Court File No. CV-13-10279-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO GROWTHWORKS CANADIAN FUND LTD.

BOOK OF AUTHORITIES

October 26, 2015

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TAB 1

Case Name:

4519922 Canada Inc. (Re)

**IN THE MATTER OF the Companies' Creditors
Arrangement Act, R.S.C. 1985,
C.C-36 as Amended
AND IN THE MATTER OF a Plan of Compromise
or Arrangement of 4519922 Canada
Inc.**

[2015] O.J. No. 115

2015 ONSC 124

2015 CarswellOnt 178

249 A.C.W.S. (3d) 508

22 C.B.R. (6th) 44

Court File No.: CV-1410791-00CL

Ontario Superior Court of Justice
Commercial List

F.J.C. Newbould J.

Heard: December 8, 2014; January 6, 2015.
Judgment: January 12, 2015.

(81 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Applications -- Initial applications -- Motion by Chrysler Canada to set aside Initial Order under Companies' Creditors Arrangement Act dismissed -- Initial Order extended its protection to CLCA of which debtor was a partner and to CLCA's insurers, and stayed outstanding litigation during pendency of these proceedings -- Chrysler had very large claim against CLCA in the outstanding litigation -- Debtor was insolvent -- Not extending stay to CLCA and the Castor litigation would significantly impair the effectiveness of the stay in respect of the debtor.

Motion by Chrysler Canada to set aside an Initial Order granting the numbered company protection under the Companies' Creditors Arrangement Act. The initial order extended its protection to Coopers & Lybrand (CLCA), of which the debtor was a partner and to CLCA's insurers, and stayed outstanding litigation relating to Castor Holdings Limited during the pendency of these proceedings. As a partner of CLCA, the debtor was liable as a principal for the partnership's debts incurred while it was a partner. Chrysler had a very large claim against CLCA in the outstanding litigation and had not been given notice of the application for the iniial order. Chrysler argued that the debtor had not established that it was insolvent. The only asset of the debtor on its balance sheet was its investment of $100 in CLCA. At the time of the granting of the Initial Order, the proposed Monitor stated in its report that the applicant was insolvent based on its review of the financial affairs of the debtor and CLCA.

HELD: Motion dismissed.. The debtor was insolvent. It was highly likely that the $100 investment of the debtor in CLCA was worthless and unable to fund debtor's current and future obligations caused by the CLCA litigation. If the stay against the debtor contained in the Initial Order was maintained, it should extend to CLCA and the outstanding Castor litigation. The affairs of the applicant and CLCA were clearly intertwined. Not extending the stay to CLCA and the Castor litigation would significantly impair the effectiveness of the stay in respect of the debtor. CLCA was a necessary party to achieve a resolution of the outstanding litigation and significant contributions from its interest in another company and from its former partners were anticipated under the term sheet in exchange for releases to be provided to them. Chrysler's contingent claim was not scheduled to be tried until 2017 at the earliest, and it would likely still proceed to trial as scheduled if a global resolution could not be achieved in the course of the present proceeding. Since Chrysler had not obtained a judgment or settlement in respect of its contingent claim, the Initial Order had not stayed any immediate right available to Chrysler.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3,

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2(1)(a), s. 3(1)

Counsel:

Robert I. Thornton, John T. Porter, Lee M. Nicholson and Asim Iqbal, for the Applicant.

Harry M. Fogul, for 22 former CLCA partners.

Orestes Pasparakis and Evan Cobb, for the Insurers.

Avram Fishman and Mark Meland, for the German and Canadian Bank Groups, the Widdrington Estate and the Trustee of Castor Holdings Limited.

James H. Grout, for 22 former CLCA partners.

Chris Reed, for 8 former CLCA partners.

Andrew Kent, for 5 former CLCA partners.

Richard B. Jones, for one former CLCA partner.

John MacDonald, for Pricewaterhouse Coopers LLP.

James A. Woods, Sylvain Vauclair, Bogdan Catanu and Neil Peden, for Chrysler Canada Inc. and CIBC Mellon Trust Company.

Jay A. Swartz, for the proposed Monitor Ernst & Young Inc.

ENDORSEMENT

1 F.J.C. NEWBOULD J.:-- On December 8, 2014 the applicant 4519922 Canada Inc. ("451"), applied for an Initial Order granting it protection under the *Companies' Creditors Arrangement Act* ("CCAA"), extending the protection of the Initial Order to the partnership Coopers & Lybrand Chartered Accounts ("CLCA"), of which it is a partner and to CLCA's insurers, and to stay the outstanding litigation in the Quebec Superior Court relating to Castor Holdings Limited ("Castor") during the pendency of these proceedings. The relief was supported by the Canadian and German bank groups who are plaintiffs in the Quebec litigation, by the Widdrington Estate that has a final judgment against CLCA, by the insurers of CLCA and by 22 former CLCA partners who appeared on the application.

2 The material in the application included a term sheet which the applicant wishes to use as a basis of a plan and which provides for an injection of approximately $220 million in return for a release from any further litigation. The term sheet was supported by all parties who appeared.

3 I granted the order with a stay to January 7, 2015 for reasons to follow, but in light of the fact that Chrysler Canada Inc., with a very large claim against CLCA in the litigation, had not been given notice of the application, ordered that Chrysler be given notice to make any submissions regarding the Initial Order if it wished to do so.

4 Chrysler has now moved to set aside the Initial Order, or in the alternative to vary it to delete the appointment of a creditors' committee and the provision for payment of the committee's legal fees and expenses. On the return of Chrysler's motion, a number of other former CLCA partners and PricewaterhouseCoopers appeared in support of the granting of the Initial Order.

Structure of Coopers & Lybrand Chartered Accounts

5 The applicant 451 is a corporation continued pursuant to the provisions of the *Canada Business Corporations Act,* and its registered head office is in Toronto, Ontario. It and 4519931 Canada Inc. ("4519931") are the only partners of CLCA.

6 CLCA is a partnership governed by the *Partnerships Act (Ontario)* with its registered head office located in Toronto, Ontario. It was originally established in 1980 under the name of "Coopers & Lybrand" and was engaged in the accountancy profession. On September 2, 1985, the name "Coopers & Lybrand" was changed to "Coopers & Lybrand Chartered Accountants" and the partnership continued in the accountancy profession operating under the new name. Until 1998, CLCA was a national firm of chartered accountants that provided audit and accounting services from offices located across Canada and was a member of a global network of professional firms.

7 In order to comply with the requirements of the various provincial Institutes of Chartered Accountants across Canada, many of which restricted chartered accountants providing audit services from being partners with persons who were not chartered accountants, Coopers & Lybrand Consulting Group ("CLCG") was established under the *Partnerships Act (Ontario)* in September 1985 to provide management consulting services. Concurrent with the formation of CLCG, Coopers & Lybrand ("OpCo") was established as a partnership of CLCA, CLCG and two other parties to develop and manage the CLCA audit and CLCG management consulting practices that had to remain separate. Until 1998, OpCo owned most of the operating assets of CLCA and CLCG. OpCo is governed by the Partnerships Act (Ontario) and its registered head office is in Toronto.

8 In 1998, the member firms of the global networks of each of Coopers & Lybrand and Price Waterhouse agreed upon a business combination of the two franchises. To effect the transaction in Canada, substantially all of CLCA's and CLCG's business assets were sold to PricewaterhouseCoopers LLP ("PwC"), which entity combined the operations of the Coopers & Lybrand entities and Price Waterhouse entities, and the partners of CLCA and CLCG at that time became partners of PwC. Subsequent to the closing of the PwC transaction, CLCA continued for the purpose of winding up its obligations and CLCA and CLCG retained their partnership interests in

OpCo. By 2006, all individual CLCA partners had resigned and been replaced by two corporate partners to ensure CLCA's continued existence to deal with the continuing claims and obligations.

9 Since 1998, OpCo has administered the wind up of CLCA and CLCG's affairs, in addition to its own affairs, including satisfying outstanding legacy obligations, liquidating assets and administering CLCA's defence in the Castor litigation. In conjunction with OpCo, 451 and 4519931 have overseen the continued wind up of CLCA's affairs. The sole shareholders of 451 and 4519931 are two former CLCA partners. 451 and 4519931 have no assets or interests aside from their partnership interests in CLCA.

Castor Holdings litigation

10 Commencing in 1993, 96 plaintiffs commenced negligence actions against CLCA and 311 of its individual partners claiming approximately $1 billion in damages. The claims arose from financial statements prepared by Castor and audited by CLCA, as well as certain share valuation letters and certificates for "legal for life" opinions. The claims are for losses relating to investments in or loans made to Castor in the period 1988 to 1991. A critical issue in the Castor litigation was whether CLCA was negligent in doing its work during the period 1988-1991.

11 Fifty-six claims have either been settled or discontinued. Currently, with interest, the plaintiffs in the Castor litigation collectively claim in excess of $1.5 billion.

12 Due to the commonality of the negligence issues raised in the actions, it was decided that a single case, brought by Peter Widdrington claiming damages in the amount of $2,672,960, would proceed to trial and all other actions in the Castor litigation would be suspended pending the outcome of the Widdrington trial. All plaintiffs in the Castor litigation were given status in the Widdrington trial on the issues common to the various claims and the determination regarding common issues, including the issues of negligence and applicable law, was to be binding in all other cases.

13 The first trial in the Widdrington action commenced in September 1998, but ultimately was aborted in 2006 due to the presiding judge's illness and subsequent retirement. The new trial commenced in January 2008 before Madam Justice St. Pierre. A decision was rendered in April 2011 in which she held that Castor's audited consolidated financial statements for the period of 1988-1990 were materially misstated and misleading and that CLCA was negligent in performing its services as auditor to Castor during that period. She noted that that the overwhelming majority of CLCA's partners did not have any involvement with Castor or the auditing of the financial statements prepared by Castor.

14 The decision in the Widdrington action was appealed to the Quebec Court of Appeal which on the common issues largely upheld the lower court's judgment. The only common issue that was overturned was the nature of the defendant partners' liability. The Quebec Court of Appeal held that under Quebec law, the defendant partners were severally liable. As such, each individual defendant partner is potentially and contingently responsible for his or her several share of the damages suffered by each plaintiff in each action in the Castor litigation for the period that he or she was a partner in the years of the negligence.

15 On January 9, 2014, the defendants' application for leave to appeal the Widdrington decision to the Supreme Court of Canada was dismissed.

16 The Widdrington action has resulted in a judgment in the amount of $4,978,897.51, inclusive of interest, a cost award in the amount of $15,896,297.26 plus interest, a special fee cost award in the amount of $2.5 million plus interest, and a determination of the common issue that CLCA was negligent in performing its services as auditor to Castor during the relevant period.

17 There remain 26 separate actions representing 40 claims that have not yet been tried. Including

interest, the remaining plaintiffs now claim more than $1.5 billion in damages. Issues of causation, reliance, contributory negligence and damages are involved in them.

18 The Castor Litigation has given rise to additional related litigation:

(a) Castor's trustee in bankruptcy has challenged the transfer in 1998 of substantially all of the assets used in CLCA's business to PwC under the provisions of Quebec's bulk sales legislation. As part of the PwC transaction, CLCA, OpCo and CLCG agreed to indemnify PwC from any losses that it may suffer arising from any failure on the part of CLCA, OpCo or CLCG to comply with the requirements of any bulk sales legislation applicable to the PwC transaction. In the event that PwC suffers any loss arising from the bulk sales action, it has the right to assert an indemnity claim against CLCA, OpCo and CLCG.

(b) Certain of the plaintiffs have brought an action against 51 insurers of CLCA. They seek a declaration that the policies issued by the insurers are subject to Quebec law. The action would determine whether the insurance coverage is costs-inclusive (i.e. defence costs and other expenses are counted towards the total insurance coverage) or costs-in-addition (i.e. amounts paid for the defence of claims do not erode the policy limits). The insurers assert that any insurance coverage is costs-inclusive and has been exhausted. If the insurers succeed, there will be no more insurance to cover claims. If the insurers do not succeed and the insurance policies are deemed to be costs-in-addition, the insurers may assert claims against CLCA for further premiums resulting from the more extensive coverage.

(c) The claim against the insurers was set to proceed to trial in mid-January 2015 for approximately six months. CLCA is participating in the litigation as a mis-en-cause and it has all the rights of a defendant to contest the action and is bound by the result. As a result of the stay in the Initial Order, the trial has been put off.

(d) There have been eight actions brought in the Quebec Superior Court challenging transactions undertaken by certain partners and parties related to them (typically a spouse) (the "Paulian Actions").

(e) There is a pending appeal to the Quebec Court of Appeal involving an order authorizing the examination after judgment in the Widdrington action of Mr. David W. Smith.

19 The next trial to proceed against CLCA and the individual partners will be in respect of claims made by three German banks. It is not expected to start until at the least the fall of 2015 and a final determination is unlikely until 2017 at the earliest, with any appeals taking longer. It is anticipated that the next trial after the three German banks trial will be in respect of Chrysler's claim. Mr. Woods, who acts for Chrysler, anticipates that it will not start until 2017 with a trial decision perhaps being given in 2019 or 2020, with any appeals taking longer. The remaining claims will not proceed until after the Chrysler trial.

20 The fees incurred by OpCo and CLCA in the defence of the Widdrington action are already in excess of $70 million. The total spent by all parties already amounts to at least $150 million. There is evidence before me of various judges in Quebec being critical of the way in which the defence of the Widdrington action has been conducted in a "scorched earth" manner.

Individual partner defendants

21 Of the original 311 defendant partners, twenty-seven are now deceased. Over one hundred and fifty are over sixty-five years of age, and sixty-five more will reach sixty-five years of age within five years. There is a dispute about the number of defendant partners who were partners of CLCA at the material time. CLCA believes that twenty-six were wrongly named in the Castor litigation (and most have now been removed), a further three were named in actions that were subsequently discontinued, some were partners for only a portion of the 1988-1991 period and some were named in certain actions but not others. Six of the defendant partners have already made assignments in bankruptcy.

Analysis

(i) Applicability of the CCAA

22 Section 3(1) of the CCAA provides that it applies to a debtor company where the total claims against the debtor company exceed $5 million. By virtue of section 2(1)(a), a debtor company includes a company that is insolvent. Chrysler contends that the applicant has not established that it is insolvent.

23 The insolvency of a debtor is assessed at the time of the filing of the CCAA application. While the CCAA does not define "insolvent", the definition of "insolvent person" under the *Bankruptcy and Insolvency Act* is commonly referred to for guidance although the BIA definition is given an expanded meaning under the CCAA. See Holden, Morawetz & Sarra, *the 2013-2014 Annotated Bankruptcy and Insolvency Act* (Carswell) at Ns.12 and *Re Stelco Inc*. (2004), 48 C.B.R. (4th) 299 (per Farley J.) ; leave to appeal to the C of A refused 2004 CarswerllOnt 2936 (C.A.).

24 The BIA defines "insolvent person" as follows:

> "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

25 The applicant submits that it is insolvent under all of these tests.

26 The applicant 451 is a debtor company. It is a partner of CLCA and is liable as a principal for the partnership's debts incurred while it is a partner.

27 At present, CLCA's outstanding obligations for which the applicant 451 is liable include: (i) various post-retirement obligations owed to former CLCA partners, the present value of which is approximately $6.25 million (the "Pre-71 Entitlements"); (ii) $16,026,189 payable to OpCo on account of a loan advanced by OpCo on October 17, 2011 to allow CLCA to pay certain defence costs relating to the Castor litigation; (iii) the Widdrington costs award in the amount of $18,783,761.66, inclusive of interest as at December 1, 2014, which became due and payable to the plaintiff's counsel on November 27, 2014; (iv) the special fee in the amount of $2,675,000, inclusive of interest as at December 1, 2014, awarded to the plaintiff's counsel in the Widdrington action; and (v) contingent

liabilities relating to or arising from the Castor litigation, the claims of which with interest that have not yet been decided being approximately $1.5 billion.

28 The only asset of the applicant 451 on its balance sheet is its investment of $100 in CLCA. The applicant is a partner in CLCA which in turn is a partner in OpCo. At the time of the granting of the Initial Order, Ernst & Young Inc., the proposed Monitor, stated in its report that the applicant was insolvent based on its review of the financial affairs of the applicant, CLCA and OpCo.

29 Mr. Peden in argument on behalf of Chrysler analyzed the balance sheets of CLCA and OpCo and concluded that there were some $39 million in realizable assets against liabilities of some $21 million, leaving some $18 million in what he said were liquid assets. Therefore he concluded that these assets of $18 million are available to take care of the liabilities of 451.

30 I cannot accept this analysis. It was unsupported by any expert accounting evidence and involved assumptions regarding netting out amounts, one of some $6.5 million owing to pre-1971 retired partners, and one of some $16 million owing by CLCA to OpCo for defence costs funded by OpCo. He did not consider the contingent claims against the $6.5 million under the indemnity provided to PWC, nor did he consider that the $16 million was unlikely to be collectible by OpCo as explained in the notes to the financial statements of 451.

31 This analysis also ignored the contingent $1.5 billion liabilities of CLCA in the remaining Castor litigation and the effect that would have on the defence costs and for which the applicant 451 will have liability and a contingent liability for cost awards rendered in that litigation against CLCA. These contingent liabilities must be taken into account in an insolvency analysis under the subsection (c) definition of an insolvent person in the BIA which refers to obligations due and accruing due. In *Re Stelco, supra*, Farley J. stated that all liabilities, contingent or unliquidated, have to be taken into account. See also *Re Muscletech Research & Development Inc.* (2006), 19 C.B.R. (5th) 54 (per Farley J.).

32 It is obvious in this case that if the litigation continues, the defence costs for which the applicant 451 will have liability alone will continue and will more than eat up whatever cash OpCo may have. As well, the contingent liabilities of CLCA in the remaining $1.5 billion in claims cannot be ignored just because CLCA has entered defences in all of them. The negligence of CLCA has been established for all of these remaining cases in the Widdrington test case. The term sheet provides that the claims of the German and Canadian banks, approximately $720 million in total, and the claim of the Trustee of CLCA of approximately $108 million, will be accepted for voting and distribution purposes in a plan of arrangement. While there is no evidence before me at this stage what has led to the decision of CLCA and its former partners to now accept these claims, I can only conclude that in the circumstances it was considered by these defendants that there was exceptional risk in the actions succeeding. I hesitate to say a great deal about this as the agreement in the term sheet to accept these claims for voting and distribution purposes will no doubt be the subject of further debate in these proceedings at the appropriate time.

33 As stated, the balance sheet of the applicant 451 lists as its sole asset its investment of $100 in CLCA. The notes to the financial statements state that CLCA was indebted to OpCo at the time, being June 30, 2014, for approximately $16 million and that its only asset available to satisfy that liability was its investment in OpCo on which it was highly likely that there would be no recovery. As a result 451 would not have assets to support its liabilities to OpCo.

34 For this reason, as well as the contingent risks of liability of CLCA in the remaining claims of $1.5 billion, it is highly likely that the $100 investment of the applicant 451 in CLCA is worthless and unable to fund the current and future obligations of the applicant caused by the CLCA litigation.

35 I accept the conclusion of Ernst & Young Inc. that the applicant 451 is insolvent. I find that the applicant has established its insolvency at the time of the commencement of this CCAA proceeding.

(ii) Should an Initial Order be made and if so should it extend to CLCA?

36 The applicant moved for a stay in its favour and moved as well to extend the stay to CLCA and all of the outstanding Castor litigation. I granted that relief in the Initial Order. Chrysler contends that there should be no stay of any kind. It has not expressly argued that if a stay is granted against the applicant it should not be extended to CLCA, but the tenor of its arguments would encompass that.

37 I am satisfied that if the stay against the applicant contained in the Initial Order is maintained, it should extend to CLCA and the outstanding Castor litigation. A CCAA court may exercise its jurisdiction to extend protection by way of the stay of proceedings to a partnership related to an applicant where it is just and reasonable or just and convenient to do so. The courts have held that this relief is appropriate where the operations of a debtor company are so intertwined with those of a partner or limited partnership in question that not extending the stay would significantly impair the effectiveness of a stay in respect of the debtor company. See *Re Prizm Income Fund* (2011), 75 C.B.R. (5th) 213 per Morawetz J. The stay is not granted under section 11 of the CCAA but rather under the court's inherent jurisdiction. It has its genesis in *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 and has been followed in several cases, including *Canwest Publishing Inc.* (2010) 63 C.B.R. (5th) 115 per Pepall J. (as she then was) and *Re Calpine Energy Canada Ltd.* (2006), 19 C.B.R. (5th) 187 per Romaine J.

38 The applicant 451's sole asset is its partnership interest in the CLCA partnership and its liabilities are derived solely from that interest. The affairs of the applicant and CLCA are clearly intertwined. Not extending the stay to CLCA and the Castor litigation would significantly impair the effectiveness of the stay in respect of 451. It would in fact denude it of any force at all as the litigation costs would mount and it would in all likelihood destroy any ability to achieve a global settlement of the litigation. CLCA is a necessary party to achieve a resolution of the outstanding litigation, and significant contributions from its interest in OpCo and from its former partners are anticipated under the term sheet in exchange for releases to be provided to them.

39 Chrysler relies on the principle that if the technical requirements for a CCAA application are met, there is discretion in a court to deny the application, and contends that for several reasons the equities in this case require the application to be met. It says that there is no business being carried on by the applicant or by CLCA and that there is no need for a CCAA proceeding to effect a sale of any assets as a going concern. It says there will be no restructuring of a business.

40 Cases under the CCAA have progressed since the earlier cases such as *Hongkong Bank v. Chef Ready Foods* (1990), 4 C.B.R. (3d) 311 which expressed the purpose of the CCAA to be to permit insolvent companies to emerge and continue in business. The CCAA is not restricted to companies that are to be kept in business. See *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 at para. 33 (per Brown J. as he then was). There are numerous cases in which CCAA proceedings were permitted without any business being conducted.

41 To cite a few, in *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 54 the applicants sought relief under the CCAA principally as a means of achieving a global resolution of a large number of product liability and other lawsuits. The applicants had sold all of its operating assets prior to the CCAA application and had no remaining operating business. In *Montreal, Maine & Atlantic Canada Co. (Re)*, 2013 QCCS 3777 arising out of the Lac-Mégant train disaster, it was acknowledged that the debtor would be sold or dismantled in the course of the CCAA proceedings. The CCAA proceedings were brought to deal with litigation claims against it and others. In *Crystallex International Corp. (Re)* 2011 ONSC 7701 (Comm. List) the CCAA is currently being utilized by a company with no operating business, the only asset of which is an arbitration claim.

42 Chrysler contends, as stated in its factum, that the pith and substance of this case is not about the rescue of a business; it is to shield the former partners of CLCA from their liabilities in a manner that

should not be approved by this court. Chrysler refers to several statements by judges beginning in 2006 in the Castor litigation who have been critical of the way in which the Widdrington test case has been defended, using such phrases as "a procedural war of attrition" and "scorched earth" strategies. Chrysler contends that now that the insurance proceeds have run out and the former partners face the prospect of bearing the cost of litigation which that plaintiffs have had to bear throughout the 22-year war of attrition, the former partners have convinced the German and Canadian banks to agree to the compromise set out in the term sheet. To grant them relief now would, it is contended, reward their improper conduct.

43 Chrysler refers to a recent decision in Alberta, *Alexis Paragon Limited Partnership (Re)*, 2014 ABQB 65 in which a CCAA application was denied and a receiver appointed at the request of its first secured creditor. In that case Justice Thomas referred to a statement of Justice Romaine in *Alberta Treasury Branches v. Tallgrass Energy Corp.*, 2013 ABQB 432 in which she stated that an applicant had to establish that it has acted and is acting in good faith and with due diligence. Justice Thomas referred to past failures of the applicant to act with due diligence in resolving its financial issues and on that ground denied the CCAA application. Chrysler likens that to the manner in which the Widdrington test case was defended by CLCA.

44 I am not entirely sure what Justice Romaine precisely had in mind in referring to the need for an applicant to establish that "it has acted and is acting with good faith and with due diligence" but I would think it surprising that a CCAA application should be defeated on the failure of an applicant to have dealt with its affairs in a diligent manner in the past. That could probably said to have been the situation in a majority of cases, or at least arguably so, and in my view the purpose of CCAA protection is to attempt to make the best of a bad situation without great debate whether the business in the past was properly carried out. Did the MM&A railway in Lac-Mégantic act with due diligence in its safety practices? It may well not have, but that could not have been a factor considered in the decision to give it CCAA protection.

45 I do understand that need for an applicant to act in the CCAA process with due diligence and good faith, but I would be reluctant to lay down any fixed rule as to how an applicant's actions prior to the CCAA application should be considered. I agree with the statement of Farley J. in *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 57 that it is the good faith of an applicant in the CCAA proceedings that is the issue:

> Allegations ... of bad faith as to past activities have been made against the CCAA applicants and the Gardiner interests. However, the question of good faith is with respect to how these parties are conducting themselves in these CCAA proceedings.

46 There is no issue as to the good faith of the applicant in this CCAA proceeding. I would not set aside the Initial Order and dismiss the application on the basis of the defence tactics in the Widdrington test case.

47 The Castor litigation has embroiled CLCA and the individual partners for over 20 years. If the litigation is not settled, it will take many more years. Chrysler concedes that it likely will take at least until 2020 for the trial process on its claim to play out and then several more years for the appellate process to take its course. Other claims will follow the Chrysler claim. The costs have been enormous and will continue to escalate.

48 OpCo has dedicated all of its resources to the defence of the Castor litigation and it will continue to do so. OpCo has ceased distributions to its partners, including CLCA, in order to preserve funds for the purpose of funding the defence of the litigation. If the Castor litigation continues, further legal and other costs will be incurred by OpCo and judgments may be rendered against CLCA and its partners. If so, those costs and judgments will have to be paid by OpCo through advances from OpCo to CLCA. Since CLCA has no sources of revenue or cash inflow other than OpCo, the liabilities of

CLCA, and therefore the applicant, will only increase.

49 If the litigation is not settled, CLCA's only option will be to continue in its defence of the various actions until either it has completely depleted its current assets (thereby exposing the defendant partners to future capital calls), or a satisfactory settlement or judicial determination has been reached. If no such settlement or final determination is achieved, the cost of the defence of the actions could fall to the defendant partners in their personal capacities. If a resolution cannot be reached, the amount that will be available for settlement will continue to decrease due to ongoing legal costs and other factors while at the same time, the damages claimed by the plaintiffs will continue to increase due to accruing interest. With the commencement of further trials, the rate of decrease of assets by funding legal costs will accelerate.

50 After a final determination had been reached on the merits in the Widdrington action, CLCA's board of directors created a committee comprised of certain of its members to consider the next steps in dealing with CLCA's affairs given that, with the passage of time, the defendant partners may ultimately be liable in respect of negligence arising from the Castor audits without a settlement.

51 Over the course of several months, the committee and the defendant partners evaluated many possible settlement structures and alternatives and after conferring with counsel for various plaintiffs in the Castor litigation, the parties agreed to participate in a further mediation. Multiple attempts had earlier been made to mediate a settlement. Most recently, over the course of four weeks in September and October 2014, the parties attended mediation sessions, both plenary and individually. Chrysler participated in the mediation.

52 Although a settlement could not be reached, the applicant and others supporting the applicant believe that significant progress was achieved in the mediation. In light of this momentum, the applicant and CLCA continued settlement discussions with certain plaintiffs willing to engage in negotiations. These discussions culminated with the execution of a term sheet outlining a plan of arrangement under the CCAA that could achieve a global resolution to the outstanding litigation.

53 A CCAA proceeding will permit the applicant and its stakeholders a means of attempting to arrive at a global settlement of all claims. If there is no settlement, the future looks bleak for everyone but the lawyers fighting the litigation.

54 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It is also intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Without a stay, such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan would succeed. See *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 per Farley J.

55 In this case it would be unfair to one plaintiff who is far down the line on a trial list to have to watch another plaintiff with an earlier trial date win and collect on a judgment from persons who may not have the funds to pay a later judgment. That would be chaos that should be avoided. A recent example of a stay being made to avoid such a possibility is the case of *Re Montreal, Maine & Atlantique Canada Co.* which stayed litigation arising out of the Lac-Mégant train disaster. See also *Muscletech Research & Development Inc., Re.*

56 In this case, the term sheet that the applicant anticipates will form the basis of a proposed Plan includes, among other elements:

(a) the monetization of all assets of CLCA and its partnership OpCo to maximize the net proceeds available to fund the plan, including all applicable insurance entitlements that are payable or may become payable, which proceeds will be available to satisfy the determined or agreed claims of valid creditors;

(b) contributions from a significant majority of the defendant partners;

(c) contributions from non-defendant partners of CLCA and CLCG exposed under the PwC indemnity;

(d) contributions from CLCA's insurers and other defendants in the outstanding litigation;

(e) the appointment of Ernst & Young Inc. as Monitor to oversee the implementation of the plan, including to assist with the realization and monetization of assets and to oversee (i) the capital calls to be made upon the defendant partners, (ii) a claims process, and (iii) the distribution of the aggregate proceeds in accordance with the plan; and

(f) provision to all parties who contribute amounts under the plan, of a court-approved full and final release from and bar order against any and all claims, both present and future, of any kind or nature arising from or in any way related to Castor.

57 This term sheet is supported by the overwhelming number of creditors, including 13 German banks, 8 Canadian banks, over 100 creditors of Castor represented by the Trustee in bankruptcy of Castor and the Widdrington estate. It is also supported by the insurers. The plaintiffs other than Chrysler, representing approximately 71.2% of the face value of contingent claims asserted in the outstanding litigation against CLCA, either support, do not oppose or take no position in respect of the granting of the Initial Order. Chrysler represents approximately 28.8% of the face value of the claims.

58 Counsel for the German and Canadian banks points out that it has been counsel to them in the Castor claims and was counsel for the Widdrington estate in its successful action. The German and Canadian banks in their factum agree that during the course of the outstanding litigation over the past 20 years, they have been subjected to a "scorched earth", "war of attrition" litigation strategy adopted by CLCA and its former legal counsel. Where they seriously part company with Chrysler is that they vigorously disagree that such historical misconduct should prevent the CLCA group from using the CCAA to try to achieve the proposed global settlement with their creditors in order to finally put an end to this war of attrition and to enable all valid creditors to finally receive some measure of recovery for their losses.

59 It is argued by the banks and others that if Chrysler is successful in defeating the CCAA proceedings, the consequence would be to punish all remaining Castor plaintiffs and to deprive them of the opportunity of arriving at a global settlement, thus exacerbating the prejudice which they have already suffered. Chrysler, as only one creditor of the CLCA group, is seeking to impose its will on all other creditors by attempting to prevent them from voting on the proposed Plan; essentially, the tyranny of the minority over the majority. I think the banks have a point. The court's primary concern under the CCAA must be for the debtor and all of its creditors. While it is understandable that an individual creditor may seek to obtain as much leverage as possible to enhance its negotiating position, the objectives and purposes of a CCAA should not be frustrated by the self-interest of a single creditor. See *Calpine Canada Energy Ltd., Re,* 2007 ABCA 266, at para 38, per O'Brien J.A.

60 The German and Canadian banks deny that their resolve has finally been broken by the CLCA in its defence of the Castor litigation. On the contrary, they state a belief that due to litigation successes achieved to date, the time is now ripe to seek to resolve the outstanding litigation and to prevent any further dissipation of the assets of those stakeholders funding the global settlement. Their counsel expressed their believe that if the litigation continues as suggested by Chrysler, the former partners will likely end up bankrupt and unable to put in to the plan what is now proposed by them. They see a change in the attitude of CLCA by the appointment of a new committee of partners to oversee this application and the appointment of new CCAA counsel in whom they perceive an attitude to come to a resolution. They see CLCA as now acting in good faith.

61 Whether the banks are correct in their judgments and whether they will succeed in this attempt remains to be seen, but they should not be prevented from trying. I see no prejudice to Chrysler. Chrysler's contingent claim is not scheduled to be tried until 2017 at the earliest, and it will likely still proceed to trial as scheduled if a global resolution cannot be achieved in the course of this CCAA proceeding. Further, since Chrysler has not obtained a judgment or settlement in respect of its contingent claim, the Initial Order has not stayed any immediate right available to Chrysler. The parties next scheduled to proceed to trial in the outstanding litigation who have appeared, the insurers and then the three German banks, which are arguably the most affected by the issuance of a stay of proceedings, have indicated their support for this CCAA proceeding and Initial Order, including the stay of proceedings.

62 What exactly Chrysler seeks in preventing this CCAA application from proceeding is not clear. It is hard to think that it wants another 10 years of hard fought litigation before its claim is finally dealt with. During argument, Mr. Vauclair did say that Chrysler participated in the unsuccessful mediation and that it has been willing to negotiate. That remains to be seen, but this CCAA process will give it that opportunity.

63 Chrysler raises issues with the term sheet, including the provision that the claims of the German and Canadian banks and the Trustee of Castor will be accepted but that the Chrysler claim will be determined in a claims process. Chrysler raises issues regarding the proposed claims process and whether the individual CLCA former partners should be required to disclose all of their assets. These issues are premature and can be dealt with later in the proceedings as required.

64 Mr. Kent, who represents a number of former CLCA partners, said in argument that the situation cries out for settlement and that there are many victims other than the creditors, namely the vast majority of the former CLCA partners throughout Canada who had nothing to do with the actions of the few who were engaged in the Castor audit. The trial judge noted that the main CLCA partner who was complicit in the Castor Ponzi scheme hid from his partners his relationships with the perpetrators of the scheme.

65 Mr. Kent's statement that the situation cries out for settlement has support in the language of the trial judge in the Widdrington test case. Madame Justice St. Pierre said in her opening paragraph on her lengthy decision:

> **1** Time has come to put an end to the longest running judicial saga in the legal history of Quebec and Canada.

66 At the conclusion of her decision, she stated:

> **3637** Defendants say litigation is far from being finished since debates will continue on individual issues (reliance and damages), on a case by case basis, in the other files. They might be right. They might be wrong. They have to remember that litigating all the other files is only one of multiple options. Now that the litigants have on hand answers to all common issues, resolving the remaining conflicts otherwise is clearly an option (for example, resorting to alternative modes of conflict resolution).

67 In my view the CCAA is well able to provide the parties with a structure to attempt to resolve the outstanding Castor litigation. The Chrysler motion to set aside the Initial Order and to dismiss the CCAA application is dismissed.

