April 13, 2020

ARTICLE

COVID-19: Shareholder and corporate disputes

COVID-19 and the rapid collapse in oil prices have caused significant economic contraction and uncertainty. This difficult landscape may be fertile ground for a proliferation of corporate, director and shareholder disputes, particularly in Alberta. This bulletin provides a brief overview of certain areas of dispute that corporate stakeholders should be aware of in the wake of COVID-19.

Summary - What you need to know

- Claims against directors and officers: Responding and adjusting to COVID-19 requires making critical decisions on expedited timelines. This may lead to an increase in claims alleging that directors and officers breached their duties to exercise care, diligence, and skill and/or to act honestly in the best interests of the corporation.
- Shareholder oppression claims: Difficult financial decisions may result in reduced dividends or loss of share value. Decisions that are not applied fairly, and that disregard or prejudice reasonable stakeholder expectations, can trigger oppression claims.
- Derivative actions: The current economic contraction may lead to scenarios where corporations have been wronged but are unable to fund litigation. Should a corporation fail to pursue litigation, shareholders may seek to pursue litigation on behalf of the corporation.
- Dissent rights and share valuations: Fundamental strategic decisions made by a corporation may trigger shareholder dissent rights. In the current market conditions, dissent rights may lead to contested share valuations, which will be complicated by the recent volatility in the stock market.
- Shotgun clauses and liquidity challenges: The economic environment may lead to depressed valuations and liquidity shortages. Shareholders with greater access to liquidity may take advantage of this environment by exercising contractual buy-sell rights built into shareholder, partnership and joint venture agreements, which may lead to disputes.
- Leadership challenges: The current economic environment may also prompt an increase in corporate leadership challenges by disgruntled shareholders. Those disputes may increasingly end up before the court on an urgent basis.

Claims against directors and officers

Stakeholder claims against directors and/or officers of corporations could increase in the wake of COVID-19.

What you need to know:

- Directors and officers have a duty to exercise the care, diligence, and skill of a reasonably prudent individual and a fiduciary duty to act honestly and in good faith with a view towards the best interests of the corporation. The duty of care may extend to stakeholders of the corporation, such as shareholders, creditors and other parties.
- Directors may be personally liable for certain liabilities of the corporation, including employee wages, employment-related source deductions, taxes and environmental liabilities.
- Directors or officers may also be personally liable if they enter into certain transactions with the corporation on the eve of formal insolvency proceedings.
- Directors' and officers' duties of care and fiduciary duties continue to exist when a corporation is on the verge of insolvency, during which time decisions may be highly scrutinized.
- The 'business judgement rule' presumes that directors and officers act in accordance with their duties unless proven otherwise. As a result, it is possible that directors or officers may only be found liable for breaching their duties in clear cases.

Oppression claims arising out of dividend reduction or other financial coping strategies

The current economic climate may force corporations to alter their behaviour, which could have consequences for dividends payable and share valuation. Significant strategic decisions may contradict the reasonable expectations of stakeholders. A stakeholder may seek Court intervention where a decision oppresses, is unfairly prejudicial, or unfairly disregards those reasonable expectations.

What you need to know:

- The oppression remedy protects stakeholders from certain acts of a corporation. The remedy is available to a wide range of stakeholders, including security holders, creditors, directors and officers.
- An action of a corporation, its affiliates, or its directors may give rise to an oppression claim if it oppresses, is unfairly prejudicial, or unfairly disregards the reasonable expectations of stakeholders.
- Stakeholders' reasonable expectations may conflict, particularly in times of financial difficulty. In balancing the expectations of different stakeholders, a corporation must remember that the most fundamental expectation of any stakeholder is to be treated fairly.
- An unmet expectation does not on its own amount to oppression unless it was caused by oppressive or unfair conduct, and actually resulted in loss or damage.
- Significant financial decisions can frustrate reasonable expectations. A corporation cannot declare or pay a dividend if it is insolvent. In other circumstances, improperly reducing a shareholder's dividend can amount to oppression if it is not done fairly.
- Most importantly, a dividend reduction must apply fairly across shareholders of the same class. For closely-held and family corporations, a dividend reduction may be oppressive if it coincides with an increase in compensation paid to some, but not all, of the shareholders through another mechanism, such as a management fee.
- Similarly, a share offering that serves to dilute a shareholder's interest may frustrate that shareholder's reasonable expectation to not be unfairly diluted. A court may find such an "unfair dilution" if the shareholder is not able to participate in the new issuance, if the issuance is for an improper purpose, or if the new shares are issued at below market price.

Derivative actions when a corporation is unable to fund litigation

The current economic contraction may lead to scenarios where corporations have been wronged but are unable to fund litigation. Should a corporation fail to pursue litigation, derivative actions may be brought by shareholders who seek to pursue litigation on behalf of the corporation.

