Directors' Briefing

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Recent Cases

LexisNexis

REMOVAL OF DIRECTORS OF BUSINESS CORPORATIONS REVISITED[1]

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Introduction

In an earlier issue we discussed how shareholders go about removing a director of a corporation pursuant to s. 109(1) of the Canada Business Corporations Act ("CBCA")[3] or s. 122(1) of the Ontario Business Corporations Act ("OBCA").[4]

In this Article we will discuss some of the options available to a director who has received notice of a shareholders' meeting called for the purpose of removing him or her from the board. Under both *Acts*, the director is entitled to receive notice of, attend, and speak at such meeting of the shareholders. Additionally, there are two main options available to the director who wishes to oppose his or her removal from the board: (1) submitting a written statement to the shareholders and (2) initiating litigation under the oppression remedy.

1. Statement of Director

Both *Acts* provide such a director with the opportunity of submitting a written statement to the shareholders giving reasons opposing the proposed removal. Upon receiving a statement from the targeted director, the corporation is required to send a copy of the statement to every shareholder entitled to receive notice of a meeting of the shareholders or include the statement in a management information circular for the meeting.

This opportunity provides the director to have his or her voice heard by all of the shareholders of the corporation.

Attached to this Article as a Schedule is a form of written statement that contemplates a situation where a father and son who act as directors of a family run corporation have a falling out and the father, as the sole shareholder, wishes to remove the son as a director.

2. Other Option - Oppression Remedy

If the shareholder(s) vote by way of ordinary resolution, to remove the targeted director it is always open for the director to initiate litigation using the oppression remedy in

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[1] This article is an update from the version in the May 2016 issue of the Directors' Briefing.

[2] The authors wish to acknowledge the assistance of Alex Katznelson, student-at-law at Minden Gross LLP, for his assistance in the preparation of this article.

[3] RSC 1985, c.C-44.

[4] RSO 1990, c.B.16.

circumstances where conduct has been oppressive, unfairly prejudicial to or unfairly disregards their reasonable expectations and interests.

The OBCA and CBCA[5] provide that a complainant may apply to a court for an order under the oppression remedy if the court is satisfied that in respect of a corporation or any of its affiliates:

(a) any act or omission of the corporation or any of its affiliates effects a result;

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner; or

(c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

In *Civelli v. Pacific Hunt Energy Corp.*,[6] two shareholders, who were also directors of the respondent corporation, commenced an action seeking, among other things, to be reinstated as directors of the corporation. The plaintiffs were abruptly removed as directors after they had commenced an action seeking an interlocutory injunction restraining the corporation and other directors from withholding financial information and from committing to a proposed financing transaction. Following the initiation of the litigation, the remaining shareholders voted to remove the plaintiffs as directors.

In considering whether the removal of the plaintiffs from the board was oppressive, the court determined that the plaintiff's expectations were reasonable. The court found that the affairs of the respondent corporation and the other shareholders were "conducted in a one-sided manner" and were oppressive to the plaintiffs. As a result, the court made an interlocutory order that the plaintiffs be reinstated as directors of the board.

Summary

While a director may submit a written statement to the shareholders or initiate litigation under the oppression remedy, there is no guarantee that they will be able to successfully oppose the proposed removal from the board. In the event a director is removed, the director should file a notice with Corporations Canada or a Form 1 with the Ontario Corporations Branch (as the case may be) to avoid future liability as a director.

SCHEDULE "A"

William H. Watson
15 Baskerville Hall
Toronto, ON
M3B 3C2

February12, 2018

To: John H. Watson Sr.
J. H. Watson Holdings Ltd.
221b Baker Street
Toronto, Ontario M5H 4G2

RE: Shareholder Meeting for J. H. Watson Holdings Ltd. (the "Corporation") Thursday February 15, 2018 at 11:00 a.m.

STATEMENT OF DIRECTOR

Opening Remarks

1. The purpose of this meeting is to do the following, namely:

   (a) to remove me as a director from the Corporation; and

   (b) to reduce the number of authorized directors from 2 to 1 in the Corporation.

[5] RSC 1985, c. C-44, s. 241, RSO 1990, c.B.16, s. 248.

[6] 2015 BCSC 1051.

2. Let me address 1(a) – why I should not be removed as a director.

   Under S. 123(2) of the *Ontario Business Corporations Act* (the "Act") I have the right to submit to the Shareholders a written statement giving the reasons why I oppose my removal as a director of the Corporation.

