THE DIRECTORS COLLEGE

MARCH 22, 2013

CONTENTIOUS ISSUES AT DIRECTORS' MEETINGS

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CONTENTIOUS ISSUES AT DIRECTORS' MEETINGS

By: HARTLEY R. NATHAN, Q.C.*

INTRODUCTION

I LEARNED THAT: IN 1990 I WAS APPROACHED BY CARSWELL TO WRITE A BOOK ON LAW OF CORPORATE MEETINGS. AT THAT TIME I WAS SECRETARY OF 3 COMPANIES IN THE COMMUNICATION INDUSTRY. I SAW HOW GOOD BOARDS OPERATED AND FRACTIONS ONES. THIS PAPER IS A LITTLE FORMALISTIC, BUT I WILL TRY TO DEAL WITH THE HEADINGS AND LET YOU READ THE TEXT AT YOUR LEISURE. I AM HAPPY TO ANSWER ANY QUESTIONS AT THE END.

A unexpected issues can arise at board meetings that may leave directors in search for the answers and direction as to the manner in which to deal with them. The key to resolving these issues is to try and anticipate some common problems that may arise and plan for them accordingly.

Certain formal requirements relating to board meetings are common to private companies and to public companies. Particular attention to procedure is appropriate where the matters to be dealt with at a meeting are expected to be contentious.

The following are some contentious issues that directors may be faced with in their roles. It is important to give adequate attention to these issues and keep in mind that many of these carry with them potentially significant liability for the directors if they are not properly dealt with.

The writer is a senior partner in Minden Gross LLP. He wishes to thank Ira Stuchberry, articling student, for her assistance in connection with the preparation of this paper.

I. CALLING OF MEETINGS

Notice of the time and place of a meeting of the board of directors must be given to all directors, otherwise the business transacted thereat is invalid.

Most by-laws allow notice to be sent by facsimile and by e-mail. If the corporation is old, the by-laws may not provide for this process.

There is also nothing in the *Ontario Business Corporations Act* ("OBCA") *or Canada Business Corporations Act* ("CBCA") that requires a notice to be signed.

If one is preparing a notice of a meeting of directors or if one is a dissenting director it is essential to review the by-laws to determine whether any matters must be specified in the notice. A meeting may be invalidated if the notice fails to comply with the by-law.

It is imperative that there be no surprises at a meeting.

The desirable practice is that an agenda should be circulated along with the notice to advise directors of the matters to be dealt with at the meeting.

II. ATTENDANCE AT MEETINGS

1. Who is entitled to attend?

Meetings of the board of directors may be attended only by the directors of the corporation. Other persons may be admitted with the consen t of the chair of the meeting. This is however subject to the provisions of the by-laws of the corporations, which can provide that other individuals may attend, such as an executive director. Directors and officers are under a duty of confidentiality which others such as the media or special guests are not. I will talk about confidentiality later under "FIDUCIARY DUTIES."

2. Director's right to attend

Every director has the right to attend and participate in all meetings of the board of directors. As such, a director cannot be excluded from meetings of the board.[1]

It is however important to note that, although directors may miss board meetings, they would be wise to attend as many meetings as possible since they may be held liable for decisions that are made in their absence. An absent director has to dissent within seven days of receiving minutes of a meeting or he or she will be deemed to have approved the matter.

This right to participate in management and attend board meetings is not qualified. It is not open to a corporation to exclude any director from a board meeting on the basis that the director is unfit, has allegedly engaged in misconduct or also sits on the board of a competitor, subject only to the conflict rules of the corporate statutes.

3. No attendance by proxy

What if a director cannot attend a meeting or be able to phone in, can he or she send a proxy?

TALK ABOUT RATIFYING BY MEETING

The law is settled on the issue that a director cannot attend a meeting by proxy.[2] This is largely due to the fact that the directors cannot delegate their duties to a third party. This extends to resolutions in writing which cannot be signed by power of attorney.

