Immunity Shopping

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Some jurisdictions specify that the local liability exposure of a foreign legal form is defined by the liability configuration fashioned for that form by the foreign state. That blind displacement of local regulation has never been credibly justified. The regulation of risk within a jurisdiction is distorted or enfeebled when the formulation of local accountability is ceded to foreign authorities. A general rule of deference to foreign liability rules potentially subjects local competitors to uneven competition and the local population to increased levels of risk. A general rule of local dominance is preferable, even where the asymmetry of a foreign liability rule has a genuine policy justification in the foreign state.

Introduction

Liability rules for organizational forms may differ across jurisdictions. One explanation for such variation is that legislatures actively craft liability assignments to compete with each other to attract investment. While there is evidence that direct competition on liability configuration does occur at times in Canada, it appears that variations arise more commonly as local initiatives designed for local application without any political intent to compete nationally for business registrations. Still, even if designed initially only for local application and local advantage, the existence of liability differences will prompt

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immunity shopping by enterprises interested in altering or dictating their liability exposure. How should jurisdictions address the prospect that foreign firms will claim the protection of foreign liability rules?

I will first describe the nature of the concern. I then examine a number of differences in liability configuration. I will suggest that in most of these instances local interests have engineered or retained liability differences without a national market share agenda, but also without attention to policy justification or considerations of uniformity. It will be appreciated that where variations are justified by genuine fundamental policy asymmetries between jurisdictions, considerations of uniformity usually must give way. That does not mean, however, that the multiple liability configurations of foreign business forms must be tolerated locally. Policy asymmetry *between* jurisdictions invariably will not justify immunity differentials *within* individual jurisdictions. Foreign firms operating locally should be prepared to conduct their business on the same liability terms as local firms. The general default principle within each jurisdiction ought to be that the home liability rules of foreign firms will not be recognized to the extent they depart from local rules.

I. The Concern with Liability Variation

Most jurisdictions allow foreign (extra-provincial or extra-national) firms to carry on business within their borders. Some of those jurisdictions will specify by statute what liability rule will prevail where there are liability differences between foreign and local structures. Some have imposed the local rule; others have deferred generally to the foreign rule.[1] In the remaining instances where there is no express

1. Examples of explicit deference to foreign liability standards include section 27(2) of the *Limited Partnerships Act*, RSO 1990, c L.16 and section 44.4(4) of the *Partnerships Act*, RSO 1990, c P.5. The content of these provisions negates the idea that deference is accorded on the assumption that liability configurations are uniform across jurisdictions. The government plainly is aware that there may be differences, yet inexplicably exposes its population to unscreened foreign standards. Appreciate that the population likely assumes that all firms operating locally are subject to the same liability rules.

provision as to which rule applies, the matter has been regarded as a conflict of laws issue, and that is an area of uncertainty.[2] It seems often to be assumed that liability exposure is an "internal affairs" matter, or analogous to internal affairs, or that liability rules are infrangible status attributes that are carried by firms into the jurisdictions where they operate.[3] The difficulty with such assumptions is that liability issues

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2. Consider Roderick l'Anson Banks, *Lindley & Banks on Partnership*, 19th ed (United Kingdom: Sweet & Maxwell, 2010) at 989-90. Dealing with the English limited partnership, Banks seems to think exposure depends on entity status:

> Numerous other jurisdictions, both in Europe and elsewhere, have adopted the limited partnership concept. Some accord separate legal personality to the firm, whilst others do not. This gives rise to the question of whether a court will recognize any limitation on the liability of the limited partners in an overseas limited partnership which carries on business in this country. This is, regrettably, a question which does not admit of any easy answer and is, in the current editor's view, largely dependent on whether the firm is properly to be regarded, by the laws of its place of formation, as a separate legal person. If it is, it seems clear that the court will respect that and will give effect to the legal incidents which attach to that entity under those laws. This will include any limitations on the liability of the limited partners provided that such limitations can, on a true analysis, properly be characterized as a matter of substantive, rather than procedural, law.

That analysis misses the mark. Entity status per se does not justify differential liability exposure within a jurisdiction. It is not a competing local policy, or policy at all, on local liability differentiation.

3. Though widely recognized, the internal affairs doctrine has been controversial in various respects. See Donald L Block Baraf, "The Foreign Corporation—A Problem in Choice-of-Law Doctrine" (1967) 33:2 Brook L Rev 219; Stanley A Kaplan, "Foreign Corporations and Local Corporate Policy" (1968) 21:4 Vand L Rev 433; Joseph William Singer, "Real Conflicts" (1989) 69:1 BUL Rev 1; Norwood P Beveridge, "The Internal Affairs Doctrine: The Proper Law of a Corporation" (1989) 44:3 Bus Law 693; Mark R Patterson, "Is Unlimited Liability Really Unattainable?: Of Long Arms and Short Sales" (1995) 56:3 Ohio St LJ 815; Christian Kersting, "Corporate Choice of Law—A Comparison of the United States and European Systems and a Proposal for a European Directive" (2002) 28:1 Brook J Int'l L 1; Frederick Tung, "Before Competition: Origins of the Internal Affairs Doctrine" (2006) 32:1 J Corp L 33; Matt Stevens, "Internal Affairs Doctrine: California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations" (2007) 48:4 BCL Rev 1047; Gregory Scott Crespi, "Choice of Law in Veil-Piercing Litigation: Why Courts Should Discard the Internal Affairs Rule and Embrace General Choice-of-Law Principles" (2008) 64:1 New York University Annual Survey of American Law 85; Timothy P Glynn, "Delaware's VantagePoint: The Empire Strikes

arise in relation to third parties. There are no "internal affairs" or status justifications, directly or by analogy, where third party injury (public welfare) is involved.[4] This is not the place, however, to further investigate the common law. Rather, we need to acquire a particularized sense of the concern, and consider how it might be addressed directly by statutory principle.

Liability variations between jurisdictions are justified where they reflect genuine policy asymmetry. It appears, however, that variations often arise for reasons other than different substantive preferences respecting the original assignment of liability. Consider some of the reasons for liability variation. One reason may be revenue generation—to employ liability shields (along with other inducements) to capture market share for a particular organizational form so as to produce significant fees (direct and collateral) for and within the jurisdiction. Delaware frequently is perceived as having officially pursued a revenue

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Back in the Post-Post-Enron Era" (2008) 102:1 Nw UL Rev 91; Faith Stevelman, "Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law" (2009) 34:1 Del J Corp L 57. See also Robert Flannigan, "The Use of Foreign Forms to Circumvent Local Liability Rules" (2007) 44:4 Alta L Rev 803 at 804-06.

4. The point is explicit in the American cases. See *First National City Bank v Banco Para el Comercio Exterior de Cuba*, 462 US 611 at 621 (1983) ("As a general matter, the law of the state of incorporation normally determines issues relating to the *internal* affairs of a corporation. . .Different conflicts principles apply, however, where the rights of third parties *external* to the corporation are at issue"); *Re ORFA Securities Litigation*, 654 F Supp 1449 (NJ 1987); *Itel Containers International Corp v Atlanttrafik Express Service Ltd*, 1988 AMC 2117 (SD NY); *Milliken & Company v Haima Group Corporation*, 2010 US Dist LEXIS 44835 (SD Fla); *VantagePoint Venture Partners 1996 v Examen*, 871 A2d 1108 (Del 2005); *Curiale v Tiber Holding Corporation*, 1997 US Dist LEXIS 14563 (ED Pa). The English position on liability to third parties is foggy. Consider *Risdon Iron and Locomotive Works v Furness*, [1906] 1 KB 49 CA (Eng); *JH Rayner (Mincing Lane) Ltd v Department of Trade and Industry* (1989), [1990] 2 AC 418 HL (Eng); *Speed Investments Ltd v Formula One Holdings Ltd (No 2)*, [2004] EWCA Civ 1512. The point apparently has not been explicitly addressed in Canada. Consider *Cira v Rico Resources Inc*, [2004] OTC 10 (available on QL) (Sup Ct J), aff'd [2006] OJ no 436 (QL) (CA); *Zi Corp v Steinberg*, 2006 ABQB 92, 396 AR 157; *Factor Gas Liquids Inc v Jean*, [2007] OJ no 2883, 2007 CarswellOnt 4731 (Sup Ct J); *Devon Canada Corp v PE-Pittsfield LLC*, 2008 ABCA 393, 446 AR 62. Various statutory provisions (e.g. *supra* note 1) do explicitly recognise that liability issues generally are not "internal" affairs.