(iii) Should the stay be extended to the insurers?

68 The applicant 451 moves as well to extend the stay to the insurers of CLCA. This is supported by the insurers. The trial against the insurers was scheduled to commence on January 12, 2015 but after the Initial Order was made, it was adjourned pending the outcome of the motion by Chrysler to set aside the Initial Order. Chrysler has made no argument that if the Initial Order is permitted to stand that it should be amended to remove the stay of the action against the insurers.

69 Under the term sheet intended to form the basis of a plan to be proposed by the applicant, the insurers have agreed to contribute a substantial amount towards a global settlement. It could not be expected that they would be prepared to do so if the litigation were permitted to proceed against them with all of the costs and risks associated with that litigation. Moreover, it could well have an effect on the other stakeholders who are prepared to contribute towards a settlement.

70 A stay is in the inherent jurisdiction of a court if it is in the interests of justice to do so. While many third party stays have been in favour of partners to applicant corporations, the principle is not limited to that situation. It could not be as the interests of justice will vary depending on the particulars of any case.

71 In *Re Montreal, Maine & Atlantique Canada Co.*, Castonguay, J.C.S. stayed litigation against the insurers of the railway. In doing so, he referred to the exceptional circumstances and the multiplicity of proceedings already instituted and concluded it was in the interests of sound administration of justice to stay the proceedings, stating:

> En raison des circonstances exceptionnelles de la présente affaire et devant la multiplicité des recours déjà intentés et de ceux qui le seront sous peu, il est dans l'intérêt d'une saine administration de la justice d'accorder cette demande de MMA et d'étendre la suspension des recours à XL.

72 In my view, it is in the interests of justice that the stay of proceedings extend to the action against the insurers.

(iv) Should a creditors' committee be ordered and its fees paid by CLCA?

73 The Initial Order provides for a creditors' committee comprised of one representative of the German bank group, one representative of the Canadian bank group, and the Trustee in bankruptcy of Castor. It also provides that CLCA shall be entitled to pay the reasonable fees and disbursements of legal counsel to the creditors' committee. Chrysler opposes these provisions.

74 The essential argument of Chrysler is that a creditors' committee is not necessary as the same law firm represents all of the banks and the Trustee of Castor. Counsel for the banks and the Trustee state that the German bank group consists of 13 distinct financial institutions and the Canadian bank group consists of 8 distinct financial institutions and that there is no evidence in the record to the effect that their interests do not diverge on material issues. As for the Castor Trustee, it represents the interests of more than 100 creditors of Castor, including Chrysler, the German and Canadian bank groups, and various other creditors. They says that a creditors' committee brings order and allows for effective communication with all creditors.

75 CCAA courts routinely recognize and accept *ad hoc* creditors' committees. It is common for critical groups of critical creditors to form an *ad hoc* creditors' committee and confer with the debtor

prior to a CCAA filing as part of out-of-court restructuring efforts and to continue to function as an *ad hoc* committee during the CCAA proceedings. See Robert J. Chadwick & Derek R. Bulas, *"Ad Hoc Creditors' Committees in CCAA Proceedings: The Result of a Changing and Expanding Restructuring World"*, in Janis P. Sarra, ed, Annual Review of Insolvency Law 2011 (Toronto:Thomson Carswell) 119 at pp 120-121.

76 Chrysler refers to the fact that it is not to be a member of the creditors' committee. It does not ask to be one. Mr. Meland, counsel for the two bank groups and for the Trustee of Castor said during argument that they have no objection if Chrysler wants to join the committee. If Chrysler wished to join the committee, however, it would need to be considered as to whether antagonism, if any, with other members would rob the committee of any benefit.

77 Chrysler also takes exception to what it says is a faulty claims process proposed in the term sheet involving the creditors' committee. Whether Chrysler is right or not in its concern, that would not be a reason to deny the existence of the committee but rather would be a matter for discussion when a proposed claims process came before the court for approval.

78 The creditors' committee in this case is the result of an intensely negotiated term sheet that forms the foundation of a plan. The creditors' committee was involved in negotiating the term sheet. Altering the terms of the term sheet by removing the creditors' committee could frustrate the applicant's ability to develop a viable plan and could jeopardize the existing support from the majority of claimants. I would not accede to Chrysler's request to remove the Creditors' committee.

79 So far as the costs of the committee are concerned, I see this as mainly a final cri de couer from Chrysler. The costs in relation to the amounts at stake will no doubt be relatively minimal. Chrysler says it is galling to see it having to pay 28% (the size of its claim relative to the other claims) to a committee that it thinks will work against its interests. Whether the committee will work against its interests is unknown. I would note that it is not yet Chrysler's money, but CLCA's. If there is no successful outcome to the CCAA process, the costs of the committee will have been borne by CLCA. If the plan is successful on its present terms, there will be $220 million available to pay claims, none of which will have come from Chrysler. I would not change the Initial Order an deny the right of CLCA to pay the costs of the creditors' committee.

80 Finally, Chrysler asks that if the costs are permitted to be paid by CLCA, a special detailed budget should be made and provided to Chrysler along with the amounts actually paid. I see no need for any particular order. The budget for these fees is and will be continued to be contained in the cash flow forecast provided by the Monitor and comparisons of actual to budget will be provided by the Monitor in the future in the normal course.

Conclusion

81 The motion of Chrysler is dismissed. The terms of the Initial Order are continued.

F.J.C. NEWBOULD J.

TAB 2

Case Name:

Itak International Corp. v. CPI Plastics Group Ltd.

Between
Itak International Corp., Applicant, and
CPI Plastics Group Limited and Peter F. Clark,
Respondents

[2006] O.J. No. 2637

20 B.L.R. (4th) 67

[2006] O.T.C. 576

2006 CarswellOnt 3986

Court File No. 05-CL-6182

Ontario Superior Court of Justice

C.L. Campbell J.

Heard: May 19, 2006.
Judgment: June 21, 2006.

(56 paras.)

Corporations and associations law -- Corporations -- Actions -- Against corporation and directors -- Oppressive conduct -- Contracts -- The applicant company was entitled to have its shares in the defendant company purchased forthwith according to the contract -- The financial risk to the company would have to be in the nature of at least severe financial distress approaching insolvency before business judgment could justify postponing or not honouring retraction rights.

The applicant was entitled to have his shares purchased forthwith -- The applicant sought an order the CPI Plastics Group Limited purchase from Itak International Corp. all first preference shares of CPI currently held by Itak at a price of $4.22 per share in accordance with the contract between the two, the applicant being brought as seeking an oppression remedy -- CPI admitted the obligation to purchase the shares, but its board had decided to postpone the redemption due to the impact the redemption would have on the balance of its shareholders, and the priorities it should give to its shareholders without oppressing any shareholders group -- The question to be decided was if the failure of CPI to retract the applicant's shares based on the judgment of its Board of Directors that it would not be prudent to do so exercising their business judgment in the context of negative banking covenants and adverse market conditions amounted to oppressive conduct for which a remedy was appropriate -- HELD: The applicant was entitled to have his shares purchased forthwith -- There was nothing to support the suggestion that the contractual right to retraction was specifically subject to any bank financing -- The financial risk to the company would have to be in the nature of at least severe financial distress approaching insolvency before business judgment could justify postponing or not honouring retraction rights.

Statutes, Regulations and Rules Cited:

Courts of Justice Act,

Ontario Business Corporations Act, R.S.O. 1990, c. B-16, s. 248(1), s. 248(3)

Counsel:

Matthew J. Latella for the Applicant

W. Paul Huston for the Respondents CPI Plastics Group Limited and Peter F. Clark

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REASONS FOR DECISION

1 **C.L. CAMPBELL J.**:-- The Applicant seeks an Order that CPI Plastics Group Limited ("CPI") purchase from Itak International Corp. ("Itak") all 473,992 First Preference Shares of CPI currently held by Itak at the price of $4.22 per share in accordance with the contract between CPI and Itak.

2 The Application is brought pursuant to the provisions of the *Ontario Business Corporations Act* R.S.O. 1990 c. B-16 s. 248(1) and (3) the oppression remedy section.

3 On the material before the Court, CPI does not dispute its obligation to redeem Itak's preference shares but takes the position that the timing of such redemption and CPI's financial ability to redeem them is the more important issue. CPI's position is that in making the decision not to redeem Itak's First Preference Shares, the CPI directors gave due consideration to Itak's rights and privileges, the impact that such redemption would have on CPI's banking covenants, the impact that such redemption might have on the balance of its shareholders and the priorities that it should give to its stakeholders without oppressing any shareholders group. The board's decision was that CPI could not, at present, redeem any of Itak's First Preference Shares.

4 The corporate Respondent, CPI, is a Mississauga-based plastics processing company dealing in thermoplastics profile design, engineering, processing and manufacturing. It is a public company, with its common shares traded on the Toronto Stock Exchange.

5 The individual Respondent, Clark, is Director, Chief Executive Officer and controlling shareholder of CPI, owning or controlling between 56 and 57 percent of its common (voting) shares. Itak submits that the other seven members of CPI's Board of Directors have a personal connection to Clark given his shareholding; Clark also has the ability to remove those other members of the Board. The Applicant alleges that CPI does not have a majority of the members of its Board qualify as truly "independent directors."

6 Itak is a holding/investment company, wholly owned by Mr. Ciro Madonia. For many years, Mr. Madonia held between 50% and 100% of the outstanding shares and was the President of the predecessor entity to CPI, Crila Plastic Industries Limited ("Old Crila"). The series of transactions in 1998 by which Old Crila went from being a privately-held company with Mr. Madonia as its primary shareholder and President to becoming the Clark-controlled CPI of today are described in the following paragraph from the Applicant's factum and are not contested.

7 The First Preference Share Conditions prescribe all of the procedures by which the retraction of the First Preference Shares is to take place, including the price, timeframe for Itak making the

demand, timeframe for CPI making payment, method by which payment is to be made, etc. The First Preference Share Conditions also contain a clause aimed at clarifying that, while a demand for retraction is to be honoured, if retracting all of its First Preference Shares would be in any way illegal, only such number of the shares as can be retracted legally are to be retracted at that time. That clause, which is at the centre of this dispute, reads as follows:

> **1.6 Retraction Subject to Applicable Law.** If the Corporation is not permitted, by insolvency provisions or other provisions of applicable law, or otherwise, to redeem all the First Preference Shares duly tendered by the holders of such First Preference Shares, the Corporation shall redeem only the maximum number of First Preference Shares which the directors of the Corporation determine the Corporation is then permitted to redeem. Such redemption will be made pro rata (disregarding fractions of shares) from each holder of tendered First Preference Shares according to the number of First Preference Shares tendered for redemption by each such holder and the Corporation shall issue and deliver to each such holder a new share certificate at the expense of the Corporation representing the First Preference Shares not redeemed by the Corporation."

8 The Respondents rely on the "or otherwise" words of the preceding paragraph to justify their position that, based on a legal opinion and exercising business judgment in the context of CPI's banking covenants, it was appropriate for the directors of CPI to decide that the redemption rights of the Applicant be denied at the present time or at least postponed.

9 CPI advances that as long as its board of directors acted honestly, prudently, in good faith and on reasonable business grounds with the support of an independent legal opinion, Itak as first preference shareholder has not been oppressed by the refusal to retract.

10 In or about 1997, a decision was made to make Old Crila a publicly traded corporation by way of a reverse takeover of an existing publicly traded corporation, Waterford Capital Management Inc. In April 1998, an agreement was negotiated as part of this process among Itak, Mr. Madonia's three daughters.(who held some shares of Old Crila), CPI and Clark, as well as two numbered companies controlled by Clark (the "1998 Shareholders' Agreement.")

11 At the time of the 1998 Shareholders' Agreement, Mr. Madonia and his daughters owned approximately 20% of Old Crila, which shares at the time were acknowledged to be worth $8 million. It was agreed that the Madonias would be selling off some of their interest in the company prior to it going public. While Mr. Madonia had sought to have the $8 million interest addressed by way of $4 million worth of common shares and $4 million in cash, a compromise was ultimately agreed upon whereby Itak would retain $4 million in common shares, and would receive $2 million in cash and have a further $2 million worth of its common shareholdings of Old Crila converted into retractable Class A Preference Shares in that company, which could be retracted by Itak on demand (the "Old Crila Preference Shares.")

12 The Old Crila Preference Shares were to be converted into First Preference Shares of the post-takeover amalgamated company with such shares having the same rights and total value as the Old Crila Preference Shares. The operative clause of the 1998 Shareholders' Agreement (3.4(i)) stipulates that the process by which Old Crila would go public would entail the conversion of the Old Crila Preference Shares into shares of the newly created public company "on an identical basis."

13 After the completion of the transaction by which CPI went public, Itak's Old Crila Preference Shares became the First Preference Shares in CPI, with the same rights, privileges, restrictions and conditions as those earlier preference shares. Specifically, the rights and conditions attaching to the First Preference Shares include the following:

1.1 **Retraction at the Option of the Holders of the First Preference Shares.** At any time after August 1, 1998, the holders of the First Preference Shares shall be entitled to require the Corporation to redeem all or any part of the First Preference Shares registered in the name of the holders of the First Preference Shares, 30 days after giving written notice to the Corporation (the "Retraction Date").

1.2 **Retraction Price.** The price to be paid by the corporation on any redemption of a First Preference Share under this clause shall be $4.22 per First Preference Share (the "Retraction Price") being, in the aggregate, $2 million.

1.3 **Procedure on Retraction.** On receipt of a written request by the holder of a First Preference Share, the corporation shall, on the Retraction Date, redeem the shares by paying to the registered holder an amount equal to the Retraction Price for each First Preference Share redeemed. This payment shall be made by certified cheque payable at any branch in Canada at one of the Corporation's bankers for the time being. If a part only of the First Preference Shares represented by any certificate is redeemed, a new certificate for the balance shall be issued by the Corporation.

1.4 **Retraction Subject to Applicable Law**. If the Corporation is not permitted, by insolvency provisions or other provisions of applicable law, **or otherwise**, to redeem all the First Preference Shares duly tendered by the holder of such First Preference Shares, the Corporation shall redeem only the maximum number of First Preference Shares which the directors of the Corporation determine the Corporation is then permitted to redeem. Such redemption will be made pro rata (disregarding fractions of shares) from each holder of tendered First Preference Shares according to the number of First Preference Shares tendered for redemption by each such holder and the Corporation shall issue and deliver to each such holder a new share certificate at the expense of the Corporation representing the First Preference Shares not redeemed by the Corporation."

1.5 **Cessation of Rights** The First Preference Shares shall be redeemed on the Retraction Date and from that date the holders thereof shall not be entitled to exercise any of the rights of shareholders in respect of such Shares, unless payment of the Retraction Price is not made on the Retraction Date, in which event the rights of the holders of such Shares shall remain unaffected.

[Emphasis added.]

14 The Information Circular prepared by CPI as part of its disclosure for going public included representations describing the Applicant's rights as follows:

> The holders of the CPI Preference shares have the right to convert all, or any part, of such shares *at any time* into CPI Common Shares on a share for share basis and have the *right* to retract all, or any part, of such shares *at any time after August 1, 1998* at a price of $4.22 per share (the "Retraction Price"). In the event CPI is unable, for any reason, to retract all, or any part of such shares then, until the earlier of: [emphasis added]

(a)

> the day when CPI becomes a reporting issuer; and
>
> (b) December 31, 1998
>
> > the holder of such shares may put such shares to Peter F. Clark or 820597 Ontario Inc. at the "Retraction Price."

15 The Information Circular went on to clarify, under the heading "First Preference Shares":

> The terms and conditions attaching to the First Preference Shares provide as follows:
>
> > ...
> >
> > **Retraction:** The holders of the First Preference Shares shall be entitled to require CPI, *subject to applicable law*, to redeem all or any part of the First Preference Shares upon 30 days' written notice to CPI, at a redemption price of $4.22 per share. [emphasis added]

16 There is no language in the relevant contractual documents limiting the right to redeem based on any financial parameters or terms of any banking covenants.

17 The directors apparently gave consideration to the impact that such redemption would have on CPI's banking covenants and on the balance of its shareholders. CPI relies on a legal opinion obtained by the board of directors that purports to support its position that the "or otherwise" language of s. 1.4 in paragraph 12 above could be relied upon to reject the request to redeem.

18 I also note that CPI resisted the production of the legal opinion until an Order of Mesbur J. required that it be produced. The legal opinion does not in my view particularly assist the position of CPI. In my view, neither the questions recited nor the opinion in response is helpful for the issue that is now before the Court. The concluding paragraph illustrates its limitations:

> Due to the time constraints involved in providing you with our advice as set out above given the impending expiry of the 30-day period following the Retraction Notice, aside from reviewing the relevant facts and documents you provided to us, we note that *we have not had the benefit of conducting any significant legal research* into the various questions in respect of which you have sought our views. However, we would be pleased to do so if requested and we look forward to your further instructions in this regard. In the meantime, should you have any questions or wish to discuss any of the above in further detail, please do not hesitate to contact us." [Emphasis added]

With the above limitation, the lawyer's letter cannot be regarded as a careful, comprehensive, considered legal opinion.

19 The board of directors apparently considered two matters when it reached a conclusion that the "or otherwise" language supported a decision not to accept retraction within the time set out in the agreements.

20 The first consideration was that the language "or otherwise" would permit CPI to enter into banking arrangements, including negative covenants containing "debt to working capital ratios" without consideration of the retraction rights.

21 The second consideration is as set out in paragraph 18 of the CPI factum:

> At the time CPI received the redemption notice, the Company was experiencing financial pressures which included, the seasonal nature of the business, the rising cost of resin and the falling American dollar relative to the Canadian Dollar. It was felt that it was financially prudent to decline to redeem Itak's shares in these challenging financial circumstances. CPI's 2005 Q3 2005 year end results reflect these challenges.

22 The Applicant challenges that statement and its bona fides, particularly in the circumstances of its timing and of the opinion sought and obtained from outside counsel.

23 In the view I take of this Application, it is not necessary to decide all the issues of bona fides or the lack thereof. There does not appear to be any issue that CPI is contractually required to retract the First Preference Shares of the Applicant.

24 The question more appropriately put, is the following: Is the failure of CPI to retract the Applicant's shares based on the judgment of its Board of Directors that it would not be prudent to do so exercising their business judgment in the context of negative banking covenants and adverse market conditions oppressive conduct within the meaning of the provisions of the *OBCA* for which a remedy is appropriate?

25 A subsidiary question arises, namely, assuming CPI was entitled to exercise business judgment in respect of its obligation, was it exercised reasonably?

26 It is most often difficult to reach findings of fact based on affidavits and transcripts without the benefit of seeing the witnesses and hearing their evidence. In the view I take of the matter, it is not necessary to make specific findings of credibility or intent. There is sufficient objective evidence on which to reach a conclusion regarding the exercise of business judgment.

27 On the material before me, there is nothing to support the suggestion that the contractual right to retraction was specifically subject to any bank financing. The banking covenants that appear to have arisen after the rights arose do not specifically refer to such rights. The Applicant was neither consulted nor asked for consent regarding the banking arrangements after the notice of retraction was sent.

28 I agree with the submission of the Applicant that what has come to be known as the *ejusdem generis* rule would appear to apply to the "or otherwise" term as it appears in the contractual provision at issue. This legal concept was not considered by counsel retained to give the legal opinion relied on.

29 The *ejusdem generis* rule is defined in *Black's Law Dictionary*, 7th Edition, West Group, St. Paul Minnesota, 1999 at page 535, as:

> A canon of construction that when a general word or phrase follows a list of specific persons or things, the general word or phrase will be interpreted to include only persons or things of the same type as those listed. For example, in the phrase, horses, cattle, sheep, pigs, goats or any other barnyard animal, the general language or any other barnyard animal -- despite its seeming breadths -- would probably be held to include only four-legged, hoofed mammals (and thus would exclude chickens.)

There are a myriad of legal decisions that have adopted that description of the canon with similar illustrations.

30 In my view, the application of the term "*ejusdem generis*" as well as common sense would suggest that the financial risk to the company would have to be in the nature of at least severe financial distress approaching insolvency before business judgment could justify postponing or not honouring the retraction rights.

31 There is nothing in the evidence before me to suggest a risk anywhere approaching financial distress was facing the company at the time of the decision to refuse retraction.

32 The words "or otherwise" cannot in my view be relied on to permit consideration of financial condition so substantially different from insolvency or other debtor/creditor law, that a preference not to pay would meet the test.

33 The evidentiary material before me does not in any way support a contention anywhere near approaching financial impairment or distress. The following facts appear to support only a conclusion that the Board of Directors believed that they could use the "or otherwise" language to determine the time and circumstances for honouring the retraction rights.

> (i) Peter Clark in his cross-examination acknowledged that payment of the retraction amount would not cause financial distress to the company;
> (ii) the retraction rights and obligations were fully disclosed on the public financial statements of the company without reference to any limitation on their exercise;
> (iii) there is no evidence that CPI's Bank was asked or expressed any concern whatsoever about the retraction payment, given that the retraction obligation arose before the financing by the Bank.
> (iv) other than the statement by counsel for CPI, there is no quantitative or qualitative evidence to back up the submission that the value of the Canadian dollar was having an adverse impact on resin sales; and
> (v) even to the untrained eye, there would appear to be more than sufficient cash assets on hand, as exhibited in the financial statements filed, to make the required payment.

The Business Judgment Rule

34 CPI submits that its directors were entitled to rely on the reasonable exercise of business judgment in applying financial prudence to the application of the company's obligations in the interests of all the shareholders. In my view the submission of CPI gives a much broader scope to the application of the business judgment rule than justified on the case law in Canada.

35 The following statement by Weiler J.A. in *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 at p. 192 has been widely accepted as setting the parameters for the application of business judgment:

> The court looks to see that the directors made a *reasonable* decision *not a perfect decision*. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision [citations omitted]. This formulation of deference to the decision of the Board is known as the "business judgment rule." [italics in original, underlining added].

36 See also *Peoples Department Stores Inc. [Trustee of] v. Wise*, [2004] 3 S.C.R. 461 at paragraphs 64-67 and *Kerr v. Donier Leather Inc.* (2005), [2005] O.J. No. 5388, (Ont. C.A.)

37 Lax J. in *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.*, [2002] O.J. No. 2412,

(S.C.J.) affirmed, [2004] O.J. No. 636, (C.A.) made the following comments in the practical approach to the application of the business judgment rule:

> [152] The business judgment rule protects Boards and directors from those that might *second-guess their decisions*. The court looks to see that the directors made a reasonable decision, not a perfect decision. This approach recognizes the autonomy and integrity of a corporation and the expertise of its directors. *They are in the advantageous position of investigating and considering first-hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation.* [emphasis added]
>
> [153] However, directors are only protected to the extent that their actions actually evidence their business judgment. The principle of deference presupposes that directors are scrupulous in their deliberations and demonstrate diligence in arriving at decisions. Courts are entitled to consider the content of their decision and the extent of the information on which it was based and to measure this against the facts as they existed at the time the impugned decision was made ... Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination.
>
> [156] ... In the space of thirty minutes taken up with Ms. Rattner's presentation, without questions or discussion, with comment from the only director who had served for longer than two months, the Board of Directors of Repap approved an Agreement that gave someone it did not know, had not recruited, and had just met, a generous salary with a lengthy term of employment, an unprecedented bonus structure, termination and change of control protection inconsistent with the employment objective, and stock options amounting to 13.4% of the company. The directors did not fulfil their duties to Repap. Their decision was not an informed or reasoned one. The business judgment rule cannot be applied in these circumstances to protect their decision from judicial intervention.

38 Like Lax J. in the above-noted decision, I conclude that the business judgment of the directors of CPI in this instance lacks the touchstone of an informed reasoned judgment.

39 On the facts before me, it would appear simply that the Board or the officers asked the question as to whether or not the company could resist the retraction obligation utilizing the "or otherwise" phrase in the contract.

40 There must be more to the business judgment rule test than the subjective determination by a board of directors. A recent decision of the Court of Appeal for Ontario is illustrative. In *Ford Motor Co. of Canada v. Ontario Municipal Employees Retirement Board*, [2006] O.J. No. 27 (C.A.), a case involving the squeeze out of the 10% minority by the parent, Ford U.S., with a resultant fair value determination. It was observed that the trial judge had summarized the rules and went on to say that: "Absent bad faith, or some other improper motive, business judgment that, in hindsight, has proven to be mistaken, misguided or imperfect, will not give rise to liability through the oppression remedy."

41 Rosenberg J.A. stated at paragraphs 55-56:

> [55] ... The significant impediment to Ford Canada's reliance on the business judgment rule lies in the evidence accepted by the trial judge that the Ford Canada board brought little judgment to bear on the transfer pricing system.

> [56] The evidence shows that Ford Canada's board had little understanding of the transfer pricing system and its impact on the profitability of Ford Canada's operations. There was little discussion of the system at the board level and Ford Canada did not conduct any independent review of the system. The evidence suggests that Ford Canada simply accepted the system that was put in place by Ford U.S., the majority shareholder. There was no evidence that Ford Canada tried to negotiate an agreement that was more consistent with arm's-length principles and failed; the attempt was never made. In fact, when Dr. Wright concluded her study shortly before the 1995 transactions and suggested a slight change to the TELO allocation that favoured Ford Canada, the change was made.

42 As illustrative of the fact that there was little judgment brought to bear in this case is the following: there was no dialogue with the Applicant, no offer to make partial payment and no timeframe stated as to when the retraction right might be honoured. It is of some note that almost on the eve of the return of this Application, CPI made a payment of approximately 10% of the outstanding amount, again with no explanation of any circumstance that would point to a change in the conditions from that which had brought about the refusal in the first place.

43 In my view, based on the statements in the cases referred to above, there is both subjective and objective input for application of the judgment rule. Did the directors as a group bring to bear the considerations expected of reasonably prudent directors, operating in the same circumstances? The evidence before me does not meet that test.

44 The subjective belief of directors that they are acting in the best interests of the corporation is insufficient where objectively that is not the case and the subjective belief is unreasonable. See *Catalyst Fund General Partners 1 v. Hollinger Inc. et al.*, [2006] O.J. No. 944, 2006 CanLII 7392 (Ont.C.A.) at paragraph 106. That comment was made in the context of self-interested directors. In my view, it is appropriate to use the same test in a situation such as this, where the directors seek for the benefit of the company to avoid a clear contractual obligation.

Oppression

45 The touchstone used by the courts for identifying conduct that satisfies the language of s. 248 and oppression remedy has been the "reasonable expectations of the shareholder". The Ontario Court of Appeal has stated its agreement with the following articulation of this principle by Justice Farley in *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 at p. 490 (C.A.):

> Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations which are to be considered are those that a shareholder has as his own individual "wish list". They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders.

46 In that case, the Court of Appeal went on to find that the impact of the expectations of the shareholder goes beyond identifying oppressive conduct, holding:

> The determination of reasonable expectations will also, in my view, have an important bearing on the decision as to what is a just remedy in a particular case.

47 Agreements between the parties tend to constitute the best evidence of the parties' reasonable expectations. Oppression proceedings that are based on the enforcement of prior contractual arrangements tend to be clearer than other such proceedings in that such contracts may inform the Court's decision as to the reasonable expectations of the parties.

48 The importance of the reasonable expectations of these parties is particularly significant where the rights of the complainant were intended to be defined in the documentation creating the security interest upon which the claim is based. By way of example, Spence J. in *Linamar Corp. v. Westcast Industries Inc.* [2004] O.J. No. 2449 (S.C.J.) at par. 6 has confirmed that the interpretation of rights under a shareholders' agreement constitutes part of the "affairs" of a corporation and is subject to the application of the oppression remedy. Specifically, he held:

> A breach of a shareholders' agreement or breach of an obligation to perform a shareholders' agreement in good faith constitutes oppression.

49 Factors to be considered in determining whether conduct is unfairly prejudicial or unfairly disregards the interests of a shareholder have been articulated by appellate courts as follows in *First Edmonton Place Ltd. v 315888 Alberta Ltd.* (1988) 40 B.L.R. 28, at p. 57 (Alta Q.B.):

> More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: the protection of the underlying expectations of a creditor in its arrangement with the corporation, the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. The elements of the formula and the list of considerations as I have stated them should not be regarded as exhaustive. Other elements and considerations may be relevant, based upon the facts of a particular case.

50 The effect of the refusal to honour the retraction rights of the Applicant is to give preferential treatment to one class of shareholder over another. Peter Clark, the largest single shareholder, was apparently of the view that, "The decision to redeem the First Preference Shares was based solely on the honest belief that such redemption would be oppressive to the Company's [other] shareholders."

51 Such statement entirely misses the point of the reasonable expectation of all the shareholders that the contractual retraction obligation would be honoured. That unfairly prejudicial conduct underlay the decision-making process of the Board of CPI. See *Waxman v. Waxman,* [2002] O.J. No. 2528, aff'd [2004] O.J. No. 1765 (C.A.)

52 Given the above conclusion, it is not necessary to make the factual findings sought by the Applicant with respect to the conduct of Peter Clark. I recognize that he is the "controlling shareholder" and holds significant power over the composition of the Board of Directors.

53 CPI is, however, a public company, and the decision in question was made by the Board as a whole, not just Clark as one member. It would only be in the event that CPI fails now to honour its contractual obligation in a timely fashion that it would be necessary to address the role of Peter Clark.

Remedy

54 Based on the evidence before me, and the conclusions I have reached, I see no reason that the Applicant should not be entitled to have his shares purchased forthwith. This should have been done last August. Had the retraction taken place at the relevant time, the Applicant would have earned interest on the money paid to it from August to now.

55 In the absence of the parties agreeing or submitting a more appropriate rate, it would appear that the interest rate under the *Courts of Justice Act* would be appropriate. The calculation of the precise amount owing should take into account the recent partial payment.

56 If it is necessary to further refine these amounts or deal with the issue of costs, written submissions should be made within the next two weeks.

C.L. CAMPBELL J.

TAB 3

Case Name:

Renegade Capital Corp. v. Dominion Citrus Ltd.

**RE: Renegade Capital Corporation, Applicant, and
Dominion Citrus Limited, Dominion Citrus Income Fund, R. Peter
McLaughlin, Peter M. Kozicz, Eric Skillins and Paul Scarafile,
Respondents**

[2013] O.J. No. 1467

2013 ONSC 1590

86 E.T.R. (3d) 200

2013 CarswellOnt 3639

227 A.C.W.S. (3d) 596

Court File No. CV-13-10035-00CL

Ontario Superior Court of Justice

H.J. Wilton-Siegel J.

Heard: March 22, 2013.
Judgment: March 27, 2013.

(142 paras.)

Corporations, partnerships and associations law -- Corporations -- Meetings of shareholders -- Calling -- Special meeting -- Application by Renegade for order requiring trustees of company's income fund to call special meeting of unit holders and for order adjourning special shareholders meeting allowed in part -- Declaration of trust establishing fund required trustees to obtain approval of unit holders to vote company's common shares -- Postponement of principal with respect to secured notes of company that was insolvent on balance sheet basis, had been unprofitable and relied on suppliers for credit was "materially adverse" to unit holders -- Trustees had to forego voting until meeting of unit holders.

Application by Renegade for an order requiring the trustees of a company's income fund to call a special meeting of the unit holders and for an order adjourning a special shareholders meeting. The fund was established pursuant to a declaration of trust. The fund's assets consisted of the company's secured notes and common shares. The company was insolvent on a balance sheet basis and dependent on its suppliers for credit. The company intended to call a special shareholders meeting to approve the terms of a settlement agreement with a significant holder of preference shares. The declaration of trust provided that the trustees could not vote the common shares to authorize any transaction that was "materially adverse" to the unit holders without their approval at a special meeting. Renegade sought a special meeting of the unit holders to vote on whether to authorize the trustees to vote the common shares in support of the proposed transaction at the special shareholders meeting and for an order adjourning that meeting until the unit holders meeting took place. Renegade argued that the proposed transaction would prejudice the unit holders by postponing repayment of principal on, and the maturity date of, the secured notes by at least three years. The application was opposed by the company, the fund and the trustees on the basis that the proposed transaction as a whole was beneficial to the unit holders, given the benefits to the company.

HELD: Application allowed in part. The declaration of trust required the trustees to obtain the approval of the unit holders to vote the common shares. A postponement for at least three years of all principal with respect to the secured notes of a company that was insolvent on a balance sheet basis, had been unprofitable for several years and relied entirely on its suppliers for credit was materially adverse to the unit holders. The determination of whether the transaction would be materially adverse was to be made by the court on an objective basis. In order to avoid breaching the declaration of trust, the trustees had to forego voting until a meeting of the unit holders was held. As a result, it was not necessary to order a meeting of the unit holders.

Statutes, Regulations and Rules Cited:

Assignments and Preferences Act, R.S.O. 1990, c. A.33, s. 4(2)

Business Corporations Act, R.S.O. 1990, c. B.16, s. 32(2)

Counsel:

Derek J. Bell and *Emrys Davis*, for the Applicant, Renegade Capital Corporation.

Peter Wardle, James Camp and *Julia Wilkes*, for the Respondents, Dominion Citrus Limited, Dominion Citrus Income Fund, R. Peter McLaughlin, Peter M. Kozicz, Eric Skillins and Paul Scarafile.

John Callaghan, for Robert Fortune.

ENDORSEMENT

1 **H.J. WILTON-SIEGEL J.**:-- On this application, the applicant, Renegade Capital Corporation (the "Applicant" or "Renegade"), seeks, among other things, an order requiring the trustees of the Dominion Citrus Income Fund (the "Fund" or the "Trust") to call a special meeting of the holders of units of the Fund (the "Unitholders"). The purpose of the meeting is to allow the Unitholders to vote on whether to authorize the trustees of the Fund to vote the common shares of Dominion Citrus Limited (the "Company") in support of a special resolution to be considered at a special meeting of the shareholders of the Company called for March 26, 2013 (the "Special Meeting"). The Applicant also seeks an order adjourning the Special Meeting to permit the meeting of the Unitholders to take place. The application is opposed by the Fund, the Company and the Fund's trustees, who appear together and are herein collectively referred to as the "Respondent".

