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Corporate Governance and Minority Rights

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I. Introduction

Anglo-American corporate law has developed on the premise that ordinarily the majority is entitled to rule. Nevertheless, the courts have recognized the dangers in permitting tyranny by the majority and have given relief in cases where they believed the majority was clearly abusing its powers. Courts have had little difficulty in doing this where it was clear that the majority was practising fraud in the sense that it was appropriating to itself property or benefits which, in the view of the courts, belonged to the corporation or, as it was sometimes put, to the body of shareholders as a whole. However, the courts have had much greater difficulty in dealing with cases where the majority was not committing a "fraud", but, rather, was causing the company to pursue a course of action because of interests extraneous to their position as shareholders. So far, our courts have failed to develop a coherent set of principles which may be applied to determine when the power of the majority should be restrained in such circumstances, and the result is that it is very difficult to predict what limitations courts will place on the power of majorities.

Courts normally have allowed the majority to settle the direction a corporation should take on the ground that the shareholders are the best judges of their own interests and, accordingly, their business judgment and that of the directors they elect is to be preferred to that of the courts. This is a sensible principle in cases where the shareholders have a mutuality of interest, but it ceases to have the same persuasive force when such a mutuality of interest does not exist. In such cases, the course being followed by a corporation may be dictated by interests which are peculiar to some of the shareholders, and which may be contrary to the interests of the corporation. As more and more public corporations become controlled by a dominant shareholder, who either holds a majority of the shares or sufficient shares to control the proxy machinery, the relations of majorities and minorities become increasingly important

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both for the corporations and society. In practice, large corporations today are effectively controlled by those who are in control of the proxy machinery and thus are able to select the directors and, more importantly, the management of the corporations. In today's industrial society, business is so complex that it is often difficult to determine the wisdom of particular decisions without full access to all relevant information. Thus, management is able, in most corporations, to operate the business with very little in the way of effective supervision. Its unique access to the information necessary to make sensible judgments truly makes it, in a sense, king of all it surveys. Thus, it is vitally important to the corporation that the directors and management serve its interest, rather than their own.

As the modern corporation in a private enterprise society is the primary means of organizing economic activity and marshalling the finances necessary to do so, the operation of the corporate system is not only of interest to its shareholders but has very important implications for society. Although it is now recognized that a corporation may pursue objectives which are not limited to the earning of a profit for its shareholders, it is still recognized that this is its primary objective;¹ the pursuit of profit is generally recognized to be the motivating factor in its operations. This modern view differs little from the view expressed in *Dodge v. Ford Motor Company*,² where it was said that "a business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end, the discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the non-distribution of profits among shareholders in order to devote them to other purposes." Although that principle has been extended to permit the corporations to engage in activities which are not primarily directed to profit-making, the concept that the corporation exists for the principal purpose of shareholder gain is still one that commands almost universal recognition and is a basic premise of a private enterprise system. Accordingly, when those in control of a corporation cause it to engage in transactions motivated by their own particular interests, rather than by any desire to enhance the gains of the shareholders,

1. Principles of Corporate Governance and Structure, Tentative Draft No. 1 of the American Law Institute (Philadelphia) 1982, at p. 17.

2. *Dodge v. Ford Motor Company* 204 Mich. 459, at p. 507.

they are causing the corporation to depart from its fundamental objective. Once that happens, the power of the majority to direct the affairs of the corporation should be questioned and curbed, not only in the interests of the particular shareholders involved, but in the interest of the system. If the corporation is to continue to play the cardinal role it now does in the private enterprise system, it is essential that shareholders be treated equitably and that their interests not be sacrificed to those of the majority. Otherwise, confidence in the system may be undermined and it will be a much less effective way of organizing resources for commercial purposes.

Although the courts have acted to curb the most flagrant abuses of power by majorities, the movement in the United Kingdom and Canada has been painfully slow. Consequently, the development of adequate remedies by the courts has been supplemented, particularly in recent years, by statutory changes intended to afford greater protection for minority rights. These changes have made some substantive alterations in the law and have also empowered the courts to relieve a protesting shareholder from the crushing burden of costly litigation. The statutory reforms have relied heavily on the experience in the United States with regard to adopting the appraisal remedy, which gives a dissenting shareholder a right, in effect, to withdraw from the corporation if he is dissatisfied with a fundamental alteration in his rights or in its affairs. This was thought to be an effective way of protecting minorities in many situations while allowing majority control to prevail, and to ensure a satisfactory balance when coupled with an enlarged oppression remedy. In making these reforms, the legislatures have continued to rely heavily on the litigious process to provide a remedy. Despite these statutory and judicial initiatives, it is questionable whether an appropriate result has been achieved. As the differences between the rights conferred by constitutions and the rights actually enjoyed all too frequently demonstrate, it is vitally important that conferred rights be real rights in the sense that they can be practically enforced. By this standard, the existing system of protecting shareholders' rights falls far short of the ideal, as they are not easily enforceable and sometimes illusory, and the result is often that a determined majority may obtain an unfair advantage.

The main cornerstones of the protection afforded to shareholders under the existing common law and the statutory law consist largely of:

- (a) a requirement that directors shall not participate in decisions when they have conflicts of interest, so that decisions will be taken by independent directors;
- (b) an obligation of directors to account when they obtain advantages which the courts regard as properly belonging to the corporation;
- (c) an appraisal remedy for dissenting shareholders enabling them to withdraw when fundamental changes are made;
- (d) the ability of the court to give relief when it finds that the business of the corporation is being carried on or the powers of its directors are being exercised in a manner which is oppressive or unfairly prejudicial or unfairly disregards the interests of shareholders; and
- (e) the ability of the courts to require majorities to act appropriately by expanding the common law as to the duties of directors and to impose fiduciary obligations on those exercising control over corporations.

Although the legislative and judicial developments of recent years have vastly improved the lot of the minority, there is still a substantial opportunity for abuse. This is particularly true of the relations between a parent and its subsidiary, where the subsidiary and parent carry on business with one another and where the management of the subsidiary is selected by the parent. It is also true of transactions involving a corporation and its dominant shareholder. Many of these transactions, and particularly those which are out of the ordinary course of business, are so complex that intensive investigation is needed to determine whether or not they are fair to the corporations involved. Corporate reorganizations are also, on occasion, matters of infinite complexity, and, commendable as the legislative attempts to provide the shareholder with adequate disclosure have been, the result, all too frequently, is that the average shareholder is confused and bewildered by the volumes of explanations showered upon him. Even when he completely understands the transaction, he will find, as any number of proceedings before securities commissions amply demonstrate, that there are almost as many opinions as to the fairness of a transaction as there are fiscal agents. Thus, the task of a shareholder in even obtaining the necessary information and expertise to form a reasoned judgment about such transactions is not a simple one.

The existence of an independent board of directors can, and undoubtedly does, provide a significant protection for the interests of minorities. However, it must be recognized that more than

apparent independence is necessary to secure this protection because it requires an independent spirit to assume what may be the heavy burden of opposing the will of the majority. It is certainly possible to find corporations with a quiescent board ready to approve what the dominant shareholder wishes. Courts have recognized that it is sometimes asking too much of human nature to expect disinterested directors to view with the necessary objectivity the actions of colleagues whom they respect and with whom they have close ties.³ Thus, this safeguard may prove inadequate.

It is no easy task to arrive at an appropriate balance between the rights of minorities and those of majorities, as there is a danger in the tyranny of the minority as well as in the tyranny of the majority. Nevertheless, it is suggested that the existing situation is not satisfactory and that further changes are needed if the system is to work satisfactorily. An attempt will be made to demonstrate some of the inadequacies of the present system and to suggest some possible changes. Attention will be focussed on the legislative approach represented by the Canada Business Corporations Act, as it is fairly representative of the Canadian legislative reform.⁴

II. *Liabilities of Directors*

The role of the director in ensuring that the manner in which a corporation is being operated is in the interests of the shareholders is fundamental. It is sometimes argued that, in a large, complex corporation, the director only serves the purpose of ratifying the decisions of management. This undoubtedly is a great exaggeration in the case of most corporations, and, where it is true, directors are now running significant risks. Although courts are unlikely to question business judgments, even though proved erroneous by events, they are likely to fix a jaundiced eye on the director who makes little or no attempt to carry out his duties or who clearly serves interests other than those of the corporation. Directors have the right to demand all the information necessary to make informed decisions and to determine whether the actions of management are in the interests of the corporation. Accordingly, they should be the first line of defence with regard to the interests of the shareholders. It is gratifying that our courts and legislatures are moving to impose a high standard of fiduciary duty on those who are responsible for

3. *Lasker v. Burkes* 567 F. (2d) 1208 at p. 1212.

4. S.C. 1974-5, c. 33.

the affairs of corporations and that they have the power to see that they are managed with due regard to the interests of all shareholders.

The position of directors has been altered significantly in recent years by legislative changes making it significantly easier for minorities to bring actions and by a clearer and broader judicial delineation of the circumstances in which directors are accountable to corporations for breaches of their duty. The result is that a minority shareholder with a reasonable case has a much better opportunity to obtain relief when directors misuse their position than he previously had.⁵ In the past, one of the principal barriers faced by a minority seeking relief was the danger that it would be visited with crippling costs if it failed to succeed. Indeed, the problem of funding litigation as such a complex transaction progressed often constituted an effective bar which gave minorities pause, even when they were assured that their chances of success were excellent.

In the United States, the problem of funding was met by the use of contingent fee litigation, which resulted in much easier access to the courts, although the use of such fees has often been criticized and such litigation, although it has its ardent defenders, still provokes criticism.⁶ Whatever the merits of this debate, there can be no question that such actions in the United States often failed to benefit the corporation or its shareholders because there was a tendency for the real antagonists to reach private settlements that maximized their own interests. For example, the American Law Institute's analysis of the problem concluded that this could happen because the plaintiff accepts a settlement well below the discounted value "of a litigated outcome in return for the agreement of the individual defendants to approve a higher award of attorneys' fees," while "[t]he defendants may obtain covert reimbursement . . . of any damages they contribute to the settlement fund."⁷ Lately, it may be that the balance of advantage in the United States has swung significantly in favour of the defendants, as the courts have tended to accept the decisions of boards to terminate actions because the board believed they were not in the corporation's best interests. It is interesting that the institute concluded it could neither

5. *Ibid.*, s. 232.

6. Principles of Corporate Governance and Structures, *supra*, pp. 227-240.

7. *Ibid.*, p. 226.

endorse the derivative action nor, in the absence of experience with other forms of enforcement, recommend its curtailment. Rather, its thrust was to opt for a greater judicial oversight, and in this it adopted the same route as the Canadian legislative reform.⁸

Section 232 of the Canada Business Corporations Act provides that a complainant may apply to the court for leave to bring an action on behalf of the corporation for the purpose of conducting an action on behalf of the body corporate. No action may be brought unless the complainant has given reasonable notice to the directors of its intention to apply to the court for such an order if the directors do not bring an action and the court is satisfied that the complainant is acting in good faith and it is in the interests of the corporation for the action to be brought. Section 233 gives the court wide powers to supervise the conduct of the litigation and, most importantly, a power to require the corporation to pay reasonable fees incurred by the complainant. This power is sufficiently wide to permit the court to require the payment of fees from time to time as they are incurred, so that the plaintiff is not faced with the expense of funding lengthy litigation. Thus, the difficulties which were placed in the way of a minority shareholder by the rule in *Foss v. Harbottle*⁹ were swept away, and in meritorious cases at least some assurance was given that the shareholder would not be forced to pay substantial legal costs. It is to be hoped that the Canadian courts will follow the decision of the English Court of Appeal in *Moir v. Wallerstiner*¹⁰ and hold that shareholders acting reasonably in the commencement of a derivative suit, which they must be deemed to do if the court gives its approval, will be entitled to be compensated for costs, whatever the result of the action. Unfortunately, section 233 does not confer any specific power to require the corporation to pay other expenses of such litigation, such as experts' fees. Often, such litigation requires the investigation and evaluation of involved transactions, which can prove time-consuming and expensive. A court might require a corporation to pay such expenses under its general power to make orders, but might believe that the specific power to award costs implied a legislative intent to confine such awards to legal fees. Accordingly, it is regrettable that a specific right to require such a payment was not included in section 233. However, section 233 does give the court the power to direct that a

8. *Ibid.*, p. 298 *et seq.*

9. (1843) 2 Hare 461.

