LAW REFORM PROJECT - CORPORATIONS ACT

UNANIMOUS SHAREHOLDER AGREEMENT

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TABLE OF CONTENTS

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I. INTRODUCTION

The statutory unanimous shareholder agreement is relatively new in Canada. In 1975, the *Canada Business Corporations Act*[1] introduced such a concept which has now also been enacted in the recent corporate statutes in Manitoba[2] and Saskatchewan.[3] A survey of United States legislation[4] discloses schemes similar to the unanimous shareholder agreement. On the other hand, neither Ontario[5] nor British Columbia[6] chose to deal specifically with such agreements. However, a legislative committeee in Ontario is currently considering new corporate legislation in Ontario which will doubtless include unanimous shareholder agreements.

In Alberta, the Institute of Law Reform and Research is currently involved in drafting a new Corporations Act. While it appears that it will basically be similar to the *CBCA*, some attempt is being made to evaluate the federal statute and clarify any problems in that Act. Accordingly, the current project is an attempt to analyse both the theoretical basis for the unanimous shareholder agreement and the current statutory provisions relating thereto in the *CBCA*.

Since it is impossible to understand the unanimous agreement without an understanding of the current position in Alberta, the paper will commence with a discussion of shareholder agreements under the Alberta Act. It will then attempt an analysis of the rationale of the *CBCA* provision and the use that can and is currently being made of the concept. Next, the paper will then look at comparative United States developments. It will then turn to the most important question, *ie.*, the problems with section 140 of the *CBCA* and improvements that might be made. Finally, the paper will contain a draft section which attempts to

solve some of the apparent problems in the present legislation and at the same time make the unanimous shareholder agreement a more viable option for small companies.

II. GENERAL STATUS OF SHAREHOLDER AGREEMENTS UNDER THE ALBERTA ACT

There are no provisions in the current Alberta *Companies Act*[7] which deal with shareholder agreements. With one major theoretical exception,[8] most[9] shareholder agreements do not form part of the constitutional documents of the company but are separate and private contracts between such or all of the shareholders. The scope of such agreements is virtually unlimited. They may prescribe voting procedures, allocate the right to elect directors and officers to particular shareholders, govern the transfer of shares, provide for future financial contributions to the company by way of loan, and contain buy-sell agreements to deal with the contingency of shareholder death, with or without insurance funding. This list is not exhaustive but gives the most common inclusions in shareholder agreements.

Strangely enough, when one compares Alberta to the United States and even Ontario, the impression is that not a great deal of use is made of shareholder agreements in this province. Indeed, throughout the country extensive use of such agreements would seem to be a phenomenon of the last decade or two. Perhaps it is this factor which accounts for the lack of judicial statements in Canada on the limits and efficacy of agreements. Indeed, to my knowledge, the first *real* judicial interpretation of a shareholder agreement only took place two years ago.[10]

Nevertheless, some general comments on shareholder agreements can be made. First, the Courts have clearly demonstrated that such agreements cannot interfere with the discretion of directors.[11] This

attitude is, of course, based on the theory that management powers are given by the articles of association or statute to the directors and that these powers must be exercised *bona fide* for the benefit of the company. They cannot be delegated in the absence of express authority and the directors cannot bind themselves to exercise their discretion in advance.

In general terms, no one would argue with this conclusion. Where there is a minority group in the company who ostensibly relies on the independent discretion of the board of directors, the majority ought not to be able to nullify his reliance by placing restraints on the directors. The theory breaks down, however, when the shareholders agreement is unanimous. Yet, in *Atlas Developments Co. Ltd. v. Calof and Gold*,[12] the Manitoba Court of Queens Bench indicated that the prohibition against shareholders interference with the directors discretion extended even to a unanimous shareholders agreement. Bastin J. stated:

> "With respect to the directors of the company, an agreement requiring unanimity in every decision is inconsistent with their duty to decide matters affecting the welfare of the company which might come before them, in accordance with their best judgement, and such an agreement by directors is void."[13]

This result is absurd in practice. In a typical unanimous shareholder agreement, the shareholders will be the directors. If this is not so, then certainly the directors will be under the effective control of the shareholders. In this situation it is extremely unlikely that the 'company' would be hurt by any restraint on the directors. In theory it may be that such restraints would put the director in a very difficult position if he genuinely believed that any binding instructions were not in any particular circumstances in the best interests of the company.

Nevertheless, the *Atlas* decision is bad simply because it refuses to recognize that in a closely held company, the shareholders are not really concerned about the Board of Directors as an entity. The company is being run as a partnership and any agreements entered into are to further that aim. One wonders whether the same decision would be reached by an Appellate Court today.

Whatever the limits of Canadian authority, United States jurisprudence has not developed along identical lines.[14] Certainly, the United States Courts have made it quite clear that universal interference with the discretion of the directors will not be tolerated.[15] Nor will an agreement be upheld generally unless all shareholders are parties to the agreement.[16] To this stage the United States and Canadian positions are consistent. However, the United States Courts appear, in recent years, to be far more willing to permit unanimous shareholder agreements to restrict the discretion of directors in a manner which does not totally sterilize the board. Two cases should illustrate this attitude. In *Clark v. Dodge*,[17] an agreement between the owners of all the stock in a corporation provided that one, the plaintiff Clark, should remain as director and manager so long as he should be "faithful, efficient and competent." Moreover, Clark was entitled for his life to receive 25% of the net income of the corporation by way of salary or dividends and the parties agreed that no unreasonable salary would be paid to others so as to reduce the corporations net income. This agreement was reached in return for Clark's disclosure of a secret formulae for a manufacturing process. The New York Court of Appeal upheld the agreement and central to the decision was the fact that this was a unanimous agreement in a close corporation.

> "As the parties to the action are the complete owners of the corporation, there is no reason why the exercise of the power and discretion of the directors cannot be controlled by valid agreement between themselves, provided that the interests of creditors are not affected."[18]

Again, in *Galler v. Galler*,[19] the Supreme Court of Illinois upheld an agreement between two brothers and their wives which provided for, *inter alia*, (1) mandatory dividends, (2) an indefinite term for the agreement, (3) an equal split of the board of directors between the two families, and (4) equal salaries between the two families. The Court stated:

> "It would admittedly facilitate judicial supervision of corporate behaviour if a strict adherence to the provisions of the Business Corporations Act were required in all cases without regard to the practical exigencies peculiar to the close corporation.
>
> ... However, courts have long ago, quite realistically, we feel, relaxed their attitudes concerning statutory compliance when dealing with close corporate behaviour, permitting "slight deviations" from corporate "norms" in order to give legal efficacy to common business practice...[20]
>
> This Court has recognized, albeit *sub silentio*, the significant conceptual differences between the close corporation and its public issue counterpart in, among other cases, *Kantzler v. Besinger*, 214 Ill. 589, 73 N.E. 874, where an agreement quite similar to the one under attack here was upheld. Where, as in *Kantzler* and here, no complaining minority interest appears, no fraud or apparent injury to the public or creditors is present, and no clearly prohibitory statutory language is violated, we can see no valid reason for precluding the parties from reaching any arrangements concerning the management of the corporation which are agreeable to all."[21]

These two cases[22] should illustrate that, as usual, there is a much greater awareness of the philosophy behind unanimous shareholder agreements in the United States than in Canada. As stated above, it may be that the

the Supreme Court of Canada would adopt and appreciate the concerns of the United State's Courts. Until that is done one must regard any restriction on the discretion of directors with great caution. This does not mean that Canadian shareholders have felt restrained in their attempts to control directors. Shareholder agreements commonly contain undertakings by the parties which if carried to fruition would in substance impinge on the power of directors. However, none of these agreements attempt to *bind* the directors. The shareholders simply insert a clause at the end of the agreement as follows:

> "Each of the parties to this agreement undertake that they will vote and act at all times as shareholders of the Company and in all other respects shall use their best endeavours and take all such steps as may reasonably be within their power so as to cause the Company and the directors to act in the manner contemplated by the provisions of this agreement."

Since the shareholders will normally be directors or will have nominees on the Board, this will effectively bind the directors. While no doubt theoretically possible, it would be extremely difficult for an individual to convince a Court that he can wear a different hat as a shareholder and director. Thus, it would be unlikely that a shareholder could request himself to act in accordance with the agreement, but act differently as a director! Nevertheless, the point is that the *ultimate* legality and effectiveness of such clauses is unclear. For example, what remedy would flow from a shareholder's breach? In short, the clause is a formalistic and totally unnecessary requirement.

