleged misconduct on the ground that the impugned act *might* be authorized or ratified at a meeting of shareholders, a concept that has been described as "... the major absurdity of the *Foss* v. *Harbottle* rule ...": Gower, *Modern Company Law*, 3rd. ed., p. 586. Rather than set out a specific rule declaring how an act of the directors may be ratified, we think it better to characterize shareholder ratification or waiver as an evidentiary issue, which in effect compels the court to go behind the constitutional structure of the corporation and examine the real issues. If, for example, the alleged misconduct was ratified by majority shareholders who were also the directors whose conduct is attacked, evidence of shareholder ratification would carry little or no weight. If, however, the alleged misconduct was ratified by a majority of disinterested shareholders after full disclosure of the facts, that evidence would carry much more weight indicating that the majority of disinterested shareholders condoned the act or dismissed it as a mere error of business judgment. Tentative steps in this same direction are being taken in the case law: *Hogg* v. *Cramphorn Ltd.* [1967] Ch. 254; *Bamford* v. *Banford* [1969] 1 All ER 969. See also the discussion in Gower, *Modern Company Law*, 3rd. ed., p. 586. Note, however, as pointed out in the commentary on s. 9.19, this change of focus from a rule barring action to an evidentiary issue engenders significant substantive change. By giving the court wide discretion to consider the pertinent facts and by barring the court from following a simplistic path such as applying the shareholder ratification rule, we in effect compel the court to adjudge the issue on its merits. Implicit in this policy is the premise that dominant shareholders, who are in a position to control management, owe a fiduciary duty to minority shareholders comparable to the duty that directors and officers owe to the corporation. This policy constitutes a major divergence from the English common law, but it is clearly a corollary of the U.K. Companies Act, s. 210 and of the Draft Act, s. 19.04. Moreover, this approach has long been commonplace in U.S. courts, both state and federal. See O'Neal, *Expulsion or Oppression of Business Associates*, p. 137.

488. Subsection (2) of section 19.05 complements the courts' power to supervise the commencement and conduct of a derivative action, providing for court supervision of any settlement or other disposition of the action before trial. Its object is to preclude "strike suits" to extort a financial settlement from the management of a corporation. One example is where directors, who have been demonstrably negligent in the administration of the corporation's affairs, settle an action to avoid undesirable publicity. A grosser case arises where the directors, sued in a derivative action alleging that they have diverted corporate profits to themselves, settle the action using corporate funds (or settle the action personally and then seek indemnity from the corporation), a practice that has been characterized and condemned as "double looting" in one reported case: *New York Dock Co* v. *McCollum* 16 NYS 2d 844 (1939). The New York Business Corporation Law (s. 626), modelled after Rule 23.1 of the U.S. Federal Rules of Civil Procedure, like subsection (2), now prohibits the settlement of a derivative action without previous court approval.

489. Subsection (3) of s. 19.05 is self-explanatory. Its purpose is to ensure that a shareholder may institute a derivative action before any court in Canada without being required to put up security for costs. We think that court scrutiny of such actions, applying the standards set out in s. 19.02, constitutes a sufficient safeguard against frivolous actions or "strike suits". Incidentally, subsection (3) reflects a bias against those corporation statutes that specifically entitle a defendant corporation to demand security for costs in connection with a derivative action, a policy that has been vigorously censured by legal scholars: Hornstein, *Corporation Law and Practice*, para. 722. Subsection (4), derived from s. 99 of the Ontario Act, further reflects this bias, for it empowers the court to compel the corporate plaintiff to provide interim financing to the complainant in a derivative action, offering some assurance that apparently well founded actions will not be abandoned for lack of funds to maintain the litigation.

490. Section 19.06, a composite of s. 210 of the present Act and s. 116 of the U.K. Companies Act, 1948, provides for a summary application to court to rectify the registers or records of a corporation. Because the Draft Act does not permit the issue of shares subject to calls, from the shareholder's point of view the traditional use of this remedy is probably of reduced value, since one of the main purposes of the provision was to enable a shareholder to apply to have his name struck from the register of shareholders where the shares were assessable. See Gower, *Modern Company Law*, 3rd. ed., p. 377. Nevertheless, the provisions of this section may prove valuable to resolve expediently disputes arising under Part 6.00 in connection with securities registration and transfer, particularly since many of the concepts in Part 6.00 are new to Canadian law.

