

# Directors' Briefing

May 2017  
Number 67

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## ADVISORY COMMITTEES

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### Introduction

An advisory committee is a tool available to a corporation's board of directors. It will consult with Management and the board in order to provide input and guidance. Advisory committees will make recommendations to the board of directors or Management of the corporation based on processes set out in its Charter. The recommendations are not binding, but can provide the strategic direction a corporation may need in making business decisions.

A corporation may consider appointing business persons or professionals with specialized expertise to serve on an advisory committee.

### The Advisory Committee's Charter

#### *Purpose*

The advisory committee's Charter should outline its purpose and make it clear that the recommendations made will not be binding. As set out below, this will help insulate members from potential liability.

#### *Composition, Term and Compensation*

The Charter will prescribe the number of members that will sit on the committee, how they will be appointed, and how resignations will be dealt with. Any compensation paid to board members will also be set out.

#### *Matters*

The matters to be considered by the committee are listed in its Charter.

#### *Meetings*

The method of calling meetings will also be included in the Charter. Important items such as the details and time for notice, election of Chairman, and quorum will be laid out in the Charter.

<sup>1</sup> The writers wish to express their appreciation to Whitney Abrams, Student-at-law at Minden Gross LLP for her assistance in the preparation of this article.

## Avoiding Classification as a *De Facto* Director

Liabilities of directors is a real risk. Some individuals are prepared to serve as advisors but not as directors.<sup>2</sup>

The primary distinction between advisory committee members and directors is potential liability. An advisor does not face the same risk of liabilities as a board member. However, a conscious effort must be made to clearly distinguish between advisory committee members and directors to achieve that goal. Otherwise, an advisor may risk classification as a *de facto* director.<sup>3</sup>

In order to be classified as a *de facto* director, the advisor must have assumed the status and functions of a director and exercised real influence in the corporate governance of the corporation.

In the English case of *Re Hydrodam (Corby) Ltd.*, [1994] 2 BCLC 180, Millet J set out the definition of a *de facto* director as follows:

"A *de facto* director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a *de facto* director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director."

In another English case, *Elsworth Ethanol v. Ensus*, [2014] EWHC 99, the Court confirmed that there is no single test for *de facto* directors, but listed some non-exhaustive factors that should be considered in order to make such a determination.

Directorship, the court says, should not be inferred unless the evidence is clear that the individual had assumed such a role.

If a situation arises where an advisor is in fact found to be a *de facto* director, he or she will be jointly and severally liable with the other directors for any liability that arose while he or she acted in such role.

## Protection of the Corporation

Advisory committee members are not fiduciaries of the corporation that they provide advice for. This requires corporations to take various measures to ensure that the corporation is adequately protected.

### ***Confidentiality of Advisors***

Confidentiality requirements that apply to directors do not apply to advisors. In that sense, it is of the utmost importance to ensure that confidentiality agreements are entered into.

### ***Conflicts of Interest***

Similarly, it is important that members of advisory committees have a requirement to disclose their involvement in any competing businesses or projects in the industry. It is also important to ensure that the involvement of the advisor in your corporation does not present any conflicts or previous commitments they may have made. Requirements of disclosure of conflicts and/or implementing a non-compete agreement may well provide much needed protection for the corporation.

### ***Mandate of the Advisory Committee***

Should an advisory committee be created, best practices are to prepare a mandate that clearly sets out and separates the role of the advisory committee from the board of directors.

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<sup>2</sup> See Barry J. Reiter: *Directors' Duties in Canada*, 6th edition LexisNexis (2016) at 381.

<sup>3</sup> In England and Australia, the term "shadow director" is used interchangeably with "*de facto* director".

## Conclusion—What's in a Name?

Members of an advisory committee can hopefully avoid potential liability. If properly structured so that the members are not found to be *de facto* directors, it is recommended that such committees be called "advisory committees" rather than the often-used "advisory boards."<sup>4</sup>

## LEGISLATIVE UPDATE

### Ontario

#### Private Member's Bill Would Amend *Business Corporations Act*

On March 7, 2017, Harinder S. Takhar, the Liberal MPP for Mississauga-Erindale, introduced and moved first reading of Bill 101, the *Enhancing Shareholder Rights Act, 2017*. The motion carried.

Mr. Takhar stated, "This bill makes various amendments to the *Business Corporations Act* with respect to meetings of shareholders, the process of electing directors and the use of proxies. In addition, this bill requires certain corporations to place before the shareholders, at every annual meeting, information respecting diversity among directors and members of senior management. This bill also makes an amendment to provide shareholders with the opportunity to propose an executive compensation policy."

