A COMPARISON OF MINORITY SHAREHOLDERS' REMEDIES IN BRITISH COLUMBIA AND BHUTAN

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ABSTRACT

Minority shareholders investing their capital in business corporations face two primary risks. First, the business risk of the undertaking common to all investors, and second, the risk of disagreements within the corporate organization when their situation may be weaker compared to the majority shareholders. The interests of minority shareholders are often been made virtually worthless by the machinations of those in control of the corporation. Minority shareholders can be deprived of any income from the corporation, either in the form of dividends or salary, or they may be excluded from any effective voice in business decisions and denied information about corporate affairs. Often, they can eventually be ousted from the corporation and receive only a fraction of the real value of their interests.

Conflicts of interests amongst shareholders constitute a serious threat to the success and survival of the corporation. In the absence of protective mechanisms, control is usually in the hands of the majority shareholders. While remedies do exist in the law (common law) for unexpected problems, contractual mechanisms stipulated at the inception of the corporation and market forces may also reduce the possibility of conflicts of interests arising in the course of carrying on the corporate business.

The common law or even detailed mechanisms and prevailing market forces cannot, however, always take care of the wide variety and forms that the suppression of minority interests may assume. The common law is hesitant about interfering with the internal business affairs of the corporation and contractual arrangements may be inadequate due to the inherent inability of the human mind to foresee every future contingency. Market forces may also not always operate unimpeded.

Therefore, corporate statutory provisions such as the derivative action, winding-up on the just and equitable ground and oppression and appraisal remedies have been introduced to supplement the common law, contractual mechanisms and market forces in the interest of the protection of minority shareholders. The provisions of these statutory remedies enable minority shareholders to either prevent the threat or rectify the abuse of corporate power. However, most of these corporate statutory remedies are surrounded with procedural requirements and other technicalities, which may diminish their utility as productive weapons available to minority shareholders.

In this work, I propose to study the needs that gave rise to the various statutory remedies and the adequacy of these remedies made available to minority shareholders in British Columbia companies with particular reference to the responses of the common law, the legislature and the judiciary. Finally, I will study the possibility of borrowing these remedies from the British Columbia Company Act as models for the revision of the Bhutan Company Act which does not presently have such remedies.

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CHAPTER ONE

INTRODUCTION

This thesis concerns selected examples of statutory and common law remedies available for the protection of minority shareholders of companies. Such persons, because of their minority status, are vulnerable to the risks of the actions of the board of directors or the controlling shareholders. The manifestations of these risks have led, over time, to the development of various forms of relief at common law and, later on, under statute. While minority shareholders can contract, in advance, for various forms of protection (such as buy-sell agreements respecting their shares) they often lack the foresight and resources to do so. Similarly, market forces, while theoretically tending to enhance shareholder protection (by such means as the market for corporate control) may be inadequate in particular cases. These deficiencies were exacerbated by the reluctance of the courts to interfere in the internal affairs of corporations. A reluctance deriving from *laissez faire* theories of the law of contract and the discomfort of judges with second-guessing essentially business decisions.

Especially during the 1970's, a number of reports were delivered in Canada relating to the reform of corporation statutes throughout the country.[1] A major focus of these reports was the adequacy of the existing remedies available to protect the interests of minority shareholders. The recommendations of these reports were enthusiastically adopted by Parliament and provincial legislatures. These efforts included the reform of

[1] For example, the Select Committee on Company Law(1976) (Ontario Legislature) (otherwise called the Lawrence Committee); Dickerson report, otherwise called Proposals for a New Business Corporation Act for Canada(1971) and D. R. Sheppard & M. H. Smith, Departmental Study Report of the Attorney-General of British Columbia: The Company Act (1971).

the oppression remedy and the winding-up petition on the "just and equitable" ground. In addition, a statutory code for the derivative action was enacted and the appraisal remedy introduced into Canadian law for the first time.

This thesis will discuss and study these forms of minority shareholder protection in Canadian law, with an emphasis on the versions of these remedies contained in the British Columbia Company Act.[2] The history of these remedies will be discussed and their effectiveness gauged. This exercise will involve a separate assessment of the selected forms of relief in the context of both widely-held (public) and closely-held (private) companies.

Finally, this thesis will consider the suitability of incorporating the shareholder remedies selected for analysis into the new Company Act in Bhutan.[3] This discussion will include a brief summary of the corporate structures prevalent in Bhutan and the need for investor protection in Bhutan.

[2] R.S.B.C. 1996, c- 62 ("B.C. Company Act").

[3] Bhutan for the first time enacted its Company's Act in 1989 (the first such law) and later amended it in 2000. The Act does not have remedial provisions like the derivative action, the winding-up order under just and equitable ground, the oppression remedy or the appraisal remedy.

CHAPTER TWO

THE DERIVATIVE ACTION

1. Introduction

Traditional corporate theory views the directors and other corporate managers and officers as owing a fiduciary duty towards their corporation. Where there is an alleged breach of this fiduciary duty, the corporate internal autonomy principle[4] requires that the decision to sue shall be taken by the board of directors or, in certain circumstances, by a majority of the shareholders at a general meeting. It is unlikely, however, that the wrongdoers will propose instituting an action against themselves on behalf of the corporation. From the minority shareholder's perspective, this aspect of the corporate internal autonomy principle is a dilemma, for it is hardly ever possible to bring an action against an errant director whenever the wrong complained of can be classified as a wrong to the corporation. Thus, while the fiduciary duty stands as a potentially valuable form of protection for minority shareholders, the absence of a practical means to redress alleged breaches of that duty on the part of such shareholders, may make its existence meaningless.

[4] M.A. Maloney, "Whither the Statutory Derivative Action?" (1986) 64 Can. Bar Rev. 309. The corporate internal autonomy principle is one which dictates that whenever there is any problem with regard to the internal management of the corporation, it should be solved by the participants in the corporate activities. The articles of associations can be taken as an example, they regulate the internal affairs of the corporation and define the scope of management powers *vis-à-vis* the corporation and the shareholders. Usually virtually all management powers are vested in the board of directors by the articles.

2. The Development of the Derivative Action in English Common Law

The concept of the derivative action developed first in England as a way ensuring that some degree of accountability and control existed over the board of directors and senior officers. It indirectly allowed a minority shareholder or shareholders to sue in representative form, claiming redress for a wrong done to the corporation. Having suffered the wrong itself, the corporation was the proper plaintiff in the action, but the action could sometimes be maintained by the shareholders, where the wrongdoers were in control and failed to seek redress for the wrong which had been alleged.[5]

The action was derivative because the plaintiff's right to sue was secondary in nature and was accorded to him or her on the ground that the true plaintiff refused or neglected to bring the action. The corporation was at all times the injured party and was the true plaintiff even though the shareholders were permitted to maintain the action as the nominal plaintiffs. Similarly, any relief ordered belonged to the corporation and not to those suing on its behalf.

2.1. The Common Law Rule in Foss v. Harbottle

The common law position was stated in the English case of Foss v. Harbottle,[6] where it was held that the corporation itself was the proper plaintiff in an action on account of wrongs done to it. The rule is generally understood to preclude a shareholder from bringing an action to remedy a wrong allegedly done to the corporation, if the wrong complained of is capable of being ratified by the members in general meeting.

[5] The Lawrence Committee, Interim Report of the Select Committee on Company Law (1967) (Ontario), at para 7.4.1.
[6] (1843) 2 Hare 461; 67 E.R. 189.

Later, Mozley v. Alstoon,[7] extended this rule to cover internal irregularities in the conduct of the corporation's affairs. The Privy Council in Earle v. Burland[8] re-emphasized in clear terms this cardinal procedural rule of corporate law when Lord Davey, stated that:

> "It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself."[9]

The procedural rule in Foss v. Harbottle and subsequent cases hardened into a principle of substantive law[10] and, in so doing, prevented minority shareholders from pursuing remedies in situation when directors, who were often also majority shareholders, were acting wrongfully towards the corporation.

2.2. Exceptions to the Rule in Foss v. Harbottle

To mitigate the hardship which the rule in Foss v. Harbottle caused minority shareholders, certain exceptions to it were formulated. It came to be recognized that the rule was not applicable where:

(a) the acts complained of were *ultra vires* the corporation or otherwise illegal;[11]

(b) the activity could be effective only when approved by a special resolution and only an ordinary resolution had been passed;[12]

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7 (1847) 1 Ph. 790; 41 E.R. 833.
8 [1902] A.C. 83.
9 Id, at p. 93.
10 Boyle, "A Liberal Approach to Foss v. Harbottle", (1964) 27 Mod. L.R. 603, 606.
11 Earle v. Burland, supra, note 8, Ashbury Rly. Coy. v. Riche (1875) W.R. 7 H.L. 653.
12 Edwards v. Halliwell [1950] 2 All E.R. 1064.

(c) the action alleged an injury to the plaintiff's personal rights;[13] and

(d) the acts complained of amounted to a "fraud on the minority" and the wrongdoers were in control.

Fraud on the minority, defined widely, involved an abuse of power, usually by those in control. The plaintiff had to prove an abuse of power and, furthermore, that the conduct was not in the best interests of the corporation.[14] Instances of when the exception was available were where the majority attempted to appropriate the corporation's property for themselves,[15] where the majority sought to appropriate the minority's assets to themselves[16]or where the majority had been guilty of unconscionable conduct.

2.3. Judicial Reluctance to Interfere in a Corporation's Internal Affairs

In Pavlides v. Jensen,[17] a minority shareholder of a company sought to bring a derivative action on behalf of himself and all the other shareholders, save three who were directors of the company and against whom the action was sought. The allegation was that these directors by gross negligence had effected a sale of a valuable asset of the company at a price greatly below its true market value. The company was controlled by another company, which was controlled by the same directors. On an application by the defendants for a determination of whether, on the facts as alleged by the plaintiff, an action should be allowed, the court held that the sale of the asset in question was not beyond the powers of the company. There was also no allegation of fraud on the part of the directors or any appropriation of the assets of the company by the majority shareholders that could amount to fraud on the minority. The action did not, therefore,

[13] Pender v. Lushington (1877) 6 Ch.D. 70.

[14] See L.C.B. Gower, Principles of Modern Company Law (4th ed. 1979) pp 616-630.

[15] Menier v. Hooper's Telegrap Works (1874) 9 Ch. App. 350.

[16] Sidebottom v. Kershaw, Leese & Co. [1920] 1 Ch. 154, where the company passed a special resolution empowering the directors to compel the minority shareholders who also held shares in another corporation, to transfer their shares to the company.

[17] [1956] Ch. 565,[1956] 2 ALL E.R. 578 (Ch.D).

fall within any of the admitted exceptions to the rule in Foss v. Harbottle, and accordingly, it was not maintainable. The court further stated that the majority could have ratified the directors' actions or could have decided not to sue. The effect of Pavlides v. Jensen was ameliorated to an extent by the later case of Daniels v. Daniels,[18] where in circumstances similar to Pavlides, a minority shareholder was given standing to bring an action. The court found that to establish fraud on the minority, it had to be shown, not only that a wrong was done to the corporation, but that the wrong benefited the wrong-doing directors.

2.4. Rationale for the Application of the Rule in Foss v. Harbottle

Despite its narrow scope, there are some advantages inherent in the rule. In the first place, the rule prevents a multiplicity of actions by minority shareholders who are disgruntled with the policies pursued by a legitimate majority. Secondly, the courts' reluctance to interfere in internal corporate matters may ensure that the shareholders in a general meeting enjoy the last say in the corporation's affairs. If the irregular conduct could be ratified, Foss v. Harbottle prevented an action being brought until a general meeting had been held to decide on the issue. This was seen by some as preventing frivolous or vexatious proceedings at the behest of minority shareholders against the wishes of the majority.

3. American Law

3.1. Hawes v. City of Oakland

The counterpart to Foss v. Harbottle in the United States is the case of Hawes v. City of Oakland[19] decided by the United States Supreme Court in 1882, nearly 40 years after the English decision. In the case, the appellant was a resident of New York and a

[18] [1978] Ch. 406, [1978] 2 All E.R. 89 (Ch.D).
[19] (1882) 104 U.S. 450.

stockholder of Contra Costa Water-works Company ("Contra Costa"), a California corporation. The respondents were the city of Oakland, Contra Costa, and Chabot, Pierce, Pope, Holbrook, and Coleman, trustees and directors of the company. The foundation of the complaint was that the city of Oakland had used water supplied by Contra Costa without paying any compensation, for a number of municipal purposes, including watering streets, public squares and parks, flushing sewers, and the like, which had the effect of diminishing the dividends available to Contra Costa stockholders. In fact, the city was only entitled to receive water free of charge in cases of fire or other serious necessity. In this case, the court did not use the same rule as in Foss v. Harbottle to preclude a shareholder suit on behalf of the corporation. Rather, the court made use of the power vested in it to make rules under its general equity jurisdiction, and established certain procedural requirements for shareholder derivative actions while upholding the general rule that for wrong done to the corporation it is only the corporation that can sue.

The rule laid down in Hawes v. City of Oakland differs from the rule in Foss v. Harbottle in certain other respects as well. For instance, while the rule in Foss v. Harbottle precluded shareholder actions in respect of certain types of claims, the rule in Hawes v. City of Oakland regulated derivative actions by establishing preconditions for the plaintiff's eligibility to sue while not excluding, *per se,* such claims from being litigated.[20]

The rule in Hawes was that a stockholder would be allowed to sustain an action in his or her own name in a suit founded on a right of action existing in the corporation

[20] D.A. DeMott, "Shareholder Litigation in Australia and the United States: Common Problems, Uncommon Solutions", (1987) 11 Sydney Law Rev. 258, 262.

itself, and in which the corporation itself was the appropriate plaintiff, when one of the following factors was present;

(a) some action or threatened action of the managing board of directors or trustees of the corporation which was beyond the authority conferred on them by the corporation's charter or other source of its organization; or

(b) a fraudulent transaction completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with the shareholders that would result in serious injury to the corporation, or to the interests of the shareholders or

(c) where the board of directors, or a majority of them, were acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the shareholders; or

(d) where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity; or

(e) possibly other cases which may arise where, to prevent irremediable injury, or a total failure of justice, the court would be justified in exercising its powers.

In addition to the existence of grievances which call for this kind of relief, it was seen by American courts as equally important that, before a shareholder be permitted in his or her own name to institute and conduct litigation (a right which usually belongs to the corporation) he or she should show to the satisfaction of the court that he or she has exhausted all the means within his or her reach to obtain, within the corporation itself, redress for his or her grievances. He or she must have made an earnest, not simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this effort must be made apparent to the court. If time permits or has permitted, he or she must show, if he or she fails to obtain adequate response from the directors, that he or she has made an honest effort to obtain approval to bring a civil action from the stockholders as a body. And he must show that if this was not done that it could not have been done, or it was not reasonable to require it. This approach largely replicates the stand that is taken in Anglo-Canadian law.

The petitioner must also prove that he or she has made an effort to have the directors (or a majority of the shareholders) bring proceedings and show specifically that such efforts have failed. He or she must prove that he or she was a shareholder at the time of the transactions complained or that he or she has become a shareholder since then by operation of law. The petitioner must also show that the suit is not a collusive one in order to confer on the court a jurisdiction it otherwise would not have. This should be verified by affidavit.[21]

The American cases treat litigation-related questions as falling within the directors' business judgment and will not interfere if directors act in good faith and are disinterested in the outcome of the litigation.[22] Thus, if the directors refuse the prospective plaintiff's demand and the plaintiff then brings a derivative action, the court will dismiss the action unless the plaintiff can establish that the directors acted wrongfully in refusing a demand to sue.[23]

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[21] Dodge v. Woolsey, (1855), 18 H.O.W., 331 referred to in Hawes, supra, 19.
[22] Ibid. ("Id").
[23] Id.

. The derivative action in the United States developed into a well-established remedy after the decision in Hawes v. City of Oakland. Many elements (like the willingness of the courts to allow applicants to sue derivatively) contributed to the evolution of the remedy in the U.S. As observed above, the decision in Hawes was a product of the court's exercise of general equitable rule-making power in an area in which the United States Supreme Court actively determined rules of general federal common law, including principles of equity jurisprudence.[24]

3.2. The Change in the Rule in Hawes

The rule in Hawes ended in 1939 with Eric Railroad v. Tompkins,[25] which restricted the court's ability through rule-making powers granted by the federal Rules Enabling Act[26] to prescribe rules of substantive law, in addition to rules regulating procedures in federal court litigation. As a result, the substantive law relating to derivative actions brought in federal court became state law (in most cases that of the corporation's state of incorporation). The federal rules of civil procedure now contain a rule specifically addressing derivative suits.[27] However, the federal courts have disagreed on the question of whether the federal rules should be interpreted simply to apply the relevant provisions of applicable state law – such as demand requirements or whether the

[24] D.A. DeMott, supra, note 20.
[25] (1938) 304 U.S. 64. (U.S. Sup. Ct.) A passing freight train of the Erie Railroad Company injured Tompkins, a resident of Pennsylvania. Tompkins claimed that; the accident occurred through negligence in the operation or maintenance of the train; he was rightfully on the premises as a licensee because he was on a commonly-used beaten footpath which ran for a short distance alongside the tracks; and he was struck by something which looked like a door projecting from one of the moving cars. To enforce that claim he brought an action in the federal court for the Southern District New York which had jurisdiction because the company was incorporated in that State.
[26] c. 20, 28 U.S. s 725.
[27] Federal Rules of Civil Procedure, 23.1.

rules can impose significant regulation of derivative actions. Although the Supreme Court of the U.S. has not addressed this question directly, it was held in Burks v. Lasker,[28] that in derivative actions respecting claims under the federal securities law, state law governs issues concerning the right to control litigation, unless the state law in question conflicts with the policies represented by the provisions of the federal securities regulation from which the claim arises. Few states still require a plaintiff to make a demand on the corporation's shareholders before commencing a derivative action. In addition to the demand requirement on shareholders, some states impose the requirement of special security for expenses,[29] and controls on the voluntary dismissal of derivative actions.[30] The security for expenses provisions require that the plaintiff post security, out of which the defendant's litigation costs can be paid if the plaintiff owns more than a specified amount of shares.[31]

The procedural and substantive requirements which have been outlined above made the bringing of a derivative action in the United States a difficult undertaking. Designed primarily to prevent strike suits in which the plaintiff may directly benefit and to limit the diversity jurisdiction of the federal court, these requirements created more confusion in an already complicated area of law and diminished the utility of the derivative action as a remedy for corporate misconduct in the United States.[32]

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[28] (1979) 441 U.S. 471. The respondents, shareholders of an investment company registered under the Investment Company Act of 1940 (ICA), brought the derivative suit in Federal District Court. The action was against several of the company's directors and its registered investment adviser. Then alleged that the change violated their duties under the ICA, the Investment Advisers Act of 1940 (IAA), and the common law in connection with a purchase by the company of the commercial paper of another company.
[29] For example New York's Business Corporation Law.
[30] D.A. DeMott, supra, note 20.
[31] M.P. Krysinski, "Derivative Suits and the Special Litigation Committee – A Question of Balance in Michigan Law" (1982) 29 Wayne L. Rev. 149 at 153.
[32] Id.

4. The Statutory Reforms in Canada

4.1. The Derivative Action in Canada (Ontario)

In Canada, mindful of the problems faced by minority shareholders at common law in attempting to bring directors and senior management to task for breach of fiduciary duty or negligence, most legislatures decided that the shareholders should be afforded a statutory form of derivative action.[33] Ontario was the first jurisdiction to introduce such provision in Canada and it was first applied in 1974 in the case of Goldex Mines Ltd. v. Revill.[34] The Lawrence Committee[35] considered the alternatives to the oppression remedy in section 210 of the English Company Act 1948[36] and concluded that the derivative action seemed to be an equally effective remedy to enforce the statutory standard of conduct which was then to be imposed on the directors in the exercise of their responsibilities. The Committee was also mindful of the consequences generated by strike suits and collusive settlements in the United States but expressed satisfaction that these undesirable characteristics of the derivative action could be avoided by requiring the leave of the court to bring a derivative claim and by giving the court a controlling role in connection with such claims.

The Committee recommended that the Ontario Business Corporations Act be amended by adding a substantive provision to the effect that a shareholder of a company may maintain an action in a representative capacity for himself or herself and all the other shareholders of the corporation, suing for and on behalf of the company, to enforce any rights, duties or obligations owed to the corporation, which could be enforced by the

[33] Interim Report of the Select Committee on Company Law (1967) (Ontario), supra, note 5.
[34] (1974), 7 O.R. (2d) 216.
[35] Lawrence Committee Report, supra, note 5.
[36] To the extent that section 210 was available to relieve against the rule in Foss v. Harbottle.

corporation itself or to obtain damages for any breach thereof.[37] The Act should further be amended, the Committee thought, to set out the various procedural aspects of the substantive remedy. The shareholders should be required to sue in a representative capacity, it being clear that the judgment or award is to be in favor of and for the benefit of the corporation. As conditions precedent to the right to bring the action, the plaintiff should be required to establish that he or she has a right to bring the action and the courts are to determine the costs, both interim and final, which may be ordered by the court to be paid by the corporation since the true plaintiff is the corporation. [These requirements will be discussed in detail in the succeeding sections].[38]

4.2. The Derivative Action in British Columbia

Most provinces in Canada codified and, to some extent, modified the common law position in drafting their derivative action legislation. In British Columbia, under section 201 of the B.C. Company Act, a member or director of the company (corporations are called "Companies" under the British Columbia Act), subject to proof of four requirements, may, with the leave of the court, bring or defend an action in the name and on behalf of the company. An action may be brought to enforce any right, duty or obligation owed to the company that could be enforced by the company itself or to obtain damages for any breach of any such right, duty or obligation. The four requirements for leave are:

"(a) that the applicant has made reasonable efforts to cause the directors of the company to commence or diligently prosecute or defend the action;

[37] Lawrence Committee Report, supra, note 5. (Para 7.4.3 at page 63).
[38] Id.

(b) that the applicant is acting in good faith;

(c) that it is *prima facie* in the interests of the company that the action be brought or defended; and

(c) in the case of an applicant who is a member, the applicant was a member of the company at the time of the transaction or other event giving rise to the cause of action."[39]

This section was based on legislation then recently enacted elsewhere in Canada (such as Ontario, discussed above)

4.2.1. The Courts' Role in Ensuring the Effectiveness of the Derivative Action

The British Columbia statute and indeed all other statutes that have provided for the remedy in Canada give a paramount role to the court. This approach may have been influenced by the history of strike suits and other examples of harassment of corporation management by corporate litigants in the United States, about which Canadian draftsmen were most apprehensive. Leave from the court appears to have been the compromise struck by the draftsmen to allay the fears of those who thought similar problems might arise in Canada with the conferral of a new statutory right of derivative action.[40] Given the relative scarcity of such proceedings in Canada it seems reasonable to conclude that these fears may have been premature.

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[39] B.C. Company Act, s. 201(3).

[40] Ziegel, et al, Cases and Materials on Partnership and Canada Business Corporations, (2d, ed.) (Toronto: The Carswell Co. Ltd. 1989) at p. 1003. Fischell and Bradley have stated that the requirement for leave of court is recognition that the costs of a derivative action enforced by those with a small economic stake in the venture outweigh the benefits unless limitations are imposed to reduce these costs. See Fischel and Bradley, "The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis", Law and Economics Workshop Series, University of Toronto, 1985, at pp. 43-44.

4.2.2. The Award of Costs at the Courts' Discretion

While a derivative action is pending, the court may give directions for the conduct of the action and order that the corporation pay the interim costs of the persons controlling the conduct of the action.[41] In addition, on the final disposition of the action, the court may order that the costs taxed as between a solicitor and his own client be paid either by the corporation, or by the person bringing the action.[42] This characteristic of the derivative action helps in solving the problem of the costs of litigation for the minority shareholders who otherwise may not be able to bring suit against the wrongdoers due to financial constraints.[43] That said the complexity and delay that characterize such proceedings still operate as a substantial deterrent to derivative actions.

4.2.3. Restrictions on Compromise and Settlement

No action brought or defended under section 201 of the B.C. Company Act can be discontinued, settled or dismissed without the approval of the court.[44] This restriction is aimed at preventing the compromise or abandonment of the company's cause of action in favor of a personal benefit to the applicant from the company or the defendants and which is detrimental to the interests of the corporation directly and all the stakeholders of the corporation indirectly.

Subsection 201(7) goes to the issue of the majority's ability to ratify the alleged misconduct and provides that no application made or action brought or defended under

[41] B.C. Company Act, s. 201(4).
[42] B.C. Company Act, s. 201(5).
[43] This may not be true all the time. But since the action is brought in the name of the corporation and corporation is going to gain directly from the proceeds of the suit, the shareholder/shareholders will benefit only from the appreciation in value of the shares of the corporation they own.
[44] B.C. Company Act, s. 201(6).

the section shall be stayed or dismissed by reason of an alleged breach of a right, duty or obligation, owed to the corporation, being approved by the members of that corporation. However, evidence of that approval or possible approval may be taken into account by the court in making an order under the section. This apparently means that because something is ratifiable at common law, does not mean that a derivative action under the Act is barred. Ratification was a major problem at English common law when minority shareholders sought to remedy misconduct by management. This provision seems to make it still a relevant, but no longer a determinative consideration in derivative actions. In Re Northwest Forest Products Ltd.,[45] the British Columbia Supreme Court referred to the rule in Foss v. Harbottle and stated that due to the alleged wrongdoers continuing to be members of the board of directors it was impossible for the applicant to take steps to initiate proceedings. The Court thought that section 201(7) appeared to clearly direct courts to examine the merits of the case regardless of the possibility of ratification, though that could be considered in deciding whether leave should be granted.

4.2.4. The Co-existence of the common law and the statutory Derivative Actions

Following the enactment of the statutory derivative action, it is now settled in Canada that the statutory provisions dealing with the remedy have abrogated the common law so that it is no longer possible to bring a derivative action at common law on behalf of a corporation independent of these statutory provisions. This was first accepted in

[45] [1975] 4 W.W.R. 724 (B.C.S.C.), Northwest Forest Products Ltd. (Northwest") was a major shareholder of Fraser Valley Pulp and Timber Ltd.("Fraser") sold its shares in Fraser at a low price to a company called Green River Log Sales Ltd.("Green"). The executants (defendants) of the sale were at all material times the holders of all the shares of Green. The applicant sought the leave of the court to challenge in derivative proceeding the sale of the entire undertaking of Fraser Valley.