generation agenda.[5] While its capture of the largest part of the market for registrations of large public corporations has been defended on substantive grounds by some commentators, the perception remains that revenue (and prestige) trump all other considerations. A second reason for liability variation might be the effective lobbying of powerful national or local interest groups to promote a liability rule that advances their narrow interests (investor harvesting, tax rents).[6] Here, unlike the revenue generation objective, the intent may be that the original local variation will provoke replication (defensive "law reform") in all jurisdictions, and thereby produce general change from the seed of the original variation. That subsequent replication may or may not come to pass. A third reason might simply be the retention of a liability configuration that other jurisdictions ignored or abandoned, but which

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5. The continuing dominance of Delaware is attributed to a number of factors, one of which is the supposed superior expertise of the Delaware courts. On that matter, consider Kent Greenfield, "Law, Politics, and the Erosion of Legitimacy in the Delaware Courts" (2011) 55:2 NYL Sch L Rev 481. See also Roberta Romano, "Law as Product: Some Pieces of the Incorporation Puzzle" (1985) 1:2 JL Econ & Org 225.

6. See Robert Flannigan, "The Political Path to Limited Liability in Business Trusts" (2006) 31:3 Advocates' Q 257, discussing the efforts of REALpac (formerly the Canadian Institute of Public Real Estate Companies) to secure limited liability for the beneficiaries of income trusts. Query also the agenda of local professionals. Consider Bruce H Kobayashi & Larry E Ribstein, "Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies" [2011] U Ill L Rev 91 at 99:

> Any theory of state competition must explain what motivates state lawmakers to engage in the competition. Lawmakers may want to encourage firms to form under their state's statute in order to charge franchise fees and thereby reduce the tax burden on their constituents. Because closely held firms are unlikely to produce a big franchise fee payoff, however, the competition for these firms more likely has been driven by lawyers. Lawyers can earn fees by serving as local counsel for foreign firms and can attract potential clients to locate in the state by having efficient business association statutes. Lawyers may compete for market share within their states by using their participation in drafting business association statutes to develop their reputations.

Consider parenthetically that the political influence of professional groups varies across jurisdictions, which may explain the different liability configurations of limited liability partnerships in, for example, British Columbia, Alberta and Saskatchewan.

now has new utility.[7] Fourthly, it may be that a variation will arise inadvertently or as the formal product of misconceived analysis.[8] These sorts of reasons for liability variation are not grounded in justified asymmetric policy views of the actuation of liability.[9] Accordingly, quite apart from the issue of a level playing field, it is not prudent for any jurisdiction to generally grant default priority to foreign liability rules on the assumption that any variation must necessarily reflect authentic policy asymmetry.

There are two levels of policy analysis involved in addressing the issue of liability variation. The first, as noted, has to do with assessing whether there are true policy asymmetries that validate given variations. At that level I will examine several instances of liability variation within Canada. I then turn to the second level of analysis, which involves investigating the utility of alternative local responses to liability variation. I will contrast "foreign dominance" and "local dominance" responses, and explain why local dominance is the superior approach.

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7. The liability structure of the Nova Scotia unlimited liability company is an example. By the end of the twentieth century, unlimited liability companies remained available in Canada only under dated legislation in Nova Scotia. The Nova Scotia structure then became attractive as a vehicle for investment from the United States because, while it was taxed as a corporation in Canada, its shareholder liability exposure made it eligible for flow-through taxation in the United States. Alberta (*Business Corporations Amendment Act*, *2005*, SA 2005, c 8) and British Columbia (*Finance Statutes Amendment Act*, *2007*, SBC 2007, c 7) have since provided for the incorporation of unlimited liability companies. The provinces compete on dimensions of liability, fees and other elements. See also the Ontario Bar Association *Submission on Bill 152, Ministry of Government Services Consumer Protection and Service Modernization Act, 2006*, (4 December 2006), Appendix 3. The liability structure of the Manitoba limited partnership is another example. See Flannigan, *supra* note 3 at 808.

8. An instance of misconceived analysis is the attempt to justify immunity for directors and officers of nonprofit corporations. See the discussion *infra* at notes 50-73.

9. Consider the policy argument that comity should trump the likely insignificant increase in the overall risk to the population from the risk projection of a small number of foreign firms. Note first the obvious weaknesses in the underlying assumptions, and that the losses to individual victims potentially are large. A second observation is that the comity argument is external to the analysis of whether liability exposure is an appropriate means to regulate the conduct involved. Comity is offered as a reason to dismiss or supersede the conclusion produced by the foundational risk regulation analysis.

II. Shareholder Agreement Immunity

The unanimous shareholder agreement was introduced to Canada in 1975 with the *Canada Business Corporations Act*.[10] Recommended by the Dickerson committee ("Dickerson"), the new statutory device permitted shareholders to relieve directors of all or part of their management power.[11] The consequence of such shareholder action is the assumption of the coincident duties and liabilities of the directors.[12] The provision proposed by Dickerson was worded as follows:

> 11.14(5) If a unanimous shareholder agreement restricts the discretion or powers of directors then, to the extent that and so long as such restrictions exist, the directors are relieved from their duties and liabilities and the shareholders are deemed to assume the duties and liabilities imposed upon directors by this Act and by law.[13]

That recommended language did not survive the consultation process. The provision finally included in the original CBCA eliminated the Dickerson specification of the transfer of liability to the shareholders. Directors were relieved of their liability, but liability was not explicitly assumed by the shareholders:

> 140(4) A shareholder who is a party to a unanimous shareholder 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 to the same extent.[14]

The CBCA provision thus potentially could be construed to allow shareholders to control at will without the consequential liability

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10. SC 1974-75-76, c 33, s 140.
11. Robert WV Dickerson et al, *Proposals for a New Business Corporations Act for Canada*, vols 1 & 2 (Ottawa: Information Canada, 1971) vol 1 at paras 298-302.
12. *Ibid*, vol 1 ("It is implicit in the definition of director in s. 1.02(1)(1) that where a person, though never elected a director, acts as one, he incurs the liability of a director. Section 11.14(5) merely makes this explicit where a shareholder agreement has been entered into. . ." at para 300).
13. *Ibid*, vol 2 at 90.
14. *Supra* note 10.

specified by Dickerson. There was no articulated justification for that ostensible departure from the original recommendation, and no plausible justification has since surfaced. It appears that business/investor/professional interests, or their law reform agents and representatives, had endeavoured by an opaque intervention to revise the recommended terminology to serve their own ends.[15] They arranged an artful rewording that obliquely yet credibly indicated shareholder immunity.[16] That potentially would eradicate all federal liability for both directors and shareholders through the simple means of locating all power arrangements in a unanimous shareholder agreement.[17]

Manitoba[18] and Saskatchewan[19] were the first provinces to adopt the CBCA model. The white paper proposing the Saskatchewan legislation recommended acceptance of the unanimous shareholder agreement provision as enacted in the CBCA.[20] Ultimately, however, the divergence from the Dickerson recommendation was recognized, and both Manitoba and Saskatchewan crafted identical subsections that

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15. One may speculate as to who might have expected to benefit from the alteration, and who had the political or bureaucratic acumen and resources to make it happen. Foreign parent organizations, significant institutions and the corporate bar would have both motive and means.

