

PRESENTED TO THE DIRECTORS COLLEGE

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WHITE OAKS INN – NIAGARA-ON-THE-LAKE

Contentious Issues At Board & Shareholder/Member Meetings

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Contentious Issues at Board and Shareholder/Member Meetings



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1. INTRODUCTION*

Difficulties arise for corporations which lack a formal process governing the calling and conduct of corporate meetings. By-laws should (but rarely do) provide that all meetings are to be governed by specific Rules of Order such as *Robert's Rules of Order* or *Nathan's Company Meetings for Share Capital and Non-share Capital Corporations*. A group of individuals who, for some reason, wish to discredit a corporation, can, if the corporate records are in disarray, easily challenge the board, the officers and the senior managers. They can, for example, allege that the board was not properly constituted, a shareholders' or members' meeting did not have a quorum present, or that the officers were not duly appointed by a validly elected board at a properly called board meeting. Certain formal requirements relating to board, shareholders' and members' meetings are common to private companies, public companies, and not-for-profit corporations ("NFP's").

As you may be aware the *Canada Not-for-Profit Act* ("CNCA") came into effect in October, 2011. The *Ontario Not-for-Profit Act* or ONCA has been passed but not has not been proclaimed and died on the order table due to the election call in Ontario.

2. RIGHT TO ATTEND BOARD MEETINGS

(a) Who is entitled to attend?

Meetings of the board of directors may be attended only by the directors of the corporation. At common law, other persons may be admitted with the consent of the meeting.² This is however subject to the provisions of the By-laws of the corporation. Standard form by-laws often provide for attendance of others with the consent of the Chair

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² *Mayor, Alderman and Burgesses of Tenby v. Mason*, [1908] 1 Ch. 457 (CA)

or of the meeting. Directors and officers are under a duty of confidentiality which others such as special guests are not. It would not be unusual to require that a guest sign a confidentiality agreement

(b) 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.³

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.

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.

(c) 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?

The law is settled on the issue that a director **cannot** attend a meeting by proxy.⁴ 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. A shareholders resolution could be signed by power of attorney.

(d) In Camera Meetings

The term is used in two senses.

In camera sessions can be meetings where the independent directors might have an opportunity to meet without management present. *In camera* sessions can also 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. However, these latter meetings may not have a quorum present.

³ *Hayes v. Bristol Plant Hire Ltd.*, [1957] 1 All ER 685 (Ch D).

⁴ 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).

A recent situation I had to deal with was an unpopular president of a minor hockey league. 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. I recommended a full board meeting be held.

3. CHAIR OF MEETINGS

(a) Who is Entitled to Chair Meetings and Role of Chair

I would like to start with a quotation from an Australian case.

It is an indispensable part of any meeting that a chairman should be appointed and should occupy the chair. In the absence of some person (by whatever title he or she be described) exercising procedural control over a meeting, the meeting is unable to proceed to business.⁵

Most by-laws provide that the Chair of the board, if present and willing, will 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.⁶

(b) The Chair Need Not be a Lawyer

In the B.C. case of *Hastman v. St. Elias Mines Ltd.*⁷, the applicants sought to set aside a shareholders meeting. They alleged the Chair was not a lawyer and basically was not qualified to rule on the validity of proxies. The Court rejected this argument and stated:

...from a policy point of view, it would not be desirable to restrict the group of people who could be chairs of a corporation to lawyers. The authorities are replete with situations where chairs of companies are not lawyers and I was not given any authorities to contradict that history.⁸

The Chair should, however, consider having counsel to advise on issues.

⁵ *Colorade Construction Pty. Ltd. v Platus* (1966), 2 N.S.W.R. 598 at 600.

⁶ *Klein v. James* (1986), 36 B.L.R. 42 (B.C.S.C.) affirmed (1987), 37 B.L.R. (XXV1) (B.C.C.A.).

⁷ 2013 B.C.S.C. 1069.

⁸ *Ibid* at para 139.