The bill's provisions include the following:

- reduces the threshold of aggregate shareholdings for shareholder proposals for the nomination of directors from 5% to 3%;
- reduces the threshold of aggregate shareholdings for shareholders to requisition a meeting of shareholders from 5% to 3%;
- provides that every form of proxy shall provide a means to specify that the shares shall be voted for or against the election of any director and shall include the names of director nominees included under a shareholder proposal;
- provides that a person may be elected as a director only if a majority of votes cast are in favour of his or her election;
- provides that a separate vote of shareholders shall be taken with respect to each candidate nominated for director;
- requires the directors of a prescribed corporation to place before shareholders, at every annual meeting, prescribed information respecting diversity among the directors and members of senior management; and
- enables shareholders to make a proposal to adopt an executive compensation policy with respect to the remuneration of directors or officers.

## RECENT CASES

### Failure to Observe Corporate Formalities Not Oppressive

Supreme Court of Canada, November 18, 2016

Mennillo and Rosati incorporated Intramodal Inc. ("Intramodal"), a transportation company, with Mennillo contributing money to the business and Rosati contributing his skills. Both Mennillo and Rosati became directors, with 51% of the shares issued to Rosati and 49% to Mennillo. Thereafter, the formal requirements of the *Canada Business Corporations*

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<sup>4</sup> Nathan, H. R. and Goldfarb, C. S., *Nathan's Company Meetings For Share Capital and Non-Share Capital Corporations, 11th Edition* LexisNexis (2016) at 46.

Act (the "Act") were not observed and almost nothing was put down in writing. In particular, there was no written contract or any other legal formality relating to Mennillo's significant advances of money for use in the business. On May 25, 2005 Mennillo sent a letter to Intramodal indicating that he was resigning as an officer and director of the corporation. On July 18, 2005 Intramodal's lawyer filed an amending declaration indicating that Mennillo had been removed as a director and shareholder of the corporation. Mennillo continued to advance money to Intramodal. Mennillo subsequently demanded a share of Intramodal's profits but only received the money he had previously advanced. Mennillo brought an action against Intramodal, claiming a remedy for oppression pursuant to section 241 of the Act on the basis that Intramodal and Rosati had wrongfully stripped him of his status as a shareholder. In dismissing the proceedings, the trial judge found that Mennillo had agreed to remain a shareholder only as long as he guaranteed Intramodal's debts and that he no longer wished to do so as of May 25, 2005. The trial judge held that the failure to observe the statutory formalities necessary to complete the transfer of shares from Mennillo to Rosati resulted from an error or oversight on the part of Rosati's lawyer. The Court of Appeal affirmed the trial judge's decision. Mennillo appealed to the Supreme Court of Canada.

The appeal was dismissed. A trial judge's findings of fact were only reviewable on appeal if they constituted an error that was both palpable and overriding. The trial judge made no such error in this case. Accordingly, Mennillo's appeal had to be approached on the basis that, from May 25, 2005 onwards, he did not want to be a shareholder of Intramodal and did not want to be treated as a shareholder. Mennillo's oppression claim was groundless. He could have no reasonable expectation of being treated as a shareholder of Intramodal after May 25, 2005, for he no longer wished to be treated as such. The acts of Intramodal which Mennillo claimed to constitute oppression were in fact taken, albeit imperfectly, in accordance with his express wishes. The failure to observe corporate formalities in removing Mennillo as a shareholder in accordance with his express wishes could not be characterized as unfairly prejudicial.

*Mennillo v. Intramodal Inc.*

## **Oppression Not Established Where Directors of Respondent Corporation Failed to Disclose They Would Benefit Financially from Respondent's Purchase of Shares of Second Corporation and Approval of Majority of Minority Shareholders of Respondent Not Obtained**

British Columbia Supreme Court, December 8, 2016

The petitioners, Raging River Capital LP ("Raging River") and Davis, were shareholders of Taseko Mines Ltd. ("Taseko"). As a result of Taseko purchasing all of the shares of a publicly traded mining corporation, Curis Resources Ltd. ("Curis"), the petitioners instituted oppression proceedings against Taseko and certain directors of Taseko, alleging that Taseko failed to disclose that its own officers and directors would benefit financially as a result of the Curis transaction and also failed to obtain the approval of the majority of minority Taseko shareholders.