Factual Background

2 The Fund is a publicly traded, unincorporated, open-ended limited purpose income trust established under the laws of Ontario pursuant to a declaration of trust dated November 21, 2005 (the "Declaration of Trust"). The Fund's assets consist of the Common Shares (defined below) and the Secured Notes (defined below). The Fund does not carry on an operating business. The Fund has 21,186,412 issued and outstanding units (the "Units") that are listed on the Toronto Stock Exchange

(the "TSX").

3 The Company is a corporation incorporated under the *Business Corporations Act*, R.S.O. 1990, c. B.16, as amended, (the "OBCA") that carries on the business of supplying fresh produce to retail, foodservice and food distribution customers in Ontario, Quebec and the United States.

4 The issued and outstanding capital of the Company consists of 20,475,845 common shares (the "Common Shares") and 1,021,150 Series A Preference Shares (the "Preference Shares"). The Preference Shares are also listed on the TSX. In addition, the Company has issued participating secured notes in the aggregate principal amount of $19,258,000, of which $18,051,000 plus accrued interest remains outstanding (the "Secured Notes"). The Fund owns the Common Shares and Secured Notes, whereas third parties own the Preference Shares as described below.

5 The Fund's current trustees are R. Peter McLaughlin ("McLaughlin"), Peter M. Kozicz ("Kozicz"), Eric Skillins ("Skillins") and Paul Scarafile ("Scarafile") (collectively, the "Trustees"). McLaughlin owns 2,697,499 Units in the Fund, representing approximately 12.7% of the outstanding Units, through Greenbriar Holdings Limited ("Greenbriar"), a corporation understood to be controlled by him.

6 The Company's current directors are McLaughlin, Scarafile, Barry Cracower, Jason Fielden ("Fielden") and William R. Ash. Through Greenbriar, McLaughlin owns 134,874 Preference Shares of the Company, representing approximately 13.2% of the outstanding Preference Shares. Kozicz owns 2,562 Preference Shares.

7 Renegade is a corporation controlled by Michael Blair ("Blair"), a former director of the Company and Trustee of the Fund. It holds 3,750,000 Units in the Fund, representing approximately 17.7% of the outstanding Units, and 46,000 Preference Shares, representing approximately 4.5% of the outstanding Preference Shares of the Company.

The Secured Notes

8 The Secured Notes are governed by the terms of an amended and restated participating note indenture dated December 15, 2009 (the "Secured Note Indenture"). The Secured Notes mature on January 1, 2016 and bear interest at a base rate, currently 5%, plus additional interest equal to the least of: (1) 5.5% of the indebtedness represented by the Secured Notes; (2) an amount equal to the taxable income of the Company for the year, minus an amount equal to the base interest; and (3) an amount equal to the distributable cash of the Company for the year minus an amount equal to the base interest.

9 The Secured Notes were originally issued on or about January 1, 2006, when the current income trust structure was put in place. The Secured Notes were necessary to effect the tax advantages available at that time to an income trust. The Secured Notes were issued to a predecessor corporation of the Company, during one of the steps of the plan of arrangement that established the Fund, in consideration of a transfer of 95% of the aggregate value of the common shares of the Company at the time. However, as debt instruments, the Secured Notes rank prior to the Preference Shares in any liquidation of the Company. The significance of this priority is discussed below.

10 The Secured Notes were restructured in 2009. At that time, the base interest rate was reduced from 13% to 5%, and the Company was granted an interest holiday for 2010 to address its financial situation. In consideration of these amendments, pursuant to a general security agreement, the Company granted a security interest over all of the personal property, but not the real property, of the Company to the trustee under the Secured Note Indenture.

11 The Company paid the interest due on the Secured Notes during 2011. As a consequence, the Fund made a special distribution of $0.0275 per Unit to the Unitholders on December 19, 2011, which was satisfied by a distribution in kind in the form of additional Units in the Fund. Since 2011, the

Fund has granted a further interest holiday to the Company for the period December 1, 2011 to March 31, 2012, which was extended to December 31, 2012, and which was further extended most recently to March 31, 2013.

The Preference Shares

12 The Preference Shares have a stated capital of $2.25 per share and entitle the holder to a cumulative floating rate cash dividend calculated using the bank prime rate on January 1 and July 1 in each year, plus 2%, subject to a minimum rate of 4% per annum and a maximum rate of 8% per annum, payable semi-annually on January 20 and July 20 of each year.

13 As of December 31, 2012, the Preference Shares had accrued $442,285.60 in undeclared and unpaid dividends. Under the terms of the Preference Shares, the Preference Shares become voting if four consecutive dividend payments are not made. As of December 31, 2012, eight consecutive dividends had not been made. Therefore, the Preference Shares are entitled to vote together with the Fund, as the holder of the Common Shares, on the Special Resolution (defined below) on the basis of one vote per Preference Share. Pursuant to the OBCA, the holders of the Preference Shares are also entitled to vote separately as a class on the Special Resolution.

14 The Preference Shares are redeemable at the option of the Company at any time *pro rata* for cash equal to $2.25 per share plus any accrued and unpaid dividends (the "Redemption Price").

15 In addition, the Preference Shares are retractable at the Redemption Price at the option of the holders thereof effective April 1, 2013 for payment on April 15, 2013, provided the holder delivers notice to the Company at any time between January 1, 2013 and March 31, 2013. As of the date of the hearing of this application, the Applicant and one other Preference Shareholder are the only Preference Shareholders that have provided the Company with notice requiring retraction of their shares. However, I have proceeded on the basis that all of the remaining Preference Shareholders would exercise their retraction rights if, for any reason, the Special Resolution is not approved at the Special Meeting on March 26, 2013. If all of the Preference Shareholders were to exercise their right to retract the Preference Shares, the aggregate Redemption Price would be approximately $2.74 million, as of April 13, 2013.

16 The provisions of the Preference Shares provide that the Company has the option of satisfying the Redemption Price for any shares being retracted in cash or common shares of the Company. However, the share conditions regarding the determination of the number of common shares to be issued to satisfy the Redemption Price refer to the market price on the TSX of the common shares of the Company. The common shares of the Company have not traded on the TSX since January 1, 2006, when the income trust structure was put in place. The Company takes the position in the Circular (defined below) that "the method of determining the number of shares that would be issued to satisfy the Redemption Price refers to the market price of the Common Shares on the TSX and is consequently inoperable because the Common Shares are no longer traded on the TSX". There is, however, no judicial or regulatory decision to this effect at the present time.

17 At the time that the income trust structure was put in place, the Preference Shareholders voted on a resolution regarding certain proposed amendments to the rights and conditions attaching to the Preference Shares. The resolution included amendments that would have permitted the Company to satisfy the Redemption Price in respect of Preference Shares that had been retracted by the payment of Units of the Fund. The resolution included a further amendment that would also have permitted the Company to satisfy the Redemption Price of any Preference Shares in respect of which the Company exercised its right of redemption in Units of the Fund. The Preference Shareholders did not approve this resolution at a meeting of Preference Shareholders held shortly after the meeting of common shareholders of the Company that approved implementation of the income trust structure. Accordingly, the proposed amendments were not implemented. As a result, from the inception of the income trust structure on January 1, 2006, the Fund's interest in the Company has taken the form of

Secured Notes that rank ahead of the Preference Shares and Common Shares that rank behind the Preference Shares, as a matter of their respective expressed terms and conditions.

The Financial Condition of the Company

18 The parties agree that the Company is insolvent on a balance sheet test (i.e. its assets are less than its liabilities). It is also agreed that the Company is unable to obtain bank financing for its working capital, after having canvassed the market, and is dependent upon its suppliers for credit. The parties disagree, however, on the proper characterization of the current financial prospects for the Company.

19 Renegade characterizes the Company as insolvent or, at a minimum, on the eve of insolvency. It points to an ongoing decline since 2005 of total assets and net income. It says that the actual decline in total assets and net income is larger when adjusted to include the interest payable by the Company to the Fund, which is netted out on a consolidation of the financial accounts of the Fund and the Company. It also says the nine-month results ending September 29, 2012 are not representative of the likely outcome for fiscal 2012, given the experience in 2011 when the nine-month results were also positive but the Company suffered a substantial loss for the fiscal year.

20 The Respondent takes the position that the Company is not insolvent but rather "is an enterprise with a promising future and is more than capable of meeting its obligations as they become due". This view is based on the Respondent's view that, with the support of the Fund, the Company is "far from insolvent". It is understood that 'the support of the Fund' on which the Company relies, and to which it believes it is entitled, is a waiver of interest payments as required to meet the Company's obligations as they fall due. Consistent with this view, the Respondent believes that it is more appropriate to consider the financial condition of the Fund and the Company on a consolidated basis given that they are managed as a consolidated entity. On a consolidated basis, the Respondent says that, for the nine months ended September 29, 2012, the consolidated entity had a net profit of $492,000, on track for the first true net profit in five years, as compared with a net loss of $1,534,000 in the 2010 fiscal year.

21 The Respondent also says that the Company's liquidity position will be significantly improved if the transaction contemplated by the Settlement Agreement (defined below) is implemented. It says that its current ratio will increase to 1.1:1 (as the Preference Shares will drop into non-current liabilities and the accrued dividends will be waived), the Company's cash balance will be $1.825 million, and there will be no operating debt.

22 It appears that EBITDA was negative in the 2010 fiscal year, but has since improved and was positive for the 2011 fiscal year and for the nine months ended September 29, 2012. The Company has, therefore, been able to meet its liabilities as they fall due because it is cash flow positive, although this has required the interest holiday on the Secured Notes. The parties disagree on the extent to which this situation is maintainable, particularly in light of the Preference Shareholders' retraction right arising on April 1, 2013.

23 It is Blair's view that the situation is not maintainable. In 2011, in his capacity as a director of the Fund, he attempted to get the Trustees' support for some form of insolvency proceeding to address both the declining profitability of the Company and the retraction obligation in respect of the Preference Shares. At a Trustees' meeting on December 8, 2011, the Trustees resolved instead to pursue a restructuring of the Company's operations, assisted by the interest holiday on the Secured Notes referred to above. Blair resigned as a Trustee shortly after this Trustees' meeting.

24 The Trustees' resolution at the meeting of December 8, 2011 reflected the majority view that the Company had a future as a going concern under its then new management, headed by Fielden, which was implementing a restructuring plan for its operations that, in the Trustees opinion, had begun to show success. At that meeting, Scarafile is reported in the minutes to have said that he wanted a return on his investment but "felt there would be nothing left if the business was broken up". The

Respondent says that, at this meeting, the majority reached the same conclusion after reflecting on the choices available to the Company as they understood them - being some unspecified insolvency proceeding proposed by Blair, which they believed would leave little if anything for the Unitholders, or continuation of the Company as a going concern with restructured operations, which they considered had the promise of returning some value to the Unitholders in the long-run.

25 It is not possible to reach any conclusion regarding the current level of profitability of the Company, or the sustainability of the Company as a going concern, based on the record before the Court. I have the following two observations regarding this dispute between the Trustees and Blair which inform the conclusions reached below.

26 First, the parties do not dispute the actual financial results on a consolidated or unconsolidated basis. They dispute, instead, the proper perspective from which to assess the financial prospects of the Company. The Respondent says that the financial condition of the Company should be assessed on a consolidated basis. Renegade says that the financial condition of the Company should be assessed on an unconsolidated basis which, as mentioned, takes into account interest paid or accrued in each year on the Secured Notes.

27 Second, this dispute also reflects a more fundamental difference in approach to the income trust structure.

28 The Renegade position treats the Fund and the Company as separate entities, with the Trustees and the Board responsible to different constituencies. At its most basic, Renegade insists that the Secured Notes represent obligations that must be satisfied in accordance with their terms, including their legal priority relative to the Preference Shares.

29 The Respondent treats the Fund and the Company as a single operating entity, with the Trustees and the Board responsible to the same constituencies. The Respondent considers that the economic interests of the Fund are to be equated with the economic interests of the Company. This is reflected, for example, in the joint meetings of the Board and the Trustees to consider and approve the transaction contemplated by the Settlement Agreement (defined below), as well as the joint special committee established to review the negotiations described below. With this perspective, the Respondent considers it appropriate for the Fund to "support" the Company by contractually postponing and subordinating the Secured Notes given the Company's financial circumstances.

The Settlement Agreement

30 On February 28, 2013, the Company announced that the Trustees, on behalf of the Fund, and the Company had approved the terms of a proposed settlement with a significant holder of Preference Shares, Solar Harvest Company Ltd. ("Solar Harvest"). This company, which is controlled by Robert Fortune ("Fortune"), owns 482,500 Preference Shares, representing approximately 47.2% of the outstanding Preference Shares. The press release indicated that the Company intended to call the Special Meeting of the Company's shareholders to approve the terms of the settlement, which are set out in an agreement dated February 28, 2013 among the Fund, the Company, Solar Harvest and Fortune (the "Settlement Agreement"), and to incorporate the terms of the Settlement Agreement into the Company's articles to apply to all of the Preference Shares.

31 The following describes the principal terms of the transaction contemplated by the Settlement Agreement (the "Proposed Transaction"), based on the descriptions in the Circular (defined below), as the actual documents giving effect to the Proposed Transaction are not before the Court apart from the Settlement Agreement.

32 By way of overview, the effect of the Proposed Transaction is to: (1) waive all accrued and unpaid dividends on the Preference Shares; (2) restructure the current retraction right of the Preference Shareholders as a series of mandatory quarterly cash payments over the period April 1, 2013 to May 1, 2019; (3) postpone repayment of all principal and interest, whether accrued before or after the Proposed Transaction, on the Secured Notes to payment of the mandatory cash payments on account of the Preference Shares, with the exception of the permitted annual interest payments described in (4) below; (4) restrict annual interest payments on the Secured Notes made after January 1, 2013 to an amount equal to the amount of any payments made in the same year to the Preference Shareholders (the "Permitted Annual Interest Payments"); (5) provide the Preference Shareholders with the benefit of a guarantee of the Fund of payment of the mandatory quarterly cash payments referred to in (2) above (which guarantee is limited in recourse to the security described in (6) below); and (6) pledge the security given in favour of the Secured Notes to the Preference Shareholders as security for the Fund's obligations under its guarantee, effectively subordinating the Secured Notes to the Preference Shares.

Approvals

33 The Proposed Transaction is subject to the approval of: (1) at least two-thirds of the votes cast by the holders of the Common Shares and Preference Shares at the Special Meeting, voting as a single class; (2) at least two-thirds of the Preference Shareholders, voting separately as a class; and (3) the TSX, if and to the extent required by the TSX. It is understood that TSX approval has been received.

34 As mentioned, the Company has called the Special Meeting of the Company's shareholders to be held on March 26, 2013. The Special Meeting has been called to consider and vote upon a special resolution authorizing the amendments to the Preference Share conditions described below to implement the terms of the Settlement Agreement described herein (the "Special Resolution"). In connection with the Special Meeting, the Company has delivered to the Company's Preference Shareholders a notice of special meeting of shareholders and management information circular dated February 28, 2013 (the "Circular").

Priority and Payment Arrangements

35 The Settlement Agreement provides that upon receiving the approvals described above, the Fund will execute the Guarantee (defined below) and the Note Pledge Agreement (defined below), together with amended articles of the Company giving effect to the amendments to the conditions attaching to the Preference Shares described below. Such documents are to be delivered to Solar Harvest, Fortune and the Preference Shareholders, in the case of the latter by a posting on SEDAR.

Share Provision Amendments

36 The Settlement Agreement provides for the following amendments to the Preference Shares:

1. The Preference Shareholders will irrevocably waive their rights to approximately $440,000 of presently accrued and unpaid dividends. In addition, the Preference Shares will cease to accrue dividends going forward;
2. The retraction right of the Preference Shareholders will be deleted and replaced by a schedule of mandatory cash payments by way of reduction of stated capital, commencing with a ayment of $60,000 after approval at the Special Meeting, followed by quarterly payments in each twelve month period commencing August 1, 2013 and ending May 1, 2019 in varying amounts totaling approximately $2.4 million (the "Scheduled Preference Share Payments"); and
3. All unpaid Scheduled Preference Share Payments will become due and payable in the event any person acquires "control" (as defined in the OBCA) of the Fund or the Company. In addition, the Company shall have the right to make full or partial prepayments at any time.

The amendments to the Preference Share conditions giving effect to these provisions are herein referred to as the "Proposed Amendments".

Secured Notes Interest Payments

37 The Settlement Agreement further provides, as mentioned, that the Company agrees in favour of the Preference Shareholders that the annual interest payments on the Secured Notes as of January 1, 2013 will not, in the aggregate, exceed the annual payments made to the Preference Shareholders in accordance with the Scheduled Preference Share Payments and any prepayments to Preference Shareholders, being the amount of the Permitted Annual Interest Payments. In addition, the Company and the Fund agree that, until the Scheduled Preference Share Payments have been paid in full, no payments of principal or interest shall be made on the Secured Notes after January 1, 2013 apart from the Permitted Annual Interest Payments.

The Guarantee

38 The Settlement Agreement contemplates that the Fund will execute and deliver to a collateral agent, on behalf of the Preference Shareholders, a limited recourse guarantee of the Company's obligations to the Preference Shareholders pursuant to the amended Preference Share conditions, including payment of the Scheduled Preference Share Payments (the "Guarantee"). The Fund's liability under the Guarantee will be limited to the amounts owing by the Company to the Fund under the Secured Notes, and all security related thereto (collectively, the "Collateral"). Accordingly, enforcement of the Guarantee by the collateral agent and the Preference Shareholders will be limited recourse to the Collateral and any proceeds of realization arising from the Assignment (defined below). The Guarantee will also contain an obligation of the Fund that would restrict the Fund from receiving payments from the Company under the Secured Notes, except for the Permitted Annual Interest Payments.

The Note Pledge Agreement

39 The Settlement Agreement also contemplates that the Fund will execute and deliver to the collateral agent, on behalf of the Preference Shareholders, a note pledge security agreement pursuant to which the Fund will grant a security interest in the Collateral (the "Note Pledge Agreement"). The security interest in the Note Pledge Agreement will become enforceable upon failure by the Company to satisfy its obligations to the Preference Shareholders pursuant to the amended Preference Share conditions, including payment of the Scheduled Preference Share Payments.

40 The Note Pledge Agreement will also contain an assignment to the Preference Shareholders of all amounts owing by the Company to the Fund, as the holder of the Secured Notes, including all principal and interest owing on the Notes apart from the Permitted Annual Interest Payments (the "Assignment").

41 Pursuant to the Settlement Agreement, the Fund has agreed to hold any amounts received on the Secured Notes, other than in respect of Permitted Annual Interest Payments, in trust for the Preference Shareholders up to an amount equal to the amount remaining to be paid in respect of the Scheduled Preference Share Payments, and will pay such amount to the Preference Shareholders prior to any distribution or other payment for the benefit of the Fund. It is assumed that this commitment will be set out in the Guarantee or the Note Pledge Agreement.

42 The collective effect of the provisions of the Guarantee and the Note Pledge Agreement is: (1) to postpone payment to the Fund of all amounts owing on or in respect of the Secured Notes, other than the Permitted Annual Interest Payments, to payment in full of the Scheduled Preference Share Payments; and (2) to grant a security interest in the assets of the Company in favour of the Preference Shareholders (via a security interest in the security interest granted earlier in favour of the holders of the Secured Notes) to secure the Fund's Guarantee of payment of the Scheduled Preference Share

Payments which, effectively, ranks the security position of the Preference Shares ahead of the security position of the Secured Notes.

Voting Support

43 In the Settlement Agreement, Solar Harvest agreed, among other things, to vote in favour of the Special Resolution and to vote against, and forebear from taking, any actions that might impede, interfere with, delay or discourage the transaction contemplated by the Settlement Agreement. Greenbriar has executed an agreement dated February 28, 2013 having substantially similar commitments to those of Solar Harvest.

44 The Fund also has agreed in the Settlement Agreement to vote the Common Shares in favour of the Special Resolution and to vote against any action that would impede, interfere with, delay or discourage the transaction contemplated by the Settlement Agreement.

The Negotiations Between the Company and Solar Harvest Resulting in the Settlement Agreement

45 The Settlement Agreement was the outcome of a negotiation with Solar Harvest which the Company initiated in June 2012. In view of the retraction date of April 1, 2013 and the Company's inability to satisfy its retraction obligations in cash, the Company sought an agreement to defer the retraction date.

46 In January 2013, the Company retained Klein Farber Corporate Finance Inc. ("Klein Farber") to provide financial advisory services to the Company in connection with a possible restructuring of the Preference Shares.

47 On February 5, 2013, at a meeting attended by Fortune, Fielden, Skillins, Klein Farber representatives as well as legal counsel for Solar Harvest and the Company, it became clear to the Company that Solar Harvest was not prepared to agree to the Company's preferred option of a 2-3 year extension of the retraction period in return for a modest up-front payment. In addition, Solar Harvest advised that it believed that the creation of the Secured Notes in 2005, and the granting of the security interest in favour of the Secured Notes in 2009, was oppressive behavior under the OBCA as regards the Preference Shareholders, and that it was prepared to take legal action against the Company and possibly the Fund if a mutual agreement could not be reached.

48 On February 8, 2013, Klein Farber delivered a tentative proposal to the Board and the Trustees setting out its views. The Board and the Trustees met together on four other occasions during February 2013 to consider proposals negotiated between Solar Harvest and Klein Farber on behalf of the Company.

49 On February 19, 2013, the Board and the Trustees approved the formation of a joint special committee of the Fund and the Company, comprised of Fielden, Scarafile and Skillins (collectively, the "Special Committee"), to negotiate a resolution with Solar Harvest together with Klein Farber. None of the members of the Special Committee own any Preference Shares.

50 The business terms of the Settlement Agreement were approved by the Board at a meeting held on February 25, 2013. McLaughlin had previously declared a conflict of interest due to his position as a Preference Shareholder and Unitholder. He did not participate in any negotiations with Solar Harvest and abstained from voting on the proposed arrangements at the meeting on February 25, 2013.

Applicable Provisions of the Declaration of Trust

51 The following sets out the principal provisions of the Declaration of Trust relied upon by the

parties. I have italicized the provisions upon which the Respondent relies in arguing that the Declaration of Trust does not require a vote of the Unitholders in respect of the Proposed Transaction.

52 Article 4.1 describes the operations and activities of the Fund as restricted to ten specific classes. These include:

> (a) acquiring, investing in, transferring, disposing of and otherwise dealing with securities, including the New Dominion Common Shares and Participating Notes ...; ...
> (e) guaranteeing (as guarantor, surety or co-principal obligor) the payment of any indebtedness, liability or obligation of the Company ... and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering all or any part of the assets of the Fund, including securities issues by the Company or any direct or indirect subsidiary of the Fund, as security for that guarantee and subordinating its rights under the Participating Notes to other indebtedness;
> (f) disposing of any part of the Fund Assets, subject to the provisions of this Declaration of Trust;
> (g) undertaking all other usual and customary activities or taking all actions for the conduct of the activities of the Fund in the ordinary course;

53 The rights of Unitholders are extremely limited, as provided in Article 2.6. In particular:

> The legal ownership of the Fund Assets and the right to conduct the activities of the Fund are vested exclusively in the Trustees ... and no Unitholder has or is deemed to have any right of ownership in or any other interest in, any of the Fund Assets, except as specifically provided herein.

54 The powers of the Trustees, as set out in Article 9.1, are extremely broad:

> 9.1 Powers of the Trustees
>
> Subject to the terms and conditions of this Declaration of Trust, the Trustees in respect of the Fund Assets may exercise any and all rights, powers and privileges that could be exercised by a legal and beneficial owner thereof and shall supervise the investments and affairs of the Fund. Subject to the specific limitations contained in this Declaration of Trust, the Trustees shall have, without further or other action or consent, and free from any power or control on the part of the Unitholders, full, absolute and exclusive power, control and authority over the Fund Assets and over the affairs of the Fund to the same extent as if the Trustees were the sole and absolute beneficial owners of the Fund Assets in their own right, to do all such acts and things as in their sole judgment and discretion are necessary or incidental to, or desirable for, carrying out the trust created hereunder. *In construing the provisions of this Declaration of Trust, presumption shall be in favour of the powers and authority granted to the Trustees.* The enumeration of any specific power or authority herein (including pursuant to Section 9.2) shall not be construed as limiting the general powers or authority or any other specified power or authority conferred herein on the Trustees. To the maximum extent permitted by Applicable Laws, the Trustees shall, in carrying out investment activities, not be in any way restricted by the provisions of the laws of any jurisdiction limiting or purporting to limit investments that may be made by trustees.".

55 Article 9.2 gives the Trustees a lengthy list of specific powers which they may exercise "without any action or consent by the Unitholders":

> 9.2 Specific Powers and Authorities
>
> Subject only to the express limitations contained in this Declaration of Trust and in addition to any other powers and authorities conferred by this Declaration of Trust or which the Trustees may have by virtue of any present or future statute or rule of law, the Trustees *without any action or consent by the Unitholders shall have and may exercise at any time and from time to time the following powers and authorities* which may or may not be exercised by the Trustees in such manner and upon such terms and conditions as they may from time to time determine proper; ...
>
> (r) *to guarantee the obligations of the Company or any affiliate of the Company or the Fund pursuant to any good faith debt for borrowed money incurred by the Company or the affiliate, as the case may be, and pledging securities issued by the Company or the affiliate, as the case may be, as security for such guarantee;*
>
> (v) *to mortgage, hypothecate, pledge or otherwise create a security interest in all or any moveable or personal, immovable or real property or other assets of the Fund, owned or subsequently acquired, to secure any obligation of the Fund;*
>
> (y) to manage the Fund Assets; ...
>
> (gg) to do all such other acts and things as are necessary, useful, incidental or ancillary to the foregoing *and to exercise all powers and authorities that are necessary, useful, incidental or ancillary to carry on the affairs of the Fund, to promote the purpose for which the Fund is formed and to carry out the provisions of this Declaration of Trust.*

56 The Applicant argues that the Trustees are required to call a meeting of the Fund's Unitholders in the present circumstances by virtue of the provisions of Article 9.5 of the Declaration of Trust, which reads as follows:

> 9.5 Restrictions on Trustees Powers
>
> (a) Notwithstanding section 9.4, the Trustees may not under any circumstances whatsoever vote the New Dominion Common Shares or, where applicable, the Participating Notes, nor permit any of the securities of any other member of the Fund Group that are directly or indirectly owned or controlled by the Fund, to authorize any transaction which is materially adverse to the Unitholders, including, among other things:
>
> (i) any sale, lease or other disposition of all or substantially all of the assets of any members of the Fund Group, except as part of an Internal Reorganization with an affiliate or subsidiary of any member of the Fund Group or the Fund or a permitted charge, pledge or lien in accordance with Section 9.2(p); or
>
> (ii) any amalgamation, arrangement or other merger of any member of the Fund Group with any other entity, except as part of an Internal Reorganization with an affiliate or subsidiary of any member of the Fund Group or the Fund;

(iii) the winding-up or dissolution of any member of the Fund Group prior to the end of the term of the Fund, except as part of an Internal Reorganization with an affiliate or subsidiary of any member of the Fund Group or the Fund; or

(iv) any material amendment to the constating documents of any member of the Fund Group to change the authorized share capital or units or otherwise amend the rights, privileges, restrictions and conditions attaching to any class of shares or units of those entities in a manner that may be prejudiced to the Fund or the Unitholders.

without the approval of the Unitholders by Special Resolution at a meeting of Unitholders called for that purpose.

(b) Except pursuant to a pledge in accordance with Section 9.2(r) hereof, the Trustees shall have no power to sell or otherwise dispose of any of the new Dominion Common Shares, the Participating Notes (except pursuant to an in specie redemption under Section 6.5) or to sell all or substantially all of the Fund Assets or cause the Company to sell all or substantially all of its assets, except: (i) with the approval of the Unitholders by Special Resolution at a meeting of the Unitholders called for that purpose, or (ii) as part of an internal reorganization of the direct or indirect assets of the Fund as a result of which the Fund has the same interest, whether direct or indirect, in the assets as the interest, whether direct or indirect, that it had prior to the reorganization (an "Internal Reorganization").

(c) The Trustees shall only vote the New Dominion Common Shares and exercise the rights under the Participating Notes in the manner provided for herein or under the Participating Note Indenture, as the case may be.

Positions of the Parties

57 The following summarizes the views of the parties regarding the merits of the Proposed Transaction. It is not intended to be exhaustive but rather to identify the principal matters raised by the parties that have given rise to this litigation. I have addressed their respective legal positions on the two principal questions in the analysis of those questions below.

The Applicant

58 The Applicant's position is informed by its view that the Proposed Transaction would prejudice the Fund and the Unitholders in the following four ways.

59 First, it says the Proposed Transaction would severely limit the annual interest payments that can be made on the Secured Notes. The Applicant says that the restriction on interest payments on the Secured Notes to the Permitted Annual Interest Payments will restrict the Company to paying only $300,000 between April 1, 2013 and May 1, 2014, which represents an interest rate of approximately 1.56%. It says that the highest interest rate the Company can ever pay will occur in the fifth year of the Scheduled Preference Share Payments; moreover, even in that year, the Company can only pay $620,000 for an effective interest rate of approximately 3.22%, which it characterizes as far below what the Fund would be entitled to receive in the ordinary course.

60 Second, it says the Proposed Transaction would postpone repayment of the principal and unpaid interest on the Secured Notes to the repurchase of all of the Preference Shares in accordance with the Scheduled Preference Share Payments. This is the undisputed consequence of the postponement language in the Guarantee, the Assignment, the agreement to hold any amounts received in excess of payments on account of the Permitted Annual Interest Payments in trust for the Preference Shareholders, and the pledge of the security in the Note Pledge Agreement previously granted in favour of the holders of the Secured Notes.

61 Third, it says the Proposed Transaction would postpone the maturity date of the Secured Notes by at least three years past the current scheduled retirement date of January 1, 2016 by virtue of tying repayment to the completion of the Scheduled Preference Share Payments, which are not to be completed until May 1, 2019.

62 Fourth, the Applicant objects to the provision of the Proposed Transaction that requires the Company to immediately repay its entire obligation to the Preference Shareholders in the event of a change of control of the Company or the Fund. It says that this restriction discourages any person from attempting to obtain control of the Fund - and thereby paying a control premium on the Units - because it will trigger a significant obligation to the Preference Shareholders, which will likely engage the Guarantee given by the Fund.

The Respondent

63 The Respondent argues that the Unitholders will receive the following benefits from the Proposed Transaction: (1) a waiver of $340,000 in dividend arrears on the Preference Shares; (2) a waiver of the retraction rights of the Preference Shareholders in favour of payments totalling $2.4 million over the six-year period to 2018; and (3) a waiver of all future dividends. It says that implementation of the Proposed Transaction should permit the Company to continue as a going concern making payments on the Secured Notes, if it so chooses, generating yields against its current market capitalization estimated by Klein Farber to be 4.9%, 7.435%, 9.8%, 11% and 12.7% over the next five years. There is, however, no support for these calculations in the materials before the Court on this application.

64 In addition, the Respondent submits that the Proposed Transaction will avoid the prospect of insolvency or litigation to determine the competing rights of the holders of the Secured Notes and the Preference Shares in the event of a liquidation of the Company. The Respondent says it has been advised by the joint solicitors of the Fund and the Company, Cassels Brock & Blackwell LLP ("Cassels Brock"), that it was impossible to say with any certainty what the outcome of any such litigation might be. The legal opinion of Cassels Brock is not, however, before the Court on the application.

65 Lastly, the Respondent believes that Renegade's intention to cause the Company to commence an insolvency proceeding entails a significant risk for the Unitholders. It says that an insolvency process would be "perilous" to the Company. The Respondent argues that, in an insolvency, the Company's international suppliers would stop doing business with it. It says that these suppliers represent a large portion of the Company's produce and almost all of its high margin products. It says that it also expects that the quality and availability of produce provided by its North American suppliers would decline drastically in response to a concern for payment. Collectively, the Respondent believes such a decline in quality and availability would rapidly erode the Company's business.

Analysis and Conclusions

Issues Addressed on this Application

66 There are two principal questions raised by the Applicant:

1. Are the Trustees required by Article 9.5(a) of the Declaration of Trust

to obtain the approval of the Unitholders by a special resolution passed at a meeting of Unitholders in order to vote the Common Shares at the Special Meeting of the Company?

2. Did the Trustees breach their duty to exercise the degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances in reaching their decision to approve the Proposed Transaction and enter into the Settlement Agreement?

67 In each case, the relief sought is an order requiring the Trustees to convene a meeting of the Unitholders to consider a special resolution under the Declaration of Trust authorizing the Trustees to vote in favour of the Proposed Transaction at the Special Meeting of the Company called for March 26, 2013 by voting in favour of the Proposed Amendments. The Applicant also seeks an order requiring the Company to adjourn the Special Meeting until after such meeting of Unitholders is held.

68 I will address each of the two principal questions in turn.

Do the Trustees Require the Approval of the Unitholders to Vote the Common Shares at the Special Meeting of the Company to Authorize the Proposed Transaction?

69 The Applicant argues that the Proposed Transaction either falls within the specific type of transaction contemplated by Article 9.5(a)(iv) or falls generally within the introductory language of Article 9.5(a) as a transaction which is materially adverse to the Unitholders. In either case, the Trustees would require the approval of the Unitholders given by special resolution at a meeting of Unitholders in order to vote in favour of the Proposed Transaction at the Special Meeting of the Company called to approve the Special Resolution.

Preliminary Observations

70 Before proceeding to this issue, I propose to set out certain observations that inform the conclusions below.

71 This issue involves the contractual interpretation of Article 9.5(a) of the Declaration of Trust. The applicable principles of contractual interpretation were set out by Blair J.A. in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 at para. 24:

> ... a commercial contract is to be interpreted,
>
> (a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;
> (b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said;
> (c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties; 3 and (to the extent there is any ambiguity in the contract),
> (d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.

72 In this case, in addition to the plain meaning of the Declaration of Trust, the context in which the Declaration of Trust was created and executed is relevant. The principal purpose of the income trust structure was to provide the Company's shareholders with a potentially more beneficial tax

consequence on receipt of distributions from the Company. From this, I think two important principles of interpretation of the Declaration of Trust must follow.

73 First, the Company's shareholders did not intend to change in any material way the respective rights and obligations of the Company's directors or shareholders when they established the Fund and exchanged their Common Shares for Units of the Fund.

