

## The Promise of Certainty in the Law of Pre-Incorporation Contracts.

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### *Introduction*

Corporate law statutes in Canada generally provide that a corporation does not come into existence until its certificate of incorporation has been issued by the appropriate government agency.<sup>1</sup> However, in many cases, promoters (individuals who are in the process of incorporating a company or who intend to do so) may find it necessary or desirable to enter into contracts with third parties on behalf of the corporation prior to its incorporation. Such contracts may include leasing or purchasing real property and equipment, hiring key employees, arranging financing, lining up suppliers, or locking-in clients.

In practice, most pre-incorporation contracts cause no difficulty for the parties who intend to benefit directly from them. In the normal course of events, once the corporation is incorporated, both the corporation and the third party perform on the contract. However, when the corporation does not come into existence, or comes into existence but refuses to adopt a contract, difficult legal issues arise in relation to the rights and liabilities of the parties.<sup>2</sup> In these situations, the following questions must be resolved: To what extent is the promoter liable on the contract? To what extent is the corporation liable on the contract? When, if at all, is the promoter relieved from liability? The policy issue, of course, is whether the promoter or the third party must bear the risk of loss.

The law on pre-incorporation contracts has been needlessly complex and unsuccessfully applied. Justice Borins of the Ontario Court of Appeal recently stated that the law of pre-incorporation contracts "at first blush, may appear to

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<sup>1</sup> See *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 9 [hereinafter *C.B.C.A.*]; *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16, s. 7 [hereinafter *O.B.C.A.*]; *Alberta Business Corporations Act*, S.A. 1981, c. B-15, s. 9(1); and *British Columbia Company Act*, R.S.B.C. 1996, c. 62, s. 12.

<sup>2</sup> For promoters' liability generally, see: J.D. Cox, T.L. Hazen & F.H. O'Neal, *Corporations*, (New York: Aspen Law & Business, 1997) at 73-75; J.S. Ziegel, R.J. Daniels, J.G. MacIntosh & D.L. Johnston, *Cases and Materials on Partnerships and Canadian Business Corporations*, 3d ed. (Toronto: Carswell, 1994) at 269-70; J.H. Choper, J.C. Coffee, Jr. & R.J. Gilson, *Cases and Materials on Corporations*, 4th ed. (Boston: Little, Brown & Co., 1995) at 296-97 and J.A. VanDuzer, *The Law of Partnerships and Corporations*, (Toronto: Irwin Law, 1997) at 140-144.

be disarmingly simple, but which, after an examination of the common law, legal treatises and legislative attempts to find an equitable solution to a seemingly insoluble legal problem, is very complex."<sup>3</sup> Similarly, Professors Easson and Soberman state:

The conundrum of the *pre-incorporation contract* has taxed some of the finest legal minds. If one should judge by results, it is probably true to say that it has defied them. In the words of two American commentators:

The courts in interpreting and enforcing these agreements have made a sincere attempt to effect justice, and, at the same time, with rather disastrous results, to adapt contract law to the unusual situations involved. Since crystallized law has frequently no application, it is difficult to regard the decisions as precedents, for they seem predicated primarily on the facts, and only secondarily on the law. Resorting to the rules of law in these cases, particularly in this country, is an afterthought necessary to sustain and place them in some recognized category.<sup>4</sup>

Despite legislative attempts to simplify the law of pre-incorporation contracts, cases such as *Westcom Radio Group Ltd. v. MacIsaac*<sup>5</sup> have re-introduced needless complexity. Fortunately, *Szecket v. Huang*,<sup>6</sup> a recent decision of the Ontario Court of Appeal has cleared up this area of law. Part II of this comment briefly sets out and criticizes the common law of pre-incorporation contracts. Part III outlines recommendations for reform and legislative solutions. Part IV discusses and criticizes the *Westcom* decision. Part V discusses *Szecket*, and analyses the decision on three issues: its rejection of *Westcom*, the requirements for an express waiver of liability and the lack of discussion on which jurisdiction's laws apply when a corporation does not come into existence. Part VI briefly concludes.