(c) Authority of Chair

The Chair must not act to frustrate the expression of the wishes of the meeting by leaving the Chair, refusing to put proper motions to a vote, acting in an oppressive manner to end discussion or refusing to have votes counted. In *American Aberdeen-Angus Breeders' Ass'n v. Fullerton*⁹, it was stated:

The right of the majority of the members to control the action of the meeting cannot be questioned. A presiding officer cannot arbitrarily defeat the will of the majority by refusing to entertain or put motions, by wrongfully declaring the result of a vote or by refusing to permit the expression by the majority of its will. He is the representative of the body over which he presides. His will is not binding on it, but its will, legally expressed by a majority of its members is binding.

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.¹⁰

The Delaware decision in *Portnoy v Cryo-Cell International, Inc.*¹¹ is an example where the Court ordered a new election with a new chair at the expense of the management due to the improper behavior of the Chair at a shareholder meeting in trying to maintain control of the board. The Chair, Mercedes Walton and the management groups devised a plan to buy up stock and bolster their position in a proxy contest. Going into the annual meeting at 10:00 a.m. the Chair sensed defeat and did not want to close the polls and count the vote when the scheduled presentations at the meeting were over. So she had members of her management team make long, unscheduled presentations to give her side more time to gather votes and ensure that they had locked in two key blocs. She overruled motions to close the polls. Even after filibusters, Walton still harbored doubt that the Management Slate would prevail if the vote was counted and the meeting was concluded. So, at around 2:00 p.m. Walton declared a very late lunch break, supposedly in response to a request made much earlier.

In fact, Walton called the break, so that she would have more time to seek votes and so that she could confirm that the major blockholders had switched their votes to favour the Management Slate. Only after confirming the switches did Walton resume the meeting at approximately 4:45 p.m., declare the polls closed, and have the vote counted.

⁹ (1927), 156 N.E. 314 (Ill. Sup. Ct).

¹⁰ See *Re: Canadian Pacific Ltd.* (1997), 30 B.L.R. (2d) 297 (Ont. Ct. Gen. Div.).

¹¹ (2008), 940 A.2d 43 (Del.Ch.).

The judge had harsh words to say about the Chair's behavior in finding a serious breach of fiduciary duty which tainted the election of directors. The Court ordered a new meeting with a new Chair at management's cost.

The Chair must enforce designated rules of order and must preserve and maintain order and do all things necessary for the proper conduct of the meeting. The Chair may call the speakers, regulate the length of the speeches, deal with points of order and control the arrangements for any vote that may be taken. He or she may judiciously attempt to regulate interruptions from the floor. The Chair must combine fairness with tact.

The right of the majority of the members to control the action of the meeting cannot be questioned. A presiding officer cannot arbitrarily defeat the will of the majority by refusing to entertain or put motions, by wrongfully declaring the result of the vote, or by refusing to permit the expression by the majority of its will. The Chair is the representative of the body over which he or she presides. His or her will is not binding on it, but its will, legally expressed by a majority of its members is binding.

(d) Removal of Chair

A Chair appointed by the meeting can be replaced by 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. All one can do is to bring a motion in Court to order a new meeting.

(e) Casting Vote of Chair

At common law, the Chair did not have a second or casting vote¹² if directors were equally divided on a question. There is no provision for a casting vote in the corporate statutes. 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 votes¹³, not to deal with a continuous and settled deadlock condition.¹⁴ Some people think the Chair only has a vote if the Chair has a casting vote. This assertion is wrong. A Chair must act in good faith in casting a tie-breaking vote, but is not compelled to cast the tie-breaking vote.

If it is intended that consensus be achieved amongst the directors, the occurrence of a tie vote shows that obviously 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.

¹² *Nell v. Longbottom*, [1894] 1 Q.B. 767 (Q.B.D.).

¹³ Re: *Citizen's Coal v. Forwarding Co.*, [1927] 4 D.L.R. 275 (Ont. Co. Ct.).

¹⁴ Re: *Daniels and Fielder* (1988), 65. O.R. (2d) 629 (Ont. H.C.).

(f) **Appeals from Chair's Rulings**

The rulings of the Chair related to procedural matters may be appealed to the meeting. The best practice is for the person acting as Chair of the meeting to vacate the chair while a vote is taken. The appeal of such procedural rulings by the Chair should not involve speeches. A majority vote is required to vary or reverse the Chair's ruling.

