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## Private Corporation Governance\*



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Private corporations sometimes do not strictly observe corporate law requirements regarding annual shareholders' proceedings and corporate governance. Non-compliance can be uneventful. However, changing shareholder relationships can highlight potential problems, as was illustrated by a recent case involving a family investment corporation.

*Melflor Investments Ltd. v. Naim Investments Ltd.*, 2013 ONSC 6538, is an oppression remedy case. Naim was founded by three first cousins: Gerald, Stanley, and Melvyn. Chaim, the family's long-time accountant and trusted adviser, was given 10 percent of the shares. It seems that the remaining 90 percent was owned in equal proportions by the three branches of the family represented by the three first cousins.

The first crack in family relations occurred after the death of Stanley's brother. The deceased brother's shares were purchased by a member of Gerald's family, rather than Stanley's. This purchase significantly changed the proportionate shareholdings: Gerald's family became a 45 percent shareholder, Melvyn's family held its 30 interest, and Stanley's family held only 15 percent.

It appears that the number of directors of Naim was fixed at seven. There were two representatives from each family plus Chaim, the non-family or independent person. When the shareholdings changed after the death of Stanley's brother, there was no change in the composition of the board of directors. In fact, no shareholders' annual meetings or directors' meetings were held after that time. When the subsequent deaths of Melvyn and his wife resulted in vacancies on the board of directors, no shareholders' meetings were held to address the matter. Finally, Chaim died, and only four directors remained (Gerald, Stanley, and their wives).



Three years later, Chaim's estate wanted to sell its shares and was introduced to a friend of Gerald's family. The friend offered to buy the 10 percent interest held by Chaim's estate. Stanley objected because he seemed to be of the view that the friend was under Gerald's influence and that such a sale would result in Gerald having control of Naim. Stanley and Gerald had agreed that neither of them would have control of the corporation, but there was no binding shareholders' agreement to this effect. The only restriction on the sale of shares was that a transfer of shares required the consent of the board of directors. However, the board consisted of only four members, and, although this was likely a quorum, the board was deadlocked between Gerald's family directors and Stanley's family directors.

In accordance with the procedures in the Ontario *Business Corporations Act* (OBCA), Gerald requisitioned an annual general shareholders' meeting to elect directors and address other matters. He then entered into a voting agreement with Chaim's estate, whereby Chaim's estate agreed to vote for the slate of directors put forward by Gerald. Such a voting agreement is permitted under the OBCA.

In combination, Gerald's family and Chaim's estate held over 50 percent of the shares of Naim, and, as a result, Gerald's nominees were elected as directors over Stanley's objections. The board of directors approved the transfer of shares by Chaim's estate to the purchaser.

Stanley claimed oppression. The court examined Stanley's reasonable expectations and expressly noted that there had been no attempt to regularize the board of directors over a 10-year period, notwithstanding a number of deaths. The court held that Stanley could not establish that he had a reasonable expectation either about family representation on the board or about the continued existence of an independent non-family board member. Therefore, his claim was denied.

Pursuant to the OBCA, a change in the number of directors typically requires a special resolution of shareholders, involving a two-thirds majority vote. Family board representation should therefore have been raised once Gerald's family became the 45 percent shareholder. If attention had been paid to corporate governance requirements on an ongoing basis, Stanley might have been in a better position when attempting to justify his expectations about the composition of the board. Additionally, some board vacancies could have been filled while Chaim was alive and acting in the capacity of independent adviser.

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