Court File No.

**COURT OF APPEAL FOR ONTARIO**

**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 CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A" (collectively the "APPLICANTS" or "Canwest")**

**Applicants**

# BRIEF OF AUTHORITIES OF GS Capital Partners VI Fund L.P., GSCP VI AA One Holding S.ar.l and GS VI AA One Parallel Holding S.ar.l (collectively "GSCP")

**March 9, 2010**


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**TO: SERVICE LIST**

Court File No. CV-09-8396-00CL

*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 PLAN OF COMPROMISE OR ARRANGEMENT OF
CANWEST GLOBAL COMMUNICATIONS CORP.
AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

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## Schedule "A"

## Applicants

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3. MBS Productions Inc.
4. Yellow Card Productions Inc.
5. Canwest Global Broadcasting Inc./Radiodiffusion Canwest Global Inc.
6. Canwest Television GP Inc.
7. Fox Sports World Canada Holdco Inc.
8. Global Centre Inc.
9. Multisound Publishers Ltd.
10. Canwest International Communications Inc.
11. Canwest Irish Holdings (Barbados) Inc.
12. Western Communications Inc.
13. Canwest Finance Inc./Financiere Canwest Inc.
14. National Post Holdings Ltd.
15. Canwest International Management Inc.
16. Canwest International Distribution Limited
17. Canwest MediaWorks Turkish Holdings (Netherlands)
18. CGS International Holdings (Netherlands)
19. CGS Debenture Holding (Netherlands)
20. CGS Shareholding (Netherlands)
21. CGS NZ Radio Shareholding (Netherlands)
22. 4501063 Canada Inc.
23. 4501071 Canada Inc.

24. 30109, LLC

25. CanWest MediaWorks (US) Holdings Corp.

Court File No.

**COURT OF APPEAL FOR ONTARIO**

**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 CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A" (collectively the "APPLICANTS" or "Canwest")**

**Applicants**

**BRIEF OF AUTHORITIES OF**
**GS Capital Partners VI Fund L.P.,**
**GSCP VI AA One Holding S.ar.l and**
**GS VI AA One Parallel Holding S.ar.l**
**(collectively "GSCP")**

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| 2. | *Re Stelco Inc.* (2005), 2 B.L.R. (4th) 238 (Ont. C.A.) |
| 3. | *Royal Bank of Canada v. Soundair Corp et al* (1991), 4 O.R. (3d) 1 (C.A.) |
| 4. | *Re. Nortel Networks Corporation*, (2009), 55 C.B.R. (5th) 229 (ON S.C.) |
| 5. | *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68 |
| 6. | *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 |
| 7. | *Ferguson v. Imax Systems Corp.* (1984), 52 C.B.R. (N.S.) 255 (ON S.C. (Div. Ct.)) |

*Case Name:*

# Country Style Food Services 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 the Courts of Justice Act, R.S.O. 1990, C. c-43, as amended**
**AND IN THE MATTER OF a plan of compromise or arrangement of Country Style Food Services Inc., Country Style Food Services Holdings Inc., Country Style Realty Limited, Melody Farms Specialty Foods and Equipment Limited, Buns Master Bakery Systems Inc. and Buns Master Bakery Realty Inc.**
**APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985 C. c-36**

**[2002] O.J. No. 1377**

158 O.A.C. 30

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Docket No. M28458

Ontario Court of Appeal
Toronto, Ontario

**Feldman J.A.**
**(In Chambers)**

Heard: April 15, 2002.
Judgment: April 16, 2002.

(24 paras.)

*Creditors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval -- Appeal -- Leave to appeal -- Fresh evidence, bars.*

Application by the franchisees for leave to appeal an order that sanctioned a plan of arrangement for the debtor, Country Style Food Services. Within the framework of the Companies' Creditors Arrangement Act, a plan of arrangement for Country Style was submitted. One of its creditors proposed to oppose the sanction until an out-of-court settlement was reached prior to the sanction motion. The plan was subsequently approved by a substantial percentage of the unsecured creditors and by the secured creditor. No one opposed the approval of the plan at the sanction hearing. Following the approval, the franchisees became aware of facts that they alleged vitiated the approval process. According to the franchisees, they became aware that some franchisees over-contributed to Country Style's national advertising fund, such that they were entitled to claim as creditors against Country Style for unjust

enrichment in the plan process. Country Style objected to the admission of the fresh evidence and relied on the fact that due diligence has not been met. The opposing creditor filed a motion record with the court that contained affidavits outlining some of the allegations on which the franchises relied.