16. The new phrasing arguably could still accommodate the Dickerson responsibility (by concluding that the transfer of "duties" necessarily involved or implied the transfer of coincident liabilities), but a close construction did suggest immunity. As we see next, the immunity construction was sufficiently plausible to cause other jurisdictions, and eventually the federal government, to act to clarify the provision. Another CBCA example of artful (ambiguous) drafting was the change made to the Dickerson version of the standard of care expected of directors. The provision was extended by the addition of the words "in comparable circumstances". See Robert Flannigan, "Reshaping the Duties of Directors" (2005) 84:2 Can Bar Rev 365 at 374.

17. The shareholders might even agree unanimously to delegate powers to a committee of shareholders whom they would elect annually. That would precisely replicate the standard centralized management of a board of directors, but without any coincident liability for anyone participating in management.

18. *The Corporations Act*, SM 1976, c 40.

19. *The Business Corporations Act*, SS 1976-77, c 10.

20. Leo J Beaudry, Eric D Crosbie & R Bryon Horner, *Proposals for a New Business Corporations Law for Saskatchewan* (Regina: Provincial Secretary, 1975) at 100.

reflected the original Dickerson concept that shareholders would assume liability for transferred power:

> 140(4) A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers and duties *and incurs all the liabilities* 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 to the same extent.[21]

Other jurisdictions followed suit. In 1980 the Alberta Institute of Law Research and Reform proposed a more detailed provision for unanimous shareholder agreements.[22] The provision was included in the 1981 Alberta *Business Corporations Act*.[23] On the specific matter of the liability transfer, the Institute recommended the acceptance of section 140(4) of the CBCA with one change: "The directors are relieved of 'duties and liabilities', while 'duties' but not 'liabilities' devolve upon the shareholders; and we suggest that both should devolve."[24] New Brunswick in 1981[25] and Ontario in 1982[26] adopted the language used in the Manitoba and Saskatchewan statutes.

It was clear at this point that there was potentially a significant liability variation between Canada and several provinces. Curiously, however, considering the virtually immediate provincial revisions, the federal government ignored the matter for a very long time. It was not until 1996 that the issue resurfaced in a federal discussion paper.[27] Then,

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21. *Supra* note 19 [emphasis added].

22. *Proposals for a New Alberta Business Corporations Act*, Report No 36, vol 1 (Edmonton: Institute of Law Research and Reform, 1980) at 21-29.

23. SA 1981, c B-15, s 140.

24. S*upra* note 22 at 29. The Institute appeared to assume that the federal provision intentionally excused shareholders from liability.

25. *Business Corporations Act*, SNB 1981, c B-9.1, s 99(5).

26. *An Act to Revise the Business Corporations Act*, SO 1982, c 4, s 108(5).

27. Canada, *Canada Business Corporations: Discussion Paper: Unanimous Shareholder Agreements* (Ottawa: Industry Canada, 1996) ("An ambiguity in the wording of the CBCA unanimous shareholder agreement provisions is the failure of subs. 146(5) to expressly state that the shareholders assume the liabilities of which the directors are relieved, as well as their 'rights, powers and duties.' It may not be clear under the CBCA whether shareholders who take on the directors' powers under a unanimous shareholder

in 2000, a paper from the Parliamentary Research Branch revisited the matter:

> Section 146(5) of the CBCA [previously s. 140(4)] 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.[28]

The author of the branch paper predicted that it was "likely that the CBCA will be amended to clarify that under a unanimous shareholder agreement the shareholders assume the liabilities of the directors".[29] That occurred the following year. An amendment to the CBCA confirmed the original Dickerson concept:

> 146(5) To the extent that a unanimous shareholder agreement restricts the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation, parties to the unanimous shareholder agreement who are given that power to manage or supervise the management of the business and affairs of the corporation have all the rights, powers, duties *and liabilities* of a director of the corporation, whether they arise under this Act or otherwise, including any defences available to the directors, and the directors are relieved of their rights, powers, duties and liabilities, including their liabilities under section 119, to the same extent.[30]

Until it was supplanted, the ostensible federal immunity was a striking example of a liability variation produced without explicit justification, apparently by the late stage intervention of special interests. It was also an example of how variations arise and survive (whether justified or not) when other jurisdictions choose not to follow a first mover. Though the variation has now been eliminated in business

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agreement inherit related statutory liabilities as well, nor whether the directors continue to be exposed to them" at 31).

28. *Canada Business Corporations Act: Unanimous Shareholder Agreements*, PRB 99-32E (Ottawa: Library of Parliament, 2000) at 8.

29. *Ibid*.

30. *An Act to amend the Canada Business Corporations Act and the Canada Cooperatives Act and to amend other Acts in consequence*, SC 2001, c 14, s 66 [emphasis added].

statutes, the question that remains unanswered (and perhaps will remain so) is how the variation managed to endure for as long as it did. The divergence from the Dickerson recommendation was clear, the provincial reaction was clear, the lack of any policy justification was clear, and yet the provision was left unaltered without explanation for quite some time. Was there no pressure for reform? Did federal regulators dismiss the immunity interpretation? Were they reluctant for some reason to investigate the original process? Did they see the provision as a feature that might increase the federal share of the incorporation market? What eventually elevated the issue or sparked the reform? In the end, the history of this particular liability variation illustrates that, once installed, even patently indefensible variations can persist if anchored in elite instrumentation, indolence or textual ambiguity. Beyond that it demonstrates in robust fashion that liability variations may have no justification whatsoever and that allowing them to have force within a host jurisdiction through a general deference to foreign design is misconceived and irresponsible.

III. Articles of Incorporation Immunity

The forgoing discussion is relevant to another variation. As noted, Saskatchewan adopted the Dickerson concept of shareholder accountability when it enacted the SBCA. It ignored or dismissed that accountability, however, in its design of an alternative way to transfer power to shareholders. In a clear departure from the CBCA model, Saskatchewan added section 97(3) to the SBCA to permit power transfers through the articles of incorporation:

97(3) If the articles restrict in whole or in part the powers of the directors to manage the business and affairs of the corporation, the shareholders have all the rights, powers and duties of the directors to the extent the articles restrict the powers of the directors, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 114, to the same extent.[31]

31. *Supra* note 19.

The provision was unique to Saskatchewan. Nothing like it was included in the contemporary statutory revisions of other provinces.

One will rightly conclude that section 97(3) is an odd piece of work.[32] Though enacted at the same time that section 140(4) of the SBCA was properly drafted to reflect the Dickerson concept, the provision disregards that clarified phrasing and instead utilizes the phrasing of the original CBCA provision. Moreover, and significantly, there is no requirement of unanimity for this alternative shareholder control mechanism.[33]

There does not appear to be any recorded justification for this liability variation.[34] It cannot be found in the draft statute in the white paper placed before the legislature[35] and it obviously is inconsistent with the Saskatchewan treatment of power transfers under its own unanimous shareholder agreement provision. How did it find its way into the statute? Was Saskatchewan convinced it would attract foreign incorporation business? That seems an unlikely ambition at that point in time. It is rather more likely that local interests introduced section 97(3) solely to advantage local business and investor interests. The motive possibly was a narrow pragmatic one. The section may have been conceived simply as an optional mechanism that might have been

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32. The curiosity begins with the grammatical construction of its heading: "Directors' liability of restriction on powers".

33. The refusal (if not neglect) to require unanimity might imply support for a different liability consequence. That returns us to the issue of the justification for jettisoning the unanimity requirement.

34. In a 23 October 2008 email to the author, the then Director of the Corporations Branch (Phil Flory) was not able to explain the origin of section 97(3):

> I have not been able to locate any explanatory notes, drafting instructions, etc., on the inclusion of the subsection in the 1977 Act. Although the subsection appeared in the Act as passed by the Legislature, it was not in the original version of the Bill prepared for introduction in the Legislature. I can only suggest that somewhere along the way, the committee overseeing the piloting of the Act thought it was a good idea to have a subsection to permit the Articles to restrict the powers of the directors to manage the business and affairs of the corporation in a similar manner as a unanimous shareholder agreement as provided in section 140 of the Act.

