A COMMENT ON "SIX MONTHS OF THE B.C. BUSINESS CORPORATIONS ACT: CHANGES AND CHALLENGES'"

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I. INTRODUCTION

I would like to begin my brief comments by noting Linda Parsons and Kate Bake-Paterson's concluding prediction that — when all the dust settles — British Columbia's Business Corporations Act[1] (the "BCBCA" or the Act) will become "a desirable statutory regime of choice among Canadian corporations".[2] This raises an important matter, namely whether such a goal is achievable.

Parsons and Bake-Paterson's article helps to build an answer to this question. The paper is essential reading for anyone wanting to understand the nature of and rationales for British Columbia's new vision of corporations law. As the authors emphasize throughout their thoughtful analysis, the BCBCA is a unique hybrid of the contract model and division of powers model of corporate legislation.

By providing the context behind many of the important provisions of the BCBCA, this article gives us a meaningful glimpse at how the judiciary might interpret the provisions as the Act is

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1. S.B.C. 2002, c. 57.
2. Linda Parsons and Kate Bake-Paterson, "Six Months of the B.C. Business Corporations Act: Changes and Challenges", *supra*, this issue, at p. 455.

litigated, piece by piece and section by section. Some of the challenges inherent in the legislation are explored. Again, such challenges invite judicial intervention before they find any final — or even interim — resolution.

And this is, of course, one of the long-term challenges of setting up a new as well as novel corporate law regime. What will the judiciary make of it all? It is one thing to draft the legislation, to choose words that the drafters hope capture the intent behind the provision. It is quite another matter to predict how those words will fall upon judicial ears. Legislative vagueness and gaps — whether intentional or inadvertent — compel judicial intervention.

My comments will focus on three problematic sections in the legislation: the conflicts of interest provision (s. 147); the pre-incorporation contract provision (s. 20); and the oppression provision (s. 227). Each is emblematic of distinct challenges. Section 147 raises the issue of definitional uncertainty and whether that uncertainty should be resolved by the legislature or the courts. Section 20 raises the issue of choosing — at the drafting stage — between two unsatisfactory solutions to a common corporate law problem when no third way readily presents itself. Section 227 raises the issue of echoing a provision common to other jurisdictions but not in an identical way. To what extent are the differences substantive or merely cosmetic?

In short, the BCBCA generates a number of questions, many of which the courts will be called upon to resolve. And whether British Columbia becomes Delaware North — which is a favoured jurisdiction for incorporation — will remain an open question for some time to come.[3]

II. PROBLEMATIC PROVISIONS

1. The Conflict of Interest Provision — Challenges Created by Legislative Silences

Under s. 147 of the BCBCA, a director or senior officer of the company must disclose "material" interests in contracts or transactions

3. For a leading discussion of the idea that a jurisdiction can promote its corporate legislative enactments, expert judiciary, and "customer service" as part of the jurisdiction's economy, see Roberta Romano, "Law as Product: Some Pieces of the Incorporation Puzzle" (1985), 1 J. L. Econ. & Org. 225.

that are "material" to the company. As Parsons and Bake-Paterson observe, the "materiality" test is undefined.[4] And, as they also note, this definitional uncertainty counts as one of the challenges of the Act.[5]

Though the predecessor legislation may be subject to criticism because it required disclosure of *any* interest, whether direct or indirect and "no matter how trivial",[6] the BCBCA provision may manifest the opposite flaw. In short, because "material interest" is not defined, the risk is that the judiciary may unduly restrict its application.

Just such a narrow perspective was taken in a recent Alberta Court of Queen's Bench case that interpreted a comparable provision in the Alberta Business Corporations Act[7] (the "ABCA"). In *Dimo Holdings Ltd. v. H. Jager Developments Ltd.*,[8] Herb Moeller — a director of H. Jager Developments Inc. (Jager Ltd.) — arranged for the company to borrow $50,000 from another company (Dimo Holdings Ltd.). Unknown to Jager Ltd., Moeller's wife was sole director, officer and shareholder of Dimo.[9] Jager Ltd. asked that the contract be set aside on the basis of non-disclosure and was unsuccessful at first instance before Master Floyd.