Ontario in Farnham v. Fingold,[46] in a case involving Slater Inc, a public company controlled by a handful of shareholders who were related to each other. In the course of its business, Slater sold one of its operations which made the entire company an obvious candidate for a take-over. In due course, an offer was made to the controlling group for the purchase of their shares at a premium above market value. In the process of negotiations, the controlling group caused Slater's confidential records to be made available to the prospective purchasers. This control group of insiders and directors accepted the bid and, without informing the other shareholders, proceeded to buy as many Slater shares on the public market as was possible, with a view to enhancing the amount of their assured profit. This profit was unavailable to all the other shareholders, as they were unaware of premium offer being made to the control group, and, in any event, no such offer was made to them. Finally, to avoid the take-over provisions of the Ontario Securities Act, the control group caused its membership to be artificially lowered to fifteen or less, although more than fifteen persons were intended to partake in the premium offer. This exempted the offer from having to be disclosed under the take-over bid rules in the Ontario Securities Act. Based on the above facts, the plaintiff brought an action on behalf of himself and all other shareholders and former shareholders of Slater, who might benefit thereby, against the listed defendants. The court held that the codification of the representative action embraced all causes of action in which a shareholder might seek leave to sue on behalf of a corporation and thus there no longer

[46] (1973) 33 D.L.R. (3d) 156.

existed a common law representative action. Under the rule in this case the statute must be complied with, and leave must be obtained from the court[47] under the Act's terms.

Despite an argument to the contrary, based both on the rule of statutory interpretation that legislative changes to the common law must be clear and unequivocal,[48]and on the differences in the wording between the Ontario Business Corporations Act and the B.C. Company Act provisions, the courts in British Columbia reached the same conclusion as in the Farnham case in Shield Development Co. Ltd. v. Snyder.[49] In that case, the plaintiff was a minority shareholder in Western Mines Ltd. ("Mines"). As originally, constituted, Mines was named as the plaintiff. The defendants were successful in a preliminary motion to have Mines struck out as plaintiff and added as a defendant. The argument in the case was between two persons: G who said that the common law remedy was still available and M who said that the derivative action section embraced all forms of derivative actions brought by shareholders on behalf of their corporations and that leave to commence such an action must first be obtained under its terms. M also contended that leave had neither been obtained nor applied for in this case. However, the plaintiff (G) argued that while the Ontario provision may be mandatory, the British Columbia section was permissive and therefore should allow for a common law action as well as the statutory one. The British Columbia Supreme Court held that while the legislation did not expressly prohibit the bringing of a common law derivative action, such action was prohibited by necessary implication. The Court further stated that it

[47] Farnham was later followed in Goldex Mines Ltd. v. Revill (1979) 54 D.L.R. (3d) 672 (Ont. C.A.).
[48] Which, it was argued, was not achieved under the wording of the Companies Act R.S.B.C. 1973, c-18, s. 222 (now B.C. Company Act, s. 201)
[49] (1976) 3 W.W.R. 44. (B.C.S.C.).

could not imagine that the two remedies could exist side-by-side without creating confusion to an intolerable degree. In this regard Professor Beck has said as follows;

> "On balance, it is clear that the section was intended to be a Code for the expansion and control of the derivative suit. To allow both judicial controls and unfettered access to Courts would only lead to confusion. A more orderly development of law would result from one point of access to a derivative action and would allow for a body of experience and precedent to be built up to guide shareholders."[50]

5. Procedural Requirements of the Derivative Action and the Judicial Responses in British Columbia

The main thrust of the statutory derivative provision is the overriding role given to the courts to determine who should be allowed to bring an action on behalf of the corporation. Compliance with these preconditions is mandatory, but once complied with, the court's option to grant leave is still discretionary.[51] The adequacy of existing statutory provisions regulating the derivative action depends to a large extent on how successfully the courts have observed and interpreted the procedural requirements for the availability of the remedy. Some of the procedural issues relating to the remedy and the court's response to them deserve separate examination.

5.1. Standing to sue

5.1.1. "Members"

The principal group with standing to seek leave to sue derivatively is "members." The term was not defined by the initial provision in 1973 British Columbia Companies

[50] Stanley Beck, "The Shareholders Derivative Action" (1974), 52 Can. Bar Rev. 159.
[51] Re Northwest Forest Products Ltd, supra, note 45.

Act, but the definition was added by section 45 of the 1976 Companies Act Amendment Act. It defined a member for the purpose of the section to include:

"(a) A beneficial owner of share in the corporation; and

(b) Any other person who, in the discretion of the court, is a proper person to make an application under the section."

Under the first requirement, a beneficial owner of a share includes an unregistered transferee of an existing member's shares.[52] The term any other "proper person" confers significant discretion on the courts to extend the scope of persons with standing to seek leave to sue derivatively.

5.1.2. Employees

There has been judicial reluctance to expand the ambit of applicants, which may be based on concerns about overextending the availability of the derivative action to too many different categories. There may be abuses of the system if too liberal a judicial approach were taken on this issue. On the other hand, there may be good reasons for extending the scope of potential applicants to the employees of the corporation, in particular, who stand to lose their livelihood through negligent or fraudulent management.[53] Employees, however, are usually adequately protected by their employment and trade union contracts and other labour legislation such as employment standards laws. Thus, there is no immediate danger in precluding them from applying under the remedy.

[52] Re Marc Jay Investments Inc. (1974) 50 D.L.R. (3d) 45.
[53] Supra, note 4.

5.1.3. Creditors

The contracts between creditors and corporations and between shareholders and corporations differ in many significant respects. A contract of debt is generally simpler than a contract entered into by a shareholder because a creditor's claim is for a fixed amount rather than for a flow of income indirectly based on the corporation's profits. Creditors will be less concerned about profit maximization of the corporation and will have less reason to negotiate with respect to corporate governance. The result is that a contract between a creditor and a corporation is usually easier to articulate in express terms than a contract between a shareholder and the corporation.[54] When the contractual relationship is of this nature, it apparently seems that there is no need for a remedy such as the derivative action to fill the gaps in the creditors' bargain. Creditors seem able to protect themselves through the terms of their contract with a corporation and there is no compelling justification for giving them standing to apply under the derivative action. This position was upheld by the British Columbia Supreme Court in Re Daon Development Corporation.[55] The applicant, Gordon was a holder of "Series Debentures" issued pursuant to a trust indenture between Daon and National Trust Company Limited ("National Trustee"), as Trustee, which was secured by a floating charge on the assets of Daon, ranking subsequent to a floating charge secured by debentures issued under a trust indenture between Daon and the Royal Trust Company. Gordon submitted that National Trust was in a position of conflict of interest in that one of its directors was also a director of Daon and a member of Daon's audit committee, which had recommended payment of

[54] However, this may not be so in all situations as sometimes creditors can be the major player on whose support the corporation survives.
[55] (1985) 54 B.C.L.R. 235 (B.C.S.C.).

dividends when Doan was insolvent. Accordingly, Gordon submitted that National Trustee should be restricted from asserting its rights under the trust indenture in derogation of the rights of the Series Debenture holders, of whom he was one, to advance the claim against the Daon directors and to receive directly the proceeds of the action. However, Gordon (a debenture holder) was refused standing on the ground that his remedies, if any should arise from his debenture trust documents. Wallace J. held that to be a "proper person" under the Act an applicant must have some direct financial interest in the manner in which the affairs of the corporation are conducted. Given the nature of the corporation, there is not the same need to legislate for the protection of creditors as there is for shareholders. However, the decision in Daon may be distinguished from cases involving small unsecured creditors as the case leaves it open to argue that protection under the statute may be necessary to protect unsecured creditors who do not have contractual protection such as that afforded by a debenture trust agreement. Another argument in favor of including creditors is that other personal remedies contained in the B.C. Company Act expressly confer standing on this category.[56]

5.1.4. Directors as claimants in Derivative Actions

Like the Canada Business Corporations Act, the B.C. Company Act expressly extends standing to sue derivatively to directors, whether or not they are members.[57]

[56] See for example section 25 (orders regarding restricted acts) which grants standing to receivers, receiver-managers, liquidators and trustees in bankruptcy.

[57] Drove v. Mansvelt (March 5, 1998), Doc. Vancouver A972151 (B.C.S.C.). was an application for leave to commence a derivative action. It was argued by the defendants that the petitioner did not have standing because he did not own shares other than one common share without par value, issued for one cent when the company was incorporated, and because his name was not on the register of members. The court rejected this argument on the basis that whatever his designation, the petitioner performed the functions of a director and therefore, constituted a person with standing under this section.

Granting standing to directors may be premised on the market-public perspective that it would be advantageous for the action be brought by the directors, since the shareholders who own small stakes in the firm have little incentive to bring a derivative suit because the benefits of the suit accrue to shareholders according to the size of their holdings, not their efforts in bringing the action. The burden of directors' fees is less onerous than the problem faced by the collective action of shareholders. If all individual shareholders have the right to sue, high transaction costs prevent value-increasing exchanges and encourage opportunistic behavior. This is the economic justification for the legal doctrine of standing. However, on the other hand, extending such a right to a director may force upon shareholders the costs of enforcing socially desirable conduct; in effect, forcing subsidization of the public good.[58] However, even this can be defended. Firstly, many shareholders hold diversified portfolios and have tangible economic interests in ensuring honest and open corporate governance and secondly, they have a direct economic interest in the action.

5.1.5. Contemporaneous Membership

While the Canada Business Corporations Act[59] provides for a wide range of applications by conferring standing upon "complainants,"[60] the B.C. Company Act provides for a narrower range of applicants by limiting the right to apply to members and directors who were members at the time of the filing of the application. While under the

[58] D.R. Fischel and M.J. Bradley, "The Role of Liability Rules and The Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis" Symposium (1986), 71 Cornell Law Rev. They recognize the fact that no system of awarding directors' fees or assessing costs is perfect.
[59] In section 238.

[60] Defined to include shareholders, present and past, creditors, directors, and any person considered proper by the court.

Canada Business Corporations Act contemporaneity is not a requirement in order to be able to sue derivatively. Subsection 201(8) of the B.C. Company Act purports to extend the meaning of a member, but he or she must have been such at the time of transaction giving rise to the cause of action.

The requirement of contemporaneous membership (which originated in the U.S.) in the B.C. Company Act narrows the scope of potential applicants who can benefit from the protection afforded by the derivative remedy. There seems to be no justification why shareholders who discover wrongdoing or gross mismanagement, which took place prior to their becoming members, should be prevented from taking advantage of the remedy.[61] Some commentators have argued that this requirement serves as a precaution to stop or prevent strike suits or bounty hunters.[62] However, these fears can be adequately dealt with by the court's supervision of settlements. The requirement of contemporaneous membership may result in inequity as between past and present shareholders, discriminating against those who actually suffered the loss when the acts have only recently came to light. This might have affected the value of all the shares held at the time the information reaches the market regardless of whether the shareholders held them at the time of the breach of duty.

It is worth noting the British Columbia case of Buckley v. B.C.T.F.[63] Prior to 1987, the British Columbia School Act[64]required principals and vice-principals of schools to be members of the British Columbia Teachers' Federation (B.C.T.F.) and they comprised approximately 10% of the membership of the B.C.T.F. but accounted for

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[61] See Regal (Hastings) Ltd. v. Gulliver, [1942] 1 All E.R. 378 (H.L.)
[62] M.P. Krysinski, supra, note 31.
[63] (1990) 44 B.C.L.R. 31.
[64] R.S.B.C. 1979, c- 375.

approximately 20% of its annual income because dues were based on salaries. In July 1987, the School Act was amended and the requirement of compulsory membership in the B.C.T.F. was repealed. Thereafter, in a special general meeting, the B.C.T.F. passed a resolution amending its by-laws, expelling principals and vice-principals of schools from membership in the Federation. In response to a petition seeking a winding-up of the Federation by principals and vice-principals (on the ground that the resolution was oppressive), the court extended the meaning of "members" to include past members. If it had not so ruled, expelled members of the Teachers' Federation would have been precluded from bringing an action under the remedy following their unlawful expulsion from the Federation.

Therefore, the inclusion of past members has already been seen (in one context at least) as sometimes viable and appropriate by the courts in British Columbia. The legislature should expressly provide for it in the statute and allow former members of British Columbia companies to have standing to seek leave to sue derivatively.

6. The Demand Requirement: "Reasonable Efforts" and "Reasonable Notice"

6.1. The Rationale for the Demand Requirement

The demand requirement enables the corporation to have the first opportunity to exercise its own right to sue. Although the B.C. Company Act and the Canada Business Corporations Act both provide that the applicant must inform the corporation of the alleged wrongdoing and of his or her intention to pursue an action, the specific provisions of the two Acts differ. While the Canada Business Corporations Act t requires only that "reasonable notice be given to the directors" of an intention to apply to the court if the action is not prosecuted, the Company Act requires that "reasonable efforts be made to cause the directors to commence or defend the action" which clearly means the demand requirement is more onerous under the B.C. Company Act than under federal statue.

6.2. What is "Reasonable Notice" or "Reasonable Effort"?

Neither the Canada Business Corporations Act nor the B.C. Company Act stipulate what type of conduct will constitute reasonable notice or reasonable effort? The determination of the amount of information which should be given to the directors is very important, since shareholders usually have little hard evidence to support their claims. Access to corporate information may be limited. It would therefore, impose severe restraints on applicants if there was a court imposed requirement that they verify and determine, with a high level of specificity, the action to be pursued. The board of directors, on the other hand, must be given sufficient information regarding the alleged wrongs to reach a reasoned decision as to whether the corporation should take action. However, they are better placed to seek out information if given suggestions as to the area of the wrongdoing. It is suggested, therefore, that the burden on the derivative applicant should remain relatively light.

Courts have approached proof of this issue relatively liberally. The conclusion to be gathered from the decided cases suggests that it is sufficient to generally identify the impugned transaction. In Re Northwest Forest Products Ltd.,[65] Northwest Forest Products Ltd. ("Northwest"), incorporated in 1950, held 51% of the issued shares of Fraser Valley Pulp and Timber Ltd. ("Fraser"). Northwest sold its shares in Fraser to a company called

[65] Supra, note 45.

Green River Log Sales Ltd. ("Green"). The defendants who were directors of Northwest and who executed the sale of the undertaking on behalf of Northwest, were at all material times the holders of all the shares of Green. The applicant sought the leave of the court to challenge in derivative proceedings, the sale of a majority of the undertaking of Fraser. In answering the question of the degree of information needed to support a leave application, the Court held that the applicant need not specify the exact cause of the action but merely give the board of directors sufficient facts as to found an endorsement on a generally endorsed writ of summons.

Some decided cases suggest that the degree of information required from the applicant may vary depending on the expertise of the intended recipient. These cases have held that where the intended recipient had the requisite expertise to decipher with reasonable clarity the detail of the impugned transaction, no more should be required from the applicant than a general identification of the alleged breach of duty.

In an Ontario case, Armstrong v. Gardner,[66] E.Ltd's only asset was a parcel of land which was rented out. Mr. Seward planned and acquired a majority of the shares of E.Ltd., but a substantial minority of the company's shares remained. Upon the acquisition of a majority of E Ltd's shares by Seward, the new directors of E.Ltd. entered into a joint venture with a Seward interest to develop and sell a parcel of land to the Seward interest. This caused the relationship between the majority and the minority shareholders of E Ltd. to deteriorate. Dr. B. was appointed as a director of ELtd. to represent the minority shareholders but was unable to fully represent the minority interests at the board. The minority shareholders then made a derivative application, in order to sue the directors for the sale of the land (the corporation's sole asset), further alleging that the proceeds of the

[66] (1970) 20 O.R. (2d) 648 (Ont. H.C.).

sale were placed in a company without assets, over which E.Ltd., could exercise control. Cory J. considered that the two letters sent by the applicants' lawyer outlining grievances without any other further particulars were sufficient to fulfill the requirement of notice because of the expertise and qualification of the director (a lawyer) who received the demand letter.

Although the court's flexibility in determining when the demand requirement is met manifests its readiness to grant leave if other procedural requirements are satisfied, the adoption of the subjective test, as in the Armstrong case, may sometimes generate uncertainty and inequities. That case suggests that when the director receiving the request to sue is a lawyer, then no particulars about alleged grievances may be necessary to satisfy the demand requirement. However, sight should not be lost of the fact that most if not all directors (who are not lawyers) usually consult lawyers for legal advice on receipt of such demand letters. The question that arises is whether an applicant should go any further than the applicants in Armstrong to specify particulars of wrongdoings or should he or she be allowed to assume that the director intends to seek legal or other advice on receipt of the letter. The danger in adopting this test may be to bring into consideration extraneous factors (such as details about the grievance) that were not considered by those responsible for corporate law reform when the derivative action was first introduced into Canadian legislation. It is therefore, suggested that courts should be wary in following the test laid down in Armstrong and other cases based on similarly subjective reasoning.

6.3. The Relevance of the Demand Requirement When Directors are Wrongdoers: A Futility Test?

Another issue which arises under the demand requirement is with respect to situations where the incumbent directors are themselves the alleged wrongdoers. It may be useful to ask whether the demand requirement should be dispensed with altogether if it is obvious that it will be futile to ask the wrongdoing directors to initiate proceedings against themselves.[67] There is often no possibility that the directors will bring an action on behalf of the corporation against themselves. To inform them and ask them to bring such an action may lead to hostility and delay in what is, in any case, likely to be a lengthy proceeding. Some commentators have expressed the opinion that in certain circumstances the demand requirement can and should be dispensed with, in accordance with a futility test.[68]

Two conflicting interests are at stake here: the right of the board to have sufficient time to decide whether an action should be brought by the corporation; and the possible abuse by a hostile board of the demand requirement to delay and cause further expense to an applicant. It may be helpful in this regard to draw a distinction between cases where the board is apparently neutral and those where the board is comprised of the very wrongdoers against whom wrong is alleged. For instance, where a board comprises a significant number of outside directors (as well as the alleged wrongdoers), it may be more realistic to require that a demand be made. It is suggested that the legislation be amended to provide that the demand requirement on the directors be dispensed with if the

[67] England and some jurisdictions in the United States apply the futility test to dispense with the demand requirement on directors in situations where the applicant can prove that it would be futile to ask the incumbent directors to initiate proceedings. See East Pant Du Lead Mining Co. v. Merryweather (1864) 2 H.&M. 245 and Barr v. Wackman, 329 N.E.2d 180 (N.Y. 1975) (demand excused).

[68] J.H. Schell, "A Procedural Treatment of Derivative Suit Dismissals by Minority Directors", (1981) 69 Cal. L. Rev. 885.

applicant can establish that it would, in all the circumstances, be futile to make such a demand. However, where the board is apparently neutral, it should still be essential that demand be made on it first and reasonable time given to the directors to decide whether or not to initiate proceedings.

7. The "Interests of the Corporation"

7.1. What are "the Interests of the Corporation"?

The phrase "the interests of the corporation" is not defined by any Canadian statute and has been left for the courts to interpret; thereby widening the discretion of the courts. In response, the courts have kept the meaning of the phrase fluid to deal with varying fact patterns. In Re Northwest Forest Products Ltd.,[69] the Court considered that the test was met if a *bona fide* claim against the corporation could be shown. It was not sufficient for the respondents to rebut the allegation by stating that the corporation would be prejudiced by pursuit of the claim; although the court stated that it would consider the consequences of a final order on the corporation.

In Re Marc Jay Investments Inc.,[70] the applicant was the beneficial owner of 12.9% of the shares of Levy Industries Ltd. ("Levy"), at the time of purchase by Levy of Premium Forest Products Limited ("Premium"). The applicant intended to bring proceedings in Levy's name to set aside this transaction on the ground that the proposed purchase of Premium by Levy was from Seaway Ltd.("Seaway") all of whose12 directors were also the directors of Levy. Though the applicant was not at the time the registered owner of any shares in Levy, the Court granted leave with costs to bring the intended

[69] Supra, note 45.
[70] Supra, note 52.

action and reasoned that it merely had to ask itself whether the action was frivolous, vexatious, or bound to be unsuccessful. If it was not any one of these then, the court reasoned, leave should be granted. Similarly, the British Columbia Court of Appeal in Re Bellman Industries Ltd. and Western Approaches Ltd[71] refused to place a heavy onus of proof on the applicant, stating that he need only to show that an arguable case exists.

The willingness of the Canadian courts to allow use of the derivative action to remedy corporate wrongs has sometimes faced more stringent requirements as far as the evidence needed to show that it is in the interests of the corporation that an action be brought is concerned. For instance, in Daon Development Corporation, Wallace J. required conclusive evidence that the alleged wrong had been committed or at least that the petitioner show that Daon was probably insolvent at the time the directors authorized the payment of dividends.[72]

In Re Besenski,[73] Irvin Besenski was a minority shareholder of the 8th Street Theatre Co. Ltd (the corporation) and R.H. Besenski was a majority shareholder, an officer and a director and, as such, exercised effective control of the corporation. While R.H. Besenski was in control of the corporation, Irvin Besenski was unable to effect any action on behalf of the corporation if R.H. Besenski was opposed to it. An act by R.H. Besenski was proposed which, if committed, would have had a prejudicial effect upon and have been against the best interests of the corporation. For the best interests of the company, Irvin Besenski, through his solicitor, sought to bring a derivative claim against R.H. Besenski. In this case, two new requirements were introduced by the Court. First,

[71] (1981), 33 B.C.L.R. 45, 17 B.L.R. 117 (B.C.C.A.).
[72] Re Daon Development Corporation, supra, note 55, also see Maloney, supra note 4, at p. 323.
[73] (1981) 15 Sask. R. 182.

the applicant had to state circumstances upon which the Court should decide that it would be in the interests of the corporation to maintain an action. Secondly, the applicant had to disclose the financial situation of the corporation. This requirement, in effect, made the granting of leave to institute a derivative action contingent upon the corporation's financial resources to pursue such an action.[74] This is not an express requirement of any of the corporate statutes and should, therefore, be avoided.

Although the granting of leave to institute a derivative action is discretionary at the instance of the courts, it is suggested that the discretion should be exercised in accordance with the legislative purpose and intent in introducing the derivative action as a means of policing the board. If the financial strength of the corporation is taken into consideration as a factor in granting leave (as was stated in Besenski), then a director or any other person who completely raided the corporation's treasury may escape sanction because the corporation does not have funds to pursue the action.[75]

7.2. The Cost of Litigation and its Benefits

The "interests of the corporation" requirement may be a helpful barrier to granting leave if the directors put up the defense that a corporate action would be detrimental to corporate privacy or solvency. The credibility of such an argument is that there are times when the costs of corporate litigation may outweigh any advantage or benefit to be derived therefrom. In such circumstances, it may be proper to assume that it will not be in

[74] The reason given in this case is that in a derivative action sometimes court at its discretion order the corporation to pay costs of litigation since the gain resulting from such action would be for the corporation and the applicant benefits only indirectly through the increase in share value.
[75] Maloney, supra, note 4.

the interests of the corporation to bring an action. But the severity of the wrong and its possible effects on the corporation must always be considered.

7.3. "The Interests of the Corporation" verses the "Interests of Individual Shareholders"

If the view is accepted that general corporate interests usually supercede the interests of any individual shareholder, the retention of this requirement may serve to prevent shareholders from bringing actions which may not be the overall interest of the corporation. Given the facts that the corporate statutes provide other avenues for redressing personal damage or loss suffered by shareholders (for example, the oppression remedy) it is desirable to retain the "interests of the corporation" requirement consistent with the majority principle. However, the courts should be cautious in interpreting this requirement and avoid introducing extraneous considerations such as the shareholder being required to specify the exact cause of action and conditions of the sort demanded in Besenski (above).

8. The Derivative Action and "Litigation Committees"

A litigation committee is an independent committee of the board of directors, normally composed of independent outside directors, auditors or officers, which is established to investigate alleged wrongs committed by the directors or the majority shareholders of the corporation. If the committees concludes that there was no basis for a claim being in the corporation's best interest, it passes that opinion to the board which resolves not to commence an action in the name of the corporation. The expectation then is that the court will accept the board's decision and decline an application by minority shareholders for leave to bring a derivative action. The concept of the litigation committee was first developed in the U.S. and has been used to avoid the alleged wrongdoers being taken to the court by the minority shareholders in the context of a derivative action.

Advocates of litigation committees are of the opinion that such committees reflect an optimum solution to balancing the interests of the corporation and its shareholders, and are an appropriate means by which corporations can avoid derivative suits.[76] They put forward various reasons as to justify the establishment of litigation committees; viz,

i. They save time and expense for corporations by allowing a committee of the board to make its own determination and reach a proper result with lower transaction costs;[77]

ii. They are considered able to allocate risk efficiently[78] by avoiding placing the entire risk upon directors rather than the more efficient risk bearers-shareholders (as public corporations are structured to transfer most business risk to security holders who have access to capital markets and thus have a comparative advantage in bearing risk). The threat of litigation, if a particular decision turns out poorly, however, has the effect of transferring the risk from security holders to directors/managers who are far less efficient risk bearers, and

iii. If they are independent and have access to all the facts litigation committees can make a recommendation that is truly in the best interest of the corporation and accommodates business realities.

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[76] Fischel and Bradley, supra, note 40.
[77] Id
[78] Id

8.1. The Concept and Problems of Litigation Committees in the United States

The use of litigation committees has generated great controversy in the United States and there are conflicting judicial attitudes towards such committees. Where adopted, such committees usually look into an alleged wrong and determine whether it is in the best interests of the corporation to pursue the matter in court. In Auerbach v. Bennett,[79] GT&E. Corporation, by an internal preliminary investigation through an audit committee of the board of directors, found that in the period from 1971 to 1975 the corporation or its subsidiaries had made payments abroad and in the United States constituting bribes and kickbacks in amounts totaling more than $ 11 million. Upon disclosure of this information, Auerbach, a shareholder in the corporation, instituted a shareholders' derivative action on behalf of the corporation against the directors and its auditor. In response, the board of directors created a litigation committee comprised of three disinterested directors who had joined the board after the challenged transactions had occurred. This committee reported, *inter alia*, that no proper interest of the corporation or its shareholders would be served by the continued assertion of a claim against it. Thereafter, the complaint was dismissed and when it appeared that Auerbach had no intention of appealing, Wallenstein, as executor of the estate of a stockholder of the corporation, filed and served a notice of appeal. The New York Court of Appeals held that the substantive aspects of a decision to terminate the shareholders' derivative action against the defendant corporate directors, made by a committee of disinterested directors, appointed by the corporation's board of directors, were beyond judicial inquiry under the

[79] (1979) 419 N.Y.S. 2d. 920.

business judgment doctrine.[80] However, the court said it may inquire as to the independence of the members of that committee and as to the appropriateness and sufficiency of the investigative procedures chosen and pursued by such a committee.[81]

On the other hand, in Zapata Corporation v. Maldonado[82] the Delaware Supreme Court held that the court has an overriding responsibility to examine the decisions or recommendations of such committees. The courts, according to the decision, should apply a two step test. Firstly, they should inquire into the independence of and good faith of the committee and the bases supporting its conclusions. If the courts determine either that the committee is not independent or has not shown reasonable bases for its conclusions, they should hold that the committee has not carried out a reasonable investigation. The second step consists of striking a balance between legitimate corporate claims, as expressed in a derivative shareholder suit, and a corporation's best interests as expressed by an independent committee (business judgment). The court must arrive at its own decision and should not take the committee's recommendation as the final basis for its judgment but may use it as one of the criteria for deciding whether derivative action should be allowed (taking into consideration the reasons for the claim by the shareholders).