10. [1975] 1 All E.R. 849.

recovery obtained in such an action may be paid to former security holders. This recognizes the problem created by the common law rule that the right to recover as a result of a director's failure to perform his duty rested with the corporation; the result was that the recovery, after years of litigation, often benefitted the current shareholders, rather than those who had suffered as a result of the wrongful act. The power of the court to give directions for the conduct of the action avoids the problems encountered with contingent fee actions, in which the interests of the shareholders bringing the action may be preferred to those of all shareholders when settlements are made.

The duties to be exercised by directors and officers have been codified by providing that such persons must:

- (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.¹¹

Whether these changes enlarged the common law duties as much as the furor created at the time of their introduction would have one think is questionable. Certainly, the draftsmen did not believe they were making any fundamental change in the general duty of loyalty and good faith, stating that the section was "simply an attempt to distill the effect of a massive case law illustrating the fiduciary principles governing the position of directors."¹² The draftsmen did suggest that the language would have the effect of eliminating the so-called collateral purpose or abuse of power doctrine which courts had used to restrict what they regarded as an improper use of the powers conferred on directors; for example, courts had used this doctrine to prevent directors from exercising their power to issue shares to maintain control of a company.¹³ This doctrine had resulted in considerable confusion as to the cases in which courts could interfere; the draftsmen believed it desirable to simplify the test so that the real question was whether the decision was an honest one, made in good faith and with a view to the best interests of the corporation. The draftsmen did believe that they were increasing the duty of care by requiring that a director should exercise the care,

11. C.B.C.A., *supra*, s. 117.

12. Proposals for a New Business Corporations Law for Canada, Vol. 1, p. 81.

13. *Hogg v. Cramphorn Ltd.*, [1967] Ch. 254; *Bamford v. Bamford* (1969) 1 All E.R. 969.

diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.¹⁴ It was thought, as a result of decisions such as *Re: City Equitable Fire Insurance Company*, that a director was previously required only to demonstrate the degree of care, skill, and diligence that could reasonably be expected of him having regard to his experience.¹⁵ It may be questionable whether, in practice, a court would effectively judge a director by a lesser standard than that adopted, at least in modern times, or whether a counsel, acting for a director, would plead that, having regard to the experience of his client, he should be expected to have less skill than a reasonably prudent person would exercise in comparable circumstances.

The duties imposed on directors by section 117 are very general in their scope and their actual scope will depend upon the attitude of the courts. The legislation does free the courts of some earlier self-imposed limitations and permits them to impose more rigorous standards than they did in the past. Nevertheless, as in most cases, the general principles established by section 117, and particularly those relating to good faith, merely repeat statements in our jurisprudence; the positions established by the courts are likely to be maintained, save where it is obvious that the legislative intent was to effect a change. Courts have been notoriously loath to interfere with the business judgment of directors, and it is unlikely that the legislative changes will alter this judicial attitude towards decisions which they believe, however mistakenly, were entered into with a view to the benefit of the corporation. The major developments may be expected in the field of the fiduciary duties of directors, where courts recently have tended to enlarge the obligations of directors and officers, and it is in this area that the problem of minority rights is most likely to arise.

Anglo-Canadian courts have had very little difficulty in dealing with cases where a director has made a secret profit or has had a clear conflict of interest resulting in a preference of his own interest to that of the corporation. Unfortunately, they have failed to enunciate a set of coherent rules establishing the extent of the fiduciary obligations of directors, with the result that it was and is very difficult to forecast what a court might do from case to case. This is rather unfortunate, as the courts had, over a period of

14. Proposals for a New Corporations Law, *supra*, p. 83.

15. *Re City Equitable Fire Insurance Company*, [1921] Ch. 425.

hundreds of years, developed rules relating to trustees and agents which could very well have served as a basis for clearer guidelines for the responsibility of directors charged with the management of the property and affairs of a corporation. Thus, Lord Chancellor King, in *Keech v. Sanford*,¹⁶ ruled that a trustee might not acquire a lease but must hold it for his beneficiary, notwithstanding that the landlord refused to renew to the beneficiary and the trustee had acted in perfectly good faith. Thus, the ambit of the duty did not depend on loss to the trust or the acquisition of a benefit by the trustee at the expense of the trust or on whether the trust could acquire the opportunity. The trustee was not entitled to hold the lease in any event. The objective of the courts was to ensure that trustees were not placed in the way of temptation in the exercise of their duties and to avoid enquiries by courts where it would be almost impossible to determine whether the trustee had served his legal master or himself.¹⁷

Much time was devoted by courts and commentators to examining the differences in the functions carried out by directors and trustees. These distinctions served only to hamper the development of a rule based on what cannot be denied — the fiduciary position of directors. The rules as to directors' obligations of good faith are not dependent on their position as trustees but, rather, on their position as fiduciaries of whom courts of equity have consistently demanded high standards of good faith.¹⁸ Thus, Lord Upjohn, in a case involving trustees, said that "the relevant rule of decision of this case is the fundamental rule of equity that a person in a fiduciary position must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest are in conflict."¹⁹ This is a point which was put repeatedly, by Mr. Justice Kellock and Mr. Justice Rand, to counsel for the directors during the argument in *Zwicker v. Stanbury*.²⁰ It is rather unfortunate that the judgment did not clearly place the liability solely on this rule, rather than relying on English authorities, such as *Regal (Hastings) Ltd. v. Gulliver*,²¹

16. *Keech v. Sanford* (1726), 25 E.R. 223.

17. *Benson v. Heathorn*, 62 E.R. 909, at p. 916.

18. *Phipps v. Boardman*, [1967] 2 A.C. 46, at p. 123; see also pp. 102, 103, 107, and 118.

19. *Ibid.*, p. 103.

20. *Zwicker v. Stanbury* (1953) 2 S.C.R. 438.

21. *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378.

to impose liability because the opportunity arose “by reason and in course of their office as directors.” If that had been done, some of the difficulties would have been avoided which have arisen because of the doctrine, often attributed to *Regal*, that the accountability of a director depends upon showing that opportunities were appropriated which arose by reason and in the course of one’s execution of the office of director. It may be questioned, as Dean Beck has done, whether the judgments in the *Regal* case really justify such a narrow approach.²² Indeed, when one reads the judgments of all the law lords, there is nothing to indicate that they intended to narrow the accountability of fiduciaries or to negate the concept that directors should have the responsibility of advancing the interests of the corporation and, thus, prefer the corporation’s interests to their own.

Nevertheless, the Supreme Court of Canada, in *Peso Silver Mines v. Cropper*,²³ did, relying on *Regal*, make some comments which can and have been construed as restricting the obligation of directors to account to cases where it can be shown that the opportunity in question was obtained by reason of and in the course of the directors’ execution of their office. In the *Peso* case, the directors of *Peso* formed a private company to acquire some claims which they, as *Peso* directors, had previously been offered, but had turned down because *Peso* could not afford to acquire them. There was a finding that all of the directors had acted in good faith in rejecting the offer, with the result that the Supreme Court of Canada found that the defendants were not accountable, as the opportunity had not been obtained by reason of the fact that they were directors and were in the course of their execution of that office.²⁴ Mr. Justice Cartwright referred extensively to the judgments of *Regal*, concluding that he agreed with the statement of Lord Russell that “having obtained these shares by reason and only by reason of the fact that they were directors of *Regal* and in the course of execution of that office, [they] are accountable for the profits which they have made out of them.”²⁵ Accordingly, it was held that, as there was a good faith rejection of the claims by the *Peso* board, the purchase was not in the course of the execution of the directors’ office as such. The difficulty with the decision is that no one really can determine

22. *The Saga of Peso Silver Mines*, 49 C.B.R., 80 at p. 107.

23. *Peso Silver Mines v. Cropper* (1966), 58 D.L.R. (2d) 1.

24. *Peso*, *supra*, p. 8.

25. *Ibid*, p. 7.

whether directors might or might not have acquired the necessary financing for the claims if they had been precluded from acquiring the property for themselves. It leaves the opportunity open to directors to acquire for themselves what they may have a duty to acquire for the corporation, so long as, in their judgment, made bona fide, the opportunity cannot be acquired for the corporation. Indeed, the Supreme Court of Canada, in *Zwicker v. Stanbury*, was faced with a very similar problem and, in the circumstances of that case, rejected the argument that directors could acquire a second mortgage for themselves which the company was in no position to repay, indicating that the directors had been motivated solely to advance their own interests.²⁶ The motives of directors in rejecting opportunities may not always be easy to ascertain.

It is submitted that turning the question on the bona fides of directors places the court in a difficult position, as Lord Wright indicated in the *Regal* case, where he said that “[t]he facts are generally difficult to ascertain or are solely in the knowledge of the person who is being charged, they are matters of surmise; they are hypothetical because the enquiry is as to what would have been the position if that party had not acted as he did, or what he might have done if there had not been the temptation to seek its own advantage, if, in short, interest had not conflicted with duty.”²⁷ In many cases, business transactions are infinitely complex, and it will be difficult, if not impossible, for courts to ascertain whether directors did all that could be done to secure the interests of the corporation if they are free to pursue their own interests once a factual situation is created where it can be said that they acted bona fide in turning from a pursuit of the corporation’s interests to a pursuit of their own.

In these circumstances, the decision of *Canadian Aero Services Limited v. O’Malley*²⁸ was a welcome initiative by a unanimous Supreme Court to re-examine the governing principles for directors’ liability. The case is not so notable for what it actually decided as it is for the approach taken in the judgment towards the *Regal* case. The defendants were directors and officers of the plaintiff, which was engaged in the business of geophysical exploration. The defendants had spent some time in connection with an aerial mapping project in Guyana. At a time when the negotiations for the

26. *Zwicker v. Stanbury*, *supra*, 448 at p. 450.

27. *Regal*, *supra*, p. 392.

28. *Canadian Aero Services Limited v. O’Malley* (1973), 40 D.L.R. (3d) 371; (1974) S.C.R. 592.

job were well advanced, the defendants retired, formed their own company, and succeeded in obtaining the contract. The plaintiff sought to recover the benefit of the corporate opportunity which it had been developing, but its action failed at trial and in the Ontario Court of Appeal because the benefit or advantage had not been obtained “by reason and in the course of their office as directors.” The reasoning was that the defendants had not obtained any confidential information, and, as they had resigned, they had not obtained the opportunity in circumstances where they had a liability to account. Laskin J., writing for the court, held that a director, either secretly or without the approval of the company, could not acquire any property or business advantage belonging to the company or for which it had been negotiating.

The judgment repudiates the view of the *Regal* case taken by Grant J. and the Court of Appeal, as Laskin said that it was a mistake “to encase the principle stated and applied in *Peso*, by adoption from *Regal (Hastings) Ltd. v. Gulliver*, in the straight-jacket of special knowledge acquired while acting as directors or senior officers, let alone limiting it to benefits acquired by reason of and during the holding of these offices.”²⁹ Laskin J. repudiated the concept that a duty to account could depend on the question of the confidentiality of the information used, indicating that, although a breach of confidence might afford a ground for relief, it was not a necessary ingredient of a successful claim for a breach of fiduciary duty.³⁰ There is no doubt that the defendants, if they had not resigned, would have been engaged in a course of conduct where their interest was in direct conflict with their duty; the result of the Supreme Court’s judgment was that they were not to be allowed to escape their duty by walking away from it. Laskin J. said that “in this developing branch of the law the particular facts may determine the shape of the principle of decision without setting fixed limits to it.”³¹ Nevertheless, the judgment does provide some sign posts indicating the direction the Supreme Court of Canada is likely to take. The court held that directors and senior officers are precluded from obtaining for themselves, after full disclosure, either secretly or without the approval of the company, any business advantage either belonging to the company or for which it had been negotiating. Laskin J. said that this was especially so where the

29. *Ibid.*, p. 618.

30. *Ibid.*, p. 616.

