Best Practices for Directors to Limit Personal Liability Under the Oppression Remedy

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The Supreme Court of Canada's confirms that corporate directors may be held personally liable in cases of oppressive conduct.

The Supreme Court of Canada's ("SCC") decision in *Wilson v Alharayeri*[1] confirms that corporate directors, as opposed to the corporation itself, may be held personally liable in cases of oppressive conduct. The SCC held that the case was appropriate for assigning a personal remedy and affirmed an order holding two directors personally liable for the payment of $648,310 to a minority shareholder.

This note summarizes the decision and highlights how directors may practically avoid this type of liability.

Background

From 2005 to 2007, Mr. Alharayeri ("Mr. A") was the President and CEO, as well as a significant minority shareholder and director of a company (the "Company") that was incorporated under the Canada Business Corporations Act ("CBCA").[2] The Company was experiencing financial difficulties and began negotiations in order to merge with another entity (the "Buyer"). During these negotiations, Mr. A entered into discussions and signed an agreement with the Buyer to sell some of Mr. A's own common shares of the Company. The board of directors of the Company (the "Board") learned of Mr. A's proposed sale and Mr. A ultimately resigned from his position as President and CEO and director. Mr. A was replaced as President and CEO by Mr. Wilson ("Mr. W"), who also indirectly owned preferred shares of the Company.

After Mr. A's resignation, the Board sought to address the Company's continuing financial difficulties by issuing a private placement to certain existing common shareholders. The private placement had the effect of substantially diluting the shareholdings of any common shareholder who did not participate in it.

Before issuing the private placement, the Board accelerated the conversion of the preferred shares owned by Mr. W into common shares. The conversion was completed despite doubts expressed by the auditors that the requisite financial tests had been met. At the same time, the Board refused to convert Mr. A's preferred shares into common shares, even though those shares met the requisite financial tests. As a result, Mr. A could not participate in the private placement and his common shareholding was substantially diluted.

Mr. A filed an application under Section 241 of the CBCA seeking relief from oppression against four of the Company's directors, including Mr. W and Mr. Black ("Mr. B"), who was another shareholder and the chairperson of the audit committee. Importantly, the audit committee was only comprised of Mr. W and Mr. B.

The trial judge found that oppressive conduct did occur and held that Mr. W and Mr. B had used their influence as the only members of the audit committee to advocate against the conversion of Mr. A's preferred shares. Mr. W and Mr. B (but not the other two directors) were found personally liable to pay damages to Mr. A.

The SCC upheld the decision of the trial judge and found that the imposition of personal liability against Mr. W and Mr. B was a fair way of rectifying the oppression Mr. A had suffered. The SCC also affirmed the Québec Court of Appeal decision holding Mr. W and Mr. B personally liable for the payment of damages sustained by Mr. A.

SCC Decision

In its reasons, the SCC declined to limit a director's personal liability to the traditional principles at common law, namely, bad faith and using the corporation to advance personal interest.

The SCC also confirmed the two-pronged test for the determination of personal liability of directors under the CBCA set out by the Ontario Court of Appeal in *Budd v. Gentra Inc.*[3] ("*Budd*"). Under *Budd*, the first prong requires that the oppressive conduct be properly attributable to the director because he or she was implicated in the oppression. The second prong requires that the imposition of personal liability be a fit remedy in all the circumstances.

Because "fitness" is an undefined concept, the SCC distilled four general principles to guide courts in determining whether it is appropriate to assign personal liability to a director under the CBCA:

1. the oppression remedy must itself be a fair way of dealing with the situation;
2. the order assigning personal liability should go no further than necessary to rectify the oppression;
3. a finding of personal liability may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders; and
4. the court should consider the general corporate law context in exercising its remedial discretion because director liability cannot be a surrogate for other forms of statutory or common law remedies that may be more fitting under the circumstances.

Best Practices for Business

The decision confirms that corporate directors can be personally liable in oppression actions, so long as the imposition of liability is a "fit in all the circumstances" and the director is personally implicated in the oppressive conduct. The decision is also significant because it creates a standard national framework to determine when directors may be held personally liable for corporate oppression.

While the decision highlights how a court's decision to grant relief under the oppression remedy is necessarily fact-specific, directors can take away few lessons:

- directors should review their director liability indemnification clauses to determine what type of conduct may (or may not) be covered;
- directors should declare all of their potential conflicts of interest and ensure that other members of the board of directors do the same;
- directors should always record their dissent from objectionable decisions of the board of directors;
- directors should not refrain from open discourse within the board of directors; and
- directors must understand that a lack of personal benefit or bad faith is not necessarily a complete defence to personal liability.

[1] 2017 SCC 39.

[2] R.S.C., 1985 c. C-44.

[3] (1998), 43 BLR (2d) 27 (ONCA).

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