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Recent Cases

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DO YOU HAVE TO FOLLOW PROPER CORPORATE PROCEDURES?

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Introduction

The *Canada Business Corporations Act*[2] (the "CBCA") and provincial corporate statutes provide a mechanism for stakeholders of a corporation to seek redress for corporate conduct that is oppressive, unfairly prejudicial to or unfairly disregards their interests.[3] This mechanism is commonly referred to as the oppression remedy.

Recently, the Supreme Court of Canada revisited the oppression remedy in *Mennillo v. Intramodal Inc.*[4] ("*Mennillo*"). In *Mennillo,* the Court ruled that the oppression remedy was not available to a former shareholder who claimed that his reasonable expectations were violated as a result of the corporation's failure to comply with provisions of the CBCA.

Facts of Mennillo

In 2004, Johnny Mennillo ("Mennillo") and Mario Rosati ("Rosati") formed the transportation company Intramodal Inc. ("Intramodal" or the "Company") under the CBCA. The parties were the only shareholders, officers, and directors of the Company. Mennillo and Rosati held 49 Class "A" shares and 51 Class "A" shares, respectively.

The Company was run very informally and regularly did not comply with the technical requirements of the CBCA. Additionally, the parties put very little in writing over the course of their business relationship. For example, there was no written shareholders' agreement, partnership agreement, nor any contracts for monetary advances Mennillo made to the Company.

There was an understanding between the parties that, as shareholders, both would guarantee the Company's debts. Mennillo decided he no longer wanted to act as a guarantor. In 2005, Mennillo sent a letter to Intramodal resigning as an officer and director of the Company. A dispute arose as to whether Mennillo also ceased to be a shareholder at that time. Intramodal proceeded to register a share transfer that transferred all of Mennillo's shares to Rosati. The share transfer was not endorsed by Mennillo, a requirement under the CBCA.

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[1] The writers wish to express their appreciation to Joseph Jamil, student-at-law at Minden Gross LLP for his assistance in the preparation of this article.

[2] *Canada Business Corporations Act,* RSC, 1985, c. C-44. ("*CBCA*").

[3] CBCA, s. 241; See also *Business Corporations Act* (Ontario), RSO 1990, c. B.16 s. 24. ("*OBCA*").

[4] 2016 SCC 51.

In 2010, Mennillo brought a claim against Intramodal stating that (i) the Company unlawfully removed him as a shareholder and (ii) their failure to follow the requirements of the CBCA constituted oppressive conduct.

The Oppression Remedy

Prior to the *Mennillo* decision, the Supreme Court provided a comprehensive analysis of the oppression remedy in *BCE Inc. v. 1976 Debentureholders*[5] ("*BCE Inc.*"). In *BCE Inc.* the Court established a two-part test for oppression remedy claims. First, the claimant must "identify the expectations that he or she claims have been violated… and establish that the expectations were reasonably held".[6] Once this requirement is met, the claimant must then show that his or her reasonable expectation was violated by conduct that was "oppressive, unfairly prejudicial to or unfairly disregarding"[7] the interests of the claimant.

The Court in *BCE Inc.* listed several factors that the court should consider under the first stage of the test to determine whether a reasonable expectation exists, including: general commercial practice, the nature of the corporation, relationship between the parties, past practice, preventative steps, representations, shareholder agreements, and possible fair resolutions of conflicting interests between corporate stakeholders.[8]

If a claimant is able to establish both parts of the test, the court may then order a broad range of remedies to correct the oppression, including a court-supervised buy-out, the sale of the company, shot-gun remedies, the return of original shareholder investments, a payment of dividends, an award of damages, or the revocation of the issuance of shares.[9]

Mennillo Decision

In *Mennillo,* the Supreme Court upheld the lower court's decision that the Company did not unlawfully remove Mennillo as a shareholder and that failure to comply with proper corporate procedure did not by itself constitute oppressive conduct.

The Court did not find error with the trial judge's finding that Mennillo by his actions indicated that he no longer wished to be a shareholder of Intramodal and transferred all of his shares to Rosati at that time. If Mennillo no longer wished to be treated as a shareholder, then he could not have a reasonable expectation that he would subsequently be treated as one. As a result, the Court found that Mennillo could not satisfy part-one of the oppression remedy test as his expectation to be treated as a shareholder was not reasonable.

Additionally, the Court stated that even if Mennillo had a reasonable expectation to be treated as a shareholder and if he could reasonably expect the Company to comply with proper corporate procedure, the Company's failure to comply in this case did not constitute conduct that was oppressive, unfairly prejudicial to or unfairly disregarding of his interests.