31. *Ibid.*, p. 618.

director was a participant in the negotiations on behalf of the company.³² He said, "In my opinion this ethic (the fiduciary duty) disqualifies a director . . . from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing." It was his view that neither the conflict test, nor the test of accountability for profits acquired by reason only of being directors and in the course of execution of the office, "should be considered as the exclusive touchstones of liability. In this as in other branches of the law new fact situations may require reformulation of existing principles to maintain its vigour in the new setting."³³ The judgment placed the emphasis on the duty of a fiduciary to act loyally and in good faith, always avoiding a conflict of duty and self-interest. Laskin J. said, "Strict application against directors and senior management officials is simply recognition of the degree of control which their positions give them in corporate operation; a control which rises above day-to-day accountability to owning shareholders and which comes under some scrutiny only at Annual General or at Special Meetings. It is a necessary supplement, in the public interest, of statutory regulation and accountability which themselves are, at one and the same time, an acknowledgment of the importance of the corporation in the life of the community and of the need to compel obedience by it and by its promoters, directors and managers to norms of exemplary behaviour."

Thus, the Supreme Court has no intention of placing itself in any straight-jacket which will prevent it from giving relief where it considers that the conduct of a director falls short of what it deems to be appropriate. This is, in some ways, a commendable decision, leaving the court free to develop the law to conform with the needs of business conditions. However, it does have the disadvantage that the shareholder must seek relief by the litigious process which, although the cost may be avoided, is still time-consuming and, on occasion, a doubtful process. It is unfortunate that the court, by distinguishing the *Peso* case, left directors apparently free to acquire an opportunity open to a corporation by making a bona fide decision to reject it on behalf of the corporation.

32. *Ibid.*, p. 607.

33. *Ibid.*, p. 609.

The importance of the decision is that the Supreme Court has clearly indicated that it will not be bound by any strict boundaries as to what the obligations of fiduciaries are, but, rather, is intent upon establishing a general principle which may be used to ensure that fiduciaries stay not only within the letter of the law, but also within the spirit. This emphasis on requiring a strict observance of fiduciary obligations is desirable, as those who assume the burden of managing the affairs of others should not be able to invoke fine distinctions when their concern for their own interests outweighs, or may outweigh, their concern for those to whom they owe a duty.

This approach has important implications for directors appointed by controlling interests when those interests enter into transactions with companies they control or when they compete with those of such companies. The principles enunciated should also be of concern to directors, when they accede to arrangements with a parent, that a subsidiary, which is not wholly owned, shall not enter into competition with its parent. The *Can. Aero* decision certainly calls into question earlier cases indicating that a director is free to compete with his own company.³⁴ Thus, in *Scottish Co-operative Wholesale Society Ltd. v. Meyer*,³⁵ when Lord Denning was referred to authority indicating that a director could join the board of a rival company, he said, "That may have been so at the time but it is at the risk now of an application under (the section dealing with oppression) if he subordinates the interest of one company to those of the other." The *Can. Aero* case also calls into question the principle of *Burland v. Earle*,³⁶ which holds that a director may not be required to account for a corporate opportunity where it is shown that he did not have any specific commission or mandate to purchase on behalf of the company. It seems clear that if there is any concrete evidence showing that a parent company and its nominee directors acted to appropriate to the parent an opportunity in the subsidiary's business field, then such nominee directors may be accountable to the subsidiary.

Even if the Supreme Court of Canada did not intend to weaken the impact of the *Peso* case, there can be little doubt that the bona fides of decisions by directors favouring the controlling interest will be examined by courts with scrupulous care. Cases where directors

34. *London and Mashonaland Exploration Co. v. New Mashonaland Corporation Co.*, [1891] W.N. 165.

35. *Scottish Co-operative Wholesale Society Ltd. v. Meyer*, [1959] A.C. 324.

36. *Burland v. Earle*, [1902] A.C. 83.

obtain for themselves an advantage which should have been given to the company by any standards of business propriety are, fortunately, the exception, rather than the rule. A more serious concern for minority shareholders is whether directors are applying their business judgement solely with a view to the interests of the corporation when such corporations are doing business with the dominant shareholder. The approach taken by the court in the *Can. Aero* case indicates that the deference courts have traditionally shown to the business judgment of directors will, in all probability, not be extended where it is apparent that those directors were nominees of controlling shareholders having interests which conflicted or could conflict with those of the corporation. The bona fides of such directors in entering into such transactions will be closely examined to ensure that the transaction was in the interests of the corporation. Accordingly, the trend of the law should cause directors to consider their duties very carefully in such situations, and to ensure that the decisions are taken honestly and in good faith, with a view to the best interests of the corporations.

Under the federal legislation, a director who either himself is a party to a material contract or is a director, officer, or has a material interest in any person who is such a party is required to disclose the nature and intent of this interest in writing. He is prohibited from voting on such a contract unless it is one described in section 115(5). He may vote where the contract is one with an affiliate. When such an interest is disclosed, such a material contract is not void or voidable by reason only of that relationship or that such a director was present or counted to determine the presence of a quorum at a meeting of directors if “the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved.”³⁷

The wisdom of permitting directors of corporations which are not wholly owned subsidiaries to vote when such a corporation is entering into a contract with an affiliate is debatable, as the conflict of interest is just as real in such cases as in other conflict situations. Yet the director who votes in such circumstances will still be subject to the statutory obligation to act in good faith and with a view to the best interests of the corporation. Furthermore, to obtain the benefit of the protection conferred by the act, the contract must be one which “was reasonable and fair to the corporation at the time it was

37. Section 115(7).

approved.”³⁸ Such a contract may be ratified by the shareholders, but unless the directors have carried out their statutory obligations, such ratification will avail them little, as section 117(3) of the Canada Business Corporations Act provides, *inter alia*, that no resolution “relieves a director or officer from the duty to act in accordance with this Act . . . or relieves him from liability for a breach thereof.” Accordingly, when contracts are made by corporations with affiliates, directors or corporations bear a heavy fiduciary responsibility for which they may only be indemnified if they acted in good faith.

Thus, the statutory and common law applicable to directors does establish a set of principles which will permit courts to impose on directors fiduciary responsibilities which should ensure fair treatment for the minority. The major problem for minorities lies not with the law, but with the reliance on the litigious remedy, which, even though it may be pursued without cost where the court approves, is a time-consuming process, fraught with difficulties which frequently cause shareholders to sell their shares rather than engage in an uncertain process requiring initiative and determination. Faced with these difficulties, even shareholders with a significant financial interest are likely to shy away from the litigation remedy and either sell their shares or compromise their differences with a controlling interest. The direction of the courts is towards imposing a high standard of fiduciary obligation on directors, but as the developments in the last quarter century indicate, the progress is slow, depending as it does on a case-by-case approach.

III. *Power of Majority to Bind Minority*

Although the common law, supplemented by statutory law, has done much to ensure that directors of public corporations selected by controlling interests will act in the interests of the corporation, the position taken with respect to the right of the majority to vote in its own interests is much less satisfactory. Legislation has, in some jurisdictions, altered the common law by requiring that contracts in which directors have interests may only be ratified if they are fair to the corporation. Nevertheless, there are still a large number of occasions when the interests of minorities may be adversely affected by majority action. Thus, it is important to determine when

38. *Burland v. Earle*, *supra*, p. 83.

majorities may vote, the interests they may take into account in voting, and the weight to be given to such votes.

Majority rule has been one of the cornerstones of the law of corporations, as courts have ordinarily adhered to the principle that the shareholders are the best judges of their own interests. Nevertheless, although the law has always recognized that minority shareholders have certain rights worthy of protection, courts have tended to limit the occasions when they would interfere and have afforded to the majority a wide power to ratify the acts of directors which might be questioned. One feature of this approach was the infamous rule in *Foss and Harbottle* which, for so long, operated to limit effective actions by minorities. The corporate approach to the rights of majorities owed much to the concern that the courts of the nineteenth century had for freedom of contract; consequently, the courts only interfered with the right of majorities to run corporations as they saw fit where the results in their view amounted to “fraud” or where the majority was attempting to confirm ultra vires or illegal acts. Thus, in *Re Jury Goldmines Ltd.*,³⁹ Middleton J.A. said, “The company itself is the proper forum for the settlement of domestic differences.”

The result of this philosophy was that courts were very reluctant to interfere with the power of the majority, so that a minority to obtain relief had to show clear abuse by the majority, such as an appropriation by the majority of the assets of the company to themselves. The majority were afforded a substantial power to ratify contracts in which the majority had an interest by the decision of the Privy Council in *Northwest Transportation Co. v. Beatty*,⁴⁰ where Beatty, a majority shareholder, sold a ship to the company and voted his own shares at a general meeting to ratify the contract. The Privy Council held that he had a right to vote in such circumstances as his conduct did not amount to fraud or oppression of the minority. The contract was shown to be a desirable one and, in fact, would have been ratified in any event by the votes of the shareholders if Beatty had not voted. Thus, in the particular case, the judgement of independent shareholders vindicated that transaction, but this was not the focal point of the decision.

The Privy Council overruled the judgment of the Supreme Court of Canada, which took a much broader view of the obligations of

39. *Re Jury Goldmines Ltd.* (1928) 40 O.L.R. 735 at p. 736.

40. *Northwest Transportation Co. v. Beatty* (1887) 12 A.C. 589.

directors and interested shareholders who had an interest in the transaction being ratified. Chief Justice Ritchie said that “fair play and common sense alike dictate that if the transaction and act of the director are to be confirmed, it should be by the impartial, independent, and intelligent judgment of the disinterested shareholders, and not by the interested director himself who should never have departed from his duty.”⁴¹ Sir Richard Baggallay, giving the opinion of the Privy Council, noted that no unfairness or impropriety had been established, and said, “It may be quite right, in such a case the opposing minority should be able, in a suit like this, to challenge the transaction, and to show that it is an improper one and to be freed from the objection that a suit with such an object can only be maintained by the company itself . . . he [Beatty] had a perfect right to acquire further shares and to exercise his voting power in such a manner as to secure the election of directors whose views upon policy agreed with his own and to support those views at any shareholders’ meeting; the acquisition of the United Empire was a pure question of policy, as to which it might be expected there would be differences of opinion and upon which the voice of the majority ought to prevail; to reject the votes of the defendant upon the question of the adoption of the by-law would be to give effect to the views of the minority, and to disregard those of the majority.” The Privy Council took no account whatsoever of the interest of Beatty’s which differed from that of the other shareholders, beyond indicating that ratification could occur because the transaction was a fair one. Thus, the view of the Supreme Court of Canada was swept into the discard by the opinion, with the result that the powers of majorities to ratify the action of directors have since then been considered to be rather extensive, subject only to restraint where the acts complained of were, in the opinion of the court, of a fraudulent character.

Thus, in *Dominion Cotton Mill v. Amyot*,⁴² a parent was permitted to use its votes to ratify a lease to itself from a subsidiary. The approving shareholders’ resolution was set aside by the trial judge, who held that the lease had been approved by the controlling shareholders for their own benefit and that it was unfair to the subsidiary. The Privy Council disagreed with this finding, holding that there had been no unfair dealing. Lord MacNaughten, in giving

41. (1887) 12 S.C.R. 598.

42. *Dominion Cotton Mill v. Amyot*, 4 D.L.R. 306.

the opinion, said, “The cases in which the minority can maintain such an action are therefore confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company.”⁴³ The attitude of the courts in other cases is evidenced by the judgment of Middleton J.A., in *Re: Jury Goldmine Development Co.*,⁴⁴ where he said, “He is a minority shareholder and must endure the unpleasantness incident to that situation. If he chooses to risk his money by subscribing for shares, it is part of his bargain that he will submit to the will of the majority. In the absence of fraud or transactions ultra vires, the majority must govern and there should be no appeal to the courts for redress.”

