



CANADA BUSINESS CORPORATIONS ACT:
UNANIMOUS SHAREHOLDER AGREEMENTS

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INTRODUCTION

In 1975, a unanimous shareholder agreement provision was introduced into the *Canada Business Corporations Act* (CBCA). Considered innovative when introduced, the provision was intended to give shareholders of private corporations a measure of flexibility in dealing with the internal affairs of a corporation. It also overrode the common law rule that found agreements purporting to fetter the discretion of the directors to be invalid.

This note will discuss the unanimous shareholder agreement provision of the CBCA.

CONTENTS OF CBCA PROVISION

A unanimous shareholder agreement is an agreement among all the shareholders of a corporation in relation to the management of the corporation. It is both a contract between shareholders and an instrument authorized by statute that deals with the internal governance of the corporation.

Found in section 146 of the CBCA, the unanimous shareholder agreement provision provides:

- (1) Pooling agreement -- A written agreement between two or more shareholders may provide that in exercising voting rights the shares held by them shall be voted as therein provided.
- (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.

- (3) Declaration by single shareholder -- 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, the declaration is deemed to be a unanimous shareholder agreement.
- (4) Constructive party -- Subject to subsection 49(8), a transferee of shares subject to a unanimous shareholder agreement is deemed to be a party to the agreement.
- (5) Rights of shareholder -- A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers and duties of a director of the corporation in question to the extent that the agreement restricts the powers of the directors to manage the business and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 119, to the same extent.

Section 146(2) can be used to restrict the powers of the directors of a corporation.

The board of directors continues in place, however, despite its lack of power.

PROVINCIAL STATUTES

The business corporations laws of some provinces provide for unanimous shareholder agreements, while those of other provinces do not.

The Alberta *Business Corporations Act*, for example, has more detailed provisions than the CBCA and these itemize areas that can be covered by a unanimous shareholder agreement, including:

- regulating the rights and liabilities of the shareholders, among themselves or between themselves and any other party to the agreement;
- regulating the election of directors;
- management of the business and affairs of the corporation, including the restriction or abrogation, in whole or in part, of the powers of the directors; and
- any other matter that may be contained in a unanimous shareholder agreement pursuant to any other provision of the statute.

ISSUES FOR CONSIDERATION

In April 1996, Industry Canada released a discussion paper on the subject of unanimous shareholder agreements.⁽¹⁾ Among other things, this paper reviewed the present CBCA provision, examined a number of specific issues, and set out a range of options for possible change.

Issues canvassed in the Discussion Paper included:

- whether the current definition of unanimous shareholder agreement needs to be clarified;
- whether the CBCA should be amended to impose an eligibility requirement in addition to the present requirement for unanimity;
- whether a board of directors whose powers have all been transferred to the shareholders by virtue of a unanimous shareholder agreement should be eliminated;
- from what provisions of the CBCA could shareholders opt out by a unanimous shareholder agreement;
- whether section 146(5) of the CBCA should be amended to clarify the language regarding the transfer of liabilities from directors to shareholders.

A. Whether the Current Definition of Unanimous Shareholder Agreement Needs to Be Clarified

Clarifying the present definition of “unanimous shareholder agreement” involves deciding whether such an agreement must specifically “restrict” the power of the directors to manage the corporation.

The Discussion Paper points out that, at the present time, “unanimous shareholder agreement” is defined in subsection 2(1) to mean “an agreement described in subsection 146(2) or a declaration of a shareholder described in subsection 146(3),” both of which specify that the written agreement or declaration must “restrict” the powers of the directors to manage the

(1) Industry Canada, *Canada Business Corporations Act*, Discussion Paper, *Unanimous Shareholder Agreements*, April 1996.

corporation. Therefore, if an agreement “restricts” the directors’ powers and is entered into by all shareholders of a corporation, it is a unanimous shareholder agreement. If, on the other hand, it does not restrict the board’s powers, it is not a unanimous shareholder agreement.⁽²⁾

As mentioned earlier, the broad definition of “unanimous shareholder agreement” in the *Alberta Business Corporations Act* includes agreements that regulate: (i) rights and liabilities of shareholders and other parties to the agreement; (ii) the election of directors; (iii) management of the corporation, including restriction or abrogation of the directors’ powers; and (iv) other matters that a unanimous shareholder agreement may contain as stipulated by the statute.