The second point with respect to common law shareholder agreements, is that in Canada it appears that they would not be specifically enforceable. In the United States, while there appears to be some dissension, there have been many cases where performance of such agreements has been judicially recognized.[23] In Canada, however, the general feeling seems to be that shareholder agreement should be analogized to partnership agreements

and since they involve personal services should not be positively controlled by the Courts.[24] The problem is not with the analogy to partnership agreements, which is quite appropriate, but with the attitude the Courts have taken in the partnership context.[25] It may be that in the event of a serious breakdown just and equitable winding up provides the best solution. However, where minor and isolated breaches occur clearly a means of speedy enforcement is required.

Finally, one might be excused for commenting that many shareholder agreements in Canada are not drafted with sufficient care. Perhaps as a result of the fact that the shareholder agreement is a relatively recent phenomenon, many practitioners fail to appreciate the importance of questions such as whether the corporation should be a party to the agreement[26] or whether voting methods should be provided for in detail.[27] As the Courts become involved more and more, as they must, in the interpretation of such agreements, it will be realized that as much effort must be put into drafting a complex unanimous shareholder agreement as in drafting a prospectus and trust indenture for a $10,000,000 debt financing.

One final comment might be made on the status of shareholder agreements in Canada. This relates to the ability of the shareholders under non-reform statutes to act without directors. Clearly, where under a letter patent system the statutes specifically put power in the hands of the Board of Directors, the shareholders cannot withdraw such authority to themselves.[28] This is not so under a registration system whereby the shareholders do not have to delegate all authority to the directors through the Articles of Association. Needless to say, one normally finds full delegation. However, if they desire the incorporators could restrict the directors' power and if necessary, by special resolution, the

shareholders could revoke authority previously delegated. Thus, there is already in Alberta an inherent flexibility in the corporate structure which, for reasons of privacy or otherwise, has not been utilized.

Recently, with the advent of the 50% resident director requirement, there has been much discussion as to whether you need a director at all. Most practitioners hold the view that due to the number of sections in the *Companies Act* which refer to directors, you must have at least one. However, the Act does not so provide and indeed in section 145(1) states:

> "Every company shall cause minutes of all proceedings of general meetings, *and, where there are directors or managers*, of meetings of its directors or managers, to be entered in books kept for that purpose."

This is a clear statutory acknowledgement that a company in Alberta need have *no* directors.[29] Thus, shareholders currently have the ultimate flexibility of running the company with no directors if they so desire.

III. THE UNANIMOUS SHAREHOLDER AGREEMENT UNDER THE CANADA BUSINESS CORPORATIONS ACT - RATIONALE AND USE

In an attempt to avoid many of the problems discussed above, the draftsmen of the *CBCA* incorporated into the Act a statutory unanimous shareholder agreement. The final provision, section 140, is not identical to that proposed by the draftsmen. At present, however, it reads as follows:

> Section 140
>
> (2) *Unanimous shareholder agreement*.-An otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and a person who is not a shareholder, that restricts, in whole or in part, the powers of the directors to manage the business and affairs of the corporation is valid.
>
> (2.1) Where a person who is the beneficial owner of all the issued shares of a corporation makes a written declaration that restricts in whole or in

> part the powers of the directors to manage the business and affairs of a corporation, that declaration is deemed to be a unanimous shareholder agreement.
>
> (3) *Constructive party*.-Subject to subsection 45(8), a transferee of shares subject to a unanimous shareholder agreement is deemed to be a party to the agreement.
>
> (4) *Rights of shareholder*.-A shareholder who is a party to a unanimous shareholders agreement has all the rights, powers and duties of a director of the corporation to which the agreement relates to the extent that the agreement restricts the discretion or powers of the directors to manage the business and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 114, to the same extent.[29a]

This section was inserted by the draftsmen in recognition of the unique nature of close corporations. In particular, it was designed to remove any doubt as to whether and to what extent directors could divest themselves of management powers. There is little need to dwell extensively on the nature of close corporations. Much has been written. Suffice it to say that many close corporations wish to operate as partnerships. The shareholders wish to have the flexibility to handle the management of the corporation as under a partnership agreement without the technical distinction and split of powers between the shareholders in general meeting and the Board of Directors. Indeed, in that many close corporations are essentially one man corporations, such a shareholder would prefer to see the corporation run as a sole proprietorship.

The draftmen's desires can readily be seen from the present wording of section 140. The shareholders, by unanimous agreement, may restrict, in part or in whole, the scope of the management powers of the directors. In other words, the shareholders may manage the company to the extent that they desire. Moreover, to clarify the question at common law as to whether

and to what extent the directors can delegate power to a third party, the shareholders are expressly empowered to enter into an agreement with a stranger to the corporation by which the latter is granted up to exclusive management authority. Naturally, the directors are relieved from, and the shareholders assume the duties, responsibilities and liabilities which normally attach to directors to the extent such power is held by the shareholders or a third party.

Section 140, however, is worded generally. Perhaps the best indication of how the unanimous shareholder agreement will be utilized may be gained from a survey of the *CBCA* provisions which contemplate the use of such an agreement. The *CBCA* uses the phrase "unanimous shareholder agreement" eighteen (18) times. Two of these references, in sections 2 and 140, are definitional in nature and no further reference will be made to them at this stage. The remaining references are more interesting.

1. s.20 - the corporation must maintain corporate records at its registered office which shall include a copy of any unanimous shareholder agreement. By section 21(1), shareholders and creditors of the corporation, their agents and legal representatives and the Director may refer to such documents. However, in line with the general philosophy towards shareholder agreements, these are not open to the public unless the corporation is a distributing corporation.

2. s.21(2) - as a corollary to section 20, a shareholder is entitled to a copy of the unanimous shareholder agreement free of charge.

3. s.18 - this provision is basically a restatement of the common law indoor management rule. A corporation is not permitted to assert against a third party dealing with the corporation or who has acquired rights from a corporation that any unanimous shareholder agreement

has not been complied with. This section recognizes that the unanimous shareholders agreement may withdraw the directors power to deal with outsiders but that non-compliance with such agreement may not be raised as a defence against a third party asserting the corporation is bound by the acts of such director.[30]

4. s.45 - this section deals generally with the rights of a security holder. One of the problems with unanimous shareholder agreements is what happens when a security affected by a unanimous shareholder agreement is transferred. Section 45(8) provides that a unanimous shareholder agreement is ineffective against a transferee who has no actual knowledge of such agreement, *unless* it or a reference thereto is noted conspicuously on the share certificate.[31]

5. s.97 - in many ways this is one of the most important sections dealing with unanimous shareholder agreements. This provision is the statutory statement of the powers of the directors to manage the business and affairs of the corporation. However, it is expressly made subject to a unanimous shareholder agreement.[32] Now that section 6 has been amended and the contents of a unanimous shareholder agreement cannot be included in the articles of incorporation, this is the only method by which management powers of the directors can be restricted unless there is a specific statutory reference to the contrary.

6. s.98 - this is the first specific reference to inclusions in the unanimous shareholder agreement. Generally speaking, the directors have the power to propose, amend, repeal, etc. bylaws. However, s.98(1) clearly states that this power is subject to a unanimous shareholder agreement. Thus, the unanimous shareholder agreement may specifically give to shareholders the power to control the by-laws. This will

presumably mean that no shareholder approval as envisaged by section 98(2) will be required.

7. s.116 - one of the most common functions of the Board of Directors is the appointment of offices and the delegation of certain powers thereto. The reference to unanimous shareholder agreements in section 116 indicates clearly that the shareholders may withdraw to themselves the power to make such appointments.

8. s.117 - this provision lays down the basic duties of the Board of Directors. Section 117(2) simply states the obligation of the directors to comply with the terms of any unanimous shareholder agreement. It might also be added that while section 117(3) does not specifically refer to unanimous shareholder agreements, it presumably is encompassed within the word 'contract' in that subsection. Accordingly, no provision in a unanimous shareholder agreement can exempt a director from his obligation to act in accordance with the Act unless the relevant powers have been withdrawn from him.