[80] The business judgment rule has been defined as that "the courts will not interfere in the management of a corporation in the absence of an allegation that the directors' actions have been tainted with fraud, illegality or conflict of interest." The theory behind the rule is that judges have no criteria by which to reexamine business decisions. See Buckley, Corporations Principles and Policies at pp. 602-39. (Third edition, 1995).
[81] See also Roberts v. Alabama Power Co. (1981) 404 So. 2d. 629 (Ala); and Alford v. Shaw (1986) N.C. 349 S.E. 2 d. 41 (North Carolina Supreme Court).
[82] (1981) 430 A. 2d. 779.

8.2. Litigation Committees in Canadian Law

The use of litigation committees is apparently not common in Canada, though the case of Re Bellman and Western Approaches Ltd.[83] shows the use of such a committee to resolve the problem in response to the filing of a derivative action. In that case, a dispute between two control groups of Western Approaches Ltd. (Western) had made discussions difficult. The Bellman group of Western's shareholders brought an action alleging *inter alia*, that an information circular distributed by the directors of Western contained untrue statements of material fact and omitted to state material facts as required by the federal act (the Canada Business Corporations Act) and regulations, and that the directors had exercised their powers oppressively to the plaintiffs and in complete disregard of their interests. The corporation attempted to divert the action by referring the matter to their lawyers who advised that Price Waterhouse and Company (independent auditors), would scrutinize the corporate records of Western to determine whether there were any instances where the directors had not acted honestly or in good faith or exercise the skill and diligence of reasonably prudent persons or whether there were any material contracts to which the company was a party, in which the directors had an interest and whether such interest had been disclosed. Price Waterhouse carried out the investigation, apparently on the basis of limited information, and advised that no action should be taken against the directors.[84] Accordingly, Western's board of directors decided not to commence an action as requested by the plaintiffs. One of the issues before the Court was whether or not the recommendation by the board of directors not to proceed with the

[83] Supra, note 71.

[84] The Committee was appointed by those directors who were under investigation. Though not openly acknowledged the conditions of appointment had given the committee a very short time and limited scope to carry out its investigation.

action should be taken as conclusive evidence that such an action would not be in the interests of the corporation. The court held that the decision by the board of directors not to prosecute an action was not impartial. Four directors were not independent because they had been elected by the people under investigation. Although their decision was based on the independent reports of accountants and outside lawyers, the court considered that the limited scope of this investigation was insufficient for them to reach a fair result.

Since it found the litigation committee process deficient, the Bellman Court did not have to choose between the approaches in the U.S. and decide whether the recommendations of a truly independent and fully informed litigation committee would preclude it from exercising leave in an application to bring a derivative action.

8.3. Litigation Committees' Subordination to the Derivative Action

However strong the argument is in favor of the use of litigation committees, there may be good reasons for not seeing them as determinative of whether derivative actions should be allowed to proceed. The reasons for their unpopularity is two fold. Firstly, such committees may effectively destroy the real utility and purpose of the derivative action, which is adopted to serve as a deterrent, hopefully ensuring that directors carry out their fiduciary duties. Secondly, there may be problems surrounding the selection of the members of such committees. The possibility that the committee members will have ties, social or economic, and often informal in nature, with insiders and perhaps the wrongdoers themselves, cannot be ruled out. Such close relationships may affect the soundness of any decision or recommendation made by a committee. The result will be that many wrongdoings by directors and other corporate officers would be prevented from coming into full public view.

Under Canadian corporation law, the procedural requirements for initiating a derivative action are now a matter of express statutory provisions. Courts are given the mandate to decide whether it is in the interests of the corporation to grant applications for leave to bring derivative actions. Delegating such decisions to litigation committees would amount to an abdication of judicial responsibility which may have undesirable consequences, especially for minority shareholders.[85] Furthermore, it arguably requires legislative intervention to confer upon a body other than the courts the power to declare that an action is not in the best interests of the corporation. Any other course would be an unjustified interference with an unequivocal statutory conferral of judicial discretion.

It is therefore suggested that if such a committee is set-up and investigates an individual complaint, the court should consider this as information which might aid to its own decision but not as conclusive of the matter.[86]

9. Costs and Indemnity in Derivative Actions

The B.C. Company Act grants the court, on the final disposition of the action, the discretion to ultimately impose the costs of the action on the plaintiff or other person controlling the conduct of the derivative action.[87]

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[85] The impartiality of the court will always stand high against that of the litigation committees (committee members could be appointees of the board under investigation, as in Re Bellman and Western Approaches Ltd. (supra, note 71)and there could be other ways in which their decision could be influenced by the very people under investigation.
[86] This is supported by the finding in Northwest Forest Products Ltd. supra, note 45, that the courts have a residual discretion in section 201 of B.C. Company Act applications as to whether they will grant applications for leave to sue derivatively.
[87] B.C. Company Act , s. 201(5).

Given the high costs of litigation today, this provision may be a very effective deterrent to a shareholder bringing a derivative action. The essence of the derivative action is that it is brought on behalf of the corporation by its minority shareholders on the basis that they are appropriate representatives to obtain redress on its behalf. That being so, the applicant is really in an agency position acting on behalf of the corporation and, as such, should be entitled to be indemnified by the corporation against all costs and expenses reasonably incurred. This was the position adopted by the English Court of Appeal in Wallersteiner v. Moir,[88] where the plaintiff was a minority shareholder in a public company, HB Ltd. B & Co Ltd was a subsidiary of HB Ltd. The defendant, was a majority shareholder in HB Ltd and was a director of both companies. The plaintiff discovered that the defendant had been guilty of misconduct in managing the affairs of both companies in that, *inter alia*, he had procured loans from each company by means of a transaction ('the circular cheque transaction') by which monies of the companies had been applied for the defendant's benefit to enable him to purchase shares in HB Ltd. The plaintiff's request for a statutory inquiry was refused by the English Board of Trade and the defendant further prevented him from raising the matter at shareholders' meetings. The plaintiff, as a last resort, brought a derivative action. The plaintiff, in the process of suing and being sued (over ten years), had exhausted his own funds and supportive contributions from the other minority shareholders in HB Ltd. He was fearful that, should he be unsuccessful in the matters outstanding in the litigation (inquiry into damages on the interlocutory award, the remaining issues on the counterclaim and a possible appeal to the House of Lords), he might be ordered to pay the defendant's costs himself. Even if he

[88] [1975] 1 All E.R. 849(C.A.).

were to win on those issues, any benefit from the proceedings would go to HB Ltd and B & Co Ltd and not to the plaintiff, whose only benefit might be that his few shares would appreciate in value. But the court upheld a different view. Lord Denning stated that:

> "Assuming that the minority shareholder had reasonable ground for bringing the action – that it was a reasonable and prudent course to take in the interests of the company – he should not himself be liable to pay the costs of the other side, but the company itself should be liable, because he was acting for it and not for himself. In addition, he should himself be indemnified by the company in respect of his own costs even if the action fails. It is a well-known maxim of the law that he who would take the benefit of a venture if it succeeds ought also to bear the burden if it fails… This indemnity should extend to his own costs taxed on a [solicitor and client] basis."[89]

Shareholders should not be inhibited from commencing derivative actions by the fear of being ordered to pay the costs of litigation if the action eventually fails. The risk of strike suits and frivolous actions can be checked by the presence of other statutory preconditions for commencing a derivative action; a shareholder must obtain leave of the court; he must prove that he is acting in good faith and that it is *prima facie* in the interests of the corporation that the action be commenced.

It is therefore, suggested that once the shareholder has satisfied the preconditions and obtained leave of court, the position in Canadian law as to costs and indemnity should be exactly as stated by Lord Denning in Wallersteiner.

10. Corporate Structures and the Derivative Action

10.1. Widely-held Corporations

The widespread ownership structure and the separation of management from ownership phenomena which exist in the widely-held corporation may make the derivative action a more ideal remedy for the protection of minority shareholders in such

[89] Id. at p.859.

corporations. The minority shareholders can use the derivative action as an effective tool to police the actions of the directors of widely-held corporations. The derivative action may ensure that some degree of accountability and control exists over the board of directors and senior officials through allowing shareholders to bring an action indirectly, in the name of the corporation, against directors or officers who have breached their legal duties to the corporation.

The derivative action plays an important role in deterring large one-time frauds.[90] If there was no such thing as the derivative action,[91] managers could decide, at least in theory, to carry out actions that might distribute the corporation's assets among themselves instead of sharing them with investors. The derivative action can play a useful role in deterring egregious derelictions by corporate managers and officers.

Besides, the derivative action could enhance the capabilities of other remedies by:

(i) ensuring a measure of judicial oversight;

(ii) providing a remedy that does not depend upon the ability of a large body of shareholders to take coordinated action;

These factors suggest that the derivative action may be more suited to shareholders of widely-held corporations where the separation of management from control can facilitate misconduct going unremedied and there is a lack of personal expectations as between directors (managers) and shareholders (investors).

[90] This is a situation where the board and the management commit mass misappropriation of the corporate fund or assets, which may lead to dissolution of the corporation.

[91] Ignoring here the criminal law.

10.2. Closely-held Corporations

In contrast to a widely-held corporation, a closely-held corporation is usually formed or continued on the basis of a personal relationship involving mutual confidence and an understanding that all or some of the shareholders will actively participate in the conduct of the business. It is often difficult to find a buyer for the shares of a closely-held corporation, especially when a minority interest is involved. This reflects the close bonds that often exist between shareholders in this type of corporation and their unwillingness to admit outsiders.

In closely-held corporations, the normal reasons for making it appropriate for a plaintiff to employ the derivative form of action may not be present even though the action alleges a corporate injury. A closely-held corporation is often treated as essentially an incorporated partnership with each shareholder retaining the individual right to sue to rectify wrongs to the corporation.[92] Also, the likelihood of an independent board is far smaller in such corporations because the majority shareholders are likely also to be the corporation's managers.

Similarly, the concept of a corporate injury that is distinct from an injury to the shareholders becomes fictional in the case of a corporation with only a handful of shareholder-managers. The typical procedural rules applicable to derivative actions often make little sense in the context of a dispute between persons who are effectively incorporated partners. These rules originated in the United States and were essentially designed to protect widely-held corporations against strike suits and frivolous actions by

[92] For example, see Donahue v. Rod Electrotype (1975) Mass. 578, 328 N.E. 2d 505.

plaintiffs holding only a nominal interest in the corporation. In Watson v. Button,[93] an American court found that the usual policy reasons that require an action alleging an injury to the corporation to be allowed to be pursued as a derivative action were not always applicable to the closely-held corporation. The reasons given for this conclusion were that the derivative action is maintained first, to avoid a multiplicity of suits by each injured shareholder, second, to protect the corporate creditors, and third, to protect all the shareholders, since a corporate recovery benefits all of them equally. However, these reasons were found to be inapplicable in the present case as the appellant and the respondent were the only shareholders in this corporation and the creditors were adequately protected by the terms of the debenture agreement.

Apart from policy considerations, the presence of an open-ended statutory oppression remedy in many jurisdictions constitutes another reason why the derivative action may be of little relevance to the minority shareholders of a closely-held corporation. Facts giving rise to wrongs to the corporation, such as breaches of fiduciary

[93] (1956) 235 F.2d 235(9th cir.).The appellant embezzler and respondent stockholder owned all the stock in a corporation in which appellant was the general manager. All of the stock was sold to third parties. The appellant secured a discharge from any claims against him in favor of the corporation, and after the sale the respondent discovered that the appellant had misappropriated funds. On appeal, the Court affirmed the District Court's judgment, which had awarded a monetary judgment in favor of respondent. The Court held that respondent was entitled to an individual recovery for the appellant's misappropriation, because he parted with his shares without knowledge of the prior wrongful misappropriation of the corporate assets by the appellant. The Court ruled that the District Court was justified in awarding the respondent a judgment for the entire amount appropriated, because the appellant had failed to mention this argument in his statement of points intended to be raised on appeal. The court affirmed the judgment of the District Court.

duties owed by directors, can often be the subject matter of an oppression remedy[94] as well as a statutory derivative action.[95]

An applicant seeking to bring a derivative action must satisfy a number of statutory prerequisites and must obtain the leave of the court before proceeding. No such pre-requisites exist with the oppression remedy, and leave is not required to bring an application. Moreover, the forms of relief that can be ordered are much broader under the oppression remedy (which will be discussed in detail in Chapter Four).

These reasons suggest that the derivative action may be a more suitable remedy for the protection of minority shareholders in widely-held corporations and will not be as useful for shareholders in closely-held corporations. However, the derivative action may find use for other stakeholders in such corporations, such as creditors, who may not have access to other forms of relief such as the oppression remedy. In such circumstance they may find the derivative action to be a significant remedy.

11. The Corporate Structure in Bhutan and the Scope for the Derivative Action as a Remedy for Minority Shareholders

11.1. Recent Corporation Law Developments in Bhutan

The enactment of the Bhutan Company Act 1989[96] (which was revised and enlarged in 2000) together with the initiative of the Royal Government of Bhutan towards

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[94] This remedy is more general and can be availed of by minority shareholders against the oppressive or unfairly prejudicial conduct of the board. The procedures and technicalities involved are less than in the case of the derivative action. They are discussed in detail in Chapter Three.

[95] For example, Sparling v. Javelin Int'l Ltd. (1986) R.J.Q. 1073. Re Peterson and Kanta Investments Ltd., (1975) 60 D.L.R. 3d 527 and Furry Creek Timber Corp. v. Laad Ventures Ltd. (1992), 75 B.C.L.R. (2d) 246 (S.C.).

[96] The Kingdom of Bhutan for the first time enacted the Companies Act of 1989 by the National Assembly of Bhutan (called Tshogdu Chenmo). The National Assembly was established in 1953 and is the highest legislative body and one of the three organs of the Royal Government of Bhutan. Ninety-nine people's

the privatization[97] of commercial activities has opened the door to increased investment. Investors, however, have been slow to invest in Bhutanese companies because the country is still at an early stage in its economic development, and there are relatively few potential domestic investors. The Government of Bhutan has only allowed foreign direct investment since 2002.[98] An important reason for relatively slow investment growth in Bhutan could be the absence of broad shareholder legal protection, the presence of which would increase the confidence of investors.

Each decision to make a commercial investment requires a careful assessment of the risks involved. The extent of legal protection afforded investors can be seen as a risk-minimization factor. With increasing global investment and demand for capital in emerging economies, the availability and adequacy of investor protection can play a significant role in the analysis of investment risks, particularly by foreign investors.

The privatization of corporate activities provides opportunities to examine the development of investor protection, including the effect such protection has on investor decisions. The need for enhanced shareholder protection is most urgent in the case of minority shareholders. They depend on the decisions and actions of the majority shareholders or the board of directors. Thus, they will always have concerns about the level of legal protection they have against impropriety or imprudence on the part of the board or the majority shareholders.

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representatives from twenty constituencies (Dzongkhags); ten monastery representatives; nine advisory members (all represent people and monks (Dratsang) except the chairman (Kaylon) government nominee); and thirty-two other representatives form the executive branch of the Government and the Armed Forces, making the total one hundred and fifty.

[97] One of the nine points for the seventh-five year plan (July 1992 – July 1997) of the Kingdom; at page pp 47-56 Plan Document compiled by the Planning Commission of Bhutan.

[98] The Royal Government of Bhutan has allowed foreign investment since 1990, but foreign direct investment was approved only on 3rd December 2002. Reported in Kuenselonline, the National Weekly Newspaper of the Kingdom (6th December 2002).

As discussed earlier, the kind of remedies required for protecting minority shareholders depend upon the nature of corporation in which minority shareholders invest.

Companies (corporations) in Bhutan can generally be divided into two broad categories, namely; Public Companies and Private Companies.

A discussion of Bhutanese public (widely-held) companies will be included in this section as the derivative action is more suited to the protection of minority shareholders in such companies and private (closely-held) companies will be discussed under other remedies (for example, the oppression remedy) which are more frequently available in the case of such companies.

Bhutanese public companies have a large number of shareholders (often there are institutional investors and large numbers of individual investors), and enjoy substantial capital investment, and free transferability of their shares, either by individual negotiation or through the stock market.[99] The separation of ownership from management is also more usually apparent in the case of such companies. Shareholders do not usually show an interest in or actively participate in the management of public companies' affairs.[100] Though all the directors are often shareholders, their shareholdings are very insignificant due to the large number of issued shares in total. There is also usually a wide separation between the ownership (shareholders) and the management (directors) in public companies.

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[99] The Royal Security Exchange of Bhutan was established in 1985 and was initially affiliated with the Royal Monetary Authority of Bhutan (the Equivalent of the Reserve or Central Bank in other countries).

[100] There are some exceptions to this general trend as some shareholders do participate in the management of the company's affairs as directors or managers.

11.2. Bhutanese Law and the Derivative action

The widespread ownership structure and the separation of control and ownership existing in respect of public companies in Bhutan might suggest that derivative actions could be adopted to police and to ensure a certain degree of accountability and control over the boards of directors (and majority shareholders) of such companies.

A derivative action (in the name of company) would be possible when the alleged wrongs of the directors or majority shareholders resulted in harm to the corporation and not its individual members. Other remedies, like the oppression remedy and the appraisal remedy, would be initiated only when an alleged wrong caused significant harm to individual shareholders' directly. The derivative action, as a remedy for minority shareholders in public companies characterized by a wide separation of ownership from management, acts to fill the gaps left by the other remedies.

If a director of a public company were to misappropriate company assets no individual shareholder would have an incentive to initiate proceedings in his or her own name as, first, all the costs of doing so would fall solely on that person and, second, any resulting judgment would be for monies belonging to the company and not the plaintiff (except in a proportionate sense).[101] A derivative action facilitates a remedy being pursued in such a case since the action will be in the name of the company but the individual (or group) shareholders will be able to initiate the proceedings. Furthermore, a carefully crafted derivative action section will allow for such things as interim orders for the payment of costs, that will significantly reduce the financial disincentives for individual shareholders bringing such proceedings.

[101] We ignore criminal law here.

Finally, it could be said that the derivative action, as a remedy for minority shareholders, can facilitate the distribution of costs, as well as benefits, amongst the members of the company. In the absence of the derivative action there could arise a situation where the errant directors might escape with company money, as individual shareholders have no direct or proportionate benefit in initiating proceedings to secure recovery.

CHAPTER THREE

WINDING-UP ON THE JUST AND EQUITABLE GROUND

1. Introduction

A winding-up order by a court on the just and equitable ground was one of the early remedies provided to minority shareholders, before other remedies like the oppression and the appraisal remedy were considered for their protection.

The remedy developed in relation to partnerships when equitable principles were applied by English courts to dissolve these forms of business association where pressing concerns based on the unfairness of one partner towards another justified the termination of the arrangement. The early corporation statues adopted this form of relief as the basis for the winding-up of a corporation at the petition of one its members. Courts have, however, generally been conservative in response to such petitions, an approach reinforced by the addition of several new forms of relief.[102]

2. Corporate Structure and the Winding-Up Order

2.1. Closely-held Corporations

A winding-up order on the 'just and equitable' ground is a remedy usually more suited to shareholders of closely-held corporations. However, no Canadian corporate statute has limited its availability to such corporations. The closely-held corporation has certain basic features which makes the remedy more suited for the protection of minority interests. It is usually formed or continued on the basis of a personal relationship

[102] Buckley, Gillen and Yalden, Corporations; Principles and Policies. (Third edition 1995), pp. 793 – 795.

involving mutual confidence. There is usually an agreement or underlying assumption that all or some of the shareholders are to actively participate in the conduct of the business. Members (shareholders) often make relatively substantial capital contributions to the corporation, and shareholders in such corporations are often a small close-knit group involved in the day-to-day operation of the business and financially committed to the corporation. Restrictions on alienability of shares are also a dominant feature of such corporations. Since members also manage the corporation, distribution of profits is usually by way of salaries instead of dividends (tax advantage). These features suggest that most closely-held corporations are really incorporated partnerships in which the shareholders have expectations based on their personal and financial involvement in the conduct of corporate affairs.

While these expectations vary from case to case, the following are some of the reasonable expectations of minority shareholders in closely-held corporation;

(i) Dividends or other sorts of distributions of earnings (if there are sufficient earnings to otherwise provide for the reasonable needs of the corporation),

(ii) The right to participate in management,

(iii) The majority would agree to a reasonable share valuation in case of a request to sell as required by a share transfer agreement or otherwise,

(iv) Benefits that bear a *pro rata* relationship to their shareholdings.

Minority shareholders often enter into collateral contractual agreements (known as "shareholders' agreements") to protect and enhance these expectations. For instance, "buy-sell agreements" enable a minority shareholder to liquidate his or her investments whenever he or she desires to do so.[103] However, transaction costs might prevent parties from entering into buy-sell agreements. Similarly, inherent human limitations often prevent parties from taking care of unforeseen future contingencies. The result is that contractual agreements often do not fully articulate the parties' bargains.

In situations where the minority shareholders' reasonable expectations are breached or are not adequately protected under the corporate constitution or separate agreement, they may resort to corporate law remedies. However, the majority shareholders might well be acting within their legal rights and in doing so treat the minority unfairly. The presence of the winding-up remedy in closely-held corporations is premised on the fact that it covers some of those situations in which a minority shareholder is entitled to expect a certain standard of conduct from his or her particular corporate partners and such expectations have been frustrated.

The remedy is based on equitable considerations, and it enables the court to subject the exercise of legal rights to equitable considerations that are of a personal character arising between one individual and another, which may make it unjust or inequitable to insist on legal rights or to exercise them in a particular way.[104] The most significant benefit of the remedy is that, in many cases involving closely-held corporations, fulfilling the reasonable expectations of shareholders by application of other remedies, short of winding-up, may not be practical because of continuing animosity or irremediable damage done to a relationship. Either the administrative costs associated with resolving these problems are prohibitive or the courts may lack the ability

[103] Palmer, Canadian Company Law, Cases, Notes & Materials; Canadian Legal Casebooks Series, 2d. ed. (Butterworth, Toronto, 1978) at pp.10-69.
[104] See Ebrahimi v. Westbourne Galleries Ltd. [1973] A.C. 360, (H.L) discussed in Buckley's Corporations Principle and Policies, 3rd. ed. (Emond Montgomery Publications Ltd., Toronto 1995).

to construct orders that will result both in appropriate individual relief and the continued operation of the corporation. In these cases, severing the relationship between the shareholders may be the only viable alternative. However, the remedy has its own limitations (discussed later in this chapter).

2.2. Widely-held Corporations

Winding-up on the just and equitable ground is unlikely to be an appropriate remedy for protection of minority shareholders in widely-held corporations. Often, there is no underlying personal relationship amongst such shareholders. Given that the interests and expectations of shareholders in widely-held corporations are usually more restricted than in closely-held corporations, winding-up may not serve any purpose to a minority shareholder of a widely-held corporation.

The presence of an effective market exit option, in particular, makes winding-up a less useful protection in such corporations. Absent personal commitments in the corporate venture, a minority shareholder would prefer to liquidate his investment by selling his shares in the market whenever management manifests any value decreasing conduct, rather than going through a winding-up application and incurring the legal and time costs involved in such an application.

Moreover, shareholders in widely-held corporations usually have diversified investment portfolios. A minority shareholder having a portfolio of investments would be largely unconcerned about the manner in which a particular corporation's affairs were conducted. Whenever he or she feels that it is no longer profitable to continue to invest in such a corporation, the presence of a liquid market enables him or her to exit the corporation at less cost than pursuing a winding-up order. As stated above, no Canadian corporate statute has expressly limited the application of the remedy to closely-held corporations. In fact, Re R.J. Jowsey Mining Company Ltd.[105] is a Canadian reported case where the winding-up of a widely-held corporation was granted on the 'just and equitable ground.' In Jowsey, Mr. Smith gained control of the Jowsey Mining Co. Ltd. ("Jowsey") through a highly complex series of maneuvers, including appropriation of funds without the directors' knowledge or consent from another widely-held corporation that he controlled. Jowsey's sole productive asset was shares of Dension Mines Ltd. ("Dension"). An application for winding-up of Jowsey was made by a minority shareholder, the son of Jowsey's founder, on the eve of a sale proposed to be made by Smith of a substantial portion of Jowsey's Dension shares. The trial court ordered dissolution and the Ontario Court of Appeal affirmed the order. Laskin J.A. concluded that there was a substantial danger of dissipation of Jowsey's liquid assets if a winding-up was not ordered. The learned judge noted Smith's "fast and loose" history of dealing with widely-held companies controlled by him and noted that Jowsey was not in need of cash and that Smith had no plans for the investment of the Dension shares' proceeds on behalf of Jowsey. In deciding that it would not be appropriate to make a supervisory order for the conduct of Jowsey's affairs, as opposed to a winding-up order, Laskin J.A. observed that any possibility of the court becoming a superior board of directors should be avoided.

It should be pointed that the decision in Jowsey was based on the peculiar facts of the case and does not suggest that winding-up on the just and equitable ground is the

[105] (1969) 2 O.R. 549, 6 D.L.R. (3d) 97 (Ontario Court of Appeal).

ideal remedy for members of widely-held corporations. On the contrary, there is reason to suggest that the remedy is more suited for the protection of minority shareholders of closely-held corporations who have personal and underlying assumptions in entering into the corporate venture assumptions markedly different from their counterparts in widely-held corporations.

Therefore, it must be concluded that the just and equitable winding-up is a remedy ideally granted in those circumstances when the reasonable expectations of a minority shareholder in a closely-held corporation have been frustrated. As a remedy predicated on frustration of some personal understanding between the corporate participants, it will not usually be feasible in the case of a minority shareholder in the widely-held corporation. Situations such as Jowsey will be rare and could be the subject of alternative orders to the winding-up (like measures under securities laws and regulations).

