Directors in the crosshairs of the Supreme Court

August 8, 2017

Author

Bernard Trang

Senior Associate

In the context of the case of Wilson c. Alharayeri[1] ("Wilson"), issued on July 13, 2017, the highest court of the land confirmed the decision of the Court of Appeal of Québec which ordered a corporate director personally to pay an amount of $648,310 to a shareholder following an abuse he committed in respect of this shareholder. Nearly two decades after the case of Budd c. Gentra[2] ("Budd") in the Court of Appeal of Ontario, the Supreme Court of Canada seized the opportunity to reaffirm this judgment and clarify the circumstances in which the oppression remedy under the *Canada Business Corporations Act*[3] ("CBCA") may validly be exercised against a director rather than the corporation.

The test developed in Budd and adopted by the Supreme Court in Wilson to find a director extra contractually liable is less restrictive than that of the Civil Code of Québec ("**CCQ**"), which facilitates finding a director personally liable by using the remedy under the CBCA. Furthermore, although the Wilson case had been adjudicated on the basis of the federal CBCA, one may wonder about the possibility of using it in support of an application for remedy in case of abuse of power or unfairness under section 450 of the *Business Corporations Act*[4] (Québec) ("**BCAQ**").

Background

From 2005 to 2007, Mr. Ramzi Mahmoud Alharayeri ("**Alharayeri**") was the President and Chief Executive Officer of Wi2Wi Corporation ("**Wi2Wi**"). Alharayeri was also a significant shareholder of Wi2Wi, holding common shares and class A and B preferred shares. On this subject, Alharayeri was the sole holder of A and B preferred shares, which were convertible into common shares subject to the corporation meeting some of its financial targets in 2006 and 2007, respectively. Wi2Wi had also issued class C preferred shares, many of which were ultimately held by Mr. Andrus Wilson ("**Wilson**").

In March 2007, as negotiations pertaining to the merger of Wi2Wi and Mitec Telecom Inc. ("**Mitec**")

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

had been undertaken as a result of Wi2Wi having cash flow issues, Alharayeri simultaneously entered into a share purchase agreement with Mitec, without the knowledge of Wi2Wi, on whose board he sat. Once the board of directors was informed of Alharayeri's manoeuvre, he resigned and Wilson took control of the corporation's management.

Over the following months, Wi2Wi's financial woes continued. As a result, the corporation offered to the holders of its common shares secured notes which could be converted into common shares in the context of a private placement. This decision resulted in, among other things, reducing the percentage of common shares held by the shareholders who did not participate in the private placement. Moreover, for the purpose of enabling Wilson to participate, the corporation had previously accelerated the conversion of Wilson's class C preferred shares into common shares, despite the fact that doubts remained as to the validity of this conversion from a legal point of view.

However, no class A and B shares, which were solely held by Alharayeri, was converted into common shares, despite the fact that they could be in the light of the financial tests established in the constating documents of the corporation. Wilson was maintaining that converting Alharayeri's shares would not be appropriate in light of his conduct. Alharayeri has therefore been prevented from participating in the private placement and the value of his preferred shares, as well as the percentage of the common shares he held, was materially reduced. In view of the situation, Alharayeri instituted an oppression remedy under section 241 CBCA against four directors of Wi2Wi, including Wilson..

The oppression remedy under the Canada Business Corporations Act

The oppression remedy under section 241(3) CBCA is an equity remedy which allows the Court to make any interim or final order against a corporation or director to remedy a situation of abuse. The Budd judgment, issued in 1998 by the Court of Appeal of Ontario, established the essential guidelines for analyzing the liability of directors in the context of an oppression remedy by establishing a two pronged approach to directors' personal liability. Since the Budd case has not been uniformly applied throughout Canada, the Supreme Court seized the opportunity to finally clarify the guidelines applicable in determining the personal liability of directors under the CBCA.

Firstly, the oppressive conduct must be attributable to the director because of his or her action or inaction, particularly in respect of the powers conferred on him or her. Secondly, the application for remedy must in itself be a fair way of dealing with the situation and must be relevant in the light of the facts in dispute. In this respect, the Supreme Court notes that the relevance of imposing personal liability on a director must be assessed in the light of four general principles, which may be summarized as follows:

> The oppression remedy must in itself be a fair way of dealing with the situation. For instance, finding a director liable will tend to be fair when the director derives a personal benefit from the abuse, particularly an economic benefit or increased control over the corporation. To this effect, it is important to note that the existence of a personal benefit is only an indicator pointing towards a director's liability, it is not a mandatory criterion.
> Being of a remedial nature, the order must not exceed what is necessary to rectify the situation of injustice or inequity between the parties.
> The order may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders.
> Director liability cannot be a surrogate for other forms of statutory or common law relief. The courts must therefore consider the general context of corporate law in the context of the oppression remedy.

In the light of the facts in dispute and the test developed in the Budd case, the Supreme Court has concluded that Wilson had had a lead role in the decision of the board of director of Wi2Wi not to convert Alharayeri's preferred shares into common shares, which prevented the latter from participating in the private placement. The Court has further ruled that the oppression remedy

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

constituted an equitable manner to remedy the situation of abuse and was relevant in the light of the circumstances of the case. In fact, the abuse provided Wilson with a personal benefit, that is, increased control of the corporation to the detriment of Alharayeri. The order for a payment in the amount of $648,310 to Alharayeri thus constituted an equitable remedy for the abuse since it represented what Alharayeri would have obtained if his preferred shares had been validly converted into common shares. The reasonable expectations of Alharayeri have been respected.