74 However, implementation of the income trust structure involved the creation of Secured Notes that were intended to be enforceable in accordance with their terms. In particular, it was intended that the Secured Notes would constitute debt instruments in order that, among other things, payments in respect of the Secured Notes would constitute interest expense of the Company for tax purposes. In effect, the rights associated with the Common Shares prior to the transaction by which the income trust was established are now represented collectively by the rights associated with both the Secured Notes and the Common Shares.

75 However, in this case, the Company had previously issued Preference Shares which remained outstanding after the income structure was implemented. As debt instruments, the Secured Notes necessarily ranked ahead of the Preference Shares. Therefore, in analyzing the issues on this application, the rights of the holders of the Secured Notes cannot be assimilated into the rights attaching to the equity of the Company associated with the Common Shares.

76 From the foregoing, I conclude that a second important principle of interpretation of the intention of the parties at the time of the creation and execution of the Declaration of Trust was that the rights of the Unitholders in respect of the Secured Notes and the Units should not be materially different from the rights that the common shareholders of the Company would have had if such shareholders held Secured Notes and Common Shares directly in the Company immediately prior to the establishment of the income trust structure. Similarly, the rights and powers of the Trustees in respect of modification of the rights attaching to the Secured Notes and the Common Shares and the implementation of transactions of fundamental importance to the Unitholders should not be materially different from the rights and powers of the directors of the Company if the shareholders held Common Shares and Secured Notes in such manner. As is discussed below, I am of the opinion that this intention is, in fact, also reflected in the language of Article 9.5(a) of the Declaration of Trust.

Analysis

77 I will analyze the issues on this application by first setting out my conclusions regarding the interrelationship of the relevant provisions of the Declaration of Trust and addressing an important issue of contractual interpretation pertaining to Article 9.5(a). I will then address whether the provisions of Article 9.5(a)(iv), in particular, mandate a vote of the Unitholders in the present circumstances and, if not, whether the general introductory language of Article 9.5(a) requires such a vote.

The Interrelationship of the Relevant Provisions of the Declaration of Trust

78 In my view, the provisions of the Declaration of Trust referred to by the parties on this application interact in the following manner.

79 First, as the Respondent argues, one of the purposes of the Trust, set out in Article 4.1(e), can be interpreted as applying to the present circumstances, depending upon whether or not an "obligation of the Company" extends to an obligation to retract the Preference Shares. Assuming that it does, however, this provision addresses only the purposes of the Fund. It is protection to the Unitholders that neither the Trustees nor the other Unitholders will seek to extend the activities of the Fund beyond the specific purposes for which the Fund was created. It does not address the powers of the Trustees, except to the extent that it may invalidate actions of the Trustees that are directed toward purposes that do not fall within the specifically enumerated purposes of the Fund.

80 Second, while it does not appear that the specific powers of the Trustees in Article 9.2(r) would authorize the Guarantee, there is a reasonable argument that the powers in Article 9.2(v) extend to authorizing the commitments of the Fund in the Note Pledge Agreement and the Settlement Agreement respecting security. In any event, however, the powers granted to the Trustees in Article 9.2(gg) appear sufficient to authorize all of the documentation giving effect to the Proposed Transaction, assuming "obligation of the Company" extends to the obligation arising on the retraction of the Preference Shares. Article 9.2(gg) grants all powers necessary to, among other things, carry out the affairs of the Fund and the purpose of the Fund. By virtue of the specific purposes in Article 4.1(c), this provision provides the necessary authority to the Trustees. In addition, the broad italicized language of Article 9.1 supports this interpretation.

81 Accordingly, I conclude that the Trustees had authority to pursue the Proposed Transaction on behalf of the Fund. However, the fact that the Trustees had such authority does not answer the question of whether the Trustees had the authority to enter into a commitment in respect of the Proposed Transaction that was binding on the Fund in the absence of a vote of the Unitholders.

82 Third, the circumstances in which a Unitholder vote is required are addressed in Article 9.5, which overrides a general provision in Article 9.4 that provides that the Trustees have the power to vote the Common Shares in meetings of the Company. There is no provision in the Declaration of Trust that expressly states that the authority granted to the Trustees in Articles 9.1 and 9.2 is subject to the provisions of Article 9.5. However, I am satisfied that the language of these provisions compels this result. I note that the Respondent agreed with this interpretation at the hearing of this application.

83 Article 9.5 does not expressly refer to Articles 9.1 and 9.2. Nevertheless, I am of the opinion that this is the result of the introductory language of each of Articles 9.1 and 9.2. The voting provisions of Article 9.5 constitute "terms and conditions" of the Declaration of Trust for purposes of Article 9.1 and "express limitations" contained in the Declaration of Trust for purposes of Article 9.2. It is also consistent with the manner in which the Declaration of Trust is drafted. There is no attempt made to describe "watertight compartments" of actions of the Trustees not requiring Unitholder approval and actions requiring Unitholder approval, apart from the specific transactions described in paragraphs (i) to (iv) of Article 9.5(a). In particular, as discussed below, the introductory language of Article 9.5(a) expressly contemplates transactions that are materially adverse to the Unitholders that are not expressly excluded from the transactions that would also fall within the express powers of the Trustees under section 9.2. In the same manner, certain transactions could be adverse but not materially adverse - for example, a limited interest holiday - or materially adverse - for example, a permanent waiver of interest.

84 In this manner, the Declaration of Trust operates such that, on the one hand, the Trustees have the power to pursue Transactions within their powers and, on the other hand, a Unitholder vote is required in respect of transactions that are properly authorized but are nevertheless materially adverse to the Unitholders.

The Contractual Interpretation of Article 9.5(a)

85 Article 9.5(a) is structured as a statement of a general principle followed by "including without limitation" language. The introductory language states a general principle that the Trustees may not vote the Common Shares to authorize any transaction "which is materially adverse to the Unitholders". It then proceeds to refer specifically to four specific types of transactions that require a Unitholder vote.

86 The wording of Article 9.5(a) leaves open whether the transactions in paragraphs (i) to (iv) of Article 9.5(a) represent specific transactions that are understood to be materially adverse *per se* or, as the Respondent suggests, are included within the provisions of Article 9.5(a) whether or not a proposed transaction that is described by one of these paragraphs in any particular circumstance is properly characterized as materially adverse to the Unitholders. As discussed further below, I agree with the Respondent.

87 However, the important point for present purposes is the clear statement by the use of the "without limitation " language that the enumeration of the four specific types of transactions in paragraphs (i) to (iv) of Article 9.5(a) is not intended to be exhaustive of the category of transactions that can be characterized as "materially adverse to the Unitholders". This language is evidence of an intention to apply this provision broadly to include other circumstances that are not specifically described in these paragraphs and, in particular, that are not described in paragraph (iv). If authority is necessary for this conclusion based on the drafting approach in Article 9.5(a), it can be found in the decision of the Supreme Court in *National Bank of Greece (Canada) c. Katsikonouris,* [1990] 2 S.C.R. 1029, paras. 12-14.

88 This raises, however, the important issue of whether the determination that any particular transaction qualifies as a "materially adverse transaction" is an objective determination or is a determination in respect of which a court should defer to the judgment of the Trustees in application of the "business judgment rule". In this case, the Trustees have concluded, implicitly if not explicitly, that the Proposed Transaction, when considered as a whole, is not materially adverse to the Unitholders. It is their view that the Unitholders would realize a better outcome if the Proposed Transaction were implemented than they would if it were not implemented and the Preference Shareholders exercised their retraction rights on April 1, 2013.

89 The Respondent argues that the determination of whether or not a proposed transaction is materially adverse to the Unitholders is to be made by the Trustees and is a determination to which the Court should give deference in accordance with, and subject to, the limitations of the "business judgment rule".

90 The Applicant says that the determination is an objective one to be made by the Court and to which the "business judgment rule" has no application. In the alternative, it submits that the decision-making of the Trustees does not satisfy the requirements of the "business judgment rule" and should be set aside in favour of a determination of the Court that the Proposed Transaction is materially adverse to the Unitholders. In view of the determination below, it is unnecessary to reach a conclusion on the Applicant's second argument.

91 For this purpose, I adopt the description of the "business judgment rule" articulated by Lax J. as follows in *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496, paras. 152-153, 27 B.L.R. (3d) 53 (Ont. S.C.J.), aff'd (2004), 250 D.L.R. (4th) 526 at para. 6, 183 O.A.C. 310 (Ont. C.A.) [*UPM*]:

> The business judgment rule protects Boards and directors from those that might second-guess their decisions. The court looks to see that the directors made a reasonable decision, not a perfect decision. This approach recognizes the autonomy and integrity of a corporation and the expertise of its directors. They are in the advantageous position of investigating and considering first hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation.
>
> However, directors are only protected to the extent that their actions actually evidence their business judgment. The principle of deference presupposes that directors are scrupulous in their deliberations and demonstrate diligence in arriving at decisions. Courts are entitled to consider the content of their decision and the extent of the information on which it was based and to measure this against the facts as they existed at the time the impugned decision was made. Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to

examination. [citations omitted]

92 While the "business judgment rule" was developed in the context of corporate boards of directors, jurisprudence now establishes that the principle also operates in respect of trustees of income trusts and other "business" trusts in relation to business decisions taken by the trustees of such trusts: See *Rio Tinto Canadian Investments Ltd. v. Bone*, [2001] O.J. No. 2440, 2001 CarswellOnt 2418 (WL Can) at para. 16 (Ont. S.C.J.), Farley J. aff'd on other grounds 41 E.T.R. (2d) 283 (Ont. C.A.); and *Laxey Partners Ltd. v. Strategic Energy Management Corp.*, 2011 ONSC 6348 at para. 74. I think it is also clear from the case law that the consideration of the process followed by a board in reaching a business judgment and the assessment of the reasonableness of that judgment is a contextual analysis dependent on the particular circumstances of each case, including, but not limited to, the nature and size of the corporation.

93 I conclude that the determination of whether or not the Proposed Transaction is materially adverse to the Unitholders is an objective determination to be made by the Court to which the "business judgment rule" has no application.

94 The consequence of the application of the "business judgment" rule to the determination of whether or not a proposed transaction is materially adverse to the Unitholders is that a Unitholder's right to vote in respect of proposed transactions that do not fit within paragraphs (i) to (iv) of Article 9.5(a) would be severely limited, if not empty as the Applicant argues. The only circumstance in which a Unitholder vote would proceed would be the circumstance of a proposed transaction that the Trustees considered was materially adverse but nevertheless was one that the Trustees were prepared to have put to the Unitholders or otherwise considered should be put to them, for example, to insulate the Trustees from liability. For the following reasons, I do not think that this was the intention of the parties when the Declaration of Trust was created.

95 First, the plain meaning of the language of Article 9.5(a) is clear. The prospect of an adverse consequence to the current position of the Unitholders calls for a Unitholder vote. If the fact that the Trustees approved the transaction were sufficient to remove the transactions from the category of a "materially adverse transaction", the Unitholders would lose that right in the very circumstances in which Article 9.5(a) contemplates that it would operate. If that had been intended, the Declaration of Trust could easily have been drafted to refer to "a transaction which is materially adverse in the opinion of the Trustees". The absence of such language indicates a contrary intention.

96 Second, I think that an objective determination makes commercial sense in the circumstances. As the present circumstances demonstrate, there can be transactions that proceed in circumstances where the result is materially adverse to the Unitholders but is better, at least in the minds of the Trustees, than any other alternative. In other words, it is a "Hobson's choice" in which all the alternatives are materially adverse to the Unitholders, and the exercise is to select the alternative that is the least materially adverse. On the Trustee's view, there would be no vote as the Trustee's approval of a particular alternative would constitute a determination that the proposal was not materially adverse. I do not think this result was intended by the parties. In such circumstances, it is desirable from the Trustees' view, as well as from the Unitholders perspective, that the Unitholders be given the opportunity to indicate whether they agree with the Trustees' business judgment before they bear the adverse effects of a proposed transaction.

97 Third, as mentioned above, the Respondent agrees that the Unitholders are entitled to a vote in respect of a transaction that falls within paragraphs (i) to (iv) of Article 9.5(a) irrespective of whether the proposed transaction is characterized as a transaction that would be materially adverse to the Unitholders. I am satisfied that this result reflects the intention of the parties to reproduce in contractual language the circumstances in which a holder of Common Shares would have had a right to vote on a proposed transaction prior to the establishment of the income trust structure. This is consistent with the more general principle of contractual interpretation discussed above to the effect that the Declaration of Trust should be interpreted with a view to preserving, rather than altering in

either direction, the rights and obligations of the Unitholders and the Trustees from those which would have existed if the current capital structure had existed directly between the Company and the common shareholders immediately prior to the establishment of the income trust structure.

98 Applying this principle to the present circumstances, I do not think that it was intended to deprive the Unitholders of a vote in circumstances in which they would have been entitled to a vote as holders of the Secured Notes. There can be no doubt that, in such capacity, proposed amendments to the Secured Notes which were materially adverse to the holders of the Secured Notes would have given rise to a requirement of a vote of the holders under the Secured Note Indenture, regardless of the view of the directors as to the merits of the Proposed Transaction considered as a whole.

99 Lastly, as the Respondent acknowledges, the implication of its position is that every situation in which the Trustees approved a transaction that was objectively materially adverse to the Unitholders would, if opposed by one or more Unitholders, require a judicial determination as to whether the Trustees' decision was entitled to the benefit of the "business judgment rule". This impractical result cannot have been intended. The intention of a Declaration of Trust is to set out rules that govern the rights and obligations of the Trustees and the Unitholders that are sufficiently clear that they can be applied in most circumstances without judicial involvement.

Does the Proposed Transaction Fall Within Paragraph (iv) of Article 9.5(a)?

100 In its application record, the Applicant suggested that its principal argument in respect of Article 9.5(a) was that the present circumstances fell within the provisions of Article 9.5(a)(iv). At the hearing, as is addressed below, it argued more strenuously that the circumstances were engaged by the general language that introduces Article 9.5(a). This section addresses the first argument. The next section addresses the second argument.

101 The Respondent says that, in asserting that the Trustees are restricted from voting the Common Shares in favour of the Special Resolution by virtue of the provisions of Article 9.5(a)(iv), the Applicant conflates the proposed amendments to the constating documents of the Company with the other terms of the Proposed Transaction contemplated by the Settlement Agreement.

102 As a factual matter, the Respondent says that the Settlement Agreement and the Circular clearly indicate that the only proposed amendments to the articles of the Company are the following: (1) elimination of the right of the holders of the Preference Shares to dividends in arrears totalling $340,000 and the elimination of the accrual of further dividends going forward; (2) deletion of the right of retraction and the substitution of an obligation of the Company to make the Scheduled Preference Share Payments over a six-year time period; and (3) inclusion of a right in favour of the Company to make prepayments of the Scheduled Preference Share Payments and an acceleration of all outstanding Scheduled Preference Share Payments in the event of a change in control of the Fund or the Company. These are the Proposed Amendments as defined above.

103 The Respondent says that the provisions of the Proposed Transaction which the Applicant actually opposes are the following: (1) the Fund's agreement to guarantee the Company's obligations to Preference Shareholders, with recourse against the security held in favour of the Fund as the holder of the Secured Notes; (2) the Fund's agreement to forego interest payments above the Permitted Annual Interest Payments; and (3) the Fund's agreement to hold amounts received from the Company, other than in respect of the Permitted Annual Interest Payments, in trust for the Preference Shareholders until the Company's obligations in respect of the Preference Shares are fully satisfied.

104 The Respondent says that these provisions of the Proposed Transaction represent contractual obligations of the Fund that are contained in the Settlement Agreement and the documents which are contemplated to implement the Proposed Transaction, in particular the Guarantee and the Note Pledge Agreement, but do not form part of, and are not included in, the Proposed Amendments. As a result, the Respondent says that these provisions do not come within the wording of Article 9.5(a)(iv), since they do not constitute a "... material amendment to the constating documents of any member of the Fund Group".

105 I agree with the Respondent on this issue. The language of Article 9.5(a)(iv) is clear in referring to amendments to constating documents. I am not persuaded that the words "in a manner" are sufficiently broad that they extend to the totality of the Proposed Transaction or to the other elements of the Proposed Transaction that are not implemented by amendments to the articles of the Company. I would add that I consider the Applicant's position on the present issue to be contrary to its approach generally to the issues on this application. As discussed above, the Applicant proceeds on the basis that the Respondent, in particular the Trustees, failed to the treat the Fund and the Company separately in considering the merits of the Proposed Transaction. In this case, I consider that the Applicant has failed to distinguish the elements of the Proposed Transaction that affect the Company from those which affect the Fund.

Is the Proposed Transaction Materially Adverse to the Unitholders for the Purposes of Article 9.5(a)?

106 I have concluded above that the determination of whether the Proposed Transaction is materially adverse to the Unitholders is to be made by the Court on an objective basis without application of the "business judgment rule". Accordingly, the remaining issue is whether the Court should find that that the Proposed Transaction objectively constitutes a "transaction which is materially adverse to the Unitholders" for the purposes of Article 9.5(a). The onus of demonstrating that it does rests with the Applicant.

107 As a preliminary matter, I note that it could be argued that Article 9.5(a) does not apply on the ground that, in voting the Common Shares at the Special Meeting, the Trustees are not "voting to authorize any transaction" which is materially adverse to the Unitholders. The Respondent did not, however, raise this issue although, as discussed above, it did assert a somewhat similar argument based on the more specific language in Article 9.5(a)(iv). In any event, I would reject any such argument for the following reasons.

108 First, even if it is literally the case that the Special Resolution addresses only the Proposed Amendments, there is no doubt that approval of such Amendments is a condition of implementation of the Proposed Transaction. Among other things, it triggers the Fund's obligation to deliver the Guarantee and the Note Pledge Agreement. In this sense, a vote for the Proposed Amendments is a vote that authorizes the Proposed Transaction. Second, I think that it is appropriate to interpret the language of Article 9.5(a) broadly to capture circumstances, such as the present, which could have been structured to require a vote on one or more essential elements of the Proposed Transaction. To do otherwise would open up the possibility that the Trustees could structure proposed transactions so as to avoid a vote of Unitholders in respect of a transaction that was clearly materially adverse to them. In this case, the postponement and subordination arrangements could have been effected by amendments to the Secured Note Indenture. The fact that the relevant covenants are given in the Guarantee and the Note Pledge Agreement, rather than the Secured Note Indenture, should not obscure the fact that, in essence, the materially adverse features of the Proposed Transaction take the form of amendments to the rights and obligations attaching to the Secured Notes.

109 The Applicant relies on the four features of the Proposed Transaction mentioned above to argue that the Proposed Transaction materially adversely affects the Unitholders by materially adversely affecting the Secured Notes. I consider that the principal impact of the Proposed Transaction is to postpone all payments on the Secured Notes to payment of the Scheduled Preference Share Payments, apart from the Permitted Annual Interest Payments. The subordination arrangements, involving the granting of security in the Note Pledge Agreement, the trust arrangement respecting excess monies received and the Assignment, are mechanisms for ensuring that this postponement operates in all circumstances, including insolvency. In addition, but of a more secondary nature, the Proposed Transaction also imposes a limit on annual interest payments on the Secured Notes and provides for a potential "poison pill" in the form of an acceleration of the Scheduled Preference Share Payments in the event of a change of control of the Fund or the Company. The Applicant says that these elements of the Proposed Transaction are, by definition, adverse because they are borne entirely by the Secured Notes without receiving any valuable consideration.

110 The Respondent says that the language of Article 9.5(a) requires the Court to consider the Proposed Transaction as a whole in making its determination as to whether the Proposed Transaction is materially adverse to the Unitholders. It says that the Proposed Transaction is beneficial on an overall basis to the Unitholders given the benefits to the Company and, in particular: (1) the waiver of $340,000 in dividend arrears on the Preference Shares; (2) the waiver of the retraction rights of the Preference Shareholders in favour of the Scheduled Preference Share Payments over the six-year period to 2018; (3) the waiver of all future dividends; (4) the resulting avoidance of bankruptcy and continuation of the Company as a going concern; and (5) the avoidance of litigation to determine the competing rights of the holders of the Secured Notes and the Preference Shares in the event of a liquidation of the Company.

111 Do these arrangements constitute the Proposed Transaction a "transaction which is materially adverse to the Unitholders" for the purposes of Article 9.5? I conclude that the Proposed Transaction is a materially adverse transaction for the following reasons.

112 First, I am not persuaded that the Respondent is correct that the determination must be made on an assessment of the overall Proposed Transaction in the manner proposed by the Respondent. In this case, as a result of the establishment of the income trust structure, the interest of the Common Shareholders has been divided between the Common Shares and the Secured Notes. If there were no Preference Shares, or if the Company were not insolvent on a balance sheet basis, it would be appropriate to assess the Proposed Transaction on the basis proposed by the Respondent (although of course there would have been no need for this transaction). In that case, the interest of the Unitholders would be the same as the Company, given that the Secured Notes would be subordinated to the only other stakeholders in the Company i.e. any bank finance and any trade creditors (disregarding for this purpose the security which would also have been unnecessary). However, because of the Company's financial condition and the existence of the Preference Shares ranking ahead of the Common Shares, the economic interest of the Unitholders resides in the Secured Notes. This is not the same as the economic interest of the Company as a whole. In these circumstances, the fact that the Proposed Transaction is beneficial to the Company does not mean that it is necessarily to the Unitholders.

113 Further, in the absence of evidence that the Proposed Transaction will reduce the risk of insolvency to the point that there is no reasonable likelihood of insolvency over the six-year period of the Scheduled Preference Share Payments, it is appropriate to consider the adverse effects on the Secured Notes in the event of insolvency alone. In this regard, the Proposed Transaction would deprive the holders of the Secured Notes of whatever proceeds would otherwise be available to them on an insolvency. At a minimum, the Proposed Transaction defers the commencement of repayment of the Secured Notes for three years during which period the Fund, as the holder of the Secured Notes, remains exposed to the risk of insolvency. In the event of a failure to make the Scheduled Preference Share Payments, the Proposed Transaction also gives the Preference Shareholders extra leverage over the Company that they do not currently have by virtue of the provisions of section 32(2) of the OBCA.

114 The adverse effects respecting payments that would otherwise be made in respect of the Secured Notes therefore, in my opinion, are clear and unequivocal. In the present circumstances, these effects are also material. A postponement of all principal for at least three years in respect of a company that is currently insolvent on a balance sheet basis, has been unprofitable for a number of years, and is entirely reliant for credit on its suppliers must surely be materially adverse on its own.

115 Second, based on the foregoing, the Respondent argues that the issue for the Court is whether there is evidence suggesting that benefits accruing to the Unitholders from the Proposed Transaction will more than offset the adverse effects established by the Applicant. For the reasons set out below in this section, I do not think that this is the correct approach to the determination of whether a transaction is materially adverse. Even if it were, however, I conclude that the Court could not reach the conclusion urged by the Respondent.

116 In making any such assessment, the Court cannot rely on the judgment of the Trustees for the reasons addressed above. It must base its review on the record. The Respondent argues that the record supports a conclusion that, on balance, the Unitholders will be better off if the Proposed Transaction were implemented and the Company continues as a going concern, even with the economic effects on the Secured Notes. I do not agree. Based on the materials before the Court, it is not possible to reach any conclusion regarding the likely outcomes under either a going concern scenario after implementation of the Proposed Transaction or the most likely insolvency scenario if the Transaction were not implemented, let alone any conclusion based on a comparison of these two scenarios. To be clear, this is not to be taken as a conclusion regarding the judgment taken by the Trustees on this issue. This is addressed below. It is simply a statement regarding the ability of the Court to reach a conclusion on the basis of the record before it.

117 Lastly, and in any event, I think that the Respondent's approach to the question is incorrect, bearing in mind the purpose of a Unitholder vote. The Respondent approaches the question as a relative matter - is the Proposed Transaction materially adverse in the sense that the impact on the Secured Notes is worse than another alternative? It answers the question in the negative by asserting that the Proposed Transaction is better than the insolvency alternative. Apart from the issue of proof, even accepting that it might to possible to reach that conclusion, in my opinion, the test is an absolute one for two reasons.

118 First, an absolute test is consistent with the principle discussed above that the Declaration of Trust should be interpreted to reflect a continuation of the rights of Secured Noteholders in an income trust structure. I do not think there would be any question that if the Common Shareholders had held the Secured Notes prior to the establishment of the income trust structure, they would have been entitled to a vote in respect of the proposed arrangements pertaining to the Secured Notes under the terms of the Secured Note Indenture. Second, as a practical matter, I do not think that the parties would have intended that, if it were necessary to litigate this issue, it would be either desirable or appropriate for the Court to render a decision that is essentially a business judgment in such circumstances. The very purpose of a Unitholder vote in these circumstances is to permit the parties who are adversely affected by a proposed transaction to determine whether, on balance, the potential benefits justify acceptance of the adverse consequence of the Proposed Transaction. In circumstances in which the determination of the Trustees is not conclusive, it is, in my opinion, both preferable and intended by the parties that the Unitholders rather than the Court should determine whether a proposed transaction is better than any other alternative.

119 Based on the foregoing, I therefore find that the Trustees do not have the authority to vote the Common Shares in support of the Special Resolution in the absence of approval of the Unitholders by a special resolution under the Declaration of Trust passed at a meeting of Unitholders called for that purpose.

Did the Trustees Breach their Duty of Care, Diligence and Skill?

120 Article 9.7 of the Declaration of Trust, and the common law, impose two obligations on the Trustees. First, the Trustees must act "honestly and in good faith with a view to the best interests of the Fund." Second, the Trustees must "exercise the degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances."

121 The Applicant expressly says that it does not allege a breach of the duty of good faith. I would support this conclusion. There is nothing in the record that indicates that the Trustees acted otherwise than with a view to the best interests of the Fund. However, the Applicant submits that the Trustees failed to satisfy their obligation of care, diligence, and skill in arriving at the decision to enter into the Proposed Transaction.

122 As the Applicant has acknowledged, it makes perfect sense under normal operating circumstances for the Fund and the Company to engage and rely on the same advisors. That is inherent, among other things, in the purposes of the Fund, as set out in the Declaration of Trust, which do not permit the Trust to use any monies received from the Company for any other business. However, in the circumstances in which the Company is facing insolvency, the interests of the Fund and the Company diverge. As a holder of the Secured Notes, the Fund has a separate interest as a creditor in addition to its interest as shareholder (which would be identical to that of the Company). As a secured creditor, the Fund has an interest that ranks ahead of any unsecured creditors that must be taken into consideration. More importantly, in the particular circumstances of this case, the Fund also has an interest as a holder of debt, whether secured or unsecured, that ranks ahead of the Preference Shares, which must also be taken into account. The latter, in particular, is a serious complicating factor in any consideration of the best course of action for the Fund.

123 The Applicant alleges that the Trustees did not satisfy their obligation of care, diligence and skill to the Fund in reaching the decision to approve the Proposed Transaction and are not entitled to the benefit of the "business judgment rule" in respect of that decision. The Applicant alleges that the Trustees reached their decision on an uninformed basis. In reliance on the language in *UPM, supra,* at para. 153, it says that the Court should find that the decision of the Trustees was unreasonable in the circumstances. Accordingly, they say that the decision of the Trustees constituted a breach of trust that entitles the Applicant to an order requiring a vote of the Unitholders to ratify the alleged breach of trust and approve the Proposed Transaction or to withhold approval of the Proposed Transaction.

124 The Respondent submits that the decision of the Trustees, including the process followed in arriving at that decision, was appropriate in the circumstances. It says say that the Trustees are entitled to the deference afforded by the operation of the "business judgment rule" and, accordingly, that neither the Court nor the Applicant is entitled to second-guess that decision. On this basis, the Respondent also submits that the Trustees did not breach the Declaration of Trust.

125 In deciding whether to enter the Settlement Agreement, the Respondent says that the Trustees were faced with a difficult decision requiring the evaluation of a complex matrix of legal and business issues under tight time constraints. The Respondent engaged in arms-length negotiations with Solar Harvest and Fortune which resulted in what its financial advisor described as an "optimal outcome." It says that, in all the circumstances, the Trustees made a reasonable decision with the benefit of advice from legal advisors and financial advisors.

126 The Respondent also submits that the Trustees followed a robust process in connection with the negotiation and approval of the Settlement Agreement in which, together with the board of directors of the Company, it: (a) retained Cassels Brock as the legal advisor to the Fund and the Company; (b) received the advice of Klein Farber as financial advisor, who led the negotiations with Solar Harvest and ultimately made recommendations to both boards; (c) considered the issue over five separate meetings; (d) considered legal advice on the legal position being taken by the Preference Shareholders in the negotiations; (e) considered the views of Company management; (f) identified and considered conflicting interests of the Unitholders and the Preference Shareholders, including the possibility of arguments being raised regarding the appropriateness of granting security to the Preference Shareholders to the detriment of the Unitholders; (g) considered the professional opinion of its financial advisor; and (h) determined that the ultimate outcome was in the best interests of the Fund and the Unitholders, as well as all other stakeholders, and was preferable to all other options.

127 The record indicates, and Mr. Wardle has confirmed, that the Trustees based their decision in this matter on the earlier decision taken by the Trustees at the meeting on December 8, 2011 that a continuation of the Company as a going concern after having restructured its operations held the promise of returning some value to the Unitholders in the long-run while an insolvency would leave little or nothing for the Unitholders. Given that the financial results of the Company in 2012 showed an improvement over 2011, the Trustees remained of this view and say that they did not need to revisit the issue in 2013. Accordingly, from the Trustees' perspective, any settlement with the Preference Shareholders that improved the prospects of the Company's continuation as a going concern was also in the best interests of the Unitholders, apart from an arrangement that secured the Company's real property in favour of the Preference Shareholders which was rejected.

128 Given the determination above, it is unnecessary to reach a conclusion as to whether the Trustees' decision to support the Proposed Transaction satisfied their duty of care, diligence and skill and I therefore decline to do so. However, in view of the prospect of continued litigation between the various stakeholders of the Company, I wish to make a few observations.

129 First, for the reason discussed above, the Unitholders' interest in the Company is represented by the Secured Notes, rather than the Common Shares, for the foreseeable future. Given the fact that there is a real possibility of insolvency, as evidenced by, among other things, the fact that the Company is currently insolvent on a balance sheet basis, the Trustees must address the interest of the Unitholders in their capacities as potential creditors. It is not correct to conclude that the interests of the Company and the Fund are identical. This reality is heightened by the presence of Preference Shareholders who apparently assert an interest prior to the Secured Notes.

130 Second, the Trustees did address the correct question in December 2011 - that is, on balance, will the Unitholders be better off if the Company continues as a going concern or in an insolvency scenario? However, the Trustees were required to address that question again in February 2013 on the basis of the position of the Secured Notes at that time and having regard to the Proposed Transaction. I note, for example, that the issue of litigation by the Preference Shareholders had not arisen at the time of the Trustees' decision in December 2011. In order to satisfy their responsibilities, it was necessary not merely to follow a "robust process", although that is important, but also to reach their decision on an informed and current basis.

131 Third, while such a decision need not, in all circumstances, require sophisticated financial analysis, it does require some precision regarding the nature and financial consequences of the scenarios under consideration. It is not clear on the record to what extent this information was before the Trustees in February 2013. In particular, it is not clear that the Trustees addressed the insolvency scenario with any degree of clarity, given that Klein Farber did not purport to give advice on the insolvency alternatives facing, or available to, the Company. In addition, if there is a business plan of the Company for the period of the Scheduled Preference Share Payments and beyond upon which the Trustees were able to reach a conclusion regarding the going-concern scenario, it is not before the Court.

132 Fourth, it is also important that the assessment be made on a basis that excludes the possibility of any conflict of interest. The extent to which the Trustees' decision was based on a concern for litigation by the Preference Shareholders is unclear, as are the underlying circumstances giving rise to the possibility of such litigation. The Court is not in a position to address the substantive issue and I do not wish this observation to be taken as a criticism of any of the parties involved. Moreover, given that the minutes would not likely describe in detail any discussion that did take place on this issue, it would be inappropriate to conclude that a detailed decision did not occur. However, I think it is important to observe that the Trustees are required to understand the circumstances under which this litigation risk can have arisen in the first place in reaching their conclusion regarding the merits of any proposed course of action that takes any such litigation risk into consideration.

133 Fifth, the Respondent submits that, in assessing whether the Trustees complied with their obligations of care, diligence and skill, the Court should consider the fact that the Fund and the Company are small entities having limited resources whose directors have varying degrees of sophistication. They rely on a passage in *Re BCE Inc.*, 2008 SCC 69 at para. 109 [*BCE*] to the effect that the nature and size of a corporation may be relevant in assessing the reasonableness of expectations. While this is undoubtedly true, the Fund is a public vehicle that is listed on the TSX. As noted in *BCE*, *supra*, at paras. 75, 109, greater latitude may be given in the context of a small, closely held corporation than in other contexts. The credibility of the public capital markets requires that the corporate governance of public entities be conducted on an informed basis by qualified individuals regardless of the size of the entity.

Additional Issues

134 For completeness sake, the following additional issues were also raised by the Applicant and have been dealt with in the following manner.

135 First, in the application, the Applicant also sought certain relief personally against McLaughlin and Scarafile. The Applicant asserted that McLaughlin and Scarafile, as Trustees of the Trust and directors of the Company, knew that the Trustees were in breach of trust in authorizing the Fund to execute the Settlement Agreement and in committing the Fund to vote the Common Shares in favour of the Special Resolution. The Applicant submitted that the Company knowingly participated in the breach of trust by executing the Settlement Agreement and calling the Special Meeting because of these relationships of McLaughlin and Scarafile. The Applicant sought the removal of McLaughlin and Kozicz as directors, and replacement directors elected at the special meeting of Unitholders sought on this application. In addition, the Applicant sought a declaration that Greenbriar is not entitled to vote its Units at a meeting of the Unitholders in favour of the transaction contemplated by the Settlement Agreement.

136 The Applicant did not raise any of these issues at the hearing of the motion. It is my understanding that the Applicant no longer seeks the relief described above. In any event, I do not find any support in the record for the allegations described above or the relief sought in respect of such allegations.