HELD: Application dismissed. The franchisees did not demonstrate that the evidence could not have been obtained by due diligence. The court was not satisfied that the circumstances militated in favour of the exercise of its discretion. There was nothing to suggest that the plan, as sanctioned and approved, was not fair and reasonable. If leave to appeal was granted, the progress of the action would be hindered and the restructuring might not proceed. If the appeal was succeeded and the process was reopened, the franchisees did not propose any alternative to the plan, such that the significance to the action appeared to be procedural, but not substantive.

**Statutes, Regulations and Rules Cited:**

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 13, 18.1.

Courts of Justice Act, R.S.O. 1990, c. C-43, s. 134(4).

**Counsel:**

Craig R. Colraine and Mitchell D. Goldberg, for Tozeng Limited, 1124019 Ontario Ltd. and 665371 Ontario Ltd. (applicants).
Joanna Board, for 1304271 Ontario Limited and 995804 Ontario Inc. (supporting the applicants).
Patrick J. O'Kelly and Ashley J. Taylor, for Country Style (respondent).
Frank J.C. Newbould, Q.C., for the Bank of Nova Scotia (respondent).
Mahesh Uttamchandani, for CAI, DIP Lender (respondent).

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1 **FELDMAN J.A.**:-- This is an application for leave to appeal the order of Spence J. made on March 7, 2002, whereby he sanctioned a Plan of Arrangement (the "Plan" under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA") for the respondent, Country Style Group of Corporations. The application is brought under s. 13 of the CCAA which provides:

> s. 13 Except in the Yukon Territory, any person dissatisfied with an order or a decision made under this Act may appeal therefrom on obtaining leave of the judge appealed from or of the court or a judge of the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

2 The application was originally brought before Spence J. but as he was unable to hear it before April 16, 2002, the date scheduled for the closing of the plan transaction, he suggested that the application be brought to this court.

3 All three applicants are Country Style franchisees. Only one, Tozeng Limited, is also a creditor that filed a proof of claim and voted in the proceeding.

4 The applicants concede that on the record before him, Spence J. did not make any error in approving the Plan which was approved by a substantial percentage of the unsecured creditors and by the secured creditor. In fact, no one opposed the approval of the plan at the sanction hearing. The basis for this application is that immediately after the hearing approving the Plan, the applicants became aware of

facts which they say vitiate the approval process in three ways:

(1) Over a period of time, some franchisees had contributed to Country Style's national advertising fund while others had not. The applicants claim that to the extent that some franchisees thereby overcontributed, they were entitled to claim as creditors against the company for unjust enrichment in the Plan process. However, because they did not know about the overcontribution and unequal treatment until it was too late to claim in the plan process, they have been denied both the amount of their claim and the opportunity to vote for or against the Plan and to participate in the process.
(2) The company was offering improper incentives to creditors to vote for the Plan.
(3) The Monitor was in a conflict of interest.

The applicants rely on fresh evidence in order to assert these claims and rely on s. 134(4) of the Courts of Justice Act R.S.O. 1990, c. C-43, which allows a court in a proper case, to accept fresh evidence. In R. v. Palmer, [1980] 1 S.C.R. 759 at 775, the Supreme Court of Canada set out four criteria for the admission of fresh evidence on appeal, summarized as follows:

(1) by due diligence, the evidence could not have been adduced in the proceeding below;
(2) it is relevant to a decisive or potentially decisive issue;
(3) it is reasonably capable of belief;
(4) if believed, it may reasonably have affected the result.

**5** The respondents object to the admission of the fresh evidence on this application and rely heavily on the assertion that the first criterion, due diligence, has not been met in this case. They also suggest that the record discloses that Mr. English, the principal of Tozeng Limited, did know about the differential treatment of franchisees as long as one year ago.

**6** Mr. O'Kelly on behalf of Country Style, points to the fact that a creditor, Tarragon Mercantile Inc., did propose to oppose the sanction order until an out-of-court settlement was reached on the evening before the sanction motion. Tarragon filed a motion record with the court that contained affidavits outlining some of the allegations on which the applicants now rely (in particular, the alleged irregularities with the proxy solicitation process and the alleged conflict of interest of the Monitor) and raised other matters as well. I am told that Spence J. was advised on the return of the motion that Tarragon was withdrawing its opposition. The plan was thereupon sanctioned by the court. I am advised that no one opposed the order.

**7** Mr. O'Kelly's submission is that because Tarragon was in a position to find out the information necessary to bring forth some of the allegations now asserted by the applicants, the applicants could have done so as well had they exercised due diligence. In my view, on the face of it, there is merit in that submission.