491. Like a receiver under s. 8.09 or a liquidator under s. 17.10(j), the Registrar is given the right under s. 19.07 to apply to a court for directions as to how he shall fulfil any duty imposed upon him by the Draft Act. This right could prove most useful in cases where a decision of the Registrar might affect the rights of shareholders or security holders, e.g., where the Registrar has a strict duty to issue a certificate in respect of a fundamental change under Part 14.00.

492. In some Parts of the Draft Act the Registrar is given very wide discretion to make a final decision with respect to a particular issue: e.g., with respect to granting a corporate name (s. 2.08), granting an exemption from filing insider trading reports (s. 10.02), from making a proxy solicitation (s. 12.05) or from compliance with the take-over bid rules (s. 16.10), permitting continuance of a corporation under another law (export under s. 14.15), and granting exemptions or determining eligibility pursuant to several provisions of Part 15.00 (prospectus qualification). Generally, however, the underlying philosophy of the Draft Act is to make clear that persons who seek to incorporate, make a fundamental change in, or liquidate and dissolve a corporation do so as a matter of right. Where they comply with the formal requirements of the law and make an unequivocal request that the Registrar file the articles or other documents presented, the Registrar has a clear duty to accept and to file those documents. If the Registrar refuses or neglects to file the documents he must notify the applicants accordingly under subsection (1) of s. 19.08. If the Registrar does not give such notice he is deemed by subsection (2) of s. 19.08 to have refused to file the documents. In either case the applicants then have standing to appeal the Registrar's decision under s. 19.09. In addition, s. 19.09 permits an appeal to a court where the Registrar revokes a corporate name under s. 2.08 or cancels a certificate of incorporation under s. 17.05. Since under s. 2.08 the Registrar is given rather wide discretion the appeal in such cases will tend to be based on the ground that the Registrar's decision was arbitrary or capricious—or an abuse of discretion—rather than on the ground that he mistakenly applied any value criteria. To complete the pattern. s. 19.12 permits an appeal to a court of appeal from any order of the court made under this Draft Act.

493. Section 19.10 is largely self-explanatory. It empowers a court, a complainant or a creditor to compel a director, officer, employee, agent or auditor of a corporation to comply with the Draft Act, the regulations, the articles, by-laws or a unanimous shareholder agreement, or to restrain those persons from acting in breach of the provisions contained in those documents. Derived from s. 261 of the Ontario Act, s. 19.10 reflects the thrust of the common law both in England (see Gower, *Modern Company Law*, 3rd. ed., p. 586, n. 38) and in the United States where it is frequently invoked as relief in Rule 10b-5 actions: see, e.g., *Mutual Shares Corporation* v. *Genesco, Inc.* 384F 2d 540 (1967), discussed in 25 Business Lawyer, pp. 75-99.

494. Frequently the Draft Act provides for expedient resolution of problems by summary application to the court, the best example being an application to resolve a deadlock under s. 19.04. Consonant with other provisions of the Draft Act, s. 19.11 enables a summary application to a court in broadly permissive terms. The section ignores procedural details, leaving it to the court to impose its own rules of court to the extent that they are applicable to the case.

495. Section 19.13 states in general terms that it is an offence to make a misrepresentation in a document required to be filed under the Draft Act. The language in this section parallels closely the misrepresentation provisions relating to proxy circulars, prospectus statements, and take-over bid circulars. In contrast to s. 258 of the Ontario Act, where the Minister must give prior consent to a prosecution, any person may institute proceedings under this section. In a self-enforcing law such as this Draft Act, we see no reason to give the Registrar or the Minister control over all prosecutions.

496. To obviate the frequent repetition of penalties throughout the Draft Act, s. 19.14 states in one place the penalty that might be imposed when an offence under the Draft Act is committed. A section imposing the penal sanction need only state therefore that a person who commits a proscribed act is guilty of an offence. See, for example, s. 19.13. This section is as noteworthy for what it omits as for what it contains. For two reasons, no mention is made of possible imprisonment. First, although it may have a prophylactic effect, the history of corporate law indicates that imprisonment is not as effective a remedy as a very substantial fine, for an administrator will initiate penal proceedings and a court will convict with less reluctance knowing that the penalty can be varied to fit the offence, particularly to deprive the wrongdoer of any profit he derived from his misconduct. Second, unlike the common law, the Draft Act provides an abundance of civil remedies that enable an aggrieved person—whether the corporation, the shareholders collectively, or an individual—to institute a civil action claiming full indemnity for any loss caused by the alleged wrongdoer's act. We think that these civil actions are the sanctions that will best ensure compliance with the law, minimizing the need for administrative supervision and severe penalties.