137 Second, the Applicant submits that the Company is insolvent or on the eve of insolvency and, therefore, the transaction contemplated by the Settlement Agreement contravenes section 4(2) of the *Assignments and Preferences Act*, R.S.O. 1990, c. A. 33. The Applicant reasons that this is further evidence that the Trustees' decision to approve the Proposed Transaction constitutes a breach of their duty of care, diligence and skill. In view of the decision above, it is also unnecessary to address this issue. I would also observe that section 4(2) applies to transfers by debtors but not to transfers by creditors. As the impugned transfer is the granting of security by the Fund in favour of the Preference Shareholders, the provision would not be applicable in the present circumstances.

Conclusion

138 I have concluded above that the Trustees do not have the authority under the Declaration of Trust to vote the Common Shares in support of the Special Resolution in the absence of approval of the Unitholders by a special resolution under the Declaration of Trust at a meeting of Unitholders called for that purpose. This finding does not, however, constitute a finding that the Trustees have breached Article 9.5(a) of the Declaration of Trust as of the present time. This raises the question of whether the Court should order that the Special Meeting should be adjourned pending such a vote by the Unitholders.

139 The Respondent submits that, as proper notice was given and the proposed class votes comply with the provisions of the Company's articles, there is no basis for enjoining the holding of the Special Meeting. While this is correct, it does not take into account the position in which the Trustees find themselves. In order to avoid breaching Article 9.5(a) of the Declaration of Trust, the Trustees must forego voting until such time as a meeting of the Unitholders has been held. If the Special Meeting were to proceed nonetheless with the Trustees abstaining, the Preference Shareholders' votes in favour of the Proposed Amendments would pass the Special Resolution. Accordingly, the Trustees must seek an adjournment of the Special Meeting pending a meeting of the Unitholders. Given the relative number of votes of the Common Shareholders and the Preference Shareholders, a resolution to this effect would pass. In these circumstances, I consider that it is appropriate for the Court to order that the Special Meeting be adjourned rather than, by remaining silent, require the Special Meeting to be convened and immediately adjourned after a vote of the shareholders.

140 Accordingly, the Court finds that, by virtue of the provisions of Article 9.5(a) of the Declaration of Trust, the Trustees of the Dominion Citrus Income Fund do not have the authority to vote the Common Shares of Dominion Citrus Limited in favour of the Special Resolution to be voted upon at the Special Meeting of the shareholders of the Company called for March 26, 2013 in the absence of the approval of the Unitholders. In addition, the Court orders that the Special Meeting of the Company be adjourned pending a meeting of the Unitholders to consider a special resolution under the Declaration of Trust that would grant such approval to the Trustees.

141 As mentioned above, the Applicant also seeks as relief, among other things, an order of this Court convening a meeting of Unitholders. Given the determinations above, I am not persuaded that such an order is necessary or appropriate at this time. As it is not possible to anticipate the consequences of the determination herein, it is not clear that a Unitholders meeting will be necessary or, if necessary, that an order of the Court will be necessary to convene such a meeting. Accordingly, I decline to grant such relief. The Applicant is, however, at liberty to bring on a further motion in this proceeding at a later date if it considers that it is necessary to do so in order to convene a Unitholders meeting.

Costs

142 If the parties are unable to agree on costs, they shall have 30 days from the date of this Endorsement to submit a costs outline and to make written submissions not exceeding five pages in length.

H.J. WILTON-SIEGEL J.

TAB 4

Case Name:

Salah v. Timothy's Coffees of the World Inc.

Between
Abdulhamid Salah and 1470256 Ontario Inc., Plaintiffs (Respondents), and
Timothy's Coffees of the World Inc., Defendant (Appellant)

[2010] O.J. No. 4336

2010 ONCA 673

268 O.A.C. 279

74 B.L.R. (4th) 161

2010 CarswellOnt 7643

193 A.C.W.S. (3d) 1151

Docket: C51317

Ontario Court of Appeal
Toronto, Ontario

W.K. Winkler C.J.O., M. Rosenberg J.A. and R.W.M. Pitt J. (ad hoc)

Heard: September 16, 2010.
Judgment: October 14, 2010.

(33 paras.)

Commercial law -- Franchising -- Franchise agreement -- Renewal -- Termination -- Appeal by franchisor from decision finding it breached franchise agreement dismissed -- Parties entered into franchise agreement with respect to mall location -- Franchisor was lessee under head lease with mall and prior to expiry of lease, it negotiated lease for new location, entered into new franchise agreement with new franchisee and informed respondents that franchise agreement expired when lease expired -- Trial judge made no error in finding that franchisor breached franchise agreement and duty of good faith, or in assessment of damages at $230,358 for future loss of income and $50,000 for breach of duty of good faith and mental distress.

Contracts -- Remedies -- Damages -- Appeal by franchisor from decision finding it breached franchise agreement dismissed -- Parties entered into franchise agreement with respect to mall location -- Franchisor was lessee under head lease with mall and prior to expiry of lease, it negotiated lease for new location, entered into new franchise agreement with new franchisee and informed respondents that franchise agreement expired when lease expired -- Trial judge made no error in finding that franchisor breached franchise agreement and duty of good faith, or in assessment *of damages at $230,358 for future loss of income and $50,000 for breach of duty of good faith and mental distress.*

Damages -- In contract -- Breach of contract -- Type of contract -- Franchise -- Appeal by franchisor from decision finding it breached franchise agreement dismissed -- Parties entered into franchise agreement with respect to mall location -- Franchisor was lessee under head lease with mall and prior to expiry of lease, it negotiated lease for new location, entered into new franchise agreement with new franchisee and informed respondents that franchise agreement expired when lease expired -- Trial judge made no error in finding that franchisor breached franchise agreement and duty of good faith, or in assessment of damages at $230,358 for future loss of income and $50,000 for breach of duty of good faith and mental distress.

Appeal by the franchisor from a finding that it breached a franchise agreement with the respondents. In the fall of 2001, the individual respondent entered into a franchise agreement with the appellant to operate a franchise store in a mall in Ottawa. The appellant was a lessee under a head lease for a location on the third floor of the mall, and when the respondent entered into the franchise agreement, he became a sublessee under the head lease. There were only four remaining years on the head lease and the term of the franchise agreement was tied to the head lease. As the respondent was concerned about the short length of the lease, the parties included a schedule to the franchise agreement that provided that in the event the appellant entered a new head lease with the mall, the franchise agreement would be renewed with a new sublease. Concurrent with executing the franchise agreement, the individual respondent also executed an assignment, assigning the franchise agreement, the sublease and the general security agreement to his newly incorporated numbered company. Prior to the expiry of the head lease, the appellant entered into a new lease for a location on the second floor of the mall and signed a new agreement with a new franchisee for that location. The respondents were then advised that their franchise agreement would end on the day the lease expired. The trial judge found that both the individual respondent and the numbered company were franchisees of the appellant, that the schedule to the agreement was not related to the entire mall and was not limited to the existing third floor location and that the appellant breached the franchise agreement and breached a duty of good faith contrary to the Arthur Wishart Act. The trial judge awarded damages in the amount of $230,358 for future loss of income flowing from the appellant's breach of contract and an additional $50,000 for the breach of the duty of good faith and mental distress. The franchisor sought to appeal the judgment on the basis that the trial judge erred in failing to distinguish between the individual respondent and the numbered company, in her interpretation of the schedule to the agreement, in her finding that the franchisor owed a duty of care and breached it, and in her assessment and award of damages.

HELD: Appeal dismissed. There was ample evidence to support the trial judge's finding that the appellant maintained a relationship with both the individual franchisee and its assignee corporation. The trial judge engaged in an analysis of the contractual rights between the parties, considered all of the relevant documents, and there was no error in the approach she adopted. On the facts found by the trial judge, there was no doubt that the conduct at issue fell squarely within the performance or enforcement of the franchise agreement and that the appellant breached the duty of good faith it owed to the franchisee under the Arthur Wishart Act. Finally, there was no basis to interfere with the trial judge's assessment of damages.

Statutes, Regulations and Rules Cited:

Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3, s. 3, s. 3(1), s. 3(2)

Courts of Justice Act, R.S.O. 1990, c. C.43, s. 123(4), s. 123(7)

Appeal From:

On appeal from the judgment of Justice Monique Métivier[1] of the Superior Court of Justice dated October 26, 2009, with amended reasons dated January 21, 2010, and reported at (2010), 65 B.L.R. (4th) 235.

Counsel:

Alan J. Lenczner, Q.C., and Jaan E. Lilles, for the Appellant.

Stephen S. Appotive, for the Respondents.

The judgment of the Court was delivered by

1 W.K. WINKLER C.J.O.:-- Timothy's Coffees of the World Inc. ("Timothy's") appeals a decision of the Superior Court of Justice finding that it breached a franchise agreement with the respondents. The trial judge found that the franchise agreement provided the respondents with a conditional right of renewal and that the appellant denied them this right. She awarded damages for breach of contract, breach of the duty of good faith and mental distress. I agree with the trial judge's reasons and find no error in her decision. I would dismiss the appeal. My reasons follow.

BACKGROUND

2 In the fall of 2001, the respondent Abdulhamid Salah ("Mr. Salah") entered into a franchise agreement with Timothy's to operate a franchise store in the Bayshore Shopping Centre in Ottawa. Timothy's was a lessee under a head lease for a location on the third floor in the shopping centre. When Mr. Salah entered into the franchise agreement, he became a sublessee under the head lease. There were only four years remaining on the head lease, which was set to expire on September 30, 2005. The term of the franchise agreement was tied to the length of the head lease.

3 Mr. Salah was concerned about the short term of the lease and the franchise agreement, given the amount of his investment in purchasing the franchise and setting up operations. In response to Mr. Salah's concerns about the term, Timothy's proposed the inclusion of Schedule "A" in the franchise agreement. Schedule "A" provided that in the event that Timothy's entered into a new head lease with the Bayshore Shopping Centre, Mr. Salah's franchise agreement would be renewed with a new sublease. In the event that the new head lease was to be for a period of less than five years, there would be no additional franchise fee payable by Mr. Salah. If the new head lease was for a period of more than five years, Mr. Salah would be required to pay an amount equal to 50% of the then current franchise fee.

4 Concurrent with the execution of the franchise agreement, Mr. Salah assigned the agreement, the sublease, and the general security agreement to his newly incorporated company 1470256 Ontario Inc. ("147") by way of an Assignment and Guarantee. This was permitted by Timothy's, but with the condition expressed in the Assignment and Guarantee that Mr. Salah remained personally liable for all franchisee obligations under the franchise agreement.

5 Prior to September 30, 2005, the expiry date of the head lease on the third floor, Timothy's entered into a new lease on the second floor and signed an agreement with a new franchisee for that location. The appellant then advised Mr. Salah that his franchise agreement would come to an end on September 30, 2005. Mr. Salah and 147 commenced proceedings against Timothy's alleging breach of the franchise agreement and seeking damages arising both from the breach and from the appellant's conduct.

6 At trial, Timothy's argued that the respondents had no right of renewal and that the parties had

intended the franchise agreement to end with the expiry of the head lease on September 30, 2005. It submitted that any right of renewal provided by Schedule "A" only concerned the original location on the third floor of the shopping centre. Since the appellant could not renew its head lease on the third floor, the provisions of Schedule "A" were inoperative. Timothy's also argued that because Mr. Salah had assigned his franchisee rights to 147, only that corporation could bring a claim against the franchisor.

DECISION OF THE TRIAL JUDGE

7 The trial judge, in a clear and carefully reasoned decision, held as follows:

1. that both Mr. Salah and 147 were franchisees of Timothy's and could be treated as one entity for the purpose of enforcing rights or seeking remedies;
2. the proper interpretation of Schedule "A" is that it related to the Bayshore Shopping Centre in general and was not limited to the existing third floor location;
3. Timothy's breached the franchise agreement by failing to observe the terms of Schedule "A" with respect to the new head lease on the second floor of the Bayshore Shopping Centre;
4. Timothy's breached a duty of good faith, contrary to s. 3 of the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 ("*Wishart Act*"); and
5. the breach of the duty of good faith was an independent actionable wrong.

8 The trial judge awarded Mr. Salah damages in the amount of $230,358 for future loss of income flowing from the appellant's breach of contract, and an additional $50,000 for breach of the duty of good faith and mental distress.

ISSUES ON APPEAL

9 Timothy's submits that the trial judge erred in:

i. failing to distinguish between Mr. Salah and 147;
ii. interpreting Schedule "A" as providing an option to amend the franchise agreement;
iii. finding that Timothy's owed a duty of good faith and that Timothy's breached it;
iv. assessing damages for breach of contract at $230,358 and awarding $50,000 for breach of the duty of good faith and mental distress;
v. awarding damages to Mr. Salah for breach of contract when these damages were pleaded only by 147.

ANALYSIS

i. Treating Mr. Salah and 147 as one entity

10 The appellant argues that the trial judge erred in failing to distinguish Mr. Salah from his corporation, 147. Since a corporation is a distinct entity from its owner, and since Mr. Salah assigned the franchise agreement to 147, the appellant submits that only the corporate franchisee could assert contractual rights against the franchisor.

11 I cannot accede to that submission. There was ample evidence to support the trial judge's finding that the appellant "maintained a relationship with both the individual franchisee and its assignee corporation. It never intended to accept the corporation in the place of Mr. Salah for all purposes." While the franchisor allowed Mr. Salah to assign the franchise agreement to 147, one of the main purposes of the Assignment and Guarantee was to ensure that all obligations under the franchise agreement continued to be those of Mr. Salah personally. In addition, as noted by the trial judge, the concluding words of s. 4 of the Assignment and Guarantee state as follows:

> Furthermore and without restricting the generality of the foregoing, the assignor shall continue to be personally bound by any and all provisions of the franchise agreement related to confidentiality and non-competition.

12 Indeed, the business model of Timothy's, as reflected in its franchise agreement, was to treat a corporate franchisee and its personal owner as one and the same. To this effect, clause 19.19 of the agreement provides:

> In the event that there is more than one Franchisee, or if the Franchisee should consist of more than one legal entity, the Franchisee's liability hereunder shall be both joint and several. A breach hereof by one such entity or Franchisee shall be deemed to be a breach by both or all.

13 Moreover, it is revealing and significant that Timothy's June 8, 2005 letter -- in which Timothy's informed the franchisee that the franchise agreement would not be renewed -- was addressed to Mr. Salah personally, and not to the corporate respondent. The *de facto* relationship under the franchise agreement was between Timothy's and Mr. Salah.

14 The trial judge concluded that Mr. Salah and his corporation were one entity for the purposes of the franchise agreement. Accordingly, she held that to deny Mr. Salah a remedy on the basis of separateness would yield a result "too flagrantly opposed to justice": see *Kosmopoulos v. Constitution Insurance Co.*, [1987] 1 S.C.R. 2, at p. 10. I agree with her conclusion. In the context of this dispute between franchisor and franchisee, it would be incongruous, not to mention unfair to Mr. Salah, if he and his corporation were treated as one entity for the purposes of franchise liabilities, but were treated as separate entities when the question of enforcing franchisee rights under the franchise agreement is at issue.

ii. Interpretation of the franchise agreement

15 Timothy's submission that the trial judge improperly construed Schedule "A" as providing an "option to amend" the franchise agreement is an attempt to ground an appeal on a statement taken out of context in the reasons for the decision. Read as a whole, it is clear that the trial judge was engaged in an analysis of the contract between the parties, and the rights and obligations conferred by its terms. The argument fails on this basis alone. Moreover, there was no error in the approach adopted by the trial judge in construing the agreement before her.

16 The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity. Where a transaction involves the execution of several documents that form parts of a larger composite whole -- like a complex commercial transaction -- and each agreement is entered into on the faith of the others

being executed, then assistance in the interpretation of one agreement may be drawn from the related agreements. See *3869130 Canada Inc. v. I.C.B. Distributing Inc.* (2008), 66 C.C.E.L. (3d) 89 (Ont. C.A.), at paras. 30-34; *Drumbrell v. The Regional Group of Companies Inc.* (2007), 85 O.R. (3d) 616 (C.A.), at paras. 47-56; *SimEx Inc. v. IMAX Corp.* (2005), 11 B.L.R. (4th) 214 (Ont. C.A.), at paras. 19-23; *Kentucky Fried Chicken Canada v. Scott's Food Service Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.), at paras. 24-27; and Professor John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005), at pp. 705-722.

17 I see no error in the manner in which the trial judge applied the principles of construction of commercial agreements. The trial judge considered all of the relevant documents and found that the seminal document, the franchise agreement, was not ambiguous. All of the documents executed by the parties referred to the premises under the franchise agreement as "Bayshore Shopping Centre, 100 Bayshore Drive, Nepean, Ontario", and not to a specific store on the third floor.

18 Indeed, the only agreement that specifically referred to the third floor was the head lease between the Bayshore Shopping Centre and Timothy's. The appellant contends that the trial judge failed to take the head lease into account in her analysis. I do not agree. A review of her reasons demonstrates otherwise. Moreover, to the extent that any discrepancy exists between the head lease and the franchise agreement, I agree with the trial judge that the franchise agreement should be interpreted *contra proferentem.* The head lease had been negotiated by Timothy's with the landlord, and its terms were obviously known to Timothy's at the time it drafted Schedule "A". Timothy's had the opportunity to limit the scope of Schedule "A" to the third floor premises and either chose not to do so or was aware that Mr. Salah would not have accepted such a limitation. In either event, there is no basis to find that the trial judge committed a reviewable error. Her conclusions that the franchise agreement and Schedule "A" applied to the whole shopping centre and that Timothy's conduct -- which effectively amounted to a refusal to allow Mr. Salah the option of renewing the franchise agreement -- constituted a breach of contract are unassailable.

iii. Breach of duty of good faith

19 Section 3 of the *Wishart Act* provides:

> **Fair dealing**
>
> **3.(1)** Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.
>
> **Right of action**
>
> **(2)** A party to a franchise agreement has a right of action for damages against another party to the franchise agreement who breaches the duty of fair dealing in the performance or enforcement of the franchise agreement.
>
> **Interpretation**
>
> **(3)** For the purpose of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

20 Timothy's argues that its conduct leading up to the expiration of the franchise agreement could not constitute a breach of the duty of good faith because s. 3(1) of the *Wishart Act* only imposes the duty of good faith and fair dealing in the "performance or enforcement" of the existing franchise agreement. In other words, the appellant would have it that a terminated agreement is not caught by the section. In my view, it is unnecessary in this case to consider the full scope of the words "performance or enforcement" as used in the *Wishart Act*. The premise underlying the appellant's submission has been negated by the trial judge's interpretation of the agreement between the parties and the effect of Schedule "A". On the facts as found by the trial judge, there can be no doubt that the conduct at issue arises squarely within the "performance or enforcement" of the franchise agreement.

21 Since I find no error in the trial judge's conclusion that Schedule "A" applies to the whole shopping centre and that the right of renewal was triggered, the appellant's submission on the effect of s. 3(2) of the *Wishart Act* cannot succeed.

22 I turn then to the conduct of the appellant. When Timothy's could no longer renew the head lease of the third floor location and was negotiating a new lease on the second floor, the evidence showed that the franchisor deliberately kept Mr. Salah in the dark about its intentions. The trial judge found that "Mr. Black [the senior vice-president of development at Timothy's] e-mailed Bayshore Shopping Centre representatives asking them to refrain from passing on any information about the second floor location to Mr. Salah". The trial judge made further factual findings that Timothy's "actively sought to keep the franchisee from finding out what was going on with the lease" and that Timothy's deliberately withheld "critical information and did not return calls". These findings of fact more than support the conclusion that there was a breach of the duty of good faith that franchisors owe franchisees under s. 3(1) of the *Wishart Act*.

iv. Damages

23 The trial judge awarded damages under two heads: (1) damages flowing from the breach of contract, and (2) damages for the breach of the duty of good faith and for mental distress.

24 For past and future losses flowing from the breach of contract, the trial judge had before her both the opinion of the appellant's expert, who calculated the loss of profits only to 147, and the opinion of the respondents' expert, who assessed the losses to Mr. Salah and 147 collectively. As the trial judge decided to treat Mr. Salah and his corporation as one and the same, it was open to her to prefer the evidence of the respondents' expert, which took into account the loss of income to Mr. Salah as a result of the breach. I would not interfere with this decision.

25 The appellant submits that it is not open to the trial judge to award damages under the *Wishart Act* for anything other than compensatory damages relating to pecuniary losses. In other words, it is not open to a trial judge to award damages under the head of compensatory damages relating to non-pecuniary losses, or under exemplary or punitive damages. It argues that any damages flowing from the breach of the duty of good faith is limited to lost profits, and in particular the lost profits, if any, of 147. The latter point is addressed above. The trial judge treated Mr. Salah and 147 as a single entity for the purpose of determining losses flowing from the breach of contract and, on the evidence, she was entitled to do so.

26 In like fashion, the argument advanced by the appellant with respect to the limitations applicable to damage awards under s. 3(2) of the *Wishart Act* is misconceived. The *Wishart Act* is *sui generis* remedial legislation. It deserves a broad and generous interpretation. The purpose of the statute is clear: it is intended to redress the imbalance of power as between franchisor and franchisee; it is also intended to provide a remedy for abuses stemming from this imbalance. An interpretation of the statute which restricts damages to compensatory damages related solely to proven pecuniary losses would fly in the face of this policy initiative.

27 The right of action provided under s. 3(2) of the *Wishart Act* against a party that has breached the duty of good faith and fair dealing is meant to ensure that franchisors observe their obligations in dealing with franchisees. In that regard, the conduct that the trial judge found egregious in the present case is precisely the mischief that this legislation was enacted to remedy.

28 Our courts have given limited recognition to the duty of good faith between contracting parties in general. However, by enacting legislation that addresses the particular relationship between franchisors and franchisees, the legislature has clearly indicated that such relationships give rise to special considerations, both in terms of the duties owed and the remedies that flow from a breach of those duties. This is evident in the wording of s. 3(2), which focuses on the conduct of the breaching party and not injury to the other side. The trial judge's award of damages was informed by these considerations.

29 In summary, I am in agreement with the trial judge that s. 3(2) of the *Wishart Act* permits an award of damages for the breach of the duty of good faith, separate and in addition to any award in compensation of pecuniary losses. I would go further to say that any such award must be commensurate with the degree of the breach or offending conduct in the particular circumstances. Taking the conduct of the appellant as found by the trial judge into account, I see no error in her decision to award damages on a merged basis for the breach of duty of good faith and mental distress, either in principle or in respect of quantum. In my view, her findings as to the breach of duty of good faith alone would support the amount of the award.

30 Accordingly, I would not interfere with her decision as to damages.

v. The Pleadings Argument

31 I will deal summarily with the pleadings argument advanced by the appellant. The trial judge found that Mr. Salah and 147 should be treated as one entity with regard to the franchise agreement. As noted above, there was ample evidence to support this finding. Having done so, she was entitled thereafter to treat the pleadings of one as the pleadings of the other. This is a complete answer to the appellant's argument. Accordingly, I would not give effect to this ground of appeal.

CONCLUSION

32 I would dismiss the appeal.

33 The respondents shall have their costs in the amount of $32,500, all inclusive.

W.K. WINKLER C.J.O.
M. ROSENBERG J.A.:-- I agree.
R.W.M. PITT J. (ad hoc):-- I agree.

[1] The case was tried over a period of 12 days by Justice A. de Lotbinière Panet. However, due to illness, he was unable to deliver judgment. The Chief Justice of the Superior Court of Justice made an order under ss. 123(4) and (7) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, appointing Métivier J. to rehear the matter. On consent, the rehearing was based on a review of all of the transcripts, exhibits, and oral and written submissions from counsel.

TAB 5

Case Name:

UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.*

Between
UPM-Kymmene Corporation, plaintiff, and
UPM-Kymmene Miramichi Inc., F. Steven Berg, Clifford M. Sifton
and Stephen W. Phillips, defendants

[2002] O.J. No. 2412

214 D.L.R. (4th) 496

27 B.L.R. (3d) 53

19 C.C.E.L. (3d) 203

32 C.C.P.B. 120

115 A.C.W.S. (3d) 981

Court File No. 99-CL-3536

Ontario Superior Court of Justice
Commercial List

Lax J.

Heard: March 4-6, 18-22, 25, April 2-5, 8-9 and 22-24, 2002.
Judgment: June 20, 2002.

(210 paras.)

Company law -- Shareholders -- Shareholders' rights -- Oppressive acts, remedies -- Rescission -- Directors -- Duties -- Business judgment rule -- Transactions between director and company -- Breach of fiduciary duty -- Contracts, disclosure by director -- Contracts, "fair and reasonable" to corporation.

Action by a shareholder, UPM-Kymmene, and by the successor to Repap, a Canadian public company, to set aside an agreement. Repap was going through financial difficulties. After introducing a significant investor to Repap, Berg became Chairman of Repap. There was no agreement to compensate Berg at that time. However, Berg subsequently retained a law firm to prepare a lucrative Employment Agreement on his behalf, without involving Repap in the negotiation process. After Berg put the Agreement before a meeting of Repap's Board of Directors for approval, two of the directors resigned in protest. Berg had the directors replaced with new directors favourable to him. The Board decided to retain an independent consultant, Mercer, to provide a fairness opinion on the Agreement. However, due to time constraints, Mercer was not given the factual underpinnings necessary to provide a proper and thorough report. Prior to another Board meeting, Berg circulated a copy of the revised Agreement to directors, but the final version contained significant changes from that version. The Compensation Committee recommended approval of the Agreement without actually having discussed it. Berg did not advise the new or existing directors that management had expressed strong disapproval of the Agreement. Nor did he advise them of the existence of written materials from management and the former directors commenting negatively on the Agreement. After the meeting, at which the Agreement was approved, the only long-standing director on the Compensation Committee resigned. When Berg was not nominated for re-election as a director, he terminated his employment, and commenced an action for U.S. $27 million in benefits and payments due under the Agreement. UPM brought an oppression action to set the Agreement aside. Repap's new owner also sought to set it aside, but on the basis of fraud.

HELD: Action allowed. Berg breached his fiduciary duties to Repap in the way he negotiated and presented his agreement for approval. The Compensation Committee and the Board of Directors failed in their own obligations to seek sufficient information upon which to ground a reasonable judgment about whether to recommend the Agreement. They had not even seen the Mercer report before the Board meeting. The approval process should have been slowed, and the compensation package questioned. It was unreasonable for the Compensation Committee to recommend an Agreement knowing that it contained compensation provisions that Repap might not be able to afford. The directors who felt that the Agreement was improper had an obligation to express their dissent, which they failed to do. The Agreement was so unreasonable that the business judgment rule could not be applied to protect the decision of the directors from judicial intervention. Although Berg was greedy and overreaching, and failed in his duties to Repap, he was not fraudulent. However, as the Agreement unfairly disregarded the interests of Repap's shareholders, the oppression remedy was available, and the Agreement was set aside.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 120, 120(7), 241, 241(3)(h).

[* Quicklaw note: The defendant's name in these proceedings was listed as Repap Enterprises Inc. when the case was originally filed but was changed to UPM-Kymmene Miramichi Inc. following an amalgamation.]

Counsel:

Ronald G. Slaght, Q.C. and Kirsten Crain, for the plaintiff.
Paul Steep and Lara Teoli, for the defendant, UPM-Kymmene Miramichi Inc.
Earl A. Cherniak, Q.C. and George Glezos, for the defendant, F. Steven Berg.

[Quicklaw note: A replacement page was released by the Court June 25, 2002. The changes were not indicated. This document contains the amended text.]

LAX J.:--

Part I - Overview

1 This is an oppression remedy case, which examines the conduct of a director who seeks the benefit of a self-interested contract with the corporation he serves. It considers the duties of a Board of Directors when it reviews and approves this kind of contract. It engages the tension between the democratic structure of a corporation and the rights of a shareholder to obtain the court's intervention if this structure has been compromised. At the heart of it is an Executive Employment Agreement and

ancillary Stock Option Grant Agreement ("the Agreement") between Repap Enterprises Inc. and F. Steven Berg. Mr. Berg was both a director and the Chairman of the Board of Directors of Repap between January and August 1999.

2 Repap was a Canadian public company in the forest products industry. Mr. Berg is an American lawyer and businessman. He introduced Repap to Third Avenue Funds, a U.S.-based fund, and it became Repap's largest shareholder and owned 18.7% of its shares when it purchased the block of shares of Paloma Partners on January 27, 1999. Contemporaneously, the three Paloma nominees on the Board of Directors resigned and Mr. Berg was appointed a director and Chairman of the Board. He was Repap's largest individual shareholder with 4.3% of its equity.

3 Mr. Berg's proposed compensation was considered at two Board meetings on February 22, 1999 and March 23, 1999. At the February meeting, the contract was contentious and the directors did not approve it. They decided that it would be prudent to retain an independent consultant to advise them. The Compensation Committee was asked to consider the matter further and report back to the Board. Following the meeting, two directors resigned, and one of them was the Chairman of the Compensation Committee.

4 In March, the Board of Directors of Repap was differently constituted. It approved the Agreement on the recommendation of the Compensation Committee, which was also differently constituted. The Agreement provides Mr. Berg with generous payments, benefits and perquisites, including a five-year employment term with renewals, a signing bonus of 25 million shares, a stock option grant of 75 million shares, a market capitalization bonus, immediate pension credit of eight years, executive employee benefits and liberal change of control and termination provisions. Upon execution of the Agreement, Mr. Berg became Chairman and Senior Executive Officer of Repap.

5 In approving the Agreement, the Board relied in part on an opinion prepared by Margaret Engel, an executive compensation consultant at William M. Mercer ("Mercer"). Due to time constraints imposed on the preparation of the opinion, it was based on "high level observations" and was limited in scope. Ms. Engel believed that Repap had made a strategic decision to bring in Mr. Berg to restructure the company and she was providing advice to it on a non-contentious executive contract. She was not informed that Mr. Berg was unknown to the members of the Board, that his employment contract met with resistance in February, that the Chair of the Compensation Committee had resigned and that management was opposed to it and had questioned its propriety. The Board of Directors was also unaware of these matters.

6 There was immediate shareholder opposition. The original plaintiff in this action was TD Asset Management Inc. ("TDAM"). It is a wholly owned subsidiary of the Toronto Dominion Bank with responsibility for managing the Bank's equity investments. In 1999, it was Repap's second largest shareholder and owned 13.4% of Repap's shares. Robert MacLellan was TDAM's Executive Vice-President. In April, he became aware of the Agreement and came to the conclusion that it was not in the interests of Repap's shareholders and something should be done. He enlisted the support of Marty Whitman, the principal of Third Avenue Funds. In June, TDAM led a proxy fight to replace the Board.

7 Within a few weeks, the outside directors resigned and a new Board was appointed to manage the affairs of Repap. In August, the shareholders elected new directors, but Mr. Berg was not nominated to stand for re-election. As a result, he terminated his employment with Repap under the provisions of the Agreement. In a proceeding commenced in the State of New York, he is claiming U.S. $27 million in benefits and payments due under the Agreement. The New York action is stayed, and this action proceeded to trial.

8 The current plaintiff in this action is UPM-Kymmene Corporation ("UPM"). In October 2000, it acquired all of the common shares of Repap, including the shares of TDAM, who assigned its rights in the cause of action. UPM is also plaintiff in its capacity as a shareholder of Repap through an

affiliated corporation. The defendant, UPM-Kymmene Miramichi Inc. ("Repap"), is the successor by amalgamation with Repap. The Title of Proceedings has been amended to reflect these changes, but I will refer to the corporate defendant as Repap. The action against Clifford Sifton and Stephen Phillips has been dismissed.

9 UPM and Repap ask the court to set aside the Agreement but on different grounds. The UPM case is a directors' duties and oppression case. The Repap case is a fraud case. In general terms, I am asked to determine these issues:

1. Did Mr. Berg breach his fiduciary duties to Repap because of the manner in which he negotiated and presented his agreement for approval?
2. Did the Compensation Committee and the Board of Directors of Repap fail in their own obligations to establish a prudent or reasonable process that led to a contract that is not fair and reasonable?
3. Does the Berg Agreement unfairly disregard the interests of Repap's shareholders?
4. Did Mr. Berg knowingly or recklessly make false representations to the Board on which the Board relied to its detriment in approving the Agreement?
5. Does the "business judgment rule" shield the Agreement from judicial scrutiny?

10 My answer to the first three questions is yes. My answer to questions 4 and 5 is no.

The Evidence

11 I will review the evidence in some detail, but I wish here to make some general comments on the testimony, which I was fortunate to be able to consider with the benefit of transcript and with the unfailing and admirable assistance of counsel.

12 I heard testimony from four outside directors: Curtis Jensen, Guy Dufresne, Stephen Phillips and Marshall Cohen. Mr. Jensen was a portfolio manager at Third Avenue and its nominee on the Board. Mr. Dufresne is the President and Chief Executive Officer of Quebec Cartier Mining Company and had been a member of the Repap Board for five or six years. He was the only director to testify who was present at both the February and March Board meetings. Mr. Cohen is an experienced director and former CEO of a major Canadian public corporation, but he was a new Repap director attending his first Board meeting on March 23, 1999, as was Mr. Phillips.

13 Jonathan Mishkin is an investment banker, and in 1999, he was the head of the Paper and Forest Products Group at Donaldson, Lufkin, Jenrette ("DLJ"). Pierre Raymond is a corporate solicitor at Stikeman Elliot in Montreal. I have already mentioned Margaret Engel of Mercer. These individuals were involved in a more limited way, but their evidence was straightforward and, by and large, uncontroverted. They were entirely credible and reliable witnesses.

14 Steven Larson was Repap's President and CEO, Michelle Cormier was Chief Financial Officer, and Terry McBride was Vice-President and General Counsel. They were the senior officers of Repap before, during and after Mr. Berg's tenure, and their evidence is obviously important. Marty Whitman and Curtis Jensen of Third Avenue Funds were able to contribute to my understanding of the role they expected Mr. Berg to play in Repap. Mr. Jensen was present for the February Board meeting and prepared a memorandum outlining the Board's opposition, which is a significant document in the trial. Mr. Whitman was present for the March Board meeting when the Agreement was approved. I also found each of these witnesses to be credible and reliable.

15 The same is true of Robert MacLellan. In addition to the responsibilities he held in 1999 as

Executive Vice-President of TDAM, he is currently Chairman of TD Wealth Management. He is an experienced senior executive. I found him to be knowledgeable about Repap, informed about executive compensation in the Canadian context, reliable in his analysis of the Agreement, accurate in his assessment of Berg's value to Repap and credible in his evidence about his dealings with Mr. Berg. His testimony was direct, thoughtful and cogent, and I give it considerable weight.