9. s.120 - normally, the directors of the corporation have the power to set their own remuneration, and that of officers and employees. Section 120 restates this practice. However, section 120 also provides, *inter alia*, that such powers of the directors may be limited by a unanimous shareholder agreement. Thus, the statute specifically contemplates that the remuneration of all directors, officers and employees may be decided upon by the shareholders.

10. s.149 - the *CBCA* deals in some detail in Part XIII with financial disclosure. Section 149 prescribes the minimum amount of financial information that must be placed before the shareholders at the annual meeting. However, it may be that the shareholders wish to have

more detailed information than that contained in the comparative financial statements. Accordingly, section 149(1)(c) provides that the directors must also place before the shareholders "any further information respecting the financial position of the corporation and the results of its operation required", *inter alia*, by any unanimous shareholder agreement. This is an interesting provision in that it does not directly relate to the *withdrawal* of management powers as such. Rather, it contemplates the unanimous shareholder agreement as an instructional or directory contract *viz a viz* the directors which is designed to *supplement* the requirements of the Act.

11. s.183 - one of the common management powers of the directors is that of borrowing and giving security for money's borrowed over corporate assets. This is provided for by section 183(1) but such power is made expressly subject, *inter alia*, to any terms of a unanimous shareholder agreement.

12. s.207 - a common problem in close corporations is the just and equitable winding up and in what situations it may be obtained. While the attitude of the Courts has substantially liberalized over the past few years,[33] there is still some doubt as to the scope of the concept. Section 207(1)(b)(i) of the *CBCA* provides a specific ground for winding up, namely:

> "if the Court is satisfied that:
>
> (1) a unanimous shareholder agreement entitles a complaining shareholder to demand dissolution of the corporation after the occurrence of a specified event and that event has occurred..."

Presumably, the sorts of events contemplated might include failure to obtain a specific contract or complete a specific transaction or possibly financial losses incurred by the corporation for a period of two years. These are typical of clauses often inserted in partnership agreements and the express

availability of this option under the *CBCA* is a real appreciation of the partnership like nature of the close corporation. Incidentally, section 207(1)(b)(i) is another example of the unanimous shareholder agreement being utilized for purposes other than the *withdrawal* of power from the directors.

12. s.234 - the oppression remedy in s.234 is one of the most innovative features of the *CBCA*. The unanimous shareholder agreement is utilized here in a remedial sense. If the Court finds conduct oppressive in nature, it is given very broad jurisdiction by section 234(3) to deal with the matter. In particular, by clause (c), *inter alia*, it has the jurisdiction to regulate the corporation's affairs by creating or amending a unanimous shareholder agreement. Obviously, this ability to interefere with the contractual relationships of the parties is very broad and will have to be exercised with restraint.

14. s.240 - this provision is also remedial in nature. It simply gives a complainant or creditor the right to apply for an injunction to stop a variety of people acting contrary to the terms of a unanimous shareholder agreement. The Court not only has the power to restrain such conduct but also make any other order it thinks fit.

15. s.250 - this section simply states that a certificate issued on behalf of a corporation stating any fact set out in the unanimous shareholder agreement may be signed by a director, officer or transfer agent of the company.

16. The newly amended section 6(3) is extremely important. It provides that the articles or a unanimous shareholder agreement may require a greater number of votes by director or shareholders to effect any action other than is required under the Act. This means that either the directors can be effectively restrained by the shareholders, or possibly more importantly, almost absolute protection can be provided for a minority shareholder by prohibiting any fundamental changes without, for example, a 95% vote or approval.

It can be seen, therefore, that many provisions dealing with unanimous shareholder agreements simply deal in general terms with the withdrawal of power from the directors. Others are remedial in nature while some deal more specifically with powers, eg., borrowing, bylaws, and remuneration of directors and officers. As will be explained, however, these specific provisions are by no means exhaustive. The unanimous shareholder agreement may deal specifically with the employment of any individual, restrictions on the declaration of dividends or the ability to repurchase shares. In other words, any power may be withdrawn from the directors to further the aims of the unanimous shareholder agreement.

It is difficult to assess whether the current use of the unanimous shareholder agreement is extensive since as the agreements are private no record is maintained of their use. But it does appear that the concept is being used by parent corporations and their wholly owned subsidiaries and the general feeling is that many close corporations are incorporating under the *CBCA* because of its availability. This is not to say that every small company is pulling back all power from the directors. Obviously there is no way to check this, but one suspects that the agreement may well be being used to *restrict* or *limit* the powers of directors in a manner not available under common law. Thus, the shareholders may agree that no dividend shall be declared until there is $x thousand of retained earnings.

Certainly, the most public usage of the concept is that by corporate families. Assume a parent U.S.A. company A which owns 100% of B, incorporated under the *CBCA*. The parent company will appoint a 'dummy' Canadian resident as director and then pull back all the power under the unanimous shareholder agreement. The company may then be run by the vice-president in New York. This represents a very easy way of avoiding the resident director requirement under section 100(3). However, obviously a number of Canadian parent/subsidiary corporations are using the concept in a more legitimate sense. Indeed, my

personal experience has been that it is difficult to convince U.S.A. parent companies to enter into unanimous shareholder agreements. First, the concept is a little strange to many of them. Secondly, and more significantly, the U.S.A. oil and gas corporations, at least, seem to be attempting to increase the stature and independence of their Canadian subsidiaries. They find that the last thing the banks and financing bodies want to discover is that Canadian directors have no authority and that dealings have to be done with the parent in the United States. One must wonder then just how extensive this use of the unanimous shareholder agreement actually is.

Until recently, one of the intended benefactors of the unanimous shareholder agreement was unable to utilize it, namely, the one man corporation permitted under section 5. This was because section 140(2) talked in terms of an *agreement* between shareholders, thus implicitly requiring two or more parties. This problem has now been amended by the addition of section 140(2.1) and an amendment to the definition of unanimous shareholder agreement in section 2, which amendment classifies a declaration by the sole shareholder as a unanimous shareholder agreement.

Finally, one use of the unanimous shareholder agreement may be as a temporary arrangement amongst shareholders pending formal alteration of the articles of association. As Dickerson says,[34] one of the specific terms of the unanimous shareholder agreement may be to amend the articles at some future time. And, as the same writer points out, "if the 'special arrangements' are for a short term, it may be more convenient to effect them in an agreement rather than by amendment of the articles or bylaws and reamendment later."

In conclusion, as stated it is difficult to know what use is being made of unanimous shareholder agreements. It is, without doubt,

being utilized in the parent/subsidiary context. Moreover, it is difficult to believe that use is not being made of it in the forum it was designed primarily to be utilized, that is, in a close corporation where it can effectively limit some of the formalities of the traditional corporate model. It may be, as will be discussed, that the requirement to have directors even with a full unanimous shareholder agreement is causing some problems. There is no way of discovering this.

IV. ANALYSIS OF UNITED STATES EQUIVALENTS TO SECTION 140

Before commencing a discussion of some of the problem areas of section 140, it may be useful to make a brief review of a range of provisions in United States Corporations Acts which attempt to deal with the management problems in close corporations. The States adopt diverse approaches to the problem.[35] Accordingly, in trying to cover a variety of approaches I have selected provisions from *The Deleware General Corporation Law*,[36] the New York *Business Corporation Law*,[37] the California *General Corporation Law*,[38] and the Maryland *Business Corporations Act*.[39]

(a) New York

Section 620(b) reads as follows:

> (b) A provision in the certificate of incorporation otherwise prohibitied by law because it improperly restricts the board in its management of the business of the corporation, or improperly transfers to one or more shareholders or to one or more persons or corporations to be selected by him or them, all or any part of such management otherwise within the authority of the board under this chapter, shall nevertheless be valid: (1) If all the incorporators or holders of record of all outstanding shares, whether or not having voting power, have authorized such provision in the certificate of incorporation or an amendment thereof; and (2) If, subsequent to the adoption of such provision, shares are transferred or issued only to persons who had knowledge

> or notice thereof or consented in writing to such provision. (c) A provision authorized by paragraph (b) shall be valid only so long as no shares of the corporation are listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national affiliated securities association.

This provision is primarily remarkable for its brevity. It was perhaps the first real attempt to deal with the problems of shareholder management. It has now, hoever, been largely supplanted by subsequent developments.[40] A number of comments might be made.