Whether Romano's analysis would apply to Canada is open to debate given its general lack of a history of jurisdiction shopping. See Wayne D. Gray, "Corporations as Winners under CBCA Reform" (2004), 39 C.B.L.J. 4 at p. 22 and following. See too Christopher Nicholls, "Corporate Law: What Have We Learned?" (Falconbridge Professorship in Commercial Law Lecture, Osgoode Hall Law School, Toronto, October 17, 2005).

4. *Supra*, footnote 2, at p. 18.
5. *Ibid.*, at p. 17.
6. *Ibid.*
7. See R.S.A. 2000, c. B-9, which provides:

> 120 (1) A director or officer of a corporation who
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> (a) is a party to a material contract or material transaction or proposed material contract or proposed material transaction with the corporation, or
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> (b) is a director or an officer of or has a material interest in any person who is a party to a material contract or material transaction or proposed material contract or proposed material transaction with the corporation,
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> shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of the director's or officer's interest.

8. (1998), 43 B.L.R. (2d) 123 (Alta. Q.B.).
9. Of note was that the loan was repayable at an interest rate of 50% per annum. This high rate of interest was reduced, however, when Dimo sought summary judgment when it sued for repayment of the debt. In granting summary judgment, Master Floyd reduced the interest rate to under 6%: *ibid.*

Fruman J. denied the appeal, ruling that the term "material interest" under the Alberta legislation denoted

> a financial interest, but to be material, it must be more than insignificant. It is a question of fact in each case. The term would include a material beneficial interest, possibly it would even include an interest in which an individual could exercise discretion or control over sufficient shares so as to affect the financial outcome of a company.[10]

Applying this analysis to the facts, the court ruled that Moeller had no obligation to disclose his interest in Dimo:

> No one denies that Mr. Moeller is married to Mrs. Moeller. She is clearly his associate as defined in s. 1 of the *ABCA*. The concept of relationships with associates is understood and acknowledged in corporate law and in certain circumstances disclosure is specifically required. Section 115 [now s. 120] is not one of those circumstances. Mr. Moeller is only required to disclose his material interest, not his associate's.[11]

Though it was not referred to in the decision, *Dimo* clearly rejected Professor Bruce Welling's view that a material interest may take a non-financial form. For Welling, a material interest should catch even those transactions in which the director or officer has *no* monetary interest but does have an emotional one: "Thus, a deal in which the corporation is negotiating with a close relative, or even a close personal friend, of one of the directors or officers ought to be suspect . . . one can assume that the courts will address their attention to the blood relation question . . . the only question will be to what degree of relationship the section extends."[12]

Welling's analysis on this point has found favour with a subsequent Alberta court, however. In *Zysko v. Thorarinson*,[13] Chrumka J. ruled as follows:

> The authorities . . . disclose that the term "material" is a question of fact that extends beyond the notion of financially material. In my view, what is meant by material contract is that if there is a possibility that the Director was to benefit from the contract more than *de minimis* then the transaction should

10. *Supra*, footnote 8, at p. 126.
11. *Ibid.*, at p. 127. Fruman J. went on to consider whether the outcome would be different even if the disclosure provision were said to apply. He concluded that it would not because Jager would be required — in any event — to repay the debt on the basis of an unjust enrichment.
12. Bruce Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Vancouver, Butterworths, 1991), pp. 452-53, quoted with approval in *McAteer v. Devoncroft Developments Ltd.*, [2002] 5 W.W.R. 388 at p. 474, 99 Alta. L.R. (3d) 6, 307 A.R. 1 (Q.B.).
13. (2003), 42 B.L.R. (4th) 75, [2004] 10 W.W.R. 116, 25 Alta. L.R. (4th) 110 (Q.B.).

> be disclosed to the corporation. Professor Welling states what may be a good rule of thumb: there should be disclosure whenever the director or officer's involvement might be relevant to the corporation's decision making process.[14]

Because the BCBCA does not define a "material interest", its scope will almost certainly have to be decided by the B.C. Court of Appeal. Perhaps it is regrettable that the legislation did not define "material interest", particularly in light of conflicting case law. In this writer's opinion, *Zysko* represents the stronger precedent because it considers the broad policy behind the disclosure provision, namely to identify circumstances in which the director's ability to act in the best interests of her corporation may be compromised due to dealings or involvement with the other party to the transaction at issue.