16 During the course of Mr. Berg's evidence, objection was raised to some of his testimony on the basis that it contravened the Rule in Browne v. Dunn. Initially, I was inclined to give effect to the objections, but as the record will show, I decided that the better course was to hear the evidence and assess it on the basis of weight. Accordingly, I believe that Mr. Berg was given every opportunity and considerable latitude in presenting his story to the court. As his evidence unfolded, the Browne v. Dunn issues became much less significant and were not much pressed during argument.

17 Mr. Berg testified for four days, and I listened carefully to his evidence. I have taken account of the fact that giving testimony is a stressful event and that this is a long time to be in the witness box. I regret to say that I did not find Mr. Berg to be a credible witness. His evidence was tainted by self-interest. He was unresponsive to questions, both in direct examination and cross-examination. In the face of important documents that were in clear contradiction of his testimony, he made no concessions. He was prone to exaggeration. He was evasive, argumentative and lacking in candour. His evidence is not reliable.

18 The evidence that was not presented in this case has some importance. Arnold Jacobs, Andrea Rattner and Jeffrey Horwitz are lawyers at Proskauer Rose. Ms. Rattner is an employment specialist and partner at the firm and was centrally involved in the preparation of the Agreement. Mr. Jacobs was the senior lawyer on the Repap file. Both were present for the February and March Board meetings. Mr. Horwitz acted as Secretary to the Board at the March meeting and prepared the Minutes. These individuals could have clarified and given evidence about the nature of their retainer, the nature of the discussion at the Board meetings and whether there ever was an arm's-length negotiation over the Agreement. Although their evidence was available to be called, they were not called to testify.

19 Mr. Berg testified that he retained Proskauer Rose on behalf of Repap and negotiated the terms of his contract on his own behalf believing that Ms. Rattner was negotiating on behalf of Repap. Mr. Berg relies on the fact that the Proskauer accounts went to Repap and that they reveal an on-going retainer on a variety of matters. This is true. However, it was Mr. Berg who approved the accounts for payment. They show that Mr. Berg was the only person at Repap with whom Ms. Rattner was communicating in connection with his employment contract.

20 There is no magic in describing Ms. Rattner as "Repap's lawyer". This is merely a descriptive term that does not explain her role in the development of the Agreement. Neither UPM nor Repap assert that she was "Repap's lawyer". This is Mr. Berg's assertion. Normally, proof lies with the party making the assertion.

21 Neither the dockets nor the documents support Mr. Berg's understanding. Ms. Rattner was the witness who could illuminate this important issue. Mr. Berg obtained an Order from the New York court to examine Ms. Rattner, but he elected not to call her. In so doing, he ran the risk that I would draw an adverse inference and I do.[1] I find that had she been called to testify, her evidence would not have supported Mr. Berg's belief that she was representing Repap in the negotiation of the contract.

The Board Meetings

22 There were four meetings of the Board of Directors of Repap between January and March. The Agreement was discussed at the February 22, 1999 and March 23, 1999 meetings. For the meetings on January 27 and March 8, there are signed Minutes, but there is no formal record of the two most important meetings. The Minutes of the March 23 meeting were never circulated or signed, and Mr.

Horwitz's dockets indicate that he was still working on revisions on April 30. By this time, there was controversy about the Agreement and the process that had led to it. In view of this, I give greater weight to the evidence of those who were present when the contract was approved.

Part II - Factual Analysis

A Brief History of Repap

23 When Steven Larson joined Repap in the spring of 1997, it had six subsidiaries operating in Canada and the United States. The growth of the company had been very rapid, and it was top-heavy with debt, both at the corporate holding company and at each of the subsidiaries. Paper prices, which tend to be cyclical, were depressed, cash was tight and the lenders had lost patience. As a result, Repap was forced to dispose of the majority of its assets and convert a significant amount of debt into equity by issuing over 600 million new shares. It was on the debt conversion in 1997 that Paloma Partners emerged as Repap's largest shareholder.

24 By the end of 1997, there remained only one operating company, a coated paper mill in Miramichi, New Brunswick, which Repap owned through its wholly owned subsidiary, Repap New Brunswick Inc. As part of this dramatic downsizing, Repap closed its Montreal head office and reduced its staff from 80 to 5 employees. Its senior officers, Larson, Cormier and McBride, re-located to Stamford, Connecticut where the Repap sales and customer service operations were already headquartered.

25 Despite the divestitures, cost cutting, and downsizing, Repap still faced challenges. The New Brunswick mill was a state-of-the-art, world-class facility and Repap was the low cost producer with significant market share. However, it remained one of the more highly leveraged forest product companies in the industry with $1.5 billion in debt. In 1998, Mr. Larson and Ms. Cormier successfully undertook a significant refinancing and avoided further conversion of debt and dilution of shareholders' equity. However, as paper prices remained depressed, Repap was a cash-constrained company with too much debt, whose shares were trading at very low levels.

26 When Mr. Berg entered the picture in January 1999, he believed that Repap was a virtually bankrupt company and unless there was an immediate restructuring of the debt, it had no prospect for survival. He did not think anyone would invest in the company or acquire it unless it was "fixed up".

27 Not only did Repap survive, but UPM paid a premium for it. Its offer to the shareholders in August 2000 was for approximately twice the market value of the shares. Evidently, UPM saw value in Repap despite its significant debt, which was at approximately the same level then as it was in January 1999. I observe that the UPM offer, which was unsolicited, was made after Mr. Berg departed and at a time when Repap was operating with the same management that was there before he arrived.

Third Avenue Funds

28 Third Avenue Funds is a registered investment and mutual fund business based in New York. About fifteen per cent of its portfolio is invested in distressed companies, an area in which Mr. Whitman has special knowledge and experience. Mr. Berg knew Mr. Whitman slightly, but Mr. Whitman was a well-known personality in the business community, the author of two books and, for many years, an Adjunct Professor at the business school at Yale.

29 Mr. Berg and Mr. Larson knew one another from a prior business dealing in the mid-1990's while Mr. Larson was still at Domtar Inc. After he joined Repap in 1997, they stayed in touch with each other. By 1998, Mr. Larson had re-located to Stamford, Connecticut, and in May of that year, he and Mr. Berg had dinner together in Greenwich, Connecticut.

30 Mr. Berg testified that at their dinner, they discussed Repap's problems, and Mr. Berg outlined

some ideas he had for addressing them. Shortly after, he met with William Anderson, Repap's Chairman, and in October or November, he introduced Mr. Larson to Huff Asset Management, a potential investor in Repap. Mr. Berg was probably somewhat more active with Repap during this period than Mr. Larson acknowledged and somewhat less active than Mr. Berg claimed. Nothing ultimately turns on this because Mr. Berg agreed that he first contacted Mr. Whitman in late December or early January. Before this, he could have had no expectation that he would play any role in Repap.

31 In January, Mr. Whitman and Mr. Berg had several discussions about Third Avenue's purchase of the Paloma Block. By then, Mr. Berg was already a Repap shareholder, but Third Avenue would only invest in Repap if Berg increased his personal ownership as Mr. Whitman wanted them to have a "community of interest" as common stock investors. Mr. Whitman believed that there was a window of opportunity of perhaps up to five years to do something with Repap. His understanding was that both he and Mr. Berg would have a role to play in increasing shareholder value and that Mr. Larson would apply his management skills to running the mill and keeping it cost-efficient.

32 Third Avenue Funds anticipated that Mr. Berg would become Chairman of Repap, performing a non-executive role. This was also Mr. Larson's expectation. Mr. Whitman would not have invested in Repap had he thought that Mr. Berg would displace Mr. Larson as he considered Larson essential to Repap. It was in fact the dissension that developed between them as a result of the controversy created by Mr. Berg's employment agreement that motivated Mr. Whitman to lend his support to TDAM in the proxy fight.

33 Mr. Berg testified that he discussed specific compensation he would receive to implement a restructuring plan for Repap, namely - "a load of warrants" - with Mr. Larson at their May dinner and with both Larson and Whitman at a January meeting prior to Third Avenue's investment. He also testified that it was at the January meeting that his role as an executive Chairman was discussed. In direct contradiction, Whitman, Larson and Jensen testified consistently that there was no discussion about Berg's compensation or his role at Repap at any time before Third Avenue made its investment on January 27, 1999.

34 It was Mr. Whitman's expectation that Mr. Berg would perhaps get some options by way of compensation, but that Mr. Berg's basic interest would be as a common shareholder. Mr. Jensen said, "I expected that he would look into his Rolodex to make contacts in the financial community", dealing with rating agencies and "bigger picture" issues. Mr. Larson said, "I expected he would be a one-for-one replacement for Mr. Anderson". Although the Board of Repap was consulted and agreed that the Paloma nominee directors would resign, it did not ask Mr. Berg to become a full-time Chairman or agree to employ him. I find that there was no understanding that Repap would compensate Mr. Berg in any material way or that he would assume a role other than as a non-executive Chairman.

Mr. Berg's Investment in Repap

35 Much was made of the fact that Repap's financial statements had a "going concern" note, but Mr. Berg was well aware of this. This did not deter him from making a substantial investment in Repap in November 1998 for U.S. $700,000. In January 1999, he increased his investment by purchasing additional shares for U.S. $1,000,000. When he made his investment in November, Mr. Berg could not have expected to have any relationship with Repap except as a common shareholder. Mr. Berg conceded that it was common for him to make speculative investments.

36 Mr. Berg invested in Repap for the same reason as Third Avenue Funds. The shares were trading at an all-time low of U.S. $0.05. Both he and Mr. Whitman believed there was value in the company that the share price did not reflect. Mr. Whitman's hope was "to hit a home run with a penny stock", which is precisely what happened. On the acquisition by UPM, Third Avenue almost tripled its investment. Mr. Berg's motivation was no different. His purpose was to make money on the stock. It was only after he was installed as Chairman that he saw the opportunity to make money in another

way.

Mr. Berg Becomes Chairman of Repap

37 Mr. Berg was appointed a director and Chairman of Repap at the Repap Board meeting on January 27, 1999, by a Board consisting of William Anderson, Robert Poile and David McAusland (the Paloma nominees), Guy Dufresne, Robert Bellamy, John Purcell and Steven Larson. There is consistent evidence that there was no discussion at the meeting about Mr. Berg performing a senior executive or management role.

38 Two important issues in this trial are whether Repap needed a "Senior Executive Officer" in addition to a Chief Executive Officer, and, if it did, whether Mr. Berg was qualified for the job. It is therefore important to examine his credentials against the circumstances of Repap at the time.

39 In 1999, Mr. Berg was 63 years of age. During the 1970's and 1980's, he had developed a successful business, National Home Products. In 1989 or 1990, the company was involuntarily petitioned into bankruptcy. During the 1990's, he devoted some of his time providing legal services to long-standing clients and some of his time managing the investments of a family holding company. By 1998, he was no longer engaged in an active business life or practising law on any regular basis. He was semi-retired and living in Florida for substantial periods each year. He had last served as a member of a Board of Directors in 1973. However, over the years he had developed a network of business and social contacts and he was not shy about using them. He was experienced in business, but he had no recent or relevant experience to bring to Repap. He was not a restructuring expert or a specialist in the forest products industry.

40 What expectations would Repap have about the individual I have described? It knew it had not gone out and recruited Mr. Berg. There is no evidence that anyone at Repap believed Repap needed a fourth full-time executive or that he was the candidate to fill that role. Mr. Berg was assuming the role of Chairman as a nominee of Third Avenue. He was replacing Mr. Anderson, a nominee of Paloma, who had served as a non-executive Chairman. The management team had already accomplished the most difficult part of Repap's turn-around. According to Mr. MacLellan, there was little or anything that an executive Chairman could contribute. He stated:

> "... So you have to start at the beginning and say: What was REPAP'S corporate strategy? And the corporate strategy, as I think I've already explained, was to minimize costs and to wait for an upturn in commodity prices. And except for that there wasn't a lot that could be done. So what that would say, then, is: What structure does that lead you to? And that structure would be that you would have a CEO of a company who was familiar with the operations of a paper making operation, and could get costs as low as possible. A good CFO who could fend off the lenders and the other banks and could extend maturities for as long as possible. And somebody internal to do the legal work.
>
> And in addition to that I think there's room in this kind of a structure for a non-executive Chairman to run the Board meetings, and to address things like the CEO's compensation. Nowhere in this framework that I outlined did I see a need for what was described in this contract as a Senior Executive Officer ...".

41 Mr. Berg testified that he outlined at the May 1998 dinner with Mr. Larson (or shortly after) a detailed plan for Repap's restructuring. This plan included converting the second priority bonds to equity and offering the seconds preferred stock with a right to redeem at 100 cents on the dollar over five years. The redemption value of the shares would be the face amount of the bonds, which were then trading in the market below par. He also proposed to give the bondholders warrants, which would become valuable if he could increase the price of the common shares. The bondholders would then get a "free ride on the shares of the stocks".

42 He planned to change the company's name, re-incorporate in Delaware, re-list Repap's shares on the NASDAQ and, in order to meet the minimum trade amount of $5.00, do a reverse stock split. Mr. Berg produced some notes that he made on a napkin at that dinner on which he jotted the names of "Anderson", "Poile", a Repap director, and "Sussman", the principal of Paloma Partners. However, he acknowledged that, apart from these jottings, he was unable to locate any document that he prepared at that time or at any time, that set out this plan, or any plan, for restructuring Repap.

43 In contrast to Mr. Berg's evidence, five witnesses testified that Mr. Berg had neither a detailed nor a feasible plan. Each of these witnesses described Mr. Berg's "three-point restructuring plan", which consisted of a corporate name change, a reverse stock split and a re-listing of Repap's shares on the NASDAQ exchange or the New York Exchange. Some of them recalled Mr. Berg talking in a general way about restructuring the debt. None of them recounted the plan described by Mr. Berg in his testimony.

44 Mr. Cohen was asked for his recollection about Mr. Berg's restructuring plans. He did not have a detailed recollection, but on the basis of what he could recall, his evidence is consistent with the testimony of other witnesses. He stated:

> "As I recollect, his plans really were strategic and financial. He didn't purport to be a paper manufacturer or know very much about running a mill. But he did have a lot of business experience, and he thought that he could go in and -- what the company needed really was a refinancing, they had too much debt. And that it needed a new strategic vision which might lead to some sort of perhaps a sale or a take-over, or something of that sort.
>
> But nothing would really happen unless and until the financial structure had been repaired, and he had a lot of ideas in that regard.
>
> Q. Did he tell you what those ideas were?
> A. He probably did, but I don't recall specifically other than something had to be done about the debt -- either some conversion of the debt into equity, or some refinancing, new loans, and what have you. But, again, specifically, I don't recall."

45 Mr. Larson noted that a reverse stock split was a commonly suggested strategy that had been discussed and discounted. Mr. MacLellan confirmed that a reverse stock split was not a desirable solution and could actually worsen the situation.

46 It was Mr. Whitman's evidence that neither he nor Mr. Berg had any clear idea about how to restructure, but he did not think that there was any opportunity to convert debt into equity. Mr. Jensen characterised Berg's "three-point plan" as "cosmetic" and said it did not address the financial problems Repap was facing.

47 Credit Suisse First Boston had been retained in December 1998 and had concluded that a debt restructuring was not feasible. In April 1999, Jonathan Mishkin of DLJ came to a similar conclusion. This was the opinion of Oasis Capital Group who was also consulted in April about a possible debt restructuring. In rejecting the idea, Oasis explained:

> "The bondholders are not geared to voluntarily enter into such arrangements especially when they feel that a company is merely passing through a liquidity squeeze rather than facing a solvency issue."

48 This statement was an accurate picture of Repap's financial situation. The company had too much debt and needed to manage it, which Mr. Larson and Ms. Cormier were doing. Michelle Cormier had an excellent relationship with Repap's bondholders. Along with Mr. Larson, she had successfully raised $320 million of financing in June 1998. Together, they had managed a major restructuring. Before Mr. Berg arrived, discussions were well under way with DLJ and others to refinance Repap's operating credit facility, which was falling due. Larson and Cormier were a sophisticated, effective, financial management team and were generally credited with keeping the company afloat despite its burdensome debt. That the bondholders had confidence in Repap and in its management was demonstrated in May. DLJ went to the market with a high-yield bond financing on behalf of Repap, which was pre-sold. According to Mr. Mishkin, Mr. Berg's contribution to the financing was a modest one.

49 Mr. Berg's testimony about his restructuring plan stands alone, unsupported by documentation and inconsistent with the evidence of qualified and credible witnesses who were not asked about it. In view of the significance of this evidence, the plan Mr. Berg testified to at trial ought to have been put to them. I accord his evidence little weight for this reason and also because I believe the evidence of the other witnesses to be more reliable than the evidence of Mr. Berg.

50 It is also of interest that the unexecuted Minutes of the March Board meeting at which Mr. Berg discussed recapitalization with the Board, makes no mention of the plan he described in his testimony. What he reviewed with the Board then was reincorporating in the U.S., with a simultaneous reverse stock split and possible change of name.

51 For the reasons offered by Mr. Mishkin and Oasis, there was no prospect of any debt restructuring based on the premise that the bondholders would convert their high-interest, secured debt into any form of equity. Nor was there any prospect that the existing shareholders would agree to any further dilution. As Mr. Larson stated, "the restructuring had already taken place".

52 Finally, no restructuring could take place without the involvement of an investment bank. Mr. Berg admitted that his role in any restructuring would be limited to that of "point man," and in fact, he explored with several investment banks in the spring of 1999, the fees they would charge for their services. There was, therefore, no saving to Repap to have Mr. Berg aboard, as he was not equipped to do this on his own.

53 Mr. Berg did not have any particular skills to bring to Repap that weren't already available to it through its senior management team. His appointment brought no material benefits to Repap that would justify the hiring of a Senior Executive Officer with a lucrative employment contract. How and why did this happen then?

The Genesis of the Agreement

54 Mr. Berg did not begin to think about an employment contract for himself until early February. When he did, he went to see Mr. Whitman to tell him what he had in mind.

55 Mr. Whitman had strong views about Mr. Berg's proposal, which he described as a "huge - huge, huge potential cash bonus based on stock price, options, a sign up option, another option for 75 million. It was quite a package". Despite this, he said nothing to Mr. Berg. After hearing about it, Mr. Whitman concluded that he and Berg no longer had a community of interest, "Mr. Berg's interest was not in the common stock -- in making money in the common stock. His basic interest was getting rich off an Employment Contract".

56 In early February, Mr. Berg retained Proskauer Rose, and specifically, Arnold Rose, as counsel to Repap. Mr. Whitman had known Mr. Jacobs for a long time and was enthusiastic about him. However, it was Mr. Berg's idea to retain Proskauer. He testified that his primary reasons for doing so were to bring Repap's security filings up to date (a matter he said he discussed with Mr. Whitman) and

to assist in the recapitalization.

57 Mr. Whitman did not recall discussing the securities filings with Mr. Berg, and I am doubtful that they ever did. The so-called deficiencies in the securities filings were never raised with Terry McBride or with Repap's securities counsel, Sullivan & Cromwell, or with Stikeman Elliott, Repap's Canadian counsel. There is no credible evidence that the securities filings were deficient.

58 When Mr. Berg made the decision to retain Proskauer, he had not yet been to a Board meeting. Apart from Mr. Larson and Mr. Jensen, whom he had recently met, he did not know any of the Repap Directors. He had not been to the head office of Repap. He did not consult the Board, Mr. Larson or Mr. McBride about changing counsel. There was, in fact, no formal retainer of Proskauer until the Board meeting of March 23, 1999. The Proskauer accounts show that in February and March its services were primarily devoted to the preparation of Mr. Berg's contract.

59 It is very unlikely that Mr. Berg retained Proskauer for the reasons he gave. He probably did this to assert his control over Repap, to direct the process leading to his contract and to marginalize Repap's senior officers, particularly Mr. McBride. He was the logical person to consult about retaining new counsel, but his views were never sought.

60 Between February 4, 1999 and February 22, 1999, Ms. Rattner generated two versions of a document entitled "Proposed Term Sheet" and two versions of a document that was first called "Executive Summary of Proposed Employment Agreement for F. Steven Berg" and was later entitled "Employment Contract Term Sheet Between Repap Enterprises Inc. and F. Steven Berg" ("Contract Term Sheet"), collectively referred to as ("Term Sheets"). Each of those four versions of the Term Sheets was sent to Mr. Berg, and at least three contain his hand-written comments. No one from Repap reviewed any of the versions. The preponderance of changes benefited Mr. Berg and not Repap.

61 Mr. Larson first realized Mr. Berg was seeking compensation when he saw the Contract Term Sheet on February 17, 1999. He was stunned. Both Mr. Larson and Ms. Cormier tried to alert Mr. Berg to the problems that his proposed contract would create for him and for Repap. Mr. Larson's notes reflect the following concerns, which he reviewed with Mr. Berg:

(a) The past Chairman of Repap, Mr. Anderson, took nothing from the company, had no employment contract and did not draw a salary;
(b) The prior Chairman of Repap, Mr. Petty, took everything, destroyed morale, never looked to the team, and put personal greed ahead of results;
(c) The team of Larson, Cormier, McBride, the sales force and manufacturing team had turned the company around in the past two years. Mr. Berg had nothing to do with that turnaround and the toughest part was behind them;
(d) Repap was in a cyclical business, and was a one product company. The coated paper price tended to move the share value. An increase in the price of coated paper would translate into significant earnings in the company, irrespective of the actions of any person;
(e) Repap had extremely limited cash and the company did not need more costs. It was a small Canadian company with a Canadian culture. Repap was not a US company. There were also management and union sensitivities, and such a contract would be detrimental to labour negotiations;
(f) The shareholders of Repap were quiet but significantly diluted and waiting. They did not want to see the Board or management taking action that would dilute them further as would occur with the number of options Mr. Berg required; and
(g) Mr. Petty was watching the company closely, he was still an investor, and he would not react well to Mr. Berg's employment agreement.

62 Despite their comments, Mr. Berg said it was nonetheless his intention to have a contract with payments and benefits similar to those of the three senior officers.

Board Meeting of February 22, 1999

63 This was Mr. Berg's first Repap Board meeting. It was also the first Board meeting for Pierre Fitzgibbon, Clifford Sifton and Curtis Jensen. They were elected directors at this meeting to fill the vacancies created by the resignations of the three Paloma nominees, as well as that of Mr. Purcell, who decided to leave the Board at that time. Robert Bellamy, Guy Dufresne (the only remaining long-serving directors) and Steven Larson were in attendance, as were Andrea Rattner and Arnold Jacobs. They were there at the invitation of Mr. Berg.

64 It was at this meeting that Mr. Jensen was elected Chairman of the Compensation Committee. As long-term passive investors, it was not usual for Third Avenue Funds to take a position on a Board, but Mr. Whitman thought that it would be beneficial for Mr. Jensen ("one of my young people"), to gain some Board experience. Mr. Jensen testified that he felt uneasy about being appointed as Chair of the Compensation Committee. He bad no prior public company Board experience and no experience as a Compensation Committee Chairman.

65 Mr. Dufresne formed the impression that Ms. Rattner was at the Board Meeting as "an expert" to explain the Berg Agreement. Mr. Jensen testified that he did not know whether Ms. Rattner was there to represent the company or Mr. Berg. In whatever capacity she was there, it is clear the directors did not accept her advice.

66 The Minutes reflect the Board's concern with one element of the Agreement, namely the market capitalization bonus. However, this does not accurately reflect the discussion. Rather, as Mr. Jensen said, it reflects the Board's attempt to find a way to be polite and soften the blow when it had to advise Mr. Berg, after he returned to the meeting, that his contract had not been approved, while the proposed arrangements for management had been. Mr. Jensen's testimony reveals the difficult and sensitive issues that can arise with the employment contract of a Chairman, particularly if a Chairman is the nominee of the company's largest shareholder. The Board did not know anything about Mr. Berg or Third Avenue Funds. This is dangerous territory for a Board of Directors and underscores the necessity of establishing an independent Committee to delve into it.

67 The Board appreciated that it could not bless the Agreement without further scrutiny. At the conclusion of the Board discussion, it was decided some guidance from a compensation consultant was required in order to understand if the Agreement was, to use Mr. Jensen's words, "within the realm of fairness". It was Mr. Jensen's expectation that the Board would retain a firm to review the contract and the consultant would prepare a report to Compensation Committee members. This was also Mr. Dufresne's expectation. Specifically, Mr. Dufresne asked that the review include a benchmarking analysis as he did not believe that either the manner of the proposed remuneration, specifically, the market capitalization bonus, or the quantum, was common for similarly situated companies. The Compensation Committee was requested to give the Agreement further consideration and report back to the full Board.

68 There is no credible evidence to support Mr. Berg's belief that his contract was "approved in principle" at the Board meeting. Nevertheless, even if Mr. Berg genuinely believed this, he soon learned why his contract was not approved.

The Aftermath of the February 22nd Board Meeting

69 Mr. Jensen described the Board's reaction to the Berg Agreement as one of "outrage and disgust". On the day following the meeting, Mr. Bellamy, the longest standing member of the Board, unexpectedly resigned. In the week following the meeting, Mr. Jensen was inundated with calls from directors to express their concerns about the Agreement. Mr. Dufresne was one of those who

contacted Mr. Jensen.

70 In a letter to Mr. Jensen dated March 1, 1999, Mr. Dufresne highlighted his concerns, which he expanded on in his evidence. They were threefold.

71 First, he did not think Repap, which was a one-mill company, could afford or needed two highly paid top executives, that is, an active Chairman and also a President and CEO. He pointed out that the three operating officers of Repap (Larson, Cormier and McBride) were paid slightly above industry average to recognize the difficult conditions they were coping with and their excellent performance.

72 Second, he did not think Mr. Berg's remuneration should be tied to market appreciation but to the work he would be doing. In his view, the reward of market capitalization was primarily for the shareholders and to a significantly lesser extent, the senior officers.

73 Third, he wrote that he welcomed Mr. Berg as a full-time Chairman to help resolve the capital structure of the company as he thought this was a better alternative than paying a merchant bank for these services. However, he thought there should be a time limit for his active involvement and suggested three years. This comment shows that Mr. Dufresne recognized there was no benefit to Repap to have a second full-time CEO, unless it resulted in savings to the company. He realized that if Mr. Berg was there to bring about a restructuring, his appointment was a time-limited assignment.

74 Mr. Berg recognized this too. He testified that he expected to be able to accomplish the restructuring by October 1999, or at least within one year. He did not anticipate being involved with Repap after this. Mr. Berg did not tell the Board this, yet he permitted his contract to go before it with terms that are wholly inconsistent with the terms of employment that a corporation, acting reasonably, would provide to a senior executive who is employed for a short-term, task-oriented assignment.

75 Although Mr. Dufresne had sat on several Boards of Directors and continues to do so, this was the only time he had ever written to a co-director expressing concern about an issue then before a Board. He said he took this unusual step because the presentation of Mr. Berg's Contract Term Sheet to the Board was, in his words, "light weight or almost a farce".

76 Mr. Dufresne sent his letter to Mr. Jensen as head of the Compensation Committee on a confidential basis. Nonetheless, Mr. Berg acquired a copy of the letter and telephoned Mr. Dufresne. In that conversation, Mr. Berg angrily stated that Mr. Dufresne should have talked to him directly. Mr. Dufresne expressed surprise that Mr. Berg had a copy of his letter and told him that he should not be involved in this exchange because he was the party whose employment agreement was at issue. Mr. Berg's conduct is inconsistent with an independent review of a director-corporation transaction.

The Jensen Memorandum

77 Following the Board meeting, Mr. Jensen wrote a memorandum on February 26, 1999, for Mr. Whitman. He wished to alert him that there was an immediate problem that needed to be addressed. In his memorandum, he tried to capture some of the concerns expressed to him by the other directors and to illustrate one or two examples of the implications of "the market cap bonus". He testified that he had never seen an executive bonus linking compensation to market capitalization. He also prepared some calculations to illustrate "the rather staggering numbers" that Mr. Berg could earn through this bonus. He indicated that the Board was concerned not only with the absolute numbers, but also with the prospect that Berg could benefit handsomely from an increase in market capitalization, a benefit that could be completely unrelated to his performance.

78 He recorded that Mr. Berg's proposed compensation package had met with "enormous resistance". He went on to detail the concerns of three directors, Mr. Bellamy (a long-standing Board member who had by then resigned), and Mr. Dufresne (another long-standing Board member) and a newly appointed director, Pierre Fitzgibbon. He pointed out that each of these directors was Canadian

and the seven-member Board required at least four Canadians.

79 He also wrote a section entitled "Potential Solutions". He testified that this was not intended to be an exhaustive list of every possible solution. They included: (1) eliminating the market cap bonus altogether; (2) reducing the number of shares from 50 million to 15 million and making them options without a loan; and (3) increasing the strike price of the options to the $0.35 to $0.50 range in order to make it a true incentive program.

Jensen's Resignation

80 After making Mr. Whitman aware of the controversy surrounding the Berg Agreement, they decided that he should immediately resign from the Board. Jensen tendered his resignation on March 1, 1999. His resignation letter, which was sent to Mr. Larson and copied to Mr. Berg, specifically drew attention to the necessity of hiring a compensation expert. His statement leads me to infer that the directors who attended the February Board meeting were not informed that Mercer had already been retained and was in the process of preparing an opinion.

81 The concluding line of Mr. Jensen's letter states, "Third Avenue Funds is not entitled to, nor does it desire that any warrants or options be issued to it". Previously, it had been contemplated that Third Avenue would receive some options or warrants. Mr. Whitman asked Mr. Jensen to include this to make clear that it was Third Avenue's intention to divorce itself entirely from the Board and to have nothing further to do with Repap, other than as a passive outside investor. According to Mr. Whitman, this meant that Third Avenue would not interfere in decisions of management, approved through an appropriate Board process.

Mr. Berg's Response

82 By March 2, 1999, Mr. Berg had received a copy of the Jensen memorandum, Mr. Jensen's letter of resignation, Mr. Bellamy's letter of resignation and the letters from two directors, Dufresne and Fitzgibbon, commenting on Mr. Berg's proposed compensation package. He sent this material to Andrea Rattner and asked her to call him.

83 At the very same time as Mr. Berg received this material, he was in the process of recruiting Stephen Phillips and Marshall Cohen as new Board members. Although Mr. Berg met with Mr. Cohen in Toronto on March 4 and in New York on March 8, and had conversations with Mr. Phillips around this time, he did not show them this material, nor did he ever discuss its substance with them. He took no steps to ensure the existing directors or incoming Board members received it. He took no steps to ensure Mercer received it. He informed no one about his conversations with Mr. Larson or Ms. Cormier and their analysis of his contract, in light of the circumstances of Repap at the time.

84 Following the Board meeting on February 22, 1999 and in the weeks leading up to the March 23, 1999 Board meeting, five versions of the Executive Employment Agreement were prepared by Ms. Rattner and sent to Mr. Berg. Versions one through three contain Mr. Berg's hand-written mark-ups. As with the Term Sheets, no director, apart from Mr. Berg, saw these drafts. During this period, Mr. Berg also saw a draft of the Mercer opinion letter and made some comments on it, although there is no evidence that any director had the same opportunity. By March 8, there was again a functioning Compensation Committee, but Mr. Berg did not bring its three members into the process.

Berg's March 18, 1999 Memorandum

85 Mr. Berg, in his capacity as Chairman, sent the directors a memorandum dated March 18, 1999, enclosing a "finalized draft" of his Agreement. It was copied to Ms. Rattner and Mr. Jacobs. As early as March 8, Mr. Berg had prepared drafts of this memorandum and sent them to Ms. Rattner. This belies his assertion that he believed that she was "Repap's lawyer". What possible reason was there for "Repap's lawyer" to review this? Mr. Berg sent the drafts to Ms. Rattner because he wanted her advice on the wording.

86 Mr. Berg testified that he thought the version of the Agreement he sent to the directors on March 18 was the same version that was executed and he did not appreciate until much later that there was a difference between them. I reject this evidence because Proskauer's dockets show an entry for a March 22 conference between Berg and Rattner and state: "rev. option agmts; rev. emp. Agmt; conf. S. Berg ...". I find that Mr. Berg knew there were changes made to the Agreement.

87 The changes were by no means insignificant. The version the directors received provided that the grant of stock options was conditional on shareholder approval. This language was removed from the executed Agreement, giving rise to an immediate legal obligation on the part of Repap for the value of the options. This provision is the basis for Mr. Berg's claim in the New York action for U.S. $6,750,000. There were also changes made to the stock option grant, which has an extremely short vesting period. The "finalized draft" provided that the options would vest on a change of control and if Mr. Berg left Repap. Under the executed Agreement, the options vest immediately on a change of control.

The Compensation Committee

88 The Compensation Committee was Stephen Phillips, Clifford Sifton and Guy Dufresne. Mr. Dufresne was the only member who had served on the Repap Board for any period of time. Before March 23, 1999, Mr. Sifton had attended one Board meeting in person and had participated in the telephonic Board meeting on March 8, 1999, where Mr. Phillips was elected a director and Chairman of the Compensation Committee.

89 Mr. Phillips was a former employee of Mr. Berg in the 1980's. He had also held positions in sales and product development in the food and advertising industries and had worked as a business consultant for about ten years, but he had never served as a director of a public company, nor as a director of a Canadian company. He had never chaired a Compensation Committee. The only Repap officer or director he knew was Mr. Berg. He had proposed Mr. Phillips as a director because his residence was in Stamford, Connecticut.

90 Mr. Berg had also proposed Mr. Sifton as a director and a member of the Compensation Committee, although he did not know him personally. He knew him only as the son of Colonel Michael Sifton, a fellow polo player. As Mr. Sifton did not testify at the trial, I do not know what qualifications he had to serve on the Repap Board, but, based on Mr. Berg's testimony, Mr. Sifton's main qualification was that he was Canadian.

91 Mr. Phillips' knowledge of Repap was limited and in some cases, wrong. For example, he adopted Mr. Berg's view that Repap was on the verge of bankruptcy and that it was about to disappear unless immediate steps were taken to turn it around. He believed Mr. Berg had been hired to avert a bankruptcy.

92 His understanding of the Agreement was sadly inadequate. Although he believed it was important for the contract to be performance-driven, in cross-examination, he agreed that many of the key benefits in the contract, such as the signing bonus, the eight years' accrued pension credit and the market capitalization bonus, had nothing to do with Mr. Berg's performance.