PART 20.00
General

497. Part 20.00 is arranged in four divisions:

Notices—ss. 20.01 to 20.03
Evidence—ss. 20.04 to 20.07
Administration—ss. 20.08 to 20.14
Transition—ss. 20.15 to 20.16

As the title to this Part implies, these provisions are of general application and thus are superimposed on all the other provisions of the Draft Act, except where the same problem is specifically dealt with in a particular section.

498. Section 20.01, an adaptation of s. 255 of the Ontario Act, is self explanatory. The substantive rules are complemented by the particular provisions relating to securities records (s. 6.03), dealing with registered security holders (s. 6.05), and notices of meetings (s. 11.03). Subsection (2) parallels its counterpart in the Ontario Act. We have considered submissions to the effect that notices should be deemed to be given when mailed by the corporation or its transfer agent. Such a provision, in our opinion, would constitute an invitation to management to send out notices at the last minute to preclude serious shareholder scrutiny of a controversial policy. In addition, the foreign shareholder would have no time to receive a last minute notice because of the relatively short 10 day minimum period for the sending of notices of meetings. For these reasons we thought that the policy expressed in the Ontario Act was correct and we have adopted it accordingly.

499. Section 20.01 deals with notices to directors and shareholders. Section 20.02 is similar but applies only to the corporation itself. Note, however, that the section contemplates service of legal process upon a corporation as well as simple notice to a corporation. This was added to give clear legitimacy to those rules of court that permit service on a corporation by prepaid registered mail in lieu of personal service.

500. Section 20.03 enables the shareholders of a corporation to waive or to agree to an abridged notice at any time. Thus a meeting in respect of which an invalid or late notice was sent out may nevertheless be a valid meeting if all shareholders agree to waive the requirement of notice. Of course, if no actual meeting is required, then the proposed corporate action may be effected by way of a resolution in writing under s. 9.15 (directors) or s. 11.10 (shareholders).

501. Sections 20.04 to 20.07 deal generally with evidence problems. Consistent with the philosophy of the Draft Act, empty formalities are reduced to a minimum and procedural routines are designed as far as possible to reflect what is widely accepted as good practice. Section

20.04 is an analogue of s. 266 of the Ontario Act, simplified to dispense with the requirement of a seal. In this and the following sections the term "prima facie proof" is adopted instead of "prima facie evidence", reflecting more accurately the effect of such certificates. See Driedger, *Legislative Forms & Precedents*, 1963, p. 123. Mr. Driedger recommends that the phrase "prima facie" be dropped altogether and that the phrase "until the contrary is shown" be substituted for it. We would prefer to adopt Mr. Driedger's suggestion but have retained the conventional language, knowing that it is widely accepted and understood.

502. Subsection (1) of s. 20.05, adapted from s. 262 of the British Columbia Companies Act, concerns the authentication of documents issued by a corporation, particularly in respect of certificates setting out extracts of minutes of directors' or shareholders' meetings that relate to specified corporate acts. Like s. 4.05, this section minimizes the significance of the corporate seal. If some further verification is desirable, the outsider can demand a statutory declaration of a corporate representative verifying the facts upon which the transaction is predicated. In any event, many of the formalities that now accompany corporate dealings are rendered redundant by the Draft Act, which in general terms is designed to enable a third party to assume that an act of a corporation is within its capacity and that it has carried out all internal procedures required to sanction the act. Subsection (3) declares that a security certificate is prima facie proof of the title of the certificate holder. This provision continues the policy of s. 33(3) of the present Act.

503. Section 20.06 is new. It contemplates receipt by the Registrar of documents in photostatic, or photographic form, including microfilms. Note that unqualified discretion is conferred upon the Registrar to decide whether or not a document or substitute for a document is acceptable. A similar provision is contained in s. 171 of the North Carolina Business Corporation Act.

