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Canada's Top Court Rules on Personal Liability of Directors for Oppression

Authors: William Brock, Ad.E., Matthew Milne-Smith and Maureen Littlejohn

On July 13, 2017, the Supreme Court of Canada issued its decision in *Wilson v. Alharayeri* (*Alharayeri*). The decision sounds an important cautionary note to directors concerning the potential consequences of engaging in conduct that is improper or defeats the reasonable expectations of minority shareholders, creditors or other potential complainants.

Most Canadian corporate statutes, including the *Canada Business Corporations Act*, Ontario's *Business Corporations Act* and Québec's *Business Corporations Act*, allow stakeholders to obtain relief when any of the following leads to results that are oppressive, unfairly prejudicial to or unfairly disregard the stakeholders' interests: (i) an act of the corporation or its affiliates; (ii) the conduct of the business and affairs of the corporation or its affiliates; or (iii) the exercise of the powers of the directors of the corporation or its affiliates. This relief is generally referred to as an "oppression remedy" that grants the courts wide discretion to make orders to rectify the conduct complained of. *Alharayeri* confirmed and clarified the circumstances in which an individual director, as opposed to the corporation or another party, may be held personally liable for conduct that the court determines to be oppressive.

The facts of *Alharayeri* are briefly as follows. From 2005 to 2007, Ramzi Mahmoud Alharayeri (Alharayeri) was the president, CEO, a significant minority shareholder and a director of Wi2Wi Corporation. In early 2007, at the direction of Wi2Wi's board, Alharayeri began negotiations regarding the sale of Wi2Wi shares to Mitec Telecom Inc. During these negotiations, Alharayeri entered into an agreement with Mitec to sell some of Alharayeri's own Wi2Wi common shares. When Wi2Wi's board learned from Mitec of Alharayeri's proposed sale of his shares, Alharayeri was censured for failing to disclose to the board the deal to sell his shares and for putting himself in a potential conflict of interest. As a result, Alharayeri resigned from his functions at Wi2Wi.

After Alharayeri's resignation, the appellant Andrus Wilson (a director of the Wi2Wi board) (Wilson) became Wi2Wi's president and CEO. The merger of Wi2Wi and Mitec did not occur and, in light of Wi2Wi's increasingly precarious financial position, the board decided to issue convertible secured notes by way of a private placement to its existing common shareholders. Before the private placement, the board accelerated the conversion of Class C shares that were beneficially held for Wilson into common shares, even though Wi2Wi's auditors expressed doubts that the requisite financial tests had been met. At the same time, however, the board decided not to convert Alharayeri's Class A and B shares into common shares even though the financial tests for the conversion of these shares had certainly been met. In the result, Alharayeri was unable to participate in the private placement, and the values of both his Class A and his Class B shares and the proportion of his common shares in Wi2Wi were substantially reduced.

Alharayeri filed an application under s. 241 of the *Canada Business Corporations Act* seeking relief from oppression against four of Wi2Wi's directors, including Wilson and Dr. Hans Black (Black), another shareholder and the chairperson of the audit committee. The Supreme Court of Canada affirmed the decisions of the lower courts and held Black and Wilson (but not the other directors sued by Alharayeri) personally liable to pay damages.

The Supreme Court confirmed the two-pronged test set out by the Ontario Court of Appeal in the leading 1998 case of *Budd v. Gentra* for the imposition of personal director liability for oppression, holding that such liability can be imposed when (i) the director is implicated in the oppression; and (ii) the imposition of liability is "fit in all the circumstances." Recognizing that the question of fitness is "necessarily an amorphous concept," the Court went on to elaborate four general principles to "guide courts in fashioning a fit order":

1. The oppression remedy request must in itself be a fair way of dealing with the situation.

2. The order should go no further than necessary to rectify the oppression.
3. The order may serve only to vindicate the reasonable expectations of securityholders, creditors, directors or officers in their capacity as corporate stakeholders.
4. The court should consider the general corporate law context in exercising its remedial discretion.

It is the first criterion – that the remedy sought ought to be "fair" – which leaves the most room for uncertainty. The Supreme Court explained that when a director acts in bad faith and has obtained a personal benefit from the oppression, it is likely (but not necessarily) fit to hold the director personally liable; conversely, when there is neither bad faith nor personal gain on the part of the director, it is unlikely (but not impossible) that a court will find that it is fit to condemn a director to personal liability for oppression. However, a court's decision to grant relief under the oppression remedy turns on equitable considerations and is necessarily fact-specific. As a result, the Supreme Court warned that although bad faith and personal benefit "remain hallmarks of conduct properly attracting personal liability," they "should not overwhelm the analysis." There will thus certainly be many less obvious cases that must each be carefully analyzed in their particular, broader and more complex factual matrixes to determine whether the oppressive conduct is properly attributable to the director because of his or her implication in the oppression.

So what does *Alharayeri* mean for directors and their counsel? The potential extent of their personal liability is a persistent concern for directors, and they can learn a number of lessons from this case.

First, while it is a long and well-established principle that directors must avoid and declare conflicts of interest, *Alharayeri* makes clear that even when a director acts in good faith, the director's gain of even an incidental advantage by a board decision may bear directly on his or her personal liability when oppression is claimed. It is thus essential that directors ensure that not only *they* declare all of their potential conflicts of interest, but that their fellow board members also do so.

Second, even though the SCC affirmed that merely adopting a "lead role" at board meetings will never in itself be sufficient to ground a director's personal liability for oppression, evidence concerning the extent of a director's support of a decision can affect his or her personal liability. In *Alharayeri*, the Québec Superior Court relied on, among other things, evidence of Wilson and Black's "lead roles in the discussions at the Board level" to conclude that Wilson and Black (and no other directors) were personally liable for Alharayeri's loss. The Québec Court of Appeal endorsed this approach. Wilson argued that the lower courts' conclusions were wrong because the oppressive decisions were attributable to Wi2Wi's board. Wilson also argued that the fact that one director may be more vocal than another is irrelevant where the board ultimately *acted* unanimously. The Supreme Court, however, disagreed and concluded that, in light of the "lead roles" of Wilson and Black, it was open to the trial judge to determine that the oppression was properly attributable to them. In short, the unanimity of a board decision will not in itself immunize specific board members from potential personal liability for the oppressive consequences that might result from such decision.

Finally, and despite the SCC's conclusion that it can be appropriate not to hold all board members liable in cases of unanimous board decisions, it should be noted that board members always have the right to record their dissent from objectionable decisions of the board, and this remains the best way to protect directors from any liability that might result from such decisions.

Alharayeri brings much-needed clarity to the scope of potential individual liability of directors under the oppression remedy, but has left significant accommodation for further interpretation and argument about the circumstances in which such relief will appropriately be granted. Directors, companies and their insurers should carefully consider their director liability indemnification clauses in light of this decision in order to determine what types of conduct may or may not be covered.

Key Contacts: William Brock, Ad.E., Matthew Milne-Smith and Maureen Littlejohn