<u>Succession Planning</u>
The Corporation is a family business which has been in the real estate industry for almost a century. As you know, my involvement in the family business consists of sitting on the board of directors of the Corporation and giving financial and investment advice. Having a seat on the boards is crucial to my continued learning and training on the operations of the family business and to the business' successful continued growth. Additionally, in the absence of myself and my father, there is no one to represent the interests of the Watson family and to ensure the business stays in the family through to the next generation(s).

<u>Financial Experience</u>
With my experience as Vice President and Senior Investment Advisor at Sherlock Securities Ltd. and being directly responsible for the safeguarding and managing in excess of several hundred million dollars, I am well equipped to provide financial advice to the board, whenever required, and to ensure the successful continuation of the family business.

<u>Directors' Duty to Oversee</u>
Directors should assume responsibility for the integrity of the Corporation's internal control and management information systems. Without a board meeting, how could the directors oversee the sales?

Moreover, I have evidence that the sales were not at fair market value. I can provide the appraisal if required, indicating that certain properties were disposed of at significantly below market value.

Had a proper board meeting been called before the sale of these two properties, we could have considered the value of the properties and any adverse tax consequences associated with such sales.

I urge you to allow me to remain on the board, so that I may assist in considering future business decisions.

<u>Right to Inspect Books and Records</u>
Every director and officer of a corporation in exercising his or her powers and discharging his or her duties under the Act 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.

It is a fundamental right of a director to inspect corporate records and other documentation related to the corporation. I am concerned that there is other corporate information that has not been shared with the board.

3. <u>Let me address 1(b) – why the board should not be reduced to 1.</u>

I urge you to consider not removing me as a director and reducing the board to 1 director, namely, yourself. To allow me to remain as a director will allow me to assist you with fulfilling the responsibilities of a board, while ensuring the continued success of the business for this and the next generation(s).

In addition, you and I have always consulted on key decisions. You would not like jeopardizing our family's future with hasty decisions.

I very much appreciate you considering my remarks.

Fondly,

Your son
William H. Watson

RECENT CASES

Former Shareholders of Corporation Claimed Damages for Investment Losses Caused by Mismanagement by Defendants, but Claim Struck Out because Shareholders did not have Personal Cause of Action for Wrongs Done to Corporation

British Columbia Court of Appeal, November 23, 2017

Accredit Mortgage Ltd. ("Accredit") was a mortgage investment corporation. In order to maintain its status as a mortgage investment corporation under the *Income Tax Act*, Accredit was required to distribute all its net income to its shareholders through dividends. The plaintiffs were former shareholders of Accredit. The corporate defendant Great Pacific Mortgage & Investments Ltd. ("Great Pacific") was engaged by Accredit to manage its investments and related financial affairs. The directors of Great Pacific and Accredit were the same. The plaintiffs claimed that they had invested significant sums in Accredit before discovering that 88% of the loans in the Accredit portfolio were non-performing and at risk. The plaintiffs also claimed that Great Pacific and its directors were managing Accredit's financial affairs in contravention of Accredit's policies, the terms of its offering memorandum and Great Pacific's own investment policies. As a result, the plaintiffs claimed to have lost more than $3.7 million they had invested in Accredit. The plaintiffs filed a notice of civil claim against Great Pacific and directors or former directors of Great Pacific, seeking a monetary judgment in excess of $3.7 million, an accounting of fees paid by Accredit to Great Pacific and damages for misrepresentation. The plaintiffs' position was that: (a) the individual defendants had committed various false representations to induce the plaintiffs to invest in Accredit (the "misrepresentation claim"); (b) Great Pacific had mismanaged Accredit's mortgage portfolio, resulting in losses to the plaintiffs (the "mismanagement claim"); and (c) Accredit was entitled to a return of fees paid by it to Great Pacific (the "return of fees claim"). The defendants applied to strike out the mismanagement claim and the return of fees claim on the ground these were causes of action belonging to Accredit, not to its shareholders, so that the plaintiffs were barred from pursuing them under the rule in *Foss v. Harbottle* that a shareholder of a corporation did not have a personal cause of action for a wrong done to the corporation. In dismissing the defendants' application to strike, the chambers judge held that since Accredit was a mortgage investment corporation whose profits and losses must be passed on to its shareholders or investors, it was arguable that Accredit was incapable of truly suffering an actionable loss and that the plaintiffs were the only ones able to advance claims against the defendants. The chambers judge stated that the merits of the plaintiffs' argument remained to be seen, but without a full examination of all the facts, it was not plain and obvious that the plaintiffs' claim could not succeed. The defendants appealed.