The applicability of the Wilson case to the rectification remedy under the Business Corporations Act (Québec)

Following the Wilson case, one may wonder about the possibility of relying on its principles in support of a rectification remedy under the BCAQ. First, it must be noted that the wording of section 450 BCAQ is nearly identical to that of section 241 CBCA, which, according to author Paul Martel[5], results in the case law dealing with the CBCA being applicable to remedies under the BCAQ. The Superior Court of Québec has already explained that "the courts may draw from the case law developed concerning similar remedies under the CBCA"[6] to analyze the remedies under the BCAQ.

Accordingly, it is reasonable to believe that the Wilson case may at least guide the reasoning of the judges in implementing the remedy under provincial law. However, some distinctions between the remedies will have to be taken into consideration by the courts when analyzing the rectification remedy under the BCAQ:

> The CBCA provides for three situations which may give rise to the oppression remedy under section 241, namely, abuse, unfair prejudice and unfair omission to take into account the interests of security holders, creditors, directors or officers. However, section 450 BCAQ only provides for two situations which may give rise to the rectification remedy, namely, abuse and unfair prejudice. The equity remedy of the CBCA, which takes into account the interest of security holders, creditors, directors or officers, does not exist under the BCAQ.
> Under the CBCA, the order must only satisfy the reasonable expectations of security holders, creditors, directors or officers, while the remedy under section 450 CBAQ does not take into account the interests of creditors, as section 241 CBCA does. The provincial statute only takes into account the interests of security holders, directors and officers of the corporation. As a result, the relevance of imposing personal liability on a director must be assessed without regard for the interests of the creditors.

The provincial rectification remedy only exists since February 14, 2011, the date on which the BCAQ came into force, and few decisions dealing with section 450 BCAQ have been rendered by the courts. It will therefore be interesting to note to what extent the Wilson case will be applied in the context of a rectification remedy in case of abuse of power or inequity. Considering the application of the BCE Inc. v. 1976 Debentureholders[7] ("**BCE**") case in support of many rectification remedies under provincial law[8] it is reasonable to believe that the Wilson case will also be relied upon by Québec practitioners in the context of such proceedings, especially in view of the fact that BCE had also been judged on the basis of the CBCA.

Comments

Did the Supreme Court facilitate finding directors personally liable by establishing a test which is less restrictive than that provided for under the CCQ?

In principle, under the CCQ, a director cannot be held liable for the actions and obligations of the corporation he or she administers since the corporation is separate from its members[9]. Without relying on the lifting of the corporate veil[10], proceedings can however be directed against a director when he or she commits an extra contractual fault independent from the corporation's obligations or is an accomplice thereto. Such a remedy requires the plaintiff to establish the presence of a fault[11],

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

prejudice and causal link between the two last elements. However, as it has been demonstrated in the case of Multiver ltée c. Wood[12], the burden of proof may be heavy. In fact, a director who commits a fault in the context of his or her mandate is not necessarily found extra contractually liable[13].

Then, although lifting the corporate veil may be considered, case law[14] has established that it is an exceptional remedy which can only be relied upon in cases where a director hides a fraud, an abuse of right or a breach of a public policy rule while standing behind the corporation.

In fact, it seems that it will henceforth be easier to find corporate directors personally liable under corporate laws than under the CCQ, to the extent that a situation of oppression exists within a corporation.

Lastly, the test developed in Budd and used in Wilson sets out many indicators to assess the fairness of oppression remedy, particularly the existence of a personal benefit. However, the non exhaustive nature of such indicators gives broad discretionary power to the courts for finding a director personally liable. Directors will have to be very cautious and diligent in discharging their duties as it may be easier to find them personally liable in the context of a remedy under the federal and provincial corporate statutes rather than the CCQ.

---

1. *Wilson c. Alharayeri*, 2017 SCC 39.
2. *Budd c. Gentra Inc.*, 43 B.L.R. (2d) 27 (C.A. Ont.).
3. R.S.C. (1985), ch. C-44.
4. CQLR, c. S-31.1.
5. Paul Martel, *La société par actions au Québec*, vol. 1, Les aspects juridiques, Montréal, Wilson & Lafleur, Martel Ltée, 2013, no. 31-506.
6. *Gagné Excavation ltée* c. Vallières, 2015 QCCS 6223, par.a 44. Also see *Groupe Renaud-Bray inc.* c. Innovation FGF inc., 2014 QCCS 1683, par.a 56.
7. [2008] 3 S.C.R..560.
8. Particularly see *Groupe Renaud-Bray inc.* c. Innovation FGF inc., 2014 QCCS 1683 et *Langlois c. Langlois*, 2015 QCCS 4203.
9. 309 C.C.Q.
10. 317 C.C.Q.
11. As, for example, a breach of the duty of care and diligence in general or of the duty of honesty and loyalty to the corporation (article 322 C.C.Q.).
12. *Multiver ltée* c. Wood, 2015 QCCS 2847.
13. *Ibid*, para. 73.
14. Particularly see *Avi Financial Corporation (1985) inc.* c. *Pyravision Teleconnection Canada inc.*, 1998 CanLII 11474 (QCCS), para. 58.

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.