

Pre-Incorporation Contracts – Who Owns Them?

By Albert S. Frank, LL.B.

In January of 2002 the Court of Appeal for Ontario dealt with the law of pre-incorporation contracts under the ***Business Corporations Act***, R.S.O. 1990, c. B. 16, the "Act." Since the Act is similar to legislation in force federally and in various other provinces, this case is of general interest across Canada.

Act Replaces the Common Law

The case was ***1394918 Ontario Ltd. v. 1310210 Ontario Inc. et al.*** (2002), 57 O.R. (3d) 607 (C.A.). According to the Court in that case the rules for such contracts are set out not in the common law but rather in section 21 of the Act, which replaces the common law in this area. Section 21 reads:

- 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.

The Court said this section “is clearly directed at meeting the needs of a party who wishes, and has negotiated for, liability to be assumed by an as-yet-unincorporated corporation.”

Promoter’s Benefits and Burdens

Subsection 21(1) says a person who signs a contract for a yet-to-be incorporated corporation – a “promoter” – has both the benefits and the burdens of the contract unless a section 21 exception applies. The promoter would be able to sue the other side for a breach of the contract and would also be personally liable to be sued by the other side.

The exception would be subsection 21(4). Under 21(4), if the promoter enters into a contract on behalf of a corporation to be incorporated and that contract **expressly** provides that the promoter is not bound by the contract or entitled to the benefits of the contract, the promoter is not bound by the contract and is not entitled to the benefits of the contract. The promoter has neither the benefits nor the burdens.

Corporation’s Benefits and Burdens

Before the incorporation of the corporation, it does not exist so it has neither the benefits nor the burdens of the contract.

After the incorporation, the corporation may indicate that it intends to adopt a contract that was made in its name or on its behalf. The corporation would have both the benefits and the burdens.

This is retroactive. Once the corporation adopts the contract, it is as if the corporation had existed at the time the contract was made, and as if the corporation had been one of the parties making the contract. So the corporation could sue the other side for contractual breaches that took place before the corporation was even incorporated.

Effect of Repudiation

In the above case the other side repudiated the contract, and the promoter's lawyer advised that the promoter accepted the repudiation and intended to sue for damages. The Court rejected the argument that because the contract no longer existed the corporation could not sue. The obligation to pay damages had accrued and the corporation could sue for those damages.

Method of Adoption

The Court said that the promoter himself had no rights under the contract, so he could not assign it to the corporation. This was not a problem for the corporation, however, because when it sued on the contract that was an indication that it intended to adopt the contract.

Timing of Adoption

Note that the corporation must adopt "within a reasonable time after it comes into existence" rather than within a reasonable time after the agreement is made.

#

The above article originally appeared in the July, 2002 issue of ***The Bottom Line***.

#

*Albert S. Frank is a business trial lawyer
(commercial litigator).*

E-mail: afrank@FrankLaw.ca

Web: www.FrankLaw.ca

Copyright © Albert S. Frank