93 He did not understand how the market capitalization bonus worked. He believed stock prices drove an increase in market capitalization and, if this occurred, it would be due to Mr. Berg's efforts. He did not understand that Repap's stock price could rise due to factors unrelated to Mr. Berg's efforts, such as an increase in paper prices. He did not understand that Repap's market capitalization could increase without a rise in the stock price. He believed that if there was significant improvement in the company's stock price calling for payment to Mr. Berg that, "somehow the company would either find the money, or the Board and Mr. Berg would renegotiate, or if we're on the brink of success, we'll

work out the issues".

94 Mr. Phillips was never told that Curtis Jensen had been the prior Chair of the Compensation Committee. In fact, up until July 2001, Phillips did not know who Jensen was. He did not meet with or discuss the Agreement with Andrea Rattner or Margaret Engel. He did not receive Minutes from earlier Board meetings, a memo from anyone from the Compensation Committee, or any notes from anyone with respect to what might have been discussed about the employment contract. At the same time, he never asked for any material or had any discussions that might have assisted him in fulfilling his duties as Chairman in a responsible manner. Before March 23, the only discussions Mr. Phillips had with any director about the Agreement was a telephone call he said he initiated to Mr. Dufresne on March 22, 1999, about which there is conflicting evidence.

95 Mr. Phillips testified that Dufresne told him in that telephone call that the Agreement was "a significantly better draft" and he was planning to vote for it. In direct contradiction to this, Mr. Dufresne testified that he objected to the Agreement and did not vote for it. When Phillips' version of the phone call was put to Dufresne in cross-examination, he vigorously resisted the suggestion that he would have made a statement to Mr. Phillips indicating his support for the Agreement.

96 Although Mr. Dufresne did not recall the March 22 conversation with Mr. Phillips, I believe Mr. Phillips is mistaken in his recollection of this conversation. It was only three weeks earlier that Mr. Dufresne had taken the unusual step of writing to Mr. Jensen about his concerns with the Berg Agreement. It was only four weeks earlier that the Board had requested an independent opinion and had delegated to the Compensation Committee the responsibility of obtaining one and reporting back to the Board. It was Mr. Dufresne who had requested a benchmarking analysis.

97 Following the February Board meeting, the Contract Term Sheet had been developed into two documents, an Executive Employment Agreement and a Stock Option Grant Agreement. Although some of the provisions had changed, the market capitalization bonus remained, the employment term went well beyond three years and the salary and benefits were at a senior executive level. As none of Mr. Dufresne's objections had been addressed, I find it difficult to accept that he would tell Mr. Phillips he was in favour of the Agreement. Accordingly, I prefer Mr. Dufresne's evidence.

98 The Compensation Committee met only once, immediately before the commencement of the March 23, 1999, Board meeting. Mr. Phillips acknowledged that the meeting was not "long" or "involved", nor could it have been as it lasted for a total of five to seven minutes. This "meeting" can hardly be described as a serious attempt on the part of an important Board Committee to review, analyze and discuss with any diligence the matter that was before them. It took Mr. MacLellan one hour on an initial review to work through the provisions in the Agreement. In addition, he sought assistance from two analysts in his department, one with legal experience and the other with a finance background. The Agreement is incapable of being reviewed, let alone understood and discussed, in a five to seven minute meeting.

99 Apart from its lack of substance, this was not really a meeting of the Compensation Committee at all. As Mr. Dufresne's plane was delayed arriving in New York, he was not present and joined the Board meeting later. Mr. Phillips acknowledged that he had already made up his mind to support the Agreement prior to the Compensation Committee meeting and that he advised Mr. Sifton of this, although neither had seen the Mercer Report. It was distributed during the Board meeting.

The Mercer Opinion

100 There is no dispute about Ms. Engel's qualifications or her ability to provide a meaningful opinion had she been afforded the opportunity to do this. She is a very experienced executive employment consultant and a principal in Mercer's New York office.

101 Ms. Engel was retained by Ms. Rattner shortly before the February Board meeting. In her draft opinion, she requested information about Repap, including the company's business plan, strategic direction, compensation philosophy, input from the company's senior management and Board concerning comparator companies or situations to provide a context for a reasonableness opinion. Had this information been provided to her, she would have learned about the opposition from the Board and management. She would have had some history about Repap. These were matters she said it would have been important for her to know. She could have done a benchmarking analysis. As it was, she believed the Compensation Committee was involved in the negotiations, drafts were going to the Chairman, he was reviewing them and this was having an influence on the process. She did not know the Compensation Committee was not in the loop.

102 Ms. Engel testified that Ms. Rattner declined to provide the requested information because of the time frame. She stated:

> "... I made it clear because of that -- because of that constraint in terms of the time frame, that it would be just impossible to do the sort of, you know, typical back and forth with the company in terms of understanding the underlying business plan and so forth. And that it was certainly impossible to do research on market comparables given that time frame. So I made it clear that our comments would be general in nature based on anecdote or experience or whatever information was readily at hand just because of the time frame".

103 The public information on Repap that Ms. Engel reviewed was the "minimal bare bones of the corporate structure". The information did not provide an ability to prospectively judge the company or how the executive might be expected to impact on it. In cross-examination, Ms. Engel agreed that she had provided "high level" opinions in the past, but this does not change the limitations of this kind of opinion. A view from 30,000 feet does not provide a great deal of insight. Mr. Phillips acknowledged that the opinion was not the result of any due diligence, but was essentially a "high level" opinion with a "hedge". This is a rather startling admission from the Chairman of the Compensation Committee.

The Board Meeting of March 23, 1999

104 The directors present in person at the meeting were Berg, Cohen, Dufresne, Larson, Phillips and Sifton. This was the first Board meeting for Mr. Cohen and Mr. Phillips. It was the third Board meeting for Mr. Sifton and Mr. Fitzgibbon, but Mr. Fitzgibbon never attended a Board meeting. He participated by telephone each time. Mr. Dufresne was the only outside director who had been a director prior to January 1999.

105 When the time came to consider the Agreement, Mr. Larson and Mr. Berg left the room at Mr. Phillips' request, and he chaired this portion of the meeting. Ms. Rattner came into the meeting at that point and handed out copies of the Mercer opinion and made a presentation to the Board.

106 The evidence is unclear which version of the Agreement the directors considered. Mr. Cohen testified that Ms. Rattner reviewed the important clauses of the Agreement. The Minutes indicate that changes from previous drafts were drawn to the attention of the directors. However, Mr. Phillips testified he was not aware the Agreement that was executed was different from the Agreement that had been provided to the directors by Mr. Berg on March 18, 1999. Specifically, he was not aware the language requiring shareholder approval of the options was removed from the executed version of the Agreement. He acknowledged that it would have been preferable for that language to have been in the Agreement. It is evident that Mercer never opined at all on the actual signed Agreement. It did not, therefore, address the changes that had been made to it, and in particular, the implications for Repap's liability of eliminating shareholder approval as a condition of the options.

107 Mr. Cohen did not recall the Board discussion, but he believed the vote was unanimous, as did Mr. Phillips. Mr. Whitman recalled nothing about the discussion, but testified that the Board "rubberstamped" the Agreement. Mr. Dufresne testified the vote was "phony", and he did not vote in favour of approving the Agreement. However, he did not dissent. He was fair to acknowledge that he regretted this. In the course of the meeting, he decided that he was going to resign, which he did the following day.

108 There is consistent evidence that the portion of the meeting devoted to a consideration of the Agreement was brief, probably no longer than one half-hour. There is consistent evidence that no director made any comment on the Mercer opinion. Mr. Dufresne made some comments about the Agreement, although there is conflicting evidence about what he said. Apart from this, there was no comment or discussion about the Agreement. It was, as Mr. Phillips said, a "non-issue".

109 Against these facts, I turn first to the positions of the parties and next to an analysis of the legal principles that apply in these circumstances.

Part III - Analysis and Law

The Positions of the Parties

UPM

110 On behalf of UPM, Mr. Slaght and Ms. Crain submit that because of the manner in which Mr. Berg negotiated and presented for approval the Agreement, he breached his fiduciary duties to Repap. Further, the Repap Directors failed in their own obligations to establish a prudent and reasonable process. Taken together, this led to a contract that is not fair and reasonable or in the best interests of Repap. They submit that this conduct unfairly disregards the interests of TDAM and those of other shareholders. They argue that the appropriate remedy is to set aside the Agreement either under section 241, the oppression remedy provision, or under section 120 of the Canada Business Corporations Act.[2] This section permits the court to invalidate material transactions between a director and a corporation where the director has failed to make adequate disclosure and the contract is not fair and reasonable to the corporation when it is approved.

Repap

111 On behalf of Repap, Mr. Steep and Ms. Teoli submit that Mr. Berg obtained his employment agreement with Repap through breach of his fiduciary duties as Chairman of the Board and a director and also through fraudulent misrepresentations. They rely on at least three false misrepresentations: (1) that Mr. Berg was recruited to effect a restructuring of Repap in a senior executive capacity; (2) that the Mercer opinion was an informed and independent opinion; and, (3) that Mercer's comments and those of the directors had been incorporated into the Agreement. They claim these representations were made with a dishonest state of mind and the directors relied on them to their detriment. The appropriate remedy, they argue, is rescission of the Agreement.

Berg

112 On behalf of Mr. Berg, Mr. Cherniak and Mr. Glezos submit that this action is an attempt to usurp the jurisdiction of the New York court in which Mr. Berg first commenced his action against Repap. They argue that UPM and Repap seek to have this court substitute its judgment for the business judgment of the directors who were involved with the review and the approval of the Agreement, which was unanimously approved in reasonable reliance on the opinion of Mercer, a leading North American compensation consultant. They further argue that UPM has suffered no prejudice because it acquired Repap with knowledge of the Agreement and paid a premium for its shares. It is, therefore, incapable of being oppressed. They submit the Agreement should stand. In the alternative, if certain provisions of the Agreement are found to be oppressive, the appropriate remedy is to rectify the Agreement under section 241 or to vary it under section 120 of the CBCA.

The Duties of Directors

113 The cases advanced by UPM and Repap are different, but both have as their starting point the common law and statutory fiduciary duties that are imposed on directors of Canadian corporations. These duties require directors to act honestly and in good faith with a view to the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[3]

114 In the context of a director-corporation transaction, there are also duties of disclosure. The CBCA codifies the manner and extent to which disclosure must be made. It provides that a director shall disclose to the corporation the nature and extent of any interest he has in a material contract with the corporation.[4] With these principles in mind, I turn first to Mr. Berg.

The Duties of Mr. Berg

115 In Gray v. New Augarita Porcupine Mines Ltd.[5], a decision of the Judicial Committee of the Privy Council, on appeal from the Ontario Court of Appeal, the court had to consider the level of disclosure that is required to meet the statutory requirement. Lord Radcliffe stated:

> "There is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest. Rightly understood, the two things mean the same. The amount of detail required must depend in each case upon the nature of the contract or arrangement proposed and the context in which it arises. It can rarely be enough for a director to say, "I must remind you that I am interested" and to leave it at that ... His declaration must make his colleagues "fully informed of the real state of things" (see, Imperial Mercantile Credit Ass'n. v. Coleman (1873), L.R. 6 H.L. 189 at 201, per Lord Chelmsford). If it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed."[6]

116 Measured against this standard, Mr. Berg's conduct falls well short of what was required of him. The Repap directors were not fully informed of 'the real state of things'. It was material to their judgment to know about the comments of management and prior Board members on his compensation package. It was material to their judgment to know that Mercer had not done any research, benchmarking or analysis of comparable companies as requested by the Board at the February 22, 1999, meeting. It was material to their judgment to know that the Agreement tabled before it on March 23, 1999, was different in several important respects from the version they received with the March 18, 1999, memorandum. It is no answer to the duty to disclose to say the directors could have discovered this for themselves. The duty to disclose is an absolute one, because, without full disclosure, any investigation into whether the beneficiary would have acted in the same manner is impossible.[7]

117 Disclosure of a director's interest is but the first step. Disclosure does not relieve the director of his duty to act honestly and in good faith with a view to the best interests of the corporation. The director must always place the interests of the corporation ahead of his own.[8] Maple Leaf Foods Inc. v. Schneider Corp.[9] and CW Shareholdings Inc. v. WIC Western International Communications Ltd.[10] are take-over bid cases. They are helpful decisions because they raise conflict of interest issues that are not unlike those that can arise in a director-corporation transaction. The classic way that Boards protect themselves when conflicts arise is to retain independent legal and financial advisors and to establish independent or special directors' committees.[11]

118 There was little that was independent about the process Mr. Berg followed. He retained Proskauer without consulting the Board and set them to work on his contract. The employment contracts of the three senior officers were also being revised at this time. It was appropriate for Mr.

Berg to exercise an oversight role in this process. It was inappropriate for him to exercise an oversight role in regard to his own contract.

119 Mr. Berg testified that he put no restrictions on Ms. Rattner and gave her no instructions to preclude her from dealing with Repap's Compensation Committee or the Board of Directors. He says he left this to Ms. Rattner. This is not an answer to his fiduciary duties. Mr. Berg, not Ms. Rattner, was Chairman and a director of Repap. He knew or ought to have known that she was preparing drafts of his contract for his review and comment, but that the Compensation Committee was not involved. It was a breach of his fiduciary duty to instruct Ms. Rattner on the terms of his contract, as I find he was, without ensuring that Repap's interests were also protected.

120 The CBCA does not expressly provide that a director must make sure the corporation is independently represented in negotiating the terms of a transaction. However, a director is most ill-advised if he does not make every reasonable effort to ensure that the corporation receives independent representation beginning with the negotiation stage of the contract process.[12] There can be little question that there was no negotiation of this contract. Repap was not involved at all.

121 To make matters worse, Mr. Berg did not conduct himself in an upright manner, as he was required to do. He requested types and amounts of compensation that he knew or ought to have known were not in the best interests of Repap, a company, which he believed was "on the brink of bankruptcy". He removed from drafts of the Agreement reasonable safeguards for Repap, including good faith renegotiation of windfall bonuses, performance criteria and shareholder approvals. If there is any validity in his evidence that the entire restructuring was to be complete within the year, he had a duty to disclose this and to ensure the terms of his contract limited Repap's liabilities in that event. Mr. Berg's conduct fell short of the standard of integrity required of a fiduciary in its dealing with the corporation.

122 A reasonably prudent Chairman and director acting in the best interests of Repap would have provided a mostly new Board with the opportunity to educate itself about the company so as to have a basis to ground an informed business judgment about the Agreement. A reasonably prudent Chairman and director acting in the best interests of Repap would have afforded the Board adequate time to retain a compensation consultant, to instruct the consultant and to consider a genuinely independent opinion about his own employment contract. A reasonably prudent Chairman and director acting in the best interests of Repap would have arranged for someone at Repap to instruct Ms. Rattner with respect to the negotiation of the Agreement. A reasonably prudent Chairman and director acting in the best interests of Repap would have done none of the things Mr. Berg did and would have done all of the things he failed to do.

123 Mr. Berg failed utterly in his duties to Repap. His own self-interest prevailed. His conduct was exactly opposite to the conduct that the law required of him as a fiduciary - disclosure, honesty, loyalty, candour, and the duty to favour Repap's interest over his own. This failure is illustrated starkly by his conduct after the Agreement was approved and came under attack by Repap's shareholders. I will come to this shortly.

The Duties of the Board of Directors

124 There is no serious complaint that the directors who approved Mr. Berg's agreement failed to act honestly or in good faith. The focus of the attack on their conduct is their failure to act carefully, diligently and skilfully in the best interests of the corporation.

125 It is settled law that the duty of due care requires that where directors make decisions likely to affect shareholder welfare, their decision must be made on an informed and reasoned basis. In CW Shareholdings, Mr. Justice Blair expressed it in this way:

> "In the end, they must make a decision and exercise their judgment in an

> informed and independent fashion, after a reasonable analysis of the situation and acting on a rational basis with reasonable grounds for believing that their actions will promote and maximize shareholder value: see, 820099 Ontario Inc. v. Harold E. Ballard Ltd. (1991), [1991] O.J. No. 266, 3 B.L.R. (2d) 123 (Ont. Gen. Div.) at p. 176; Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd. (1986), 59 O.R. (2d) 254 at pp. 270-273, 37 D.L.R. (4th) 193 (Div. Ct.)."[13]

126 A Board is entitled, indeed encouraged, to retain advisors, but this does not relieve directors of the obligation to exercise reasonable diligence. In Hanson Trust PLC v. ML SCM Acquisition Inc.[14], the United States Court of Appeals for the Second Circuit was asked to determine if directors' approval to grant a lock-up option of substantial corporate assets in a take-over struggle was protected by the business judgment rule. As Pierce J. stated, in duty of care analysis, a presumption of propriety inures to the benefit of directors, who enjoy wide latitude under the business judgment rule in devising strategies. However, as he noted:

> "The proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a pre-condition to performing his ultimate duty of acting in good faith to protect the best interests of the corporation".[15]

127 Here, the Compensation Committee exercised no oversight role whatsoever, although it was the independent duty of that group of directors to have such involvement. It provided no instructions to Ms. Rattner or Ms. Engel. It consulted no legal or expert advice. It took no steps to inform itself of the prior deliberations or comments of the previous members of the Compensation Committee or Board. It took no steps to obtain the Mercer Report before formulating a recommendation. In short, the Committee did not have or seek sufficient information upon which to ground a reasonable judgment about whether to recommend the Agreement, yet other directors relied upon the assumption that a full review had been done.

128 No director could have considered the Mercer Report in any meaningful way as no director had seen the report before the Board meeting and there was no opportunity to study it carefully during the meeting. Mr. Fitzgibbon, who participated in the Board meeting by telephone, had never seen the Mercer letter. Nonetheless, he voted in favour of the Agreement. There were enough qualifiers, inconsistencies and question marks in the Mercer opinion that any Board acting prudently should have slowed the approval process and delved into the compensation package.

129 In Hanson, Pierce J. held that a prima facie case was made out that the directors breached their fiduciary duties in making their decision after a three-hour, late-night meeting relying on their financial advisor's "conclusory opinion" and without asking enough questions of their advisors prior to making a decision. The Board failed to read or review carefully the various offers and agreements and instead relied on the advisors' descriptions.

130 The circumstances were no different here. The Board assumed or permitted itself to believe that the Agreement was performance-driven when many aspects of it were not. Mr. Phillips admitted as much on cross-examination. Mr. Cohen acknowledged that paper prices would have an impact on the share price and increase the market capitalization, but he said that as it was very difficult to isolate the CEO's productivity contribution from exogenous factors, it was not common to try to do this. This approach may be defensible in the common case, but this was an uncommon case. Mr. Cohen had never seen a bonus tied to market capitalization. Neither had anyone else.

131 Ms. Engel described the bonus as "unique". As a result, she could find no direct comparables. The directors who reviewed the Contract Term Sheet in February did not have the benefit of Ms. Engel's comments but they understood that the bonus was not performance-driven. They also appreciated the exposure it created for Repap. On Mr. Jensen's calculations, if the share price increased to $0.15, Repap was liable to pay a bonus to Mr. Berg of $7.2 million; if the share price increased to $0.25, the bonus was $13.9 million.

132 The Jensen memorandum noted that the last time the industry announced a paper price increase, Repap's stock went from $0.10 to $0.38, although this increase was unrelated to any efforts by management. In direct contradiction to this, Mr. Berg testified that an increase in paper prices would not be reflected in an increase in share prices. There is no support for his view.

133 Mr. Cohen testified that in cyclical commodity-based industries, exogenous prices have a bigger impact on share price performance. Mr. MacLellan was asked what he would conclude about the knowledge of somebody who thought there was no relationship between paper prices and share price. He said:

> "I would find it inconceivable that anybody could think that. The -- the number one determinant for REPAP'S share prices is going to be the commodity at which they sell their product. So REPAP would be no different than any other commodity producer, which is absolutely dependent on the commodity price of the product they're selling. So, for example, Inco is absolutely dependent on the price of nickel. And Alcan is absolutely dependent on the price of aluminium. And anyone in the gas company that you want to mention would be dependent on the price of oil and gas. And as those commodities go up and down the earnings of the company are all affected the same way as the commodity price. And the share prices all move in that same direction ...".

134 The point here is that the directors did not engage in any kind of analysis. Had they done so, they should have come to the conclusion that a bonus tied to the market capitalization of a company such as Repap was wholly inappropriate. It was the price of paper and not the performance of Mr. Berg that would have an impact, if not the biggest impact, on the share price. Mr. Berg's evidence on this point is not credible, but if he genuinely believed paper prices and share price were unrelated, this reflects a complete lack of understanding of the factors that influenced Repap's stock price.

135 The Agreement that went before the directors in March did not contemplate the payment of a bonus upon a debt to equity conversion. This provision had been in the Contract Term Sheet. Its removal was a basis for Mr. Berg's contention that the concerns of the directors had been addressed. However, an equity issue, merger, or rights offering, could equally cause the share price to stay flat and the market cap to go up, resulting in a cash bonus to Mr. Berg without any corresponding benefit to shareholders.

136 The whole concept of the market capitalization bonus was flawed. It exposed Repap to cash payments of potentially millions of dollars, notwithstanding that an increase in market capitalization would not necessarily result in an increase in cash to pay the bonus. There was no correlation to either share price or performance. Although earlier drafts of the Agreement had limiting language to achieve this, this language had been deleted.

137 Repap was a cash-constrained company. It was unreasonable for the Compensation Committee to recommend an Agreement with this provision knowing that Repap might not be able to afford it, and relying, as Mr. Phillips testified, on the assumption that Mr. Berg would be willing to renegotiate with Repap. The directors who approved the Agreement in March could not have understood the implications of this bonus for Repap. The Mercer opinion very clearly states that it exposed Repap, to "significant compensation expense". In view of this, it was unreasonable for the directors to approve an Agreement with this provision when they knew that Repap might not have the cash to pay the bonus.

138 The comparators that are used throughout the Mercer opinion are to U.S. practice. Mr. Cohen testified that he thought that this was appropriate, as Repap was, in most ways, an American company. This was not Mr. Larson's view. Mr. Larson is American, but he took pains to point out to Mr. Berg in February that Repap was a Canadian company with a "Canadian culture". Ms. Engel could have provided a benchmarking analysis. She could have compared the Agreement with other paper companies or with other Canadian companies. She compared it only to other highly leveraged companies in the United States. This should have raised a duty of inquiry.

139 Ms. Engel was not invited to the Board meeting to address her opinion, which she said was unusual. She should have been there. Mr. Berg, the Compensation Committee and the Board failed in their duties to ensure her presence in these circumstances.

140 Mercer described the amount of dilution created by the equity and stock option grants as "at the high end of practice", meaning American practice. Mr. MacLellan had never heard of a stock option grant of this magnitude under Canadian practice. As he said:

> "... the thought that an individual could be awarded immediately 10% of the company under option was something that was so large that I had never seen it before. It's very rare that you see companies giving the whole management team 10% over a long period of time. It is unheard of in my experience to give one individual 10% under option".

141 Under the policies of the Toronto Stock Exchange ("TSE") and Montreal Exchange ("ME"), the maximum number of options normally permitted to one individual was up to 5% of the total capitalization of the company. Other aspects of the stock option grant, for example, the pricing of the options, provoked a large number of comments and concerns from staff at both exchanges. Mr. Raymond, Canadian securities counsel to Repap at Stikeman Elliot in Montreal, testified that this degree of comment was highly unusual because the TSE and ME did not normally receive a request for approval of a stock option grant of this magnitude and with these features.

142 Whether or not Repap was in substance an American company in 1999, it was nonetheless, a company incorporated under the CBCA with its shares trading on Canadian exchanges. The approvals of the TSE and ME are required so these regulators may be satisfied that the issuance of the options does not create dilution for the shareholders of a publicly traded company. The stock option grant of 75 million shares and the signing bonus of 25 million shares together amounted to an award of 13.4% of Repap. By any standard, this was excessive shareholder dilution.

143 Although the Board knew next to nothing about Mr. Berg, it approved a contract that is drafted in such a way that it would virtually be impossible for Repap to terminate him for cause. On termination without cause, there are a host of payments that are due. According to Mr. Berg, the value of the termination provisions is $27 million, which is the amount that he is claiming in the New York action. The directors never turned their mind to the kind of exposure this could create for Repap.

144 The Board never questioned why there was a change of control provision in the Agreement. It is drafted in the widest possible language and includes any sale or reduction in share ownership to less than 10% of the stock. It is effectively a single trigger provision as the only requirements are that there be a change of control, and that Mr. Berg leave, involuntarily or voluntarily, within a specified time frame. Upon that event, he was entitled to a number of extraordinarily generous payments, including the remainder of his salary (U.S. $420,000 as of January 27, 1999) for the full employment term (5 years plus two automatic renewals of 2 years each), an additional eleven years past service credit (a pension of approximately U.S. $190,000 annually) and full vesting of the stock options, tied only to a change of control.

145 The Board had a duty to understand why Mr. Berg was at Repap. Mr. Berg knew why he was there. As he testified, he was there "to fix it up and sell it". What possible commercial purpose did a change of control provision serve in such circumstances? Under the language of the change of control provision, a restructuring would in all likelihood result in a change of control, as would a sale. A change of control provision is a form of protection for a senior executive. It is not a form of payment for performing the job you were hired to do. That Mr. Berg was protected by this provision at all is illogical. That 75 million stock options would immediately vest and trigger other extremely generous payments was never questioned by the Board and should have been.

146 There was no urgency and yet the entire process was the subject of haste and a rush to approval. In Hanson, the court rejected SCM's defence that it was a "working board" that was familiar with the corporation and therefore capable of making the swift decisions it did. This was not a "working board". As a mostly new Board, the directors owed the shareholders a higher duty to go slowly and to educate itself thoroughly. Mr. Dufresne was the only serving director who tried to address the unfavourable implications of the Agreement for Repap. Still, Mr. Dufresne did not do enough. He did not press his concerns forcefully enough. He did not formally dissent or otherwise act to protect the shareholders' interests. This was his obligation even if he chose to resign.

147 The position of "Senior Executive Officer" gave Mr. Berg general oversight responsibilities for all aspects of Repap except day-to-day manufacturing operations. Although the Board did not know this, it is clear from the mark-ups to the drafts of the Agreement in Mr. Berg's hand that he developed the title and the job description, which progressively increased his area of responsibility and diminished Mr. Larson's duties. On its face, the position responsibilities of the SEO overlap those of the CEO and, to some extent, the CFO.

148 The Board never asked why Repap required a full-time "SEO" when it already had a CEO and CFO who were performing well. Neither the Compensation Committee nor the Board sought management's views about the Agreement. Instead, the Board directed Mr. Larson to absent himself from the deliberations, when they ought to have required his presence in order to ensure that these views were thoroughly aired and considered.

149 The SEO title first appeared in a version of the Agreement around the middle of March. When Mr. Larson saw this, he called Mr. Berg who told him this had been inserted at the request of "his advisors", but Larson should not be concerned because, "it's just part of the game; don't worry about it, you're still in charge".

150 These were difficult circumstances for Mr. Larson with a new Chairman making excessive compensation demands and new lawyers and directors selected by the Chairman. Even so, if he knew the Chairman regarded his position title and responsibilities as a fabrication to justify his contract, he had an obligation to say something. He spoke to Mr. Dufresne before the March 23rd Board meeting, but only about the overlap with his duties. Apart from Mr. Berg, Mr. Larson had the most knowledge about the process and the terms of the Agreement. As a Repap director, it was Mr. Larson's obligation to bring this information to the attention of the Board, consistent with his duty to place the interests of Repap ahead of his own.

151 Finally, Mr. Whitman was present for the Board meeting on March 23, 1999, but said nothing. Despite his views, he did not communicate either his approval or disapproval of the Agreement. This posture may be an unusual one for a company's largest shareholder, but the directors were not entitled to take his silence as acquiescence. Whatever views Mr. Whitman had or was assumed to have, the Board owed duties to all the shareholders of Repap. A Board does not act in the interests of the largest shareholder. In exercising its duty of care to the corporation, a Board must consider the shareholders generally not only the shareholder with the largest single vote.[16]

The Business Judgment Rule

152 The business judgment rule protects Boards and directors from those that might second-guess their decisions. The court looks to see that the directors made a reasonable decision, not a perfect decision.[17] This approach recognizes the autonomy and integrity of a corporation and the expertise of its directors. They are in the advantageous position of investigating and considering first-hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation.

153 However, directors are only protected to the extent that their actions actually evidence their business judgment. The principle of deference presupposes that directors are scrupulous in their deliberations and demonstrate diligence in arriving at decisions. Courts are entitled to consider the content of their decision and the extent of the information on which it was based and to measure this against the facts as they existed at the time the impugned decision was made.[18] Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination.

154 In March 1999, Repap did not require, nor could it afford, Mr. Berg's services. With a minimum of effort, the Compensation Committee and the Board could have learned this and everything else they needed to know to make an informed decision on a reasonable basis. This did not occur. Instead, the Agreement was approved on the recommendation of a Compensation Committee that never met to discuss it and had no substantive involvement in the process that led to it.

155 The business judgment rule cannot apply where the Board of Directors acts on the advice of a director's committee that makes an uninformed recommendation.[19] Although it was not unreasonable for the Board to assume the Committee had done a careful job, this did not relieve the directors of their independent obligation to make an informed decision on a reasonable basis. In order to act in the best interests of the shareholders of Repap, each director was required to understand the terms and meaning of the Agreement and to consider it carefully against the circumstances of Repap at the time. They were required to review the Mercer opinion carefully and evaluate it thoughtfully against the circumstances of Repap at the time. This did not happen.

156 A contract, such as the one in issue between the Chairman and the Company, should be the subject of careful, objective analysis, and it was not. The process leading up to the March 23, 1999, meeting and the proceedings there fall far short of the exercise of prudent judgment in the interests of the shareholders that is expected of directors. In the space of thirty minutes taken up with Ms. Rattner's presentation, without questions or discussion, with comment from the only director who had served for longer than two months, the Board of Directors of Repap approved an Agreement that gave someone it did not know, had not recruited, and had just met, a generous salary with a lengthy term of employment, an unprecedented bonus structure, termination and change of control protection inconsistent with the employment objective, and stock options amounting to 13.4% of the company. The directors did not fulfil their duties to Repap. Their decision was not an informed or reasoned one. The business judgment rule cannot be applied in these circumstances to protect their decision from judicial intervention.

Events Subsequent to March 23, 1999

Shareholder Opposition

157 The Agreement first came to the attention of Robert Poile of CAP Advisors Inc. when it was annexed to Repap's "Form 10K" S.E.C. filing. CAP was a shareholder of Repap and Mr. Poile was a former director. Byers Casgrain, counsel to CAP, sent a letter dated April 14, 1999, to several stock exchanges, which was copied to the Repap Board. The letter states in part:

> "At the request of our client, we have reviewed the Employment Agreement and the Option Agreement. This review was made in view of our client's substantial concern about the legitimacy and fairness of the Employment Agreement and the Option Agreement and possible related issues of conflict of interest. Our client is of the view that the Employment Agreement and the Option Agreement are oppressive to the shareholders of the Corporation,

> contain abusively generous terms for the Executive, may have been negotiated on a non-arm's length basis".

158 The letter goes on to review other concerns including a possible lack of independent assessment of the Agreement by a separate and independent committee of the Board and share compensation arrangements in contravention of the rules of the TSE and the ME. Despite the clear language of the letter, which is highly critical of the Agreement and the process by which it was approved, Mr. Berg refused to admit the letter was a fundamental attack on the whole Agreement and this refusal reflects generally and adversely on his credibility.

159 In May and June, Mr. Berg had several discussions with Mr. MacLellan and Mr. Larson about the Agreement against the background of increasing shareholder opposition to it. In these conversations, Berg made remarks that were intended to threaten and intimidate. For example, he told Mr. MacLellan that if the 75 million options were not approved by the TSE, he intended to take cash from Repap to offset the amount that would represent his loss. He emphasized that Repap was a cash-constrained company and that if MacLellan were to defeat the Agreement, he intended to present Repap with an immediately payable cash amount. He outlined the dire consequences that could flow from a change in control of the Board. None of this evidence was contradicted or explained.

160 Mr. Larson urged Mr. Berg to unilaterally change his Agreement so the option grant would comply with TSE requirements. In response, Mr. Berg said, "My contract is a play - just to negotiate a settlement when (the) company is sold (or) merged - (and) then get the cash, (U.S. $10 million)". He made similar comments to Mr. MacLellan. These statements echo ones made to Mr. Lawson in March in connection with the SEO title and to Ms. Cormier in February. When she asked him whether Repap would have to purchase immediately the automobile that his contract provided, he replied, "No, but I want to set it up in the contract as a liability".

The "Berg Put"

161 There had been on-going discussions between Ms. Cormier and Jonathan Mishkin of DLJ since the end of 1998 about a refinancing of Repap's debt. This came together in April in the form of a proposal for a high-yield bond financing to which I have already made reference. An engagement letter was signed on May 17, 1999, but DLJ had been working on this for some weeks when Mr. Berg called Mr. Mishkin to tell him that he wanted to put a change of control clause in Repap New Brunswick's offering memorandum. This request was referred to at trial as the "Berg Put". The idea Mr. Berg proposed was the same concept as that set out in a handwritten note, which Mr. Berg admitted he sent to Mr. Jacobs of Proskauer on May 14, 1999. The note says:

> "If the present Chairman and SEO leaves for any reason except by his own consent, illness, disability or death on 60 days notice this (sic) Bonds are callable if present (sic)".

162 In uncontradicted evidence, Mr. Mishkin testified that Berg said to him:

> "Look, all I want to make certain is someone comes to buy the company or force me out they got to come through me, they got to pay me off, they got to make me whole, do something for me or else it will collapse the capital structure".

163 According to Mr. Mishkin and Mr. Raymond, "the put" made no sense from Repap's perspective. Repap had a very precarious capital structure, and this language would have interfered with the balance the bankers were trying to achieve. None of the bondholders had ever asked for this and, frankly, it is difficult to imagine why they would. Mr. Mishkin had never seen it done before in the high-yield market. Moreover, the company issuing the bonds was Repap New Brunswick Inc. Mr. Berg was not an officer of this company, although he soon attempted to see to it that he was. A proposed Board of Directors resolution of May 25, 1999, emerged just prior to the closing of the DLJ bond financing. Mr. Berg claimed it "came from the lawyers" but the evidence does not support this. Contrary to the terms of his own contract, the resolution gave Mr. Berg sole responsibility to manage and supervise the business affairs of Repap New Brunswick. It put Mr. Berg exclusively in control of Repap's most valuable asset.