504. Section 20.07 sets out the right of the Registrar to demand verification of any facts by affidavit. Subsection (2) permits either a statutory declaration under the Canada Evidence Act or an affidavit. The reference to the proof of a fact required by the Draft Act is to provisions such as ss. 7.06 and 7.07, which relate to the verification of facts that confirm compliance with the terms of a trust indenture either at the time of its execution or at any other time.

505. Except for the terminology, s. 20.08 is self-explanatory. The term "Registrar" was adopted in the Draft Act, following the usage of the United Kingdom Companies Act, 1948, first because it is a well-known term in jurisdictions having so-called registration Acts and second, because to use the term "Director" as it is employed in the Canada Corporations Act would cause some confusion with the directors of a corporation. In fact, the term "Registrar" is somewhat misleading, since the Registrar does not maintain any registry in the sense that a transfer agent maintains a register of shareholders; but in our opinion the term is useful to avoid ambiguity. Given the broad wording of s. 20.08, the Minister may appoint the Director of the Corporations Branch as the Registrar, if necessary to reconcile the language of the Draft Act with the organization of the Department.

506. A fundamental tenet implicit in the Draft Act is that much of the detail set out in contemporary laws should, for three reasons, be contained in regulations: first, it enables the draftsmen to economize on the length of the statute, which would be very long indeed if it had to include, say, all the particulars to be set out in financial statements; second, it facilitates change of what are essentially formal or disclosure matters to ensure that they correspond with changes in the practices of accountants, trustees under trust indentures, and so forth; and third, it permits the use of clear, concise and consistent forms that make practice under the Draft Act easily comprehended by lawyers across Canada, irrespective of different local procedures and formalities. For these reasons, s.20.09 confers very broad regulatory powers on the Governor in Council. As pointed out in the Introduction, we think there is little danger in such a grant of regulatory powers if a system of scrutiny similar to that proposed by Bill C-182 (Statutory Instruments Act) does become law.

507. Most of the references in the Draft Act to matters that may be prescribed by regulation are to forms such as articles of incorporation. Note, however, the power given to regulate in respect of information returns, in effect replacing s. 125 of the present Act and substituting instead the policy set out in s. 19(a) of the U.S. Securities Act, 1933. Of special significance, too, are the provisions dealing with further mandatory terms of trust indentures (s. 7.05), the form and content of financial statements (s. 13.01), prospectus qualification (Part 15.00) and discretionary continuance (s. 20.15). The effect of these regulatory powers is discussed in greater detail in connection with those specific sections.

508. In principle the Draft Act, like the Ontario Act, adopts the system of formalities recommended in the Model Business Corporation Act, making the Draft Act procedures parallel not only to the new Ontario Act but also to virtually all the corporate laws of the important commercial jurisdictions in the United States which have already adopted at least that aspect of the Model Business Corporation Act. This will tend to bring

Canadian corporation law, or at least its terms and procedures, into the mainstream of the North American capital market, something that has already been partly accomplished by the provincial securities acts and Part 15.00 of the Draft Act.

509. In terms of drafting style, the Draft Act provisions vary substantially from the Model Business Corporation Act and therefore from the Ontario Act, which follows the Model Act closely in this respect. Instead of repeating the formal procedures in connection with each vital event in the corporation's existence—incorporation, amendment, amalgamation and so on—the formalities of filing are consolidated in one section (s. 20.10) and incorporated in the related sections by reference. A similar drafting technique has been employed in the New York Business Corporation Law (s. 104). The reasons for this consolidation can best be understood by a comparison of the counterpart provisions of the Draft Act and the Ontario Act, which shows strikingly the economy of language thus achieved.

510. Section 20.11 is a simplified version of s. 8(5) of the present Act. Its objective is to expedite incorporation and other fundamental changes in a corporation's structure. Note that, unlike the precedent followed, it applies to all documents filed with the Registrar and therefore includes a notice of directors, a notice of registered office, all articles, and even documents that are filed in conjunction with a proposed distribution to the public.

511. Section 20.11 applies to errors that are noticed before the issue of a certificate by the Registrar. Section 20.12 sets out the procedure to be followed if an error is contained in an issued certificate. It follows generally the policy of s. 10 of the present Act.