### 1. *Form over Substance: The Common Law on Promoter's Liability for Pre-Incorporation Contracts*

The 19th century English case of *Kelner v. Baxter*,<sup>7</sup> which was long followed in Canada, held that a promoter is always personally liable on a pre-incorporation contract. The Court employed the principle of agency law that requires a principal to be in existence and capable of contracting at the time of the transaction; consequently, a promoter cannot contract for a non-existent corporation.<sup>8</sup> In *Kelner*, the Court then reasoned that since the parties must have

<sup>3</sup> *Sherwood Design Services Inc. v. 872935 Ontario Limited* (1998), 39 O.R. (3d) 576 at 607 [hereinafter *Sherwood*].

<sup>4</sup> A.J. Easson & D.A. Soberman, "Pre-Incorporation Contracts: Common Law Confusion and Statutory Complexity" (1992) 17 *Queens L.J.* 414 at 415 quoting from M.W. Ehrlich & L.C. Bunzl, "Promoters' Contracts" (1929) 38 *Yale L.J.* 1011 at 1012 [emphasis in original].

<sup>5</sup> (1989), 70 O.R. (2d) 591 (Div. Ct.) [hereinafter *Westcom*].

<sup>6</sup> (1998), 42 O.R. (3d) 400 (C.A.) [hereinafter *Szecket*].

<sup>7</sup> (1866), L.R. 2 C.P. 174 [hereinafter *Kelner*].

<sup>8</sup> *Ibid.* at 183.

intended that *someone* would be liable, and the corporation did not yet exist, it followed that the promoter must be liable on the contract.<sup>9</sup> The court's position would prevail regardless of whether the corporation purported to adopt the contract once it came into existence.

Roughly one hundred years later, the High Court of Australia in *Black v. Smallwood*<sup>10</sup> re-interpreted *Kelner*. It held that *Kelner* did not set down a categorical rule that promoters would always be liable on pre-incorporation contracts; rather, a promoter would be liable on a pre-incorporation contract only if the parties so intended. As with most subjective tests, the courts would look to various objective factors to ascertain the intentions of the parties.

One method courts have employed to ascertain the intention of the parties is an examination of the promoters' form of signature on the contract. For example, in *Newborne v. Sensolid (Great Britain), Ltd.*, the promoter signed the contract as follows:

Leopold Newborne (London) Ltd.

Leopold Newborne<sup>11</sup>

The Court reasoned that the parties intended that only the corporation would be bound, because the company name was set out before the promoter's name; as a result, the promoter was not held liable. Since a non-existent corporation cannot validly contract, the Court held that there was no contract, and the third party was forced to bear the loss. Courts have distinguished the above noted form of signature from one in which the name of the promoter appears before the company name (*i.e.*, Leopold Newborne, on behalf of Leopold Newborne (London) Ltd.). The courts have reasoned that the latter form of signature suggests an intention that the promoter was binding himself or herself personally.

Under *Kelner*, the common law was needlessly inflexible, inconvenient, and unfair, because a promoter remained liable despite a corporation's purported adoption of the contract. Under the intentions analysis developed in *Black*, the common law created a climate in which promoters and third parties contracted under tremendous uncertainty as to their legal rights and obligations. The intentions analysis was often unjust to third parties because "a great deal may turn upon the form of a contract, and minor differences in wording may be decisive of the rights and liabilities of the parties."<sup>12</sup>

<sup>9</sup> *Ibid.*

<sup>10</sup> (1966), 117 C.L.R. 52 [hereinafter *Black*].

<sup>11</sup> [1953] 1 All E.R. 708 at 709 (C.A.) [hereinafter *Newborne*].

<sup>12</sup> R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada*, vol. 1 (Ottawa: Information Canada, 1971) at 22, para. 69.

## 2. Legislative Reform

Reform of corporate law statutes, beginning in the late 1960s, clarified and simplified the common law position on pre-incorporation contracts.<sup>13</sup> The Lawrence Committee, reviewing the *O.B.C.A.*, recommended that a corporation should have the option to adopt pre-incorporation contracts, and that until the corporation adopts the contract, the promoter should be liable. Section 20 of the *O.B.C.A.*, enacted in 1970, reflected these recommendations.