[1] *Hayes v. Bristol Plant Hire Ltd.*, [1957] 1 All ER 685 (Ch D).
[2] See *David Greenberg v Harrison* (1956), 124 Atl. Rep (2nd) 216 (Conn) and *McGuire & Forester Ltd. V. Cadzow*, [1933] 1 D.L.R 192 (Alta CA).

4. *In Camera* Meetings

Where there are sensitive issues, directors often hold what are called *in camera* meetings where only a certain number of directors, which may or may not constitute a quorum attend. A recent situation I had to deal with was an unpopular president of a minor hockey league. Issues had arisen and it was alleged the president had breached the league's Code of Conduct. The president had two supporters on the board. A meeting was held without them and the president. A decision was made to suspend the president as a member, thus disqualifying him as president. Apart from the issue of lack of natural justice. I advised that the in camera decision made had no legal effect at law.

In camera sessions are meetings where the independent directors might have an opportunity to meet without management present. Often the *in camera* sessions will consist of a series of meetings between the independent directors and key stakeholders such as the CEO, internal and external auditors, the chief risk officer, etc. This provides the independent directors an opportunity to meet with these individuals privately and to have a candid discussion about the affairs of the company without other parties being present.

5. Quorum Issues

A quorum must be maintained throughout the meeting or the business conducted would not be lawfully transacted. In the case of *Mega Blow Moulding Ltd. v Sarantos*[3], the court addressed the validity of a resolution passed where the quorum was not achieved at a board meeting. In reaching their decision, the court referred to section 114(2) of the CBCA, which reads as follows:

> Subject to the articles or by-laws, a majority of the number of directors or minimum number of directors required by the articles constitutes a quorum at any meeting of directors, and, notwithstanding any vacancy among the

[3] (2001) 16 B.L.R. (3d) 52 (Ont S.C.J.).

> directors, a quorum of directors may exercise all the powers of the directors.

The court found that the meeting of the directors did not comply with the quorum requirements and therefore ruled that the resolution passed at the meeting was invalid.

6. Refusal to attend

What if a director(s) refuses to attend a meeting and thus prevents the formation of a quorum?

A court will not easily issue a mandatory injunction to compel attendance by directors. In a Delaware case,[4] a shareholder sought a mandatory injunction to compel individual directors to attend directors' meetings. The argument made was that they were unlawfully attempting to prevent the board from exercising its duties by ensuring that no quorum could be obtained. The court held that the directors' action was not such a breach of fiduciary duty as to require an injunction.

Another court has stated:

> There is no legal process by which a director of a private business corporation can be forced to attend a meeting, and he cannot lawfully be compelled by physical force to attend, nor can he be trapped into attendance against his will.[5]

In Canada, when directors refuse to attend meetings and thereby frustrate a quorum, the available remedies are limited. These may include:

a) A special meeting of shareholders could be convened to remove the "dissident" directors by an ordinary resolution and to

[4] *Campbell v. Lowe's Inc*., (1957), 134 A. 2d 852 (Del.Ch.).
[5] *Trendley v. Illinois Traction Co*. (1912), 145 S.W. 1, at 6-7 (Mo.Sup.Ct.).

replace them with more compatible ones. Without a quorum, however, the board cannot call a shareholders' meeting.

b) In the appropriate case, the shareholders may have to requisition a meeting of shareholders under section 109 of the CBCA or section 122 of the OBCA. This is the process by which activists with the requisite percentage of shares can force a meeting of shareholders to remove directors and replace them with their nominees.

c) Where appropriate, proceedings might be brought by the corporation claiming damages occasioned by the director's absence and any resultant breach of fiduciary duty.[6]

d) Provide in the by-laws that if a person fails to attend two (or whatever is the appropriate number of) board meetings within a specified period, he or she will be deemed to have resigned and the vacancy may be filled.

e) Provide in the by-laws that if a quorum is not constituted by the absence of a director, the second meeting can be called and can proceed with the balance of the directors in attendance constituting a quorum.

f) Request the director to resign.