512. Section 20.13 permits examination of documents filed in the office of the Registrar. It is a composite of section 121F of the present Act and s. 265 of the Ontario Act.

513. In the course of preparing the Draft Act numerous suggestions were received with respect to the destruction of old records. For example, in s. 6.03(7) a corporation has a duty to keep cancelled security certificates for a minimum period of 6 years after the date of cancellation. The provision is based on the assumption that claims under such instruments will normally be raised within the prescription period established by provincial law. Similarly, s. 20.14, by indirection, imposes upon the Registrar a duty to maintain documents filed with him for a period of at least 6 years. Note, however, that the section requires that certificates and annexed articles must be retained in permanent storage. We presume that, ultimately, these documents will be maintained in microfilm form or even in files that may be integrated with electronic data processing facilities.

514. Section 20.15 deals with the formidably difficult problem of transition. Several alternatives were considered: (a) allow the present Canada Corporations Act to continue but disallow new incorporations under that Act; (b) allow the present Act to continue, disallow new incorporations under it, but permit continuance under the Draft Act; (c) allow the present Act to continue for a limited period of time during which existing corporations may effect continuance under the Draft Act; or (d) repeal the present Act and make the Draft Act applicable to all federal corporations as of the effective date of the Draft Act. The last alternative is superficially attractive, but it is really the most difficult of all, both for corporations and for the Department. It would require many additional and complicated provisions in the Draft Act because the Act would then apply both to corporations created under the old letters patent regime and to those incorporated under the simpler scheme of the Draft Act. The result would be a statute more complicated than the present one, defeating one of the major objectives of the Draft Act. Therefore a variation of the third alternative has been adopted: that is, to require continuance under the Draft Act.

515. Quite apart from the rather short (and entirely arbitrary) time limit of three years imposed in s. 20.15(1), we recognize that the mandatory continuance rule will impose a burden on every corporation presently in existence under the Canada Corporations Act. It is a question of choosing the lesser evil. Although the continuance procedure in s. 14.14 is straightforward, for corporations incorporated under the wholly different machinery of the present Act continuance is, in fact if not in law, a re-incorporation. Some corporations (those with partly-paid shares outstanding, for example) will no doubt have to do a lot of internal re-structuring before they can apply for a certificate of continuance Subsection (3) alleviates the problem somewhat. A rule which allowed the present Act (and corporations governed by it) to continue indefinitely would be easier at the outset, but much more troublesome and expensive in the long run. It would create two quite different regimes of corporation law at the federal level, two continuing streams of case law would develop and increasingly conflict, and public confusion would deepen, not lessen. We venture to hope that even the legal profession would not want this to happen. It therefore seemed to us that it would be better to endure a temporary cost and inconvenience as the price of a better corporation law for the future. Section 20.15 therefore looks to a fairly early transfer of all federal corporations into the Draft Act, following which Part I of the present Canada Corporations Act could be repealed.

516. Other difficult problems are posed by subsection (2) of s. 20.15. It confers discretion upon the Governor in Council to require, by regulation, that a corporation governed by an Act other than the Canada Corporations Act or by a special Act of Parliament be continued under the Draft Act. The ultimate objective is to have one regime of corporation law applicable to each business corporation incorporated at the federal level irrespective of the nature of its business. Thus, where a corporation carries on business in a regulated industry its corporate affairs will be governed by the Draft Act. But its business will continue to be governed by the special regulatory statute. If the principle of this transition provision is accepted, the federal corporations presently in existence under Acts other than the Canada Corporations Act will probably have to be dealt with on an ad hoc basis. In addition, many amendments will be required to those other Acts. It is of course impossible for us to predict how long this will take. For this reason s. 20.15(2) allows the transition to be implemented by Cabinet decision. See also the commentary on Part 1.00.

517. Whether a corporation is governed by the present Canada Corporations Act, by a special Act, or by one of the Acts relating to a specific industry, it may be continued under the Draft Act without fee, pursuant to subsection (3) of s. 20.15. The continuance would be effected under s. 14.14, such corporations being imported into the Draft Act just like any other foreign corporation. Failure to effect continuance as required by s. 20.15 will bring into play the sanction set out in subsection (4), which declares that a non-complying corporation is automatically dissolved.