There is a presumption that the Chair's decision was a correct one. There have been several pronouncements in cases to this effect. For example, In the *Re Indian Zoedone Co.*¹⁵ case in the English Court of Appeal, Cotton L.J. stated:

Whether the objection depends on the form of the document or on the general point of law, the Court can decide, and is bound to decide, when the question comes before it, whether the decision of the chairman was right or wrong; but until the contrary is shown his decision must be held to be right, that is to say, the Court must decide the questions between the parties, but not until those who object to his decision satisfy the Court before whom the question comes that his decision was wrong.

4. PROCEDURAL ISSUES

(a) **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 fax 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.

¹⁵ (1884), 26 Ch. D. 70.

(b) Conflicts Of Interest

Pursuant to corporate statutes, 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.

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.¹⁶

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.¹⁷ This provision is stricter than that of the CBCA, which only provides that the director may not vote on the contract. By-laws could be expanded to provide as the OBCA does.

(c) Dissent Votes

A director is often faced with a position put forward at a meeting with which he or she does not agree. That person should vote "NO" to the resolution and request that his or her dissent vote be recorded in the minutes. Failure to do so may lead to potential liability since the corporate Acts deem the director to have consented to the resolution if the dissent is not recorded in the minutes.¹⁸

A director not present at such meeting is deemed to have consented unless, within seven days after becoming aware of the resolution, the director, causes his or her dissent to be placed within the minutes of the meeting; or submits his or her dissent to the corporation and that should be done at the meeting.

An unusual situation could arise if a board consisted of 5 with 3 forming a quorum. If two were absent and the vote went 2 to 1 in favour of the resolution at the meeting, the resolution would pass. If the two absent directors requested their dissents be recorded afterwards, the question that arises is if this could make a difference in the vote. Since the meeting was over, this would not affect the vote. Their dissent may, however, protect these two directors from liability.

¹⁶ See *Re North Eastern Insurance Co.*, [1919] 1 Ch 198.

¹⁷ OBCA at s. 132(5).

¹⁸ OBCA s 135, CBCA s 123, CNCA s 147.

(d) Abstentions

Another option for directors would be to abstain from voting on a motion. An abstention is defined as “the refusal to vote either for or against a motion.”

A director at a meeting may be “sitting on the fence” or just does not want to offend one faction or another so he or she decides not to vote at all on a proposed resolution. I am not referring at this point to abstention from voting for a director who is in a conflict situation, as that is statutorily mandated under the corporate Acts.

A director may well be deemed to have consented unless the abstention is recorded. As such, it would appear to be prudent for the undecided director to at least request that an abstention is recorded instead of “doing nothing”, even though that may not act as a liability shield for a director who did not dissent. However a director who wishes to abstain (and to have the abstention recorded) has the right to do so.

In my opinion, an abstention is not necessarily the equivalent to a “no” vote as such, but may have that effect in some circumstances. If for example, a matter under the By-laws must be passed unanimously by all of the directors then in office and not just by all directors who form a quorum, an abstention will be considered a “no” vote.¹⁹

As an example, a By-law may provide for the directors to approve any resolution by at least 2/3rds of the votes cast by the directors who voted in respect of that resolution. The underlining makes it clear that an abstention does not count at all in this circumstance. 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.

If the matter is a sensitive 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.

In my opinion, 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?²⁰ A person who has dissented could insist that his or her dissent be recorded in the minutes. My view is that secret ballots should be used only in exceptional circumstances.

¹⁹ See *Municipal Mutual Insurance Ltd. v. Harrop* [1998] B.C.L.C. 540 (UK Ch. D.).

²⁰ For example, shareholders may decide to sue directors for breach of their fiduciary duties.

(e) Quorum Issues

A quorum must be maintained throughout a meeting of directors or the business conducted would not be lawfully transacted. In the case of *Mega Blow Moulding Ltd. v Sarantos*²¹, the court addressed the validity of a resolution passed where the quorum was not achieved at a board meeting. In reaching its 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 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 accordingly ruled that the resolution passed at the meeting was invalid.