The appeal was allowed. The rule in *Foss v. Harbottle* that a shareholder of a corporation did not have a personal cause of action for a wrong done to the corporation was a bedrock principle of corporate law that had survived for more than 170 years with no significant modification, apart from the statutory provision relating to derivative actions. The rule had been applied broadly to any association of persons that had a distinct legal status such that it could sue or be sued. It had been applied to trusts, limited partnerships, strata corporations and trade unions, among other entities. The fact that a loss suffered by a mortgage investment corporation would eventually be felt by its plaintiffs, through reduced dividends or a diminution of share value, was common to corporate structures. It was in the nature of any corporation that corporate losses would flow in some form or other to the detriment of its shareholders. That did not mean that the corporation had not suffered a loss. The rule in *Foss v. Harbottle* applied to mortgage investment corporations to bar shareholders from bringing an action to enforce a claim that was properly the claim of the mortgage investment corporation. The rule was a complete answer to the two claims challenged by the defendants. The mismanagement and return of fees claims were therefore struck from the plaintiffs' pleadings. However, while the plaintiffs could not maintain these claims directly, it was possible that a derivative action was available to bring these claims forward in the name of the company. No challenge was made to the right of the plaintiffs to bring the misrepresentation claim, which survived this appeal.

EY Holdings Ltd. v. Great Pacific Mortgage & Investments Ltd.

Liquidation of Corporation Appropriate Remedy where Respondent Acted Oppressively by Issuing Shares to Himself, Causing Corporation to Enter Transactions with Entities Controlled by him and Using Corporation's Funds for his Own Purposes

Ontario Divisional Court, February 6, 2018

Akman, Kocturk and Basegmez were shareholders of the corporate respondent Tarn Financial Corporation ("Tarn"). In oppression proceedings instituted by the applicants Kocturk and Basegmez, the application judge concluded that Akman had acted in a manner that was unfairly prejudicial and oppressive to Kocturk and Basegmez by purporting to issue shares in Tarn to himself, thus giving himself voting control of Tarn without their consent, by causing Tarn to enter into transactions with other entities controlled by him, by using Tarn's funds for his own purposes, and by using Tarn as a personal bank account, thus diverting millions of dollars out of Tarn for his personal benefit. The application judge ordered Tarn to be liquidated under the winding-up provisions of the *Business Corporations Act*. Akman appealed on the ground the application judge failed to explore the entire panoply of options available to remedy Akman's oppressive conduct, and, had he done so, he would have ordered the applicants' shares in Tarn to be sold to Akman, rather than requiring Tarn to be liquidated.

The appeal was dismissed. There was evidence before the application judge to support his findings of fact. Also, the application judge did consider a late offer by Akman to purchase the applicants' shares in Tarn, but justifiably rejected this on the ground if Tarn remained under Akman's management, the applicants would have no ability to obtain the information required to set a fair value for the business. Conversely, a liquidation sale provided an assurance to the parties that they would all realize their fair market value in Tarn by exposing the business to the test of the marketplace. Although a valuation and mandatory buyout of Tarn would avoid the risk that liquidation could destroy its value, a closely held corporation could often be analogized to a partnership that required trust and confidence among the investors, and if one of the partners was excluded from his entitlement to management participation, the company must be wound up. In the absence of any palpable and overriding error of fact or law by the application judge, and in the absence of any error of principle in his exercise of his discretion, there was no need to interfere with his findings. Liquidation was the most appropriate order to remedy the oppressive conduct.

Basegmez v. Akman

Petitioner Incurred Remediation Costs due to Contamination on Property Formerly Owned by Dissolved Company; Restoration of Company and Reconstitution of Directorship Ordered to Enable Petitioner to Seek Recovery of Costs

British Columbia Supreme Court, April 9, 2018

Between 1987 and 2000, the corporate respondent, Tundra Turbos Inc. ("Tundra"), owned a property on which it sold natural gas stored in an above-ground tank and gasoline stored in an underground tank. In 1993 Tundra stopped selling gasoline and in 1996 ceased selling natural gas and began decommissioning the property. Tundra conveyed the property to a numbered company in 2000. The individual respondent, Mr. Clarke, was a director of both Tundra and the numbered company. The petitioner, Mr. Foster, purchased the property from the numbered company in 2005. Because of environmental contamination problems associated with the property, Mr. Foster conducted a site remediation program and incurred $225,682.05 in remediation costs. Tundra had been dissolved in 1999, briefly restored in 2000 to allow it to transfer the property, then dissolved again in 2000, and its records were subsequently destroyed. Mr. Foster commenced a cost recovery action against a number of defendants to recover the remediation costs that he had incurred, seeking a declaration that the defendants were "responsible persons" under the *Environmental Management Act* (the "EMA") for those remediation costs. Pursuant to section 160 of the *Business Corporations Act*, Mr. Foster applied for orders for the retroactive and prospective restoration of Tundra and the restoration of Mr. Clarke as a director of Tundra. Mr. Foster aimed to add Tundra as a defendant in his cost recovery action and to seek relief against Mr. Clarke on the basis of his status as a director of Tundra. Mr. Foster submitted that it was consistent with the goals under the EMA that polluters should pay, and that companies and their directors should be precluded from using dissolution as a means of escaping liability for remediation costs. The respondents argued that "responsible persons" under the EMA did not include persons who have ceased to exist, that Mr. Clarke was severely prejudiced by the destruction of Tundra's records and that investigations thus far revealed that there was no insurance available to Tundra.