2. The Pre-incorporation Contract Provision — Challenges Created by Having No Good Solution to Intractable Problems

Pre-incorporation contracts have been confounding company law since the 19th century days of *Kelner v. Baxter*.[15] Canadian legislators — in an effort to reform and rationalize the common law concerning promoter liability — have followed two very different approaches. Under the Canada Business Corporations Act (the "CBCA"),[16] for example, the promoter is "personally bound by the contract and is entitled to its benefits"[17] unless and until it is adopted by the corporation[18] or, alternatively, unless it is expressly provided in the written contract that the promoter "is not in any event to be bound by the contract or entitled to the benefits thereof".[19]

The BCBCA follows the alternate approach, which is exemplified by the ABCA. That is, the promoter (called the "facilitator" under the BCBCA) is liable for breach of warranty of authority should the corporation not come into existence and adopt the contract within a reasonable time, unless promoter liability is expressly excluded.[20]

14. *Ibid.*, at p. 91.
15. (1866), L.R. 2 C.P. 174.
16. R.S.C. 1985, c. C-44, as amended.
17. *Ibid.*, s. 14(1).
18. *Ibid.* s. 14(2).
19. *Ibid.* s. 14(4).
20. See BCBCA, s. 20(2) and s. 15(2).

The measure of damages under the BCBCA is as follows:

> 20(2)(c) the measure of damages for that breach of warranty is the same as if
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> (i) the company existed when the purported contract was entered into,
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> (ii) the person who entered into the purported contract in the name of or on behalf of the company had no authority to do so, and
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> (iii) the company refused to ratify the purported contract.

The ABCA contains a virtually identical provision except that it does not refer to "purported contract", merely to "the contract".[21]

There is every argument that pre-incorporation contract provisions of the CBCA miss the mark and that the drafters of the BCBCA were right to avoid it. As the Institute of Law Research and Reform (now the Alberta Law Reform Institute) observed in its 1980 report, *Proposal for a New Alberta Business Corporations Act*:

> Our principal difficulty with [the CBCA provision] is that in the usual case the imposition of a contract will be contrary to the intention of both parties: B, who intended to be in a contract with X. Ltd., will find himself bound by a contract with A [the promoter] and A, who did not intend to enter into a contract at all, will find himself bound by a contract with B. We view with reserve the imposition of a [statutory] contract which neither intended . . .[22]

On a related front, it might be said that under the CBCA, B is receiving *more* than he bargained for by being able to enforce his contract against the promoter. The promoter becomes, in essence,

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21. By using the word "purported", the BCBCA avoids the problems created by *Westcom Radio Group Ltd. v. MacIsaac* (1989), 70 O.R. (2d) 591, 63 D.L.R. (4th) 433, 36 O.A.C. 288 (Div. Ct.) which, controversially, required there to be a determination that a contract existed at common law before the statutory provision could take effect. This case has been roundly criticized and no longer states the law in Ontario due to *Szecket v. Huang* (1998), 168 D.L.R. (4th) 402, 42 O.R. (3d) 400, 115 O.A.C. 300 (C.A.). To avoid the possible application of *Westcom*, recent amendments to the CBCA now refer to "purported contract". For an excellent discussion of pre-incorporation contracts and the state of the law in Ontario, see Wilfred Estey, "Pre-Incorporation Contracts: The Fog is Finally Lifting" (2003), 33 C.B.L.J. 3.

22. Institute of Law Research and Reform, *Proposals for a New Alberta Business Corporations Act*, Report No. 36, Vol. 1 (Edmonton, Institute of Law Research and Reform, 1980), pp. 41-42. The institute also notes some practical problems flowing from such a scheme. For example, if the contract is an employment contract, does B now have to work for the promoter? (at pp. 41-42). The institute concedes that a court might well not hold the parties to performance of such a contract, "but it does seem to us that the difficulties are real" (at p. 42). For discussion of conceptual difficulties common to the provincial acts and the CBCA, see Jacob S. Ziegel, "Preincorporation Contracts: A Further Comment on *1394918 Ontario Ltd. v. 1310210 Ontario Inc.*" (2002), 37 C.B.L.J. 445.

a guarantor who backstops the contract should the intended corporation fail to come into existence and adopt the contract in question.