The number of shareholders or members that constitute a quorum is determined by the governing statute, the By-laws, and by any unanimous shareholder or member agreement. At common law, absent any other provision in the constating documents, a quorum was a majority of the shareholders. Subsection 139(4) of the CBCA and subsection 101(4) of the OBCA each provide that two persons form a quorum for a shareholders' or members' meeting (CNCA s.164(2)). Of course, in some larger corporations, the quorum is often specified to be a stipulated percentage of shareholders' shares or members represented at the meeting.

Where a shareholder or member attends only to protest the meeting, such person or such person's shares should not be counted for quorum purposes.

One issue that arises from time to time is that of the "disappearing quorum". That refers to the situation where a quorum is present at the start of the meeting but the quorum is lost at some point during the meeting itself. At common law, unless the corporation's constitution otherwise provided, the loss of a quorum during the meeting deprived the meeting of its authority. It had to be adjourned and any business transacted after the quorum was lost was invalid.

At the same time, at common law, after the commencement of the meeting, there was no obligation to ensure that the quorum was present thereafter. If a quorum was present at the start of the meeting and no quorum count is demanded or taken, a quorum was presumed to have been present throughout.

²¹ (2001) 16 B.L.R. (3d) 52 (Ont S.C.J.).

This is no longer the case under the CBCA, OBCA or CNCA. All state that, unless the by-laws otherwise provide, if a quorum is present at the opening of the meeting of shareholders or members, the shareholders or members present may proceed with the business of the meeting even if a quorum is not present throughout the meeting.²²

In some cases, the articles or by-laws impose a quorum higher than the general one prescribed in respect of certain matters that are considered to be of special importance.

(f) Election/Appointment of Directors under the Corporate Statutes

Whether a for-profit or a NFP corporation, the rules on election or appointment of directors are the same. The basic rule is that shareholder/members elect directors. However, where there is a vacancy on the board, the directors then in office may appoint a suitable replacement for the departed director to hold the office until the end of the term of the departing director. Under all Ontario and Canadian statutes where there is a minimum and maximum number provided for in the articles, the board can increase the number by up to one third, within the limits set out in the articles.²³

If however, there are not enough directors remaining on the board to constitute a quorum, a meeting of shareholder/members must be called for the purpose of electing new directors to the board.²⁴

(g) Business Judgment Rule

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

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

²² .Section 139(2) of the CBCA, section 101(2) of the OBCA and s.164(3) of the CNCA. The OCA is silent on this point so it would have to be covered in the by-law.

²³ Under the CBCA (s. 106(8)) and CNCA (s. 128(8)), this must be provided for in the articles.

²⁴ What if the shareholders or members elect more directors than are authorized? The election will be void.

a timely basis in order for them to make the decisions and have adequate time to seek clarifications.

There are numerous cases where directors have been sued in derivative actions where hasty improvident decisions have been made.

(h) How decisions are made at Board Meetings

It is the best practice to have decisions made by directors at a meeting or on a conference call when all of them or at least a quorum is present. In the English case of *Re: Duomatic Ltd.*²⁵ Buckley J. said this:

Where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be.²⁶

The so-called “*Duomatic* principle” has been applied to directors as well. However, this principle will only apply where unanimous consent can be established. This is not to be watered down to encompass decisions made informally by a majority.²⁷ To have held otherwise would be to embark on a very slippery slope.²⁸

5. MINUTES AND NOTES OF MEETINGS

(a) Minutes of Meetings

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 under the CBCA any shareholder or member may review minutes of meetings where a director has declared a conflict of interest.²⁹

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

²⁵ [1969] Ch. 365 (Ch D)

²⁶ *Ibid* at pg 373.

²⁷ See *Extrasure Tracel Insurance Ltd. v. Scattergood* [2003] 1 BCLC 598.

²⁸ See *Nathan and Voore: The Law of Corporate Meetings in Canada* at 1-12(1) for further discussion.

²⁹ CBCA at s. 120(6.1), CNCA, s.141(7).

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.

A ruling in the *James Hardie Industries Limited* 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.³⁰

In this case, the board 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.