1. The agreement must be contained in the certificate of incorporation. This raises the question of public versus private documentation of such agreements.
2. The section clearly contemplates, as does the *CBCA*, the assignment of management rights to a third party.
3. The section does not recognize the independent validity of unanimous shareholder agreements outside the certificate of incorporation, thus leaving them in the state of flux indicated above. It certainly seems clear that a complete delegation of directors powers would be invalid.
4. The section still seems to require directors to be elected.
5. Because of its brevity, the section does not deal with a number of contentious issues. Among these are:
   (a) arbitration of disputes among shareholders who have withdrawn power;
   (b) the winding up of the corporation on the basis of the shareholder agreement;
   (c) the question of who carries the liability for delegated powers; and

(d) enforcement of the provisions in the certificate of incorporation although presumably this would be available under general New York law.

6. The agreement must be unanimous.

7. Any transfer to a party who had no knowledge or notice of the provision and had not consented in writing will make the provision invalid.

8. Under paragraph (c) such provision in the certificate only remains valid if the shares of the company are not listed on a national securities exchange or regularly traded in an over the counter market. Obviously, this is inserted to essentially confine the impact of such provisions to close corporations and to maintain the board of directors as the management vehicle in public companies.

(b) Deleware

The Deleware *General Corporation Law* is, of course, regarded as perhaps the most flexible in the United States by the multitude of corporations incorporated in that jurisdiction. There are basically two sections dealing with the management of the company:

> 350. *Agreements restricting discretion of directors*
>
> A written agreement among the stockholders of a close corporation holding a majority of the outstanding stock entitled to vote, whether solely among themselves or with a party not a stockholder, is not invalid, as between the parties to the agreement, on the ground that it so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors. The effect of any such agreement shall be to relieve the directors and impose upon the stockholders who are parties to the agreement the liability for managerial acts or ommissions which is imposed on directors to the extent

and so long as the discretion or powers of the board in its management of corporate affairs is controlled by such agreement.

351. *Management by stockholders*

The certificate of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect,

(1) No meeting of stockholders need be called to elect directors;

(2) Unless the context clearly requires otherwise, the stockholders of the corporations shall be deemed to be directors for purposes of applying provisions of this chapter; and

(3) The stockholders of the corporation shall be subject to all liabilities of directors.

Such a provision may be inserted in the certificate of incorporation by amendment if all incorporators and subscribers or all holders of record of all of the outstanding stock, whether or not having voting power, authorize such a provision. An amendment to the certificate of incorporation to delete such a provision shall be adopted by a vote of the holders of a majority of all outstanding stock of the corporation, whether or not otherwise entitled to vote. If the certificate of incorporation contains a provision authorized by this section, the existence of such provision shall be noted conspicuously on the face or back of every stock certificate issued by such corporation.

Comments

1. The theory of section 350 is to state conclusively that a restriction of the board of directors is not void as a matter of public policy because it interferes with the directors statutory powers.

2. It should be noted that section 350 does not require a unanimous agreement among the shareholders but only between those holding a majority of the outstanding stock. Thus, the agreement is only void as between the parties to the agreement. This means, presumably,

that there may be circumstances when a non-party minority shareholder could strike the agreement down if it is or is utilized oppressively.

3. Liability is shifted from the directors to the parties to the agreement to the extent of the withdrawal.

4. The sections contemplate the transfer of management power to a third party in the same manner as the *CBCA*.

5. Frankly, I have some problems rationalizing sections 350 and 351. It seems, and certainly Folk[41] indicates this, that despite the lack of words such as "in whole or in part", the discretion and power of the directors can be totally restricted or interfered with. Section 351 also covers this situation. It may be that section 350 will be utilized to deal with incidental or specific restrictions on the directors such as dividends, borrowing and compensation. Nevertheless, it may be that, in theory, it is possible to envisage a situation where the only difference between applying the two sections, apart from the obvious technical distinction, would be that you would still have a board of directors under section 350 whereas section 351 permits abolition of the board.

6. As stated, section 351 authorizes the abolition of the board of directors where a provision is included in the *certificate of incorporation* that the shareholders are to manage the corporation. This is an acknowledgement of the manner in which close corporations function in practice and is, thus, highly desirable.

7. This section, unlike section 350, requires unanimous approval of shareholders. Yet, strangely enough, such an agreement may be altered by those holding a majority of outstanding stock. This is clearly a statutory interference with the concept at common law contract

but is perhaps realistic in that the majority group will control the operation of the company. Interestingly, those who have non-voting shares are computed in the majority.

8. All liabilities are shifted to the shareholders of the corporation.

9. There is no express statement of the circumstances in which such agreement will become invalid, but presumably it will cease to have effect if the existence of such a provision is not noted conspicuously on all share certificates issued by the corporation. This flows from the facts that a transferee of a silent stock certificate would not be bound by the agreement and, therefore, there would be no unanimity.

(c) California

> 300. *Corporate powers exercisable by board: Delegation of day-to-day management: Close corporations: Validity of shareholders' agreement: Liability for managerial acts: Corporate formalities.*
>
> (a) Subject to the provisions of this division and any limitations in the articles relating to action required to be approved by the shareholders (Section 153) or by the outstanding shares (Section 152), the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board. The board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.
>
> (b) Notwithstanding subdivision (a) or any other provision of this division, but subject to subdivision (c), no shareholders' agreement, which relates to any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits or distribution of its assets on liquidation, shall be invalid as between the parties thereto on the ground that it so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the board or that it is an attempt to treat the

corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners. A transferee of shares covered by such an agreement which is filed with the secretary of the corporation for inspection by any prospective purchaser of shares, who has actual knowledge thereof or notice thereof by a notation on the certificate pursuant to Section 418, is bound by its provisions and is a party thereto for the purposes of subdivision (d). Original issuance of shares by the corporation to a new shareholder who does not become a party to the agreement terminates the agreement, except that if the agreement so provides it shall continue to the extent it is enforceable apart from this subdivision. The agreement may not be modified, extended or revoked without the consent of such a transferee, subject to any provision of the agreement permitting modification, extension or revocation by less than unanimous agreement of the parties. A transferor of shares covered by such an agreement ceases to be a party thereto upon ceasing to be a shareholder of the corporation unless the transferor is a party thereto other than as a shareholder. An agreement made pursuant to this subdivision shall terminate when the corporation ceases to be a close corporation, except that if the agreement so provides it shall continue to the extent it is enforceable apart from this subdivision. This subdivision does not apply to an agreement authorized by subdivision (a) of Section 706.

(c) No agreement entered into pursuant to subdivision (b) may alter or waive any of the provisions of Sections 158, 500, 501, and 1111, subdivision (e) of Section 1201, Sections 2009, 2010, and 2011, or of Chapters 15 (commencing with Section 1500), 16 (commencing with Section 1600), 18 (commencing with Section 1800), and 22 (commencing with Section 2200). All other provisions of this division may be altered or waived as between the parties thereto in a shareholders' agreement, except the required filing of any document with the Secretary of State.

(d) An agreement of the type referred to in subdivision (b) shall, to the extent and so long as the discretion or powers of the board in its management of corporate affairs is controlled by such agreement, impose upon each shareholder who is a party thereto liability for managerial acts performed or omitted by such person pursuant thereto that is otherwise imposed by this division upon directors, and the directors shall be relieved to that extent from such liability.

> (e) The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in connection with the management of its affairs, pursuant to an agreement authorized by subdivision (b), shall not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations.

Added in 1977, the California management provision is one of the most recent of the United States' attempts to deal with this problem. Perhaps the first comment, before making any more detailed observations, is that from a drafting style my opinion is that the section is extremely difficult to read and could well have been broken down into various subsections.

Comments

1. Section 300(a) is the standard statutory grant of power to the directors. It is interesting, however, that it specifically permits the delegation of power to manage to a third party *provided* that the board of directors retains ultimate authority. Thus, any common law doubt as to whether the day-to-day functions of management has been expressly eliminated.
2. While it is not clear from section 300(b), a shareholder agreement is defined as a unanimous agreement between all shareholders or between the shareholder and the corporation if there is only one shareholder (see section 186).
3. The phraseology of section 300(b) is interesting in that the agreement may relate to "any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits or distribution of its assets on liquidation". It is doubtful whether this is any broader than the effect of section 140, *CBCA*, but it is interesting that the draftsman has made explicit the fact that the close corporation is so unique that all aspects of it can be dominated by the agreement. The only statutory provisions in the General Corporations Law

Division I that cannot be waived, except for the filing of any required agreement, are sections 158 (definition of close corporation), 500 (financial restrictions on distributions), 501 (prohibited distributions), 1111 (shareholder approval of certain close corporation mergers), 1201(e) (shareholder approval of reorganization if it would lead to destruction of close corporation), 2009 (recovery of amounts improperly distributed in winding up), 2010 (continuance for purposes of winding up), 2011 (Actions against shareholders when corporation dissolved), Chapter 15 (books and records of accounts), Chapter 16 (rights of inspection), Chapter 18 (involuntary dissolution), and Chapter 22 (crimes and penalties). It can thus be seen that the provision goes to much greater length than the *CBCA* to detail the great flexibility that can be obtained by use of a unanimous shareholder agreement.