The Dickerson Committee, which drafted the 1975 amendments to the *C.B.C.A.*, improved upon the 1970 amendments to the *O.B.C.A.* It noted the "unsatisfactory state of the common law"<sup>14</sup> of pre-incorporation contracts, and endorsed the recommendation of the Lawrence Committee that the promoter should be held liable until the corporation adopts the contract, but added that the promoter should be able to contract for an express waiver of liability, and that a court should have the power to order that the promoter be relieved of liability.<sup>15</sup> The rationale provided by the Dickerson Committee for promoter liability prior to adoption by the corporation was that "as a matter of business reality, the promoter is usually in control of the pre-incorporation and immediate post-incorporation process and is able to protect himself."<sup>16</sup>

The Dickerson Committee recommended that the promoter cease to be liable upon the adoption of the contract by the corporation. It also recommended that a court retain a residual discretion to apportion liability between the promoter and the corporation, since "a promoter can evade liability by procuring the adoption of the contract by a shell corporation with insufficient assets to meet its obligations under the contract."<sup>17</sup> The Committee noted that "[t]he effect of this may well be to give the third party a choice of debtors where ordinarily there would at best be only one."<sup>18</sup> Nevertheless, the Committee continued,

it is desirable to confer a wide discretion upon the court to make adjustments. The courts will clearly not impose liability upon the corporation where the promoter has no effective control over it and the other party's sole basis for seeking an order is that he is stuck with an unsubstantial promoter. On the other hand, a fraudulent promoter should not be allowed to evade his obligations by hiding behind a corporation that he in fact dominates.<sup>19</sup>

However, the Committee recommended that a promoter should be allowed to expressly and in writing disclaim liability, and that the court's discretion should

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<sup>13</sup> Lawrence Committee, Interim Report of the Select Committee on Company Law, (Toronto: Legislative Assembly of Ontario, 1967) cited in *Sherwood*, *supra* note 3 at 599.

<sup>14</sup> *Supra* note 12 at 22, para. 68.

<sup>15</sup> *Ibid.* at 23, para. 70.

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.* at 23, para. 72.

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

not override this express waiver of liability. It justified its recommendation on the basis that “[t]he inclusion of an express written disclaimer should make the third party fully aware of the kind of arrangement he is getting himself into, and there seems no case for allowing the court to override the provisions of the disclaimer.”<sup>20</sup> The Committee also recommended that a corporation should be able to validly adopt only written contracts because “this seems the only way of ensuring full disclosure of the terms of the contract, which is an essential protection for the corporation.”<sup>21</sup>

Section 14 of the current *C.B.C.A.* reflects the Dickerson Committee’s recommendations.<sup>22</sup> It provides that a promoter is liable on a pre-incorporation contract before the corporation is formed.<sup>23</sup> The corporation becomes liable on the contract once it adopts it, at which time, the promoter is released from liability.<sup>24</sup> The promoter can expressly opt out of liability;<sup>25</sup> and, subject to the promoter’s express waiver of liability, the court can apportion liability between the promoter and the corporation upon application by the promoter or the third

<sup>20</sup> *Ibid.* at 24, para. 73.

<sup>21</sup> *Ibid.* at 23, para. 71.

<sup>22</sup> Section 14 of the *C.B.C.A.* was amended by Bill S-11, *An Act to Amend the Canada Business Corporations Act and the Canada Cooperative Act and to Amend other Acts*, (Royal Assent given 14 June 2001.) The 2001 amendment to the pre-incorporation provisions removes a gap in the wording of the provision by adding the wording “purports to enter into a written contract.” See *infra* text accompanying notes 29-34. Current section 14 of the *C.B.C.A.* (with Bill S-11 amendments in bold) reads:

14. (1) Subject to this section, a person who enters into, **or purports to enter into** a written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to its benefits thereof.