[6] *Gearing v. Kelly* (1962), 182 N.E. 2d 391 (N.Y. Ct. App.) and see Comment on *Bearing v. Kelly* in (1962) 62 Col. L. Rev. 1518).

III. CONDUCT OF MEETINGS

1. Appointment of the Chair

Most by-laws provide that the Chair of the board, if present and willing, shall preside at meetings of the board. In the absence or refusal of the Chair to preside, or to continue presiding, the president shall preside, unless the constitution provides otherwise. If no such provision exists, a remaining quorum of the board **may** elect a new Chair from among the directors.[7]

If the by-laws are silent as to who is to serve as the Chair and the Chair is appointed by the directors present at the meeting, that individual can be replaced by the directors present at the meeting. If the by-law provides who is to chair, a resolution cannot be passed to remove that person and appoint another as Chair.

2. Duties of the Chair

It is not possible to give a full dissertation on the duties of the Chair.

Most importantly:

a) The Chair is expected to preserve order, conduct proceedings regularly, and ascertain the sense of the meeting with regard to any question before it.

b) As the presiding officer of the board, the Chair is authorized to decide in the first instance on questions arising at the meeting. The Chair has the power to disallow certain comments as well as to disallow certain votes.

[7] *Klein v. James* (1986), 36 B.L.R. 42 (B.C.S.C.) affirmed (1987), 37 B.L.R. (XXV1) (B.C.C.A.).

c) In short, the Chair has the duty to settle points of contention even if it means using his or her second or casting vote where authorized to do so.[8]

d) The Chair can also vouch for the correctness of the minutes by signing them.

3. Chair must act fairly

A Court may set aside a meeting for the failure of a Chair to preside at the meeting in a proper manner and allow questions to be put or to allow questions to be answered, if the conduct was such as to affect the outcome of the meeting itself. [9] In *Portnoy v Cryo-Cell International, Inc. et al.*[10] the Chair kept the polls open for voting for an inordinate period of time and had numerous management reports delivered while trolling for votes to keep management directors from being voted out. The Court ordered a new meeting at management's cost.

IV. PROCEDURAL ISSUES

1. Right to be heard

Vocal participation and support are essential for an effective board meeting – up to a point. Directors should be pro-active and are expected to contribute, but within limits. This means they should not raise more than their fair and reasonable quota of questions.

OHBPA DIRECTOR

Even though the majority directors can normally bind the minority directors on any vote,

[8] See *Nathan and Voore Law of Corporate Meetings* in *Canada* (Toronto, Carswell) at 2-7.
[9] See *Re: Canadian Pacific Ltd.* (1997), 30 B.L.R. (2d) 297 (Ont. Ct. Gen. Div.).
[10] (2008), 940 A 2d 43 (Del. Ch.).

the minority have a right to be heard at any meeting of directors.[11] In one New Zealand case[12], the majority directors resolved to exclude the minority directors from deliberations on a takeover offer because the latter were also directors of the offeror corporation. The court granted an injunction restraining the company from excluding them. Heron J. said:

> The right to attend board meetings and to participate in the affairs of the company is a right which is implicit in the duties and responsibilities of a director, and on the basis that without those rights their obligations cannot be properly discharged.

2. Conflict situations

In both the CBCA and the OBCA directors must disclose their interest at the meeting of directors and must also refrain from voting on any contract in which they may have an interest.

In Mayor Rob Ford's case it was held that the "interest" had to be a pecuniary one which is the law under the OBCA and the CBCA, but there are grey areas.

There can arise situations where two directors refrain from voting on their own contracts, however they vote in favour of each other's contracts, being a "you scratch my back, I'll scratch yours" transaction. The courts frown on such agreements and will likely declare both contracts void.[13]

In addition to this, the OBCA provides that a director cannot attend any part of a board meeting where the contract in which he or she has an interest is being discussed.[14] This provision is stricter than that of the CBCA, which only provides that the director may not vote on the contract. CBCA by-laws could be expanded to provide as the OBCA does.

