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PUBLICATION

Floodgates now opened? SCC rules on personal liability of directors for oppressive conduct

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Based on an important recent decision of the Supreme Court of Canada, the situations in which harm caused to a shareholder could potentially expose a director to personal liability under section 241(3) of the *Canada Business Corporations Act* have been broadened.

The decision generates significant new cautions for directors of corporations about the language they use and the decisions they make as directors.

The facts in *Wilson v. Alharayeri*, 2017 SCC 39, reduced to their essence, are that the president, CEO and director of a company (who I will call the "**Oppressor**") directed the company board to take certain actions against the former president, CEO and director of the company (the "**Oppressed**") that would result in a significant dilution of the Oppressed's shareholdings, and a financial loss of $648,310.

The dilution arose from the conversion of the Oppressor's Class C preferred shares to common shares. The financial loss arose from the refusal to convert the Oppressed's Class A and Class B preferred shares to common shares, despite certain financial tests for such conversion having been met. This reduced the Oppressed's ability to participate in a private placement of a new issuance of convertible secured notes offered to the common shareholders.

The Oppressor conceded that the board actions were oppressive in this scenario and this was therefore not at issue in the case. Instead, the issue was whether personal liability should attach to the Oppressor.

The court, reaffirming the legal test as set out in the leading Ontario Court of Appeal decision in *Budd v. Gentra Inc.* (1998), 43 B.L.R. (2d) 27, stated that there are two requirements for determining a director's personal liability.

First, the oppressive conduct must be properly attributable to the director because of his or her implication in the oppression.

Second, the imposition of personal liability must be suitable or "fit" in all of the circumstances.

The court, however, found inconsistencies in past decisions as to the content of the above test and therefore attempted to provide further guidance to be applied in future cases.

With respect to the first prong of the test, the Oppressor tried to argue that "the oppressive conduct should be attributable to a director only where the director has control of the corporation and acts in bad faith by using the corporation to advance his or her own personal interest, or where the corporation functions as the director's 'alter ego'". The position of the Oppressor finds support in the common law, which provides that personal liability can only attach where the actions "exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own."

The court, however, refused to narrow the scope of the broad language found in the statute which "the common law sometimes failed to promote". It then offered the example "that it may be open to a court to impose liability on a director who strongly advocates for an oppressive decision motivated by a personal gain unique to that director, despite lacking control". This statement, while not necessarily binding on lower court judges deciding future cases, is enough to give a director pause.

With respect to the second prong, the Oppressor argued that "a personal order against a director can be fit only where the director has obtained a personal benefit at the expense of the oppressed party and where there is a direct connection between the impugned conduct and that benefit". In other words, the Oppressor alleged that there was no correlation between conversion of the Class C shares and the non-conversion of the Class A and B shares.

The court, in rejecting this argument, confirmed that the oppression remedy "is not a gain-based remedy" and instead "exists to rectify harm to the complainant". The focus is on the result of the action, not the intent. While a "personal benefit and bad faith remain hallmarks of conduct properly attracting personal liability" these are not necessary conditions to the imposition of personal liability. Again, a director should pause at this notion.

The Supreme Court set out four guiding principles that courts should follow before finding that personal liability is suitable in the circumstances. The principles are as follows:

1. The oppression remedy must, in itself, be a fair way of dealing with the situation. The court said that this must be assessed on a case-by-case basis. It did, however, set out the following list, though not exhaustive, of signs of unfairness:

    a. where directors obtain a personal benefit from their conduct;
    b. where directors have increased their control of the corporation by the oppressive conduct;
    c. where directors have breached a personal duty they have as directors;
    d. where directors have misused a corporate power; and
    e. where a remedy against the corporation would prejudice the other security holders.

2. The order should go no further than necessary to rectify the oppression.

3. An order may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders. Here, the court, while recognizing that individuals have “rights” that “are not necessarily submerged in the company structure”, attempts to limit the scope of this principle by saying that these expectations are “derived from an individual’s status as a security holder, creditor, director or officer”. It is not entirely clear what this means, although the court says it will look to the “scent of tactics” used by the so-called oppressed claimant in this regard.

4. A court should consider the general corporate law context exercising its remedial discretion. Here, it is important to note that while the statutory oppression remedy “can be a help”, it “cannot be a surrogate for other forms of statutory or common law relief, particularly where such relief may be more fitting in the circumstances”.

Notwithstanding the above, the court admits that the “appropriateness” of a remedial order for oppression under the statute “turns on equitable considerations” and that “it would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise”.

In applying the two prong test to the facts in this case, the court found the first prong to be met, since the Oppressor played a “lead role” in the oppressive conduct. But this alone was not sufficient for personal liability to attach.

Looking at the second prong and the four guiding principles, the court identified the personal benefit that accrued to the Oppressor as the main *indicia* of unfairness. In the court’s view, the remedy went no further than necessary to rectify the Oppressed’s loss, since the amount of personal liability ($648,310) matched what the Oppressed would have received had his Class A & B shares been converted, and it vindicated the Oppressed’s reasonable expectations as a shareholder, since it provided the Oppressed with the value that would have accrued had the shares been converted. The fourth principle, for some reason, was not explicitly discussed by the court.

This author has no issue with the result of this case, which seems fair in the circumstances. The refined law as articulated here, on the other hand, may prove problematic when applied to future fact scenarios.

In particular, personal liability for oppressive conduct can now attach even in circumstances where a director has: (i) not acted in bad faith; (ii) no control of the corporation; and (ii) received no personal benefit from his or her actions.

While attempting to clarify the rules as to when directors may be held personally liable under the statutory oppression remedy, the court, by expanding the scope as to what actions might be caught under this remedy, has likely created some uncertainty for directors and should give them pause when making decisions in such capacity going forward for fear of potential personal exposure.

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