In addition, that statute allows shareholders to deem what would otherwise be a unanimous shareholder agreement to be a private agreement.

The options set out in the Discussion Paper with respect to this issue were to:

- (i) maintain the status quo: to qualify as a unanimous shareholder agreement, the agreement would have to restrict the power of the directors to manage the corporation;
- (ii) adopt the approach of the *Alberta Business Corporations Act* and include a broad definition of unanimous shareholder agreement, as well as the ability to designate an agreement that would otherwise be a unanimous shareholder agreement as a purely private agreement;
- (iii) adopt the Alberta approach in (ii) above, but further clarify that only a unanimous shareholder agreement could restrict the powers of the directors.

The Discussion Paper did not recommend a particular course of action. From a policy perspective, however, it may be appropriate to broaden the definition of unanimous shareholder agreement so that such agreements can be adapted to fit the needs of a particular corporation.

(2) *Ibid.*, p. 22.

B. Whether the CBCA Should Be Amended to Impose an Eligibility Requirement in Addition to the Present Requirement for Unanimity

A unanimous shareholder agreement must be in writing, be otherwise lawful, and have the agreement of all the shareholders. There is no restriction on the use of unanimous shareholder agreements that is based on the number of shareholders or the type of corporation.

The Discussion Paper points out that, since use of a unanimous shareholder agreement could lead to the “override” of some corporate law requirements, some jurisdictions have limited these agreements to corporations that have no more than a specified number of shareholders.⁽³⁾

The options outlined in the Discussion Paper with respect to the eligibility issue included:

- (i) maintaining the status quo;
- (ii) limiting the use of unanimous shareholder agreements to non-distributing corporations or private corporations;
- (iii) limiting the use of unanimous shareholder agreements to corporations with 15 or fewer shareholders.⁽⁴⁾

The Discussion Paper did not come to any conclusions about whether there should be eligibility criteria for a unanimous shareholder agreement in addition to the present unanimity requirement. The current approach is largely self-limiting because, once a corporation exceeds a certain number of shareholders, unanimity may be difficult to achieve. Furthermore, because unanimous shareholder agreements tend to be used by corporations with a relatively small number of shareholders, additional limitations may not be necessary.

(3) *Ibid.*, p. 25.

(4) *Ibid.*, p. 26-27.

C. Whether a Board of Directors Whose Powers Have All Been Transferred to the Shareholders by Virtue of a Unanimous Shareholder Agreement Should Be Eliminated

A unanimous shareholder agreement allows for the transfer of all the rights, powers, duties and liabilities of the directors to the shareholders of a corporation. The CBCA does not permit the board to be eliminated, however, even though it has no powers. It has been suggested that a board may be superfluous when all of the powers have been transferred to shareholders under a unanimous shareholder agreement.

Some of the options with respect to this issue outlined in the Discussion Paper include:

- (i) maintaining the present requirement for a board of directors;
- (ii) permitting shareholders of smaller corporations (for example, closely held corporations with less than \$5 million in revenues, or as defined by some other specified threshold) to enter into unanimous shareholder agreements that transfer all the directors' rights, powers, duties and liabilities to the shareholders and eliminate the board. Shareholders of larger corporations could transfer some, but not all, of the directors' powers and would have to maintain a board of directors;
- (iii) prohibiting corporate shareholders from entering into unanimous shareholder agreements to transfer all the directors' powers and eliminate the board (while allowing shareholders who are natural persons to do so);
- (iv) permitting corporate shareholders to enter into unanimous shareholder agreements to transfer all the directors' powers and eliminate the board but require that one or more natural persons (for example, directors from the parent board) also be parties to the agreement and that all the directors' powers be transferred to the natural persons;
- (v) permitting shareholders of all CBCA corporations to enter into unanimous shareholder agreements to transfer all the directors' powers and eliminate the board;
- (vi) requiring the elimination of the board where a unanimous shareholder agreement transfers all the directors' powers.⁽⁵⁾

(5) *Ibid.*, p. 42-43.