Courts did give relief where they concluded that the majority was attempting to expropriate the company’s money, property, or advantages for its own benefit.⁴⁵ The underlying justification for relief in these cases was that the majority, by appropriating to themselves the property of the company, was committing a fraud on the minority. Little attention was paid to whether the majority had any greater duty to the minority or to the corporation in exercising its powers, or whether the case for shareholders’ interests being determined by the majority lost some of its force when its business interests differed from those of the corporation. However, the Ontario Court of Appeal, in *Grey v. Yellowknife Goldmines Limited*,⁴⁶ held that a majority could place itself in a fiduciary position to a subsidiary. In that case, the parent had caused the subsidiary to sell its holdings of Giant Yellowknife Mines to the parent, and the minority shareholders of the subsidiary were deprived of a chance to share in a potentially profitable development program. Both companies had common directors who held large share interests of the parent company, but only nominal personal holdings of the subsidiary, so that there was a clear conflict of interest with duty. The court held that, by assuming the management of the subsidiary pursuant to a management agreement, the parent had placed itself in a fiduciary position to the subsidiary and the conduct of the directors of the subsidiary in furthering the interests of the parent constituted a fraud on the minority. The case could have been decided on the sole ground that

43. *Ibid.*, p. 310.

44. *Re Jury Goldmine Development Co.*, *supra*, at p. 736.

45. (1874) 9 Ch. App. 350; *Cook v. Deeks*, [1916] 1 A.C. 554; *Nolan v. Parsons* (1942) O.R. 358.

46. *Grey v. Yellowknife Goldmines Limited* (1946) O.R., p. 639.

the majority's actions were designed to appropriate the property of the subsidiary to the parent. Nevertheless, the decision is a significant one, as it may indicate the attitude courts will take where it is perfectly apparent that the management and directorate of the subsidiary have been selected by the majority.

The decision of the House of Lords in *Scottish Co-operative Wholesale Society Limited v. Meyer*⁴⁷ is a step in the same direction, as, although it was decided under section 210 of the United Kingdom companies legislation, which gives a remedy for oppression, there seems no real reason why the same approach could not be taken in the development of the common law and the oppression remedy of the Canada Business Corporations Act. In that case, a parent had attempted to obtain all of the shares of a subsidiary, and upon its offer being rejected, it established a competing business. It refused to supply further raw materials to the subsidiary, which was dependent on it for such materials, with the result that the value of the subsidiary's shares was considerably reduced. The majority of the directors of the subsidiary were nominees of the parent and were well aware that its policy was to destroy the business of the subsidiary. The nominee directors took no action to destroy the business of the company, but neither did they take any action to save it. It was argued that the conduct of the parent was not oppression in carrying out the affairs of the subsidiary, as the activities complained of related to the conduct of its own affairs, which could not constitute any ground for relief for the section. Viscount Simonds said, with reference to the nominee directors:

But in all the evidence I have not been able to find the least trace that they regarded themselves as owing any duty to the company of which they were directors. They were the nominees of the Society (the parent) and if the Society doomed the company to destruction it was not for them to put out a saving hand. Rather, they were to join in that work and when a frank and prompt statement to their co-directors might have enabled them to retrieve its fortunes they played their part by maintaining silence. That is how they conducted the affairs of the company and it is impossible to suppose that that was not part of the deliberate policy of the Society. As I have said, nominees of a parent company upon the board of a subsidiary company may be placed in a difficult and delicate position. It is then the more incumbent

47. *Scottish Co-operative Wholesale Society Limited v. Meyer* (1959) A.C. 324 at p. 341; *Selangor United Rubber Estates v. Craddock*, [1968] 1 W.L.R. 1555.

on the parent company to behave with scrupulous fairness to the minority shareholders and to avoid imposing upon their nominees the alternative of disregarding their instructions or betraying the interests of the minority.

In answer to the argument that the society's conduct may have been oppressive but that it did not constitute conduct in relation to the affairs of the society, Viscount Simonds said:

It is not possible to separate the transactions of the Society from those of the company. Every step taken by the latter was determined by the policy of the former. It is just because the Society could not only use the ordinary and legitimate weapons of commercial warfare, but could also control from within the operations of the company that it is illegitimate to regard the conduct of the company's affairs as a matter for which it had no responsibility.

He also stated that:

Whenever a subsidiary is formed as in this case with an independent minority of shareholders, the parent company must, if it is engaged in the same class of business, accept as a result of having formed such a subsidiary an obligation so to conduct what are in a sense its own affairs as to deal fairly with its subsidiary.

Lord Keith said:

But I cannot think that where directors having power to do something to save a company lie back and do nothing they are not conducting the affairs of the company perhaps foolishly, perhaps negligently, perhaps with some ulterior object in view. They are certainly conducting the affairs of the company in breach of their duties as directors. In the present case I would go further for I think that the production of rayon cloth at the mill was an affair of the company and that the Society being a majority shareholder in the company cannot claim that in divesting this production to itself and obstructing supplies to the company it was acting for itself and not conducting the affairs of the company in a manner unfair and oppressive to the minority shareholders.

Lord Denning said:

It must be remembered that we are here concerned with the manner in which the affairs of the textile company were being conducted. That is, with the conduct of those in control of its affairs. They may be some of the directors themselves, or behind them a group of shareholders who nominate those directors or whose interest those directors serve. If those persons, the nominee directors or the shareholders behind them conduct the affairs of the company in a manner oppressive to the other shareholders the Court can intervene to bring an end to the oppression.

The House of Lords found that the inaction of the directors was oppressive conduct.

Clearly, this decision applies in those jurisdictions where a statutory oppression remedy is available. The rationale underlying the decision may, as indicated in the *Grey & Yellowknife* case, have a much wider application and cause the courts to restrain voting by majority shareholders or disregard such votes completely in assessing whether a shareholder's resolution should stand.

Although the courts are not prepared to allow a majority to, in effect, expropriate the property of the company, they have accorded, even in modern times, a rather broad power to ratify the action of directors in acquiring corporate opportunities for themselves or acting in circumstances where they have a conflict of interest. Thus, in *Zwicker v. Stanbury*,⁴⁸ Kellock J. indicated that a transaction in which directors were in breach of their fiduciary duties could be ratified.⁴⁹ Unfortunately, the judgment did not indicate whether the directors could have voted their own shares for ratification of the transaction. Similarly, Lord Russell concluded, in the *Regal* case, that a majority of the shareholders could have ratified the directors' breach of their duty.⁵⁰ It is regrettable that the courts, in considering this question of ratification, have not dealt conclusively with the right of the interested shareholder to vote and that the statutory reforms have also failed to address the question conclusively. There seems to be much merit in the suggestion of Idington J., in *Theatre Amusement Co. v. Stone*,⁵¹ that the sooner the corporate legislation is amended to prevent "any shareholder by his own vote to help himself to sell his property to the company of which he is a shareholder, the better it will be for the moral health of the business community." The same comment is apt in any situation where a shareholder has an extraneous interest which is clearly in conflict with the mutual interests of shareholders. If one concedes that shareholders should be entitled to govern corporations because they are the best judges of their own interests, it seems apparent that it is those shareholders who have a common interest with the corporation who should decide and not those whose

48. *Supra*, note 20 at 438.

49. *Ibid.*, p. 451.

50. *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378 at p. 389. See also *Peso* (1966) 56 D.L.R. 117 at p. 139 and *Canadian Safeway Ltd. v. Thompson* (1951) 3 D.L.R. 295.

51. *Theatre Amusement Co. v. Stone* (1915), 50 S.C.R. 35.

interests may be adverse to it. The appropriate approach is surely that no man is likely to be a good judge of his own cause and the deference afforded to majority decisions should cease when it is apparent that the majority has an interest which is or may be adverse to that of the corporation.

There is a strange dichotomy in the decisions of the courts as to the ratification of transactions at meetings of common shareholders and the approach which has been taken to the right of a majority of debenture holders, or the majority of the shareholders of a class, to exercise their votes as they see fit. The courts have held, in a series of cases, that such a shareholder or debenture holder must vote in the interests of the class of which he is a member. Thus, in *Re Wedgwood Coal & Iron Company*,⁵² Malins V.C. said that:

I think it is perfectly clear that all resolutions of this kind, whether they are resolutions by a majority of debtors to buy the minority, as in bankruptcy, or whether they are by a majority to bind the minority under any Act of Parliament, must be passed bona fide and without sinister objects.

In that case, he held that it was quite improper for a debenture holder to vote when he had interests adverse to the class of debenture holders. The Court of Appeal in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company*⁵³ approved a scheme of arrangement which had been sanctioned by a majority of first debenture holders who were also holders of junior securities. Lindley L.J. held that where there were adverse interests, “[t]hat state of complicated interest would not prevent them from voting, but it would necessarily induce the court to look with caution and care at the effect of what was done at that meeting.”⁵⁴ Bowan L.J. took much the same position, holding that the debenture holders in question could vote, but indicating that he would not regard that as determinative of the interests of the class if it turned out that the majority was composed of persons who really did not have the interests of that class at stake. The Court of Appeal in effect examined the merits of the proposal and satisfied itself that it was one that a member could reasonably have approved of as acting in the interest of the class.⁵⁵

52. *Re Wedgwood Coal & Iron Company* (1877) 6 Ch. D. 627 at p. 635.

53. *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company*, [1891] 1 Ch. 213.

54. *Ibid.*, at p. 239 *et seq.*

55. See also *Re English, Scottish and Australian Chartered Bank*, [1893] 3 Ch. 385.

Accordingly, in cases involving class votes, the courts, at a rather early date, arrived at a position where they would not regard a vote as binding where there were adverse interests. They would consider whether the arrangement was a fair and reasonable one which could be adopted as being in the interest of the class as a whole; the inquiry was not directed solely to whether the act of the majority constituted fraud or oppression.

The leading case on the subject is *British American Nickel v. O'Brien*, which related to a class vote on a reconstruction scheme by members of a class of debentures.⁵⁶ In that case, one of the debenture holders was induced by the promise of a large block of stock to vote in favour of the scheme. The Privy Council held that the approving resolution was invalid because the promise made to the debenture holder caused him to vote in his own interest, rather than in the interest of the class. Viscount Haldane considered the power to vary the rights of the debenture holders to be analogous to the power of a majority of a special class of shareholders to change the articles of association. "There is, however, a restriction of such powers when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on a majorities of classes enabling them to bind minorities; namely, that the power must be exercised to the purpose of benefiting the class as a whole and not merely individual members only. Subject to this the power may be unrestricted."⁵⁷ He then reviewed the decisions in *Burland v. Earle* and *Northwest Transportation v. Betty*, stating that it had been suggested that the decisions in these cases were difficult to reconcile with the restriction applicable in the case of class votes. However, he also said, "[b]ut their Lordships do not think there is any real difficulty in combining the principle that while a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class, he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity as being a member."⁵⁸ He concluded that the distinction "may prove a fine one", a sentiment which is easily echoed.

56. [1927] A.C. 369.

57. *Ibid.*, p. 371.

58. *Ibid.*, p. 373.

The principle enunciated in that case has also been applied to votes by class of shareholders in *Carruth v. Imperial Chemical Industries Limited*,⁵⁹ which involved a scheme to alter the rights of several classes of shares and reduce the capital. It was shown that a number of ordinary shareholders had voted at the meeting of deferred shareholders and that the interests of these groups differed. Lord Russell of Killoreen held, in effect, that, in view of the large number of votes given at the meeting of deferred shareholders by holders of ordinary shares, the court should itself decide the question of fairness or unfairness on the evidence before it.⁶⁰ Lord Maugham said⁶¹ that both Eve J. and the Court of Appeal seemed to have laid considerable stress on the well-known proposition that shareholders acting honestly are usually much better judges of what is to their commercial advantage than a court can be:

I do not intend to throw the smallest doubt on this general proposition which I have had occasion, more than once, to repeat, but I doubt very much whether it is of great value as a guide when it is proved that the majority of the class have voted or may have voted as they did because of their interest as shareholders of another class. If the court is satisfied that the deferred shareholders in this case considered the matter from a proper point of view; that is, with a view to the interest of the class to which they belong and are empowered to bind, the court ought to be slow to differ from them.