The Court ruled that deficiencies in a company's compliance with CBCA or other governing corporate law formalities does not, on its own, constitute oppressive conduct unless it frustrates the reasonable expectations of the stakeholder. In *Mennillo*, Intramodal's failure to comply with the formalities associated with removing Mennillo as a shareholder adhered to his express wishes, and was not an unfair or oppressive act.

FOLLOWING CORPORATE PROCEDURES GENERALLY

The *Mennillo* case provides an interesting background for discussion on whether corporations must follow proper corporate procedures as set out in legislation, common law, or corporate agreements and the possible consequences of non-compliance.

The Court's analysis in *BCE Inc.* and *Mennillo* strongly suggests that the courts will grant more leeway to smaller corporations where the dealings between the parties are marked by informality in relation to strict compliance with

[5] 2008 SCC 69.

[6] Ibid. at para 70.

[7] Ibid. at para 114.

[8] Ibid. at paras 72-88.

[9] CBCA, s. 241(3); see also OBCA, s. 248(3).

technical corporate procedure. The Court reiterated that "[c]ourts may accord more latitude to the directors of a small, closely held corporation to deviate from strict formalities than the directors of a larger public company."[10]

For smaller corporations, it appears that courts will not readily find oppressive conduct by businesses that have not strictly followed the technical formalities of their governing corporate statutes. Future complainants seeking an oppression remedy must claim something more than merely a company's failure to follow corporate law formalities as such conduct will not automatically trigger the oppression remedy.

CONCLUSION

Although the *Mennillo* decision may provide some comfort to officers and directors of smaller corporations, it is important to note that this analysis so far has been limited to oppression remedy cases. In the *Mennillo* case, Mennillo could have made a claim under s. 243 CBCA for rectification of registers or s. 247 CBCA for failure by a corporation to comply with the legislation or with its articles.[11] While the remedies under these provisions are not as wide as the oppression remedies noted above, directors and officers of a corporation can prevent these types of lawsuits by following proper corporate procedure.

RECENT CASES

Defendant Directors of Corporate General Partners for Limited Partnerships Owed Duty of Care, as Directors, to General Partners rather than Limited Partnerships, but Triable Issue Existed on Whether Law of Negligence Imposed Duty of Care on Defendants to Investors in Limited Partnerships

Ontario Superior Court of Justice, January 31, 2017

The plaintiffs were investors in limited partnerships. The 16 defendants were directors of corporations which acted as general partners for the limited partnerships. The plaintiffs lost a substantial amount of their investments in the limited partnerships when an application was made under the *Companies' Creditors Arrangement Act* for court protection for the limited partnerships. The plaintiffs brought an action for damages against the defendants, alleging negligence, breach of fiduciary obligations, breach of statutory duties and oppressive conduct. Nine of the defendants brought motions to have the plaintiffs' actions against them dismissed. The moving defendants' position was that there was no genuine issue requiring a trial because, as directors, they owed no duty to the plaintiffs, they made no representations to the plaintiffs and the claims for breach of trust, oppression and breach of statutory duty were untenable.

The motions were granted in part. The statutory duties of good faith, loyalty and care under section 134 of the Ontario *Business Corporations Act* and section 122 of the *Canada Business Corporations Act* were owed to the corporation. The defendants owed their duties, not to the limited partnerships, but to the corporate general partners. It fell to the general partner to consider the interests of the limited partnership as a whole, and not the individual situation of one or more limited partners. There may be situations in which a director's duty of care is owed to someone other than the corporation, but in this case there was no evidence that any of the moving defendants acted in a manner that had a separate identity or interest from that of the corporation so as to make the act or conduct complained of their own. In addition, the plaintiffs did not plead fraud, dishonesty, want of authority or conduct by the moving defendants in the nature of a separate identity or interest of the corporations. In the absence of such evidence and pleadings, the only duty these defendants owed appeared to be to the general partnership corporation of which they were directors. At common law, there was no general fiduciary obligation owed by a director to shareholders. However, there may be times where it may be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of shareholders. In this case the moving defendants were or should have been aware of financial concerns following the release of a certain audit report. Despite this "wake up call", there was no evidence that any of these concerns were really addressed by the moving defendants. The evidence was also incomplete as to what action, if any, the moving defendants took respecting these concerns, although it did appear that, over the following years, few, if any,

[10] BCE Inc., *supra* note 5 at para 74; cited in Mennillo, *supra* note 4 at para 10.