35. *Supra* note 20.

thought desirable for practical or parochial reasons (to avoid the perceived cost or complexity of a separate shareholder agreement or to accommodate practitioners who might prefer to address all matters in the articles and bylaws). Alternatively, the intent may have been to install a unique immunization for local advantage. Local reform insiders may have inserted section 97(3) as a quiet revision precisely to acquire the ostensible shareholder immunity that would be lost as a result of the imminent clarification of SBCA section 140(4). That arguably is the more plausible explanation given the simultaneous drafting and committee review of sections 140(4) and 97(3). Unless we assume temporal or personnel discontinuities, the content of the two provisions strongly suggests that section 97(3) was designed to immunize local interests against both local and foreign liabilities.[36] The very clarification of section 140(4) buttresses support for the immunization construction of section 97(3).[37]

Unlike the experience with CBCA section 140(4), there was no immediate contestation of the wording of section 97(3), although challenge was implicit in the fact that no similar provision was included in the contemporary revisions of other provinces. The provision actually gained a measure of support years later when in 1986 it was adopted almost verbatim for the new corporate legislation of Newfoundland and Labrador.[38] In 2002, however, an opposed version appeared in the new British Columbia statute.[39] British Columbia adopted the Dickerson approach to power transfers. Because it is novel in various respects, the whole of section 137 is reproduced:

137 (1) Subject to subsection (1.1) but despite any other provision of this Act, the articles of a company may transfer, in whole or in part, the powers of the directors to manage or

36. Local interests would be immunized against liability for local operations and also for operations in other jurisdictions that allowed shareholder liability to be governed by the rules of the jurisdiction where the firm was formed.

37. Note further that section 43(1) explicitly recognizes potential shareholder liability under section 140(4), but not section 97(3). Query also whether section 97(3) is consistent with section 117(3).

38. *Corporations Act*, SNL 1986, c 12, s 165.

39. *Business Corporations Act*, SBC 2002, c 57, s 137.

supervise the management of the business and affairs of the company to one or more other persons.

(1.1) A provision of the articles transferring powers of the directors to manage or supervise the management of the business and affairs of the company is effective

(a) if the provision is included in the articles at the time of the company's recognition or if the company resolved, by special resolution, to add that provision to the articles, and

(b) if the provision clearly indicates, by express reference to this section or otherwise, the intention that the powers be transferred to the proposed transferee.

(2) If the whole or any part of the powers of the directors is transferred in the manner contemplated by subsection (1),

(a) the persons to whom those powers are transferred have all the rights, powers, duties and liabilities of the directors of the company, whether arising under this Act or otherwise, in relation to and to the extent of the transfer, including any defences available to the directors, and

(b) the directors are relieved of their rights, powers, duties and liabilities to the same extent.

(3) If and to the extent that the articles transfer to a person a right, power, duty or liability that is, under this Act, given to or imposed on a director or directors, the reference in this Act or the regulations to a director or directors in relation to that right, power, duty or liability is deemed to be a reference to the person.

(4) A company may resolve to alter its articles, by special resolution, to alter a provision referred to in subsection (1.1).

The British Columbia provision affirms the application of the Dickerson liability treatment for power transfers arranged through the articles of incorporation. It underscores that section 97(3) of the SBCA is a rogue variation that potentially confers local and foreign immunity without justification and at the cost of an elevated risk of injury to local and foreign populations.

IV. Nonprofit Member Immunity

We have yet to exhaust the impact of the original CBCA terminology regarding power transfers. The same liability variation appears in the nonprofit corporation context.[40] Saskatchewan is again

40. Consider parenthetically the liability structure of nonprofit unincorporated associations. See Robert Flannigan, "Contractual Responsibility in Non-Profit

the rogue jurisdiction. It enacted its *Non-profit Corporations Act* in 1979,[41] adopting the legislative regime initially proposed (though never adopted) by the federal government.[42] Conforming to the CBCA template, the statute allowed members to transfer power through a "unanimous member agreement":

> 132(5) A member who is a party to a unanimous member 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 powers of the directors to manage the activities and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 103, to the same extent.[43]

As is apparent, the Saskatchewan provision mirrored the original CBCA failure to specify that members assumed the "liabilities" associated with any transferred power. Saskatchewan evidently ignored or silently rejected the clarification made earlier to its own SBCA section 140(4), as well as the Dickerson report and the federal report on nonprofit corporations.[44]

It might be assumed that there is a good argument that nonprofit activity is fundamentally different from business activity and that a concession on liability is justified for such activity. That is a mistaken

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Associations" (1998) 18:4 Oxford J Legal Stud 631; Robert Flannigan, "The Liability Structure of Nonprofit Associations: Tort and Fiduciary Liability Assignments" (1998) 77:1 Can Bar Rev 73.

41. SS 1979, c N-4.1.

42. Consumer and Corporate Affairs, *Proposals for a New Not-For-Profit Corporations Law for Canada*, vols 1 & 2 (Ottawa: Information Canada, 1974).

43. *Non-profit Corporations Act*, *supra* note 41.

44. The federal report on a new nonprofit regime (*supra* note 42) adopted the Dickerson view of the liability consequence of a power transfer. The report repeated essentially verbatim the explanation given in the Dickerson report ("It is implicit in the definition of director in s. 1.02(1) that where a person, though never elected a director, acts as one, he incurs the liability of a director. Section 11.15(4) merely makes this explicit where a members' agreement has been entered into. . ." at vol 1, para 261). The 1974 report was sandwiched between the 1971 Dickerson report and the 1975 CBCA. Its draft of the liability transfer (vol 2, s 11.15) referred only to duties and did not use the term "liabilities" in relation to either members or directors. The supposition, presumably, was that duties necessarily implied liabilities.

assumption.[45] Though arguments have been advanced, there is no basis whatsoever for a different liability exposure for those engaged in nonprofit pursuits.[46] Loss experience is not tied to the character of an activity or operation. Risk is projected in the same way, and losses are felt in the same way.

The Saskatchewan liability variation was maintained when the province replaced its 1979 statute with the *Non-profit Corporations Act, 1995*.[47] It was then not until 2009 that the issue was addressed implicitly at the federal level by the enactment of the *Canada Not-for-profit Corporations Act*.[48] The Dickerson approach was affirmed once again. Section 170(5) of the federal Act explicitly transfers liabilities to members who assume management powers.[49] It fairly may be concluded at this point that the continuation of the apparent liability variation in the Saskatchewan statute is wholly unjustified.

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45. See the view expressed by the Supreme Court in *Bazley v Curry*, [1999] 2 SCR 534 at para 56:

> I conclude that the case for exempting non-profit institutions from vicarious liability otherwise properly imposed at law has not been established. I can see no basis for carving out an exception from the common law of vicarious liability for a particular class of defendants, non-profit organizations. The record before us does not support crafting such a status-based exemption from liability, and I am unconvinced that such a course would be appropriate.

46. Robert Flannigan, "Tort Immunity for Nonprofit Volunteers" (2005) 84:1 Can Bar Rev 1.
47. SS 1995, c N-4.2, s 136(5). In the interim the Alberta Institute of Law Research and Reform had released its report *Proposals for a New Alberta Incorporated Associations Act*, Report No 49 (Edmonton: Institute of Law Research and Reform, 1987).
48. SC 2009, c 23. Query the ambiguity in an earlier federal proposal: Corporate and Insolvency Law Policy Directorate, *Reform of the Canada Corporations Act: Draft Framework for a New Not-for-Profit Corporations Act* (Ottawa: Industry Canada, 2002). The document states (at 18) that "with a unanimous member agreement, the members would assume all liability," but then (at 44) there is a failure to specify that members assume liabilities.
49. *Ibid*.