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt a written contract made before it came into existence in its name or on its behalf, and on such adoption

(a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and

(b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

(3) Subject to subsection (4), whether or not a written contract made before the coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order **respecting the nature and extent of the obligations and liability** under the contract of the corporation and the person who **entered into, or** purported to enter into, the contract in the name of or on behalf of the corporation. **On the** application the court may make any order it thinks fit.

(4) If expressly so provided in the written contract, a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof.

<sup>23</sup> *Ibid.* s.14(1).

<sup>24</sup> *Ibid.* s. 14(2).

<sup>25</sup> *Ibid.* s. 14(4).

party.<sup>26</sup> The *C.B.C.A.* provisions apply only to written contracts;<sup>27</sup> however, the *O.B.C.A.* provisions apply to both written and oral contracts.<sup>28</sup>

### 3. *A Disappointing Judicial Interpretation of the Statutory Provisions: Westcom Radio Group Ltd. v. MacIsaac*

The statutory provisions were intended to provide a complete set of default rules on pre-incorporation contracts. However, the *Westcom*<sup>29</sup> decision re-introduced unnecessary complexity into the determination of rights and liabilities in relation to pre-incorporation contracts. *Westcom* unsuccessfully attempted to address a contradiction in the statute concerning the term "contract".<sup>30</sup> At common law, courts have held that if the parties intended that only the corporation would be liable, then no contract can be formed because the corporation does not exist at the time of transacting.<sup>31</sup> A "contract" formed under such circumstances is a nullity at common law. On the other hand, the legislative pre-incorporation provisions seem to assume that a valid contract has been formed and that the only issue is who is liable under it. The statute may be read as saying that once a corporation adopts a pre-incorporation agreement,

<sup>26</sup> *Ibid.* s. 14(3).

<sup>27</sup> *Ibid.* s. 14(1).

<sup>28</sup> See *supra* note 1, s. 21 which states:

21(1) Except as provided in this section, a person who enters into an oral or written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to the benefits thereof.

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt an oral or written contract made before it came into existence in its name or on its behalf, and upon such adoption,

(a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and

(b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

(3) Except as provided in subsection (4), whether or not an oral or written contract made before the coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order fixing obligations under the contract as joint or joint and several or apportioning liability between the corporation and the person who purported to act in the name of or on behalf of the corporation, and, upon such application, the court may make any order it thinks fit.

(4) If expressly so provided in the oral or written contract referred to in subsection (1), a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof.

<sup>29</sup> *Supra* note 5.

<sup>30</sup> *Szecket*, *supra* note 6, and Bill S-11's amendments to the *C.B.C.A.* both clarify this ambiguity. See *supra* note 22, which states that section 14(1) applies to contracts purported to be entered into with a corporation prior to its incorporation.

<sup>31</sup> See Kelner, *supra* note 7 at 183 and *Wickberg v. Shatsky* (1969), 4 D.L.R. (3d) 540 (B.C.).

this action is sufficient to validate the contract retroactively. In cases where the company does not adopt the contract or where the corporation is never formed, it is more difficult to assume that a contract has been created which can then be thrust on the promoter. However, (in these instances), the most sensible way around the contradiction in the statute is likely to read the statute to mean that a contract is deemed to have been made between the promoter and the third party.

The Court in *Westcom* refused to embrace this sensible approach; instead, the Court created a two-step analysis. The analysis first requires an examination of whether there was a contract<sup>32</sup>; then, if a valid contract has been found, the statutory provisions are applied.<sup>33</sup> The Court reasoned on the basis of *Black* that one must look to the intention of the parties to determine if there was a valid contract.<sup>34</sup> If the parties intended that the promoter would be bound personally, then there is a valid contract and the statutory provisions can be applied. If there was no intention that the promoter would be personally bound, and the only intention was to contract with a non-existent company, then the contract is a nullity. Since there is no "contract" to begin with, the statutory pre-incorporation provisions cannot apply to fix liability on the promoter.

