

SHARE CAPITAL (Notes)

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0.00 GENERAL REMARKS

How share capital is structured varies from one corporation to the next. There may be one or more classes of shares, as needed. Within each class, the presence, combination and state of each of the characteristics attributable to a share can be quite varied¹. This very broad diversity in terms of the composition of the share capital makes an already abstract concept difficult to define. In order to understand the overall functioning of the share capital structure and make the necessary corrections to it under any circumstances, our analysis must begin with the smallest component of the share capital structure—the characteristic that can be attached to a share.

Before examining the characteristics as such, they must be identified and classified. It is not difficult to identify the characteristics of a class. From established practice we can draw up the following list, which is not exhaustive: voting, dividends, sharing of the remaining assets, repayment of capital, conversion, purchase, redemption, the creation of series, veto, pre-emptive right, guarantees and par value.

Unfortunately, it is not as easy to classify the characteristics of a share. The inherent difficulty in such a classification lies in the fact that corporate law is constantly changing. Paradoxically, this sector of law is built on tradition to a great extent. There are therefore still many reminders of its slow evolution over the centuries. This mix of tradition and innovation can sometimes lead to confusion.

One of the best examples of this confusion involves the classification of the characteristics of a share. Traditionally, there are TWO (2) classes of shares: common shares, which give their holder fundamental rights—the right to vote, the right to receive dividends and the right to share in the remaining assets of the corporation—and preferred shares, which play an exceptional role compared to common shares. Corporate law is progressively abandoning this traditional classification, although it is still firmly entrenched. Today there is a range of characteristics which we can combine as we wish.

By referring mainly to the law as a source of this classification, we first note the mandatory characteristics, i.e. those which the law requires to be present in the share capital structure. These mandatory characteristics may be the subject of a sub-classification, namely fundamental characteristics, in that they must appear in the share capital description, and statutory characteristics which, other than a few variations, also owe their presence to the law. On the other hand, the other characteristics which the law does not consider essential

¹ For the purposes hereof, the term "characteristic" is used to designate collectively or individually the rights, privileges, conditions and restrictions generally attributed to a share, for the sake of conciseness and without affecting the meaning.

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or which only owe their presence within the share capital structure to a particular need of the corporation, become optional characteristics which legal counsel can use at will. Despite the fact that they are optional, these characteristics often occupy a very important place in the share capital description due to the growth of the particular needs of corporations, and they must therefore be flexible.

1.00 LEGAL FRAMEWORK

1.01 Laws and Regulations

The basic principles governing share capital are found in the following corporate laws:

LAWS AND REGULATIONS				SECTIONS
Ontario (O.B.C.A.)	Business Corporations	Act		22 to 25, 27 to 30, 32, 34, 35, 38, 92
Canada (C.B.C.A.)	Business Corporations	Act		6(1)c, 24 to 45, 182(2), 184(1)b)i, 184(2)b)i

1.02 Case Law

Several rules of interpretation may affect the share capital description and we will examine a few of them. In the past, the courts have examined the share capital description and have developed rules which could lead to unexpected and unwanted consequences with respect to the characteristics relating to a specific class of shares.

1.02.01 The Principle of Equality

This is no doubt the most important interpretation rule with respect to the characteristics of a share. It essentially states that, unless indicated otherwise, the shares of all classes in the capital stock of a corporation are deemed to be equal.

Unless distinctions are specifically made between the characteristics relating to a share of a particular class compared to a share of another class, such shares are deemed to be equal in terms of exercising a right for which no distinction has been made. Therefore, unless expressly indicated in the articles of incorporation, no distinction can be made between the shares of different classes.

1.02.02 Deemed Distinction

When faced with a share capital which includes several classes of shares, we must assume that the existence of the various classes is indicative of, but does not constitute, a distinction between the shares of the various classes. The only reason for having separate classes is to differentiate certain characteristics attached to the shares of each of the classes. However, the presence of separate classes is only indicative of an intention to draw distinctions. The confirmation of this intention must be found in the wording of the share capital description which reproduces the various distinctions based on each characteristic distinguished.

1.02.03 The Fundamental Characteristics Presumption

As the fundamental characteristics represent the very essence of a share, it is understandable that they are presumed. This presumption is confirmed in section 22 of the Ontario *Business Corporations Act*. Federally, the legislator does not seem to have considered it necessary to include this presumption in the law; this is an omission on its part and the courts have consistently confirmed this presumption.

The corollary of this presumption is that if one wants to change any of the fundamental characteristics which constitute the very essence of a share, it must be done explicitly in the share capital description, failing which the fundamental characteristics will remain.

1.02.04 Strict Interpretation

As the fundamental characteristics constitute the very essence of a share, any change of them must be interpreted strictly.

1.02.05 Specific Rules

The rules of interpretation we have examined so far may be described as general rules of interpretation. There are also various particular rules relating to specific characteristics. They should be examined based on each of the characteristics in question.

(a) The Right to Vote

When a share includes a right to vote conditional upon the occurrence of an event (e.g. non-payment of a dividend for a specific period), it must be assumed that the shares do not include any right to vote before the condition occurs. In a sense, the maxim "*inclusio unius, exclusio alterius*" applies. However, very precise drafting can avoid having to use this rule of interpretation. The appropriate step in such a case is not to provide a right to vote in specific circumstances, but to exclude the right to vote unless a specific event occurs. This drafting method simplifies the interpretation of this characteristic enormously.

(b) Preferential Dividend