V. Nonprofit Director Immunity

There is another liability variation in the nonprofit context that requires attention. Saskatchewan is once again the rogue jurisdiction.[50] It amended its nonprofit legislation in 2003 to grant unparalleled immunity to directors and officers of nonprofit corporations.[51] The amendment had been recommended after a seemingly thorough analysis by the Law Reform Commission of Saskatchewan.[52] We therefore have an explicit record of the original arguments for this nonprofit liability variation. The amendment added section 112.1 to the statute:

112.1(1) In this section, "loss" means any pecuniary or non-pecuniary loss respecting, arising out of or stemming from any act or omission of:

(a) the corporation; or

(b) any director, officer, employee or agent of the corporation in the exercise or supposed exercise of any of his or her powers or in the carrying out or supposed carrying out of any of his or her duties.

(2) Unless another Act expressly provides otherwise, no director or officer of a corporation is liable in a civil action for any loss suffered by any person.

(3) The limitation on liability mentioned in subsection (2) applies only if the director or officer was acting in good faith at the time of the act or omission giving rise to the loss.

(4) The limitation on liability mentioned in subsection (2) does not apply if:

(a) the loss was caused by fraudulent or criminal misconduct by the director or officer; or

(b) the act or omission of the director or officer that caused the loss constituted an offence against this Act, any other Act or any Act of the Parliament of Canada.

(5) This section is to be interpreted as not affecting the liability of the corporation for loss suffered by any person.

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50. Consider whether there was a coordinated effort in Saskatchewan to systematically retool liability exposure. On the face of it, the incentive trail leads back to multiple local interests.

51. *The Non-profit Corporations Amendment Act, 2003*, SS 2003, c 33, s 2.

52. *Report on the Liability of Directors and Officers of Non-profit Organizations* (Law Reform Commission of Saskatchewan, 2003).

The section purports to exclude all director and officer liability, other than for fraudulent or criminal conduct, if the director or officer was acting in good faith.

One might expect a law reform commission to construct a sound analysis. That did not happen in this instance. The report is deficient in multiple respects. The consistently weak research and reasoning in the report has been examined at length elsewhere.[53] No credible substantive justification for section 112.1 is discernible. No other provincial law reform agency, it may be added, has proposed anything like it.[54]

Significantly, the federal government did not accept the views of the Saskatchewan commission. The new federal nonprofit legislation retains conventional liability exposure for directors and officers.[55] The government took that position despite a concerted lobbying effort in support of the Saskatchewan immunity. The Canadian Bar Association, one of the main proponents of immunity, asserted that the Saskatchewan provision had been enacted "to protect directors and officers of voluntary organizations from excess or unwarranted liability".[56] That statement misconceives what is voluntary, excessive or unwarranted.[57] The specific justifications offered by the association, in addition to the predictable recruitment argument,[58] are hollow assertions:

> In part, the allocation of liability is about striking a fair balance. Voluntary directors of NFP corporations serve the public interest, with little or no prospect of personal gain. To visit such directors with personal liability is unfair. This is in contrast to the situation of directors of publicly-traded corporations or private corporations. Most directors of publicly-traded corporations are protected by directors and officers liability policies, are

53. See Flannigan, *supra* note 46.

54. The British Columbia Law Institute rejected the immunity. See its *Report on Proposals for a New Society Act*, BCLI Report No 51 (Vancouver: British Columbia Law Institute, 2008) at 143-44.

55. *Canada Not-for-profit Corporations Act*, SC 2009, c 23.

56. *Submission on Bill C-4 – Canada Not-for-profit Corporations Act* (Ottawa: Canadian Bar Association, 2009) at 24.

57. See Flannigan, *supra* note 46.

58. The recruitment argument invariably is specious. See Robert Flannigan, "The Personal Tort Liability of Directors" (2002) 81:2 Can Bar Rev 247 at 313-17.

competitively compensated, may enjoy stock options and have access to public markets for financing. Generally, directors of NFP corporations have none of these advantages. Directors of private corporations are often shareholders and, therefore, have all of the upside potential that entails. Directors of NFP corporations (at least those NFP corporations that cannot distribute assets to members pursuant to s. 237) are clearly in a different position and not analogous to directors of private corporations.[59]

Directors of nonprofits do not necessarily serve the public interest and frequently they realize significant personal gains from their positions.[60] Moreover, imposing on nonprofit directors the same accountability that is imposed on other directors is entirely *fair*.[61] Further, it simply is wrong to imply that the "advantages" of insurance or compensation are not generally available to nonprofit directors. And it is quite opaque to this observer how it could possibly matter that other directors have stock options or "access to public markets for financing". Lastly, while directors of private corporations are shareholders, directors of nonprofit corporations are members, and therefore have "all of the upside

59. S*upra* note 56 at 23.

60. Understandably from a tactical perspective, some nonprofit representatives publicly embrace self-interest as a motive for volunteering. See Dave McGinn, "Giving Back: It's All About Free", *The Globe and Mail* (13 July 2009) ("It doesn't have to be something that's purely altruistic, says Ruth MacKenzie, president of Volunteer Canada. It's actually okay to benefit personally from volunteering"). See also Jane Taber "Growing Volunteer Gap Impedes 'Smart and Caring Nation'", *The Globe and Mail* (8 December 2010).

61. It has been suggested that there is a positive correlation between tort immunity and volunteering. See Jill R Horwitz & Joseph Mead, "Letting Good Deeds Go Unpunished: Volunteer Immunity Laws and Tort Deterrence" (2009) 6:3 J Empirical Legal Stud 585. The data, however, is crude and open to contradictory interpretation. Given that there never was a true "liability crisis" in the nonprofit sector and that much volunteering is "forced" or "expected" (family, church, work expectations), the recent proliferation of unjustified statutory immunities only created *more room* for volunteering beyond the equilibrium that existed under the conventional universal liability standards. In that respect, the new political solicitude was nothing more than an indirect legislative subsidy (in the form of immunity) to nonprofit activity. Politicians, it may be added, are amendable to conferring immunities because of halo considerations, their own personal liability exposure and the fact that state expenditures usually are not required ex ante (the state costs of altered risk levels arise ex post). As for any supposed correlation between participation rates and the *perception* of greater liability exposure (created largely by the nonprofit sector itself), the proper response would be education.

potential that entails" (the receipt of member benefits). When it comes to regulating risk projection and opportunism, directors of nonprofits are *not* in any sense "in a different position" than directors of private corporations.[62]

Ontario also considered the immunity issue[63] when constructing its new *Not-for-Profit Corporations Act, 2010*.[64] It similarly chose to retain conventional liability exposure for nonprofit directors and officers. Here too the Canadian Bar Association, through its Ontario branch, had proposed adoption of the Saskatchewan immunity.[65] Its initial

62. The failure of the lobbying effort at the federal level incensed one immunity advocate. See Wayne D Gray, "The Late, But Welcome, Arrival of a New Federal Not-For-Profit Corporations Law" (2010) 49:1 Can Bus LJ 40 at 60-62. Gray, who was deeply engaged in lobbying both the federal and Ontario governments on behalf of the Canadian Bar Association, reiterated the bar association arguments as if they were patently sound. He amplified his reasoning with a troubling remark: "Even if an individual agrees to stand as a director of an NFP corporation, there are few incentives to devote the time required to adequately meet the same objective standard of care, diligence and skill that is imposed on directors of a CBCA corporation" at 60. The deficiency of that statement as a reason for immunity is obvious. Gray ended his discussion with the remonstration that it will take years "to know whether or not the courts" will "rectify" the "imbalance" that he saw in the *equal* treatment of nonprofit and other directors. Gray, it may be noted, has been engaged in advocating immunity in other contexts. He was the chair and reporter for the working group of the Uniform Law Conference of Canada that proposed limited liability for investors in income trusts. See *The Uniform Income Trusts Act: Closing the Gap Between Traditional Trust Law and Current Governance Expectations*, Report of the Uniform Income Trusts Act Working Group to the Uniform Law Conference of Canada, Civil Law Section, 2006. The difficulty with the income trust proposal is that trusts are not corporations, and there are reasons for the conventional difference in liability exposure—reasons which the working group ignored.