164 Ultimately, the proposed resolution was revised and the "Berg Put" was not included in the final offering memorandum, because the Canadian tax lawyers were unable give a supportive tax opinion. When Mr. Mishkin called Mr. Berg to tell him this, Mr. Berg was angry. This evidence is consistent with testimony from Ms. Cormier, who reported Mr. Berg saying, "I know what Stikeman Elliott is up to and this is not going to be the end of it".

165 There was no valid commercial purpose for either the Board resolution or the "Berg Put". Both were detrimental to Repap's interests. Mr. Berg's motive was entirely improper. Knowing that the Agreement was under attack and required shareholder approval at the annual meeting then scheduled for June 18, these were plans to protect and entrench himself at the expense of Repap.

The Lawsuits

166 As opposition to the Agreement mounted, Mr. Berg completely lost sight of the obligations imposed on him by law, and, in particular, his duty to favour Repap's interest over his own. This is perhaps best revealed in a "speech" made by Mr. Berg to Mr. Larson and Ms. Cormier on May 28, 1999, following the closing of the DLJ bond financing. Mr. Larson made the following notes of Mr. Berg's soliloquy. The statements attributed to him were not disputed or explained in Mr. Berg's testimony:

> "I have huge resources at my disposal ($100 million financing) and now I have the company till as well. I'm in the catbird seat and can't lose. I'm also going to get a letter from DLJ to attach to the suit that opines the bonds will go down with my removal (change of control, rating downgrade, default the company, that's the $1 billion). He (Mr. Poile) better understand. That any attempt to remove me or this Board will result in my taking intentional steps to destabilise the bonds and default the company. I wrote the book on proxy fights don't corner me. Even if I lose I win. I'll immediately file a US $25 million suit against the company for my contract the next day. This will also destabilise the bonds. I'm also filing a personal suit against Poile for tortuous interference with my legal employment contract. I'm in the catbird seat. You do what you want Larson but if not with me, you're putting your position at risk. If you oppose me in this, I'll come at you and your personal assets with the company and its resources aligned with me".

167 While Mr. Berg was Chairman, Repap sued Mr. Poile and Mr. McBride, much as he had threatened. Mr. Berg also terminated Mr. McBride's employment. Subsequently, Mr. Berg took legal action against Mr. Larson and the Toronto-Dominion Bank. In this lawsuit, he alleged that the take-over of Repap by the new Board was engineered by Mr. Cohen who "... masterminded the resignation of Repap's independent directors so that TD Bank could appoint five new directors under his control". This allegation is completely false and without any foundation.

Part IV - Remedies

168 The remedies that are requested by UPM and Repap arrive at the same result -- the setting aside of the Agreement. I will begin with the fraud case advanced by Repap and then will consider the remedies sought by UPM under section 120 and 241 of the CBCA.

Fraudulent Misrepresentation

169 The appropriate test for civil fraud is the test that was stated by Lord Hershell in Derry v. Peek in the following passage:[20]

> "[f]raud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made."

170 To succeed in an action for fraudulent misrepresentation, the plaintiff must show that the defendant not only spoke falsely and contrary to belief, but that the defendant had the intent to deceive, which is to say he had the aim of inducing the plaintiff to act mistakenly and the plaintiff did so to its detriment.

171 Repap alleges that Mr. Berg actively misled the Board into believing, among other things, he was recruited to effect a restructuring of Repap, that Third Avenue wished to have him employed as Chairman and SEO to do this, that the Mercer opinion was informed and independent, and that the Agreement that the directors received as the "finalized draft" incorporated the comments of Mercer and of the directors when he knew that none of this was true.

172 Fraud involves a discordance between what a person says and what a person believes:[21]

> "The question is not whether the defendant in any given case honestly believed the representation to be true in the sense assigned to it by the court on an objective consideration of its truth or falsity, but whether he honestly believed the representation to be true in the sense in which he understood it albeit erroneously when it was made."[22]

As it is the defendant's belief and intent that are in issue, the false statements must be understood with the meaning placed on them by Mr. Berg.

173 I do not agree Mr. Berg actively misled the Board about his role at Repap. Mr. Berg had brought the deal to Mr. Whitman. It was understood that Mr. Berg would become Chairman and they would work together on some kind of restructuring. From early February, Mr. Whitman knew Mr. Berg was planning to do this as an executive Chairman, on a full-time basis. He did not oppose it. It was not unreasonable for Mr. Berg to believe he had been "brought in" by Third Avenue to do this and Mr. Whitman supported this plan. There was nothing that Mr. Berg said or did or failed to say or do, that amounts to a fraudulent misrepresentation on this score.

174 Mr. Berg provided the Jensen memorandum and the directors' letters to Ms. Rattner. There is no evidence that he instructed her to conceal this material, and I will not draw an inference that there was a nefarious reason that she did not bring this to the attention of the directors. Fraud must be strictly proved. Mr. Berg was not entitled to assume Ms. Rattner would look after its distribution, but his conduct was not fraudulent. If he wanted to intentionally deceive the Board, he would not have sent anything to Ms. Rattner. Moreover, he knew Mr. Whitman and Mr. Larson had the material, and he did not have any control over their use of it.

175 Repap's case relies heavily on the contents of Mr. Berg's March 18th memorandum, which it characterizes as a "landmark in the evidence" against which to measure his misrepresentations and omissions. Its salient portion reads:

> "Enclosed you will find a finalized draft of my employment agreement with Repap Enterprises, Inc. This draft incorporates a number of comments and suggestions previously made by the Directors, as well as the consultants and others. It has been further reviewed by William M. Mercer, Inc., the independent compensation consultants retained by the company whose comments are also incorporated therein. I had hoped to enclose Mercer's letter to the Board concerning their review with respect to the reasonableness of the proposed contract, a copy of which I am advised you will receive if not before, then at the meeting on the 23rd."

176 After the February Board meeting, there were some changes made to the Agreement. Specifically, the Contract Term Sheet provided for a loan for the stock options, which was removed, as was the payment of a market capitalization bonus upon a debt to equity conversion. Mr. Berg testified that these changes addressed the directors' concerns. On any fair reading of the Jensen memorandum, the executed Agreement did not address all of the objections and Mr. Berg's refusal to acknowledge this also reflects adversely on his credibility. However, the memorandum does not misrepresent this. It says the Agreement incorporates "a number of comments and suggestions" and it did.

177 Was it fraudulent then for him to describe Mercer as "the independent compensation consultants retained by the company whose comments are also incorporated herein"? The reference to Mercer is more troubling as Mr. Berg alone had seen a draft of the opinion and had made some factual comments on it. Mr. Cohen testified that there was nothing unusual about an executive reviewing a draft of an opinion concerning the executive's own compensation. I must say I find this surprising. Nevertheless, there is no evidence that Mr. Berg spoke with Ms. Engel or influenced the content of her opinion in any way. Nor is there evidence that he was involved in her retainer, which Ms. Rattner arranged.

178 The percentage payments on which the market capitalization bonus is based were amended as a result of Ms. Engel's comments. Therefore, to this extent, it was not inaccurate to say that Mercer's comments were incorporated. Viewed objectively, the memorandum is somewhat inaccurate and somewhat misleading, but I cannot say the meaning placed on it by Mr. Berg is so far removed from the sense in which it would be understood by a reasonable person as to make it impossible to hold that he honestly understood it to bear the meaning claimed by him.[23]

179 There is no evidence that Mr. Berg's description of Mercer deceived any Repap director. Mr. Phillips knew that the Mercer opinion was being prepared at the request of Ms. Rattner as he had spoken with her to find out when it would be available. He could have contacted Ms. Engel. In the memorandum, Mr. Berg invited the directors to contact Mr. Phillips or himself with any questions and he provided phone numbers. This is inconsistent with an intention to deceive the Board about Mercer's role.

180 Fraud involves intentional dishonesty. Repap must show that the fraud was an inducing cause to the contract. If the statements would not have changed the plaintiff's conduct, then they are not material. They must be of a type likely to make the plaintiff act upon it. Only then can it be inferred that the defendant had the intent to make the plaintiff act accordingly. In Hinchey v. Gonda, Schroeder J. stated the proposition in this way:

> "A misrepresentation to be material, must be one necessarily influencing and inducing the transaction and affecting and going to its very essence and substance ... The test, therefore, of material inducement is not whether the person's conduct would, but whether it might have been different if the misrepresentation had not been made."[24]

181 The best evidence of what the directors relied on is contained in a memorandum dated June 21, 1999, authored by Mr. Cohen, but sent with the approval of the outside directors, except Mr. Dufresne, who had by then resigned. In it, they set out their rationale for approving the Agreement and give four reasons: (1) that the Compensation Committee had done a careful job; (2) that the Mercer report supported the Agreement; (3) that the Agreement was performance based; and, (4) that the Board had taken Mr. Whitman's silence as acquiescence.

182 As to the first reason, Mr. Berg never represented that the Compensation Committee had done a careful job, but any of the directors could easily have discovered what they had done or not done. I have already mentioned that the memorandum invited the directors to contact Mr. Phillips or himself if they had any questions, but none ever did. Contrary to inducing the directors to mistakenly believe there had been a careful review, he invited them to conduct their own due diligence.

183 There is no persuasive evidence that the directors were induced to approve the Agreement in reliance on Mr. Berg's description of the Mercer opinion in his March 18th memorandum. They took comfort from the existence of the opinion and not from Mr. Berg's representations about it. I have earlier dealt with the third and fourth reasons and do not propose to say anything further, except that nothing Mr. Berg said or did, or failed to say or do, induced a mistaken belief about these matters.

184 Repap relies on the conduct of Mr. Berg after March 23, 1999, (the "Berg Put", the May 25th Board resolution), as well as the statements he made before and after the approval of the contract, as evidence of fraudulent intention, constituting admissions of improper motive. This evidence has troubled me, but in the end, I am not satisfied that this is evidence of "a wicked mind" that proves Mr. Berg intended to deceive Repap.

185 When I consider all the evidence, it appears to me that Mr. Berg genuinely, but erroneously believed that he could do some good for Repap. He genuinely, but erroneously believed that he was entitled to be compensated in a grand manner. For his own reasons, Mr. Berg wanted to be Chairman of Repap with a contract that proved he was valuable to it. His entire course of conduct was designed to achieve and preserve this objective. His statements were grandiose, boastful and ill considered. They were intended to intimidate and squelch opposition to the Agreement. He did and said things that were designed to entrench his position. In breach of his fiduciary duties, he at all times put his own interests ahead of the interests of Repap. He was greedy and overreaching and failed miserably in his duties to Repap, but in my opinion, he was not fraudulent.

186 I conclude that Repap has failed to establish the elements of fraud. Although negligent misrepresentation is pleaded in the alternative, Repap conceded in argument that the facts on which it relies do not fit very well with this cause of action and I agree.

Section 120 of the CBCA

187 Section 120 of the CBCA presumes the invalidity of a contract or transaction between a director or officer and the corporation unless approval of the directors is obtained, the disclosure requirements are met and the contract was reasonable and fair to the company when it was approved.[25] The section appears to contemplate that the contract must meet all three parts of the test, but there is little to guide me on its interpretation.

188 I was referred to two Canadian cases on the meaning to be ascribed to the words "reasonable and fair to the corporation". In Rooney v. Cree Lake Resources Corp.,[26] Dilks J. was called on to interpret the equivalent provision in the Ontario Business Corporations Act. He refused to give effect to a "golden parachute" provision in a contract as it would have triggered the payment of unearned compensation in a lump sum equal to over 70 per cent of the corporation's assets, although there was no reasonable prospect of any sudden influx of capital or income to support the payment. Dilks J. concluded that since such a provision would prevent dissatisfied shareholders from exercising their

right to effect a legitimate ouster of what they consider to be incompetent management, this was neither reasonable nor fair to the corporation.

189 Cannaday v. Sun Peaks Resort Corp.[27], was also a case that concerned a "golden parachute" provision. Lowry J., sitting in chambers, was required to interpret a provision of the Alberta Business Corporations Act, which is similar to section 120(7) of the CBCA. On appeal, it was successfully argued that Lowry J. had committed an error by considering only the language of the agreement and he should have had regard to the factual matrix that formed the background to the contract. Mr. Justice Dilks, in Rooney, did not have the benefit of the reasons on appeal. Nevertheless, he came to a similar conclusion. He stated:

> "In determining whether a particular contract is reasonable and fair to the corporation, one must examine all the surrounding circumstances including the purpose of the agreement and its possible ramifications for the corporation. It need not be either fair or reasonable to the director. It is his fiduciary duty to the corporation which requires it to be fair and reasonable to the corporation".[28]

190 It seems to me that Cannaday stands for a proposition that is already well imbedded in the jurisprudence surrounding the interpretation of a commercial contract. It has been said many times that no contract is made in an vacuum, and the court is obliged to consider its factual matrix when interpreting it.[29] This direction is expressly contained within the language of subsection 120(7)(c) of the CBCA itself as it states:

> 120(7) A contract for which disclosure is required under subsection (1) is not invalid ... if
>
> (c) the contract or transaction was reasonable and fair to the corporation when it was approved.

191 In view of this, I do not see how one could determine if the contract was reasonable and fair to the corporation when it was approved without considering the circumstances against which it was approved. During the course of these reasons, I have endeavoured to do this.

192 In Cannaday, Lowry J. was dealing with the issue on a summary application where the relevant facts had not been determined. In that case, there were also issues as to the adequacy of the disclosure and the approval, but he found it unnecessary to reach a conclusion on those issues in light of his conclusion that the contract on its face was "wholly one-sided" and neither fair nor reasonable when approved.

193 The Court of Appeal reviewed the evidence at some length to illustrate that there were matters that ought to have weighed in the balance. In particular, Mr. Cannaday asserted the corporation's chief lender, who had functioned as the controlling mind of the corporation, had knowledge of the contract and had approved it. Mr. Berg relies on this decision, but I do not think it greatly assists him. Here, Repap's largest shareholder knew about the Agreement, but Mr. Whitman was not the controlling mind of Repap and had no direct or indirect involvement in the process that led to the contract or to its ultimate approval. While his apparent lack of opposition is a factor to be considered, it is not determinative, particularly in view of the explanation that he offered for his lack of intervention. Mr. Jensen's resignation letter was intended to make this clear. In any event, Mr. Whitman's views about the Agreement do not support the conclusion that it was fair and reasonable to Repap.

194 The purpose of section 120 of the CBCA is to mitigate the strictness of the common law principle relating to contracts between a director and a corporation. In Cannaday, the court appears to be concerned that in setting aside a contract, a party could be unjustly enriched if benefits are obtained for which no consideration is required. I do not regard this as a serious concern here. In any event, a court is normally quite capable of weighing the equities to arrive at a just result. For example, in Rooney, the court found the "golden parachute" provision was unenforceable, but then went on to award damages against the corporation for wrongful dismissal.

195 I was referred to one American authority, a decision of the Supreme Court of Delaware in Weinberger v. UDP, Inc.[30] There, Justice Moore held that the concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when a transaction was timed, how it was initiated, structured, negotiated, disclosed to directors and how the directors' approval was obtained. In that case, which dealt with minority shareholders' attack on a cash-at-merger transaction, Moore J. held that the transaction did not meet the requirement for fair dealing, because there were inadequate arm's length negotiations, a lack of material information in the possession of the Board and undue haste, including a cursorily prepared fairness opinion supporting the transaction in question.

196 The Agreement in this case is flawed on both counts. Its procedural unfairness is imbued with the same characteristics of unfair dealing referred to in Weinberger, supra -- inadequate or, more accurately, non-existent arm's length negotiations, a lack of material information in the possession of the Board and undue haste, including a cursorily-prepared "reasonableness" opinion supporting the Agreement.

197 I have already considered in some detail the substantive unfairness of this contract. It created an enormous liability for Repap, without any corresponding benefit to it. It represented excessive dilution for its shareholders, and, like the contract in Rooney, it burdened the company with extraordinarily large and unearned cash payments, with the potential to create a financially perilous situation for it.

198 It is also relevant to consider that Mr. Berg viewed his contract as a liability for Repap that could be useful to him as a negotiating tool when the company was sold or merged. This is further evidence that the contract was not fair and reasonable to Repap. The question is what is to be done about it. I will consider this below.

The Oppression Remedy

199 The oppression remedy has been a part of the Canadian corporate law landscape since 1975. It is a broad, remedial, curative provision that is designed to protect reasonable shareholder expectations, although the acts complained of may be entirely lawful. The court is concerned with the effect of conduct that is oppressive or unfairly prejudicial or unfairly disregards the interests of any security holder. The court has broad powers under section 241, and there are a variety of orders that can be made, including compensatory orders, or, under subsection 241(3)(h), an order to vary or set aside a contract to which a corporation is a party. It is this remedy that UPM seeks.

200 The fact that UPM paid a premium for the shares of Repap is irrelevant. UPM does not seek damages. It asks that the Agreement be set aside. If the Agreement stands, UPM is bound by it. As assignee of TDAM's cause of action, and as a shareholder of Repap, it is entitled to ask for an Order setting aside the Agreement if the effect of the conduct complained of unfairly disregards the interests of TDAM and other shareholders.

201 TDAM had a reasonable expectation that its directors would comply with their statutory obligations to act in good faith and in the best interests of Repap, with due care, diligence and skill. For the reasons I have already given, the process by which the Agreement was negotiated and approved and the terms of the Agreement unfairly disregard the interests of TDAM and other shareholders as a consequence of the conduct of Mr. Berg and of the Board of Directors of Repap. The oppression remedy is available to rectify conduct by directors that amounts to self-dealing at the expense of the corporation or other shareholders.[31] There is no principled reason that it should not also be available to rectify conduct by a Chairman and directors that saddles a corporation with a huge liability and no corresponding benefit to shareholders.

202 In 820099 Ontario Inc. v. Harold E. Ballard Ltd., supra, at 197, Mr. Justice Farley made this observation about the role of the court when it is asked to "rectify the matters complained of":

> "The court should not interfere with the affairs of a corporation lightly. I think that where relief is justified to correct an oppressive type of situation, the surgery should be done with a scalpel, and not a battle axe. I would think that this principle would hold true even if the past conduct of the oppressor were found to be scandalous. The job for the court is to even up the balance, not tip it in favour of the hurt party."

203 Mr. Berg therefore submits that if a remedy is to be fashioned, the court should revise the employment agreement, and only to the extent necessary to relieve the oppression. He also submits that section 120 should be interpreted consistently with the court's power under section 241 of the CBCA and it should vary the Agreement by severing those provisions that are not fair and reasonable.

204 The setting aside of a self-interested contract can hardly be described as a significant interference in the affairs of a company. In cases of breach of fiduciary duty, disgorgement is a common remedy. I was referred, for example, to the decision in Sparling v. Javelin Internationale Lteé.[32] There, the court "rectified the matters complained of" by ordering the cancellation of the shares of Mr. Doyle, ordering the removal from office of the Board of Directors of Javelin and amending the articles of association and the by-laws of the corporation to reduce the number of directors. In appropriate circumstances, it seems that courts have not been hesitant to use a heavier hand if this is required to rectify the oppression.

205 Mr. Berg was at Repap for seven months. His contribution was a modest one, and there is no reliable evidence that he would have or could have contributed a great deal more. In that time, he earned approximately U.S. $200,000. The Chairman who succeeded him was a restructuring specialist who was remunerated at an annual salary in the range of $100,000 to $150,000, with no other benefits. The Chairman who preceded him was not paid. In my view, these are the appropriate comparisons. Measured against them, Mr. Berg was generously compensated for the work he performed.

206 UPM makes no claim in this action to be reimbursed for the payments Mr. Berg has already received. Setting aside the Agreement would not tip the scale in favour of the corporation. It would leave Mr. Berg with more than adequate remuneration for the services he provided to Repap and would relieve UPM of the obligation of further performance under an unjustified contract that ought never to have been approved. Rectifying the Agreement would tip the scale in favour of Mr. Berg. In any event, there is no adequate evidentiary record upon which I could do this. While the court is encouraged to be creative in fashioning an appropriate remedy to cure oppression, there is no need to be creative here. In many ways, this is an easy case because the only parties affected are Mr. Berg, who wishes to retain the benefit of some or all of the contract, and the corporation, who wishes to be relieved of its burden. There are no third party interests at stake.

207 The oppression remedy is an equitable remedy and those who wish the court to rectify matters with a scalpel, rather than a battle axe, should give the court some reason to do this. In this case, I can think of no reason why the court should preserve aspects of the Agreement for Mr. Berg, when he had every reasonable opportunity to revise it himself.

208 He had this opportunity in February when Mr. Larson and Ms. Cormier explained to him why his proposed compensation package was wholly inappropriate. He had another opportunity in early March, when he reviewed the Jensen memorandum and the letters from the directors. Mr. Larson again urged him in May to modify his demands. In early June, with a proxy fight looming and a shareholders' meeting pending, he told Mr. MacLellan that he was amenable to changing the Agreement, or even leaving, but he proposed no terms to him or to the Board. Instead, while Mr. Berg was Chairman, Repap commenced litigation against Mr. Poile, a Repap shareholder, and Mr.

McBride.

209 UPM has satisfied me that it is entitled to a remedy under section 241(3)(h) of the CBCA. I conclude that the appropriate remedy in this case is to set aside the Agreement. There are also grounds for doing this under section 120(7) of the CBCA..

210 In the result, the claim is allowed. The crossclaim of Mr. Berg is dismissed. The crossclaim of Repap for a declaration that the employment agreement is unenforceable having been procured through a breach of fiduciary duty is granted, but the balance of the crossclaim is dismissed. If costs are not agreed within 30 days, counsel are directed to arrange a conference call attendance with me. I am greatly indebted to all counsel who presented this case with skill, candour and civility.

LAX J.

[1] J. Sopinka, S.N. Lederman and A.W. Bryant, The Law of Evidence in Canada, 2d ed. (Toronto and Vancouver: Butterworths, 1999) at para. 6.321 pg. 297.

[2] R.S.C. 1985, C-44, ("CBCA").

[3] CBCA, s. 122(1).

[4] CBCA, s. 120.

[5] Gray v. Augarita Porcupine Mines Ltd., [1952] 3 D.L.R. 1 (P.C.) ("Gray").

[6] Ibid at 14.

[7] K.P. McGuiness, The Law and Practice of Canadian Business Corporations (Toronto and Vancouver, Butterworths, 1999) at para. 8.235, p. 754; see, Crighton v. Roman, [1960] S.C.R. 858, per Cartwright J. at p. 869.

[8] Levy-Russell Ltd v. Tecmotiv Inc. (1994), 54 C.P.R. (3d) 161 at 341 [123-124 QL] (Ont. Ct. (Gen. Div.)).

[9] (1998), 42 O.R. (3d) 177 (C.A.) (QL) ("Maple Leaf Foods").

[10] (1998), 39 O.R. (3d) 755 (Gen. Div.) (QL) ("CW Shareholdings").

[11] Ibid at 10.

[12] McGuiness, supra, note 5 at para. 8.248, 760.

[13] CW Shareholdings, supra, note 8 at 10.

[14] Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F. (2d) 264 at 274-276 [14-16 (Lexis)] (2d Cir. 1986).

[15] Ibid at 16.

16 820099 Ontario Inc. v. Harold E. Ballard Ltd., supra, note 10 at 177.

17 Maple Leaf Foods, supra, note 7 at 10.

18 CW Shareholdings, supra, note 8 at 10.

19 CW Shareholdings, supra, note 8 at 13-14.

20 (1889), 14 A.C. 337 (H.L.) at 374.

21 Paul M. Perell, "The Fraud Elements of Deceit and Fraudulent Misrepresentation", [1996] 18 Advocates' Q 23 at 24.

22 Akerhielm v. de Mare, [1959] A.C. 789 (P.C.) at 805, per Lord Jenkins.

23 Ibid.

24 [1955] O.W.N. 125 (H.C.) at 127.

25 CBCA, s. 120(7)(a)(b).

26 Rooney v. Cree Lake Resources Corp., [1998] O.J. No. 3077 (Gen. Div.) (QL).

27 Cannaday v. Sun Peaks Resort Corp. (1998), 44 B.C.L.R. (3d) 195 (C.A.) rev'g (1995), 25 B.L.R. (2d) 75 (B.C.S.C.).

28 Ibid at para. 52.

29 Kentucky Fried Chicken Canada v. Scott's Food Services Inc. (1998), 114 O.A.C. 357 at 363.

30 Weingberger v. UOP, Inc. 457 A. (2d) 701 at 711-712 [13-15 (Lexis)] (Del. S. Ct. 1983).

31 C.I. Covington Fund Inc. v. White (2000), 10 C.P.R. (4th) 49 at paras. 21, 40, 41, 43 (Ont. S.C.J.), aff'd (2001), 15 C.P.R. (4th) 144 (Ont. Div. Ct.).

32 [1986] R.J.Q. 1073 (Que. S.C.).

TAB 6

Case Name:

UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.

Between
UPM-Kymmene Corporation, plaintiff (respondent), and
UPM-Kymmene Miramichi Inc., F. Steven Berg, Clifford M.
Sifton, Stephen W. Phillips, defendants (F. Steven Berg,
appellant) (UPM-Kymmene Miramichi Inc., respondent)

[2004] O.J. No. 636

250 D.L.R. (4th) 526

183 O.A.C. 310

42 B.L.R. (3d) 34

32 C.C.E.L. (3d) 68

40 C.C.P.B. 114

137 A.C.W.S. (3d) 742

2004 CarswellOnt 691

Docket No. C38603

Ontario Court of Appeal
Toronto, Ontario

Rosenberg, MacPherson JJ.A. and Lane J. (ad hoc)

Heard: February 16, 2004.
Judgment: February 20, 2004.

(14 paras.)

Company law -- Actions against corporations and directors -- Action for oppressive conduct -- Conditions precedent -- Practice -- Appeals -- Duty of appellate court respecting conclusions or interpretation of trial judge.

Appeal by the defendant, Berg, from a judgment in favour of the company, UPM-Kymmene. Berg and the board of directors approved a contentious employment contract. The trial judge applied the oppression remedy, finding that the process by which the board approved the contract was flawed, and its decision fell outside the range of reasonableness. The judge further found that Berg breached his duty to the company. Berg argued that the oppression remedy was only available to shareholders who were unable to use the normal corporate machinery. In this case, he argued that the aggrieved minority shareholder, TD Asset Management, could have joined forces with the controlling group, and ousted Berg and the board that approved the employment contract. The new board could have then sued Berg and the former board members for negligence.

HELD: Appeal dismissed. The oppression remedy could not be limited as proposed by Berg. There was nothing in the section that would result in that limitation. The judge's conclusions were supported by the evidence. She did not substitute her view of the reasonableness of the employment contract for that of the board.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 120, 241

Appeal From:

On appeal from the judgment of Justice Joan L. Lax of the Superior Court of Justice dated June 20, 2002, reasons for judgment reported at [2002] O.J. No. 2412 (QL) and [2002] O.J. No. 4137 (QL).

Counsel:

Sheila Block and Andrew Gray, for the appellant F. Steven Berg.
R. Paul Steep and Lara Teoli, for UPM-Kymmene Miramichi Inc.
Ronald Slaght and Kirsten Crain, for the respondent UPM-Kymmene Corporation.

The following judgment was delivered by

1 THE COURT (endorsement):-- We agree with the reasons of the trial judge and her conclusion. We add these comments to address certain of the issues raised by the appellant.

2 The appellant's principal submission was that this was not an appropriate case for the use of the oppression remedy. Counsel for the appellant submits that the oppression remedy should only be available to shareholders who are unable to use the normal corporate machinery. She points out that in this case, the aggrieved minority shareholder, TD Asset Management Inc. ("TDAM") was able to join forces with the controlling group and oust the appellant and the Board that had approved the employment contract. She submits that it would then have been open to the new board to sue the former Board members, and presumably the appellant, for negligence. She argues that in the absence of proof of fraud, which the trial judge did not find, it was wrong for the trial judge to grant a rescission remedy.

3 In our view, the oppression remedy in s. 241 of the Canada Business Corporations Act, R.S.C. 1985, c. C.44, cannot be so limited. There is nothing in the section that would lead the court to read in that limitation. As is pointed out in Dennis H. Peterson, Shareholder Remedies in Canada, looseleaf (Ontario: Butterworths, 1989) at section 2.36, limiting the oppression remedy to shareholders that do not have majority voting control fails to recognize that "at a fundamental level, [the statutory remedies] address abuse of power in the corporate context." It was open to the trial judge to find that the conduct of the affairs of the company by the appellant and the Board of Directors was oppressive or unfairly prejudicial to, or unfairly disregarded the interests of, the shareholders within the meaning of s. 241 of the Act. As the trial judge said at para. 201, "[T]he oppression remedy is available to rectify conduct by directors that amounts to self-dealing at the expense of the corporation or other shareholders".

4 We also point out that this limitation on the availability of the oppression remedy was not argued

at trial. Rather, the focus of the trial was on whether the appellant had breached his fiduciary duty to the company and whether the decision of the Board fell within the parameters of the business judgment rule. The trial judge made findings of fact that support her conclusions that the appellant breached his duty to the company, that the process by which the Board came to approve the contract was seriously flawed, and that the Board's decision fell outside the range of reasonableness.

5 While the appellant did not seriously challenge the trial judge's findings of fact, counsel submits that the trial judge, in effect, substituted her view of the reasonableness of the compensation package for that of the Board. It is argued that she subjected the contract and the procedure that led to its approval to a microscopic ex post facto examination. The appellant submits that a better measure of the reasonableness of the contract is the view of the experienced board member, Mr. Cohen, who was one of the members of the Board that approved it, and the view of Mr. Whitman, who represented the controlling shareholder and made no comment about the contract.

6 We do not agree with this characterization of the trial judge's reasons. The trial judge was well aware that the court is not entitled simply to second-guess the Board's decision. As the trial judge said, the court looks to see whether the Board made a reasonable decision, not a perfect decision. She stated that the business judgment rule "recognizes the autonomy and integrity of a corporation and the expertise of its directors" since they are "in the advantageous position of investigating and considering first-hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation". [Reasons para. 152.]

7 As we have said, the process by which the Board members came to make their decision was seriously flawed. As just one example, the Board relied upon the recommendation of the compensation committee but that committee did not have the time or expertise to review the contract and its members did not understand its key components. The trial judge found at paragraph 156 that the process leading up to the meeting and proceedings at which the contract was approved "fell far short of the exercise of prudent judgment in the interests of the shareholders that is expected of directors". This finding is supported by the evidence.

8 At paragraph 193 of her reasons, the trial judge expressly referred to Mr. Whitman's silence. She was entitled to take into account his explanation for his silence. Further, as she pointed out, the resignation of Mr. Jensen, Mr. Whitman's nominee, was intended to make clear Mr. Whitman's disapproval of the contract.

9 We would not give effect to the submission that the oppression remedy should be limited to circumstances in which the shareholders have no other remedy, nor would we give effect to the submission that the trial judge substituted her view of the reasonableness of the compensation package for that of the Board.

10 The appellant also submits that the plaintiff purchased the shares of Repap with full knowledge of the contract and that TDAM was able to sell its shares at a premium. Thus, it is submitted there is nothing to show that either the plaintiff or TDAM was oppressed. The trial judge addressed this issue in paragraph 200 of her reasons:

> The fact that UPM paid a premium for the shares of Repap is irrelevant. UPM does not seek damages. It asks that the Agreement be set aside. If the Agreement stands, UPM is bound by it. As assignee of TDAM's cause of action, and as a shareholder of Repap, it is entitled to ask for an Order setting aside the Agreement if the effect of the conduct complained of unfairly disregards the interests of TDAM *and other shareholders*. [Emphasis added.]

11 We agree with that conclusion and would not give effect to this submission. In light of our conclusion that the trial judge properly invoked the oppression remedy, we need not consider the application of s. 120 of the Act.

12 The appellant sought leave to appeal the costs order in favour of Repap Enterprises Inc. (UPM-Kymmene Miramichi Inc.) because this respondent failed to prove fraud as alleged in its cross claim, which allegation it maintained at trial. The appellant relies upon the statements of Blair J. in Bargman v. Rooney (1998), 30 C.P.C. (4th) 259 (Ont. Gen. Div.) at paras. 18 and 19:

> It matters not, in my view, at what stage in the proceedings the unproved allegations are levelled. Because of their extraordinarily serious nature - going, as they do, directly to the heart of a person's very integrity - allegations of fraud and dishonesty are simply not to be made unless there is every reasonable likelihood that they can be proved. The cost sanction exists in these circumstances to help ensure that such will be the case.
>
> ...
>
> The cost sanction should be imposed sharply and firmly by the Courts, in my opinion, at any stage in the proceedings when unsupported and unproven allegations of fraud and dishonesty are put forward.

13 The trial judge was aware of the normal rule that a successful plaintiff who has failed to establish fraud should be deprived of its costs. The trial judge provided reasons for exercising her discretion in favour of the respondent. We have not been persuaded that she erred in so doing. In this case there was "every reasonable likelihood" that the allegations of fraud would be made out. As it was, the trial judge found that the appellant made false allegations against Mr. Cohen, that his motive for the "Berg Put" was entirely improper, that he threatened to collapse the company's capital structure if his wishes were not carried out, that he completely lost sight of his obligations to the company, that he "failed utterly" in his duties to the company, that his conduct was "exactly opposite to the conduct that the law required of him as a fiduciary", and that he was "greedy and overreaching and failed miserably in his duties to Repap". Accordingly, leave to appeal costs is refused.

14 The appeal is dismissed with costs fixed as follows:

To the respondent UPM-Kymmene Corporation: inclusive of disbursements and G.S.T.	$39,138.15
To the respondent UPM-Kymmene Miramichi Inc.: inclusive of disbursements and G.S.T.	$27,245.75

ROSENBERG J.A.
MacPHERSON J.A.
LANE J. (ad hoc)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Court File No: CV-13-10279-00CL

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO GROWTHWORKS CANADIAN FUND LTD.

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

Proceeding commenced at Toronto

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