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 only where no immediate action is required or seeking the directors' approval on a particular matter;

³⁰ *ASIC v Hellicar & Ors*, [2012] HCA 17; *Shafron v ASIC*, [2012] HCA 18.

- 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.

(b) Notes of Meetings

There are 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.

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.

On the other hand a director seeking to show he or she exercised due diligence in coming to a decision at a board meeting may have notes to back this up.

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.

6. RESIGNATION OF DIRECTORS

(a) Resignation of Director

People become directors of corporations for a variety of reasons. If you do, the simplest thing to do is make sure you are joining the board of a financially stable corporation and that you obtain an indemnity from a creditworthy source and you are covered by directors' and officers' insurance.

There may come a time when a director wishes to step down from the board, for any one of a number of reasons. His or her other professional commitments may no longer leave enough time to devote to the corporation, personal circumstances may make it difficult for a director to continue to participate fully in the work of the board, or the director may simply be ready for a change.

A director may also choose to leave the board because of a concern with the corporation. Perhaps he or she discovers matters about the corporation that make the director

uncomfortable about being identified with the organization; such as; a corporation is in financial difficulties is being badly managed; or it is involved in practices which are incompatible with the acceptable standards of corporate behaviour.

In one recent Delaware case, on a motion to dismiss by the former directors, it was considered that their resignations might be a breach of their fiduciary duty of loyalty to simply resign upon discovering a flagrant crime by a corporate insider, as opposed to pursuing legal action against him.³¹

The resignation of a director is effective irrespective of whether it is accepted by fellow directors or by shareholders.

(b) Accrual of Liability

A director cannot escape liability for any liability that may have accrued while he or she was a director.

(c) Filing Form 1

The Corporate statutes require notice of resignation be sent to the Corporation. In Ontario, the Corporations Act requires the filing of a Form 1 with the Ministry. Failure to file will not affect the validity of the resignation if notification is given to the Corporation. It is of the utmost importance to keep a copy of the letter sending the resignation. The CRA or the Ministry of Labour (Employment Standards Branch) usually starts by pulling a Corporate Profile to see who the directors are.

7. FIDUCIARY DUTIES

The collapse of Bernard Madoff's multi-billion dollar Ponzi scheme left ripples across the international investment world and resulted in a multitude of lawsuits across the globe. One of these cases is *Madoff Securities International Limited v Stephen Raven et al*³², a recent decision released by the High Court of Justice in the UK. In this case, the Court clarified the scope of a director's duty to act in what he or she believes in good faith to be in the interest of the company. The Court also provided important guidance on how directors are expected to comply with this duty in light of the practical commercial realities of their role; in particular, the need to work together with other directors.

³¹ See *Re Puda Coal Stockholders' Litigation*, C.A. No. 6476-CS (Del. Ch. Feb. 6, 2013)

³² [2013] EWHC 3147 (Comm).

(a) **Background**

The case concerned the actions of the former directors of Madoff Securities International Limited (“**Madoff Securities**”), a UK company, with regard to certain payments that were made by Madoff Securities prior to the discovery of the Ponzi scheme and the subsequent conviction of Mr. Madoff in the United States.

There were three sets of payments made by Madoff Securities that were the subject of this litigation. The first series of payments (the “**MSIL Kohn Payments**”) involved payments made to Mrs. Kohn for services rendered by her such as the introduction of important individuals, advice on financial matters and research. These payments to Mrs. Kohn totalled \$27 million over a 15 year period. The second series of payments (the “**Interest Payments**”) were in the form of interest payments made on personal loans made by Mr. Madoff to Madoff Securities. The third series of payments (the “**Lifestyle Payments**”) made out of the company’s directors’ loan account, concerned goods and services purchased by Madoff Securities on behalf of Mr. Madoff and his family.

