



**FINANCIAL ASSISTANCE UNDER THE
CANADA BUSINESS CORPORATIONS ACT**

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N.B. Any substantive changes in this publication which have been made since the preceding issue are indicated in **bold print**.

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FINANCIAL ASSISTANCE UNDER THE CANADA BUSINESS CORPORATIONS ACT

INTRODUCTION

Section 44 of the *Canada Business Corporations Act* (CBCA)⁽¹⁾ restricts the loans, guarantees and other kinds of financial assistance that can be given by a CBCA corporation. The section covers two situations: (a) giving financial assistance to a range of specified persons who have a connection with the corporation; and (b) giving financial assistance to any person for the purchase of shares issued by the corporation or an affiliated corporation. More specifically, section 44 prohibits a corporation from giving financial assistance in these two circumstances where the directors have reasonable grounds for believing that, as a result, the corporation either is or would become insolvent or the corporation's assets either are or would be less than all of its liabilities and stated capital.

Directors who authorize financial assistance contrary to section 44 are personally liable to the corporation for the amount. The CBCA does, however, provide directors with a limited defence that permits them to avoid liability if they have relied in good faith upon the financial statements or a report of a lawyer, accountant or other professional.

Subsection 44(2) sets out certain exceptions allowing financial assistance to be given whether or not there are reasonable grounds for believing the corporation is insolvent; an example would be financial assistance given to employees under a share purchase plan or to a subsidiary in any circumstance.

Except for minor changes, section 44 is largely the same as it was when adopted in 1975.

(1) The text of section 44 is set out in Appendix 1.

In March 1996, Industry Canada released a discussion paper on this issue, *Financial Assistance and Related Provisions*,⁽²⁾ which reviews section 44, outlines problems with the provision, sets out options for dealing with these problems, and recommends changes.

This note will review section 44 of the CBCA and outline some of the options for change.

APPROACHES TO DEALING WITH FINANCIAL ASSISTANCE

Where there are reasonable grounds for believing that a corporation is insolvent, section 44 appears largely designed to protect creditors and minority shareholders against impairment of the corporation's capital through the giving of financial assistance to corporate insiders. The section does not impose an absolute ban on financial assistance; such assistance is permitted where it will not adversely affect the corporation's finances.

There are many approaches to regulating the granting of financial assistance. These include

- an assets/solvency test ;
- little or no regulation;
- enhanced disclosure obligations;
- corporate governance restrictions such as review of related-party transactions by a committee of independent directors;
- financial limits on assistance;
- absolute prohibitions on giving financial assistance when a company is or would become insolvent;
- imposition of liability on directors for all debts of a corporation that trades while it is insolvent.⁽³⁾

(2) Industry Canada, *Canada Business Corporations Act*, Discussion Paper, *Financial Assistance and Related Provisions*, March 1996.

(3) *Ibid.*, p. 14.

The Discussion Paper outlined a number of concerns with respect to section 44. The section was criticized for being vague; for example, it uses such imprecise terms as “directly or indirectly,” “realizable value,” and “loan, guarantee or otherwise.”

Another concern is that directors may find it difficult to ensure that they have complied with the requirements of section 44 if they have been unable to obtain opinions on the matter from lawyers or accountants

Yet another issue is the nature of the protection provided by section 44 to creditors and minority shareholders. Since section 44 requires only that the solvency and assets tests be met, a transaction could conceivably harm the interests of shareholders even though it was not contrary to the section.

In 1994, Industry Canada officials held preliminary consultations with some CBCA stakeholders on amendments to the CBCA and also received a number of written comments on section 44 from practitioners and organizations. Some called for the repeal of the section, others supported keeping the section but redrafting it, and still others, wanting greater flexibility for corporations, favoured more permissive legislation.⁽⁴⁾

OPTIONS AND RECOMMENDATIONS FOR AMENDING OR REPEALING SECTION 44

The Discussion Paper set out a number of options for addressing the various concerns with respect to section 44. Among these options were:

- repealing section 44;
- replacing the solvency/assets test for both share-purchase transactions and related-party financial assistance with an express authorization of financial assistance when made in the best interests of the corporation;
- replacing the solvency/assets tests with a disclosure requirement;
- replacing the solvency/assets test with the requirement for notice and shareholder approval of financial assistance transactions that are “material”;
- maintaining and clarifying section 44;

(4) *Ibid.*, p. 28-29.