The *Westcom* analysis is odd, if not perplexing, because if a court finds an intention by the parties to bind the promoter personally, then the common law (following *Black*) would hold the promoter liable. This approach would render the statute meaningless, at least with respect to determining promoter's liability. The *Westcom* analysis has been criticized on this point, most severely by Professor Jacob Ziegel, who emphatically states that it "[makes] nonsense of the whole subsection and [deprives] it of all meaning."<sup>35</sup>

#### 4. *Szecket v. Huang*

Fortunately, the Ontario Court of Appeal's recent decision in *Szecket* has cleared up the confusion in the area of pre-incorporation contracts by stating that the two-stage analysis articulated in *Westcom* is "unnecessarily complex"<sup>36</sup> and that the statutory provisions were "enacted to replace the common law."<sup>37</sup> The case also provides guidance on exactly what is required to constitute a waiver of promoters' liability. However, the Court of Appeal in *Szecket* failed to address a fundamental conflict of laws issue: the Court did not indicate which jurisdiction's laws on pre-incorporation contracts should apply when a corporation does not come into existence.

<sup>32</sup> *Supra* note 5 at 597.

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.* at 593.

<sup>35</sup> J.S. Ziegel, "Promoter's Liability and Preincorporation Contracts: *Westcom Radio Group Ltd. v. MacIsaac*" (1990) 16 Can. Bus. L.J. 341 at 345.

<sup>36</sup> *Supra* note 6 at 411.

<sup>37</sup> *Ibid.*

(i) *The Facts*

Szecket and Geddo, the plaintiffs/respondents, developed a process for bonding metals, for which Szecket held three patents. In 1985, Huang, the defendant/appellant, approached Szecket and Geddo with an opportunity to develop their technology in Taiwan. Over the next three years, they discussed the proposed business venture. Szecket and Geddo flew to Taiwan with Huang to inspect the proposed facilities and to meet with the appellant's associates, who would be providing funds for the project.<sup>38</sup>

In 1988 a co-operation agreement was signed, and the parties began negotiating a formal technology license and assistance agreement. Huang and his associates rejected a draft agreement that contained a provision that they would personally guarantee payment to the respondents of the fees payable during the first three years of the agreement. The draft also included the words "Personally and on behalf of a company to be incorporated" below the signatures of Huang *et al.*<sup>39</sup> The final version of the formal licensing agreement, which was signed by Szecket, Geddo, Huang, and two of Huang's associates, did not contain the personal guarantee clause. Further, following Huang's signature on the last page of the agreement were the words "on behalf of a company to be incorporated" without the word "personally".<sup>40</sup>

The company was never incorporated and the contract was not performed upon. Szecket and Geddo, who had moved to Taiwan in the fall of 1988, returned to Canada in March 1989 to find employment. They commenced an action for breach of contract against Huang, Mien, and Lu, claiming that, as promoters, they were personally liable for the breach under section 21 of the *O.B.C.A.*<sup>41</sup> (The respondents subsequently abandoned their action against Mien and Lu because they were not able to locate and serve them with statements of claim).<sup>42</sup>

(ii) *The Trial Court's Decision*

Justice Conant of the Ontario Court (General Division) found Huang to be personally liable on the contract and ordered him to compensate Szecket and Geddo for damages suffered as a result of the breach.<sup>43</sup> Conant J. applied the test set out in *Westcom*<sup>44</sup> to the facts of the case before him, and thus based his

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<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.* at 403.

<sup>40</sup> *Ibid.* at 404.

<sup>41</sup> *Ibid.* at 406.

<sup>42</sup> *Ibid.*

<sup>43</sup> *Szecket v. Huang* [1995] Ont. G.D. No. 4324 (QL) at para. 56-64.

<sup>44</sup> *Supra* text accompanying notes 32 & 33.



holding on a combination of common law principles and section 21(1) of the *O.B.C.A.* On the basis of *Westcom*, Conant J. first considered “whether there is any evidence tending to demonstrate that the parties intended that Huang be personally liable for the obligations of [the company to be incorporated] to the Plaintiffs.”<sup>45</sup> He found that such evidence existed and that a valid contract was formed. Conant J. then proceeded to apply section 21 of the *O.B.C.A.*

### (iii) *The Decision of the Court of Appeal*

Huang appealed, *inter alia*, on the basis that the trial judge incorrectly applied section 21(1) of the *O.B.C.A.*, and that under section 21(4) of the *O.B.C.A.* he was not personally bound. Chief Justice McMurtry, Laskin J.A., and Borins J.A. heard the appeal. The Court held that the *Westcom* two-stage analysis was unnecessary<sup>46</sup> and that there had been no express waiver of liability under section 21(4)<sup>47</sup>.

