Ontario Justice Education Network

Introduction to Business Law

A *corporation* is a legal structure which is often used by people as a way to carry on business. For a company to become a corporation it is required to incorporate its business under the law. Once a business goes through this process and legally becomes a corporation, it is now considered a separate individual under the law. In a corporation, there are several different parties including directors, shareholders and creditors. A corporation is owned by its shareholders in that each shareholder owns a share or multiple shares of the company in return for the money or assets they invest. Depending on the type of corporation, there can be just a few shareholders or a large number of shareholders that jointly own the company. Often you will see or hear on the news about the stock market and the value of certain shares. The purpose of the stock market is to create a place for people to buy and sell shares of corporations. Sometimes one corporation can own another corporation, therefore making it the *parent* corporation; the company it owns is known as the *subsidiary*.

The shareholders elect a Board of Directors, which has overall responsibility for the business. The board of directors in turn elects the officers of the corporation (e.g. chief executive officer, chief operating officer, vice president, etc.) to handle the day-to-day affairs, along with the employees of the corporation. Before the directors and officers can make important decisions, the shareholders need to agree with the decisions being made. Often a meeting is called where the shareholders are given the opportunity to vote (usually 1 vote per share) on the decisions being considered.

Since businesses require a lot of money to run, they often take out loans so that they have enough money to do things such as advertise, buy equipment or property, or pay suppliers. Often corporations take out loans from major banks or other people who have enough money to lend to these businesses. Those giving loans to the corporation are called *creditors*. The corporation agrees to pay back the loan, usually with interest over a period of time.

Businesses struggle financially for many reasons such as a bad economy or poor management. Businesses may be able to improve their financial situation or they may no longer have enough money to continue, and therefore are forced to declare bankruptcy. *Bankruptcy* occurs when the company legally declares that it is unable to repay money owed to its creditors. Once a company goes into bankruptcy, a trustee is appointed, either privately or by a court, to take over the business and handle its affairs. In most bankruptcy cases, the trustee will then determine all the parties owed money by the corporation (the creditors) and then would sell parts of the business to others and use the money to repay the loans that the company still owes.

Duties Of Directors and Officers

In running the business on behalf of the corporation, directors and officers must meet two separate duties: the *Fiduciary Duty* and the *Duty of Care*. If a director or officer does not fulfill one of the duties owed to the corporation, the corporation can sue the directors or officers for a breach of

their duties. Section 122(1) of the *Canada Business Corporations Act* (*CBCA*) is where the law assigns these duties to the directors.

Canada Business Corporations Act
Duty of Care of Directors and Officers

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

(*a*) act honestly and in good faith with a view to the best interests of the corporation; and

(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Subsection 122(1)(a) of the *CBCA* outlines the fiduciary duty of directors and officers. This refers to the duty of the directors and officers to act in a manner that is honest and loyal to the corporation. For example, directors and officers should not make business decisions that would be harmful to the corporation or conduct fraud which would harm the corporation. As well, they must act honestly, not abuse their powers, nor only make a profit for themselves. Directors and officers have to make sure that when they make decisions they focus on what is best for the corporation. The "best interests of the corporation" means that the directors must try to increase the value of the corporation as much as possible. While doing what is best for the business, the directors should remember that there are a number of parties involved and they have to try to balance the interests of all the stakeholders, including shareholders, employees, consumers, managers, suppliers, the government, creditors, the environment, the community etc, in making business decisions. However, ultimately, under ss. 122(1)(a) their duty is to the corporation and not the others involved.

The directors and officers of a corporation also owe what is called in law a duty of care. This means that they must make informed decisions that are good for the company after having gathered all available information. For example, if the directors are planning to buy some equipment, they have to make sure that they have properly researched the suppliers, made sure that the equipment will improve the business and only buy it if there is enough money. The law requires this duty of directors and officers under ss. 122(1)(b).

The courts often use the concept of the "business judgment rule" to reach decisions on whether or not directors of corporations should be held responsible for business decisions which had negative results for the company and/or the stakeholders involved. In such situations where a breach of duties is being considered, the role of the court is to evaluate the decision making process of the directors to determine if they should be held liable for errors of judgment. If the directors thought through an issue, identified possible solutions and chose one that they thought was in the best interests of the corporation, and it turned out to be a bad decision, this fact alone is not enough to find liability. The courts recognize that running a business involves risks, and while decisions are intended to raise profits, risks may lead to losses as well. Therefore, the courts will not second guess the decisions made by the directors, but will look at the process used to get to that decision.