- rationalizing section 44 by removing all restrictions on financial assistance for share acquisitions but retaining a solvency test for related-party financial assistance;
- maintaining the status quo for both share-purchase transactions and related-party financial assistance;
- requiring publicly traded corporations with a dominant shareholder to establish a committee to approve significant non-arm's-length transactions and contracts;
- adopting disclosure, valuation, special committee review and a minority approval regime for significant related-party transactions of publicly traded corporations;
- adopting a comprehensive regime regulating all related-party transactions of publicly traded corporations.⁽⁵⁾

The authors of the Discussion Paper concluded that eliminating section 44 would create more problems than it would solve “because it could lead to more litigation and confusion as to whether fiduciary duties permit financial assistance.”⁽⁶⁾ The Paper went on to recommend that, in relation to financial assistance for share purchases, the solvency/asset test be maintained and clarified but, for related-party financial assistance, the test be eliminated and replaced by three requirements: disclosure, a “best interests of the corporation” test, and director or shareholder approval. The Paper also recommended that, for publicly traded CBCA corporations, a conduct committee composed of independent directors should review all material related-party transactions with significant shareholders, directors and officers of the corporation or a holding corporation and their associates.

(5) *Ibid.*, p. 30-35.

(6) *Ibid.*, p. 36.

CONCLUSION

It is clear that section 44 of the CBCA is flawed and needs to be improved. There is no one approach to dealing with the issue of financial assistance, however. After examining a number of options, the Discussion Paper recommended that the present assets/solvency test be retained and clarified for share purchases but eliminated and replaced by another test for related-party transactions.

Although the recommendations in the Discussion Paper are not government policy, they signal that changes to section 44 will most likely be part of the forthcoming amendments to the CBCA.

APPENDIX 1

44. (1) Prohibited loans and guarantees -- Subject to subsection (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise

(a) to any shareholder, director, officer or employee of the corporation or of an affiliated corporation or to an associate of any such person for any purpose, or

(b) to any person for the purpose of or in connection with a purchase of a share issued or to be issued by the corporation or affiliated corporation,

where there are reasonable grounds for believing that

(c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due, or

(d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan and in the form of assets pledged or encumbered to secure a guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.

(2) Permitted loans and guarantees -- A corporation may give financial assistance by means of a loan, guarantee or otherwise

(a) to any person in the ordinary course of business if the lending of money is part of the ordinary business of the corporation;

(b) to any person on account of expenditures incurred or to be incurred on behalf of the corporation;

(c) to a holding body corporate if the corporation is a wholly-owned subsidiary of the holding body corporate;

(d) to a subsidiary body corporate of the corporation; and

(e) to employees of the corporation or any of its affiliates

(i) to enable or assist them to purchase or erect living accommodation for their own occupation, or

(ii) in accordance with a plan for the purchase of shares of the corporation or any of its affiliates to be held by a trustee.

(2.1) Wholly-owned subsidiary -- A corporation is a wholly-owned subsidiary of another body corporate for the purposes of paragraph (2)(c) if

(a) all of the issued shares of the corporation are held by

(i) that other body corporate,

(ii) that other body corporate and one or more bodies corporate all of the issued shares of which are held by that other body corporate, or

(iii) two or more bodies corporate all of the issued shares of which are held by that other body corporate; or

(b) it is a wholly-owned subsidiary of a body corporate that is a wholly-owned subsidiary of that other body corporate.

(3) Enforceability -- A contract made by a corporation in contravention of this section may be enforced by the corporation or by a lender for value in good faith without notice of the contravention.