**8** The one issue which is not fully detailed in the Tarragon material is the national advertising fund issue. However, the information relied on in respect of the fund is contained in an affidavit of Catherine Mauro dated March 25, 2002 and filed on this application. She is the former director of marketing and product development who was terminated by Country Style on February 4, 2002. Ms Mauro also provided one of the affidavits which is included in the Tarragon material. Again, therefore, it appears that the applicants could have discovered further information from Ms. Mauro prior to the March 7 hearing had they acted with due diligence in speaking with her.

9 Even more significant, however, is the fact that in his affidavit filed in connection with the original material seeking court protection, Mr. Gibbons, the President of Country Style, disclosed as part of his description of the financial status of the debtor companies that one of the historical responses by management when a franchisee developed financial difficulties was "deferring or accepting reduced royalty, advertising and/or sign rental payments for a period of time" (affidavit para. 37). This information was also included in the Management proxy circular which was sent out to all creditors, of which Mr. English was one.

10 The applicants' position is that until they talked to Catherine Mauro after the sanction hearing, they did not know that some franchisees were not paying the full 3.5% of monthly gross sales to the national advertising fund, and that the 13 corporate stores, taken over from failed franchisees, paid nothing into the fund. The applicants also take the position that the company and the monitor made it impossible for the franchisees to learn of this by failing to disclose it to the franchisees. Their evidence is that representations were made to franchisees by senior management that all franchisees paid the same percentage of their sales into the national advertising fund.

11 However, it appears that there was disclosure of the differential treatment of franchisees in respect of the advertising fund in Mr. Gibbons' affidavit and the Management circular. Counsel also pointed out that franchisees could ask to be added to the service list for all of the documentation and that some were added, including Ms. Board's clients who have been represented by her here in support of the application.

12 I conclude, based on the material currently before the court, that it cannot be said that there was non-disclosure of the differential treatment of franchisees in respect of the contribution to the national advertising fund, or that the applicants could not have discovered this evidence if they had exercised due diligence. Although it appears that the potential significance of the different contributions as a possible claim against Country Style based on unjust enrichment, may not have been considered by the applicants until after the sanction motion, a failure to appreciate the significance of information does not meet the due diligence test.

13 Finally, the respondents point to the fact that Mr. English has deposed that in May 2000, he sought and obtained differential treatment in respect of the royalty fees he was paying and that he has been trying to retain the so-called "tiered store" status for his stores which allows them to pay lower fees. Therefore, Mr. English was aware of differentiation among franchisees in respect of some of the amounts payable to the franchiser and wanted to preserve that differentiation when it benefited him. The respondents say this shows that the new evidence should not be accepted and that furthermore, there is no merit to the suggestion that the franchisees have any claim against the debtor company based on alleged overpayments. As a result, they argue that the new evidence would not have affected the outcome of the sanction hearing had it been available at that hearing.

14 I am satisfied that I need not deal with this part of the submission on this motion, as the due diligence criterion is not met.

15 Even if the fresh evidence met the test for admission, which it does not on the due diligence criterion, the court must be satisfied that this is a case where leave to appeal ought to be granted. The jurisprudence in this area dictates that leave to appeal in CCAA proceedings should be granted sparingly: Re Consumers Packaging Inc. (2001), 27 C.B.R. (4th) 197 at 199 (Ont. C.A.); Re Blue Range Resources Corp. (1999), 12 C.B.R. (4th) 186 at 190 (Alta. C.A.). In order to grant leave the court must be satisfied that there are "serious and arguable grounds that are of real and significant interest to the parties": Re Multitech Warehouse Direct Inc. (1995), 32 Alta. L.R. (3d) 62 at 63 (C.A.). This is determined in accordance with a four-pronged test as follows:

(a) whether the point on appeal is of significance to the practice;
(b) whether the point is of significance to the action;
(c) whether the appeal is prima facie meritorious or frivolous;
(d) whether the appeal will unduly hinder the progress of the action.

See Blue Range Resource Corp., supra at 190; Cineplex Odeon Corp. (2001), 24 C.B.R. (4th) 201 at 202 (Ont. C.A.)

**16** As I understand it, the main issue on appeal is the submission that the applicant franchisees and other franchisees, some of whom have filed affidavits in support, over-contributed to the national advertising fund in relation to other franchisees and the company in connection with its corporate stores. This overcontribution entitled them to make a claim against the company for unjust enrichment. However, because they did not know about this potential claim until after the sanction hearing, they did not file claims in the process; they therefore did not have the right to participate as unsecured creditors, and they did not have the right to vote for or against the Plan.