3. The Grounds for Relief

The B.C. Company Act and other statutes in Canada (like the Canada Business Corporations Act) contain provisions which give the courts discretion, upon the application of a member, to order that a corporation be wound-up, when it is just and equitable to do so.[106]

[106] B.C. Company Act, s. 271(3) and Canada Business Corporations Act, s. 241(b) (ii).

3.1. The Statutory Provision

Section 271 of the B.C. Company Act t 1996[107], authorizes courts to wind-up British Columbia companies. It reads, *inter alia* that "the court may order that the company be wound-up; if the court thinks it just and equitable to do so." Therefore, it is up-to the court to find out and decide what circumstance give rise to the "just and equitable" ground and enable it to order a winding-up the company.

3.2. When Will a Winding-Up Be "Just and Equitable"?

As discussed earlier in this chapter, minority shareholders in closely-held corporations are sometimes vulnerable to oppression and misconduct on the part of a majority or the board. Absent any protective provisions in the corporate constitution, the minority shareholder can be removed from any salaried position that he holds in the corporation or from his office as a director. He can be deprived of a return on his investment either because of the director's refusal to register a transfer of his shares, of his inability to find a purchaser for his interest in the corporation or the failure of the board to declare dividends.

A minority shareholder who finds himself subject to this type of discriminatory treatment can apply to the court for an order to wind-up the corporation on the just and equitable ground. In exercising the powers conferred by this remedy, the courts have not limited their discretion but have felt free to consider in the "widest possible terms what justice and equity require."[108] The courts have also agreed that the facts rendering it just and equitable that a corporation should be wound-up cannot be resolved into categories

[107] R.S.B.C. 1996, c-62.

[108] Re Davis & Collett Ltd.[1935] Ch.693, 698; Per Crossman J.

and that the tendency to create categories or headings is wrong. The general words of the section should be borne in mind and not be reduced to the sum of particular instances.

In recognition of the special nature and needs of closely-held corporations, the courts have expanded the relief into new areas as fresh circumstances and situations have arisen. In Loch v. John Blackwood Ltd.,[109] Lord Shaw stated that the court ought to proceed upon a sound induction of all the facts of the case and not exclude but include circumstances which bear upon the problem of continuing or stopping courses of conduct which substantially impair those rights and protections to which shareholders both under the statute and any contract are entitled.

The English and Canadian cases where a winding-up order has been granted on this ground appear to fall into one or more of the following categories, although, as already observed,[110] care must be taken that categorization not lead to ossification or over-simplification. These categories include following:

3.2.1. Deadlock

Deadlock may imply either an inability to elect directors or an equal spilt among an even number of directors on fundamental corporate policy, which makes it impossible to carry on the corporation's business. It also arises where there is constant fighting among the owners whose cooperation is necessary for the continued conduct of business. Refusing to meet on matters of business, continued quarrelling, and such a state of animosity as precludes all reasonable hope of reconciliation and friendly cooperation are sufficient to justify dissolution. It is not necessary, in order to induce the court to

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[109] [1924] A.C. 783 (H.L.).

[110] Per Lord Wilberforce in Ebrahimi v. Westbourne Galleries, supra, note 104.

interfere, to show personal rudeness on the part of one member to the other or even any gross misconduct of a member. All that is necessary is to satisfy the court that it is impossible for the members to place that confidence in each other which each has a right to expect and that such impossibility has not been caused by the person seeking relief. An example is the British Columbia case of Great Western Land & Investment Co. v Wellington Shipping Co.[111]

In Re Yenidji Tobacco Co. Ltd.,[112] the voting shares of corporation were equally divided between W and R, who were also the only directors. The articles of association of the corporation provided for the settlement of all disputes between W and R by arbitration. Use was made of this arbitral procedure, but R refused to abide by its outcome. Relations between W and R eventually deteriorated to the point where they refused to communicate with each other directly, invoking the offices of the corporation's secretary for this purpose. W successfully petitioned for a winding-up. Of particular concern to the court was the fact that the only two directors were not on speaking terms, that the so-called meeting of the board of directors had been almost a farce or comedy, that the directors would not speak to each other on the board and that some third person had to convey communications between them, which ought to go directly from one to the other.

In Bondi Better Bananas Ltd.,[113] the plaintiff and the defendant held equal shares in a private (closely-held) corporation which, together with one share each held by their wives comprised all the issued share capital of the corporation. After the Second World

[111] (1986) B.C.W.L.D. 4474 (S.C.). The facts and findings in the case are discussed at p 63 (infra)
[112] [1916] 2 Ch. 426.
[113] (1952) 1 D.L.R. 277.

War, the activities of the corporation declined and disagreement arose between the plaintiff and the defendant. This led to their refusal to cooperate, continued and abusive quarrelling, and deadlock in the conduct of the corporation's business. The Ontario Court of Appeal held that it was just and equitable to order that the corporation be wound-up. The court found that this would be in the interest of the shareholders.

While it is difficult to state a general principle based on these kinds of cases it is clear that like situations of inability of management to function in a closely-held situation are likely candidates for a winding-up based on the "dead lock" category.

3.2.2. Justifiable Lack of Confidence in the Directors and Management

This has been the most commonly asserted, although less commonly successful, basis for claiming a winding-up on the just and equitable ground. Claims on this basis usually assert that management has demonstrated a lack of probity in the conduct of company affairs. As stated by Lord Clyde in Baird v. Lees,[114]

> "A shareholder usually puts his money into a company on certain conditions. One of these is that the business shall be carried on by certain persons elected in a specified way. Another is that the business shall be conducted in accordance with certain principles of commercial administration defined in the statute, which provide some guarantee of commercial probity and efficiency. If the shareholder finds that these conditions or some of them are deliberately and consistently violated and set aside by the action of a member and official of the company who wields an overwhelming voting power, and if the result of that is that, for the extrication of his rights as a shareholder, he is deprived of ordinary facilities which compliance with the Companies Acts would provide him with, then there does arise a situation in which it may be just and equitable for the court to wind-up the company."

[114] [1924] S.C. 83, at 92.

The leading case in this area of the law is Loch v. John Blackwood,[115] the facts of which manifested a series of abusive practices by an entrenched management intent upon destroying the minority's claims. A testator had instructed his executors to incorporate his business and distribute half of the shares to his sister and one quarter each to his niece and nephew. One of the executors was the sister's husband. He incorporated the business and distributed half of the shares to his wife and slightly less than one-quarter each to the niece and nephew. He gave the remaining few shares to his nominees, thus guaranteeing that he and his wife could always outvote the other two. Under the husband's management, the corporation was highly profitable. The husband took an enormous salary for himself, but no dividends were ever paid, no shareholder meetings were ever held, and no financial accounting was ever made to the niece and nephew. After the nephew's death, the husband sought unsuccessfully to enlist the niece's aid in a scheme to purchase the shares from the nephew's estate at a grossly inadequate price. The niece's petition to have the corporation wound-up was granted. In the course of its advice, the Privy Council (Lord Shaw) observed that:

> "...at the foundation of applications for winding-up, on the "just and equitable" rule, there must be a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the company's business. Furthermore the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter, and it is under statute just and equitable that the company be wound-up."[116]

[115] Supra, note 109.
[116] Supra, note 109, at p. 788.

In the case of Re R.C. Young Ins. Ltd.,[117] the Ontario Court of Appeal held that before a winding-up of a company at the instance of a shareholder will be ordered, there must be a justifiable lack of confidence in the conduct and management of the company's affairs by the directors indicating lack of probity, good faith or other improprieties on their part.

The British Columbia Supreme Court in Great Western Land & Investment Co. v Wellington Shipping Co.,[118] granted an order where the majority shareholder, was the ex-husband of the minority shareholder applicant. The ex-husband excluded his wife from conduct of the company's affairs after their divorce and deliberately concealed financial and other information from her, including particulars of loans improperly advanced to another company owned by the husband. The court held that an applicant need not adduce evidence of gross misconduct. Rather it is sufficient to show the likelihood of future deadlock arising from the impossibility of the parties to place that confidence in each other, which they have the right to expect, provided such impossibility has not been caused by the person seeking to take advantage of it.

3.2.3. The Partnership Analogy

Winding-up has been ordered in situations where the corporation is deemed an "incorporated partnership" and where there has been an irreversible breakdown in mutual trust and confidence. The House of Lords adopted a more expansive approach in determining the rights of the members of an incorporated partnership in Ebrahimi v.

[117] [1955] O.R. 598.
[118] Supra, note 111.

Westbourne Galleries Ltd.,[119] and forged the winding-up remedy into a highly effective mechanism for remedying minority shareholder oppression. The court stressed that the function of the winding-up provision is to enable the court to subject the exercise of legal rights to equitable considerations which are of a personal character between one individual and another and which may make it unjust or inequitable to insist on legal rights.

Canadian courts have applied the principle laid down in Ebrahimi. For example, in Re Rogers and Agincourt Holdings Ltd.,[120] the Ebrahimi principle was applied to a case where two partners incorporated a company on the basis that the shareholdings were to be split 70-30. The corporation carried on the business on this basis for a number of years when the majority shareholder took the position that Rogers did not, in fact, have a 30 % interest but had merely been a salaried employee. There was an action on this issue and ultimately Rogers was issued 30% of the shares. The majority shareholder was unhappy with the judgment and took action to ensure that Rogers was excluded from the board of the corporation and from another corporation that was used as an operating corporation. The court, following Lord Wilberforce in Ebrahimi, used the partnership analogy in characterizing the relationship between the two shareholders. There was clearly an understanding that the two would participate in the conduct and management of the corporation's affairs and that is what took place when they shared the trust and confidence of one another. When that trust and confidence broke down, the majority shareholder excluded the minority shareholder from participation and treated him as an employee. Although the situation could not be characterized as one of deadlock, the

[119] Supra, note 104.
[120] (1977) 14 O.R. (2d) 489.

exclusion from management came within the Ebrahimi principle, and a winding-up on the just and equitable ground was ordered. The judgment of the Ontario Court of Appeal in this case makes it clear, that in appropriate circumstances, winding-up can be a very effective remedy for a minority shareholder in a closely-held company.[121] Thus, in De Cotiis v. De Cotiis,[122] the British Columbia Supreme Court held that it would be just and equitable to wind-up two companies that had been involved in a corporate partnership. The partnership had since been dissolved and the companies' shareholders were estranged family members who no longer had a relationship of mutual confidence.

However, it is not every dispute between shareholders in closely-held corporations that will call for a winding-up on the just and equitable ground. To justify the court exercising its equitable jurisdiction there must be a real departure from the understanding upon which the enterprise was founded and upon which the shareholders agreed to participate. There must be something more than mere unhappiness or dissatisfaction at being a minority shareholder.

4. Adequacy of the Protection Offered by the Remedy

Notwithstanding the courts' willingness to grant a winding-up order whenever the circumstances of the case justify it, a fundamental proposition runs through most cases under the just and equitable rule that there seems to be a general reluctance on the part of some courts to interfere in the internal affairs of the corporation. These courts have often asserted that while the words "just and equitable" are clearly intended to be elastic in their application in order to prevent injustice and inequity, a very strong case must be

[121] Re Dunham and Apollo Tours Ltd. (No. 2) (1978) 20 D.L.R. (2d) 9.
[122] (1995) B.C.W.L.D. 1980 (S.C.).

made to justify its interference, on this basis, in the internal management of the corporation's affairs.

The utility of a winding-up order as an effective remedy is diminished by many factors. In the first place, the remedy could disadvantage the minority shareholder who wishes to continue his investment and maintain the business enterprise as a viable entity. Moreover, the proceeds from dissolution might not reflect the damage already allegedly inflicted upon the minority shareholder's investment. The proceeds could also be small compared to the earnings potential of the business, especially where the only buyers for the shares are the alleged oppressors. In addition, the minority shareholders would in most cases incur considerable legal expenses in pursuing the remedy. Moreover, the disruption of the business associated with a winding-up order may, on a general level, harm the public. Such harm may arise from displaced employees, suppliers, and customers.

Finally, the widespread circumstances in which the oppression remedy applies, has also diminished the importance of the winding-up remedy. The oppression remedy covers most of the conduct which provides grounds for a winding-up order, and the courts are often more reluctant to wind-up a corporation than to grant relief under the oppression remedy. This is buttressed by the fact that under section 271 and 200(2)(f) of the B.C. Company Act of 1996[123] these remedies may be given in the alternative. If a winding-up is sought, the court is not only given power to order that remedy but also another under the oppression section if it considers it to be more appropriate section. For

[123] Canada Business Corporations Act, s. 214.

example in Mortel Development Co. v. Cottyn Construction Ltd.,[124] the parties, who were equal shareholders in a development company, had a serious falling-out over the petitioner's (originally he was a defendant) transfer of property to his wife without payment to the company, allegedly in breach of the parties' letters of agreement. As a result, the respondent commenced an action (he at first moved the court as a plaintiff) on behalf of the company against the petitioner and his wife to recover the property from the petitioner and his wife. In the meantime, the petitioner applied for an order that a receiver be appointed or that the company be wound-up under section 271 of the B.C. Company Act.[125] The Court held that such relief would be premature in the circumstances. Although the deadlock between the parties was sufficiently serious as to justify a winding-up order, nevertheless such relief would be premature in the circumstances and the Court thus allowed the parties further time to seek, with the help of advisors, a resolution of their disputes more advantageous to them than a fire-sale of the company's assets. Accordingly the application was adjourned for three months. The result is that, in most cases, a minority shareholder would more appropriately apply for relief under the oppression remedy than for winding-up order.

Notwithstanding these limitations, the remedy might still be an appropriate one for a minority shareholder whose wealth and lifetime savings are substantially tied to the corporate venture. It would be unfair merely to give an order compelling the majority or the corporation to buy the shares of the minority in situations where the latter reasonably expects continuous participation in the corporation, along with a voice in management.

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[124] (1993) B.C.W.L.D. 177 (S.C).

[125] At the time of this case the equivalent of section 271 was section 295(1) of the Companies Act, R.S.B.C. 1979, c-59.

The degree of discussion might be such that any other remedy (such as the oppression remedy) would be insufficient where irreparable damage has been caused to the interests of minority shareholders without fault on their part.

5. The Winding-up Order as a Remedy for the Protection of Minority Shareholders of Bhutanese Companies

As discussed earlier, the kind of remedies required for protecting minority shareholders depend upon the nature of corporation in which minority shareholders invest. For instance, minority shareholders in closely-held corporations can be seen as well-protected by a well-drafted form of the oppression remedy, but there could be a situation where this remedy might be insufficient; as when the damage caused to the minority shareholder is irresponsible and irreparable. In circumstances such as this, putting an end to the existence of the corporation may well be the only appropriate remedy. Thus, a winding-up order would then be an appropriate remedy. However, the minority shareholders in widely-held corporations might more effectively invoke other remedies (such as the derivative action or the appraisal remedy) more beneficially and conveniently.[126]

[126] However, these remedies involve lengthy and rigorous procedures. For example, section 207 of B.C. Company Act requires a series of steps to be followed like dissent from the resolution of meetings, filing a dissent, demand for purchase and return of share certificates.

At present, private companies dominate business activities in Bhutan (which is discussed in detail under the oppression remedy for Bhutan in the succeeding chapter). Therefore, the winding-up remedy under the 'just and equitable' ground may be appropriate for the protection of Bhutanese minority shareholders in private companies. Extreme caution, however, must be taken by the courts to find alternative remedies than ordering winding-up, except when the situation is so grave that no other existing remedies could justifiably right the alleged wrongs.

Bhutan, while adding a winding-up remedy to the Company Act, can refer to the winding-up provision of the B.C. Company Act, as discussed. The enactment of a winding-up section may be appropriate for the reason that there is the tendency for most new Bhutanese companies to be closely-held (more like incorporated partnerships). However, it will be the responsibility of the legislative authority as far as possible, to clearly state the situation where the court can apply this remedy. If the winding-up remedy's availability were too broadly based its introduction could cause more problems than those upon which relief could be sought.

CHAPTER FOUR

THE OPPRESSION REMEDY

1. Introduction

The oppression remedy, like other remedies,[127] was introduced to protect minority shareholders whose interests, though protected at common law, by corporate charter provisions and earlier statutory provisions, were still not adequately secured. The oppression remedy was introduced for the same purpose as these other remedies but differs in that it involves less procedural and technical complexities thus making it more accessible to minority shareholders. The scope of the remedy is broad since anyone with *locus standi* to seek it can approach the courts for redress. The oppression remedy comes to the forefront of all the other remedies and is the most widely used remedy based on the number of reported cases (which will be appreciated as we explore this case law in the succeeding sections).

The various committees that recommended extensive corporate law reform in Canada in the 1960's and early 1970's did not provide detailed guidelines as to how the oppression remedy was expected to operate. Only the Dickerson Committee (entitled "Proposals for a New Business Corporation Act for Canada," 1971), which formulated the proposals for reforming the federal corporation legislation, made comprehensive statements on this matter. That committee gave examples of "freeze out" techniques as instances where the remedy would probably be invoked more frequently in relation to closely-held corporations and indicated that a broad standard of fairness should be

[127] Such as the derivative action and the appraisal right.

invoked in applying it.[128] It became obvious that the remedy would rely heavily upon judicial interpretation in individual cases for its overall effect. The oppression provision, instead of defining clear-cut standards that the applicant must meet, demanded only that a vague standard of "unfairness" be proven. It is, therefore, the judicial interpretation of the section that determines the overall range of this remedy.

2. The History of the Oppression Remedy in Canada

Major corporate law reform took place in Canada in the late 1960's and early 1970's. During this period, many committees were set up by both the federal government and some provinces to examine the law relating to corporations.[129] As a result, new corporate and securities statutes came into force in various jurisdictions.[130] These committees and the ensuing legislation, while based on the previous statutes in these jurisdictions, were very much influenced by developments in the law in England and, to some extent, in the United States.

2.1. The Inadequacy of Common Law Shareholder Protection

It was recognized that the position of minority shareholders under Canadian law was unsatisfactory in many respects. In the first place, Canadian courts were traditionally reluctant to interfere in the internal affairs of corporations and the Canadian common law

[128] B. Cheffins, "Oppression Remedy in Corporate Law: The Canada Experience"; (1988) 10 U. Pa. J. Int'l. Bus. L. 307.
[129] For example, the Lawrence Committee (The Select Committee on Company Law 1967) (Ontario), D. R. Sheppard & M. H. Smith, Departmental Study Report of the Attorney-General of British Columbia: The Company Act (1971), and Report of Auditor General's Committee on Securities Legislation Ontario (March 1965) (the Kimber Report).
[130] Such as the Ontario Business Corporation Act , S.O. 1970, c. 25 and the B. C. Companies Act, R.S.B.C. 1973, c. 18.

relating to corporations reflected that fact.[131]The general view was, and still is, that directors owe fiduciary duties to their corporations, and not to their shareholders directly.[132]Likewise, majority shareholders owe no direct duties to their fellow minority shareholders.[133] Thus, majority shareholders can act in their own interests and are entitled to use their votes to exculpate themselves from those acts which would otherwise constitute breaches of their fiduciary duties as directors of the corporation.[134]

The common law also strictly limits when individual shareholders can bring an action on behalf of the corporation.[135] Although there were certain exceptions,[136] to this common law rule they were insufficient to protect the minority shareholders in many instances.

2.2. The Ineffectiveness of Early Statutory Protection for Minority Shareholders

Statutory provisions initially providing protection for minority shareholders were inadequate. The absence of effective statutory and judicial remedies implied that often the only alternative open to a dissenting minority shareholder was to apply to the courts to have the corporation wound-up under statutory provisions that authorized the court to

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[131] For example, the courts do not interfere in the management of a corporation in the absence of an allegation that the directors' actions have been tainted with fraud, illegality or conflict of interest, ignoring where the legal or permitted act may some times produce negative impact on shareholders and others.

[132] Percival v. Wright [1962] 2 Ch. 421. This case represents judicial recognition in England of the principle that is also accepted in Canada.

[133] See B. Cheffins, supra, note 128.

[134] See Pender v. Lushington, (1877) 6 Ch.D. 70 (Ch.D) and Northwest Transportation v. Beatty (1887) 12 App. Cas.589 (PC), In the latter case, the Privy Council held that a director who is also a member can vote his shares anyway he likes at a shareholders' meeting.

[135] Supra, note 6.

[136]At common law a derivative action was allowed if the acts complained of were *ultra vires* the corporation or illegal; the activity effected with an ordinary resolution required a special resolution; the action caused an injury to the plaintiff's personal rights; or the acts amounted to a "fraud on the minority" with the wrongdoers in control, See Macintosh, "Minority Shareholder Rights in Canada and England, 1860-1987" (1988) 27 Osgoode Hall L.J.1.

dissolve a corporation on the application of a minority shareholder.[137] However, this remedy was far from being adequate to solve the problems of the minority. There were many potential disadvantages in applying for the winding-up remedy. First, the remedy could result in a disadvantage to a minority shareholder who wished to continue his or her investment and maintain the business enterprise as a viable entity. Secondly, the proceeds from dissolution might not reflect the damage inflicted upon the shareholder's investment and the proceeds could also be small compared to the earnings potential of the business, especially where the only buyers for the shares were the alleged oppressors. Furthermore, although Canadian corporate legislation often set out a variety of grounds for dissolution, more especially on the ground that it was "just and equitable" that the corporation be wound-up, the courts labored under the assumption that a winding-up was a drastic remedy to be granted only very occasionally.

For example, in Mortel Development Co. v. Cottyn Construction Ltd.,[138] the parties, who were equal shareholders in a development company, had a serious falling-out over the petitioner's (originally the defendant) transfer of property to his wife without payment to the company, allegedly in breach of the parties' letters of agreement. As a result, the respondent (the plaintiff in first instance) commenced an action on behalf of the company against the petitioner and his wife to recover the property. In the meantime, the petitioner applied for an order that a receiver be appointed or that the company be wound-up under section 295(1) of the B.C. Company Act.[139] The court held that such relief would be premature. Although the deadlock between the parties was sufficiently

[137] For example, Company Act, R.S.B.C. 1996, c-62, s. 271 and see, Ziegel, Daniels, Johnston and Macintosh, Cases and Materials on Partnerships and Canadian Business Corporations (2nd ed. Volume 2), at page 1083 ("Ziegel").
[138] Supra, note 124.
[139] Now B.C. Company Act, s. 271(1).

serious as to justify a winding-up order, the court thought such relief would be premature in the circumstances and allowed the parties further time to seek, with the help of advisors, a resolution of their dispute more advantageous to them than a fire sale of company's assets. Accordingly, the application was adjourned for three months.

Apart from the winding-up remedy (or seeking leave to sue derivatively) there were few other forms of personal relief accessible to minority shareholders. Unless they had had the foresight to bargain for contractual rights in advance, they were generally vulnerable to the will of the majority. A will the courts often felt it their duty to support.

As a result of cases such as Mortel it was no surprise that those responsible for recommending Canadian corporate law reform proposed major statutory revisions to improve the position of minority shareholders. These proposals were generally accepted by those jurisdictions enacting new general incorporation legislation in Canada during the 1970's.

2.3. Reliance on the English Oppression Remedy

With respect to the phrasing of the oppression remedy, Canadian corporate reformers had relied heavily on English corporate law provisions. The oppression remedy first appeared in Canada when it was introduced into the British Columbia Companies Act of 1960. The provision was borrowed directly from Section 210 of the English Companies Act 1948. However, the English provision suffered many limitations, and the British Columbia provision was thus similarly defective in many important respects. For example, the applicant was first required to show that the conduct of the directors or those in control of the company was serious enough to warrant a winding-up before the courts could exercise its remedial powers under the oppression remedy. Secondly, the conduct had to be oppressive against a member applicant in his capacity as a member (qua shareholder), and as a result the remedy did not reach one of the prototypical fact situations in many cases; the removal of a member from the board of directors. Further, the remedy was read as requiring a continuous course of oppressive conduct rather than a single oppressive transaction.[140]

2.4. The Oppression Remedy in other Canadian Jurisdictions

Throughout the 1960's and until the early 1970's no other Canadian jurisdiction, besides British Columbia, had a statutory oppression remedy and the remedy generally received a poor and pessimistic response from other committees appointed in Canada to consider corporate law reform. In Ontario, the Lawrence Committee did not find favor with the remedy which it described as constituting a complete dereliction of the accepted principle of judicial non-interference in the management of corporations.[141] The Committee further stated that the underlying philosophy of the remedy had an air of reservation and defeatism about it, as if the legislature was unable to offer any resolution to the plight of minority shareholders, other than by abandoning the problem to the judiciary to be dealt with on an *ad hoc* basis by determining, from case to case, whether or not the affairs of the company were being conducted in a manner oppressive to some part of the shareholders.[142]

[140] Re H.R. Harmer Ltd. [1958] 3 All E.R. 689 (C.A.).
[141] The Lawrence Committee, Interim Report of the Select Committee on Company Law (1967) (Ontario), at para 7.3.12 (page 60).
[142] Id.

2.5. Revision of the Oppression Remedy in England and the Response in British Columbia

In England, in 1962, the influential Jenkins Committee recommended substantial amendments to overcome what had turned out to be a number of judicially constructed limitations on the scope and application of the oppression remedy.[143] In particular, the Jenkins Report highlighted four situations where the remedy would be most appropriate:

(a) where controlling directors unreasonably refuse to register transfers of the minority's holdings to force a reduced sale price for them;

(b) where directors award themselves excessive remuneration that diminishes the funds available for distribution to shareholders as dividends;

(c) to prevent the issuing of shares to directors and others on special or advantageous terms; and

(d) to prevent the refusal to declare non-cumulative preferential dividends on shares held by the minority.[144]

These categorizations notwithstanding, the determination of the type of conduct which amounts to oppression has been an evolving phenomenon and it would not take an abundance of imagination to envision many other circumstances in which the oppression remedy would be appropriate.

When a revised Companies Act[145] was enacted in British Columbia in 1973 the oppression remedy was significantly revised with close reference to the important recommendations made by the Jenkins Committee in England for the English Companies

[143] Report of the Company Law Committee (United Kingdom) Cmnd. 1749 (1962).
[144] Id.
[145] R.S.B.C. 1973, c. 18.

Act. The improvements on the previous British Columbia Companies Act were as follows. First, the requirement that grounds for ordering a winding-up must exist for there to be a successful oppression application was removed. Second, the type of conduct for which relief could be granted was broadened to include "unfair prejudice"(this had not been included in the Jenkins Report's recommendation) and, third, the requirement that the petitioner show a course of conduct which was oppressive was removed. It was specified that a single and isolated act of oppression was enough to justify the availability of the remedy.