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[11] *Great Western Railway Co. v. Rushout* (1852), 5 De G. & Sm. 290, 64 E.R. 11221 (Ch. D.).
[12] *Trounce v. NCF Kaiapoi Ltd.* (1985), 2 N.Z.C.L.C. 99,422 (H.C.N.Z.) See also *Cameron v. Campney & Murphy* (1993) 85 B.C.L.R. (2d) 293 (B.C.S.C.).
[13] See *Re North Eastern Insurance Co.*, [1919] 1 Ch 198.
[14] OBCA at s. 132(5).

3. Business Judgment Rule

Directors are elected by shareholders with the assurance they will discharge their duties with care and loyalty.

US CASES WHERE RUBBERSTAMPED BAD DEALS

In fulfilling their duties, boards must spend an adequate time considering the decisions before them, as the courts may scrutinize whether the decisions were given appropriate contemplation. The courts will not second guess a board decision of the directors made honestly, prudently, in good faith and on reasonable grounds. The court will not look at whether the decision made by the board was the perfect decision, but rather, whether the decision made was reasonable in the circumstances.

It is therefore the directors' responsibility to ensure that the decisions they make are informed decisions. The directors must ensure they obtain the necessary information on a timely basis in order for them to make the decisions and have adequate time to seek clarifications.

V. VOTING RIGHTS

1. Secret ballots

There are no provisions in corporate statutes as to how votes are to be conducted at directors' meetings. Generally, voting is carried out by show of hands and each director has one vote.

A matter before the board may be a sensitive or contentious one. There is a question of whether there can be a secret ballot at a meeting of directors, so directors would not be aware of how other directors have voted. Only the Chair who counts the ballots would know, assuming directors' names were on the ballots.

TENCHER SITUATION

The call for a secret ballot is within the discretion of the Chair, but a secret ballot could give rise to problems. How does one dissent in a secret ballot so that the dissent can be reflected in the minutes of the meeting?[15] A person who has dissented could insist that his or her dissent be recorded in the minutes.

2. Dissent rights

Provision is made in corporate statutes allowing directors to register their objections to certain corporate proceedings in the minutes.[16] If a dissent is recorded, a director who makes this disclosure may be exonerated from liability for certain corporate proceedings such as improper declaration of dividends. The filing of a statutory dissent may also have a psychological effect on other directors, who may feel that if at least one director considers the proposed conduct questionable, they should perhaps reconsider the proposed action.

A director who wishes to dissent at a meeting should request at the meeting that the secretary have the minutes show the opposition to the resolutions and the reasons therefore if they are specified. The director may also wish to follow this statement with a letter to the secretary confirming the director's intention to dissent.

A director who was not present at a meeting is deemed to have approval of a board resolution unless he or she objects in writing within seven days of when he or she becomes aware of it (s.127 CBCA and s.123 OBCA).

3. Casting vote

This can be confrontational.

[15] For example, shareholders may decide to sue directors for breach of their fiduciary duties.
[16] OBCA at s. 135 and CBCA at s. 123.

At common law, the Chair did not have a second or casting vote[17] if directors were equally divided on a question. There is no provision for same in either of the CBCA or the OBCA. If the Chair is to have a casting vote, it is to be provided for in the by-laws. If there is provision for the Chair to have a casting vote it is meant to be used to remedy occasional tie votes[18], not to deal with a continuous and settled deadlock condition.[19] A Chair must act in good faith in casting a tie-breaking vote. There are several cases where the exercise of a casting vote was an issue. Many are fact driven.

If it is intended that consensus be achieved amongst the directors, the occurrence of a tie vote shows that consensus has not been achieved. Those who are of the consensus view would argue that the Chair should not have a casting vote or exercise a casting vote in order to break a deadlock in this situation.

A Chair is however not required to use the casting vote. The Chair may abstain from voting on an issue like any other director.

MANY PRACTITIONERS SIMPLY USE A STANDARD FORM BY-LAW WITHOUT CHECKING THIS POINT

VI. MINUTES AND NOTES

1. Corporate requirement to keep minutes

Both the CBCA and the OBCA set out the requirements for keeping minute books.