**17** Counsel for the applicants concedes that there is no evidence in the record to demonstrate that had the affected franchisees made claims and voted, the Plan would have been defeated or amended in any way.

**18** Counsel also concedes that no alternative plan has been proffered at any stage. He suggests, however, that because of the circumstances set out, the Plan cannot be considered fair and reasonable. The Monitor has made it clear in its reports that the only alternative to the Plan is bankruptcy or receivership, whereunder there would be nothing for the unsecured creditors. Counsel suggested in argument that his clients would be prepared to see the debtor company go bankrupt rather than proceed with the sanctioned Plan. There is no affidavit evidence to this effect, and I frankly find it hard to accept that franchisees with viable operations would prefer to see the corporate entity with which they are associated be liquidated in a bankruptcy or receivership.

**19** Based on the record, there is nothing to suggest that the Plan as sanctioned and approved by the court is not "fair and reasonable." If leave to appeal is granted, the progress of the action will clearly be hindered and the restructuring may not go ahead at all. If the appeal were to be successful and the process reopened, the applicants do not propose any alternative to the plan, so that the significance to the action appears to be procedural but not substantive.

**20** For all of these reasons, the applicants have not satisfied the test for the court to exercise its discretion to grant leave to appeal.

**21** During argument, counsel for the applicants suggested that one of the problems facing his clients is that they owe money to the debtor company, but are not able to make a claim against the company in respect of the overpayment into the advertising fund because of the orders made in the CCAA process. In response, counsel for Country Style took the position that s. 18.1 of the CCAA preserves the applicants' ability to assert a right of set-off against the company in respect of their claims against any monies which they may owe to the company. In other words, their claims against the company are not necessarily barred.

**22** As this was not an issue for resolution on this leave to appeal motion, I make no comment on (1) the effect of s. 18.1 of the CCAA on post-Plan claims by or against the debtor company; or (2) on the effect of the claims bar order in respect of claims by people who were not listed or served as creditors in the proceeding, or people who did not know that they had claims against the company.

**23** Finally, I note that the franchisees as a group were not considered to be people to be officially served with and included in the CCAA process. I was advised by a representative of the Monitor who was present in court for this appeal, that Mr. Gibbons did send a letter to all franchisees enclosing the original stay order and advising them of the Monitor's website where much of the CCAA material would be posted. Although the process under the Act contemplates the participation and protection of creditors, the debtor company, and possibly the shareholders, in cases where the debtor company is a franchisor, the franchisees may have an interest in the ultimate structure of the franchise operation as proposed by the Plan process. It may therefore be appropriate where a franchisor seeks CCAA protection, to consider whether the franchisees ought to be given notice of the proceedings and the opportunity to request the ability to participate on an appropriate basis.

CONCLUSION

**24** Leave to appeal is denied.

FELDMAN J.A.

cp/e/nc/qlsar/qlkjg

*Case Name:*

**Stelco Inc. (Re)**

**IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C., c. C-36, as amended AND IN THE MATTER OF a proposed plan of compromise or arrangement with respect to Stelco Inc., and other Applicants listed in Schedule "A"***
**[* Editor's note: Schedule "A" was not attached to the copy received from the Court and therefore is not included in the judgment.]**
**APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended**

**[2005] O.J. No. 1171**

75 O.R. (3d) 5

253 D.L.R. (4th) 109

196 O.A.C. 142

2 B.L.R. (4th) 238

9 C.B.R. (5th) 135

138 A.C.W.S. (3d) 222

2005 CarswellOnt 1188

2005 CanLII 8671

Docket: M32289

Ontario Court of Appeal
Toronto, Ontario

**S.T. Goudge, K.N. Feldman and R.A. Blair JJ.A.**

Heard: March 18, 2005.
Judgment: March 31, 2005.

(79 paras.)

*Creditors & debtors law -- Legislation -- Debtors' relief -- Companies' Creditors Arrangement Act -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005]*

*O.J. No. 730 allowed.*

*Civil procedure -- Courts -- Jurisdiction -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Civil procedure -- Courts -- Superior courts -- Inherent jurisdiction -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Corporations and associations law -- Corporations -- Directors -- Appointment or election -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Corporations and associations law -- Corporations -- Directors -- Duties -- Business judgment rule -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Corporations and associations law -- Corporations -- Directors -- Duties -- Fiduciary duties -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Insolvency law -- Proposals -- Court approval -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

*Administrative law -- Natural justice -- Reasonable apprehension of bias -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.*