The petition was dismissed. As a preliminary matter, Raging River did not become a shareholder of Taseko until almost 15 months after the Curis transaction, so it could hardly have had any reasonable expectation concerning that transaction upon which to base its oppression claim. The expectation that Taseko's directors would disclose an interest in the Curis transaction potentially amounting to \$4.2 million in an \$85 million transaction, in the context of Taseko's financial position holding close to \$1 billion in assets, would be unreasonable because such an interest was not material. These oppression proceedings could be disposed of on the basis that neither petitioner showed a reasonable expectation that Taseko would conduct itself in a particular way. Moreover, there was still no evidence that the Curis transaction would have been opposed by Taseko's shareholders, including Davis, if a vote had been held. The fact that no such vote was held did not amount to oppressive or unfairly prejudicial conduct. There was no evidence establishing either that the decline in the value of Taseko's shares was attributable to the Curis transaction or that Taseko's directors had acted dishonestly. The application was not brought in a timely manner, since it was brought in March 2016, long after the occurrence of the allegedly oppressive conduct in September 2014 when Taseko's board recommended proceeding with the Curis transaction.

*Raging River Capital LP v. Taseko Mines Ltd.*

## **In Oppression Proceedings Respondents Who Removed Applicant as Director and Officer of Closely Held Family Corporation Ordered to Purchase Applicant's Shares**

Ontario Divisional Court, December 30, 2016

The respondent Juan Arturo ("Arturo") controlled the corporate respondents Xela Enterprises Ltd. ("Xela"), Tropic International Limited ("Tropic"), Fresh Quest, Inc. and 696096 Alberta Ltd. ("696096"). The applicant Margarita (Arturo's daughter) owned 44% of the shares in Tropic, in addition to shares in the other corporations. The respondent Juan (Arturo's son) also held shares in these corporations. Margarita's relationship with Arturo and Juan became strained over time. At a special meeting of Tropic, Margarita was removed as a director and officer of Tropic, but did not become aware of this until approximately one month later. In oppression proceedings instituted by Margarita, the application judge concluded that a trial was not necessary to determine the matter and ordered Arturo, Juan and Xela to jointly purchase Margarita's interest in Tropic for \$4.25 million. The respondents appealed.

The appeal was dismissed. Given the heightened level of fact specificity inherent in oppression remedy cases, considerable deference had to be paid to the application judge's determination that Margarita's application ought not to have been converted into an action with a trial. It was necessary to recognize a "culture shift" which entailed simplifying pretrial procedures and moving the emphasis away from the conventional trial in favour of proportional procedures tailored to the needs of the particular case. The application judge's decision not to order a trial was not undermined by any palpable or overriding error. He gave sufficient weight to the relevant factors, the conclusion which he reached was open to him, based on the facts, and that conclusion was consistent with the "cultural shift." Family circumstances and motivations affected the imposition of the oppression remedy in closely held family corporations, but only if those family differences affected the corporate interests in question. The application judge applied the law correctly and found that Margarita's alleged disloyalty in another action involving Xela had no bearing on the respondents' duties to her in her capacity as an officer and director of Tropic. Accordingly, he made no reviewable error in concluding that the respondents' conduct toward Margarita and Tropic (other than the conduct of 696096) amounted to oppressive conduct. The oppression remedy chosen by the application judge was appropriate, for to expect Margarita to remain as a minority shareholder in Tropic would invite further discord and corporate conflict in what was an already toxic atmosphere. The application judge correctly chose as between competing theories on three disparate issues when determining the fair market value of Margarita's shares and then used those findings as a basis for determining "fair value" while considering other relevant factors (such as Xela's offer to purchase). There was no error in this approach.

*Castillo v. Xela Enterprises Ltd.*

## **Corporate Officers and Directors Did Not Owe Duty to Protect Employee From Her Own Wrongdoing in Misappropriating Corporation's Funds**

Ontario Superior Court of Justice, July 15, 2016

The defendant Mardonet was employed by the plaintiff non-profit company to manage its affairs and finances. In proceedings instituted against Mardonet and others, the company alleged that she had abused her position and had misappropriated more than \$1.6 million. The other defendants were persons related to Mardonet, the company's auditor, Penner, its accounting firm, BDO Canada LLP ("BDO"), and its Executive Director, Dr. Service. In her statement of defence Mardonet denied all liability and cross-claimed against Penner, BDO, and Dr. Service for full indemnity if she were to be held liable in the principal proceedings, alleging that these three defendants breached their duty of care and their fiduciary duty to her by failing to provide her with the supervision, management, support and guidance that was part of their responsibility. In a counterclaim against the company and officers and directors of the company, Mardonet made a claim for wrongful dismissal, and made the same claim against the officers and directors for "indemnity and contribution" as the one made in her cross-claim arising from the collective failure of these individuals to supervise her through their individual responsibilities as officers, and their involvement with the Board of Directors, its committees and the company's accountants. The defendants by counterclaim moved for an order striking out those paragraphs in Mardonet's statement of defence and counterclaim claiming for indemnity and contribution. These paragraphs reflected the idea that each of the defendants by counterclaim owed either or both a duty of care and a fiduciary duty to Mardonet.