4. One point common to many recent United States' statutes is a reference not only to interference with directors' discretion but also a statement that the agreement is not invalid because "it is an attempt to treat the corporation as if it were a partnership or arrange [the shareholders'] relationship in a manner that would be appropriate only between partners." It is difficult for an outsider to assess the importance of such a clause. Presumably it is there merely to say that a more informal arrangement inconsistent with the more structured traditional corporate model is not invalid. The clause should also be read in conjunction with section 300(e) which essentially states that running a company like a partnership pursuant to a shareholder agreement without regard to corporate formalities shall not mean that shareholders are contracting or acting on their own behalf. Presumably this also contemplates no liability as partners. In my view, the addition of such clauses is unnecessary in Canada.

5. As in the *CBCA*, a transferee of a security with actual notice of the agreement or notice thereof by a notation on the share certificate is bound. No statement is made as to what happens in the case of a transferee without notice but presumably since the agreement must be unanimous it will be invalid. The next sentence of the section does, however, contemplate invalidity if the shares are *issued* to a shareholder who does not become a party to the agreement. Interestingly, however, the section provides that the agreement may provide for its own continuance to the extent that it is valid apart from section 300. Having regard to the scope of the agreement this is very sensible.
6. There is the usual shifting of liability.
7. There appears to be no provision for the abolition of directors or for arbitration of shareholder disputes under the agreement.
8. The agreement must terminate if the corporation ceases to be a close corporation as defined in section 158 (essentially no more than ten shareholders on record). This is certainly an appreciation of the practical application of unanimous shareholder agreement but probably does not add anything.

(d) Maryland

The relevant provisions of the Maryland Code are amongst the best in the United States insofar as they deal with the present management problem. Section 105 provides:

> "(a) A close corporation shall initially have one or more directors, to serve until such time as may be elected pursuant to s. 105 (b), and thereafter may, by election pursuant to its charter, provide that it will have no board of directors, in which case:
> (1) The business and affairs of the corporation shall be managed by direct action of the stockholders of the corporation and all powers given to directors by this article or otherwise by law, may be exercised by the stockholders.

(2) The stockholders of the corporation shall be responsible for taking any action required by this article or otherwise by law to be taken by the board of directors.

(3) Any action under this article requiring for its validity both a director resolution and a vote of stockholders may be validly taken by the required stockholder vote alone without the necessity of a prior director resolution.

(4) Any requirement of this article that an instrument filed with the Department contain a statement that a specified action has been taken by the board of directors, shall be satisfied by a statement that the corporation is a close corporation having no board of directors pursuant to the authority of this session.

(5) Any action for which the vote of a majority of the entire board of directors is required by any provision of this article may be taken by the stockholders by the affirmative vote of a majority of all of the votes entitled to be cast thereon.

(6) Action by stockholders shall be taken by the voting of shares of stock as provided in this article.

(b) An election to have no board of directors shall become effective at (i) such time as the organization meeting of directors under 55 of this article and the issuance of some stock of the corporation have been completed, (ii) the effective time of the charter document in which the election is made or (iii) such other time as may be provided by the charter, whichever is later; and at such time the directors shall cease to be directors, without further act.

(c) In the case of an election to have no board of directors under this section--

(1) The stockholders shall be subject to the special liabilities imposed on directors in paragraphs (1), (2), (3) and (4) of s.62(a) of this article.

(2) The provisions of subsections (b), (c), (d) and (e) of 62 of this article shall be applicable to the stockholders of the corporation. For purposes of 62(b), the term "present" shall mean present in person or by proxy.

(3) No stockholder shall be liable by virtue of a vote of stockholders (whether under paragraphs (1) and (2) of this subsection or otherwise) for any action taken by such a vote, unless he had the right to vote on such action. (1967, ch. 649, s.14; 1970, ch. 689).

Section 104 states:

"(a) The stockholders of a close corporation may, by an agreement to which all of the stockholders of the corporation have actually assented, regulate any aspect of the affairs of the corporation or the relations of the stockholders, including, but not limited to:

(1) The management of the business and affairs of the corporation
(2) Restrictions on the transfer of stock;
(3) The right of one or more stockholders to dissolution of the corporation at will or upon the occurrence of a specified event or contingency;
(4) The exercise or division of voting power;
(5) The terms and conditions of the employment of any officer or employee regardless of the length of the period of such employment;
(6) The persons who shall be directors and officers of the corporation; and
(7) The payment of dividends or division of profits.
Such stockholders' agreement shall be embodied in the charter, the bylaws or a written instrument signed by all of the stockholders of the corporation.
(b) A stockholders' agreement authorized by this section shall not be amended except by the unanimous written consent of all stockholders then parties to the agreement.
(c) A stockholder who acquires his stock after a stockholders' agreement authorized by this section has become effective, shall be deemed to have actually assented to, and shall be a party to, such agreement if at the time of acquiring his stock the stockholder has actual knowledge of the existence of the agreement; provided, however, that any stockholder whose stock was acquired by gift or bequest from a person who was a party to a stockholders' agreement authorized by this section, shall be deemed to have actually assented to, and shall be a party to, such stockholders' agreement whether or not he had knowledge of such agreement at the time of acquiring his stock.
(d) A stockholders' agreement authorized by this section may, in the discretion of a court of equity, be enforced by injunction or by such other relief as the court may determine to be fair and appropriate in the circumstances. As an alternative to the granting of an injunction or other equitable relief, the court may, upon the motion of a party to the proceeding, order dissolution of the corporation under the provisions of s.109(b) and (c) of this article.
(e) Nothing in this section shall otherwise affect otherwise valid agreements among stockholders of a close or other corporation. (1967, ch. 649, s. 14.)

Comments:

1. Section 105 is a quite detailed pronouncement of the principles and consequences of doing away with the Board of Directors and having a shareholder managed corporation.

2. The unanimous shareholder agreement, as in the case of California, is subject to the corporation having the status of a close corporation.

3. The requirement is that any agreement be unanimous and the agreement may only be amended with written consent of all the shareholders.

4. The section is structured generally in the sense that the agreement may regulate any aspect of the affairs of the corporation. However, without limiting this phrase, it specifies many of the common attributes of shareholder agreement as being valid. While this probably adds nothing to the CBCA, it does give an excellent indication of the potential scope of such agreements.

5. The agreement may be in the charter, by-laws, or in a written agreement, but presumably the fact that it is in the by-laws or charter does not mean that it can be amended with less than written unanimous consent.

6. Any person acquiring shares with actual notice of the agreement will be bound. A person acquiring by gift is deemed to have actual notice. Presumably the word 'acquired' contemplates both acquisition by subscription and transfer. Moreover, while not stated in Section 104 if the acquirer does not have notice, the unanimous nature of the agreement should fall and it will cease to be effective.

7. A provision similar to Section 240 of the CBCA empowers the Court to enforce the agreement by injunction or such other fair and reasonable relief. Presumably this would include specific performance. The Court is also given the power to dissolve the corporation if the agreement has been breached. This is an interesting extension to the just and equitable relief available in Canada.

8. Finally, it is interesting to note that Section 104(c) specifically

contemplates the continuing validity of otherwise valid agreements even if they do not fit within section 104; this may be particularly important for unanimous shareholder agreements in other than close corporations.

As can be seen from this survey, the scope of the management provisions for close corporations in the United States is varied. Many of the states adopt different methods, some more general that the *CBCA*, and some more specific. However, as will be seen, some of the United States provisions may well deserve consideration in the course of drafting the new Alberta Companies Act.