Application by two former directors of Stelco for leave to appeal and appeal from the order of their removal from the board of directors. Stelco was engaged in an extensive economic restructuring while under statutory insolvency protection that involved court-appointed capital raising via a competitive bid process. The appellants were involved with two companies that purchased approximately 20 per cent of Stelco's publicly traded shares during the protection period and were subsequently appointed to its board of directors to fill vacancies caused by resignations. As part of the appointment process, the appellants were informed of their fiduciary duties and agreed that their companies would have no further involvement in the competitive bid process. Stelco's employees sought the appellants' removal from the board on the basis that the participation of two major shareholder representatives would tilt the evaluation of the bids in favour of maximizing shareholder value at the expense of bids more favourable to the interests of the employees. The motions judge held that the involvement of the appellants on the board raised an unnecessary risk that their future conduct potentially jeopardized the integrity and neutrality of the capital raising process, and declared the appointments to be of no force and effect. The judge cited the inherent jurisdiction of the court as the basis for the order. The appellants submitted that the judge had no jurisdiction to make a removal order, and in the alternative, he erred in applying a reasonable bias test to the removal of directors. The appellants further submitted that the judge erred by interfering with the board's exercise of business judgment, and that the facts did not justify the removal order.

HELD: Application for leave and appeal allowed. The judge misconstrued his authority, and made an order that he was not empowered to make. The court had no statutory or inherent authority to interfere with the composition of the board of directors. The judge erred in declining to give effect to the business judgment rule, and was not entitled to usurp the role of the directors and management in conducting the company's restructuring efforts. The record did not support a finding that there was sufficient risk of misconduct to warrant a conclusion of oppression, nor was the level of such risk assessed. There was no

statutory principle that envisaged screening the neutrality of the appellants in advance of their appointment to the board of Stelco. Legal remedies were available to the employees of Stelco in the event that the appellants engaged in conduct that breached their legal obligations to the corporation. The applicability of such remedies was dependent on actual misconduct rather than mere speculation. Therefore, an apprehension of bias approach was not appropriate in the corporate law context.

**Statutes, Regulations and Rules Cited:**

Canada Business Corporations Act ss. 1, 102, 106(3), 109(1), 111, 122(1)(a), 122(1)(b), 145, 145(2)(b), 241, 241(3)(e)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 As Amended, ss. 11, 11(1), 11(3), 11(4), 11(6), 20

**Appeal From:**

Application for Leave to Appeal, and if leave be granted, an appeal from the order of Farley J. dated February 25, 2005 removing the applicants as directors of Stelco Inc., reported at: [2005] O.J. No. 729.

**Counsel:**

Jeffrey S. Leon and Richard B. Swan, for the appellants, Michael Woollcombe and Roland Keiper

Kenneth T. Rosenberg and Robert A. Centa, for the respondent United Steelworkers of America

Murray Gold and Andrew J. Hatnay, for the respondent Retired Salaried Beneficiaries of Stelco Inc., CHT Steel Company Inc., Stelpipe Ltd., Stelwire Ltd. and Welland Pipe Ltd.

Michael C.P. McCreary and Carrie L. Clynick, for USWA Locals 5328 and 8782

John R. Varley, for the Active Salaried Employee Representative

Michael Barrack, for Stelco Inc.

Peter Griffin, for the Board of Directors of Stelco Inc.

K. Mahar, for the Monitor

David R. Byers, for CIT Business Credit, Agent for the DIP Lender

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The judgment of the Court was delivered by

**R.A. BLAIR J.A.:--**

PART I - INTRODUCTION

**1** Stelco Inc. and four of its wholly owned subsidiaries obtained protection from their creditors under the Companies' Creditors Arrangement Act[1] on January 29, 2004. Since that time, the Stelco Group has been engaged in a high profile, and sometimes controversial, process of economic restructuring. Since October 2004, the restructuring has revolved around a court-approved capital raising process which, by

February 2005, had generated a number of competitive bids for the Stelco Group.

2 Farley J., an experienced judge of the Superior Court Commercial List in Toronto, has been supervising the CCAA process from the outset.

3 The appellants, Michael Woollcombe and Roland Keiper, are associated with two companies - Clearwater Capital Management Inc., and Equilibrium Capital Management Inc. - which, respectively, hold approximately 20% of the outstanding publicly traded common shares of Stelco. Most of these shares have been acquired while the CCAA process has been ongoing, and Messrs. Woollcombe and Keiper have made it clear publicly that they believe there is good shareholder value in Stelco in spite of the restructuring. The reason they are able to take this position is that there has been a solid turn around in worldwide steel markets, as a result of which Stelco, although remaining in insolvency protection, is earning annual operating profits.