The motion was granted and the offending paragraphs were struck out. The officers and directors of the company did not owe Mardonet a duty to protect her from her own wrongdoing and failings. Both the Ontario *Business Corporations Act* and the *Canada Business Corporations Act* described the duties and responsibilities of corporate directors and officers using the same words, whereby there was a fiduciary duty relating to the corporation itself, without mentioning third parties such as employees. It was not reasonable to suggest that the duty of loyalty owed to a corporation by its directors and officers could extend to a duty to an employee, such that the loyalty to the employee would override the duty owed to the corporation. It was not possible that a director carrying out his or her duties as a director could have a duty to an employee who through fraud, deceit, conspiracy, negligence or negligent misrepresentation, breach of contract or breach of trust harmed and damaged the corporation such that he or she became responsible for the wrongdoing and failures of the employee.

*Ontario Psychological Association v. Mardonet*

## **Applicant Not Entitled to Requisition Shareholders' Meeting Where Primary Purpose of Requisition was to Redress Personal Grievance**

Ontario Superior Court of Justice, November 28, 2016

The applicant held 42% of the outstanding shares of Ellipsiz Communications Ltd. ("ECL"), whose principal asset was a wholly-owned Taiwanese operating subsidiary. Following a reverse takeover, ECL became a publicly traded corporation. At ECL's first annual and general shareholders' meeting as a public corporation, a slate of directors was elected, including the applicant and three Canadian directors. The applicant later demanded that the Canadian directors resign, but they refused to do so. The applicant formally submitted a requisition, seeking a shareholders' meeting pursuant to subsection 105(1) of the Ontario *Business Corporations Act* (the "OBCA"). The requisition proposed that a shareholders' meeting be convened to consider two resolutions, one to remove the Canadian directors, the second to elect three new directors. ECL's Board of Directors (the "Board") declined the requisition on the basis it was for the primary purpose of redressing a personal grievance of the applicant against ECL or its directors, including the applicant's grievance that he wanted to be the chairman of ECL. The applicant purported to exercise his right to call a meeting of shareholders under subsection 105(4) of the OBCA and applied for a declaration that he had validly requisitioned a shareholders' meeting.

The application was dismissed. Paragraphs 99(5)(b) and 105(3)(c) of the OBCA provided that the Board must call the requisitioned meeting unless it was "clearly apparent" that the business proposed by the applicant (the removal and election of directors) was proposed for the primary purpose of redressing a "personal grievance". A "personal grievance" involved a dispute that did not entail an issue of corporate policy or operations, but, rather, involved an issue primarily pertaining to the personal interest of the complainant. Relevant considerations could include the extent to which the dispute was properly the subject of a shareholders' meeting or lay within the domain of directors and the extent to which the complainant acted alone or with the support of other like-minded individuals. It was clearly apparent that the applicant's primary purpose in requisitioning the meeting was to redress a personal grievance against ECL and the Canadian directors. There was no evidence before the Court that the Board had functioned in a dysfunctional manner nor that any directors had engaged in clandestine activity. Nor was there any evidence of complaints from any shareholders other than the applicant. There was no issue of corporate policy or operations in dispute. On the applicant's own testimony, this issue involved a question of respect for him personally. The matters in dispute demonstrated that the applicant's position reflected his own personal interests rather than any larger sense of the best interests of ECL. Accordingly, the applicant was not entitled to a declaration that the proposed meeting was validly called pursuant to subsection 105(4) of the OBCA and there was no basis for the applicant's alternative request that a meeting of ECL's shareholders be ordered by the Court pursuant to subsection 106(1) of the OBCA.

*Koh v. Ellipsiz Communications Ltd.*

**DIRECTORS' BRIEFING**

Published three times annually as the newsletter complement to the *Directors Manual* by LexisNexis Canada Inc. For subscription information, contact your Account Manager or call 1-800-387-0899.

*For LexisNexis Canada Inc.*

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