[11] See also: OBCA, s. 250 and s. 253 and the dissenting opinion of Côté J. in *Mennillo*, *supra* note 4 at para 97.

management changes were made. What might be reasonably expected of these directors concerning the financial stewardship of the corporations involved, as it affected the plaintiffs, and whether the law of negligence should be extended to address the situation was a triable issue. Despite the plaintiffs' contention to the contrary, however, their allegation that the moving defendants' decision to have a receiver appointed for a limited partnership had a negative impact on the plaintiffs' investments was untenable. The moving defendants, like the plaintiffs, were investors in the limited partnership, and their decision to appoint a receiver was entirely a business judgment to which deference was owed. This part of the plaintiffs' claim, therefore, was dismissed. The plaintiffs' oppression claim was not against the corporations, but against the individual defendants, their pleadings did not contain facts justifying an oppression order, and there was no evidence that any defendant benefited personally from his or her conduct as a director. The plaintiffs' oppression claim was dismissed accordingly. Two of the moving defendants stated that this action should be dismissed against them, as they took no part in any directors' meetings. In the absence of any authority cited in support of this proposition, however, the plaintiffs' action against them could not be dismissed at this stage, since this issue was a triable one.

Poole v. Phillips

Director not Personally Liable to Corporation for Alleged Breach of Duty where Director Obtained No Personal Advantage and Her Actions Aimed at Preventing what She Perceived as Disastrous Course of Action

British Columbia Supreme Court, June 20, 2017

The plaintiff Ascent One Properties Ltd. ("Ascent One") was incorporated for the sole purpose of undertaking a real estate development project which was eventually aborted. Chiang, Yang, and Liao were the directors and shareholders of Ascent One. Liao subsequently assigned her shares of Ascent One to a holding corporation, 0949652 B.C. Ltd. ("0949652"). Yang and Liao each loaned Accent One $2.3 million under the provisions of a shareholders' loan agreement. Each of Chiang, Yang, and Liao also executed a shareholders agreement, which, in part, set out their respective roles in the management of Ascent One, and provided for a comprehensive feasibility study. Yang also advanced an additional $1.3 million to Ascent One. Ascent One subsequently instituted proceedings against Liao alleging that she breached her fiduciary duties as one of its directors and officers, as a result of which the real estate project was abandoned. This breach was said to have consisted of the institution by Liao of oppression proceedings against Accent One which were frivolous and vexatious, the abandonment by Liao of her responsibilities as a director and chief financial officer of Ascent One by withdrawing from its management and absenting herself from regularly scheduled directors' meetings, and the thwarting of bank financing being arranged by Ascent One which was exacerbated by her dispute with Yang, in which she was attempting either to buy his shares of Ascent One or sell to him her shares of Ascent One. 0949652, as the assignee of Liao's shares of Ascent One, instituted proceedings against Ascent One and its other directors and officers (Chiang and Yang), seeking a return of the monies that Liao or 0949642 had invested in the project, on the ground they had repudiated the shareholders' agreement. Such repudiation was alleged to have consisted, in part, of Ascent One's demands that Liao invest more money in the project, Ascent One's grant of a mortgage to Yang (the "Yang Mortgage") in priority over the existing shareholders' loans without the proper approval of its directors, and contrary to the shareholders' agreement, Ascent One's wrongful issuance to Yang of certain common and preferred shares contrary to the shareholders' agreement, the loan agreement and section 64 of the *Business Corporations Act*, and Ascent One's repeated demands that Liao provide a net worth statement and a guarantee of $500,000.