#### (a) *Rejecting but not Overruling Westcom*

The Court of Appeal rejected the *Westcom* two-step analysis, stating:

*Westcom* was of no assistance to the trial judge in resolving the issue of Mr. Huang’s personal liability. There was no need for him to undertake the two stage analysis suggested by *Westcom* and first determine whether it was the intention of the parties to the pre-incorporation contract that Mr. Huang incur personal liability before determining the ultimate issue of his liability through the application of s. 21(1). This represented one of the problems arising from the common law of pre-incorporation contracts, which the legislature intended to remedy by the enactment of s. 21.<sup>48</sup>

The Court further stated:

[P]ersonal liability of the promoter is established by s. 21(1) and prevails unless either contracted out of pursuant to s. 21(4), or displaced by the adoption of the contract by the company subsequent to its incorporation pursuant to s. 21(2).<sup>49</sup>

However, the Court refused to overrule *Westcom*. In a classic case of judicial deference to precedent, the Court stated: “[W]e have not been asked to consider the correctness of the decision in *Westcom*, and, therefore, we decline to do so.”<sup>50</sup> Given that the Court did not overrule *Westcom* it was forced to

<sup>45</sup> *Supra* note 43 at para. 24.

<sup>46</sup> *Supra* note 6 at 411.

<sup>47</sup> *Ibid.* at 410.

<sup>48</sup> *Ibid.* at 411.

<sup>49</sup> *Ibid.*

<sup>50</sup> *Ibid.*

distinguish *Westcom* from *Szecket* on their facts. In *Westcom*, the promoter was purportedly contracting on behalf of an existing company that, in fact, did not exist. In contrast, the Court held that in *Szecket*, the parties knew that the corporation was not yet in existence.<sup>51</sup>

The Court's refusal to overrule *Westcom* is troublesome and raises at least two concerns. First, it may narrow the application of the holding in *Szecket* to cases with similar facts—that is cases where both parties know that the corporation is not in existence. A broad interpretation of *Szecket* would suggest that a promoter is liable on a pre-incorporation contract when the corporation is never formed or does not adopt the contract, regardless of the parties' state of mind. However, a narrower reading—although not desirable—may also be defensible.<sup>52</sup> On this narrow reading, in cases where the corporation does not come into existence, a promoter would be liable. In contrast, in cases where there is a mistaken belief by the promoter and/or the third party that the corporation is in existence, the *Westcom* two stage analysis would continue to be applicable.

The second difficulty arising from the refusal to overrule *Westcom* is that the *Szecket* decision leaves room for the intentions analysis to creep through the interpretive cracks of section 14 of the *C.B.C.A.* Despite rejecting the *Westcom* analysis, and despite distinguishing the facts of *Szecket* from *Westcom*, it appears that the Court nonetheless felt compelled to apply the *Westcom* intentions analysis. The Court stated: "all the evidence pointed to only one conclusion—that the respondents and Mr. Huang knew, and indeed, *intended*, that Mr. Huang and his associates were contracting on behalf of a company to be incorporated."<sup>53</sup> If one reads the phrase literally, it would suggest that Mr. Huang should not be liable because he was contracting on behalf of a non-existent corporation, and as such, any contract was a nullity. This result is different than the one arrived at by the Court.

For the reasons discussed in Part V above, the Court's rejection of the *Westcom* intentions analysis is commendable. This author hopes that courts will continue to adopt a broad reading of *Szecket*. *Szecket* provides a clear rule in an area of law that has been plagued with needless complexity; it provides certainty for transacting parties in an area of law in which so much in the past has turned on form; it allows for greater efficiency in the administration of justice, because courts are no longer required to find the intentions of the parties; and finally, the rule produces efficient outcomes.