This decision was followed in *Hanson v. Canada Trust*,⁶² a case involving a composition between a mortgagor and the holders of its mortgage bonds. The court found that the majority had been influenced by motives of charity and benevolence to the mortgagor in approving a composition which deprived the bond holders of substantial amounts of interest. There was no imputation of bad faith or collateral advantage raised against the majority shareholder, but the court held that the majority could not impose its will on the minority as it was not acting in the interests of the class.⁶³

The distinction, made in *British American Nickel Corporation v. O'Brien*, between the position of a shareholder when he votes as a member of a class and his position when he votes purely in his capacity as a shareholder is difficult to understand. If the courts are

59. *Carruth v. Imperial Chemical Industries Limited*, [1937] A.C. 707.

60. *Ibid.*, p. 763.

61. *Ibid.*, p. 769.

62. *Hanson v. Canada Trust* (1951) S.C.R., p. 366.

63. *Ibid.*, pp. 379-380.

prepared to question the decision of a majority in a class vote where the decision has been motivated by outside interests differing from those of the class, it seems right that they should be prepared to do so whenever a majority is imposing its will on the minority. The rationale for the view that the majority and not the courts are in the best position to judge what is in the interest of the company disappears when the majority decision is or may be based on the self-interest of that majority.

It is quite clear that courts are unlikely to be content with the decisions made by majorities where they do not share the same interests as all shareholders. An interesting example of this is the decision in *Re Hellenic & General Trust*.⁶⁴ In that case, a vote was held on a scheme of arrangement proposed as an alternative to a takeover bid which would not have succeeded because the dissenting minority held a sufficient block of shares to prevent the exercise of the compulsory acquisition powers. Under the arrangement, the parent company of the majority shareholder would have become the sole owner, as the minority would have been required to dispose of its shares for cash. Templeman J. refused to sanction the arrangement because the majority had an interest differing from that of the other ordinary shareholders, and concluded that there were really two classes of ordinary shareholders and that separate class meetings should have been held. He said that it had been suggested to him that all shareholders had the same interest and that they were all capable of forming an independent and unbiased judgement, irrespective of the interest of the parent company:

This seems to me to be unreal. Hambros are purchasers making an offer. When the vendors meet to discuss and vote whether or not to accept the offer, it is incongruous that the loudest voice in

64. *Re Hellenic & General Trust*, [1975] 3 All E.R. 382. It is interesting to compare the approach taken in *Jones v. H. F. Ahmanson & Company*, 1 Cal. 3d 93, where the California Court of Appeal considered a case where the majority had used their powers to destroy the marketability of the minority's shares. The court held that the majority had acted improperly in using their control to secure for themselves an advantage not made available to all shareholders, by establishing a public holding company for their own shares which effectively destroyed the market for the shares of the corporation, thus diminishing the value of the minority holding. The court said that, in California, the power of a majority "may not be exercised for the aggrandizement, preference or advantage of the fiduciary to the exclusion or detriment of the cestuis." In their view, the majority owed a duty of inherent fairness "from the viewpoint of the corporation and those interested therein."

theory and most significant vote in practice should come from the wholly owned subsidiary of the purchaser. No one can be both a vendor and a purchaser and in my judgment, for the purpose of the class meetings in the present case, MIT were in the camp of the purchaser.⁶⁵

In determining that ordinary shareholders could be divided into different classes on the basis of their economic interests, Templeman J. was following some earlier precedents. In *Sovereign Life Insurance Company v. Dodd*,⁶⁶ the English Court of Appeal, in a case relating to the winding-up of an insurance company, held that it was appropriate under the governing statute to require separate meetings of policy holders who had differing economic interests. Speaking of the statute authorizing the meetings, which was a rather general one, Bowen L.J. said:

What is the proper construction of that statute. It makes the majority of the creditors or of a class of creditors bind the minority; it exercises the most formidable compulsion upon dissentient or would-be dissentient creditors and it therefore requires to be construed with care so as not to place in the hands of some of the creditors the means and opportunity of forcing dissentients to do that which it is unreasonable to require them to do or of making a mere jest of the interests of the minority.

He construed the word “class” in the statute as requiring a separate vote by these two groups of policy holders with divergent interests, in the sense that one held matured policies and the other did not.⁶⁷ Similarly, in *Re United Provident Assurance Company Limited*,⁶⁸ it was held that holders of partly paid shares constituted a different class from holders of fully paid shares. Whatever one may think of the device of segregating shareholders or policy holders into differing classes on the basis of their differing economic interests, there is little doubt that the result achieved is a salutary one, unless one believes that the majority have the right to prefer their own interests to that of the general interest of shareholders when exercising their voting power. A simpler approach is that adopted in *British American v. O’Brien*, as an equitable result can be achieved by simply regarding the votes cast by those with conflicting interests as being without weight or persuasive value.⁶⁹

65. *Ibid.*, p. 386.

66. *Sovereign Life Insurance Company v. Dodd*, [1892] 2 Q.B. 573.

67. *Ibid.*, pp. 581-3.

68. *Re United Provident Assurance Company Limited*, [1910] 2 Ch. 477.

69. The issue of whether the minority within a legal class is entitled to a separate

Courts have interfered in a somewhat different class of cases at the suit of minority shareholders where the majority were exercising their powers to amend the corporation's charter. In such cases, the courts have intervened when they believed that a power to alter the articles was being exercised not "bona fide for the benefit of the company as a whole"⁷⁰ or where they believed that the result of the action was "to give the (majority) an advantage of which the (minority) was deprived."⁷¹ Thus, in *Brown v. British Abrasive Wheel Co. Limited*,⁷² the court acted to restrain a change in the articles which would have provided for the compulsory acquisition of minority shareholdings at a fair value. The defendant company needed further capital, which the holders of 98 percent of the shares were willing to provide if they could acquire the remaining 2 percent. Astbury J. ruled that such an article was not for the benefit of the company as a whole, but was only for the benefit of the majority and was oppressive to the minority even though there was no question about the good faith of the majority. In this case, it is obvious that the interests being protected were those of the body of the shareholders which were considered to be the same as those of the company.

A somewhat similar compulsory acquisition was restrained in *Dafen Tinplate Co. v. Llanelly Steel Co.*,⁷³ where an article provided for the compulsory acquisition of the shares of any shareholder. This article was being adopted because the plaintiff had ceased to buy its steel from the defendant and had opened its own steel plant. Peterson J. ruled that the article was wider than was required to protect the interest of the company, as it enabled the majority to acquire the shares of any shareholder and was, accordingly, not for the benefit of the company as a whole. It appears from this judgment that the article would have been upheld if it was directed at the particular shareholder who was competing with the company, as Peterson J. said the power not being restricted to cases where the shareholders' conduct was detrimental to the company, it could not be for the company's benefit. In *Sidebottom*

vote has been raised, but not determined, in two Ontario cases: *Carlton Realty Company Ltd. v. Maple Leaf Mills Ltd.* (1978) 22 O.R. 198 and *Alexander v. Westeel-Rosco Ltd.* (1978) 22 O.R. 211.

70. *Allen v. Goldreefs of West Africa*, [1901] Ch. 656 at p. 671.

71. *Greenhalgh v. Arderne Cinemas Ltd.*, [1951] Ch. 286 at p. 291.

72. *Brown v. British Abrasive Wheel Co. Limited*, [1919] 1 Ch. 290.

73. *Dafen Tinplate Co. v. Llanelly Steel Co.*, [1920] 2 Ch. 124.

v. *Kershaw Leese & Co. Ltd.*,⁷⁴ an article providing for compulsory acquisition of the shares of a competitor was upheld by the Court of Appeal on the ground that it was enacted bona fide for the benefit of the company to protect it from competitors. The *Brown* case was distinctive because in it the article was enacted only for the benefit of the majority. In *Shuttleworth v. Cox*,⁷⁵ a majority was allowed to enact an article removing a permanent director who had been accused of financial irregularity. In that case, Bankes L.J. said that the court should not interfere with the action of the majority unless the alteration “is such that no reasonable man could consider it for the benefit of the company.”⁷⁶

There has been a considerable difference of opinion as to the meaning of the requirement that the majority, when enacting resolutions, must act “bona fide for the benefit of the company as a whole”. In *Greenhalgh v. Arderne Cinemas Ltd.*, Evershed M.R., in discussing this problem, said that:

Certain things, I think, can be safely stated as emerging from these authorities. In the first place, it is now plain that “bona fide for the benefit of the company as a whole” means not two things but one thing. It means that the shareholder must proceed on what, in his honest opinion, is for the benefit of the company as a whole. Secondly, the phrase “the company as a whole” does not . . . mean the company as a commercial entity as distinct from the incorporators. It means the corporators as a general body. That is to say, you may take the case of an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favour, for that person’s benefit. I think the thing can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter were deprived.

When the cases where the resolution has been successfully attacked are examined, it is on the ground of discrimination that such attacks have been successful. However, this ground of interference is a relatively narrow one, for, if the amendment applies equally to all shareholders, it appears that the court may not hold it to be discriminatory even though it only affects the minority adversely. In *Greenhalgh*, an amendment to the restrictions on

74. *Sidebottom v. Kershaw Leese & Co. Ltd.*, [1920] 1 Ch. 154 at 162.

75. *Shuttleworth v. Cox*, [1927] 2 K.B. 9.

76. *Ibid.*, p. 18.

transfer of the company's shares was made to permit a shareholder to sell to an outsider with the approval of a majority, thus negating an article prohibiting a transfer to an outsider when a shareholder was prepared to purchase at fair value. It was held that this did not discriminate against the minority because it applied equally to all shareholders seeking to acquire control and prevented all shareholders from selling their shares to an outsider if the majority was opposed to it. Yet Evershed M.R. said that the appropriate test was to determine whether the effect of the resolution was "to discriminate between the majority shareholders and the minority shareholders so as to give to the former an advantage of which the latter was deprived." In the result, only the majority could effectively sell to outsiders, as majority consent was required. The result, effectively limiting the right of the minority to acquire the shares and permitting the majority to effectively sanction a take-over, may be explained because the majority was acting bona fide, as the purchaser was bidding for all the shares of the company at what the court considered to be a fair price.⁷⁷ Thus, the minority did not suffer any real disadvantage and the majority did not acquire any benefit denied to the minority. The result may have been different if a sale by the minority had been blocked.

Courts have permitted majorities to ratify an issue of shares, by directors, designed to preserve the voting control of a company. In *Hogg v. Cramphorn Ltd.*,⁷⁸ the board of directors, faced with a takeover which they believed not to be in the interest of the company, issued to an employees' pension trust sufficient preference shares to permit the directors and their associates to control the company. Buckley J. decided that their action could be ratified at a general meeting of shareholders, saying that:

Unless a majority in a company is acting oppressively towards the minority, this court should not and will not itself interfere with the exercise by the majority of its constitutional rights or embark on an inquiry into the respective merits of the views held or policies favoured by the majority and the minority . . . A majority of shareholders in general meeting is entitled to pursue what course it chooses within the company's power, however wrong-headed it may appear to others, provided the majority do not unfairly oppress other members of the company.⁷⁹

Accordingly, he adjourned the hearing to permit a shareholders'

77. *Greenhalgh v. Arderne Cinemas Ltd.*, [1946] 1 All E.R. 512.

78. *Hogg v. Cramphorn Ltd.*, [1966] 3 All E.R. 420.

79. *Ibid.*, p. 428.

meeting to be held at which the disputed shares could not be voted, although the directors were not restrained from voting their own shares. Thus, they could effectively vote to secure a continuing control of the corporation by ratifying the issue of shares. The right of a majority to ratify an issue of shares was also considered in *Bamford and Another v. Bamford and Others*,⁸⁰ where the court reviewed what it regarded as an *intra vires* issue of shares by the directors of the company which was voidable because the directors were actuated by improper motives. Shares had been issued for the purpose of blocking a take-over; subsequent to the issue of the writ, a meeting of shareholders approved the allotment. Relying on the decision in *Northwest Transportation Co. Limited v. Beatty*, Harman L. J. held that the issue was voidable, but could be ratified by the majority because it was neither illegal or fraudulent or oppressive towards the shareholders who opposed it.⁸¹ In this case, shareholders voting to ratify the issue were, in effect, determining whether they wished to accept or reject the take-over bid, and their interest and their vote was being cast having regard to their interest as shareholders and nothing else. In such circumstances, there can be no objection to the majority will prevailing. The ratification at a general meeting secured by the votes of directors of an issue of shares to preserve their own control raises different considerations. Unfortunately, Buckley J. in *Hogg v. Cramphorn* did not consider the propriety of the directors voting in such circumstances where their interests were different from those of other shareholders.