[17] *Nell v. Longbottom*, [1894] 1 Q.B. 767 (Q.B.D.).
[18] Re: *Citizen's Coal v. Forwarding Co.*, [1927] 4 D.L.R. 275 (Ont. Co. Ct.).
[19] Re: *Daniels and Fielder* (1988), 65 O.R. (2d) 629 (Ont. H.C.).

Corporations are required to prepare and maintain records containing minutes of meetings and resolutions of directors. The minutes may be kept in a bound or loose-leaf book, or electronically. The corporation must take reasonable steps to prevent the loss or destruction, or the falsification, of the minute books.

Minute books are also admissible in court as proof of all the facts contained within in the absence of any evidence to the contrary and as per recent amendments under the CBCA, shareholders may review minutes of meetings where a director has declared a conflict of interest.[20]

2. Accuracy of Minutes

CUC SITUATION

A recent ruling in the James Hardie Industries Limited ("JHIL") appeals handed down by the High Court of Australia has brought to the forefront the importance of maintaining accurate minutes of meetings of the board of directors.[21]

In this case, the board of JHIL approved a separation proposal which included the creation of a fund to compensate claimants in respect of asbestos related liabilities. This proposal was announced to the Australian Stock Exchange in a form that was later found to be misleading.

The draft announcement was distributed to the directors present at the board meeting prior to its release. There were significant errors in the minutes of the meeting, not only in relation to the order in which certain events took place, but also in the recording of certain recommendations made to the board. The directors argued that the minutes were drafted before the meeting actually took place.

[20] CBCA at s. 120(6.1).
[21] *ASIC v Hellicar & Ors,* [2012] HCA 17; *Shafron v ASIC,* [2012] HCA 18. ["James Hardie Cases"]

Although the directors claimed that the minutes of the meetings were not accurate, the High Court concluded that the directors had approved the release of the announcement to the public and therefore had breached their duties.

These cases exemplify the importance of maintaining accurate minutes of meetings of the board, as it may not be possible to claim that an event occurred or a resolution was actually approved at a meeting if the minutes are inaccurately drafted.

Some considerations that directors should keep in mind at all times are the following:

- Prior to their approval, minutes should be critically and carefully reviewed by directors;
- The bases of directors' decisions at board meetings on crucial matters should be understood and noted in the minutes;
- Management should be clear as to whether it is providing documents for information where no immediate action is required or seeking the directors' approval on a particular matter;
- The materials provided to the directors before and at the meeting should be carefully reviewed and included as attachments to the minutes;

Therefore, it is important that directors take into consideration the points outlined above and adhere to them at board meetings.

3. Signing of Minutes

Normally the minutes of directors' meetings are signed by both the Chair and secretary of a meeting. There does not appear to be any legal requirement to approve minutes of a meeting at a subsequent one nor does there appear to be any obligation to have minutes

signed to be valid. In one case, the court stated that the signatures of the chair and the secretary would strengthen the evidence in the sense that at least two persons who attended the meeting would be concurring on what took place. If minutes are signed, the person signing may not afterwards be able to claim an error was made.

4. Notes of Meetings

There are also two views of whether directors should maintain their notes of the meeting after satisfying themselves the minutes reflect what transpired at the meeting - that is, whether to maintain them or destroy them. Here is what one writer stated:

> Notes can be a double-edged sword. It is often prudent for there to be only one record of the deliberations of the board of directors - the minutes which are approved by the board and inserted with the company's corporate records. It may create problems if the official record is subsequently challenged by conflicting notes kept by individual directors. Accordingly, the company's corporate secretary will often suggest that directors keep their own notes, if they wish, until the minutes have been approved and then destroy them.

My advice is that it is a good practice to put into place a policy or guideline on managing notes and working files relating to meetings that is clear on the destruction of notes of meetings.