The petition was granted. The respondents conceded that all of the contamination of the property occurred while Tundra was the owner and that if it had not been dissolved it would be solely responsible for the remediation costs. The destruction of Tundra's records was not a sufficient reason to dismiss Mr. Foster's petition. This lack of documentary evidence might even be more prejudicial to Mr. Foster than to Mr. Clarke. Both Tundra and the numbered company had a common director, Mr. Clarke, and no unrelated third party was involved in the ownership of the property between the periods of ownership of those two companies. Mr. Clarke was well aware of the nature of Tundra's activities on the properties and his role in those activities. The potential use of dissolution as a means of escaping liability for remediation costs weighed in favour of restoring Tundra and reconstituting Mr. Clarke's directorship.

Foster v. Tundra Turbos Inc.

Former Directors of Company brought Oppression Petition after Company Issued Notice of Special Shareholders' Meeting, Seeking Authority to Pursue Legal Action Against Former Directors, but Meeting Never Held and Petition Dismissed as Untimely

British Columbia Supreme Court, April 9, 2018

The petitioners were past directors of the respondent company, which was closely held. The individual respondents were the company's current directors. The company alleged that the petitioners had gained unauthorized access to the company's offices and had searched its files. The petitioners, therefore, were accused of having in their possession some of the company's corporate records. The company demanded that the petitioners return these documents. In response, the petitioners denied having possession or knowledge of the whereabouts of any of the company's records. The petitioners, along with other shareholders, sent a requisition, pursuant to section 167 of the *Business Corporations Act* (the "BCA"), that a general meeting of the company be called requiring the directors, among other things, to provide a copy of any agreement entered into by the company for the purpose of leasing the community centre owned by the company; to revoke any such lease agreement; and to direct that an independent third party make a fair market appraisal of the company's shares. The company reiterated its demand that the petitioners return the corporate documents allegedly in their possession, and threatened to repurchase the petitioners' shares in the company for $1,000 per share. The petitioners again denied having any information regarding the corporate documents in dispute, and repeated their demand for the calling of a general meeting. The company issued a Notice of Special Meeting of Shareholders, in part to ratify the value of the company's shares at $1,000 each, and to authorize the company to commence legal action against the petitioners for the return of the corporate documents allegedly in their possession. The petitioners obtained a court order that the Notice of Special Meeting was not lawful and directing that the meeting not be held. The company did not seek to set aside this order and the special meeting was cancelled. Notwithstanding their pleas of vulnerability to the majority, the petitioners continued to insist that the current directors were under an ongoing obligation to conduct a special meeting for the purpose of addressing the resolutions brought forward by the petitioners in their requisition. The petitioners brought a petition for an order declaring that the respondents oppressed the petitioners, as defined in section 227 of the BCA; directing the respondents to value the shares of the company through an independent third party accredited appraiser; and requiring the company to provide the petitioners with a copy of the current lease entered into by the company. The petitioners also commenced a defamation action against the current directors, and the latter brought an application to strike the pleadings in that action.

Both the petition and the application to strike the defamation pleadings were dismissed. Subsection 227(4) required that an oppression application be brought in a timely manner. Given that the current directors were no longer pursuing their attempts to have the special meeting convened, it could not be said that they were oppressing the petitioners, so the petitioners' request for an oppression declaration was denied. The petitioners specifically indicated that they did not intend to sell their shares of the company, and, in any event, all share transactions during the time they were directors had been undertaken at the price of $1,000 per share. Their request for an order requiring a valuation of these shares, therefore, was also dismissed. The petitioners, in their capacity as shareholders, had no right of access to contracts entered into by the company's board of directors. There was neither justification nor authority for the proposition that the company should be required to disclose the terms of the lease to the petitioners, so their application for such an order was also denied. The current directors' motion to strike the defamation pleadings was dismissed, and leave was granted to amend the pleadings to include particulars that supported the allegation that the current directors published the allegedly defamatory Notice in their personal capacities rather than in their capacities as directors of the company.

Dhillon v. Sher-A-Punjab Community Centre Corp.

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