Gradually, other Canadian jurisdictions adopted and improved on the English oppression provision.[146] Outside British Columbia, the oppression remedy was later introduced into other Canadian statutes such as the federal Canada Business Corporations Act of 1975[147] and into other provincial corporate statutes that followed the federal model, like the 1982 Ontario Business Corporations Act.[148]

3. The Essence of the Oppression Remedy

The introduction of the oppression remedy into Canadian corporate law was premised on the belief that minority shareholders did not have adequate protection at common law or under statute against misconduct by those in control of corporations. It was introduced to cover all those situations in which there has been some sort of impropriety but for which the winding-up remedy was not appropriate or available.

[146] This provision was significantly altered by section 459 of the English Companies Act 1985 and the 1985 amendment was further amended by the Companies Act 1989.
[147] Later amended in 1985 and now the Canada Business Corporations Act R.S.C. 1985, c-44.
[148] S.O. 1982. c. 4.

Judicial decisions have helped in clarifying and stating what the oppression remedy intends to achieve. In Goldex Mines Ltd. v. Revill, the Ontario Court of Appeal made a broad statement of principle with respect to the meaning of oppression:

> "The principle that the majority governs in corporate affairs is fundamental to corporation law, but its corollary is also important – that the majority must act fairly and honestly. Fairness is the touchstone of equitable justice and when the test of fairness is not met, the equitable jurisdiction of the court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused."[149]

In Elder v. Elder and Watson Ltd,[150] Lord Cooper said that the essence of the remedy seems to be that the conduct complained of should at a minimum involve a visible departure from the standards of fair dealing and fair play on which every shareholder who entrusts his money to a corporation is entitled to rely.

A shareholder has some reasonable expectations in investing in a corporation. He or she is equally held to be entitled to expect a certain pattern of behavior from management and his or her fellow shareholders, depending on the nature of the corporation and other circumstances. It, therefore, follows that relief ought to be granted when those expectations have been frustrated. The courts have indicated that the oppression remedy should be applied in situations where the reasonable expectations of the shareholders have been frustrated. The abrogation without cause of the rights and expectations of minority shareholders to participate in the direction of the company's affairs is necessarily prejudicial to their status as members (at least where the corporation is closely-held).[151]

[149] (1975), 7 O.R. (2d) 216, at p. 224.
[150] [1952] S.C. 49.
[151] Safarik v. Ocean Fisheries Ltd. (1995), 12 B.C.L.R. (3d.), 342.

4. The Current Oppression Remedy in British Columbia

Section 200 of the B.C. Company Act[152] provides;

"(1) A member of a company may apply to the court for an order on the ground

(a) that the affairs of the company are being conducted, or the powers of the directors are being exercised, in a manner oppressive to one or more of the members, including the applicant, or

(b) that some act of the company has been done, or is threatened, or that some resolution of the members or any class of members has been passed or is proposed, that is unfairly prejudicial to one or more of the members, including the applicant.

(2) On an application under subsection (1), the court may, with a view to bringing to an end or to remedying the matters complained of, make an interim or final order it considers appropriate, and, without limiting the generality of the foregoing, the court may

(a) direct or prohibit any act or cancel or vary any transaction or resolution,

(b) regulate the conduct of the company's affairs in future,

(c) provide for the purchase of the shares of any member of the company by another member of the company, or by the company,

(d) in the case of a purchase by the company, reduce the company's capital or otherwise,

(e) appoint a receiver or receiver manager,

(f) order that the company be wound-up under Part 9,

(g) authorize or direct that proceedings be commenced in the name of the company against any party on the terms the court directs,

(h) require the company to produce financial statements,

(i) order the company to compensate an aggrieved person, and

(j) direct rectification of any record of the company.

[152] R.S.B.C. 1996, c-62.

(3) Every company referred to in subsection (1) must file a certified copy of an order made by the court under this section, or on appeal from it, with the registrar within 14 days from its entry in the court registry.

(4) The rights granted by this section are in addition to those granted under section 227.

(5) Every company that contravenes subsection (3) commits an offence.

(6) For purposes of this section a member includes

(a) a beneficial owner of a share in the company, and

(b) any other person who, in the discretion of the court, is a proper person to make an application under this section."

Under section 200, when the powers of the directors of the corporation have been exercised or are threatened to be exercised in a manner that is oppressive or unfairly prejudicial to the member, the court may, at its discretion, make various interim or final orders as it thinks fit. The remedies, which the court may grant, are comprehensive, allowing it to rectify almost any type of conduct to protect the interests of members.[153]

In some respects, the B.C. Company Act is narrower than the Canada Business Corporations Act, and others that follow its model. For example, the B.C. Company Act restricts the class of potential applicants to current members, whereas former members are eligible applicants under the Canada Business Corporations Act and other statutes based on it.

Furthermore, there is a third category of conduct which can give rise to relief under the Canada Business Corporations Act, that is, conduct which 'unfairly disregards' the interest of the applicant. This third category of conduct does not appear in the British Columbia oppression section.

[153] B.C. Company Act, s. 200(2).

The Canada Business Corporations Act provides that the conduct complained of can affect the applicant in its capacity as a security holder, creditor, director or officer. The list of remedies which are specifically authorized is also broader under the Canada Business Corporations Act, than under the B.C. Company Act.

5. Standing

5.1. Generally

The initial issue with respect to the adequacy of the statutory oppression remedy is to determine whether the standing requirement is adequate for the protection of minority shareholders and other categories of applicants. All jurisdictions that have the oppression remedy allow members to apply. Most Canadian jurisdictions, except British Columbia, also allow other security holders, creditors, directors and officers to apply for the remedy. The extension of the availability of the remedy by the Canada Business Corporations Act and other statutes adopting its model, to groups other than shareholders is an indication that the oppression remedy is an open-ended one, which recognizes the existence of many groups with interests in the proper management of the corporation. Apart from shareholders, creditors and directors have economic interests in ensuring the fair management of the corporation. Canadian legislatures recognize that certain acts of those in control of corporations might prejudice the interests of other groups, besides shareholders. Thus, provision has been made for groups besides members to have standing to seek the oppression remedy.

The "nexus of contract" theory also appears as a justification for extending the scope of potential applicants beyond shareholders.[154] Under this economic approach, shareholders are not treated as owners of the business, but as parties who have contracted to lend capital to the corporation. They are simply viewed as one of the several groups who contract with the corporation. This implies that they should not be singled out for special treatment or privilege in corporate law. This approach validates the open-ended approach of the Canada Business Corporations Act that allows applications by other persons who contract with the corporation, such as creditors and managers. Under this approach secured creditors[155] and the federal government[156] have successfully applied for standing to seek the oppression remedy.

5.2. Creditors

Even if the "nexus of contract" view is accepted, contracts between creditors and corporations and between shareholders and corporations differ in many significant respects. A contract of debt is generally simpler than a contract entered into by a shareholder because a creditor's claim is for a fixed amount rather than for a flow of income based on the corporation's future profits. A creditor will be less concerned about profit maximization of the corporation and have less reason to negotiate with respect to corporate governance. The result is that a contract between a creditor and a corporation is

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[154] Under the orthodox traditional legal approach the corporation is viewed as a mere concession from the state. It explained how economic activity could be efficiently carried out by means of the firm rather than by contracting in the market. But the economic approach represents new thinking and viewed the corporation as founded on private contract (contractual nexus) where the role of the state is limited to enforcing contracts entered into by the participants to the intra-corporate contract. B. Cheffins, Company Law Theory, Structure, and Operation (1997) pp. 31-41.

[155] Bank of Montreal v. Dome Petroleum (1987) 54 Alta. L.R. (2d) (Alta. Q.B.).

[156] R. v. Sands Motor Hotel Ltd.[1985] W.W.R. 59 (Sask. C.A.).

usually easier to articulate in express terms than a contract between a shareholder and a corporation.[157] When the contractual relationship is of this nature, it apparently seems that there is no need for statutory relief such as that provided by the oppression remedy to fill the gaps in the creditors' bargain. In addition, creditors can protect themselves by the terms of their contract with the corporation and there is no compelling justification for giving them standing to apply under the oppression remedy. This was the approach adopted by the Supreme Court of British Columbia in Re Daon Development Corporation,[158] where the court denied relief to a debenture holder and stated that to be a "proper person" to apply under the Act an applicant must have some direct financial interest in the manner in which the affairs of the corporation are conducted. Given the nature of the corporation, there is generally not the same need to legislate for the protection of creditors as there is for shareholders. However, the decision in Daon may differ from cases involving small unsecured creditors, and it can still be argued that the protection under the statute may be necessary to protect unsecured creditors who do not have the protection of a debenture trust agreement or some other security.

5.3. Directors

The same reasoning that justifies giving at least unsecured creditors standing to seek relief from oppression, also applies to directors and officers, who are treated as one of the contracting participants under the bargaining approach.[159] To determine whether the inclusion of directors within the scope of potential applicants is justified, it is

[157] However, this may not be so in all situations as sometimes creditors can be major players on whose support the corporation depends for its survival.
[158] Supra, note 55.
[159] See B. Cheffins, supra, note 154, at pp. 95-108.

necessary to examine the nature of the contractual relationship between them and the corporation. Managers usually invest a considerable amount of their human capital in the corporation in the hope of a long term reward and cutting this off by firing them might be seen as a form of shareholder opportunism.[160] This may lead to inefficiencies, since informed managers would react to the threat of shareholder opportunism by under-investing in the firm in terms of specific human capital. Offering them the opportunity to apply for relief from oppression might be an effective response to the problem, since the managers are then given a greater incentive to seek long term rewards in the firm.

The Canada Business Corporations Act and other statutes which have followed the federal model give standing to directors to apply for relief under the oppression remedy. The inclusion of directors as potential applicants may not seem justified given that shareholders usually suffer the most direct consequences of any oppressive conduct by those in control. Where oppressive or unfairly prejudicial acts have direct effects on shareholders, they ought to be left to their own devices to decide whether to seek redress or not. As an action under the oppression remedy is primarily designed to protect the private interests of shareholders such a hands off policy is on the whole defensible.[161] However, in certain instances the shareholders may not have adequate financial resources to protect their interests by bringing an oppression remedy action, in which case directors whom the shareholders can trust may appropriately be granted standing to seek the oppression remedy.

[160] D.D. Prentice, "The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of English Companies Act 1985," (1988) 8 Oxford J. of Legal Studies 55, 79.
[161] This is not to argue that there is not a compelling public interest that the affairs of corporations should be conducted in a proper manner as if they are not his will have an external effect in reducing enthusiasm for the use of the corporate form.

5.4. Former Members

One notable omission from the B.C. Company Act, as regards standing to sue, is the non-eligibility of past members to bring an application under the oppression remedy. The Canada Business Corporations Act and other statutes modeled after the federal legislation extend standing to previous members and directors. The B.C. Company Act should cover former members of the corporation, as oppression or unfairly prejudicial conduct which occurred when they were members may only come to light after they have ceased to be members. This would correct one of the defects of corporate law which tends to ignore the plight of ex-members, who discover wrongdoing which may have diminished the value of their shares only after ceasing to be members.

Two British Columbia cases show a willingness on the part of the courts to allow former members to apply for the oppression remedy despite the apparent statutory limitation. In Chernoff v. Parta Holdings Ltd.,[162] the respondent argued that the petitioners lacked standing since they did not hold shares in the company at the time of the action. The Court concluded that, in the circumstances, it was appropriate to exercise the discretion afforded by the statutory provision[163] in favor of the petitioners. The proposed parties as former members had, the Court thought, a legitimate interest in the manner in which the affairs of the company had been conducted and had the same direct financial interests in the action as existing members.

In another case, Buckley v. B.C.T.F.,[164] legislation required school principals and vice-principals to be members of a Teachers' Federation. These persons comprised approximately 10% of the membership of the federation but accounted for approximately

[162] (1995) B.C.W.L.D. 988.
[163] B.C. Company Act, s. 200(6)(b).
[164] (1990) 44 B.C.L.R. 31.

20% of its annual income because dues were based on salary levels. The British Columbia School Act was then amended and the requirement for compulsory membership in the Federation was repealed. Thereafter, in a special general meeting of the Federation, a resolution was passed expelling Principals and Vice-Principals from membership. The petitioners applied for a winding-up of the Federation on the just and equitable ground or, in the alternative, for compensation based on oppression. The Court extended the meaning of "members" under the oppression remedy to include past members, since not doing so would have meant that expelled members of the Federation would be precluded from seeking the oppression remedy following their unlawful expulsion from the Federation.

The inclusion of former members amongst those with standing to seek the oppression remedy has been seen as viable by the courts of British Columbia. It is now up to the legislature to expressly provide for standing for former members in the Act itself.

6. The Concepts of Oppression and Unfairly Prejudicial Conduct

The various statutes which have provided for the oppression remedy do not define what constitutes either oppression or unfair prejudice. Canadian courts have taken a narrow view of what constitutes oppression and largely followed the jurisprudence developed under the original English oppression provision.[165] They have, however, given a broad meaning to the phrase "unfair prejudice," as will be discussed below.

[165] See B. Cheffins, supra note 128.

6.1. Oppression

Canadian Courts have restricted the circumstances that can constitute oppression and, as stated above, have followed the jurisprudence developed under the original English provision, which imparted a restrictive meaning to the term. Oppression has been held to amount to conduct which is "burdensome, harsh and wrongful or which lacks probity and fair dealing."[166] In an Ontario case, Re Abraham and Inter Wide Investments Ltd.,[167] Griffiths J. commented that conduct which is oppressive has an element of coercion.

In Re Brant Investments Ltd. v. KeepRite Inc.[168] the management of KeepRite acquired certain assets from its subsidiary and some minority shareholders voted against and applied for the oppression remedy. In dismissing the petition, the Ontario Court held that the jurisdiction conferred by this kind of provision must be exercised with care. While the Court thought minority shareholders were entitled to be protected against unfair treatment, it did not think the oppression remedy should usurp the function of the directors in managing the company, nor supplant the legitimate exercise of control by the majority. The Court thought that business decisions, honestly made, should not be subject to microscopic examination and should not be interfered with merely because they were unpopular with the minority.

The non-payment of dividends might in some cases constitute oppression. However, directors often have sound commercial reasons for not distributing profits and

[166] Nystad v. Harcrest Apartments (1986) 3 B.C.L.R. 40; Redekop v. Robco Construction Ltd. (1987) 89 D.L.R. 3d. 507; Applying the decision of House of Lords in Scottish Co-operative Society Wholesale Ltd. v. Meyer [1959] A.C. 324 (H.L.).
[167] (1985), 51 O.R. (2d.) 460 (H.C.).
[168] (1987), 60 O.R. (2d) 737 (H.C.).

a court should not interfere unless the decision is patently unreasonable, contrary to law or founded on inadmissible considerations.[169] This is a kind of "business judgment rule" approach and the courts will not usually grant relief for ordinary business problems that a corporation could solve itself.

One way an applicant can bring himself or herself within the ambit of remedy is to show that the oppressive conduct arose out of the manner in which the company's affairs are being or have been conducted. In Re Lajoie Lake Holdings Ltd.,[170] the petitioner and two respondents, the petitioner's in-laws, were the directors of a company incorporated to purchase certain lands for the purpose of establishing a family heritage property. The petitioner put up his share of the purchase price but the respondents, fearing future dissension within the company, financed the sale themselves by the way of a shareholders' loan to the company. Subsequently, after giving only 24 hours notice to the petitioner and without disclosing the nature of the proposed business, the respondents held a directors' meeting at which they removed the petitioner as a director and officer and cancelled his share certificate on the grounds of non-payment of the share issue price. The respondents then completed the sale to the exclusion of the petitioner and his family. The Court found the directors' resolution amounted to oppressive conduct, as the power to remove the directors rested with the shareholders of the company and not the directors. Furthermore, the company had never demanded payment for the share certificate or given notice of its intended cancellation. The petitioner had already advanced his share of the property purchase price and the respondents' real motive for canceling the certificate was

[169] Low v. Ascot Jockey Club Ltd. (1986), 1 B.C.L.R. (2d) 123 (S.C.).
[170] (1991) B.C.W.L.D. 541 (S.C.).

to avoid confrontation with a minority shareholder over the conduct of the company's affairs.

There is, however, no precise definition of what constitutes the "affairs" of the company. It was stated in one Australian case not to be limited to trade matters, but to encompass capital structure, dividend policy, voting rights, consideration of take over offers and indeed, all matters which may come before the board for consideration.[171]

Despite the lack of legislative guidelines, the judiciary has made extensive use of the oppression remedy, notwithstanding that some judges have adopted a narrow interpretation of it.[172] On the whole judicial response to the oppression remedy has brought it to the forefront of remedies available to minority shareholders, as applications have succeeded in a wide range of cases.

Case law on the oppression remedy has gradually increased over the years, affirming the rights of minority shareholders as the oppression remedy is used with greater versatility to define and correct unacceptable corporate behavior. Courts have frequently followed the often-cited recommendation in Ferguson v. Imax Systems Corporation[173] that:

> "the section which provides for the oppression remedy must not be regarded as being simply a codification of the common law today. One looks to the section when considering the interest of the minority shareholders and the section should be interpreted broadly to carry out its purpose. What is oppressive or unfairly prejudicially in one case may not necessarily be so in the slightly different setting of another."

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[171] Morgan v. 45 Flers Avenue Property Ltd (1986) 10 A.C.L.R. 692, 704 (C.A.).

[172] Brant Investments Ltd. v. Keepright Inc. (1987) 37 B.L.R. (Ont. H.C.), cf. Sparling v. Javelin International Ltd. (1986) R.J.Q. 1073 (Que. S.C.)

[173] (1983) 43 O.R. (2d) 128.

Notwithstanding judicial readiness to ever increase the ambit of the oppression remedy, it has its limits. In Mason v. Intercity Properties Ltd.,[174] Intercity Properties Limited was incorporated in 1953 by Johan and he transferred his substantial property holdings to it. His six children became equal shareholders and directors. Before 1980, when the present controversy arose, two of the children disposed of their shares to the others, leaving the appellant, Mrs. Mason, her two sisters and a brother as the only shareholders of the company. In 1980, Gordon Beattie, a chartered accountant and the son of one of the shareholders, became president. He was not a shareholder, but was the president and a director. The appellant continued as a director but held no office and had a bad relationship with her nephew. At Gordon's instigation, prior to the meeting in September 1980 at which he became the president and a director, shares of the Bank of Montreal and of Texaco were acquired at a total cost of \$ 806,000 without prior authorization by resolution. The appellant's position was that she owned a 27% share of the equity but that there had been no return to her in respect of the substantial monies, which were hers, in this venture, and no participation by her in how the money was being used and reinvested. The Court directed that the company should purchase her shares "at a fair value but subject to a deduction for a minority discount" as the applicant's conduct had contributed substantially to the company's difficulties. The Court further stated that the oppression remedy does not open the door to every disgruntled shareholder and relief will be granted only when there is real oppressive conduct by the defendant.

[174] (1987) 37 B.L.R. 6, 29 (Ont. C.A.).

In Re H.J. Rai Ltd. and Reed Point Marina,[175] the Court said that the remedy does not alter the basic principle of majority rule and cannot be used by the minority to abuse the majority. Where a shareholder obtains an order directing that the company purchase his or her shares at a value determined by an agreed-upon, independent appraiser and the shareholder is subsequently dissatisfied with that appraisal, it is not open to the court to by-pass its earlier order by making a new order for the valuation of the shares by a different method.[176]

Notwithstanding these qualifications, most applications under the oppression remedy typically involve bad faith on the part of the management or directors of the corporation and the denial of the shareholders' rights to a return on investment or some economic damage to the corporation. Applications under the remedy have also succeeded in cases where it is alleged that the controllers of the corporation have diverted corporate profits to their own use or have used corporate money or assets for their personal advantage. In Redekop v. Robco Construction Ltd.,[177] the Court found a breach of fiduciary duty by the defendant arising out of a conflict of interest because the majority shareholder of Robco received shares in another corporation as a result of his position in Robco. As a shareholder and director of both companies, the defendant caused Robco to contract with the new corporation to carry on its construction business for the new corporation's account at a fixed price, thus incurring the risk of cost over-runs. There was no allegation of fraud or bad faith and the evidence before the Court was at least consistent with the new agreement being a sound business deal for both companies.

[175] (B.C.S.C.1981) Unreported.
[176] Ginther v. Bain Insulation & Supply Ltd., (1988), 93 A.R. 71 (C.A.).
[177] Supra, note 166.

Because he had not complied with the disclosure provisions of the Companies Act,[178] the majority shareholder was bound to account to Robco for his shares in the new company and for any profits he might have made through it. Despite a lack of evidence of any loss to Robco, the court held that the majority shareholder was "helping himself with the use of Robco's assets, ultimately at the expenses of Robco's shareholders" and the conduct was held to be oppressive.

6.2. Unfair Prejudice

The concept of "unfairly prejudicial" has not received as narrow an interpretation from the courts as the concept of oppression. In fact, it is not feasible to formulate a generally accepted or comprehensive definition of what will be treated as being unfairly prejudicial. Any attempt to formulate a precise definition would have the unfortunate effects of confining the terms within a judicially imposed straightjacket. The existence of unfairly prejudicial conduct is usually, however, based on the impact and effect of conduct on the shareholder and not on the motives or the nature of the conduct itself. In Re Bovey and Hotel Ventures Ltd.[179] Slade J. stated that:

> "The test of unfairness must be an objective, not a subjective one. In other words, it is not necessary for the petitioner to show that the persons who have had *de facto* control of the company have acted as they did in the conscious knowledge that this was unfair to the petitioner or that they were acting in bad faith. The test is whether a reasonable bystander observing the consequences of their conduct would regard it as having unfairly prejudiced the petitioner's interest"

[178] Section 144 of the Companies Act, B.C. (now B.C. Company Act, s. 120).
[179] 31st July 1981 (unreported), also see Re R.A. Noble & Sons (clothing) Ltd. (1983) B.C.L.R. 273, 290-91(per Nourse J.).

It is not necessary for the applicant to point to any actual legal irregularity or to an invasion of his or her pre-existing legal rights, as the test is whether there were some unfairly detrimental effects on the interests of the complaining member and this is to be assessed by balancing the interests of the members in the light of the history of the company and the policies underlying the legislation.[180] To seek redress for unfair prejudice it is not necessary (as required in the case of oppression) for a complainant to point to any actual irregularity or to an invasion of his or her legal rights or a lack of probity or want of good faith towards him or her on the part of those in control of the company. It is for this reason that acting on legal advice would not necessarily prevent conduct from being unfairly prejudicial if it is otherwise so.[181]

It may also be pointed out that the boundaries of what constitutes unfairly prejudicial conduct do not stop at constitutional propriety.[182] While a particular act may on its face appear to be legally proper, it may nevertheless constitute unfair prejudice. In Re A Company,[183] Harman J. held that a rights offer on a *pro-rata* basis could unfairly prejudice a shareholder where it was known that the shareholder did not have the resources to take up his allotment and the allotment was intentionally made to exploit this situation and to dilute his holdings in the company. Even though the offer itself was a legal measure *per se*, its effect on the applicant could be the basis for relief under the section.

Similarly, on this same reasoning, the failure by a corporation with distributable profits to declare a dividend could constitute a ground for relief. In Ferguson v. Imax

[180] Thomas v. H.W. Thomas Ltd.(1984) 1 N.Z.L.R. 686, 693.
[181] Re M. Dalley & Co. Pty. Ltd., (1974-76) 1 ACLR 489, 492.
[182] See B. Cheffins, supra, note 128.
[183] [1985] B.C.L.R. 80.

Systems.,[184] Imax Systems was incorporated in 1967 to exploit a patented film projection system. The original shareholders were the three respondents and their wives, one of whom was the complainant. The three husbands received equal numbers of the common shares and class B shares of the company, and the wives received equal numbers of class B shares only. The class B shares were non-redeemable and participated in dividends and in return of capital on liquidation, dissolution or winding-up, but were non-voting, unless the company failed for two consecutive years to pay a preferred dividend. The complainant, unlike the other two wives, was actively engaged in the business of the company in its early years, largely without compensation as the company faced financial problems until 1974. The complainant and her husband divorced in 1974. In 1979, a special meeting of the shareholders of Imax was called to consider a resolution to convert the class B shares into class A shares. The class A shares would receive a cumulative preferred dividend until 1984, but would then be redeemed at $ 175 per share. The complainant took the position that the purpose and effect of the resolution was to exclude her from the company, as she was the only holder of class B shares without any other share interest, personally or through a spouse, by which she could continue to participate in the growth of the company. She had been discharged from her employment with the company, and she alleged that further pressure was being put on her by the refusal of the company to pay dividends. The Court held that the failure to declare dividends and the resolution eliminating the class B shares were acts which amounted to unfair prejudice to the petitioner. Once again, it was the effect of apparently innocuous conduct on the petitioner that was the focus of the Court's reasoning in her favor.

[184] Supra, note 173.

The British Columbia Court in Starcom International Optics Corporation v. Macdonald,[185] stated that an action which is otherwise oppressive or unfairly prejudicial to minority shareholders cannot be considered as not oppressive or not unfairly prejudicial merely because it also resulted in financial gain to the company.

However, an applicant will not necessarily be unfairly prejudiced whenever he or she is adversely affected by the operation of the corporation. In O'Connor v. Winchester Oil & Gas Inc.,[186] the directors of a British Columbia reporting company negotiated a share exchange offer with a third party, from which petitioner, a minority shareholder residing in the United States, and other U.S. resident shareholders, were excluded. The Court held that the directors' decision in this regard, while apparently unfair, was not oppressive or unfairly prejudicial because the directors had acted on *bona fide* advice that U,S. securities law prevented the inclusion of the American shareholders without severely prejudicing the effectiveness of the offer or incurring significant legal costs. In this case, the Court suggests that if the majority's action appears based on *bona fide* considerations it may not be the basis of a successful claim, even though it is prejudicial in effect.

An applicant can also bring himself or herself, within the ambit of the remedy by showing that the unfairly prejudicial or oppressive act arises out of any actual or threatened act of the company or an actual or proposed resolution of the members. In Lafaille v. Amorous Oyster Restaurant Ltd.,[187] the petitioner and two respondents were

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[185] (1994) B.C.W.L.D. 1002 (S.C.). The brief facts of the case; the respondent issued a news release about the postponement of the annual general meeting, the surrender of shares by the founder *in lieu* of cash payment or issue of common shares. These facts were actually not true but done to induce the petitioner to buy shares of the corporation.
[186] (1996) 69 B.C.L.R. 330, 337.
[187] (1991) B.C.W.L.D. 1411 (S.C.).

equal shareholders and the only directors of a company that owned a restaurant. The petitioner took no active managerial role, but she received monthly dividends of $ 600 and kept appraised of the company's affairs. Some years later the respondents informed the petitioner that her dividend payment would be suspended in order to finance repair of the restaurant and to augment their salaries, which been minimal, in order to subsidize profits available to the shareholders. Subsequently, after the parties became involved in an unrelated commercial dispute, the respondents circulated a draft notice and resolution purporting to remove the petitioner as a director. The Court held that in the light of the reasons advanced for suspension of the dividend payments, the decision was neither oppressive nor unfairly prejudicial. However, the respondents' decision to remove the petitioner as a director was clearly precipitated by their falling-out over the commercial dispute. In these circumstances, the preparation and presentation of resolution was held to amount to conduct unfairly prejudicial to the petitioner in her capacity as a member and the respondents were ordered to repurchase her shares.