Having regard to the substantial powers exercised by majorities to control the destinies of corporations by effectively selecting their directors, and the important role they exercise in determining whether fundamental changes shall be made in the charter of corporations, it is unfortunate that the courts have not formulated clearer rules as to when an extraneous interest of a majority will lead a court to restrain its actions. The position taken by American courts provides an interesting contrast. In 1920, the Supreme Court of the United States, in *Geddes, et al v. Anaconda Copper Mining Company, et al*,⁸² held that:

The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as zealously by the law as are personal

80. *Bamford and Another v. Bamford and Others*, [1969] 1 All E.R. 969.

81. *Ibid*, p. 972 *et seq*.

82. *Geddes, et al v. Anaconda Copper Mining Company, et al*, 254 U.S. 590.

dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which it has declared, is founded in soundest morality, and we now add in the soundest business policy.

In *Pelzman v. Feldmann*,⁸³ the United States Court of Appeal, Second Circuit, held that a dominant stockholder and principal officer was accountable to minority stockholders when he sold his own stock to steel users who were seeking control of the corporation in order to control the distribution of steel at a time of steel shortage. Chief Judge Clark, who gave the majority judgment, held that:

Both as director and as dominant stockholder, Feldmann stood in a fiduciary relationship to the corporation and to the minority shareholders as beneficiaries thereof . . . Directors of a business corporation act in a strictly fiduciary capacity. Their office is a trust . . . directors of a corporation are its agents and they are governed by the rules of law applicable to other agents and, as between themselves and their principal, the rules relating to honesty and fair dealing in the management of the affairs of their principal are applicable. They must not in any degree allow their official conduct to be swayed by their private interest which must yield to official duty. In the transaction between a director and a corporation where he acts for himself and his principal at the same time in a matter connected with the relation between them it is presumed, where he is thus potentially on both sides of the contract, that self interest will overcome his fidelity to his principal, to his own benefit and to his principal's hurt . . . absolute and most scrupulous good faith is the very essence of a director's obligations to his corporation. The first principal duty arising from his official relation is to act in all things of trust wholly for the benefit of the corporation.⁸⁴

Chief Justice Clark said that although the principles were particularly relevant to Feldmann as a director, the same rule should apply to his fiduciary duties as majority stockholder, "for in that capacity, he chooses and controls the directors and thus is held to assume their liability."⁸⁵ He then commented on the issue of bona fides:

83. *Pelzman v. Feldmann*, 219 F(2d) 173.

84. *Ibid*, p. 176.

85. *Ibid*, p. 176.

It is true . . . that this is not the ordinary case of breach of fiduciary duty. We hear of no fraud, no misuse of confidential information, no outright looting of a helpless corporation but on the other hand, we do not find compliance with that high standard which we have just stated and which we and other courts have come to expect and demand of a corporate fiduciary. In the often quoted words of Judge Cardozo, "Many forms of conduct permissible in a work-a-day world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honour, the most sensitive, is then the standard of behaviour."

In *Levien v. Sinclair Oil Corporation*,⁸⁶ the Delaware Court of Chancery held that a parent had not dealt fairly with its subsidiary as it had not made any serious effort to develop the subsidiary corporation, but had acted to restrict its activities. The parent company held ninety-seven percent of the outstanding stock of the subsidiary and, at all relevant times, had selected its directors and management. The court held that, given the domination which the selection of directors and officers secured, the parent's duty to its subsidiary was that of a fiduciary. Chancellor Duffy quoted with approval the decision of *Guth v. Loft Inc.*,⁸⁷ saying that:

When the persons be they stockholders or directors, who control the making of a transaction and the fixing of its terms are on both sides then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness tested by all relevant standards is then the criterion.

However, a shareholder may vote in his own interest so long as he meets whatever duty may be imposed upon him toward the minority. That is established by *Tanzer v. International General Industries Inc.*,⁸⁸ where the Supreme Court of Delaware held that a majority shareholder was entitled to vote his shares for approval of a merger made primarily to advance his own business purpose. The court held that, subject to this duty to other shareholders, the stockholder was free to represent his own interest, including the expectation of personal profit, limited, of course, by any duty he owed to other shareholders. In *Weinberger v. UOP Inc.*,⁸⁹ the Delaware Court of Chancery held that in the case of a merger

86. *Levien v. Sinclair Oil Corporation*, 261 A (2d) 911; *Pepper v. Litton*, 308 U.S. 295 at p. 306.

87. *Guth v. Loft Inc.*, 5 A (2d) 503.

88. *Tanzer v. International General Industries Inc.*, 379 Atlantic Reporter 1121.

89. *Weinberger v. UOP Inc.*, 426 Atlantic Reporter, 2d series, p. 1333.

transaction, a majority shareholder owed a fiduciary duty of entire fairness to minority shareholders where the equity position of the minority in a merged corporation was being affected. It was of the view that those who controlled the corporate machinery owed a fiduciary duty to the minority in the exercise of such powers and the use of such powers to perpetuate control may be a violation of that duty. It also found that the use of corporate power to eliminate the minority was a violation of that duty. It concluded that, even if the purpose of the merger was bona fide, there must still be a hearing to determine whether the terms were fair to the minority stockholders. The underlying rationale for the decision appears to be that whenever the majority is exercising its power to obtain some advantage which will not be shared in by all shareholders, then the court will determine whether the transaction is fair to minority shareholders. In cases involving ratification of an interested director transaction, the approval by a majority of the disinterested shareholders has not generally been required as a condition of shareholder ratification. However, there is a trend in this direction, as courts recently have been declining to accept ratification by an "interested majority as immunizing an unfair transaction."⁹⁰

This is a very cursory view of the United States' position, and fails utterly to describe all the fiduciary obligations which American courts have imposed on dominant or majority shareholders.⁹¹ Nevertheless, the cases quoted are representative of the trend in the United States to impose fiduciary obligations on dominant or majority stockholders where they are exercising control over the affairs of companies. In such cases, courts do not regard the decision of the majority with deference, but, instead, apply equitable principles and a test of intrinsic fairness to determine whether a transaction should stand.⁹² Dealings between corporations and majority stockholders are not prohibited, but courts require that these meet a fairness standard. Under this standard, the burden is on the parent corporation or majority stockholder to prove, "subject to careful judicial scrutiny, that its transactions with a subsidiary or a minority stockholder were objectively fair."⁹³

The American courts have had more occasions to consider the problems of the majority's use of its power, when it has interests

90. *Fliegler v. Lawrence*, 361 A 2d 218; *Scott v. Multi-Amp*, 386 F, Supp. 44.

91. *Fletcher Cyclopedia Corporation*, Vol. 13, Ch. 58, p. 5811 *et seq.*

92. *Ibid*, 5811; *Southern Pacific Co. v. Bogart*, 250 U.S. 483.

93. *Ibid*, p. 5835.

which are in conflict with those of the corporation, than our courts have had. Given the common equity tradition shared by both countries, it is not improbable that our courts would eventually reach similar results. It is clear that our courts are not content to let the majority rule in all cases, but they have failed to develop a consistent set of principles which would allow one to predict when they are likely to set aside the will of the majority. It is not particularly useful to rely on such indefinite concepts as “fraud on the minority” as a guideline to intervention. The distinction made between class votes and other votes of shareholders has, if anything, served to confuse the issue of majority rights and there seems little to commend it. Shareholders will differ on many occasions as to the course which a corporation should follow and there is every reason to allow the majority will to prevail if that will has been exercised with a view to the advancement of the common interests of shareholders. When the majority has an extraneous interest, courts have viewed, and will undoubtedly continue to view, their decisions with scepticism, and will themselves consider the fairness of the transactions in question. It would be useful if this principle, which is the underlying principle in *British American v. O'Brien*, was established as one of general application in all cases of shareholders’ votes. It would also be helpful if the courts declared that, where a shareholder, either alone or with others, is in a position to direct the management of a corporation, he occupies a fiduciary position towards the corporation in the exercise of such powers. It is desirable that, in all cases where the action of a majority with such extraneous interests is challenged, it should bear the burden of establishing that its actions are fair to the corporation. Even if such positions were taken by our courts, the problem of challenging the actions of such minorities would not be an easy one.

IV. *The Oppression Remedy*

The Canada Business Corporations Act, as well as some provincial legislation, provides security holders with a remedy against oppressive conduct.⁹⁴ The remedy may be granted when:

- (a) the powers of the directors of a corporation, or any of its affiliates, are being exercised in a manner;

94. C.B.C.A., *supra*, s. 234, Business Corporations Act, S.M.C. 225; Business Corporations Act, S.S. 1977, C. 10.

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

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

that is “oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder.” The court is given a broad power to make such orders as it sees fit, including orders for an investigation, appointing a receiver, amending the articles or by-laws, replacing directors, requiring the securities of a complainant to be purchased, varying or setting aside transactions, and compensating aggrieved persons. Section 235 provides that, in any such application, the action shall not be stayed by reason only that it is shown that the alleged breach of a duty owed to the corporation may be, or has been, approved by the shareholders of such body corporate, although this may be taken into account by the court in determining whether to make an order.

Thus, the court is given a very wide-ranging power to right almost any conceivable wrong suffered by a shareholder, and, in giving a remedy, need not be bound by the long-held distinction between rights enjoyed by a shareholder and rights enjoyed and only enforceable by the corporation. Also, the court may act even when the course of conduct complained of is an isolated act, rather than a continuing course of oppressive conduct; this approach is a broader one than section 210 of the U. K. Companies Act 1948, which served as a model for the legislation, as, under that section, relief was limited to cases where there was a continuing course of conduct.⁹⁵ The object of the legislation was to avoid the necessity of a winding-up order in cases of a substantial abuse of majority power, while giving a remedy that would offer continuing relief or indemnity to the complainant.⁹⁶

It is too early to tell what use the courts will make of these very broad powers, but there is some indication that they will use them liberally whenever convinced that a shareholder has been unfairly treated. In *Re Peterson v. Kanata Investments Ltd.*,⁹⁷ Tay J. appointed a receiver manager when a shareholder took control of a corporation by threatening to suspend financial assistance to it unless the board created a new class of shares which effectively

95. Proposals for a New Business Corporations Law for Canada, *supra*, p. 163.

96. Proposals for a New Business Corporations Law for Canada, *supra*, p. 164.

97. *Peterson v. Kanata Investments Ltd.* (1975) 60 D.L.R. (3d) 527.

gave him control. On receiving such shares, the shareholder agreed with a group, which was attempting a take-over of the corporation's principal subsidiary, to vote the corporation's shares of the subsidiary to support the take-over. The shareholder also proposed to cause the corporation to be wound-up, which would have resulted in the other shareholders receiving considerably less than their invested capital. The court found that his method of obtaining control was not bona fide and that the price of the shares issued to him as a result of his demand was inordinately low.⁹⁸ The court also found that the sale proposal and the threat of winding-up were unfairly prejudicial because the other shareholders might have "a genuine and practical desire" to hold the shares of the subsidiary; it did not find that the agreed price for the sale of the subsidiary's shares was too low, or that the sale agreement was made in bad faith. The court ordered the controlling shareholder to sell the shares issued to him back to the corporation at their original cost, so that a new and independent board could be elected.⁹⁹ It is interesting that the court was prepared to act to restrain the disposition of a corporate asset even though it was not satisfied that there was anything unfair in this aspect of the transaction. This is a major interference with the ordinary right of a majority to determine what is in the business interest of the corporation, and appears to recognize an interest of individual shareholders in the retention of a profit-making asset. Undoubtedly, the conduct of the controlling shareholder in securing control by what the court regarded as unfair tactics was a major factor in the decision, but the decision does indicate a substantial willingness on the part of the court to intervene broadly.