V. PROBLEMS WITH SECTION 140 - *CBCA*

Generally speaking, commentators seem reasonably happy with the unanimous shareholder agreement envisaged within Section 140.[42] However, in my view, there are a number of problems with the provision, some serious and other of minimal importance. The following comments identify those problems and where necessary suggest amendments to the current wording. A full version of the amended section is attached as Schedule A.

(a) The Requirement for Directors

Section 97(2) of the *CBCA* requires all corporations to have at least one director. There is nothing wrong with this in the traditional corporate structure. Yet, when all power is withdrawn to the shareholders pursuant to a unanimous shareholder agreement, there seems little sense in the requirement. Certainly, the draftsmen of the original *CBCA* did not require directors in this situation and their views were simply caught up in the tide of economic nationalism.[43] It appears that the Alberta Government has chosen to take a similar tack.

If there is to be a residency requirement in all corporations there seems no sense to insist on it always being imposed on the directors. In

the first place, as mentioned, it can be easily avoided. Secondly, there is another alternative. If all management is in the hands of the shareholders, why is the residency requirement not simply shifted to the shareholders? The requisite majority will have to be based on outstanding shares rather than shareholders; otherwise, the requirement could be avoided simply by the use of nominees.

A resident requirement for shareholders will mean, of course, that the parent/subsidiary under a unanimous shareholder agreement could never satisfy the statute. Thus, they will have to maintain the formal structure of a nominee director. This may not, however, be a bad consequence since it means that an absent parent company will have a 'body' in Alberta to take notices served on the corporation. In the case of the close corporation notice can be served on the registered office only.

This alteration will not make a great change in the running of corporations. At present, the shareholders can do without directors' meetings. However, the requirement for one director is a formal and unnecessary requirement. The abolition of it would recognize the true character of the close corporation as a partnership. Accordingly, I would suggest the following clauses be added to Section 140:

> "(6) Without limiting the generality of subsection (2), a unanimous shareholder agreement may provide that the business and affairs of the corporation shall be managed entirely by the shareholders rather than the directors; while such a provision remains in effect, there shall be no requirement to elect any directors pursuant to section 97(2).
>
> (7) Where no directors are elected pursuant to subsection (6), shareholders holding beneficially no less than fifty percent (50%) in value of the issued and outstanding shares of the corporation shall be resident Albertans."

(b) Use of the Word "Restrict" and Scope of "Business & Affairs"

Frankly, I am reasonably happy with the present language of section 140 in this context. However, one commentator has argued at length that the word 'restricts' prevents the shareholders from *totally* withdrawing all power from the directors.[44] The shareholders could *veto* the directors' powers but not utilize it themselves. Moreover, one of the draftsmen of the proposals has suggested that the words 'business and affairs' contemplate only the general delegation under section 97 and may not extend to other express delegations, for example, those for which they are liable under section 113.

I am not sure whether either of these points are correct. First, the Oxford Dictionary defines restrict as:

> "To confine/some person or thing/to or within certain limits; to limit or bound; ... to restrain by prohibition."

This definition would not seem to exclude an absolute restriction on directors' powers and if the directors have no power then surely the shareholders must be permitted to initiate and exercise such power. Second, the definition "affairs" contemplates all internal relationships within the corporation and by implication also includes within 'business' all external relationships incidental to the business being carried on by the corporation. This should surely cover off all powers of the directors. The one point I was a little concerned about was the liability of the directors under section 114, but this has now been remedied. Unfortunately, this amendment now possibly suggests that the wording in section 140 does not cover all the directors' powers and liabilities.

At any rate, if some people are concerned as to the effect of the wording of section 140, it may be a slight amendment can remedy the problem. It would be possible to add in a phrase such as "the shareholders may

regulate any aspect of the affairs or business of the corporation", but I do not think this is necessary. The addition of the words 'withdraw' and 'under this Act' to emphasize the broadness of the section should be sufficient. Thus, section 140(1) would read:

> "An otherwise lawful written agreement among all the shareholders of a corporation and the corporation, or among all the shareholders and the corporation and a person who is not a shareholder, that restricts or withdraws, in whole or in part, the powers of the directors under this Act to manage the business and affairs of the corporation is valid."

(c) The Unanimity Requirement

Under the present registration system in Alberta it is, of course, possible to retain power in the shareholders by not delegating it to the directors or withdraw it from the latter by a seventy-five percent (75%) vote. The requirement under the *CBCA* and under most of the United States statutes is that the agreement must be unanimous. From a practical point of view there seems no need for agreements which are not unanimous. It is difficult to imagine shareholders of a close corporation regulating the management affairs of the corporation without unanimous agreement and, indeed, it could well be inequitable from the minorities' point of view to allow this. The unanimous shareholder agreement is designed to allow the close corporation to function as a partnership and to do this consistently with partnership principles you must have unanimity.

It must be remembered that the unanimous requirement technically only relates to 'management' agreements. If a smaller group wishes to enter into an agreement for other purposes, e.g., pooling agreements, this is permitted under section 140(1).

The more contentious issue on unanimity centers on the amendment of the agreement. At present, while the prospect of amending an agreement by two-thirds automatically because the agreement is in the articles of incorporations has been removed, it appears that if the unanimous agreement provides for amendment by fifty percent (50%) this would be valid. From a policy point of view, this is a difficult question to resolve. On the one hand you can say that those parties to the agreement have knowledge of the amendment requirement and, therefore, should be bound. On the other hand, these agreements will be utilized almost entirely in close corporations. If the agreement provides for pooling agreements, etc., in addition to the management structure, would not the amendment of the agreement with less than an unanimous vote signify a breakdown in the corporation which would likely lead to a just and equitable winding up? In short, it may be said it is inconsistent with the rationalization of a close corporation as a partnership to allow such a fundamental change with less than a unanimous vote. This, however, can be answered with the comment that many partnership agreements provide for amendment with less than a unanimous vote.

The United States examples are of limited help. Some statutes require a unanimous vote to amend, others require a mere majority. In practice, this difference may not be important. In the Act was silent, 99.9% of agreements would require unanimity to amend or would not deal with the issue which would have the same result. However, while I am not sure, I think on balance, a more equitable situation would be reached if the statute provided that the agreement could only be amended by unanimous written consent. Thus, section 140(7) would read:

> "A unanimous shareholder agreement authorized by this section shall not be amended except by the unanimous written consent of all the parties to the agreement."

(d) Private or Public Documents

There are really no problems with a *CBCA* unanimous shareholder agreement. Often these will contain provisions relating to management which the parties think should remain private and confidential. There seems no reason why this should not be the case. If a potential shareholder wishes to obtain a copy of such agreements he can request a copy as can a bank or other financial agency. Any danger of non-disclosure could be reduced by a requirement that the existence of such an agreement be conspicuously noted on the share certificates.

The only real problem I have is when the shareholders, as envisaged, take back all management powers and do not elect directors. This is a major restructuring of the organization of the company and a strong argument can be made that outsiders should be aware that there are *no* directors and that the corporation is managed. This is done in several United States jurisdictions.

This is a simple policy question, and I have not attempted to draft the appropriate clause. All that would be needed is a statement that the existence of such a unanimous shareholder agreement should be noted in the articles of incorporation.

(e) Definition of Shareholder

One small problem that might arise in very unusual situations is which actual shareholder would be subject to liability under section 140. If the statute when drafted, or the by-laws, contemplate the only shareholder as the holder of record, as opposed to the beneficial owner, then presumably liability would attach to the former. I do not feel anything should be done

about this. Presumably in any unanimous shareholder agreement the beneficial owner will be a party. The practical likelihood of this problem arising is too remote to justify coverage.

(f) Arbitration

This is a more substantive issue. Normally there is no dispute as to the legal effectiveness of arbitration provisions in shareholder agreements. Indeed, they are quite normal. On the other hand, the Alberta Supreme Court in *Motherwell v. Schoof*[46] held that an arbitration clause to deal with disputes between the directors was invalid as being contrary to the discretion delegated to the directors. The Deleware Supreme Court in *Abercrombie v. Davies*[47] reached the same conclusion.