6.3. Reasonable Expectations and Corporate Structures

Closely-held and widely-held corporations manifest different economic structures. This implies that the application of the oppression remedy may be more suited to the shareholders of one type of corporation than the other. Indeed, some writers have even suggested that the oppression remedy should not be available to shareholders of widely-held corporations.[188] There is no differentiated availability of the remedy in Canada as no Canadian corporate statutes contain any limitation with regard to types of corporations

[188] See for example, Buckley & Connelly, Corporations: Principles and Policies, 2d. ed. (Toronto: Edmond Montgomery Publishers, 1988).

and there are cases where relief has been granted in respect of widely-held corporations.[189] The Dickerson Committee,[190] however, suggested that the remedy would likely be most useful in the case of closely-held corporations. To determine what economic analysts have said about the oppression remedy and the different types of corporations, the identification of the interests of the shareholders and the nature of bargains reached in closely-held and widely-held corporations is necessary.

6.3.1. Shareholder Expectations and Closely-held Corporations

A closely-held corporation is usually formed or continued on the basis of a personal relationship involving mutual confidence. There is usually an agreement or understanding that all or some of the shareholders will participate in the conduct of the business. Restrictions on the transferability of shares is the rule rather than the exception. The members often make relatively substantial capital contributions to the corporation. Shareholders in such corporations are usually a small closely-knit group who are involved in the day-to-day operation of the business and financially and personally committed to the corporation. The positions of managers and those in control of closely-held corporations are seen as secure, as there is usually no reason for concern about them being displaced by outsiders, regardless of the manner in which the business is carried on.[191]

Shareholder interests in closely-held corporations lie in four main areas:

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[189] For example, see Sparling v. Javelin Int'l Ltd., (1986) RJQ 1073 (Que. S.C.), Palmer v. Carling O'Keefe Ltd., (1989) 67 OR 161 (Ont. Div. Ct.) and Alexander v. Westeel-Rosco Ltd.(1978) 22 OR (2d) 211.
[190] Supra, note 1, at 1.
[191] See B. Cheffins, supra, note 154.

a. Employment or some other form of active participation (given the close involvement of shareholders with the corporation);

b. Preservation of the status quo, in order to protect the implicit basis on which the business has been set up;

c. The proper conduct of the corporation's affairs, in order to ensure continued goodwill among the parties and the likely prosperity of the business; and

d. Securing the financial investment of the shareholders.

Another important characteristic of such corporations is the lack of a market for the shares so that minority shareholders do not have an effective exit option. Minority shareholders seeking to sell their shares will usually not be able to find bidders. Frequently, the only available buyer is a majority shareholder who will have no incentive to purchase the shares at a price greater than the discounted value of the future stream of payments to which the minority shareholders would be entitled. Given these factors, a minority shareholder in a closely-held corporation has a greater incentive than his or her counterpart in a widely-held corporation to somehow contract for protection. However, this contractual protection cannot often fully deal with all possible contingencies because of the inherent inability on the part of shareholders to foresee all future contingencies and the costs of contracting may exceed the potential benefits of doing so. According to economic analysis, this is an ideal situation for the application of the oppression remedy since it will provide a relief for conduct that breaches the agreement that the participants would have reached, absent transaction costs.[192]

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[192] See D.D. Prentice, supra, note 160.

The inclusion of a broad and open-ended oppression remedy fills the vacuum created by the lack of shareholder agreements (due to unforeseeable future contingencies and costs involved). The oppression remedy enables the courts to give full effect to the terms and understanding upon which the members of the corporation impliedly became associated. Where this is the case, the nature and structure of the firm should provide guidance as to how internal disputes should be settled. Given the nature of the bargains reached by the shareholders, in closely-held and widely-held corporations, a strong argument can be made that the oppression remedy ought to be limited to closely-held corporations.[193] The lack of a market exit option, greater personal interests of minority shareholders in running of the corporation which they established (their major capital is tied-up in the corporation) and employment and income are reasons for the suitability of the oppression remedy for minority shareholders of closely-held corporations.

A number of applications under the remedy had been successfully brought based on conduct which was permissible under relevant legislation and the corporate constitution, but which allegedly constituted a breach of an underlying understanding on the basis of equitable considerations. This concept of a fundamental and underlying understanding or expectation on the part of the shareholders in relation to the oppression remedy has been employed frequently in respect of closely-held corporations where the expectations of shareholders are usually little more than a reasonable return on investment and responsible behavior on the part of the directors. Applications under the oppression remedy in the case of closely-held corporations have increasingly been

[193] Application for the oppression remedy does not involve lengthy procedures and technicalities which are a common feature with other remedies, like derivative actions and the appraisal remedy (discussed in chapters two and five respectively).

resolved by balancing the expectation interests of the shareholders in forming or investing in the corporation against the rights of the board of directors to exercise its legal powers. Courts have often implemented the legitimate expectations of shareholders and have provided remedies in situations where those expectations have been frustrated by the conduct of the majority.

Further, with the introduction of the "unfairly prejudicial act" as one of the grounds upon which an application could be brought, the courts came to recognize general equitable considerations as an additional ground for relief and one which is not based upon the corporation's statute or charter. For example, in Diligenti v. RWMD. Operations Kelowna Ltd.,[194] the participants had been in partnership before incorporation and the relationship between them was personal as well as commercial. A subsequent disagreement among the participants saw the plaintiff ousted from the exercise of any management authority and his removal as a director. At the same time the directors' fees were increased and a management fee payable to the respondents' company was raised. Mr. Justice Fulton noted that under English law and earlier British Columbia oppression cases, a member applicant could not complain of oppression merely on the basis of his removal as a director.[195] However, the Court relied partly on the House of Lord's decision in Ebrahimi v. Westbourne Galleries Ltd.,[196] and held that in a closely-held corporation, where participation in management is of the essence of the shareholders' interest, the removal of a shareholder as a director does affect the member in his or her capacity as a member. The judge found the conduct was unfairly prejudicial to the

[194] (1976), 1 B. C.L.R. 36 (S.C.).
[195] The reason being that such conduct did not oppress him in his capacity as a shareholder.
[196] Supra, note 104.

applicant, given the nature of the understanding present in the setting up of the corporation. He found that the plaintiff's removal as a director was oppressive to him as a shareholder (based on Ebrahimi) and even if that was wrong the plaintiff was unfairly prejudiced in any case. It is unlikely, however, that removal as a director could be a similar basis for relief in the case of a widely-held corporation.

Applications for the oppression remedy often involve the exclusion of the applicant from the operations of the corporation, more especially from employment, participation in management or remuneration.[197] However, it should be pointed out that exclusion *per se* does not attract the granting of the remedy because the various corporation statutes recognize and permit the legitimate removal from office of directors and officers of the corporation.[198] Therefore, courts awarding relief under the oppression remedy must always look for something more than mere removal or exclusion from the operation of the corporation.

6.3.2. Shareholder Expectations and Widely-held Corporations

The interests of shareholders in widely-held corporations are quite different and considerably more restricted than is the case with closely-held corporations. There is usually no underlying personal relationship in widely-held corporations and employment is rarely an issue. Generally the relationship is much more a purely financial one, with the shareholders interested mainly in such matters as dividend yield, capital appreciation and possible takeover bids and less concerned with the day-to-day running of the

[197] See Diligenti, supra, note 194.
[198] For example B.C. Company Act, s. 130.

corporation.[199] Moreover, most shareholders in widely-held corporations hold diversified investment portfolios and when there is loss on an investment in one corporation it may be covered by earnings from other corporations.

There is generally a liquid market for the shares of widely-held corporations. In widely-held corporations, "the market for corporate control" creates incentives for management to maximize the welfare of the shareholders.[200] Incumbent managers acknowledge that they will be subjected to a challenge to their control if they do not act in the shareholders' best interests.[201] This knowledge induces them to behave appropriately. Therefore, these situations suggest that the oppression remedy is not a requirement for minority shareholders of widely-held corporations.

However, this notion of the unsuitability of the oppression remedy for widely-held corporations could be challenged from the perspective of the other stakeholders in widely-held corporations who may not have the same protection as minority shareholders (who are protected by corporate constitution/charter or common law remedies besides statutory remedies). For example, unsecured creditors[202] of widely-held corporations may have no remedial measures against the oppressive or unfair prejudice to their interests in the corporation by the acts of its directors. Therefore, the oppression remedy may have a role to play in respect to protecting the interests of certain non-member groups, such as creditors, of widely-held corporations.

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[199] This does not imply that all the shareholders are not interested in the management of the corporation. Indeed, institutional shareholders and other shareholders with large shareholdings are as much concerned as shareholders in the closely-held corporation about management matters. However, a large proportion of the shareholders usually have small stakes and, therefore, no identifiable management interests

[200] Manne, "Our Two Corporation Systems: Law and Economics," (1967) 53 Va. L. Rev. 259.

[201] Id.

[202] Some oppression remedies may extend standing to such categories.

6.4. "Threatened" Acts of the Board or the General Meeting

This is provided for only in the B.C. Company Act and is not found in other corporate statutes. There is uncertainty with respect to the circumstances in which a "threatened act" will constitute the basis for obtaining relief under section 200. Many corporate plans never advance beyond the stage of discussion which, had they been implemented, might have been unfairly prejudicial or oppressive to some members. It may be asserted that such tentative acts do not and cannot constitute the basis for successful application under the oppression remedy. For a threatened act to justify a relief, it must have reached a degree of maturity that is such that there is a strong likelihood of its implementation by the company. Otherwise what may have been prejudicial may turn out to be beneficial and no basis for a claim.

Again, for any actual or threatened act to give rise to relief, the applicant must prove that it is the act of the company. These requirements would be satisfied in the case of an act of the board of directors.[203] Similarly, the acts of a managing director to whom the powers of the board have been delegated, or of director who has been allowed to conduct the affairs of the corporation without any interference from the other directors, would be treated as those of the corporation.[204]

The provision also applies to an actual or proposed "resolution of the members," which unfairly prejudices the applicant. The inclusion of this proviso is apparently in recognition of the likelihood that majority shareholders could use their powers to pass resolutions which might unfairly prejudice the minority. Such resolutions of company

[203] The directors function for the body corporate and its acts are attributable to the company provided they are within the limits of its power.
[204] Re H.R. Harmer Ltd. [1959] 1 W.L.R. 62, 75.

meetings may be equated to acts of the corporation, since the majority shareholders control the meeting. In this regard, the B.C. Company Act may be seen as an advancement over the English Companies Act and other Canadian statutes that follow the federal model which make no express provision for actual or proposed resolution of the shareholders.

In Cathay Development Inc. v. 32824 B.C. Ltd.,[205] the petitioners were minority shareholders in a company in which the respondent held the remaining shares. After the relationship between the parties deteriorated, the petitioners learned that the respondent planned to pass a resolution at the next general meeting removing the petitioners' representatives from the board of directors. In an application for relief under this provision, the petitioners sought the appointment of a monitor. The court held that the petitioners had a legitimate expectation of continuous representation on the board and the respondent's proposed conduct manifested an intention to act in a manner unfairly prejudicial to them. The Court, however, ordered the respondent to purchase the petitioners' shares as the appointment of a monitor risks the company's only business as it may have led to the dissolution of the company.

6.5. The Relationship of the Oppression Remedy to the Derivative Action

The absence of any precise categorization of the circumstances giving rise to relief under the oppression remedy has not precluded the courts from using it in a wide variety of situations from which it is difficult to make any overall classifications. The difficulty in classifying the cases which have arisen under the remedy becomes even

[205] (1995) B.C.W.L.D. 1291 (S.C.).

more evident when it is realized that any such attempt will not only be arbitrary to some degree, since the factual circumstances in each of the cases have been different, but also because some cases can fit comfortably into two or more classes. For example, in Furry Creek Timber v. Laad Ventures Ltd.,[206] a director has acted contrary to the best interests of the company and in breach of the statutory disclosure of interest provision. This could obviously be the subject matter of a derivative action for the breach of a duty owed to the company and at the same time it could also form the basis of a shareholder oppression action, provided the complainant shareholder has been affected by the breach in a manner different from or in addition to an indirect effect on the value of all shareholders' shares generally. Other Canadian cases support this proposition.[207]

7. Relief

The type of relief available under the oppression is varied and flexible. The various orders listed in section 200 of the B.C. Company Act are only illustrative and others can be devised. This flexibility, together with few procedural difficulties, is a major reason for the success of the remedy.

Despite the freedom the courts have to make different orders, the decided cases sometimes show certain patters in the making of certain forms of relief.

In Jackman v. Jackets Enterprises Ltd.,[208] the complainant minority shareholder received her shares as a gift from the majority shareholder and had never been involved in the management of the company. She had received no notices, financial statements or

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[206] (1992) B.C.W.L.D. 2546 (S.C).

[207] Starcom International Optics Corporation v. Macdonald , supra note 185. Facts of the case also discussed therein.

[208] (1977) 4 B.C.L.R. 358 (S.C.).

other information about the company, and no annual meetings were held. Besides, the majority shareholder had caused the corporation to mortgage its assets as security for a loan paid to another corporation, of which the majority shareholder was the sole shareholder. The related corporation had no prospect of being able to repay the loan and, consequently, the complainant's equity in the defendant corporation had been impaired. The Court found that this conduct was indeed oppressive, as there was no adequate security for the loan to the related corporation.

In deciding on his order, Fulton J. with the consent of the defendant shareholder, ordered that he provide a personal guarantee of the loan and that he pay or cause to be paid the difference in interest obligations that the defendant corporation had incurred through these financial arrangements for the related corporation's benefit. The Court also ordered that the affairs of the corporation be regularized in future and that meetings be held as required.

Relief has also been granted against the diversion of corporate profits or the personal use of corporate assets by those controlling the corporation. In Palmer v. Carling O'Keefe Ltd.,[209] a vertical amalgamation, which involved incurring debt that left the corporation highly leveraged, was held to be oppressive towards the preference shareholders, even though the shareholders' dividend entitlement was supported by an agreement with the parent corporation guaranteeing payment of the dividends. The relief granted was an order that the subsidiary corporation undertake to pay dividends to the preference shareholders.

[209] (1989), 67 O.R. (2d.) 161 (Div. Ct.).

Such relief (dispossessing the majority of a self assigned privilege) was also granted in a case where a majority shareholder issued itself special shares, which paid substantial dividends and refused to furnish information to the minority shareholder.[210] In Mason v. Intercity Properties Ltd,[211] the Court, in response to the petitioner's plea for relief in the form of an order to the company to repay her investment, directed the company to purchase her shares at a fair value subject to a deduction for a minority discount.

Another example is Lafaille v. Amorous Oyster Restaurant Ltd.,[212] where the Court held that the removal of the petitioner from the position of director, after the parties became involved in an unrelated commercial dispute, was unfairly prejudicial and ordered the respondents to repurchase the shares of the petitioner. The granting of the appraisal remedy in such cases is typically based on situations where a founding member always expected to be a director. In a case like Jackman, where no such expectation arose, the appraisal remedy will not usually be granted.

8. The Issue of "clean hands" in granting Relief under the Oppression Remedy

An issue in a number of recent oppression cases is what effect, if any, the applicant's conduct should have in the granting of relief under the oppression remedy. The applicant's conduct may be relevant in one of the two ways:

i. It can either have a bearing on the question of whether oppression or unfair prejudice has been proven, or

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[210] Brown v. MacFarlane 8 July 1988 (unreported), Ont. H.C. Doc. No. Re 760/87.
[211] Supra, note 174.
[212] Supra, note 187.

ii.. It can affect the nature of the remedy that could be granted.

A situation might arise where the applicant has acted in a way that justifies his exclusion from the corporation. For example, if the corporation has been set up on the basis that the applicant will make a contribution to the running of its affairs and he or she fails, without cause, to do so, that may justify exclusion.[213] No action lies under the remedy where the acts complained of are in accordance with both the shareholders' agreement and the employment contract between the company and the complaining shareholder.[214] Thus, on the shareholder expectations approach, the conduct of the applicant is a relevant consideration under the remedy.

The relevance of the conduct of the applicant also finds support from those analyzing corporate law from an economic perspective. Under this approach, the participants in the corporation are seen as having contracted among themselves with reciprocal obligations and expectations from each contracting party. An applicant who had engaged in some form of misconduct in such a case may justly be removed from his or her employment either as director or as officer and this might not constitute unfairly prejudicial conduct.

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[213] For example, see Re Wondoflex Textiles Pty. Ltd. (1951) V.L.R. 458.

[214] See Camroux v. Armstrong (1990), 47 B.L.R. 302; A and C were the registered shareholders of a limited company. They made an agreement on a number of topics. i. the acquisition by A of C's shares in the company if C's employment with the company ended, or ii. that if A tells C she wanted to buy his shares, then C had to sell his shares to her; iii. that the consideration to be paid, by A to C, would be the fair market value of the shares. They also promised that if they could not agree on fair market value, then auditors would determine fair market value. Subsequent to their promise two things happened, first, C's employment with the company ended; and, second, A told C that she wanted to buy his shares. The parties failed to agree and the auditors determined a "nil" fair market value for C's shares.

In Cairney v. Golden Key Holdings Ltd.,[215] the petitioner, a majority shareholder and director, sub-mortgaged the company's assets without informing M., the other director, and applied the company seal with his signature alone, although the articles required the signature of both directors. He then misappropriated the proceeds of the loan for his own purposes and disappeared after the sub-mortgage fell into arrears. M., who in the petitioner's absence could not use the company's assets to redeem the sub-mortgage, privately raised the necessary funds and took an assignment of the sub-mortgage in his personal capacity. The petitioner's fraud disentitled him to relief and M's conduct was held not to be oppressive to the petitioner. Canadian courts seem to have acknowledged the reciprocal nature of corporate obligations and have been willing to hold that the conduct of an oppression remedy applicant may be a bar to oppression relief.

9. Summary

After having closely studied the oppression remedy under the B.C. Company Act, I will make some general observations about the remedy in British Columbia. The protection afforded by this remedy to minority shareholders is wide in scope. For instance, it applies from cases involving oppressive conduct, which require proof of bad faith, harsh or burdensome conduct or lack of probity, to acts which involve negative effects on minority shareholders without there necessarily being proof of bad faith (*mala fides*). This gradual trend towards a more liberal approach in regard to the availability of the remedy is both the result of a series of amendments to earlier statutory versions of the remedy and judicial readiness to give effect to these changes.

[215] (1988), 40 B.L.R. 289 (B.C.S.C.); see also Tessman v. Brown, (1990) B.C.W.L.D. 2147 (S.C.); and Broken Circle Resources Inc. v. UnderHill Geographic Systems Ltd., (1991) B.C.W.L.D.2645 (S.C.).

The oppression remedy in British Columbia has moved far beyond a simple bad faith requirement. Furthermore, recent case law indicates that its availability will increasingly infringe upon the actions of the majority, incorporating such issues as the extent of legitimate shareholder expectations, the degree to which the court should intervene in internal corporate matters and review a corporation's business decisions and the overall scope of the minority shareholders' rights. The courts, while increasingly extending the scope of the remedy, have imposed sensible limits as well, such as taking into account a shareholder's own responsibility for his or her situation.

The oppression remedy is wide enough to cover most cases where other remedies, like derivative actions, appraisal rights and winding-up orders, fail to address the core problem adequately.[216] The issue then becomes whether the oppression remedy is too broad in scope and is starting to compromise the majority's powers in a manner that might undermine the original intentions of those who formed the corporation. It could be that if the remedy is too generously made available it may reinforce the old concerns that led to restrictions on the scope of derivative actions.

My overall conclusion is that the oppression remedy as provided by the B.C. Company Act adequately covers most aspects of the conduct of the majority or the board that may lead to unfairness or prejudice to minority shareholders.

[216] However, those remedies may be available where the oppression remedy may not be permitted or is unsuitable.

10. The Suitability of the Oppression Remedy for the Protection of Minority Shareholders of Bhutanese Companies

As discussed earlier, the kind of remedies required for protecting minority shareholders depend upon the nature of corporation in which minority shareholders invest. For instance, minority shareholders in closely-held corporations can be seen as well protected by a well-drafted form of the oppression remedy. This remedy can then be invoked by minority shareholders who allege oppression or unfair prejudice. However, minority shareholders in widely-held corporations might more effectively invoke other remedies (such as the derivative action or the appraisal remedy) more beneficially and conveniently.[217]

Corporate activities in Bhutan started only recently with moderate investment by a relative few[218]. Most Bhutanese corporations are closely-held and managed by their shareholders.[219] Therefore, at present, closely-held corporations are the most common form of business entity in Bhutan.[220] Such corporations generally have a small number of shareholders and do not have a ready market for their shares.[221] In addition, shareholders in closely-held corporations often participate in management. Viewed as intimate relationships, closely-held corporations are usually formed by family members and friends. The reasons for such trends in the Bhutanese context are: the small size of the

[217] However, these remedies involve lengthy and rigorous procedures, for example section 207 of B.C. Company Act requires a series of steps to be followed, like dissent from the resolution, filing of a dissent, demand for purchase and return of the share certificate.

[218] The Government of Bhutan started economy development of the country only from 1960's onwards; Source texts – Hasrat, B.J., "History of Bhutan, Land of the Peaceful Dragon" (1980); Aris, M., "The Raven Crown, the Origins of Buddhist Monarchy in Bhutan" (1994); and Dasho K. Tshering, "Integrating Environment and Development in Bhutan, A legal Perspective"

[219] widely-held companies may increase in number with privatization and liberization of restrictions on foreign investment.

[220] Though there are some widely-held corporations and more are coming up with liberalization of the commercial activities by the Government of Bhutan.

[221] Even shares in widely-held public corporations are not very freely traded in Bhutan.

economy; a traditional sentiment towards a partnership way of doing business and, perhaps, most importantly, government restrictions on foreign direct investment in Bhutan.[222]

The oppression remedy is recommended for the protection of Bhutanese minority shareholders in closely-held companies. Support for making this remedy available is based on the following reasons;

a. Minority shareholders may face the problem of inability to sell or transfer their interests in their companies. A lack of any market for their shares is the predominant reason for this problem.

b. Although participation in management may afford minority shareholders control over their investments, minority shareholders often cannot successfully oppose majority shareholders' oppressive decisions, which may include: (a) awarding themselves excessive compensation, (b) sacking minority shareholder-employees, (c) refusing to pay dividends, (d) engagement in other self-interested activities and other similar forms of conduct. These actions may result in lost investment opportunities, income and livelihood for minority shareholders.

At present, there is little evidence that minority shareholders in Bhutanese companies face oppression from majority shareholders or from boards of directors, as no complaint of this kind has come before the courts. Nevertheless, the potential threat to minority shareholders cannot be ignored, as commercial activities are ever expanding with many new private companies coming into existence.

In this emerging commercial context it seems appropriate to consider adding an oppression remedy to the Bhutan Company Act. The B.C. Company Act oppression

[222] Supra note 98.

remedy, discussed in detail above, could provide a useful model for this exercise. Two factors, in particular, support this conclusion. The first, is the tendency of most new Bhutanese companies to be closely-held (the situation where the oppression remedy is usually most appropriate). Second, is the advantage of using as a model a remedy that has been subject of extensive judicial interpretation in its original context. This should mean that not only can Bhutanese judges use Canadian precedents to decide cases involving the new provision but its enactment is unlikely to require further modification and amendment.

CHAPTER FIVE

THE APPRAISAL REMEDY

1. Introduction

At common law, unanimous shareholder consent was necessary to effect a change in a corporation's letters patent or its articles of association. This rule was drawn from the law of partnership.[223] It then became apparent that a recalcitrant minority might unjustly thwart the will of the majority. The rule thus evolved towards recognition of the principle that by means of a "special resolution" the will of majority could be imposed on the minority in such circumstances. Specific remedies were provided for in cases where the minority was abused by the majority exercising its power improperly. Short of the drastic remedy of a winding-up, the notion of the oppression remedy evolved and if that was successful the court could oblige either the majority shareholders or the corporation to purchase shares at an appraised value. Since then, the appraisal right has also been recognized as one of the major statutory remedies available to protect minority shareholders.

The appraisal remedy, like other remedies discussed in earlier chapters, was introduced to protect the interests of minority shareholders in corporate activities and bears certain functional features. The appraisal remedy is a mechanism for assuring investors that if capital is invested in a corporation, "majoritarianism" will not run roughshod over the considered business judgment of the shareholder by transforming the enterprise entirely at its whims. The appraisal remedy offers fair compensation, as a

[223] Ziegel, et al, Cases and Materials on Partnerships and Canadian Business Corporations, (2d, ed.) (Toronto: The Carswell Co. Ltd. 1989).

fundamental change in the corporation may entail more than a disagreement over business planning. The appraisal remedy permits the corporation to achieve a maximum corporate flexibility and at the same time saves minority shareholders from being dragged along into a drastically changed enterprise in which he or she has no confidence.[224] The appraisal remedy encourages the appropriate ideal of shareholder democracy by vesting in dissenting shareholder a greater weight in the balance of power.[225]

Generally, speaking a dissenting shareholder has available to him or her two courses of action besides the appraisal remedy. First, he or she may decide to go along with the majority and hold on to his or her shares or, second, he or she may sell his or her shares in the market (if the corporation is widely-held). Where he or she chooses to exercise his or her appraisal right, it will be assumed that he or she considers this right more beneficial than the other options open to him or her. As a shareholders' remedy, the usefulness and adequacy of the appraisal remedy depends on the ease and efficiency of the applicable appraisal procedures. If the appraisal remedy entails substantial costs, or if the shareholder is required to endure uncertainty for a protracted period, then seeking appraisal may not worth the effort.

Relevant questions in examining the adequacy of the appraisal remedy include the following: How long will the procedure take to obtain compensation under the appraisal statute? Who is to pay for the expenses of the appraisal right; the claimant or the corporation? When and how must the dissenter make up his mind about filing the claim,

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[224] Thereby furthering the ideals of fairness in the modern enterprise by allowing the change the majority genuinely feels is good for the corporation and at the same time safeguarding a shareholder from being forced into a change he or she considers unfair.