The decision in *Redekop v. Robco Construction Ltd.*¹⁰⁰ also indicates a liberal approach to the legislation in a case involving a conflict of interest. The majority shareholder of Robco received shares in another corporation as a result of his position. As a shareholder and director of both, he caused Robco to agree to carry on its construction business for the new company's account at a fixed price. Despite a lack of evidence of loss, the court held that the majority shareholder was aiding himself with the use of Robco's assets and, ultimately, at the expense of Robco's shareholders, and

98. *Ibid.*, p. 544 *et seq.*

99. *Ibid.*, p. 545.

100. *Redekop v. Robco Construction Ltd.* (1978) 89 D.L.R. (3d) 507.

concluded that, as this conduct was oppressive, he should account for all profits and, in addition, should buy the complainant's shares. Thus, any breach of a director's duties, whether or not it results in loss to the corporation, may be actionable through the oppression remedy. The power has even been used in *Diligenti v. RWMD Operations Kelowna Ltd.*¹⁰¹ to give relief where a shareholder complained about his removal from his company's management, on the ground that this was "unfairly prejudicial" to the shareholder as the defendant company was effectively a "quasi-partnership". In *Re Sabex Internationale Ltee.*,¹⁰² a Quebec court used the section to restrain the board of directors from issuing shares which would lead to a dilution of the position of the existing shareholders, unless they subscribed for new shares. This was done on the ground that such a rights offering would unfairly prejudice the shareholders' equitable rights within the meaning of section 234. In *Jackman v. Jackets Enterprises Limited*,¹⁰³ the court ordered the majority shareholder to give a personal guarantee of a loan and pay for excessive interest obligations which the court believed had been incurred.

Thus, the oppression remedy does give the court a very wide power to afford relief when it believes that the complainant has been unfairly dealt with, without being circumscribed in its relief by a rigid set of rules. It is too early to tell whether the courts will make extensive use of these very wide powers or will shy away from interference which they believe would excessively circumscribe the power of the majority to take the corporation in whatever direction it believes to be in its business interests. There is no doubt, however, that courts are becoming increasingly aware of the disparate bargaining power of various segments of society and are inclined to find methods to relieve against what they regard as unfairness leading to unjust results.

The very breadth of the section leads to problems for both majority and minority shareholders. For the minority shareholder, the remedy requires a resort to litigation with all of its uncertainties. Although the court has the right under section 235(4) to make an order for interim costs, including legal fees and disbursements, the complainant may ultimately be held accountable for such interim costs upon a final disposition of the matter. Accordingly, the

101. *Diligenti v. RWMD Operations Kelowna Ltd.* (1977) 4 B.L.R., p. 134.

102. *Re Sabex Internationale Ltee.* (1979) 6 B.L.R., p. 65.

103. *Jackman v. Jackets Enterprises Limited* (1977) 4 B.C.L.R., p. 358.

procedure is certainly not without risk, and the prospect of a long trial and the possible exhaustion of all appeal procedures by the majority will constitute a substantial deterrent in most cases. For the majority shareholder, the procedure also involves a considerable risk because the only real limitation on the power of the court is imposed by the requirement that it must find conduct which, in its view, is unfairly prejudicial to, or unfairly disregards the interests of, any security holder. Undoubtedly, as the law is developed by a series of actions and appeals, the position of both groups will become much clearer. However, the resolution of such matters by a prolonged litigious process, governed by little or nothing in the way of guidelines, leaves something to be desired, although such a remedy unquestionably will make a real contribution to the fair treatment of shareholders.

V. *Fundamental Changes*

The authors of the Proposals for a New Business Corporations Law for Canada concluded that the common law governing the conduct of majority shareholders in cases where fundamental changes were being made was unsatisfactory.¹⁰⁴ Accordingly, they recommended that, instead of relying on common law standards to govern the conduct of majority shareholders, a right should be conferred upon a shareholder who dissents, upon the making of a fundamental change, to opt out of the corporation and demand fair compensation for his shares.¹⁰⁵ Their view was that this right, instead of placing the minority shareholder at the mercy of the majority, would permit him to withdraw from the enterprise where the majority was able to obtain the requisite special resolution. They believed that this would allow the majority shareholders to effect almost any fundamental change with impunity. In their opinion, “the result is a resolution of a problem that protects minority shareholders from discrimination and at the same time preserves flexibility within the enterprise, permitting it to adapt to a changing business condition.”¹⁰⁶

These recommendations were substantially adopted in Part IV of the Canada Business Corporations Act. The result is that all significant changes in the articles affecting shares or the nature of the business to be carried on, amalgamations, continuances under

104. Proposals for a New Business Corporations Law for Canada, *supra*, p. 114.

105. *Ibid*, p. 115.

106. *Ibid*, p. 115.

the laws of other jurisdictions and sales, and leases or exchanges of all or substantially all of the property of the corporation give rise to a right of dissent. In addition, section 170 confers on a shareholder of a class or series an extensive right to vote separately as a class upon proposals to amend the articles where his rights are affected. One salutary aspect of this change was to exclude the effect of such decisions as *Greenhalgh v. Arderne Cinemas Limited*, *White v. Bristol Aeroplane Co.*, and *re John Smith's Tadcaster Brewery Company*,¹⁰⁷ so that shareholders are entitled to have such a class vote not only where their rights are altered directly, but also in many cases where there is an indirect effect upon those rights as a result of action in respect of the shares of another class.

Despite these improvements, it is questionable whether the statutory provisions as to fundamental changes and, in particular, the appraisal remedy constitute as great a protection for the rights of minority as the draftsmen believed. For example, under the provisions of section 170(1), it is possible to draft articles so that the right to a class vote is excluded where the fundamental change alters the maximum number of shares, where it cancels, exchanges, or reclassifies shares, or where it adds, changes, or removes rights attached to shares. All of these measures, of course, may radically alter the position of a shareholder who may well have acquired shares without any considered examination of the articles. It also may be questionable whether the legislation has successfully avoided a not uncommon method of diluting a shareholder's voting position by splitting another class of shares. It has been suggested that, although the share split itself would require an amendment of the articles, a class vote of the shares diluted would probably not be required unless the company's articles provided for a maximum number of shares of the class being divided and that class were found to have rights or privileges equal or superior to those of the diluted class.¹⁰⁸ Furthermore, the provisions as to fundamental changes do not provide any statutory code as to when shareholders within a class who have conflicting interests with those of the class may vote to advance their own interests. Unless an application is made to a court to enjoin such shareholders, they are free to vote.

107. *Greenhalgh v. Arderne Cinemas Limited*, *supra*; *White v. Bristol Aeroplane Co.*, [1953] Ch. 65, and *Re John Smith's Tadcaster Brewery Company*, [1953] Ch. 308.

108. Mary Ann Waldron *The Protection of Preference Shareholders in a Closely Held Corporation*, 4 Canadian Business Law Journal, 29 at p. 41.

Also, it must be recognized that some fundamental changes to the business of a corporation are not considered to be “fundamental changes” within the meaning of the legislation. For example, a right to dissent applies upon the sale, etc., of all or substantially all of the property of a corporation other than in the ordinary course of business. This still leaves a majority shareholder free to make sweeping changes in the business of a corporation without creating dissent rights. This comment is not meant to suggest that every major change in a company’s affairs should require shareholder approval; rather, it is suggested that the very broad powers which a majority can still exercise free of dissent rights require that, when it exercises control over the affairs of a company, it should be subject to fiduciary obligations.

In many cases, the effectiveness of the appraisal remedy will determine whether the position of the minority is adequately protected. A detailed examination of the appraisal remedy is beyond the scope of this paper, but its effectiveness as a remedy is open to question. Its exercise involves embarking on a complex litigious procedure, the outcome of which may be very uncertain and very much delayed. The shareholder may, if the court believes it right to do so, be awarded costs, but at the commencement of the process he cannot be certain of this. He will be forced to end his participation in the corporation and he can be certain that, at the end of the day, he will be visited by a tax collector intent upon gathering capital gains tax, and, accordingly, he will certainly lose part of the earning power of his investment. Even after he has obtained what he regards as a satisfactory order, he may find that the corporation is precluded from making payment because it is insolvent.¹⁰⁹ In circumstances where he has some question about the viability of the corporation as a result of the course adopted by its controlling elements, he may regard this as a real risk impelling him to take what he can get at once. Also, the process of arriving at fair value is a complex one, frequently involving substantial delays.

In determining the fair value to be awarded, the court may consider a number of factors, including the market value, the net asset value, the investment value, and the value arrived at by a discontinued cash flow analysis. In *Re Wall & Redekop Corporation*,¹¹⁰ a case arising under section 228 of the Companies

109. C.B.C.A., *supra*, section 184 (26).

110. *Re Wall & Redekop Corporation* (1975) 1 W.W.R., 621.

Act, 1973 (B.C.), McFarlane J. held that he was not persuaded that the “fair value” of shares could be determined by the stock market price of the shares when management held two-thirds of the shares and the stock was very thinly traded. Relying on American authorities, he found that:

There are at least three ways of determining the fair value of shares in any given corporation. That value may be determined by reference to the market value of the shares in the stock exchange, by calculating the net asset value, or the amount to be obtained upon a hypothetical liquidation, or the investment value of the shares based on a capitalization of the earnings of the company.¹¹¹

After declaring that “whatever method is employed the dissenting shareholder is to be paid for his proportionate interest in the company as a going concern”, he left the actual determination to a referee.¹¹²

In *Neonex International Ltd. v. Kolasa, et al*,¹¹³ Bouck J. considered the effect of section 184 of the C.B.C.A. in a case involving an amalgamation by which the minority were to be squeezed out of the company for cash or redeemable preference shares. The shareholders asked for the appointment of an appraiser. Bouck J. refused to make such an order, saying that:

It might be appropriate where a company had only one easily appraised piece of property. It is not suitable for this kind of complaint due to the complex nature of the operations of Neonex. Many practical problems come to mind . . . For example, who would pay the cost of the appraiser during the course of such an inquiry? Costs are a creature of statute and not of the common law. An appraiser could take months or years conducting an investigation. Generally speaking the rules and procedure of this court only allow an award of costs at the conclusion of a proceeding. They cannot be advanced part way through to help finance the other side’s claim or defence.

Nothing could better underline the difficulties of the dissenting shareholder than this exposition of the problems involved in fixing the value of shares. The dissenting shareholder, in the case of any complex corporation, will be faced with a well-prepared case by the corporation and will need to arm himself with experienced advisors, both legal and financial, if he is to have any hope of success. As

111. *Ibid*, pp. 625-6.

112. *Ibid*, p. 628.

113. *Neonex International Ltd. v. Kolasa, et al* (1978) 2 W.W.R. p. 593.

Bouck J. said, the task may take years; in the meantime, his investment is locked into an enterprise with which he is dissatisfied. The risks of such a venture are likely to deter anyone other than the shareholder with a substantial interest. In the *Neonex* case, Bouck J. ordered a trial, although he did order that the burden of proof of the fair value of the offer should be placed upon the petitioner. The complainant, nevertheless, was left with the problem of valuation, which the judge recognized to be a complex task. Bouck J. concluded that the value might be fixed by taking the market value, the net asset value, the investment value, or a combination of all three. The shareholder must have concluded that his application was only the first step on a long road.

The provisions of section 184 of the C.B.C.A. were considered in *Montgomery v. Shell Canada Ltd.*,¹¹⁴ a case involving a dissent by shareholders upon the creation of a new class of preferred shares ranking in priority to theirs. In that case, Shell offered a figure based on the weighted average of closing stock exchange prices during the one-month period prior to the vote. A very small minority of the outstanding shares refused to accept the offer. Estey J. held that the fair value of Shell shares was \$16.50, measured by the market value. No effort had been made to put forward investment value as representing “fair value”, and Estey J. declined to accept the applicant’s evidence of net asset value on the ground that this was an inappropriate method when a corporation was to continue as a going concern.¹¹⁵ He did conclude that the market price of Shell stock had not been significantly depressed because a majority of its shares was held by a single shareholder, finding that there was a sufficient volume of trading to indicate that the market value was an appropriate test as to the price at which shareholders were prepared to buy and sell the shares. Very different results were reached in *Re Whitehorse Copper Mines Ltd.*,¹¹⁶ where a very substantial part of the outstanding shares was held by a small number of shareholders, and shares were not actively traded. McEachern C.J.S.C. rejected market value as an appropriate test, having regard to the relatively thin trading, the generally pessimistic nature of the information released to the public about the company, and the failure to pay dividends. He also was unimpressed by the acceptance of the offer

114. *Montgomery v. Shell Canada Ltd.* (1980) 10 B.L.R., p. 261.