The BCBCA/ABCA approach also has its arguable frailties. This is because damage awards under the breach of warranty provision will almost always be nominal. As *Wickberg v. Shatsky*[23] clearly explains, the plaintiff must show a causal connection between his loss (in this case, arising due to wrongful dismissal under a pre-incorporation contract), on the one hand, and the promoter's breach of warranty of authority, on the other. This can be a most difficult task. According to Dryer J.:

> The fact that Rapid Data (Western) Ltd. [the company warranted] was not incorporated . . . did not cause the plaintiff's loss . . . His loss, as I see it, resulted from the fact that the business was not a success, not from the breach of warranty . . . See *Mayne & McGregor on Damages*, 12th ed., para. 635, p. 635, and *Bowstead on Agency*, 13th ed., arts. 125, 127 and 128 at pp. 392, 397 and 404. At p. 392 Bowstead says:
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> > Where the agent is not personally liable on the contract, an action for breach of warranty of authority would only produce nominal damages, because since the company or association has no existence and so no funds, it would hardly be possible to prove a loss arising from the lack of authority: the case would be like that of an insolvent principal. Any effective liability would have to be in deceit, or possibly in negligence.
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> The plaintiff is therefore, as I see it, entitled only to nominal damages for this breach of warranty.[24]

The concern about the BCBCA (and ABCA) provision is that unless the facilitator has taken the unusual step of warranting the existence of a corporation of some means, the plaintiff's damages will nearly always be minimal.[25] One might argue on this basis that the statutory provision provides a right without a robust remedy. On the other hand, the point on causation is strong: if there is no connection between the loss and the breach of warranty, there should be no damages on that front.

Though the BCBCA provision is clearly an improvement over the predecessor legislation, which had no saving provision for

23. (1969), 4 D.L.R. (3d) 540 (B.C.S.C.).
24. *Ibid.*, at pp. 543-44.
25. *Supra*, footnote 22, at p. 43. As William Hurlburt (of the Alberta Law Reform Institute) has observed, the provision may cover reliance damages but may not cover damages for lost opportunity (in conversation with author, October 19, 2004).

pre-incorporation contracts,[26] whether the drafters were correct to follow the ABCA approach over the CBCA is an open question. As noted in the introduction, certain corporate law problems may require the drafters to choose between two uncomfortable alternatives.

3. The Oppression Provision: Challenges Created by Echoing a Provision Common to other Jurisdictions But Not in an Identical Way

The BCBCA remains consistent with its predecessor act by permitting a remedy where the impugned conduct is oppressive or unfairly prejudicial.[27] As Parsons and Bake-Paterson note, it is not known why the drafters of the BCBCA declined to adopt the more expansive definition of oppression found in the CBCA and its provincial counterparts.[28] One rationale might be that in light of the considerable common law that has developed under the oppression provision of the BCCA,[29] maintaining the *status quo* would enhance the certainty of what oppression means in the province of British Columbia.

This hypothesis nonetheless invites the question: does the BCBCA (and BCCA) oppression provision capture the same conduct as the CBCA and its related, provincial counterparts? The question arises because the CBCA prohibits conduct that is oppressive, unfairly prejudicial and that *unfairly disregards* the interest of protected persons.[30] The BCBCA merely prohibits conduct that is oppressive and unfairly prejudicial of those persons.[31] What difference does this make, if any?

It is clear that there is a difference between oppressive conduct, on the one hand, and unfairly prejudicial or unfairly disregarding conduct, on the other. In short, the latter two phrases have been interpreted as requiring "less rigorous grounds" than oppression.[32]

26. Continuing Legal Education Society of British Columbia, *British Columbia Company Law Practice Manual*, 2nd ed., vol. 1 (Vancouver, The Continuing Legal Education Society of British Columbia,, 2003), looseleaf, at para 1. 17.
27. BCBCA, s. 227.
28. *Supra,* footnote 2, at p. 476.
29. For a very helpful account of the BCCA provision and related case law, see the *British Columbia Company Law Practice Manual, supra,* footnote 26, at para. 14.41 and following.
30. CBCA, s. 241(2).
31. BCBCA, s. 227.
32. Dennis Peterson, *Shareholder Remedies in Canada* (Toronto, Butterworths Canada, 1989), looseleaf ed., para. 18.40 and cases cited therein. As Blair J. notes in *Deluce*

