The Supreme Court clarifies the circumstances in which the director of a corporation can be held personally liable for oppression

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While the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("**CBCA**") is silent on the circumstances that will result in a director's personal liability for oppression, and the Canadian courts have failed to agree on the application of the principles considered in the case law in this regard, in the recent decision in *Wilson* v. *Alharayeri* [1] (hereinafter "Wilson"), the Supreme Court has now clarified the essential criteria that apply.

Background

This case originated in 2007 at a time when Wi2Wi Corporation, a technology company incorporated under the CBCA, was facing recurring cash flow issues.

Prior to the events that led to the dispute, Mr. Alharayeri held 2 million common shares of the Corporation and was the sole holder of class A preferred shares (1 million) and class B preferred shares (1.5 million) (hereinafter the "A shares" and "B shares" respectively).

The A shares were convertible into common shares if the Corporation met certain financial targets in the 2006 fiscal year, while the conversion of the B shares was also subject to certain targets to be met in the 2007 fiscal year.

On the other hand, Mr. Wilson, the President, CEO and member of the audit committee of Wi2Wi, beneficially owned or controlled 100,000 class C preferred shares ("C shares") through another company. The C shares were also convertible into common shares if the Corporation achieved a financial target, set out in its articles of incorporation.

In order to resolve the Corporation's persistent financial difficulties, Wi2Wi's board of directors decided to offer a private placement of convertible secured notes to its common shareholders (the "Private Placement"), giving each shareholder the right to subscribe for $1 in notes for every two common shares the shareholder held in the Corporation. The notes were convertible into common shares at the rate of 50,000 common shares per principal amount of $1,000 in notes.

This Private Placement enabled Mr. Wilson, provided that he first converted his 100,000 C shares into common shares, to subscribe for 50,000 notes of $1, for a value of $50,000 in notes. He would then be able to convert every $1,000 tranche of this $50,000 in notes into 50,000 common shares, giving him a total of 2,500,000 common shares. Thus, the Private Placement would have the effect

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of considerably reducing the proportion of common shares held by Mr. Alharayeri, if he did not participate in this transaction.

Before implementing the Private Placement, the board of directors decided to “accelerate” the conversion into common shares of the 100,000 class C shares beneficially owned by Mr. Wilson through another corporation. This so-called “accelerated” conversion was completed despite the doubts expressed by the auditors as to whether the test for the conversion of these shares had been met. The other C shareholders did not benefit from this conversion.

Furthermore, despite the fact that the audited financial statements for 2006 contained a note stating that, based on the financial test laid out in the articles of incorporation, the A shares, held by Mr. Alharayeri, could, at the holder’s option, be converted into 1 million common shares, and despite the fact that he had made requests at meetings of the board of directors and by email for those shares to be converted, this was never done.

Similarly, Mr. Alharayeri’s B shares were also not converted, notwithstanding that, based on the approved 2007 financial statements, they could be converted into 223,227 common shares.

Mr. Wilson and the audit committee justified the failure to convert Mr. Alharayeri’s shares by pointing to the fact that he had placed himself in a conflict of interest in the past when he was previously the president of Wi2Wi.

Dispute

As a result of this failure, the value of Mr. Alharayeri’s A and B shares — convertible as they were into common shares — greatly decreased. Faced with what he alleged to be oppressive conduct by the Corporation, Mr. Alharayeri filed an application for oppression in the Superior Court of Québec under s. 241(3) of the CBCA against some of the corporation’s directors, including Mr. Wilson. The issue before the Court was not the right to relief itself, but rather, whether or not Mr. Wilson was personally liable.

Indeed, while section 241 CBCA gives the trial judge broad discretionary powers to “make any interim or final order [he or she] thinks fit” against a director personally, it does not specify the circumstances in which a director is justified in being held personally liable under this provision.

Applicable principles

To date, in the leading decision on the issue of whether or not a director can be held personally liable, rendered by the Ontario Court of Appeal in 1998 in *Budd v. Gentra Inc.*[2], the Court had adopted a two-pronged test. Thus, according to this test, (1) the oppressive conduct must be properly attributable to the director because he or she is implicated in the oppression, and (2) the imposition of personal liability must be fit in all the circumstances.

Regarding this second prong of the test, in *Wilson*, the Supreme Court of Canada states that a minimum of four general principles must be considered for this part of the analysis:

> The oppression remedy must in itself be a fair way of dealing with the situation. For example, it may be fair to hold a director personally liable where he or she has derived a personal benefit — whether in the form of an immediate financial advantage or increased control of the corporation — breached a personal duty or misused a corporate power, or where a remedy against the corporation would unduly prejudice other security holders;
> The order rendered should go no further than necessary to rectify the oppression;
> The order rendered may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders;
> The court should consider the general corporate law context in exercising its remedial discretion

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After identifying these principles, the Supreme Court upheld the trial judge's analysis to the effect that Mr. Wilson should be held personally liable for oppression, and also upheld the conclusion ordering him to pay compensation in the amount of $648,310 to Mr. Alharayeri.

On the first prong of the test, the Supreme Court affirmed that Mr. Wilson was implicated in the Corporation's oppressive conduct, since he played a lead role in the board of director's discussions resulting in the non-conversion of Mr. Alharayeri's A and B shares.

On the second prong of the test, it noted firstly that the oppression remedy was a fair way of dealing with the situation. Mr. Wilson accrued a personal benefit from the oppressive conduct, namely he increased his control over Wi2Wi through the conversion of his C shares into common shares (while the C shares of others were not converted), which enabled him to participate in the Private Placement, despite the existence of doubts as to whether the test for conversion had been met. This was all done to the detriment of Mr. Alharayeri, whose own interests in the company were diluted due to his inability to participate in the Private Placement.

The Court then noted that since the compensation ordered corresponded to the value of the common shares prior to the Private Placement, the remedy went no further than necessary to rectify Mr. Alharayeri's loss.

Finally, the remedy was appropriately fashioned to vindicate Mr. Alharayeri's reasonable expectations that :

1) his A and B shares would be converted if the Corporation met the applicable financial tests set out in the Corporation's articles, and
2) the board would take into account his rights in any transaction having an impact on the A and B shares.

Conclusion

Thus, this decision clarifies the framework for analyzing the personal liability of directors and is a new and important ruling which should be taken into account by any board of directors that is concerned about providing good governance.

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1. 2017 SCC 39.
2. 1998 CanLII 5811 (ON CA), 43 B.L.R. (2d) 27 (C.A. Ont.).

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