115. *Ibid.*, pp. 275-6.

116. *Re Whitehorse Copper Mines Ltd.* (1980) 10 B.L.R., p. 113.

by the overwhelming number of eligible shareholders, finding that this was the result of pessimistic annual reports and opinions expressed in the directors' circular as to value, which he found unsatisfactory. In this case, each side had put forward evaluations based on a discounted cash flow analysis; using this approach, the judge fixed the fair value of the shares for the commercially viable properties held by the company and an assigned value in respect of the future potential of other properties held by it.

The market value of shares was once again rejected as constituting "fair value" for the purposes of section 184 of the C.B.C.A., in *Domglas Inc. v. Jarislowski, Fraser & Co.*¹¹⁷ The *Domglas* case arose out of an amalgamation which effectively eliminated minority shareholders. Greenberg J. reviewed a substantial number of American authorities, concluding that one could adopt a market value approach, a net asset value or an investment value approach, or some combination of all of these. While *Domglas* shares had been listed on the Toronto Stock Exchange for a number of years, the public float had been very small and trading was very thin. He rejected the net asset value approach, stating that:

The Canadian jurisprudence reviewed . . . although it placed primary emphasis on the earnings method, reserves as well a role for net asset values. The basic concept currently accepted by valuation theorists is that a business is worth only what it can earn except where it is worth less on a going concern basis than the amount that would be realized if it were liquidated.¹¹⁸

Greenberg J. concluded that, because the procedure was equivalent to an expropriation, the fair value must include a premium for forceable taking and should not be subject to a minority discount.¹¹⁹

In addition to the problems outlined, questions can arise in determining fair value as to what effect should be given to tax advantages to be gained as a result of the transaction or whether tax liabilities should be taken into account in preparing the valuation.¹²⁰ Thus, no general rule can be established as to what valuation method a court will find acceptable in a particular case, but, rather, the method chosen will depend upon the facts of the case.

117. *Domglas Inc. v. Jarislowski Fraser & Co.* (1980) S.C. 925.

118. *Ibid.*, p. 953.

119. *Ibid.*, p.p. 965-6.

120. *Re Ripley International Ltd.* (1977) 1 D.L.R. 269, at p. 273; *Redekop v. Robco Construction Ltd.* (1980) 3 A.C.W.S. 408; *Re VCS Holdings Ltd.* (1978) 5 W.W.R. 559; *Re Diligenti v. RWMD Operations, etc.* (1977) 4 B.C.L.R. 134.

This examination of the appraisal right is intended only to illustrate that it is not a simple remedy. Many shareholders will conclude that their interests will be better served by having their money quickly than by engaging in a piece of litigation involving a substantial expenditure on their part and an outlay for substantial costs which may or may not be recovered. At a minimum, legislation should require that interest will be payable, rather than leaving this question to the discretion of the court, as it is now.¹²¹ The legislation should also provide that the court may, upon any application to it to fix the fair value, make an order at the outset requiring the corporation to pay reasonable legal fees and expert fees incurred by the dissenting shareholder in connection with the proceeding. However, even if these changes were made, a shareholder is unlikely to resort to the remedy unless he has a very substantial investment, and even then he may be prepared to take less than might be awarded as fair value in the interests of speed and certainty. The small shareholder is most unlikely to resort to the courts. Thus, although the remedy may be useful in some cases, its existence does not ensure fair treatment of minorities or any assurance that fundamental changes will be made with a view only to the interests of the body of shareholders, rather than to the interests of the majority.

VI. Conclusion

The development of the law, both by the courts and by statute, indicates that a fairness standard is being adopted as the appropriate one for considering the treatment of minorities by majorities. There will always be some difference of opinion as to the degree to which courts should interfere in the internal management of corporations and what the appropriate balance should be between protecting minorities and allowing the majority's will to prevail. It should be recognized that this is not simply an issue involving shareholders, but, rather, the whole of society, as the corporation is the means by which much of the nation's economic activity is organized. Once this interest is recognized, the appropriate question becomes what type of regime will best permit corporations to marshal the savings of society for these economic activities. It seems apparent that whenever minorities are, in a broad sense, treated unfairly, such treatment constitutes a detriment to the effective working of the

121. C.B.C.A., *supra*, section 184 (23).

capital markets. It has long been recognized that society has an interest in having an effective capital market which ensures a full and fair disclosure of all the facts material to a decision to purchase a security. Thus, it has been recognized that the public interest requires a fair system for trading in securities. Equally, the public interest should dictate that companies will be managed so as to advance the common interests of all shareholders and not the special interests of a few.

If this is a legitimate conclusion, then it is doubtful whether the existing methods of securing a requisite degree of fairness to shareholders are adequate. Our courts will, in all probability, slowly but surely use the common law and the new statutory remedies to impose a system which requires a high degree of fair dealing when majority shareholders impose their will on minorities, and will be astute to restrain actions by majorities dictated by interests extraneous to those of the whole body of shareholders. However, this progress has, in the past, been painfully slow and will depend upon a case-by-case development by way of a costly litigious process. It must be recognized that shareholders are loath to resort to litigation, even when they have some assurance that crippling costs will not be imposed upon them. In many cases, even the largest shareholders are content to accept settlements which fall short of what fairness might dictate and what might be achieved if one were content to await the outcome of litigation. Accordingly, a majority shareholder can take advantage of such a situation and secure results which fall far short of what are ideal if the objective is to have all shareholders treated fairly. Given these realities, it would seem preferable to anticipate this slow development process and enact some rules now which would make it more difficult for majorities to mistreat minorities. When a majority exercises a power to direct the course which a corporation will follow, it is surely desirable that this power be subject to the overriding consideration that it must act fairly.

We have no trouble in imposing fiduciary obligations on the agents and officers of corporations, believing that those who have a duty to act for others should exercise the utmost good faith in the performance of such duties. By the combined force of statutes and the development of the common law, the same standards are required of directors. There seems to be every reason for applying similar standards to controlling or dominant shareholders who, in practice, exercise ultimate control over both officers and directors.

These standards can co-exist with the principle that the majority has a right to govern, but they will ensure that the governance will be directed to furthering the interest of the corporation. When the governing shareholder has interests opposed to those of the corporation, his right to dictate the course to be followed should be subject to the overriding principle that the power may be exercised only in the interest of the corporation.

The reality of the present position is that, although the courts may impose a standard of fairness on dominant shareholders, the burden of enforcement falls on the protesting shareholders. A right is only useful when it can be practically exercised; if it cannot be enforced readily, it will be breached by all those who are more interested in their own advancement than in questions of equity. Unfortunately, in an increasingly complex society we are finding that, although the courts may be an admirable method of resolving disputes, the right to find relief there does not always result in citizens enjoying the protection the law affords them. What is needed is a system which results in respect for the rights society believes to be worthy of protection, so that citizens need not resort to the courts for relief. Thus, society has, more and more, resorted to administrative tribunals, regulation, and the substantial restriction of freedom of contract by statute, in an effort to ensure fair treatment whenever it is recognized that there is an inequality of bargaining power. Recent efforts to afford consumers greater protection are an illustration of society's ultimate response when it believes a system is working unjustly. Such initiatives, it is suggested, would be an undesirable response to this problem, as there is certainly merit in the traditional view that shareholders normally are the best judges of their own interest. Indeed, a detailed statutory or regulatory scheme for the governance of corporations is unlikely to be more successful than many of society's attempts to regulate complex and rapidly changing events. A more promising approach, it is suggested, would be to create a regime where the burden is placed on dominating shareholders to show that their actions are fair to the corporations whose destinies they control and where their votes will not have the ultimate power of decision whenever they have interests opposed to or competing with the corporations they control. If dominating shareholders were faced with this onus and the further onus of seeking court approval for major transactions out of the ordinary course of business involving self-dealing, and for

fundamental changes where they, in effect, were on both sides of the table, many dubious transactions would never be attempted.

In developing such rules, it must be recognized that there is a danger of the tyranny of the minority, as it would be most unfortunate to have a system in which a small minority could effectively stalemate a corporation and “blackmail” the other shareholders. The objective must be to ensure fair treatment, while, at the same time, not stalemating the business of the corporation. Such a goal could be attained by making the court the final arbiter when a majority has an interest extraneous to its shareholder interest.

A better balance might be achieved if legislation was enacted, adopting these principles:

- (a) directors having a conflict should not be entitled to vote and the existing rule as to the voting by directors in transactions involving affiliates should be repealed, save in situations where the matter at issue involves wholly owned subsidiaries;
- (b) directors and dominant shareholders may only exploit opportunities in which their corporations have been or are interested if their actions are disclosed to the shareholders and approved by independent directors after full disclosure;
- (c) a dominant shareholder and his associates should be regarded as having a fiduciary obligation to the corporation, so that the exercise of their power to control the corporation and its management would be subject to a standard of fairness comparable to that imposed by the American courts;
- (d) shareholders should only be entitled to vote at general shareholders’ meetings or class meetings with court approval when they have interests which affect the matter at issue and which are in conflict with those of the corporation or with those of the class;
- (e) a corporation or a dominant shareholder should have the right to apply to a court for approval of any action in respect of which shareholders are disenfranchised because of extraneous interests;
- (f) whenever shareholders are disenfranchised because of such a conflict, the balance of the shareholders should be entitled to approve the transaction in question;
- (g) all material transactions between such a shareholder and a corporation which are out of the corporation’s ordinary course of business should be submitted either to a court or to a meeting of shareholders for approval;
- (h) in any action involving the propriety of a transaction between such a shareholder and the corporation, the onus should be on the

shareholder to establish that the transaction was in the best interests of the corporation;

(i) the court should be entitled to make an order at the commencement of an appraisal proceeding, directing that any shareholder exercising the appraisal remedy be paid all reasonable costs and expenses regardless of success.

The object of these proposals is to require a much greater independent scrutiny of matters where the interests of the dominant shareholder differ from those of the corporation or the interests of the class of shareholders affected by some fundamental change. The prohibition against a director voting when the matter at issue relates to an affiliate which is not wholly owned should ensure that transactions between a parent and such affiliates will be sanctioned by independent directors. This may not be a completely effective solution; as has been noted elsewhere in this paper, independence may be a rare quality in some directors. Yet, it does not seem reasonable to require shareholder approval of all such transactions when many parents and subsidiaries are vertically integrated, so that they do business together in the ordinary course. Generally speaking, it is easier to judge the fairness of such transactions because, in many cases, they involve business transactions carried out at arm's length on a fairly regular basis, so that an adequate standard of comparison exists. Accordingly, a requirement that all such material transactions and their terms should be disclosed on a regular basis should go a considerable distance towards ensuring fairness. Transactions outside the normal course of business present an entirely different type of problem, as often there is no benchmark by which to judge them and frequently they are more complex. It seems appropriate that all such transactions should be ratified, for if independent shareholders cannot be persuaded of their value, their validity is probably questionable. However, there is clearly the danger in such a system that a shareholder with a miniscule interest will seize on the opportunity to "hold up" the corporation by exacting a price for his consent. Unfortunately, majorities have no monopoly on the tendency to advance their own interests unfairly in some cases. Accordingly, it is suggested that the corporation always have the right to apply to a court as the final arbiter in the same way as is done in the case of reorganizations.

These proposals, if adopted, will not introduce any millennium, as there will always be difficulties in resolving differences between majorities and minorities, both in corporate governance and in life.

Their adoption, however, would clarify the obligations of those who, in many cases, are the real managers of our public corporations. There will always be different views as to what these obligations are. Nevertheless, the public interest in the effective workings of the corporate sector should be better served by requiring that the interests of the corporation be preferred to those of the majority than by leaving a majority free to pursue its own interests when they conflict with those of the corporation.