63. Ontario, *Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations*, Consultation Paper # 2 (Toronto: Ontario Ministry of Government Services, 22 August 2007) at 22-24.

64. SO 2010, c 15.

65. See also the views of Imagine Canada, *Submission to the Minister of Government Services (MGS) Ontario on the Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations, Submission II Response to Consultation Paper 2* (15 February 2008). Consider the problematic comments (at 12) about risk, liability and insurance:

The Ontario Government recently established an Ontario Voluntary Partnership (OVP) through its Ministry of Citizenship and Immigration (MCI). The OVP oversees the *Insurance* submission in 2008 did little more than assert that section 112.1 was "a useful model".[66] Its subsequent submission in 2010 added a few arguments while continuing to promote the acceptance of section 112.1.[67] The association introduced its analysis with the observation that members of the legislature had (during second reading debates) "expressed concern about the personal liability faced by the directors" of nonprofit corporations.[68] That appeal to legislative sentiment is of little significance, however, without relative numbers or formal votes, and given the reality that concerns expressed by politicians in the legislature often are pre-arranged with supporters or lobbyists and that politicians commonly serve as directors on multiple nonprofit boards. The association went on to offer the following reasoning:

Many directors of NFP corporations worry about how they would personally fund the defence to litigation and they often spend less time worrying about the risk of an ultimate

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and Liability Resource Centre for Nonprofits whose mandate is to address the insurance and liability issues facing Ontario's charities and not-for-profit corporations, arising from volatile pricing of insurance premiums, particularly for organizations providing services to vulnerable communities. Such services are often associated with high levels of liability and risk and therefore attract high premiums that can result in the withdrawal of such programs and services. The application of the legal doctrines of vicarious liability and joint and several liabilities to our charities and not-for-profits now render them liable in law for the wrongdoings of Canada's 22.2 million volunteers. As a matter of law and public policy, this allocation of risk requires review. The OVP is a partnership between the insurance, academic and not-for-profit sector, facilitated by the Government of Ontario. The Centre is identifying reforms aimed at making insurance more affordable for voluntary sector organizations. Reduced insurance costs will ensure that donor funds can be applied to program delivery rather than insurance costs.

66. *Submission on the Phase III Business Law Modernization Consultation Paper # 2 Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations* (Toronto: Ontario Bar Association, 22 February 2008) at 11-12.
67. *Bill 65, the Not-for-Profit Corporations Act, 2010* (Toronto: Ontario Bar Association, August 26, 2010) at 15-16. The language of the submission was predictable. The "Partial Immunity Shield" heading suggested limited (partial) immunity that would provide protection (shielding) against liability. The use of the term "protection" also is instrumental. It perverts the understanding of the original ascription of legal liability as "protection" against the specified act or omission.
68. *Ibid* at 15.

adverse judgment. Also, insurance is often only practicable for a small subset of the 46,000 NFP corporations that will fall under the ONCA. Corporate indemnification tends to be worthless when it is most needed: the insolvency of the underlying corporation. The due diligence and good faith reliance defences are also not much help except at the ultimate trial (or late in the litigation). A statutory limitation on liability for directors and officers of NFP corporations would benefit the Sector.

It is hard enough to get directors to act when they are concerned about protection from liability. Providing directors and officers of NFP corporations with partial immunity from liability is a method of encouraging participation in the Sector. A limitation on liability would bring ONCA corporations in line with corporations under the SK Act. It may also make the ONCA a more attractive governance structure if directors/officers feel that they may have adequate legal protection while carrying out their duties as directors of NFP corporations.[69]

The weakness of this reasoning should be evident. *Every* organization and resident will on occasion worry about the cost of litigation and the cost of insurance.[70] Nonprofit directors are not a special case in that respect. As well, the "worthless indemnification" and "unhelpful defences" arguments are of no greater significance in the nonprofit context than in the general business context (they are deficient counterpoints to liability ascription in both instances). As for the recruitment argument in the second paragraph, we find the standard plea to encourage participation, but no reference to elevated risk levels or real victims. It would of course be a "more attractive governance structure" *for directors* if they have "adequate" legal protection. The question, however, is whether their "adequate" protection requires an unprecedented legal immunity that has no discernible substantive justification and is not available to anyone else in the population. Finally, to say that adopting section 112.1 "would bring ONCA

69. *Ibid*.

70. Immunities, it should be apparent, do not eliminate litigation costs or negate the utility of insurance cover. Litigation will continue with the *additional* issue of the applicability of the immunity. And insurance will remain a prudent investment for obvious reasons. It of course is irrelevant as a substantive matter that some nonprofit organizations would *prefer*, or *choose*, to forgo the purchase of insurance.

corporations in line with corporations under the SK Act" is to argue disingenuously for alignment with the rogue Saskatchewan position.

Section 112.1 likely was regarded by its Saskatchewan promoters (and its superficially informed population) as an uncontroversial affirmation and encouragement of halo endeavours. It uniquely signalled a commitment to the nonprofit sector. It was novel local policy in support of local activity, and therefore need not (it may have been assumed) concern less charitable populations in other jurisdictions. The difficulty, however, is that local policy may be exported by mechanical principle into jurisdictions that clearly do not subscribe to what would be considered defective or infirm policy. The mechanical principle is the rote acceptance or recognition by other jurisdictions of the liability structures of foreign forms. Thus, for example, in order to immunize its directors and officers against what now is crystalline local liability policy in Ontario, a nonprofit in Ontario might be advised by counsel to incorporate or continue under the Saskatchewan statute, and then register in Ontario as an extra-provincial corporation. That is not an idle possibility.[71] It was suggested recently in one review of the new federal legislation:

> For directors and officers who want greater liability protection than the [federal legislation] affords (particularly directors and officers of NFP corporations engaged in high-risk activities), consideration might therefore be given to continuing the corporation from the federal jurisdiction to the Saskatchewan Act as soon as the [federal legislation] comes into effect.[72]

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71. That incentive was apparent from the outset. See Flannigan, *supra* note 46 at 23. It will be appreciated that the desired immunity may not be realized in the absence of an explicit statutory deference to foreign liability configurations.

72. Wayne D Gray, "A Practitioner's Guide to the New Canada Not-for-profit Corporations Act" (2010) 89:1 Can Bar Rev 141 at 181. Gray, as noted earlier (*supra* note 62), was not pleased with the rejection of his proposals for director immunity. This last effort may be an attempt on his part to raise a fear of loss of market share, and thereby initiate a defensive domino adoption of immunity across the whole country. Highlighting the mechanical circumvention of local liability, however, may work against his project. It is just as likely that Canadian jurisdictions will now proceed to prevent or constrain the importation of foreign immunity.

In short, if loss is likely ("high-risk activities"), nonprofit organizations in other provinces may choose to import Saskatchewan liability policy exclusively for their personal liability-evasion advantage. While their legal advisors initially might be reluctant to have to deal with Saskatchewan law, at some point it will be a compelling option.[73] Each organization that takes that step will (uncharitably) increase the risk that must be digested by the local population.

VI. Other Liability Variations

The variations discussed to this point all involve corporate structures.[74] There are other variations noted elsewhere for other business structures, including the limited partnership, limited liability partnership and business trust.[75] Perhaps because of the modern specialized or niche application of these other legal forms, their liability variations have largely avoided critical assessment.[76] The concern, however, is the same.