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<sup>51</sup> *Ibid.*

<sup>52</sup> A narrower reading of the holding is suggested by the Court *ibid.* at 411: "where the company is not incorporated and the contract is not performed, liability for breach of the pre-incorporation contract depends on the application of s.21, which was enacted to replace the common law."

<sup>53</sup> *Ibid.* at 411 [emphasis added].

The policy issue that remains to be addressed in relation to pre-incorporation contracts is whether it is the promoter or the third party that ought to bear the risk of loss when a corporation is not formed or does not adopt a pre-incorporation contract. The promoter is almost always in the best position to determine if and when a corporation will come into existence. Even when parties mistakenly believe a corporation to be in existence, as in *Westcom*, it appears that the promoter, rather than the third party, ought to know the true nature of the ostensible corporation. Any other rule may also encourage promoters to enter into pre-incorporation contracts in haste and without reflection. An argument can be advanced, however, that where a third party is a sophisticated lender who has experience with pre-incorporation contracts, s/he should bear some of the risk of loss. Presumably, sophisticated lenders have the ability to confirm the corporation's existence or legitimacy, assess the probability of the corporation's adoption of the contract and protect themselves accordingly.

(b) *No Express Waiver of Liability*

After holding the promoter liable under section 21(4) of the *O.B.C.A.*, the Court held that Huang had not expressly disclaimed liability—and therefore did not meet the standard required by section 21(4)—because there was no express waiver of liability in the licensing agreement. The Court stated that section 21(4) is “clear and unambiguous. To limit the liability of a person who enters into a pre-incorporation contract, an express provision to that effect must be contained in the pre-incorporation contract.”<sup>54</sup>

The Court refused to consider the draft agreements and the removal of the personal guarantees by Huang; it stated that Huang ought to have expressly provided for an exemption from liability in the agreement. The Court stated:

Whatever may have been the result of the negotiations between the parties preceding the execution of the contract about the personal responsibility of Mr. Huang for the obligations of the company to be incorporated, the contract itself contained no express provision relieving Mr. Huang from personal liability under s. 21(1) if the company was not incorporated, or if it was incorporated, and failed to adopt the contract. Had he wished to avail himself of s. 21(4), Mr. Huang could have sought the consent of the respondents to include an appropriate provision in the agreement.<sup>55</sup>

While it may seem harsh, the Court's finding on this issue is sensible. There was no evidence of an express written disclaimer of liability in the formal licensing agreement to the effect that Huang would not be liable if the corporation did not come into existence or did not adopt the contract after coming into existence.

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<sup>54</sup> *Ibid.* at 410.

<sup>55</sup> *Ibid.*

There was also no evidence of an express oral disclaimer of such liability.

In his effort to avoid liability, the best argument that Huang could have presented is that the drafts of the agreement implied a disclaimer of liability by the promoters. However, even this argument is tenuous, because a personal guarantee is different in character from promoters' liability. A personal guarantee allows a third party to recover from the promoters and other individuals once the corporation begins to perform on the contract (that is, it assumes that a corporation has come into existence and that it has adopted the contract). In contrast, promoters' liability deals with situations in which the corporation does not come into existence or refuses to adopt the contract.

The removal of the personal guarantee, at most, suggests that the promoters were concerned about liability issues. Reasonable people may disagree as to whether the removal of the clause was sufficient to imply a disclaimer of promoters' liability, but certainly, the removal of the clauses cannot reasonably constitute evidence of an express waiver of liability.

A related point in the Court's analysis suggests that only an express written waiver will relieve a promoter from liability to a third party.<sup>56</sup> What if, in a future case, the waiver is express but orally made? Would section 21(4) of the *O.B.C.A.* relieve the promoter of liability? Given that the *O.B.C.A.* provisions on pre-incorporation contracts deal with both written and oral contracts, it seems odd that a waiver of promoter's liability must be in writing, even if a pre-incorporation contract is orally made. The better analysis would be that if the pre-incorporation contract is in writing, then the waiver must expressly be in writing, and that if the pre-incorporation contract is oral, then the waiver may be oral as well. It will, of course, be more difficult to establish an express oral waiver than an express written waiver, but the same difficulty applies when dealing with all oral contracts. In contrast to the *O.B.C.A.*, the *C.B.C.A.* deals only with written pre-incorporation contracts; it is therefore conceivable that a valid waiver of liability must be in writing to meet the standards of the *C.B.C.A.*