What follows is a very helpful discussion of these three standards in the decision of Moore J. in *Westfair Foods Ltd. v. Watt*:[33]

> Several cases have attempted to define the key elements contained in s. 241. In *Scottish Co-op Wholesale Soc. Ltd. v. Meyer*, [1959] A.C. 324 at 342, Viscount Simonds defined "oppressive" as "burdensome, harsh and wrongful" . . . The phrase "unfairly prejudicial" was considered by Fulton, J. in *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 where, at p. 45, he determined that the deliberate use of the words "unfairly prejudicial" in this context, denotes a legislative intent that the Court give those words "an effect different from and going beyond that given to the word 'oppressive'". He concluded, after referring to the Shorter Oxford English Dictionary for definitions of "prejudicial" and "unfair", that
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> > It is significant that the dictionary definitions support the instinctive reactions that what is unjust and inequitable is obviously also unfairly prejudicial.
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> Finally, in *Stech v. Davies*, [1987] 5 W.W.R. 563 at p. 569, Egbert, J. defined "unfair disregard" as:
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> > . . . to unjustly or without cause . . . pay no attention to, ignore or treat as of no importance the interests of the security holders, creditors, directors or officers of a corporation.
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> Therefore, the addition of "unfairly prejudicial" and "unfair disregard" to "oppression" in the context of s. 241 [the oppression section], provides the court with broad discretionary powers to determine whether the act or conduct of the directors or majority, are equitable or fair with respect to the interests of minority shareholders . . . Furthermore, the presence of the words "unfairly prejudicial" and "unfair disregard" within s. 241 makes it clear that the section applies where the impugned conduct is wrongful, but not actually unlawful. Moreover, in choosing to speak of the interests rather than the rights of the security holder, creditor, officer of director, the legislature clearly intended the courts to look beyond those legal rights to which complainants might have and to consider questions of equity.[34]

Moore J. summarizes this challenging area by concluding that the "threshold" test in each case is fairness and that the legislation "confers a broad power of discretion upon the court to exercise its

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Holdings Inc. v. Air Canada (1992), 12 O.R. (3d) 131 at p. 142, 98 D.L.R. (4th) 509, 8 B.L.R. (2d) 294 (Gen. Div.), conduct that is "'unfairly prejudicial or which unfairly disregards' constitutes grounds that are 'less rigorous' than oppression: see *Mason v. Intercity Properties Ltd.* (1987), 59 O.R. (2d) 631 . . . [and] *Re Jermyn Street Turkish Baths Ltd.*, [1971] 3 All E.R. 184 (C.A.)". See too analysis in the *British Columbia Company Law Practice Manual*, *supra*, footnote 26, at para. 14.45 and following.

33. (1990), 106 A.R. 40, [1990] 4 W.W.R. 685, 73 Alta. L.R. (2d) 326 (Q.B.), affd 79 D.L.R. (4th) 481, [1991] 4 W.W.R. 695, 79 Alta. L.R. (2d) 363 (C.A.), leave to appeal to S.C.C. refused [1998] S.C.C.A. No. 634.

34. *Ibid.*, at p. 51.

equitable jurisdiction in determining what is fair in each particular case".[35]

Based on this kind of analysis, it seems reasonable to conclude that "unfairly prejudicial" and "unfairly disregards" are synonymous. On this basis, nothing should turn on the absence of "unfairly disregards" in the BCBCA. Case law decided under the CBCA wording should be relevant to understanding the BCBCA provision and *vice versa*. Whether this assessment is correct, however, remains to be determined by British Columbia's appellate court. Some uncertainty invariably accompanies the B.C. oppression section because it does not strictly follow the words of the CBCA.

III. CONCLUSION

Linda Parsons and Kate Bake-Paterson's article is of tremendous assistance to those seeking a grounding in British Columbia's new corporate law regime. I learned a great deal from their analysis and am grateful to them for their insights.

35. *Ibid.*, at p. 52. The Alberta Court of Appeal expressly agreed, *ibid.*, at p. 53, noting that the words of the oppression section "charge the courts to impose the obligation of fairness on the parties".