WERNER DAHNZ

VII. RESIGNATION OF DIRECTORS

1. Resignation by a Director

If a director does not agree with a proposed course of action he or she should dissent. If matters get worse the ultimate step is to resign to avoid potential liability.

2. Revocation of a Resignation

What if the course of action changes for the better and the former director wishes to revoke his or her resignation? The courts have held that the purported revocation of a resignation must be approved by the board.[22]

VIII. FIDUCIARY DUTIES

1. Fiduciary Duty

It is of vital importance for corporations and in turn their directors to have the ability and responsibility to keep certain information confidential. The failure to keep certain information confidential can have drastic effects on the corporation and the individuals that breach the confidentiality. The following is a useful summary of the need for confidentiality:

> A director must keep confidential all matters involving the corporation that have not been disclosed to the public. Directors must be aware of the corporation's confidentiality, insider trading, and disclosure policies and comply with them. Although a public company director may receive inquiries from major shareholders, media, analysts, or friends to comment on sensitive issues, individual directors should avoid responding to such inquiries, particularly when confidential or market-sensitive information is involved. Instead, they should refer requests for information to the CEO or other designated spokesperson. **A director who improperly discloses non-public information to persons outside the corporation can, for example, harm the corporation's competitive position or damage investor relations** and, if the information is material, incur personal liability as a tipper of inside information or cause the corporation to violate federal securities laws. Equally important, unauthorized director disclosure of non-public information can damage the bond of trust between and among directors and management, discourage candid discussions, and jeopardize boardroom effectiveness and director collaboration.[23] (**my emphasis**)

[22] *Alama v. APEO* (2012), ONSC 3850 (Ont. Sup. Ct. Jus.).
[23] *Corporate Director's Guidebook* (sixth edition) (see (2011) 66 *The Business Lawyer* 977).

In addition, there have been several cases which have addressed the need for confidentiality. In the Nova Scotia Supreme Court case of *Cameron Seafoods (2005) Limited v. Jumelet et al.*[24], Mr. Justice MacAdam stated:

> …the fiduciary obligation of directors generally include, *inter alia*, duties to "act in the best interests of the corporation and, correspondingly, not to do anything that undermines or thwarts those best interests," to "maintain the confidentiality of information received or knowledge obtained through the fiduciary position, including a prohibition against making use of such confidential information for the director's or officer's personal benefit",…. and a duty "not to compete with the corporation, including a prohibition against appropriating its business opportunities and assets."

In the case of *SRM Global Master Fund Limited Partnership v. Hudbay Minerals Inc.*[25] Wilton-Siegel J. stated the following:

> The board of directors of a corporation is charged with the responsibility to manage the corporation. The directors must be able to conduct open and frank discussions if they are to discharge their responsibilities to the corporation and the shareholders. In the ordinary course, it is certainly arguable that, for this reason, disclosure of minutes of board meetings, and related notes of participants, would give rise to a serious risk to an important commercial interest.

2. Remedies

What action may be taken for a breach of fiduciary duty?

a) An injunction may be applied for to prevent the disclosure of confidential information or the fiduciary from taking certain action, for example, working for a competitor or misusing confidential information.

b) The agreement entered into by the fiduciary in breach of his duties could be set aside by a Court.

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[24] (2011) 208 ACWS (3rd) 287.

[25] [2009] OJ No, 797 (SCJ). The quote is from a textbook *McGuinness Canada Business Corporations Law* (2nd edition):

c) A claim may be brought against the fiduciary to account for any gain made as a result of the breach for example by diverting a business opportunity to his own business.

d) The fiduciary could be sued for the loss suffered as a result of his breach.

IX. CONCLUSION

The contentious issues discussed in this paper showcase the importance of staying informed as to the duties and responsibilities of a director. These roles are not to be taken lightly and in many cases can carry with them not just large amounts of responsibility, but also liability.

By staying informed and aware of your rights and responsibilities as directors, many of the issues that may arise at board meetings can either be avoided or easily remedied, without cost or negative effect to the corporation or the people involved.

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