What you need to know:

- While the oppression remedy is available where the corporation has acted in an oppressive manner to a shareholders interests, the derivation action empowers a shareholder to bring an action on behalf of a corporation to pursue a wrongdoing done to the corporation itself.
- It is important the directors are aware of this remedy in the current economic environment. Depressed markets lead to increased risks of contractual breaches and other wrongdoings against corporations. The current economic climate may also impede a corporation's ability to fund the litigation required to contest those wrongdoings.
- There are a number of options available to corporations facing this scenario. Since a shareholder must obtain leave from the Court to commence a derivative action, the corporation may seek an order that the concerned shareholder fund the litigation. Alternatively, corporations may also consider pursuing alternative third-party litigation funding options, which courts have grown more favourable towards in recent years.

Triggering dissent rights

Certain changes of corporate direction and/or structure may allow shareholders to trigger dissenting rights, which allow them to receive compensation for their shares at fair market value. Given the difficulty of assessing share value in the current economic climate, parties may seek to exercise and litigate dissent rights through the courts.

What you need to know:

- A shareholder may "dissent" to fundamental changes in corporate direction. These changes include amending articles to change share transfer restrictions, modify the business that the corporation may carry on, or to add or remove an express statement establishing the unlimited liability of shareholders. A shareholder may also dissent following a corporation's decision to engage in an amalgamation, a change of corporate jurisdiction, or an extraordinary sale, lease or exchange of the substantial entirety of the corporation's property.
- A dissenting shareholder is entitled to be paid the fair value of the shares held. Fair value should not include an increase in underlying share value resulting from the decision dissented from.
- The Court will determine fair value if the parties cannot agree. In doing so, the Court can make an order for advance payment to the shareholder, with interest. The cost of the application and resulting appraisal will be born by the corporation in most cases.
- Importantly, a corporation must not make any payment to a dissenting shareholder if it is insolvent, or would become so by reason of the payment.

Triggering shotgun clauses/buy-sell arrangements in a depressed market

The current economic contraction may lead to depressed valuations and liquidity shortages. This environment may incentivize shareholders with greater access to liquidity to take advantage of contractual buy-sell arrangements built into shareholder, partnership and joint venture agreements.

What you need to know:

- Shotgun or buy-sell provisions are often included in unanimous shareholder agreements, partnership agreements and joint venture agreements.
- Under a shotgun provision, an offeror can make an offer to an offeree to either buy the offeree's shares or sell its own shares to the offeree at a certain price. The offeree has the option to either buy the offeror's shares or sell its own shares at the price specified in the offer. If the offeree declines to respond, the offeror can force the sale under the agreement.
- In normal circumstances where both parties have similar access to capital, the shotgun provision usually results in a fair offer price, as the offeree must be willing to purchase the offeree's shares at the original offer price. This tends to avoid overvalued and undervalued offers.
- However, depressed markets may lead to scenarios where (1) the company's valuations are significantly lower, and (2) shareholders may have unequal access to capital. Shareholders in a comparatively strong financial position may take advantage of this environment by making a low-ball offer knowing that the offeree is unable to secure the capital required to purchase the offeror's shares.
- Courts will typically enforce buy-sell offers when they strictly comply with the shotgun provision in the agreement. Shareholders should be aware of these provisions and review the specific mechanism contained in the applicable agreement.

Contesting corporate leadership

Hard decisions in the wake of COVID-19 may also prompt corporate governance contests. Directors and concerned shareholders should be aware of the prerequisites for requisitioning an electoral meeting. The heightened stakes of the current financial reality means that aggrieved parties may turn to the Court for immediate assistance in navigating corporate election issues.

What you need to know:

- Statutory deadlines for hosting annual general meetings have been suspended for both Albertan and Federally-incorporated corporations.
- However, in Alberta registered holders or beneficial owners of 5 per cent or more of the issued shares of a corporation, that also carry the right to vote at a meeting, retain the right to requisition a meeting to depose or elect directors.
- This right, and the form such a meeting will take, may be qualified by corporate bylaws. Special attention should be paid to any bylaw pertaining to the ability to conduct shareholder meetings remotely. BLG has provided guidance on this point here.

- The courts can, and will, rule on the validity of requisition requests, where those requisitions are rejected. Such applications will take on added importance and urgency with the suspension of annual general meeting requirements.

For legal advice on issues arising from COVID-19, please contact the authors or related contacts below who are ready to assist businesses navigate these uncertain times. BLG has also created a COVID-19 Resource Centre to assist businesses on a variety of topics, including labour and employment, contractual risks, public disclosure requirements, education, and criminal law.

By: Michael A Marion, David Madsen, Matthew Epp, Matti Lemmens, Loni da Costa, Zach Seymour, Matthew Schneider, Brett Carlson

Services: Disputes, Corporate Commercial

Related Contacts

Matthew Epp
Partner

Calgary

MEpp@blg.com

403.232.9712

Karine Chênevert
Partner

Montréal

KChenevert@blg.com

514.954.3180