The point should now be clear. Variations between jurisdictions may arise instrumentally, accidentally or as misguided reforms. The concern for each state that is attentive (rather than indifferent) to the welfare of its residents is that foreign configurations may transfer mechanically and without any systematic assessment or filtering of the unpredictable elusion of local regulation by foreign firms. Further, local populations will have no notice or appreciation of the local policy circumventions or

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73. Commentators have noted the incentives (and conflicts) for counsel who are asked to advise on the choice of state of formation. See Robert Daines, "The Incorporation Choices of IPO Firms" (2002) 77:6 NYUL Rev 1559 at 1584-86; Romano, *supra* note 5 at 273-77.

74. Query the general decay in accountability in business organization law. See Daniel S Kleinberger, "Delaware Dissolves the Glue of Capitalism: Exonerating from Claims of Incompetence Those Who Manage Other People's Money" 38:1 Wm Mitchell L Rev [forthcoming].

75. See Flannigan, *supra* note 3.

76. On the modern uses of the business trust, see Robert Flannigan, "Business Applications of the Express Trust" (1998) 36:3 Alta L Rev 630.

the distortion of local risk levels and local competition. How then should we respond to foreign variations claimed locally?

VII. Foreign Dominance

There are a number of ways to respond to liability variation.[77] One is to conclude that economic imperatives require deference to the foreign legal attributes of mobile foreign firms. Specifically, it might be assumed that attracting investment crucially depends on foreign firms retaining their home liability configurations. There is, however, little to suggest that is the case. No one openly (or credibly) defends the idea of differential or privileged liability exposure as between foreign and local versions of a given organizational form. Within each policy range liability exposure should be uniform.[78]

The reality is that, while foreign firms might *prefer* to retain their home liability configuration, they do not *expect* it. Given their understanding that different jurisdictions have different liability rules, they make the requisite calculations to identify their greatest overall advantage. Their decision to invest locally is determined solely by whether the expected benefits exceed the expected costs, including liability costs. If they receive a local liability subsidy (just as they might receive a tax subsidy), that is merely another consideration in their cost/benefit analysis. Where large investments are involved, they may attempt to pit jurisdictions against each other to secure special liability dispensations or indemnities, but they are just as willing to instead take infrastructure or other subsidies. Only the net benefit matters.

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77. Though perhaps unlikely, liability variation might be addressed by the jurisdiction of formation. Jurisdictions might specify that the liability configurations of their organizational forms will be subordinate to the liability rules of the foreign jurisdictions where those forms operate. That would respect the liability policies of other jurisdictions and imply that their own forms are entitled to any liability advantages for their foreign operations.

78. Standard civil accountability principles require the congruent regulation of symmetric risk projection. Differential cost externalization only further distorts economic functioning (beyond the externalization itself).

It should be emphasized that local liability standards rarely are a decisive consideration in investment decisions made by firms of the kind and size that are in a position to expand outside their home jurisdictions. Prospective ordinary-course liability costs are of minor importance from a firm perspective in the great majority of cases because they are almost always manageable ex ante through insurance, system design or other means. If liability issues really are a significant concern for a foreign firm, it likely is because the firm has a record of injuring others or possibly intends to risk injury to others in its proposed operations. That is not the sort of firm that most jurisdictions should want to attract with *immunity* incentives.

A main concern with deferring to foreign liability configurations is the asymmetry it produces between local firms and foreign firms operating locally. Local firms will be at a competitive disadvantage in terms of their production activities. Managers of foreign firms will be less constrained to the extent they are immunized against local liability policy. The effect at the margin is to replace local firms with foreign firms. A second serious concern is that *local* firms might incorporate elsewhere and then register locally solely or primarily to acquire the foreign liability shield ("pseudo-foreign" firms).[79] They thereafter compete with other local firms under different *self-selected* liability constraints. Here of course there is not even a foreign investment argument available to offer as justification for the privileging of one local firm over another. There is no policy asymmetry in fact of any kind.

It might be argued that de facto jurisdictional competition with respect to liability exposure will produce efficient configurations, and therefore ought to be encouraged. The difficulties with that argument should be apparent. The relative efficiency of different configurations frequently is not what is at issue. Commonly it is market share. As noted earlier, a first mover jurisdiction (and its lawyers and accountants) may be seeking the increased fees associated with a larger share of the market for a particular legal form. The liability configuration is merely the instrument (or price) to attract foreign firms. Or a first mover may

79. See Elvin R Latty, "Pseudo-Foreign Corporations" (1955) 65:2 Yale LJ 137.

create a market share effect unintentionally merely by producing an exploitable liability difference. Once the option to assume a different liability configuration is available, other jurisdictions must adopt the same configuration (or make some other adjustment) or lose market share. It is a one-way process of firm predation on worried legislatures. There is no competition between configurations as such.[80] The installation of the configuration is merely an act that prompts market share protection by other jurisdictions. The configuration may eventually become the new norm for all jurisdictions—but that will be because its adoption protects market share, not because it is immanently more efficient than the configuration it replaced. There are a number of examples of just this kind of effect.[81] Market share concerns, for example, drove the serial adoption in Canada of what was thought to be a significant liability variation for the beneficiaries of business trusts.[82]

There is a further practical difficulty with the efficient competition argument. Unlike decisions to build bridges or fund new programs, there usually are no upfront implementation costs to jurisdictions when adopting new liability configurations.[83] The costs surface later, and are diffusely absorbed over time and through multiple government, employment and charitable programs. Those costs are difficult to calculate, and invariably they are *not* calculated. Consequently, the relative efficiency of new liability configurations is almost never properly or accurately assessed ex ante. That clearly has been the experience with the liability variations discussed above. At best, the variations are predicated on untested suppositions about the motives, incentives or circumstances of those intended to be shielded from liability.

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80. The competition is over the range and depth of the risk that each state is prepared to impose on its population in order to retain market share. Usually the quality and quantum of that risk remains unknown and unexamined.

81. See generally Flannigan *supra* note 6.

82. *Ibid* at 277-91. The lobbyists had sought a liability exposure that was equivalent to the limited liability of shareholders. The enacted statutes appear only to alter the default rule that had required beneficiaries with fully vested interests to indemnify their trustees.

83. Other than the investigation and process costs common to all legislative activity.

VIII. Local Dominance

Once the increasing scope and scale of liability variation is appreciated, allowing foreign rules to have unqualified default local application cannot reasonably be justified. The alternative is to adopt a local dominance principle specifying that foreign legal forms will not receive preferential treatment. Some Canadian jurisdictions have moved in that direction. The nature and extent of the protection for the local population, however, is variable and sometimes unclear.

Consider the partnership law of Ontario, British Columbia and Alberta. The Ontario *Limited Partnerships Act* adopts the deference or foreign dominance approach to the liability of limited partners:

> 27(2) The laws of the jurisdiction under which an extra-provincial limited partnership is organized govern its organization and internal affairs and the limited liability of its limited partners.[84]

The subsection was enacted at a time when there was little variation in the limited partnership liability configuration across North America.[85] In particular, it predates developments in the United States culminating in the uniform law commissioners' proposal for uniform legislation that eliminates the possibility of open liability for limited partners who participate in the control of the business.[86] That radical unjustified change in liability exposure was not adopted by Ontario. Accordingly, the limited partners of foreign limited partnerships carrying on business in Ontario will enjoy a substantial immunity advantage relative to the limited partners of Ontario limited partnerships. As well, the Ontario

84. RSO 1990, c L.16.

85. The provision was introduced with the new 1980 statutory regime. See *An Act to Revise The Limited Partnerships Act*, SO 1980, c 48, s 25(2).

86. *Uniform Limited Partnership Act (2001)*, s 303. The relevant part of section 303 states: "A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership." The commissioners did not offer any substantive justification for the change.

population will be exposed to a greater level of risk without any justification in defensible policy asymmetry.