Ascent One's action was dismissed and 0949652's action was allowed. Directors must avoid conflicts of interest and abusing their position for personal benefit. Nor could they usurp for themselves a maturing business opportunity. Directors, however, would not be liable for breach of fiduciary duty when the conduct at issue was qua shareholder and not qua director. In this case Liao obtained no personal advantage. The oppression proceedings instituted by her were not instituted in her capacity as a director, but as a shareholder of Ascent One. Liao's concerns respecting Ascent One's proposed financing were reasonable. Her concerns that such financing not proceed without a full feasibility analysis were totally understandable, and led to her discussions with Yang concerning her purchase of his shares of Ascent One or her sale of shares to him. Although Liao failed to attend most of Ascent One's directors' meetings in person she did respond to many, if not most, of the agendas that she received by email, and such agendas expressly provided that this was a permitted method of attendance. Liao's emails documented her consistent and ongoing attempts to engage herself in Ascent One's business affairs. On balance, Liao took the actions she did in fulfillment of her role as a director and officer of Ascent One and were aimed at preventing what she *bona fide* perceived was a potentially disastrous course of action. Even if Liao had breached her fiduciary duties, there was no causal connection between those breaches and any loss suffered by Ascent One. Ascent One's action against her, therefore, was dismissed. 0949652's claim against Ascent One was allowed. The directors' resolution authorizing the Yang Mortgage and the issuance of certain shares to Yang was invalid since it was not passed by a majority of directors who were entitled to vote and Yang was not entitled to vote because of his interest in the transaction. The attempt by Chiang and Yang to subvert Liao's position as an equal shareholder of Ascent One, and to undermine the priority of her $2.3 million shareholder's loan in violation of Ascent One's articles and the *Business Corporations Act* was indefensible. The Yang Mortgage was unenforceable. Yang's advance of an additional $1.3 million formed part of Ascent One's capital. The net proceeds from Ascent One's sale of certain lands and from the Yang Mortgage were to be held in trust to be paid to Liao and Yang in equal amounts.

Ascent One Properties Ltd. v. Liao

In Oppression Proceedings, Corporate Director Personally Liable for Corporation's Failure to Convert Plaintiff's Preferred Shares into Common Shares, thereby Reducing Proportion and Value of Plaintiff's Common Shareholdings

Supreme Court of Canada, July 13, 2017

Alharayeri was the president, chief executive officer, a significant minority shareholder and a director of Wi2Wi Corporation ("Wi2Wi"), a technology company. Along with others, he held common shares of Wi2Wi, and was the sole holder of its convertible Class A and Class B preferred shares. These Class A and Class B shares were convertible into common shares if Wi2Wi met certain financial performance standards. Wi2Wi had also issued Class C preferred shares that were convertible into common shares if Wi2Wi met certain financial targets. Wi2Wi considered merging its operations with those of another corporation, Mitec Telecom Inc. ("Mitec"). While negotiating the merger, and without notifying Wi2Wi's board of directors, Alharayeri agreed to sell some of his own Wi2Wi shares to Mitec in order to alleviate personal financial difficulties. When Wi2Wi's board learned of Alharayeri's personal share purchase agreement, he was censured for concealing the deal and failing to disclose the potential conflict of interest. Alharayeri resigned as president, chief executive officer and director. Wilson became the new president and chief executive officer of Wi2Wi. A deal between Wi2Wi and Mitec failed to materialize and Wi2Wi's board decided to issue a private placement of convertible secured notes to its existing common shareholders. Prior to the private placement, the board accelerated the conversion of convertible Class C shares held beneficially for Wilson into common shares. Alharayeri requested that his convertible Class A and Class B shares be converted into common shares, but the board's two-person audit committee, consisting of Wilson and Black, expressed doubts about permitting such a conversion in light of Alharayeri's conduct and the board never sent Alharayeri a formal notice of his crystallized conversion rights. As a result of the private placement, Alharayeri's proportion of common shares, and the value thereof, were significantly reduced, as was the value of his convertible preferred shares. Alharayeri filed an application for oppression under section 241 of the *Canada Business Corporations Act* (the "CBCA") against four directors of Wi2Wi, including Wilson and Black. The trial judge granted the application in part, holding Wilson and Black liable for the board's refusal to convert Alharayeri's preferred shares into common shares and ordering them to pay compensation to Alharayeri. The trial judge's decision was affirmed by the Court of Appeal. Wilson appealed to the Supreme Court of Canada. On his appeal, Wilson argued that oppressive conduct should be attributable to a director only where that director had control of the corporation and acted in bad faith by using the corporation to advance his or her own personal interests, or where the corporation functioned as the director's alter ego, and that the remedial scope of the oppression provisions in subsection 241(3) of the CBCA should be narrowed by reference to principles traditionally limiting directors' liability at common law.