My concern is basically whether this rather technical approach would carry through to the shareholder under a unanimous shareholder agreement. Kessler, in an analysis of the New York General Corporation Law concludes:

> "If a section 620(b) provision transfers director power to the shareholders, all management disputes become shareholder disputes, and accordingly, should be arbitrable under a shareholder agreement providing for this remedy."48

I am afraid that I do not feel the conclusion is as clear as Professor Kessler suggests. If the shareholders are in fact making management decisions and through section 140 that power is delegated to them, I think it is quite possible that a Court will construe their deliberations as those of directors and strike the arbitration clause down. This would clearly be ridiculous. Partnership agreements frequently contain such clauses which are enforceable. A similar attitude should be taken to unanimous shareholder agreements. The point, I admit, is unclear but I strongly feel a provision such as the following should be inserted to clarify the problem:

> "A unanimous shareholder agreement may provide for, in addition to any other rights available, arbitration of any issue as to which the shareholders are deadlocked in voting power."

(g) When Does the Unaimous Shareholder Agreement Become Void?

The *CBCA* is somewhat unclear as to when a unanimous shareholder agreement becomes void. The draftsmen's intent was clearly to provide that any lack of unanimity would make the agreement void. This presumably flows from the definition in section 140 but the section is unclear as to whether there need be unanimity at all times or simply at the time of signing. I do not feel anything need be done to clarify this. The statute as a whole strongly suggests that unanimity at all times is required.

Should there be any additional requirement for the validity of the agreement? The draftsmen of the *CBCA* felt that the existence of the unanimous shareholder agreement should be noted on the share certificate; otherwise it would be void. This approach is adopted in the Illinois Close Corporation provision,[49] and note of the agreement on the share certificate is deemed to constitute notice to the purchaser of the share. I have no objection to this general approach but could perhaps make two points:

1. This may be unfair on the parties to the agreement who have not noted the agreement on the certificate if the purchaser still has actual knowledge. Should he not be bound in this situation?
2. In theory, since the share certificate will often be delivered after the contract, it may be possible for a purchaser not to have notice of the existence of the agreement. In practice, however, considering we are dealing with close corporations, the chances of this happening are minimal.

Under the *CBCA*, the draftsmen's proposal for an absolute requirement of notation on the share certificate was dropped. Rather, the *CBCA* deals with the problem in section 45(8) which provides that a transferee of shares is a party to the unanimous shareholder agreement unless he has no actual notice of any such agreement *and* the agreement or a reference thereto was not noted conspicuously on the share certificate. Thus, section 45(8) is dealing with the problem of notice but at the same time is giving a constructive notice effect to the share certificate. The Maryland statute takes the actual notice approach.[50]

Frankly, I have no strong view as to which method should be adopted. While the requirement for noting on the share certificate has a valuable publicity factor I really wonder whether it is necessary in that it may constitute an unreasonably interference with an otherwise valid agreement through an ommission. Surely, the locus in this question should be on the third party - he should not be forced to be a party to an agreement of which he has no notice. To this end, perhaps section 45(8) provides the better answer.

A number of minor points, however, might be made about section 45(8):

1. One would have thought it would have been wiser to deal with all aspects of the unanimous shareholder agreement in section 140 rather than hide them away in section 45(8) which deals generally with security transfers.

Both issues in transfer if not in 140.

2. I wonder whether the *CBCA* in section 45(8) does not have an incorrect emphasis. Section 45(8) talks about *shares* being subject to a unanimous shareholder agreement. I would have thought that, since such an agreement deals with statutorily imposed power, it is the *corporation* that is subject to the agreement rather than the shares.

45(8) assumed how it does so. 140 might be mat

3. Section 45(8) deals with *transferees* of shares. I wonder whether this is a broad enough term to cover the acquirers of shares through subscription.

We wondered! [illegible] – This [illegible] as a gift, + the Commission could be put in 140.

4. If a subscriber or transferee is not a party to the agreement, the latter will fall through a lack of unanimity. However, the agreement may contain more than matters relating to the structure of the management of the company. It may, for example, deal with pooling agreements and why should such an agreement be void simply because it is now between three rather than four persons. Thus, I feel a provision should be inserted to provide that the parties to the agreement can insert a clause to make any provisions otherwise voted continue, even if the unanimous shareholder agreement is void. A suggested clause might be:

> "s.140
>
> (3) Subject to subsection (4), a transferee of or subscriber to shares of a corproation subject to a unanimous shareholder agreement is deemed to be a party to the agreement.
>
> (4) If a corporation is or becomes subject to a unanimous shareholder agreement and
>
> > (a) a transferee of or subscriber to shares of the corporation has no actual notice of the agreement; and
> >
> > (b) such agreement or a reference thereto was not noted conspicuously on the share certificate;
>
> the unanimous shareholder agreement shall be void; provided that if the agreement so provides it shall continue to the extent it is enforceable apart from this provision."

(h) The Company as a Party

I would simply make the brief point that it seems preferable that the company should be made a party to any unanimous shareholder agreement. This would make enforcement of the agreement, for example, clearer in many cases. If you wish to draft this in as a statutory requirement, it would be extremely simple.

(i) Relief of Directors' Liability

Generally speaking, section 140(4) is quite clear. It shifts liabilities, duties, and obligations of the directors to the shareholders to the extent that power is withdrawn or restricted and the directors are relieved of their burdens to the same extent. The only problem point from a drafting point of view is a small one. It is unclear whether the directors are relieved of *all* their duties and liabilities or simply duties and liabilities under the CBCA. For example, if the directors has provincial liabilities under *Workers Compensation* and *Labour* legislation would they be relieved of any obligations under section 140? I do not know the answer to this and I do not know whether from a constitutional point of view the federal draftsmen could cover the problem off. Presumably, however, in a provincial Act, the statute could characterize the liability of director and shareholder for provincial purposes.

The second problem is more of a policy question. Assume that the shareholders withdraw all power from the directors and delegate that power to a third party who acts as manager. At present, only the shareholders are liable instead of the directors. Should the third party also be made liable?

There are several answers against liability being extended. First, in most cases the third party will be a bank, finance company or venture capitalist who is simply a party to the agreement to make sure the shareholders conduct the business within the terms of the agreement. Such people should not, it is said, be exposed to liability. Moreover, where power is properly

delegated to a third party manager, the shareholders will possibly have actions based in negligence and contract against him in the event of invalid actions. The shareholders have taken back residual control and, therefore, they should accept ultimate responsibility for the delegatee's actions.

These arguments have some force *except* that where power is properly delegated in a manner envisaged by section 140 the delegatee is acting as a director. Should he not bear the responsibility of the director? My view is yes. However, after several attempts I have concluded it is impossible to draft a clause specific enough to cover off this one problem area without exposing bankers and venture capitalists to undue risk. Perhaps the section should be left as it stands, on the basis that if the shareholders delegate power they may enter into a contribution agreement with the third party. This will give them some protection but leave it up to contract rather than the statute to determine the extent of their protection.

(j) Enforcement Order

The basic enforcement provision for shareholder agreements is likely to be the summary procedure under section 240. One small point might be made. Namely, it might be preferable to add the word *'shareholder'* as a party against whom the action can be commenced. After all, the shareholder is likely to be the one who breaches a unanimous shareholder agreement.

VI. CONCLUSION

There is nothing substantially wrong with section 140. Indeed, it is markedly superior to many of its United States equivalents. However, there are at least two fairly serious problems that could easily be remedied, namely, the total withdrawal of power and the abolition of directors, and the insertion of an arbitration clause. Moreover, a number of the smaller

points discussed above might be considered simply because amendments would clarify the present ambiguities.

All in all, however, it is an excellent provision which recognizes the peculiar status of the close corporation and the need to give that status legislative sanction. Hopefully, the concept will be adopted in Alberta.

SCHEDULE A

Section 140

(2) An otherwise lawful written agreement between all the shareholders of a corporation and the corporation, or between a shareholder who is the sole beneficial owner of all the issued shares of a corporation and the corporation, or between all the shareholders and the corporation and a person who is not a shareholder, that restricts or withdraws, in whole or in part, the powers of the directors under this Act to manage the business and affairs of the corporation is valid.

(3) Subject to subsection (4), a transferee of or subscriber to shares of a corporation subject to a unanimous shareholder agreement is deemed to be a party to the agreement.

(4) If a corporation is or becomes subject to a unanimous shareholder agreement and

(a) a transferee of or subscriber to shares of the corporation has no actual notice of the agreement; and
(b) such agreement or a reference thereto was not noted conspicuously on the share certificate;

the unanimous shareholder agreement shall be void; provided that if the agreement so provides it shall continue to the extent it is enforceable apart from this section.