The Discussion Paper did not make any recommendations about eliminating the board of directors after the board's powers have been transferred to the shareholders. It is doubtful that the CBCA will be amended to allow for the complete elimination of the board. Such a proposal would be controversial and mark a definite departure from corporate tradition. In the case of small closely held corporations, however, a stronger case can be made for eliminating the board since a board may be superfluous after its rights, duties and liabilities have been transferred to shareholders, who are usually the same persons as the directors.

D. From What Provisions of the CBCA Could Shareholders Opt Out by a Unanimous Shareholder Agreement?

Section 146 of the CBCA states that an agreement can restrict, in whole or in part, the powers of the directors to manage the business and affairs of the corporation. The CBCA expressly provides the ability to "opt out" of certain provisions through the use of a unanimous shareholder agreement. These provisions are: section 102 -- the directors' general power to manage the corporation; subsection 6(3) -- power to increase votes required for shareholder or director actions; section 25 -- directors' power to issue shares; section 103 -- the power to make, amend or appeal by-laws; section 121 -- the appointment of officers; section 125 -- directors' power to set remuneration; section 189 -- borrowing powers of the corporation; and paragraph 214(1)(b) -- the dissolution of a company by request of a shareholder. It is not clear, however, whether this list is, or should be, exhaustive.⁽⁶⁾

The Discussion Paper suggests that it may be appropriate to consider the provisions of the CBCA from which shareholders may opt out by using a unanimous shareholder agreement. This could be done by establishing: (1) a comprehensive list of the statutory requirements from which shareholders could opt out; (2) a list of statutory provisions that might not be affected by a unanimous shareholder agreement; or (3) a general clause to group either the statutory provisions that might not be affected or the provisions that might be overridden.⁽⁷⁾

The Discussion Paper does not come to any conclusions about whether there should be an exhaustive list of statutory provisions that can or cannot be overridden by a

(6) *Ibid.*, p. 52.

(7) *Ibid.*, p.53.

unanimous shareholder agreement. It may be useful to have such a list, however, if only to clarify the scope of a unanimous shareholder agreement.

E. Whether Section 146(5) of the CBCA Should be Amended to Clarify the Language Regarding the Transfer of Liabilities from Directors to Shareholders

Section 146(5) of the CBCA does not expressly state that, where a unanimous shareholder agreement is in place, the shareholders assume the liabilities of which the directors are relieved, in addition to their “rights, powers and duties.” Under the CBCA, it may not be clear whether shareholders who take on the directors’ powers under a unanimous shareholder agreement are subject to related statutory liabilities or whether the directors continue to be so subject.⁽⁸⁾

The unanimous shareholder agreement provisions of the *Ontario Business Corporations Act*, for example, provide that the shareholders take on the directors’ liabilities as well as their duties and that the directors are relieved of their liabilities to the same extent.

The Discussion Paper outlined several options for dealing with the liability issue. These include:

- (i) maintaining the status quo; and
- (ii) amending section 146 to clarify that
 - (a) the shareholders would assume the directors’ liabilities as well as their rights, powers and duties and that the directors would be relieved of their liabilities to the same extent,
 - (b) the common-law as well as the other statutory duties and liabilities of directors would pass to the shareholders, and
 - (c) the defences to liabilities that would have been available to the directors would also be available to the shareholders.⁽⁹⁾

It is likely that the CBCA will be amended to clarify that under a unanimous shareholder agreement the shareholders assume the liabilities of the directors.

(8) *Ibid.*, p. 29-30.

(9) *Ibid.*, p. 31.