[225] Magnet, J.C., "Shareholders' Appraisal Rights in Canada." (1979) 11 Ottawa L.R. 100.

and does he or she forfeit other remedies if he or she files under this remedy? When does the dissenter cease to be a shareholder for the purpose of dividends, notice, suit, and other matters? Once a member has undertaken the route to dissent and claim the appraisal right, can he or she change their mind and rejoin the corporation? These questions and many more are relevant in assessing the adequacy of the statutory provisions which confer the right of appraisal on shareholders. The following will be an attempt to highlight the more important issues surrounding the appraisal right and use the outcome of this discussion to assess the potential of extending the remedy to shareholders in Bhutan.

The discussion is divided into five sections:

(a) The first section considers the origin and rationale for the introduction of the appraisal remedy in Canadian corporation law, with special reference to the B.C. Company Act.

(b) The second section examines the statutory provisions regulating the appraisal procedure. The procedural requirements will be highlighted as they form the basis for examining the adequacy of the current form of the appraisal right. Since most Canadian corporate statutes contain provisions relating to the appraisal right, no attempt will be made to review all of these, so the B.C. Company Act will be discussed and whenever necessary the Canada Business Corporations Act may also be referred to.

(c) The third section, considers the practical problems of designing and administering an effective appraisal remedy. It is believed by many that the current form of the appraisal remedy is far from adequate. In fact, it is said by some to be bridled with many problems which include the allocation of the burden of costs, taxation of the price for the shares, questions of procedure, and the lack of precise valuation methods. Suggestions for improvement in these areas will also be made.

(d) The fourth section, examines the important question of the exclusiveness of the appraisal remedy. The answer to this may give some insights into the extent to which the appraisal right affords adequate protection for minority shareholders. While the federal Act contains two conflicting subsections which render the issue ambiguous and unresolved, the B.C. Company Act is silent on the issue. Recent judicial and academic opinions are examined. It is suggested that the appraisal remedy ought not to be an exclusive remedy. Suggestion for legislative intervention to clarify this issue will be offered,

(e) The fifth section studies the possible availability of the appraisal remedy to minority shareholders of corporations in Bhutan.

2. Corporate Structure and the Appraisal Remedy

2.1. Closely-held Corporations

Shareholders in closely-held corporations for which there exists no liquid market for their shares tend to have different responses to shifts in enterprise risk than their counterparts in widely-held corporations. Minority shareholders in closely-held corporations are often substantially underdiversified[226] since a large part of their wealth (including their employment) is usually tied up with a single corporation. In most such enterprises, there is no reliable market exit option. Shares of closely-held corporations will generally be difficult to sell and may be subject to strict restrictions on alienability,

[226] Diversification mitigates the risk of loss from one corporation by investing in other corporations, so loss from one will be covered by the gains from others, provided the shareholder has enough resources to invest.

reflecting the quasi-partnership status of many small incorporated businesses. On this basis, the exit option provided by the appraisal right reflects an important protection for the minority shareholder against the dangers of shifts in the risk of the enterprise.

Similarly, opportunistic fundamental corporate changes designed to accommodate the risk preferences of managers or majority shareholders are likely to occur in closely-held companies.[227] Managers of closely-held corporations are often underdiversified, given that both their private wealth and employment are tied up in the enterprise, thus increasing the chances of opportunism. If protection is desired against unwise or opportunistic fundamental changes that the majority has approved, the appraisal procedure is likely to be the only exit option available (aside from private ordering arrangements to effect the same result) for minority shareholders.

However, it can be argued that the exercise of the appraisal right also generates many costs for minority shareholders. The appraisal procedure is technical, time consuming and expensive. The amount of the award is often unpredictable and may be taxable whereas the transaction dissented from may have produced tax-free benefits to the minority shareholder.[228] All these issues will be discussed in detail in the succeeding sections of this chapter.

Notwithstanding its costs, the exercise of the appraisal right is often desirable in connection with transactions which involve self-interest on the part of the management or a lack of investment skills which seriously obscure management's vision and that could result in loss in value of the shareholders' holdings.

[227] See, J.G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1986) 24 Osgoode Hall L.J. 201, at page 298.
[228] Id.

The absence of a market exit option increases the value of the remedy to minority shareholders of a closely-held corporation who are often substantially underdiversified. Moreover, events compelling a minority shareholder to desire to exit the enterprise in response to an anticipated diminution in value of his or her shareholding are likely to arise with some frequency in the closely-held corporation.[229]

Finally, while the appraisal remedy could be useful for minority shareholders of both widely-held and closely-held corporations, it is likely to play a bigger role in protecting minority shareholders of closely-held corporations, where there are no public markets for their shares.

2.2. Widely-held Corporations

Economic analysts argue that the appraisal remedy is likely to be of little value to protect shareholders in widely-held corporations. Because of the normal availability of a liquid market for its shares, a dissenting shareholder in such a corporation may simply decide to sell his or her shares in the open market without loss of capital and purchase a more satisfactory investment. The quoted market price, however, may not always reflect the fair value of the shares. Where a corporation's shares are thinly traded (as is the case with many Canadian corporations) there is a risk of short-run fluctuations in the market price of the shares away from an equilibrium value. Arguably, the minority shareholders might wish to be protected against this risk by being assured of a reliable and fair exit option such as that provided by the appraisal remedy. However, given the relative costs

[229] Bahl, S., "Resolving Shareholder Dissension: Selection of an Appropriate Equitable Remedy." (1990) J. Corp. Law. 285.

of the appraisal option as opposed to a market alternative it would not be a useful protection for minority shareholders against changes that do not affect share value.

In Canada, the Ontario Business Corporations Act[230] formerly restricted the appraisal remedy to closely-held corporations. This was based on the recommendation of the 1973 Ontario Committee on Mergers, Amalgamations and Certain Related Matters (known as the "Merger Report)[231] which advised that if the appraisal remedy were granted at all to minority shareholders of widely-held corporation, then it must be on the ground of an absence of share marketability. According to the Committee, in the case of widely-held corporations, the remedy would not appear to be any more effective than if the shareholders were to sell their stock in the face of a triggering transaction like a fundamental change by way of a merger. However, there is the possibility that a triggering transaction might have to be called off because of the excessive cash drain in meeting the appraisal rights when many minority shareholders opt to exit the corporation.[232] The Committee seemed to have agreed with the earlier conclusion reached by Professor Bayless Manning[233] that "appraisal should be considered an economic substitute for the stock exchange, and its use should be limited to situations in which the exchange or some kind of a reasonable market is not available."

The current form of the B.C. Company Act and other Canadian corporate statutes like the Ontario Business Corporations Act do not limit the availability of the appraisal right to closely-held corporations. There are some good reasons why the market exit

[230] Ontario Business Corporations Act, S.O. 1982, c-4, section 100.
[231] The Report on Mergers, Amalgamations and Certain Related Matters or the Ontario Selected Committee on Company Law (1973) 52.
[232] This assumption is based on the understanding that there will greater bargaining strengthen when many minority shareholders collectively opt to exit the corporation in the face of fundamental change.
[233] Manning, "The Shareholder's Appraisal Remedy: An Essay for Frank Coker" (1962) 72 Yale. L.J.223.

option may not be an adequate protection for shareholders in widely-held corporations. First, large shareholders who are forced to sell quickly to escape a fundamental corporate change may realize an inferior price in the market because of the hurried liquidation of a large block of shares. Second, all shareholders, whether large or small, may only be able to realize a price that already reflects the market's anticipation of the effect of the fundamental change.[234] The possibility of a demoralized market in which fair prices are not available and in which many corporations publicly offer to buy their own shares, because the market grossly undervalues them, suggests that access to market value is not always a reasonable alternative for a dissenting minority shareholder.

While the appraisal right may not be of substantial concern to minority shareholders of widely-held corporations, because of the common availability of a market exit option, there are good justifications why it is still desirable that the right be made applicable to those corporations. This line of reasoning mainly stems from the occasional inadequacy of the stock market to accurately reflect the value of the minority shareholder's shares.

Finally, any restriction in the exercise of appraisal rights based on the availability of the stock market may be seen as inconsistent with the purpose of the enactment of the appraisal remedy provision which is to protect the interests of minority shareholders.

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[234] M.A. Eisenberg, "The Structure of the Corporation", (Boston: Little, Brown & Co., 1976) 79-84. This is actually part of definition of "fair market value" in section 207(5) of the B.C. Company Act.

3. The Origin and Rationale for Introducing the Appraisal Remedy in Canadian Corporation Law (the B. C. Company Act)

The introduction of statutory appraisal rights in Canadian corporation law, which permit shareholders to demand, upon the occurrence of certain events, that the corporation buy their shares, was intended to alter the balance of rights between majority and minority shareholders in the case of fundamental corporate changes.[235] The Dickerson Committee recommended the introduction of the appraisal remedy into the Canada Business Corporations Act and, in so doing, was significantly influenced by the reluctance of courts at common law to intervene to protect minority shareholders in the absence of fraud or bad faith. It concluded that the state of the common law was "at best unsatisfactory, at worst downright unjust."[236] The appraisal remedy was intended to strike a new balance between majority and minority shareholders – while the majority could if they go through the proper formalities and if they pay dissenting shareholders, "effect almost any fundamental change with impunity,"[237] the minority would have the right to opt-out of the enterprise on the occurrence of the change. Furthermore, if enough shareholders dissented, they gained the ability to block the fundamental change altogether. According to the committee, the result is a resolution of the problem that protects minority shareholders from discrimination and simultaneously preserves flexibility within the enterprise, permitting it to adapt to changing business conditions.[238]

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[235] For general overview of the origin of appraisal rights, see MacIntosh, supra, note 227. The first modern appraisal provisions applying to a variety of fundamental changes in widely-held corporations was adopted in the British Columbia Companies Act, R. S.B.C. 1973, c- 18, section 228.
[236] R.W.V. Dickerson, J.L. Howard and L. Getz, 1 Proposals for a New Business Corporations Law for Canada, (Ottawa: Information Canada, 1971) at 114-115. (known as "Dickerson Report")
[237] Dickerson Report, id. at para 1.
[238] Id.

Discrimination was thus not the only problem which the appraisal right addressed. The Dickerson Report observed that the remedy could perform another function allowing minority shareholders to escape fundamental corporate changes that "changed fundamentally the nature of the business in which the shareholder invested."[239]

The appraisal remedy thus seeks to strike a balance between the interests of the majority and minority shareholders of the corporation. Traditional corporate legal theory recognizes the ability of the majority shareholders, if they obtain the requisite consent, to undertake fundamental corporate changes. In a rapidly changing commercial environment, a great deal of corporate flexibility is necessary to meet evolving conditions of business. Such a changing environment may, for example, require an alteration of the capital structure of the corporation, the alteration of the rights attached to different classes of shares in the corporation, or even the creation of new shares or the elimination of existing classes of shares. In addition, changes in the business environment may necessitate rescaling the enterprise either by merger or amalgamation or by the reduction of the size of the enterprise.

On the other hand, minority shareholders desire protection against such fundamental corporate changes that alter either the risks of the business or impair the enterprise's value and thus reduce the market value of the firm's various securities. Similar protection may be needed against changes in the rights attached to various securities of the corporation which may have the effect of diminishing the value of those securities.

[239] Id.

In general, the appraisal remedy recognizes the power of the majority shareholders to effect fundamental changes in the corporate structure while at the same time giving any dissenting shareholder the right to insist that his or her shares be purchased by the corporation at the time when the fundamental change occurs. The appraisal remedy is 'two-way' relief whereby the corporation can also demand the minority shareholders sell their shares if they dissent.[240]

4. The Statutory Provisions

Appraisal rights are triggered by fundamental corporate changes. Most corporate statutes in Canada afford shareholders the appraisal remedy in the event that a triggering transaction occurs. For instance, section 207(1) of the B.C. Company Act enumerates a number of fundamental changes in which a shareholder may insist on appraisal as a matter of right. This right is available if:

a. the incorporation is transferred from British Columbia and continued in another jurisdiction (under section 37(4));

b. financial assistance is granted to a person by the company directly or indirectly by way of loan, guarantee, the provision of security, or otherwise in violation of section 103(4);

c. the company proposes to sell, lease, or otherwise dispose of the whole, or substantially the whole, of its undertaking as stated in section 126(5);

d. the company varies restrictions contained in its memorandum on its capacity to carry on certain businesses (under section 221);

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240 B.C. Company Act, s. 207(4) and see Re Wall and Redekop Construction, (1974) 50 D.L.R. (3d) 733.

e. a specially limited company alters its memorandum and articles to convert itself into a company having an ordinary memorandum under Form 1 of the Second Schedule to the Act (under section 243);

f. the company enters into an amalgamation under section 249;

g. any transfer, sale or arrangement occurring in accordance with section 289.

Courts may order the appraisal remedy in other contexts when adjudicating claims for other relief, such as the oppression remedy. In such cases, the appraisal remedy is not available to the minority shareholder as a matter of right but is ordered by the court as an appropriate form of relief,[241] in the process of adjudicating another claim.

The appraisal procedure contained in the statute is highly technical,[242] with several distinct steps to be completed within a limited time-period. First, appraisal rights do not arise unless the shareholder dissents or abstains at the meeting on the proposed resolution and then sends a written notice of dissent to the corporation at or before the shareholders' meeting. The appraisal remedy is not triggered by this written objection, and the shareholder must send, in addition, a demand for payment for his or her shares by the corporation within a 14-day period[243] of the meeting being held. Only then does it have a responsibility to repurchase the dissentient's shares. Dissenting shareholders must also return their share certificates to the corporation within the 14 day period.[244]

The B.C. Company Act does not specify the time-period by which the company must respond to a demand from a member for the appraisal remedy. It is however, clearly stated in the Canada Business Corporations Act that shareholders have 30 days to accept

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[241] Although our concern here is with situations where the shareholder claims appraisal as a matter of right.
[242] B.C. Company Act, s. 207(1) – (10).
[243] Under the Canada Business Corporations Act, s. 190(7) it is 30 days.
[244] Under the Canada Business Corporations Act, s. 190(8) it is 30 days.

a demand made on them by the corporation. If no such response is forthcoming, or if the demand is rejected, the corporation may bring the matter to the court, failing which the shareholders have a 20-day period to do so.[245] After the demand for payment is sent in, the dissenting shareholder looses any rights to participate in the affairs of corporation.[246]

These procedural steps are mandatory and failure to perform one-step in the required time may mean that the appraisal rights are lost. However, the courts sometimes do not interpret these requirements strictly. In Jepson v. The Canadian Salt Company Ltd.,[247] MIC was a wholly-owned subsidiary of Morton-Norwich Products Inc. ("Morton"). A notice of an offer was made by MIC[248] to acquire the shares of the remaining minority of Canadian Salt Company Ltd. ("Salt") at $ 20.00 per share. The same notice advised that after making its take-over offer, MIC intended to implement an amalgamation between itself and Salt. By the terms of this amalgamation, Morton would receive one common share of the amalgamated company for each share of MIC held by it. Other shareholders would receive one $ 20.00 redeemable preferred share in the amalgamated company for each share of Salt. Since such an amalgamation may proceed under section 177 of the Canada Buisness Corporations Act with the sanction of a two-thirds vote at a shareholders' meeting, this amalgamation, and the $ 20.00 price for the shares, seemed to be a foregone conclusion even before the offer was made or the shareholders' meeting was held. The plaintiffs immediately objected to the proposal. The meeting was attended by 99.97 per cent of the shareholders who approved the proposed amalgamation. The plaintiffs did not attend the meeting and did not file proxies within

[245] The Canada Business Corporations Act , s. 190(16) and the B.C. Company Act is silent on it.
[246] The B.C. Company Act, s. 207(7) and the Canada Business Corporations Act, s. 190(11).
[247] (1979) 7 B.L.R. 181 (Alta. S.C.).
[248] MIC owned 80% of the issued shares of the Canadian Salt Company Limited.

the time frame as set in the Act. The corporation used the default of the plaintiffs (non-attendance and non-filing of dissent) as defence against the petition for the appraisal remedy.

Laycraft, J. allowed the appraisal application even though it was conceded that there were certain procedural lapses on the part of plaintiffs. The reason for this decision was that many minority shareholders will not possess a sufficient degree of business sophistication or will not have available the expert advice needed to meet on equal terms the persons able to devise such take-over mechanisms. Where amalgamation provisions are used as a "force-out" mechanism, the Court stated that the courts must be astute to protect the rights of minority shareholders, so far as it is possible to do, while giving effect to the clear provisions of the statute. The courts are also given the power to determine the value of the shares on the appraisal being granted, where the corporation and the dissenting shareholders fail to do so.[249]

5. The Adequacy of the Appraisal Provisions in the British Columbia Company Act

Whether or not giving the minority shareholders an appraisal right is an effective means of protecting them depends largely on whether the appraisal right can be designed to meet the specific needs of the shareholders and also on the costs of the exercise of the right to the shareholder and to the corporation.

The current form of the statutory provisions regulating the exercise of the appraisal remedy raise basic questions about the value of this right to shareholders. It is

[249] See for example, Re Wall and Redekop Construction, supra, note 240.

worthwhile to take a closer look at some of the problems that have arisen and discuss what improvements could be made to produce a more adequate and effective appraisal remedy.

5.1. Taxation Problems

The current income tax[250] treatment in Canada of the proceeds of the disposition of shares arising from the exercise of the appraisal right is far from satisfactory. While the exercise of the appraisal right by a dissenting shareholder triggers a taxable event for him or her, the fundamental corporate change dissented from often does not result in any taxable event for the non-dissenting shareholder who chooses to stay with the corporation.

A decision whether to exercise the appraisal right or not will invariably depend on, *inter-alia*, the relative tax treatment accorded to dissenting and non-dissenting members. On the one hand, a less favorable tax treatment for dissenters may create an artificial disincentive to the exercise of the appraisal right and thus diminish the protection that the remedy affords minority shareholders. On the other hand, the preferential tax treatment of dissenters may result in shareholders exercising the appraisal right only for tax reasons, "a clearly wasteful and unproductive use of social resources."[251] It would be improper to accord dissenters more favorable treatment than non-dissenters and *vice-versa.*

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[250] Section 248(1) of The Practitioner's Income Tax Act, David M.S., (Carswell, 11ed. 1997), defines " 'disposition' of any property except as expressly otherwise provided, includes (b) any transaction or event by which; (i) where the property is shares..., (iii) where the property is share, the share is converted because of an amalgamation or merger," at p. 8.12.
[251] See J.C. MacIntosh, supra, note 227.

A solution, therefore, lies in fashioning a tax rule which, while not having the effect of diminishing the utility of the appraisal remedy, does not create a tax reason for exercising the appraisal right. This implies that a balance should be struck in the tax treatment of dissenters and non-dissenting shareholders. In this regard it may be suggested that dissenters should receive the same tax treatment that non-dissenting shareholders will receive under the terms of the fundamental corporate change. More specifically, if the fundamental transaction is such that taxable consequences will be created for non-dissenters, then any shareholder who dissents from the transaction should be subjected to the same tax treatment. This approach will invariably remove the tax system as a consideration either for or against exercising the appraisal right, and allow the decision to be made purely on the basis of the nature of the fundamental corporate change that triggers the remedy.[252]

5.2. Costs of Re-Investment

Most minority shareholders re-invest the proceeds arising from the exercise of an appraisal right into the shares of another corporation. Where this is the case, one of the burdens which the shareholder has to bear is the brokerage and reinvestment costs of doing so. The thought of bearing this extra burden may create a disincentive for the minority shareholder to exercise his or her appraisal rights. This has led some commentators[253] to suggest that any brokerage fees or other investment costs be added to the appraised value of the shares and the amount the shareholder will receive. This approach has the potential to alleviate hardships which may confront the minority

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[252] Id.
[253] Id.

shareholder after exercising his or her right of appraisal.[254] However, as in the case of tax considerations, the objective here should also be to ensure the equal treatment of dissenters and non-dissenters, in order to eliminate any artificial incentive for shareholders to exercise (or not to exercise) their appraisal rights. This could be done on a pre-determined schedule, computed and revised from time to time on the basis of industry averages and awarding a constant fraction of these costs determined by computing a mean present value of future investment costs.[255]

This approach may be ideal, but it involves computations which may add even more confusion to an already technical area of corporate law. Pending the adoption of a legislative solution to the problem, minority shareholders still must bear any brokerage costs arising from the re-investment of the proceeds of the appraisal of their portfolio. This is an ongoing cost to the overall efficacy of the appraisal right.

5.3. Procedural Problems with the Appraisal Remedy

The complex procedural provisions surrounding the appraisal provisions, that exist in British Columbia and other Canadian jurisdictions, have led to situations where shareholders who fail to strictly comply with these provisions may be disentitled, as a result, from being able to exercise their appraisal rights. Detailed procedures increase the likelihood of technical violations. Appraisal applicants are entitled to receive "fair value" for their shares but no indication is given as to who bears the burden of proving "fair value" and what are the relevant criteria surrounding this issue.

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[254] At least to compensate for the involuntary loss of "ownership" and make up for the fact that the sales is, in the shareholders' eyes, a forced sale.

[255] Supra, note, 225, supra, note 227 and see Krishna, V., "Determining the 'Fair Value' of Corporate Shares" (1987-88) 13 Can. Bus. L.J. 132

Under the Canada Business Corporations Act [256] it is provided that the court may, in its discretion, appoint one or more appraisers to assist it in fixing a fair value for the shares, but no provision is made with respect to whom bears the costs of a court-appointed appraiser. The B.C. Company Act does not contain a similar provision but simply provides that the court shall determine the fair value of the shares on the application of the company or the dissenting member. It is suggested that if the court decides to appoint an appraiser to help it in fixing a fair value then the burden of the costs of appointing the appraiser should be split equally between the parties.

Courts have, however, often indicated their willingness to be flexible in interpreting the procedural requirements of the appraisal statutes. In Neonex International Ltd. v. Kolasa,[257] Neonex International Ltd.(old) ("Neonex O")., was amalgamated with Jim Pattison Ltd. ("Jim") and out of this amalgamation a new company bearing the identical name-Neonex International Ltd.(new) ("Neonex N") - came into existence. Jim was wholly-owned by Pattison. Pattison also held 46.5% of the shares of Neonex - O. A shareholders' meeting of Neonex O took place in Winnipeg where it was proposed that each shareholder of Neonex O, other than Pattison, could elect to receive either $3.00 in cash per share or a non-voting preference share in Neonex N with a par value of $3.00. Pattison agreed to exchange the 46.5% interest he held in Neonex O for preference shares in Neonex N, with the aim of gaining 100% ownership of Neonex N. To complete these transactions a special resolution had to be passed by not less than a two-third's majority. This requirement was duly met as Pattison held shares carrying more than two-thirds of the votes. The respondents objected to the amalgamation resolution and asked for further

[256] S. 190(21).
[257] [1978] 2 W.W.R. 593.

information so they might decide whether $3.00 in fact represented the fair value of their shares and to this end they applied for the appointment of an expert appraiser. In response, Bouck J. converted the dissenters' application to determine fair value into an "action" to give the claimants the benefit of "the fair value" of their shares and the Court ordered the corporation to stand as plaintiff and the applicant as defendant in the reconstituted action. Bouck, J. stated as follows;

> "(58) At first I was inclined to think .the respondents should be the plaintiffs because it was in their interest to move the matter along. But on reflection it seems this would place the burden of proof upon them. They would have to show the fair value was not $3.00 but something more. All the petitioner would have to do to defend the allegation. That would be unfair.
>
> (59) The better, but not the perfect answer is to put the petitioner in the position of the plaintiff and require that it prove the fair value of each share is in fact $3.00. Through discovery of documents and examination for discovery the respondents will be able to inquire into the basis of the petitioner's evaluation.
>
> (60) I quite appreciate the financial burden this may place upon the respondents. Also, I am not overlooking the obvious. It will be in the petitioners' interest to try and prove the fair value was something less than $3.00. There is no particular answer to this dilemma which has been created by the legislation. Since the Act does not shut out the dissenters right to a trial it seems to be the only common law remedy left available to them.
>
> (61) Costs of the motion were not argued at the hearing. They usually follow the event. This is to say, if the petitioner proves the shares have a "fair value" of $3.00 or less it may be given its costs after the trial. If the respondents show the "fair value" is more than $3.00 the petitioner may be ordered to pay the respondents' costs. But, the Supreme Court Act, R.S.B.C. 221 1960, Ch. 374, s. 80(2) allows a court complete discretion when it comes to an award of costs. In addition, a court may give costs on a solicitor and client scale rather than the lower party and party scale. Because the costs of this motion would not have to be paid until the conclusion of the hearing, I believe it would be better to have them assessed both as to scale and entitlement by the trial Judge. That is the order I am now making, however, as the issue was not argued, counsel may if they wish set it down for further submissions."

Similarly, in Roberson v. Canadian Canners Ltd.,[258] the Ontario High Court directed a trial of the issue of fair value, complete with pleadings, discovery, and production, with the corporation standing as plaintiff.

Laycraft, J. stated,[259] in Jepson v. The Canadian Salt Company Ltd.,[260] that the use of the amalgamation provisions of the Canada Business Corporations Act as a "force-out" mechanism against the minority shareholders had made virtually redundant the sections of the same Act designed to cover the "force-out" situation. Section 199 of the Canada Business Corporations Act provides a significantly more elaborate procedure to safeguard the minority than does section 184.[261] For example, the "force-out" procedure in section 199 requires that the take-over offer be accepted by holders of 90 percent of the shares apart from those owned by the offeror, while an amalgamation may be achieved by a two-thirds majority without any requirement that the majority be independently held shares. Laycraft, J. allowed the appraisal application even though it was conceded that there were certain procedural lapses on the part of plaintiff. Laycraft, J. explained that if Parliament had intended to deprive the minority of its common law rights then the law demands that the statute say so in the most clear and unequivocal language, otherwise, the common law will try to ensure that justice is done in specific cases. Therefore, the dissenting shareholder was allowed to proceed, though apparently he had failed to

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[258] (1978) 4 B.L.R. 29. The court stated, "the Act casts upon the directors an obligation to fix a fair value of the shares and to show by accompanying statements how it was determined. We read this provision as casting upon the directors an obligation, in the first instance, to justify the fair value.

[259] Laycraft J. also made reference (at para 15) to the decision of Bouck J., in Neonex International Ltd. v. Kolasa, supra, note 257.

[260] Supra, note, 247, where the facts and issues in this case are also discussed.