(c) *Which Jurisdiction's Laws Apply When a Corporation Does Not Come Into Existence?*

Unfortunately, the Court of Appeal in *Szecket* refused to resolve, let alone acknowledge, the issue of which jurisdiction's corporate law ought to apply to determine the rights and liabilities of the parties when the corporation does not come into existence. Both the trial court and the Court of Appeal applied the provisions of the *O.B.C.A.* without any discussion of why Ontario corporate law was the most appropriate legislation to apply. Constitutional matters aside,<sup>57</sup>

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<sup>56</sup> *Ibid.*

<sup>57</sup> For an extended discussion on constitutional matters see M.A. Maloney "Pre-Incorporation Transactions: A Statutory Solution?" (1985) 10 Can. Bus. L.J. 409.

why were the provisions of the *C.B.C.A.* not applied? Why not apply Delaware law? Why not the laws of Taiwan or China either? What was the basis for applying Ontario law?

The conflict of laws issue is important because the application of the law of pre-incorporation provisions from different jurisdictions may lead to dramatically different results. As mentioned above, Canada's federal statute applies only to written contracts,<sup>58</sup> certain provincial statutes apply to both oral and written contracts,<sup>59</sup> and other provincial statutes have no pre-incorporation provisions, so the common law rules would apply.

Scholars have suggested at least two approaches to deal with the issue of jurisdiction. Professor M.A. Maloney argues that one should apply the laws of the jurisdiction in which the promoter intended to incorporate.<sup>60</sup> Professor Ziegel, on the other hand, suggests that the law of the jurisdiction with the most connecting factors to the transaction and transacting parties ought to be applied.<sup>61</sup>

Unfortunately, neither court's decision discloses sufficient facts to indicate where Szecket intended to incorporate. Using the approach suggested by Professor Ziegel, it is difficult to explain why the *O.B.C.A.* was applied, since more of the connecting factors seemed to be with Taiwan. While the technology appears to have been developed in Ontario and the parties appear to be residents of Ontario, the production facilities were to be in Taiwan and the parties to be residing in Taiwan.

As a policy matter, one problem with the intentions test is that it may be an inefficient use of judicial resources to ascertain the promoter's subjective intention as to the jurisdiction of incorporation (assuming that the promoter had put his or her mind to it, at all). A conceptual problem with Ziegel's proposal is that a corporation can be incorporated in a jurisdiction with which it has no connecting factors, a phenomenon that we have seen in relation to the competition for corporate charters.<sup>62</sup> It is disappointing that the Court did not seize the opportunity to comment on and clarify this difficult issue.

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<sup>58</sup> *Supra* note 1, s. 14(1).

<sup>59</sup> See *supra* note 1, *O.B.C.A.*, s. 21(1) and *Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 12(2).

<sup>60</sup> *Supra* note 57 at 433. See also *supra* note 34 at 345.

<sup>61</sup> *Supra* note 35 at 346-47.

<sup>62</sup> For a discussion on competition for corporate charters, see generally R. Romano, *The Genius of American Corporate Law* (Washington D.C.: AEI Press, 1993); R.J. Daniels "Should Provinces Compete: The Case for a Competitive Corporate Law Market" (1991), 36 McGill L.J. 130; and J. MacIntosh & D. Cumming "The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law: A Second Look" (1996) Law-and-Economics-Working-Paper-Series-WPS-49.

### *Conclusion*

Pre-incorporation contracts are a necessity in the business world, but the law on pre-incorporation contracts has been continuously plagued with difficulties. The *Szecket* decision successfully resolves issues regarding promoters' liability by rejecting the *Westcom* intentions analysis and clarifying the requirements for waivers of liability; unfortunately, it leaves for another court the resolution of the pressing issue of which jurisdiction's laws apply when a corporation does not come into existence.