(5) A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers and duties and assumes the liabilities of a director of the corporation to the extent that such agreement withdraws or restricts the discretion or powers of the directors to manage the business and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities under any Act, including their liabilities under section 114, to the same extent.

(6) Without limiting the generality of subsection (2), a unanimous shareholder agreement may provide that the business and affairs of the corporation shall be managed solely by the shareholders rather than the board of directors; while such a provision remains in effect, section 97(2) shall not apply and there shall be no requirement to elect any directors.

(7) Where no directors are elected pursuant to subsection (6), shareholders holding no less than fifty (50) percent in value of the issued shares of the corporation shall be resident Albertans.

(8) A unanimous shareholder agreement authorized by this section shall not be amended except by the written consent of all the parties to the agreement.

(9) A unanimous shareholder agreement may provide for, in addition to any other rights available, arbitration of any issue as to which the shareholders are deadlocked in voting power.

Section 2 "unanimous shareholder agreements" means an agreement described in subsection 140(2).

Section 240

Restraining or compliance order. - If a corporation or any director, officer, shareholder, employee, agent, auditor, trustee, receiver, receiver-manager or liquidator of a corporation does not comply with this Act, the regulations, articles, by-laws, or a unanimous shareholder agreement, a complainant or a creditor of the corporation may, in addition to any other right he has, apply to a court for an order directing any such person to comply with, or restraining any such person from acting in breach of, any provisions thereof, and upon such application the court may so order and make any further order it thinks fit.

FOOTNOTES

1. S.C. 1974-75, c.33 *as am.*

2. S.M. 1976, c.40.

3. S.S. 1977, c.59.

4. See generally *post* under *'Analysis of United States' Equivalents to Section 140'*.

5. R.S.O. 1970, c.53.

6. S.B.C. 1973, c.18 *as am.*

7. R.S.A. 1970, c.60 *as am.*

8. *Post.*

9. I say most because presumably it is possible to incorporate the provisions of an agreement into the articles or memorandum. This does not make the shareholder agreement a constitutional document but has the same effect. To my knowledge a shareholder agreement as such cannot be filed with the Registrar.

10. See *Field v. Bachynski* (1976), 1 A.R. 491 (Alta. A.D.) which would have been better left undecided.

11. *Rinquet v. Bergeron* (1960), 24 D.L.R. (2d) 449 (S.C.C.); *Motherwell v. Schoof*, [1949] 4 D.L.R. 812 (Alta. S.C.), Pickering, *Shareholders' Voting Rights and Company Control*, (1965) 81 L.Q. Rev. 248. See also the strange case of *Stewart v. Schway*, [1956] 4 S.A.L.R. 791.

12. (1963), 41 W.W.R. 575 (Man. Q.B.).

13. *Id.*, at 575-576.

14. See generally, O'Neal, *Close Corporations* (Callaghan & Co.) Vol. 1 at 5.16; Painter, *Corporate and Tax Aspects of Closely Held Corporations* (Little Brown) at 122; Delaney, *The Corporate Director: Can His Hands be Tied in Advance* (1950), 50 Columbia L. Rev. 52; *Note*, (1936) 3 Chicago L. Rev. 640, 646.

15. *Long Park Inc. v. Trenton-New Brunswick Theatres Co.* 77 N.E. (2d) 633; *Manson v. Curtis* 119 N.E. 559 (1918); *McQuade v. Stoneham* 189 N.E. 234 (1934).

16. *Abercrombie v. Davies* 123 A (2d) 893 (1956).

17. 199 N.E. 641 (1936)

18. *Id.*, at 643.

19. 203 N.E. 2d 577.

20. *Id.*, at 584.

21. *Id.*, at 585.

22. *Inter alia, Glazer v. Glazer* 374 F2d 390 (1967); *Burnett v. Wood Inc.*, 412 S.W. 2d 792 (1967); *Simonson v. Helburn* 97 NYS 2d 406 (1950); *Pohn v. Diversified Industries, Inc.* 403 F. Supp. 413.

23. See O'Neal, *Close Corporations (supra)* at 5.30 and Painter, *Corporate and Tax Aspects of Close Corporations (supra)* at 117.

24. While there seems no case directly on point, this view is considered to be correct by most practitioner. As usual, it may well be that the American approach would be adopted if the point arose for consideration today. See, however, *Puddephatt v. Leith*, [1916] 1 Ch. 200 where a mortgagee of shares had agreed to vote only after consultation with the mortgagor and only as he wished. A mandatory injunction was granted to enforce this clause.

25. See *Blundon v. Storm* (1971), 20 D.L.R. (3d) 413. But compare *Swec v. Biamonte* (1978), 18 O.R. (2d) 625. See generally, Higgins, *The Law of Partnership in Australia and New Zealand* (Law Book Co. Ltd.) at 27.

26. *Sloan and Holt v. Margolian, Sidler and Margolians (Truor) Ltd.* (1957), 8 D.L.R. (2d) 115.

27. *Field v. Bachynski* (1976), 1 A.R. 491.

28. *Kelly v. Electrical Construction Co. Ltd.* (1907), 15 D.L.R. 232.

29. Presumably, it is possible to argue that shareholders managing the company fall within the definition (extended) in s.2 but it is doubtful whether the definition was intended to cover this and is consistent with the registration system. See *Harris v. S.* (1976), 2 A.C.L.R. 51.

29a. As amended by S.C. 1978-79, c.9. Royal assent, December 22, 1978.

30. There is a slight problem with section 18 but it is not one that is unique to unanimous shareholder agreements. Under section 18 you cannot argue that a unanimous shareholder agreement cannot or has not been complied with. But can you argue the *existence* of the agreement? Thus, section 18(d) states that you cannot say a director has no authority to perform the duties that are usual for *such* director. Does this mean *the* director under a unanimous shareholder agreement or a normal director? Should section 18(d) be amended to read "as usual for *a* director, officer or agent in a corporation carrying on such business"?

31. See *post*.

32. S.C. 1978-79, c.9. Royal assent, December 22, 1978.

33. See, *Rogers v. Agincourt* (1977), 14 O.R. (2d) 489; *Re Ben's Pipeline Ltd.* 7 Alta. L. Rep. (2d) 114; *W.S. Johnson & Sons Ltd.* S.C. 18427.

34. Paper by Robert Dickerson, *Law Reform and the Closely Held Corporation* (delivered at Vancouver, B.C., August 11, 1978).

35. See generally, O'Neal, *Close Corporations (supra)* at 5.07a; Hecker, *Close Corporations and the Kansas General Corporation Code of 1972* (1974) 22 Kansas L. Rev. 1; Kessler, *The Shareholder-Managed Close Corporation Under the New York Business Corporation Law* (1974) 43 Fordham L. Rev. 197; Hoffman, *New Horizaons for the Close Corporation in New York Under its New Business Corporation Law* (1961) 1 Brooklyn Law Review 1; Burbury, *The Rule of the Board of Directors in the Closely Held Corporation: A Comparative Assessment of Recent Legislation* (1971) 6 J. Int'l Law and Ecc. 59; Bradley, *A Comparative Assessment of the California Close Corporation Provisions and a Proposal for Protecting Individual Participants* (1976) 9 Loyola of Los Angeles Law Review 865; Bradley, *A Comparative Evaluation of the Deleware and Maryland Close Corporations Statutes*, [1968] Duke L.J. 525.

36. Del. Code Ann. tit.8.

37. New York Business Corporation Law, Effective April 1, 1963.

38. [1975] Cal. Statutes s.7.

39. Md. Ann. Code. tit.4.

40. See *post*.

41. Folk, *The Deleware General Corporation Law* (Little Brown) at 518.

42. See Sotimer, *Controlling the Power to Manage in Closely Held Corporations Under the Canada Business Corporations Act* (1976), 22 McGill L.J. 673; McCarthy Q.C., *Shareholder Agreements* in Meredith Memorial Lectures (1975, De Boo Ltd.) at 465.

43. See Dickerson, *supra*, n.34.

44. See Sotimer, *supra* , n.42.

45. See Dickerson, *supra*, n.42.

46. [1949], 4 D.L.R. 812.

47. 123 A2d 893 (1956).

48. Kessler, *supra*, n.35 at 215.

49. Ill. Rev. Stats. c.32, s.1208.

50. Md. Ann. Code s.104(c).