4 The Stelco board of directors ("the Board") has been depleted as a result of resignations, and in January of this year Messrs. Woollcombe and Keiper expressed an interest in being appointed to the Board. They were supported in this request by other shareholders who, together with Clearwater and Equilibrium, represent about 40% of the Stelco common shareholders. On February 18, 2005, the Board appointed the appellants directors. In announcing the appointments publicly, Stelco said in a press release:

> After careful consideration, and given potential recoveries at the end of the company's restructuring process, the Board responded favourably to the requests by making the appointments announced today.
>
> Richard Drouin, Chairman of Stelco's Board of Directors, said: "I'm pleased to welcome Roland Keiper and Michael Woollcombe to the Board. Their experience and their perspective will assist the Board as it strives to serve the best interests of all our stakeholders. We look forward to their positive contribution."

5 On the same day, the Board began its consideration of the various competing bids that had been received through the capital raising process.

6 The appointments of the appellants to the Board incensed the employee stakeholders of Stelco ("the Employees"), represented by the respondent Retired Salaried Beneficiaries of Stelco and the respondent United Steelworkers of America ("USWA"). Outstanding pension liabilities to current and retired employees are said to be Stelco's largest long-term liability - exceeding several billion dollars. The Employees perceive they do not have the same, or very much, economic leverage in what has sometimes been referred to as 'the bare knuckled arena' of the restructuring process. At the same time, they are amongst the most financially vulnerable stakeholders in the piece. They see the appointments of Messrs. Woollcombe and Keiper to the Board as a threat to their well being in the restructuring process, because the appointments provide the appellants, and the shareholders they represent, with direct access to sensitive information relating to the competing bids to which other stakeholders (including themselves) are not privy.

7 The Employees fear that the participation of the two major shareholder representatives will tilt the bid process in favour of maximizing shareholder value at the expense of bids that might be more favourable to the interests of the Employees. They sought and obtained an order from Farley J. removing Messrs. Woollcombe and Keiper from their short-lived position of directors, essentially on the basis of that apprehension.

8 The Employees argue that there is a reasonable apprehension the appellants would not be able to act

in the best interests of the corporation - as opposed to their own best interests as shareholders - in considering the bids. They say this is so because of prior public statements by the appellants about enhancing shareholder value in Stelco, because of the appellants' linkage to such a large shareholder group, because of their earlier failed bid in the restructuring, and because of their opposition to a capital proposal made in the proceeding by Deutsche Bank (known as "the Stalking Horse Bid"). They submit further that the appointments have poisoned the atmosphere of the restructuring process, and that the Board made the appointments under threat of facing a potential shareholders' meeting where the members of the Board would be replaced en masse.

**9** On the other hand, Messrs. Woollcombe and Keiper seek to set aside the order of Farley J. on the grounds that (a) he did not have the jurisdiction to make the order under the provisions of the CCAA, (b) even if he did have jurisdiction, the reasonable apprehension of bias test applied by the motion judge has no application to the removal of directors, (c) the motion judge erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) the facts do not meet any test that would justify the removal of directors by a court in any event.

**10** For the reasons that follow, I would grant leave to appeal, allow the appeal, and order the reinstatement of the applicants to the Board.

PART II - ADDITIONAL FACTS

**11** Before the initial CCAA order on January 29, 2004, the shareholders of Stelco had last met at their annual general meeting on April 29, 2003. At that meeting they elected eleven directors to the Board. By the date of the initial order, three of those directors had resigned, and on November 30, 2004, a fourth did as well, leaving the company with only seven directors.

**12** Stelco's articles provide for the Board to be made up of a minimum of ten and a maximum of twenty directors. Consequently, after the last resignation, the company's corporate governance committee began to take steps to search for new directors. They had not succeeded in finding any prior to the approach by the appellants in January 2005.

**13** Messrs. Woollcombe and Keiper had been accumulating shares in Stelco and had been participating in the CCAA proceedings for some time before their request to be appointed to the Board, through their companies, Clearwater and Equilibrium. Clearwater and Equilibrium are privately held, Ontario-based, investment management firms. Mr. Keiper is the president of Equilibrium and associated with Clearwater. Mr. Woollcombe is a consultant to Clearwater. The motion judge found that they "come as a package."

**14** In October 2004, Stelco sought court approval of its proposed method of raising capital. On October 19, 2004, Farley J. issued what has been referred to as the Initial Capital Process Order. This order set out a process by which Stelco, under the direction of the Board, would solicit bids, discuss the bids with stakeholders, evaluate the bids, and report on the bids to the court.