The appeal was dismissed. Subsection 241(3) gave the trial court broad discretion to "make any interim or final order it thinks fit." However, this discretion was not limitless. Any order made under subsection 241(3) existed solely to "rectify the matters complained of." The purpose of the oppression remedy was therefore corrective. Determining whether directors should be personally liable under section 241 required a two-pronged approach, first that the oppressive conduct be properly attributable to the director because he or she was implicated in the oppression, and, second, that the imposition of personal liability be fit in all the circumstances. Four general principles should guide courts in fashioning a fit order under subsection 241(3). First, the oppression remedy request must in itself be a fair way of dealing with the situation. The trial judge must determine whether it is fair to hold the director personally liable, having regard to all circumstances, including whether the director acted in bad faith and/or obtained a personal benefit. Second, any order under subsection 241(3) should go no further than necessary to rectify the oppression. Third, any order under subsection 241(3) could serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers. Fourth, a court should consider the general corporate law context in exercising its remedial discretion under subsection 241(3). Here, Wilson and Black, the only members of the audit committee, played the lead roles in the non-conversion of Alharayeri's preferred shares. It was open to the trial judge to determine that the oppression was properly attributable to these two defendants. In addition, Wilson accrued a personal benefit as a result of the oppressive conduct, increasing his control over Wi2Wi. The remedy went no further than necessary to rectify Alharayeri's loss and was appropriately fashioned to vindicate his reasonable expectations.

Wilson v. Alharayeri

Plaintiffs Awarded Judgment against Corporate Developer for Negligent and Fraudulent Misrepresentation; Court Refused to Pierce Corporate Veil to Hold Developer's Sole Director Personally Liable

Alberta Court of Queen's Bench, June 23, 2017

The defendant partnership Valour Park at Currie Limited Partnership, through its general partner Valour Park at Currie Inc. (collectively "Valour Park"), was the developer of a condominium townhouse project which was to be carried out in three phases. The defendant Mr. Friesen was the sole director of Valour Park at Currie Inc. Mr. Lau and Ms. Sezanaeva were employees of a Valour Park affiliate, and promoted the project. Phase I of the project was enrolled with the Alberta New Home Warranty Program, so that the purchasers in Phase I were protected under that program. Although Phase II of the project was not so enrolled, the plaintiffs alleged that Mr. Lau and Ms. Sezanaeva represented to them that Phase II was so enrolled and that, because of this representation, the plaintiffs entered into agreements with Valour Park to purchase certain condominium units in Phase II of the project. The plaintiffs provided Valour Park with their deposits, but Valour Park used monies from these deposits without the plaintiffs' consent and without Valour Park itself having enrolled Phase II of the project in the Alberta New Home Warranty Program. Valour Park was aware that the deposits were to be held in trust under section 14 of the *Condominium Property Act* (the "CPA"), and could not be used unless Alberta New Home Warranty Program deposit protection insurance was in place. Valour Park at Currie Inc. was granted protection under the *Companies' Creditors Arrangement Act* (the "CCAA") on May 9, 2012. In a letter of October 15, 2012, Alberta New Home Warranty advised Valour Park that it had not approved Phase II of the project for enrolment. Valour Park never commenced construction of Phase II of the project. After the commencement of the CCAA proceedings, Valour Park obtained additional financing from a bank, which subsequently sold Valour Park's lands. Valour Park's law firm, McLeod Law, returned to the plaintiffs the portion of their deposits that it was holding in trust. The plaintiffs subsequently instituted proceedings against Valour Park, Mr. Friesen, McLeod Law, Alberta New Home Warranty and others for the return of the lost portions of their deposits.

The action was allowed in part. The plaintiffs succeeded in proving negligent misrepresentation, fraudulent misrepresentation and breach of trust on Valour Park's part. The plaintiffs failed, however, to demonstrate that McLeod Law had either been negligent, or had knowingly assisted Valour Park in its breach of trust, inasmuch as McLeod Law had done nothing other than what the CPA and the Law Society of Alberta required it to do. The plaintiffs also failed to demonstrate that Alberta New Home Warranty had negligently or fraudulently misled some of them concerning the status of their deposit protection. The plaintiffs' claim against Mr. Friesen was based on piercing Valour Park at Currie Inc.'s corporate veil in order to hold him personally liable for the lost deposits. On a balance of probabilities, Mr. Friesen was not aware of the lack of Alberta New Home Warranty protection for the plaintiffs, having put into place an appropriate management team to ensure that warranty protection was in place, even though it was not. This was not a case in which Mr. Friesen committed an intentional tort, fraud, physical damage or other misconduct. It was Mr. Friesen's right to use the limited liability feature of a corporation in his business dealings. There was no evidence that the plaintiffs were relying on Mr. Friesen's personal involvement so as to create a personal duty of care on him. It was inappropriate to pierce Valour Park at Currie Inc.'s corporate veil. The plaintiffs' claims against Valour Park were allowed, and those against the other defendants were dismissed.

UBG Builders Inc. (Re)

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