(b) **Duties of Directors**

The liquidators of Madoff Securities claimed that the directors, by permitting these payments, acted in breach of their duties as directors of Madoff Securities. With regards to the MSIL Kohn Payments, amongst other allegations, the liquidators claimed that the directors knew Mrs. Kohn’s written research was useless and of no value. Therefore, the payments made for the worthless research constituted a breach of the directors’ duties. In addition, it was alleged that the Interest Payments were unnecessary and that the Lifestyle Payments were an improper use of company funds. With these serious allegations, the Court took the opportunity to revisit the law on the duties of directors and what may constitute a breach of those duties. Throughout the analysis, the Court identified the three main duties of directors as follows:

- 1. to act in good faith in the interest of the company***
- 2. to exercise power for the purposes for which they are conferred***
- 3. to exercise reasonable care, skill and diligence***

Within English law, these three duties have been legislatively codified in much more detail than in Canadian law. However, although these duties may be provided for through legislation, the case law is very important in identifying what may constitute a breach of these duties.

As with English law, the general duty owed to a company is set out in section 122(1) of the CBCA³³ which reads as follows:

- 122.** (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
- (a) act honestly and in good faith with a view to the best interests of the corporation; and
 - (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.³⁴

In the case of Madoff Securities, the Court identified the importance of this duty on directors. The Judge stated:

... it is trite law that a director owes a duty to the company to act in what he honestly considers to be the interest of the company. This may be regarded as the core duty of a director. It is a fiduciary duty because it is a duty of loyalty.³⁵

Although these duties are imposed on directors through legislation, they have been interpreted through jurisprudence on several occasions. These Court interpretations have clarified the duties for directors and have also, on some occasions, increased the standard of care for directors.

The Court in this case has summarised some of these important considerations as follows:

- 4. ...the duty is to act in what the director believes, not what the Court believes, to be the interest of the company. The test is a **subjective** one.” (our emphasis)

In Canada, the test for the duty of care of directors is an **objective** test. The Supreme Court of Canada concluded in *People’s Department Stores Inc.*³⁶ that the standard of care pursuant to section 122 of the CBCA is an objective standard and indicated that “the factual aspects of the circumstances surrounding the actions of the directors or officers are important in the case of the ... duty of care”³⁷. (our emphasis)

- 5. A director “owes a duty to the company to inform himself of the company’s affairs and join his fellow directors in supervising them. It is therefore a breach of duty for a director to allow himself to be

³³ RSC 1985, c C-44.

³⁴ *Ibid* at s 122(1).

³⁵ [2013] EWHC 3147 (Comm) at para 187.

³⁶ 2004 SCC 68.

³⁷ *Ibid* at para 63.

dominated, bamboozled or manipulated by a dominant fellow director where such involved a total abrogation of this responsibility.

6. A director who has knowledge of his fellow director's misapplication of company property and stands idly by, taking no steps to prevent it, will thus not only breach the duty of reasonable care and skill ... but will himself be treated as party to the breach of fiduciary duty by his fellow director in respect of that misapplication by having authorised or permitted it.
7. In fulfilling this personal fiduciary responsibility, a director is entitled to rely upon the judgement, information and advice of a fellow director which integrity skill and competence he has no reason to suspect.
8. Directors may reach a decision... by a majority. A minority director is not thereby in breach of his duty, or obliged to resign and to refuse to be party to the implementation of the decision.
9. Where a director fails to address his mind to the question whether a transaction is in the interest of the company, he is not thereby, and without more, liable for the consequences of the transaction.
10. A director owes a fiduciary duty to exercise the powers conferred on him by the constitution for the purposes for which they were conferred.

(c) Nominee Directors

A director may be nominated by a particular stakeholder, whether it is in the context of a wholly-owned subsidiary where the board is nominated and elected by the sole shareholder or in the context of a minority shareholding where a particular director is nominated and elected by a significant minority shareholder. It may also come about that a director of a non-profit is appointed to represent the interests of another for-profit or non-profit organization. In each of these instances there is the very real possibility for tension to arise between the fiduciary duty owed by the director to the corporation and the director's role in representing the stakeholder's interest.

The fact that a director is nominated or elected by a particular stakeholder does not change the director's fundamental fiduciary obligation to the corporation is to act in its best interests. In Canada, in considering the best interests of the corporation, a director may take into account the interests of a variety of stakeholders but this does not change the fundamental obligation to act in the best interests of the company in so doing.³⁸

³⁸ See *Re London Humane Society* 2010 ONSC 5775 (Can LII). See also C.S. Goldfarb: *Dual Loyalties on Non-Profit Boards: Serving Two Masters*; CBA-OBA National Symposium on Charity Law, Friday, May 6, 2011.