**15** On November 9, 2004, Clearwater and Equilibrium announced they had formed an investor group and had made a capital proposal to Stelco. The proposal involved the raising of $125 million through a rights offering. Mr. Keiper stated at the time that he believed "the value of Stelco's equity would have the opportunity to increase substantially if Stelco emerged from CCAA while minimizing dilution of its shareholders." The Clearwater proposal was not accepted.

**16** A few days later, on November 14, 2004, Stelco approved the Stalking Horse Bid. Clearwater and Equilibrium opposed the Deutsche Bank proposal. Mr. Keiper criticized it for not providing sufficient value to existing shareholders. However, on November 29, 2004, Farley J. approved the Stalking Horse

Bid and amended the Initial Capital Process Order accordingly. The order set out the various channels of communication between Stelco, the monitor, potential bidders and the stakeholders. It provided that members of the Board were to see the details of the different bids before the Board selected one or more of the offers.

**17** Subsequently, over a period of two and a half months, the shareholding position of Clearwater and Equilibrium increased from approximately 5% as at November 19, to 14.9% as at January 25, 2005, and finally to approximately 20% on a fully diluted basis as at January 31, 2005. On January 25, Clearwater and Equilibrium announced that they had reached an understanding jointly to pursue efforts to maximize shareholder value at Stelco. A press release stated:

> Such efforts will include seeking to ensure that the interests of Stelco's equity holders are appropriately protected by its board of directors and, ultimately, that Stelco's equity holders have an appropriate say, by vote or otherwise, in determining the future course of Stelco.

**18** On February 1, 2005, Messrs. Keiper and Woollcombe and others representatives of Clearwater and Equilibrium, met with Mr. Drouin and other Board members to discuss their views of Stelco and a fair outcome for all stakeholders in the proceedings. Mr. Keiper made a detailed presentation, as Mr. Drouin testified, "encouraging the Board to examine how Stelco might improve its value through enhanced disclosure and other steps." Mr. Keiper expressed confidence that "there was value to the equity of Stelco," and added that he had backed this view up by investing millions of dollars of his own money in Stelco shares. At that meeting, Clearwater and Equilibrium requested that Messrs. Woollcombe and Keiper be added to the Board and to Stelco's restructuring committee. In this respect, they were supported by other shareholders holding about another 20% of the company's common shares.

**19** At paragraphs 17 and 18 of his affidavit, Mr. Drouin, summarized his appraisal of the situation:

> 17. It was my assessment that each of Mr. Keiper and Mr. Woollcombe had personal qualities which would allow them to make a significant contribution to the Board in terms of their backgrounds and their knowledge of the steel industry generally and Stelco in particular. In addition I was aware that their appointment to the Board was supported by approximately 40% of the shareholders. In the event that these shareholders successfully requisitioned a shareholders meeting they were in a position to determine the composition of the entire Board.
>
> 18. I considered it essential that there be continuity of the Board through the CCAA process. I formed the view that the combination of existing Board members and these additional members would provide Stelco with the most appropriate board composition in the circumstances. The other members of the Board also shared my views.

**20** In order to ensure that the appellants understood their duties as potential Board members and, particularly that "they would no longer be able to consider only the interests of shareholders alone but would have fiduciary responsibilities as a Board member to the corporation as a whole," Mr. Drouin and others held several further meetings with Mr. Woollcombe and Mr. Keiper. These discussions "included areas of independence, standards, fiduciary duties, the role of the Board Restructuring Committee and confidentiality matters." Mr. Woollcombe and Mr. Keiper gave their assurances that they fully understood the nature and extent of their prospective duties, and would abide by them. In addition, they agreed and confirmed that:

> a) Mr. Woollcombe would no longer be an advisor to Clearwater and Equilibrium

with respect to Stelco;

b) Clearwater and Equilibrium would no longer be represented by counsel in the CCAA proceedings; and

c) Clearwater and Equilibrium then had no involvement in, and would have no future involvement, in any bid for Stelco.

**21** On the basis of the foregoing - and satisfied "that Messrs. Keiper and Woollcombe would make a positive contribution to the various issues before the Board both in [the] restructuring and the ongoing operation of the business" - the Board made the appointments on February 18, 2005.