[261] This provision facilitates take-over bids by allowing offerors who have acquired 90 percent of the shares of a target corporation to compulsory acquire the remaining 10 per cent. See also B.C. Company Act, s. 255.

comply with the provisions of the statute in a number of important respects that might otherwise have proved fatal to his appraisal application with a less sympathetic judge.[262]

Notwithstanding this sort of judicial benevolence towards minority shareholders it is still clear that the present procedural requirements involved in the appraisal remedy are far from being satisfactory. More could be achieved by legislative drafting to take care of the sorts of procedural difficulties illustrated by the above cases. The alternative is to leave dissenters to fundamental changes dependent on the goodwill or sympathy of the courts in individual cases.

5.4. The Costs of Exercising the Appraisal Right

A minority shareholder who intends to exercise his or her appraisal right ought not to encounter financial costs that would prevent him or her from doing so and thereby destroy the utility of the right. On the other hand, rules relating to the financial cost of appraisal ought not to be an incentive for shareholders to seek relief in inappropriate cases.

Under Canadian law, courts have usually adopted the rule that costs follow the event; in this case it follows the relative success of each party in establishing a claim in respect of fair value.[263] The uncertainty surrounding costs may deter an average risk-averse shareholder from exercising his or her appraisal rights. If the corporation is compelled to bear the cost of the appraisal right, then the burden of costs will be shifted to other shareholders. This invariably removes costs as an obstacle to the exercise of the

[262] See also Douglas Inc. v. Jarislowsky, Fraser and Co. (1980) 13 B.L.R. 135 (Que. S.C.); Alexander v. Westeel-Rosco Ltd., (1978) 4 B.L.R. 313.
[263] Supra, note 227; where the writer referred to Re Johnston and West Fraser Timber Co. Ltd. (1980), 22 B.C.L.R. 337, 18 C.P.C. 218 (S.C) (no award of costs because of dividend success at valuation hearing).

appraisal right. However, this generates its own problems: shareholders may exploit the appraisal right for improper purposes. A solution may be found in imposing the costs of valuation on the corporation, subject to the court's discretion to order otherwise if the applicants exercise the appraisal right, bargain for a settlement, or proffer a valuation in bad faith.

5.5. Lack of Precise Share Valuation Methods

Another problem which diminishes the efficacy of the appraisal remedy is the lack of any precise method of valuation of the shares concerned. Under the B.C. Company Act and the Canada Business Corporations Act, the court is empowered, on the application of the corporation or the shareholder, to fix the "fair value" of the shares. Under the Canada Business Corporations Act, the court may appoint an expert valuer to help make the calculation. The B.C. Company Act does not contain a similar provision, but states that the price to be paid to a dissenting member for his or her shares is their "fair value as of the day before the date on which the resolution ...was passed, including any appreciation or depreciation in the anticipation of the vote on the resolution."[264]

Although the B.C. Company Act provision appears more promising, both Acts leave open the important question of what constitutes a "fair value" and what criteria are to be used in establishing it. The meaning to be assigned to fair value is very important as dissenting shareholders must have all the information they need to be able to assess the utility of dissenting and seeking the appraisal remedy. Where there is a sizeable minority this assessment may be crucial for the fair value to be assigned to their shares is likely to be higher than current market value because of the likely greater bargaining strength of

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[264] Section 207(5) and see Re Wall and Redekop Construction, supra, note 240.

the larger group. The costs of seeking the remedy may become prohibitively high and cause its abandonment. In addition, lack of a precise valuation method may lead to uncertainty in the anticipated amount to be awarded.

As the determination of fair value is a matter for judicial discretion in each separate case, it also gives rise to a multiplicity of decisions and interpretations by courts. A minority shareholder, uncertain about the amount the court may consider his or her shares to be worth, may be skeptical about seeking the appraisal remedy, even in the face of a fundamental corporate change which he or she considers value-decreasing. The result is that the efficacy of the appraisal remedy is further diminished.

Some courts have, however, confronted this problem. An extensive examination of the jurisprudence in the area is contained in Re Wall and Redekop Corporation ("Wall").[265] Wall passed a resolution for its amalgamation with certain subsidiaries. B (a shareholder in Wall) dissented and gave notice of his dissent. Wall then served notice on B of its intention to act upon the authority of the said special resolution and demand B sell his shares to it. Subsequently, an application to the court for determination of the fair value of the shares was made. Mr. Justice Macfarlane declined to hold that fair value must mean market value. He agreed that market value was one of the factors to be weighed in determining fair value but did not think it was the sole or only factor and, in particular, did not think it likely to represent fair value in the case at hand. He based this view on the fact that though the company was publicly-traded there had been very little trading in its shares and referred the issue of valuation to a referee. He listed three points for the referee in determining the value of the shares: (a) their fair cash value is the

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[265] Id.

amount of money the shares would most probably exchange freely for between a buyer and a seller, having full knowledge about the corporate facilities and the continuation of the business enterprise. (b) the basic concept of the appraisal is that the dissenting stockholders are to be paid for their proportionate interest in a going concern and. (c) the appraisers were to consider and weigh as they deem fit, in their expert opinion, all the factors which bear upon the fair cash value of the shares as defined by the court.

In more recent cases, the courts have interpreted the phrase "fair value" in a manner which advances the remedy provided by the appraisal right. For instance, in Domlas v. Jarislowsky, Fraser and Co.,[266] the petitioner, D Inc., a public company formed by amalgamation under the Canada Business Corporations Act, applied under section 184 (15) of the Canada Business Corporations Act for a fixing of the fair value of the shares of the dissenting minority shareholders of DLtee, one of the amalgamating corporations. The petition was following the non-arm's length vertical amalgamation of DLtee with its parent corporation (CB (DG) Ltd.). Over a period of several years, the parent corporation had acquired 96.5 per cent of the outstanding common shares of DLtee by, *inter alia* a formal take-over bid and a standing bid on the Montreal and Toronto Stock Exchanges. Dividend payments on the common shares of DLtee (and the amalgamated corporation D Inc.) were suspended and earnings used for an ambitious program of diversification, acquisition, improvements and modernization. Although DLtee's shares continued to be listed, trading was minimal, and the market for the shares was established by only one significant buyer; CB (DG) Ltd. The amalgamation proposal, from which many of the minority shareholders dissented, was effected following the requisite approval by the

[266] (1980) 13 B.L.R. 135 (Que. S.C.); affd. (1982) 138 D.L.R. (3d) 521.

shareholders. It provided for the shareholders of CB (DG) Ltd. to receive one common share of D Inc. for each common share of D Ltee., and for the shareholders of D Ltee (other than CB (DG) Ltd. whose shares of D Ltee were to be cancelled) to receive one redeemable preference share of D Inc. for each common share of D Ltee, which shareholders were then "squeezed out" by the redemption of their preference shares at a price of $20.00 per share.

The Court held that the premium for forcible taking and the minority discount (as calculated by an appraiser) cancelled each other out. However, when pressed in cross-examination to reveal what percentage minority discount and what percentage premium he had calculated, the appraiser answered: "Between 25% and 30%." After weighing all the relevant principles and factors in this case, and still guided by the criteria of fairness and equity to the dissenting shareholders and without doing an injustice to the petitioner, the Court fixed and granted a 20% premium for forcible taking. When adding that premium to the fair market value of $29.94 per share, it arrived at a fair value of $35.93 per share (the Court rounded this up to $36 per share). Hence, the Court fixed a fair value, as at "the close of business on the Valuation Date, of $36.00 per share for each common share of Domglas held by the dissenting shareholders on that date." The Court further noted that:

> "The appraisal remedy should be construed and applied in a fair, large and liberal manner, so as to achieve its primary purpose of protecting and benefiting the dissenting shareholders."

The Court went on to conclude that a "fair value" would be one which was "just and equitable." The term ("fair value") contained, the Court thought, within itself the concept of adequate compensation consistent with the requirement of justice and equity.

Notwithstanding apparent willingness on the part of the courts to interpret what constitutes "fair value" in a manner that advances the efficacy of the remedy offered by the appraisal right, the basic appraisal provisions still need amendment to establish a more precise evaluation method (which will take care of such matters as the prospect of future earnings, the cost of re-investment and taxation issues).

6. Is the Appraisal Remedy an Exclusive Remedy?

The appraisal remedy gives rise to the further problem of whether or not is it exclusive? The resolution of this problem will help evaluate the adequacy of the appraisal remedy as a remedial option for minority shareholders. If the appraisal remedy is an exclusive remedy, the exercise of which forecloses other types of relief, it will be of little value to a minority shareholder for whom merely exiting the corporation might not be adequate relief. Furthermore, taking into consideration the uncertainties of the current form of the appraisal remedy, with its catalogue of procedures which demand complete and rigorous adherence, a minority shareholder should not bear the risk of losing all of his or her other rights if he or she fails to obtain relief under an appraisal provision on the ground of non-compliance with its procedures.

If the appraisal remedy is not an exclusive remedy minority shareholders could apply for it simultaneously with their seeking other relief. In another sense, such a course would appear beneficial to the minority shareholder; claiming more than one form of relief in the same cause of action reduces litigation costs involved in separate actions, as well as increasing the likelihood of obtaining at least one form of relief.

The Canada Business Corporations Act states that the appraisal right is in addition to any other rights which the shareholders may have.[267] This implies that a minority shareholder may bring an action under section 190 simultaneously with another action, for instance under the oppression remedy. The matter does not end there, however, because subsection 190(11) of the Canada Business Corporations Act and subsection 207(7)[268] of the B.C. Company Act both provide that upon sending a demand for payment to the corporation, the dissenting shareholder ceases to have any rights as a shareholder other than the right to be paid the fair value of his or her shares.

Although the statutes try to mitigate the problem of the exclusion of other remedies by providing a right of application to the court for the determination of a fair value for the shares, another important question arises as to what happens if, during the interval when the shareholder is awaiting a court's ruling on the determination of what constitutes a fair value for his or her shares, the corporation decides to issue bonus shares or pay dividends to other members and excludes the dissenting shareholder from this benefit? Again, the corporation presumably cannot argue that once a demand is made on the corporation, the rights of a dissenting shareholder, as a member, are extinguished altogether. Ideally, the rights attached to membership of the corporation should run until the member receives fair value for his or her shares. Prior to this time, it would be unfair on the minority shareholder to deny him or her any entitlement in his or her capacity as a member, merely on the basis of an indicated "intention" not to go along with the corporation with respect to certain fundamental corporate changes.

[267] Section 190(3).
[268] A dissenting shareholder may assert his rights as creditor until he is paid in full.

The B.C. Company Act does not contain any detailed provision but simply states that:

> "Every dissenting member who has complied with subsection (3) .. (a) may not vote, or exercise or assert any rights of a member, in respect of the shares for which notice of dissent has been given, other than under this section, (b) may not withdraw the requirement to purchase the shares, unless the company consents, and (c) until the dissenting member is paid in full, may exercise and assert all the rights of a creditors of the company."[269]

Judicial opinion is divided on the issue of the exclusivity of the appraisal remedy. In McConnell v. Newco Financial Corporation,[270] minority shareholders brought a petition under section 241[271] of the Canada Business Corporations Act challenging the passing of an extraordinary resolution consolidating the corporation's shares on a basis of 1,000 to one. The petition was resisted by the corporation because, long before the section 241 action was commenced, the minority shareholders had sent notice under section 190 requiring the company to purchase their shares at fair value. The corporation argued that the shareholders had, thereafter, ceased to have any rights other than the right to receive a fair value for their shares. The shareholders were allowed to continue with the action under section 241 on a technicality. The notices sent under section 190 were held invalid and did not therefore bar the availability of the appraisal remedy.

While this decision avoided the question of the exclusiveness of the appraisal remedy, the matter was dealt directly in the Ontario case of Re Brant Investments Ltd. v. Keeprite Inc.[272] A meeting was called to vote upon Keeprite Inc's ("Keeprite") proposal to purchase substantially all of the assets and business of I.C.G. Manufacturing Ltd.

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[269] Section 207(7)(a).
[270] (1979) 8 B.L.R. 180 (B.C.S.C.).
[271] This section provides for the oppression remedy (S.C. 1994, c-24).
[272] (1983) 44 O.R. (2d) 661.

("I.G.C.") for approximately $ 20 million. I.C.G coincidentally was the owner of 65% of the outstanding shares of Keeprite. Brant Investments Ltd. ("Brant") the owner of 28% of Keeprite's shares, voted against the resolution and then exercised its right to dissent under section 190 of the Canada Business Corporations Act. There was a disagreement as to the fair value of the shares and an application was brought to the Court. While the determination of the fair value of the shares was pending, Keeprite decided to make a rights offering, the proceeds of which would finance the assets purchase. Brant brought a motion for interim and permanent relief alleging that the proposed acquisition of I.C.G. was for an amount in excess of fair market value and had been made without full disclosure. Keeprite urged subsection 190(11)(cf, B.C. Company Act s. 207(7)) upon the Court.

While acknowledging the force of that subsection, the Court stressed that subsection 190(11) must be interpreted in the light of the object and purpose of all of the provisions of section 190. The Court thought the appraisal remedy was a contingent remedy, since the corporation would only be permitted to pay the dissenters if it met the liquidity and solvency requirements of the section. If it could not meet those requirements, the dissenting shareholders would have the right to withdraw their dissent and would retain their rights as shareholders. Further, subsection 190(3) states that the appraisal remedy is in addition to any other rights the shareholders may have. A remedy with such characteristics, the court reasoned, was not intended to preclude the broad rights of the oppression remedy. The Court pointed to the very short period of time within which the shareholder was required to send in his demand for payment of the fair value for his shares. He could not reasonably be expected, the Court thought, to be able to make an intelligent choice between invoking the remedies in section 190 or section 241 (oppression) in such a short time.[273] The writer submits that the reasoning in Brant is a sound judicial interpretation of this aspect of the appraisal provisions.[274] Academic opinion also favors the non-exclusiveness of the appraisal remedy. Professor Vorenberg, in his leading article, succinctly summarizes the disadvantages to the dissenting shareholder on relying exclusively on the appraisal remedy as follows;

> "Resort to appraisal will, even under the best of the statutory procedures, often give the stockholder less than his stock is worth. Failure to comply with statutory provisions may deprive him of his uncertainty, with expenses which may cut into his recovery. The valuation process itself may involve a significant financial sacrifice. The nub of the problem is that an absolute freeze-out right would mean that those in control rather than the stockholder himself would decide when he should sell his stock. Far more difficult is ensuring to departing stockholders the benefit of improvement prospects, where, at the time of appraisal, the evidence of improvement is more intuitive than tangible. The appraisal process will tend to produce conservative results where the values are speculative, and the majority's power to pick the time at which to trigger appraisal may encourage them to move when full values may be temporarily obscured."[275]

Thus, the appraisal remedy ought not to be considered as an exclusive option for minority shareholders. It should be looked upon as merely one option that is available to an aggrieved minority shareholder. Legislative amendments may be necessary in this regard, to clarify the ambiguity of subsections 190(3) and 190(11) of the Canada Business Corporations Act, and in the case of the B.C. Company Act, to make it clear

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[273] The same reasons were stated by Laycraft, J. in Jepson, supra, note 247, allowing the petitioner to go ahead with a request to sue the defendant corporation though there had been failure to comply with certain procedural aspects of the Act(s. 184 of the Canada Business Corporations Act)

[274] In the United States, the Delaware Supreme Court considered the pursuit by a shareholder of the concurrent remedies of appraisal and a challenge of the terms of a cash-out merger on the basis of breach of fiduciary duty. The decision of the Court is the first which recognizes that a shareholder may pursue independently, appraisal and fraud actions. See Cede & Co. v. Technicolor Inc. (1988) 542 A. 2d. 1182.

[275] Vorenberg, "Exclusiveness of the Dissenting Shareholder's Appraisal Remedy", (1964) 77 Harv. L. Rev. 1189 at 1201 -2.

that the appraisal right is not an exclusive remedy. Making the appraisal right available simultaneously with other remedies will only enhance the adequacy of the appraisal remedy.

7. Observations and comments on the Appraisal Remedy under the British Columbia Company Act

The discussion of the appraisal remedy will be concluded here with a few comments on the overall efficacy of the appraisal remedy under the B.C. Company Act and will avoid the Canada Business Corporations Act and other statutes for the sake of brevity. The introduction of the appraisal remedy into the B.C. Company Act was designed to supplement existing remedies already available to minority shareholders.[276] The appraisal remedy was designed to strike an appropriate balance between majority and minority shareholders when there is a need to allow the majority to effect fundamental change in the corporation but also give the minority shareholders an option to leave the company when such change is unacceptable to them. This kind of protection is also needed in the case of unwise business decisions that threaten to diminish security values and in the case of discriminatory treatment of shareholders. The current form of the statutory appraisal remedy in British Columbia suffers from serious procedural, costs and other practical limitations that render it a less attractive remedial option than was originally envisaged.[277]

Another specific shortcoming of the provision is that the current tax treatment of the proceeds of the dispositions resulting from an appraisal is entirely unsatisfactory. The

[276] Like the derivative action, the winding-up order, and the oppression remedy.
[277] Supra, note 236.

burden of tax on the appraised proceeds overshadows any advantage the dissenter obtains from the application of the remedy. There is a bias in taxation treatment as the non-dissenters who remain in the corporation when a fundamental change takes place do not incur tax liability, whereas the dissenter who leaves the corporation under forced circumstances is prejudiced by the imposition of tax on his supposedly less productive capital.

The other problematic aspects of the appraisal remedy are the rigorous, technical, lengthy, and time-limited procedures that the dissenting minority has to flawlessly follow in the shortest allotted time. This procedure, with its associated requirements, acts more like a minefield than a protective shield for dissenting minority shareholders.[278] The remedy is further complicated by the non-availability of a statutorily provided precise or standard method of valuation of the shares of the dissenting shareholders. This lack of a standard method of valuation makes the appraisal remedy a high-risk area into which only few dissenting minority shareholders may venture. The costs of re-investment are another detrimental factor in regard to the efficacy of the appraisal remedy.

Whatever the potential attractions inherent in the appraisal right, unless it can be made to work in practice, it cannot fulfill its promise. Many procedural and other limitations seriously affect the adequacy of the right in its current form. Amendments can be made to the procedural provisions that could improve its efficacy. Any change in this direction would definitely have the effect of reducing the uncertainties currently associated with the exercise of the remedy. Minority shareholders would benefit from any improvements which would make the appraisal right more attractive.

[278] Especially when the appraisal right is considered an exclusive right.

If the appraisal right is to be an effective remedy for minority shareholders, there is an urgent need for legislative reform on the issue of taxation policy,[279] the procedural aspects of the remedy, the valuation of shares and the costs on re-investment.[280] New legislation is recommended as the courts have already done seemingly all that is possible within their powers. The appraisal right in the B.C. Company Act needs thorough revision, with special emphasis on relaxing the technicalities involved and shortening the mandatory procedural steps.

8. Corporate Structures in Bhutan and the Scope for the Appraisal Remedy as a form of Relief for Minority Shareholders

In Bhutan as seen in the preceding chapters, there are two broad categories of companies; public companies and private companies. The character of these companies will not be discussed again here but the applicability of the appraisal remedy to them will be investigated.

8.1. Arguments in favor of an Appraisal Remedy for Minority Shareholders in Bhutanese Public Companies

Bhutan still lacks efficient stock markets, so dissenting shareholders (either in private or public companies) cannot easily sell their shares in the market and expect to earn a satisfactory return on their investment. The shares of companies are usually very

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[279] This restructure could only be done by the federal Government as taxation is within federal jurisdiction; Constitution Act, s. 91.

[280] The problem of cost on re-investment may not be due to legislative shortcomings as it is something which market forces may decide. However, given the inadequacy or non-existence of the market for shares of closely-held corporations, it may need to be addressed in legislation as suggested by some writers, like Professor J.G. MacIntosh.

thinly traded[281] and there is always a risk of short-run fluctuations in the market price of shares. As discussed earlier, the appraisal right should be considered an economic substitute for the stock exchange, and its use should be limited to situations in which an exchange or some kind or a reasonable objective share market is not available. This argument justifies the need for appraisal rights to protect minority shareholders in Bhutanese public companies, as the Bhutanese stock market has still to gain size and efficiency. Even in the presence of the market exit option, the appraisal remedy may still be necessary for the following reasons. First, large shareholders who are forced to sell quickly to escape fundamental corporate changes may realize an inferior price in the market because of the hurried liquidation of a large block of shares. Second, all shareholders, whether large or small, may only be able to realize a price that already reflects the market's[282] anticipation of the effect of the fundamental change.

It is recommended that until an efficient share market[283] comes into being the appraisal remedy should be available to minority shareholders of public companies in Bhutan. Further, since it seems that the appraisal remedy fits well in developed economies like Canada, it could be argued that the appraisal remedy should be made available to minority shareholders of Bhutanese public companies even after the stock market in Bhutan gains in efficiency. The mere existence of such markets overall does not preclude the possibility of situations where, such as thin trading, their apparent benefits may not exist.

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[281] The concept of a stock market was first introduced in Bhutan in the 1980's with the establishment of the Royal Security Exchange of Bhutan.
[282] Though inefficient, the stock market keeps operating.
[283] Supra, note 99.

If the appraisal remedy is not made a part of the Company Act in Bhutan, shareholders might be forced into applying for winding-up on the just and equitable ground. This would, in many cases, be a too drastic remedy in the light of the actual circumstances. While an appraisal of the petitioner's shares can be ordered in the context of the oppression remedy it is discretionary. The availability of an appraisal remedy would ensure the ability of a shareholder to sell his or her shares when a fundamental change takes place but the corporation can continue on as a viable enterprise.

8.2. The Need for the Appraisal Remedy for Minority Shareholders in Bhutanese Private Companies:

Shareholders in private companies, for which there exists no liquid market for their shares, need the appraisal remedy to protect them in the event of fundamental changes. A large part of a dissenting minority shareholders' wealth (including their employment) may be tied up in the company, but there may be no reliable market exit option available. Private contractual arrangements may not cover all possible eventualities due to the inherent human inability to foresee all future contingencies. Shares of closely-held companies will generally be difficult to sell (no public market for their shares) and be subject to strict transfer restrictions reflecting the quasi-partnership status of many private companies. On this basis, the exit option provided by the appraisal right provides an important protection for minority shareholders in private companies against the dangers of shifts in the risks of the enterprise.

8.3. Summary

The appraisal remedy could be an important aspect of the overall protection of minority shareholders in Bhutanese companies. This is especially true since Bhutan lacks efficient stock markets where shareholders can trade their shares. This remedy should apply in the case of both private and public companies. For the appraisal remedy to benefit dissenting minority shareholders, it must avoid being subject to the same problems[284] as have arisen under the version contained in the B.C. Company Act. Therefore, an appraisal remedy for the Bhutan Company Act should, *inter alia,* address the issues of:

(a) The concurrent availability of other forms of minority relief (such as the oppression remedy),

(b) Formulae for valuation of shares and simplification of procedural issues,

(c) Taxation consequences

If these, and other matters, are sensibly addressed the appraisal remedy should prove a useful adjunct to an overall scheme for the protection of minority shareholders in Bhutanese companies.

[284] Including problems with tax, procedures, and valuation of shares, to name a few.

CHAPTER SIX

COCLUSION

This thesis has examined the basis for a selection of statutory remedies directed at the needs of minority shareholders in both closely and widely-held corporations. Minority shareholders seem to be perpetually vulnerable to the risks of various degrees of prejudice to their interests on the part of the majority (usually in the form of the board of directors). Their entitlement to relief, however, has to take into account the voluntaryness of their position and general need for majority-rule in regard to the business activities of the corporation.

The common law began by seeing pre-emptive contractual provisions (both in the corporate charter and in extraneous agreements) as most suitable for addressing minority concerns. This approach was reinforced by pointing to market forces which were thought to work, at least theoretically, in favor of investors. This approach played-out differently depending on the type of corporation involved. In the case of closely-held corporations it was more realistic to envisage arms-length contracts being drawn-up between relatively equal parties. The usual scenario here is of a wealthy investor who lacks managerial skills or interest but has the resources to protect herself in advance through well-chosen contractual language. This model does not work well for widely-held corporations where there are often a multitude of small investors. In an ideal world these investors can sell their shares if they are fearful of management but a healthy share market does not always exist that will enable them to do so. Preliminary contractual arrangements are not feasible in widely-held corporations but market forces are present that many argue make up for the risks investors as individuals cannot protect themselves against.

The common law courts, in countries like England, Canada and the United States, were, for a long time, unwilling to aggressively develop rules to enhance minority shareholder protection. This reluctance derived from a number of factors. The *laissez-faire* approach in the law of contract fed into the business judgment rule and justified a lack of judicial interference in internal corporate affairs. Courts also believed that they lacked the expertise to evaluate what were mostly disagreements about purely business matters. Since corporations were creatures of statute, the courts thought the rules applicable to them were best developed by legislatures and not by the courts.

As the corporation became a universal form of business association the assumptions underlying these early approaches became questionable. The logic of reliance on contractual mechanisms became less credible once the inability to foresee every future eventuality was recognized and the costs of such mechanisms became evident. The adequacy of market forces was also brought into question. The costs of acquiring information and other transaction costs were seen as undermining the credibility of reliance on market forces. The market alone cannot guarantee a one-time divergence from optimum standards on the part of management.

Beginning in the 1930's and continuing, in Canada, into the 1980's, a series of law reform reports began to recommend the introduction of new forms of statutory protection for minority shareholders. In most cases, these recommendations were quickly implemented and created a kind of momentum for more change. Beginning with the introduction of a revised form of the winding-up provision, and quickly introducing the oppression remedy, this momentum led to a statutory form of the derivative action and the establishment of the appraisal remedy. These multiple remedies played-off one another, so that a shareholder for whom one remedy was unsuitable might resort to another.

Once again, however, the limits on these various forms of relief became apparent over time. The costs of litigation were often a significant deterrent and procedural and technical aspects of the various statutory remedies emerged. These limitations were gradually exposed by developing jurisprudence in Canada and elsewhere.

This thesis has surveyed four distinct statutory forms of relief for minority shareholders and critically analyzed the strengths and weakness of all of them. It proposes that all would be suitable for inclusion in a revised Company Act in Bhutan. This conclusion and recommendation is based on two principal grounds. First, there is a gap in the Bhutan Act in respect to the availability of remedies for minority shareholders in Bhutanese companies and the versions of the four remedies that exist in Canada have the advantage of having been amended and improved upon over a lengthy period of time. Second, if the Canadian forms of statutory protection for minority shareholders were adopted in Bhutan, Bhutanese courts would be able to study Canadian case-law interpreting these remedies and adopt the parts of it considered appropriate for the situation of companies in Bhutan.

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