In contrast, at roughly the same time the Ontario provision was enacted, both Alberta and British Columbia adopted the local dominance approach. The respective provisions read as follows:

> 52(5) A firm registered as a limited partnership under subsection (2) has the same rights and is subject to the same duties, restrictions and liabilities under this Act as a firm formed as a limited partnership under subsection (1).[87]

> 80(3) A limited partnership registered under this section or under regulations made in accordance with Part 7 has rights and privileges the same as but no greater than, and is subject to the same duties, restrictions, penalties and liabilities as are imposed on, a limited partnership formed under section 51.[88]

It appears that the partners of foreign limited partnerships will not receive preferential liability treatment in Alberta or British Columbia. There is, however, a concern with the two provisions.

Both provisions reference the limited partnership, rather than the partners, possibly suggesting to some that only liabilities of the "firm" or "entity" are addressed by each provision.[89] That is not a plausible interpretation for limited partnerships formed in Canadian common law jurisdictions because it is clear that such partnerships are not legal entities, and consequently the liabilities involved necessarily are the liabilities of the general and limited partners.[90] On the other hand, limited partnerships from other jurisdictions may have legal entity

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87. *Partnership Act*, RSA 2000, c P-3. The provision was introduced by the *Partnership Amendment Act*, 1981, SA 1981, c 28, s 51(4).

88. *Partnership Act*, RSBC 1996, c 348. The provision was introduced by the *Partnership Amendment Act*, 1978, SBC 1978, c 33, s 10.

89. It is disingenuous to advocate personal immunity on the argument that the firm itself (of whatever kind) is liable. The risk of personal liability typically is an important concern only when a firm is insolvent.

90. See *Kucor Construction & Developments & Associates v Canada Life Assurance Co* (1998), 41 OR (3d) 577, 167 DLR (4th) 272 (CA); *Asset Engineering LP v Forest & Marine Financial Limited Partnership*, 2009 BCCA 319, 96 BCLR (4th) 77. On the position in Quebec, consider *Laval (Ville de) c Polyclinique médicale Fabreville, sec*, 2007 QCCA 426, [2007] RJQ 557.

status. Where that is the case, the Alberta and British Columbia provisions would appear by their terms to apply to the limited partnership alone. That would leave the determination of the liability of the limited partners to an uncertain conflict of laws analysis. The effect is to create an unintended liability distinction between limited partners predicated on whether their partnership is or is not a separate entity. There is no justification for that result. The solution is to draft the provisions more carefully to assure equal liability treatment.

Consider next the rules relating to limited liability partnerships. In Ontario the rule is again deference to foreign liability configurations:

> 44.4(4) The laws of the jurisdiction under which an extra-provincial limited liability partnership is formed shall govern,
>
> (a) its organization and internal affairs; and
>
> (b) the liability of its partners for debts, obligations and liabilities of or chargeable to the partnership or any of its partners.[91]

In Alberta and British Columbia, there is partial local dominance.[92] The respective sections are roughly equivalent. The Alberta provision reads as follows:

> 104(1) The law of the governing jurisdiction of an extra-provincial LLP applies
>
> (a) to the organization and internal affairs of the LLP, and
>
> (b) to the liability of the partners of the LLP for debts, obligations and liabilities of or chargeable to the partnership.
>
> (2) Notwithstanding subsection (1), an Alberta partner of an extra-provincial LLP does not have any greater protection against individual liability in respect of that partner's practice in Alberta than a partner in an Alberta LLP would have under this Part.[93]

A draft version of the provision was discussed by the Alberta Law Reform Institute in its report recommending the legislation.[94] The discussion of the deference extended by the first subsection was not deep. The Institute noted that "[t]he approach that is taken by the vast

91. *Partnerships Act*, RSO 1990, c P.5.

92. The British Columbia provision is section 125 of the *Partnership Act*, RSBC 1996, c 348.

93. *Partnership Act*, RSA 2000, c P-3.

94. *Limited Liability Partnerships*, Report No 77 (Edmonton: Alberta Law Reform Institute, 1999) at 156-58.

majority, if not all, US states and by Ontario is generally to defer to the partner liability rules of the home jurisdiction".[95] Without any further analysis, the Institute went on to "propose that Alberta should generally follow the current of LLP legislation in other jurisdictions. That is, where an extra-provincial LLP incurs an obligation in Alberta, the laws of its home jurisdiction should determine the personal liability of its partners for that obligation".[96] That analysis is weak in obvious respects. The failure to articulate any reason for the recommended deference other than a wish to "join the club" or "follow the leader" is plainly a serious deficiency, particularly since neither Ontario nor any of the states appear to have provided an explicit defensible justification.[97] Further, the Institute failed to explain why its approach to limited liability partnerships should differ from the approach applied to Alberta limited partnerships.

The local dominance approach appears in the second subsection. The Institute explained that malpractice liability should apply to the responsible professional "whether the partner who is implicated in the wrongful acts or omissions is a member of an Alberta LLP or an extra-provincial LLP carrying on business in Alberta".[98] It then added a curious observation: "Since liability would be imposed on this partner because of their own negligent or otherwise wrongful conduct in the provision of professional services, their liability is not really a matter of 'business organization' at all".[99] The substance of that remark is not obvious. A foreign law may grant the responsible partner some measure of immunity, albeit less than that extended to the partners who are not responsible. Absent subsection 104(2), that immunity would be available under subsection 104(1). Apart from that observation, it is clear that Alberta and British Columbia did perceive the problem of differential liability exposure and sought to address it in a significant respect. Partners who are Alberta partners of foreign limited liability

95. *Ibid* at 156.

96. *Ibid*.

97. States with aspirations to export their configurations obviously would support a foreign dominance rule. Consider *VantagePoint*, *supra* note 4 and Glynn, *supra* note 3.

98. *Supra* note 94 at 157.

99. *Ibid*.

partnerships (defined as partners who ordinarily reside outside Alberta all or part of the time but practice in Alberta) have the same liability exposure as the partners of local partnerships.

Liability variation, we have seen, does not always reflect authentic policy asymmetry. Consequently, a general deference to foreign liability rules founded on that supposition is unsound. A jurisdiction could instead choose to separately assess each foreign application for registration to determine whether there is a variation, and whether that variation is inconsistent with local policy. That, however, likely would involve considerable cost. Each application would require a fresh review of the particular foreign configuration to ascertain whether it had been amended or altered by legislative or judicial fiat since the last review. The more prudent response to the economic reality of variation is for every jurisdiction to adopt a general principle of local dominance. That produces a *uniform* liability exposure for each kind of organizational form within each jurisdiction. No longer will foreign firms (including externally registered local firms) enjoy privileged liability exposure as they compete with local firms. No longer will local populations be subjected to risk projection that is not regulated by local policy. And if it matters, local professional fees will be generated as foreign firms seek local advice on the liability exposure associated with their local operations.

It appears that the local dominance approach has traction in Canada. Significantly, in that respect, there has been no adverse reaction to the local dominance rule that for more than three decades has applied to foreign limited partnerships operating in Alberta and British Columbia. Presumably that reflects the difficulty of challenging a principle which properly subjects the local operations of each kind of organizational form to one set of invariant liability rules.

Conclusion

Liability variation is of increasing concern as more foreign and pseudo-foreign firms conduct local operations. Local policy is compromised when divergent liability rules may be imported freely. That is manifest where the variation is not justified by demonstrable asymmetric policy. A foreign dominance rule also is inappropriate even if there is a credible basis for the variation in the foreign jurisdiction. Ceding dominance to foreign liability rules is a reckless surrender of the power to define accountability. A local dominance rule is preferable from every perspective. Local operations are regulated uniformly in terms of liability discipline, the local population is not exposed to undisclosed inordinate risk, and foreign firms are not likely to forgo profitable investment merely because their liability exposure is *equal* to that of their local competitors. The prospect now is that the sensibility of local dominance will eventually displace blinkered general deference to foreign liability rules.