Having said that, it is possible for a nominee director to represent the interests of a stakeholder without compromising his or her duty to the corporation. For example, a key role of the nominee director is to act as a steward of the shareholder's interest in a subsidiary and provide oversight and advance the shareholder's position. This can be exercised in a way that is compatible with a director's duties more broadly, provided that the nominee director takes care to proactively identify and manage conflicts of interest and absents him or herself from discussions where that conflict arises. In doing this the director must take care to understand the applicable statutory requirements around conflicts of interest and be consistently vigilant to avoid placing him or herself in a position of conflict.

By virtue of recent amendments to the CBCA, shareholders may examine the portions of any minutes of meetings of directors or of committees of directors that contain disclosures of conflicts of interests under this section, and any other documents that contain those disclosures during the usual business hours of the corporation.³⁹

All of the other fiduciary duties of a director, including the duty of loyalty and the duty of confidentiality, also apply and there are times when this can put a nominee director into a very difficult, if not impossible, situation.

8. REMOVAL OF DIRECTORS/OFFICERS

(a) Removal of Directors by Shareholders/Members

In Canada, when a director is considered to be a problem because of misbehavior, or where a faction of the board refuses to attend meetings and thereby frustrates a quorum, the available remedies are limited.

A special meeting of shareholders or members could be convened to remove the "dissident" directors by an ordinary resolution and to replace them with more compatible ones. The current *Ontario Corporations Act* requires that the right to remove directors to be set out in the Letters Patent or by-laws and requires a 2/3 majority of members (s.67), otherwise a director cannot be removed during his or her term. The CBCA and OBCA provide that the removal is by a simple majority vote. The percentage of votes required for this purpose cannot be increased in the articles or by-laws.⁴⁰ While a resolution may be signed by all the shareholders, in many cases, directors may not be removed by a

³⁹ See CBCA s.120(6.1). Members have the same rights under s.141(7) of the CNCA.

⁴⁰ CBCA, s.7(4) and 109; OBCA, s.7(5) and 122; CNCA, s.7(5) and 130.

resolution in writing, but only at a properly constituted meeting of the shareholders pursuant to section 123 of the OBCA and Section 110 of the CBCA.

The operative words in the CBCA (s. 110) and OBCA (s. 123) are: “a director of a corporation is entitled to receive notice of and to attend and be heard at every meeting of shareholders”.

See *Kaiser v. Borillia Holdings Inc.*⁴¹ The sole shareholder removed the sole director and admitted that he did not follow the requirements of the OBCA. He argued that the breach was technical because he would have removed the director in any event. The director was successful in his application for a determination that he was still a director because he was not removed in accordance with the Act. The Court so held even though it stated that it was fairly evidenced that the shareholder would remove the director as soon as he could.

If the director ceases to be qualified, for example, he or she is certified to be mentally incapable, becomes a bankrupt, or if the by-laws of a charity so provide, becomes an “ineligible individual” under the *Income Tax Act*, the director is automatically off the board.

(b) Removal by Directors Not Possible

Directors normally do not have the right to remove other directors as this is the role of the body that elected them.⁴² However, under S. 155(2) of the *Canada Corporations Act* there is a requirement that the by-laws provide for the election and removal of directors. As a result it would appear that provision could be made for the board to remove a director. This will become academic once the CCA is no longer in force or a corporation continues under the CNCA.

(c) Removal of Officers

Officers are normally elected by directors where there are no rights to remove officers dealt with under corporate statutes, it has been assumed those who appointed the officers have the power to remove them.⁴³

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⁴¹ 2007 CarswellOnt 3207, 32 BLR (4th) 306

⁴² Fraser and Stewart, *Company Law of Canada* (5th Edition), 1962 at p.129 citing *Van Alstyne v. Rankin and St. Lawrence Corp. Ltd 1952 Que. S.C. 12.*

⁴³ See s.289 of the Ontario Corporations Act