**22** Seven days later, the motion judge found it "appropriate, just, necessary and reasonable to declare" those appointments "to be of no force and effect" and to remove Messrs. Woollcombe and Keiper from the Board. He did so not on the basis of any actual conduct on the part of the appellants as directors of Stelco but because there was some risk of anticipated conduct in the future. The gist of the motion judge's rationale is found in the following passage from his reasons (at para. 23):

> In these particular circumstances and aside from the Board feeling coerced into the appointments for the sake of continuing stability, I am not of the view that it would be appropriate to wait and see if there was any explicit action on behalf of K and W while conducting themselves as Board members which would demonstrate that they had not lived up to their obligations to be "neutral." They may well conduct themselves beyond reproach. But if they did not, the fallout would be very detrimental to Stelco and its ability to successfully emerge. What would happen to the bids in such a dogfight? I fear that it would be trying to put Humpty Dumpty back together again. The same situation would prevail even if K and W conducted themselves beyond reproach but with the Board continuing to be concerned that they not do anything seemingly offensive to the bloc. The risk to the process and to Stelco in its emergence is simply too great to risk the wait and see approach.

PART III - LEAVE TO APPEAL

**23** Because of the "real time" dynamic of this restructuring project, Laskin J.A. granted an order on March 4, 2005, expediting the appellants' motion for leave to appeal, directing that it be heard orally and, if leave be granted, directing that the appeal be heard at the same time. The leave motion and the appeal were argued together, by order of the panel, on March 18, 2005.

**24** This court has said that it will only sparingly grant leave to appeal in the context of a CCAA proceeding and will only do so where there are "serious and arguable grounds that are of real and significant interest to the parties": Country Style Food Services Inc. (Re), (2002) 158 O.A.C. 30; [2002] O.J. No. 1377 (C.A.), at para. 15. This criterion is determined in accordance with a four-pronged test, namely,

a) whether the point on appeal is of significance to the practice;

b) whether the point is of significance to the action;

c) whether the appeal is prima facie meritorious or frivolous;

d) whether the appeal will unduly hinder the progress of the action.

**25** Counsel agree that (d) above is not relevant to this proceeding, given the expedited nature of the hearing. In my view, the tests set out in (a) - (c) are met in the circumstances, and as such, leave should be granted. The issue of the court's jurisdiction to intervene in corporate governance issues during a CCAA restructuring, and the scope of its discretion in doing so, are questions of considerable

importance to the practice and on which there is little appellate jurisprudence. While Messrs. Woollcombe and Keiper are pursuing their remedies in their own right, and the company and its directors did not take an active role in the proceedings in this court, the Board and the company did stand by their decision to appoint the new directors at the hearing before the motion judge and in this court, and the question of who is to be involved in the Board's decision making process continues to be of importance to the CCAA proceedings. From the reasons that follow it will be evident that in my view the appeal has merit.

**26** Leave to appeal is therefore granted.

PART IV - THE APPEAL

The Positions of the Parties

**27** The appellants submit that,

a) in exercising its discretion under the CCAA, the court is not exercising its "inherent jurisdiction" as a superior court;

b) there is no jurisdiction under the CCAA to remove duly elected or appointed directors, notwithstanding the broad discretion provided by s. 11 of that Act; and that,

c) even if there is jurisdiction, the motion judge erred:

   (i) by relying upon the administrative law test for reasonable apprehension of bias in determining that the directors should be removed;

   (ii) by rejecting the application of the "business judgment" rule to the unanimous decision of the Board to appoint two new directors; and,

   (iii) by concluding that Clearwater and Equilibrium, the shareholders with whom the appellants are associated, were focussed solely on a short-term investment horizon, without any evidence to that effect, and therefore concluding that there was a tangible risk that the appellants would not be neutral and act in the best interests of Stelco and all stakeholders in carrying out their duties as directors.

**28** The respondents' arguments are rooted in fairness and process. They say, first, that the appointment of the appellants as directors has poisoned the atmosphere of the CCAA proceedings and, secondly, that it threatens to undermine the even-handedness and integrity of the capital raising process, thus jeopardizing the ability of the court at the end of the day to approve any compromise or arrangement emerging from that process. The respondents contend that Farley J. had jurisdiction to ensure the integrity of the CCAA process, including the capital raising process Stelco had asked him to approve, and that this court should not interfere with his decision that it was necessary to remove Messrs. Woollcombe and Keiper from the Board in order to ensure the integrity of that process. A judge exercising a supervisory function during a CCAA proceeding is owed considerable deference: Algoma Steel Inc. (2001), 25 C.B.R. (4th) 194, at para. 8.

**29** The crux of the respondents' concern is well-articulated in the following excerpt from paragraph 72 of the factum of the Retired Salaried Beneficiaries:

> The appointments of Keiper and Woollcombe violated every tenet of fairness in the restructuring process that is supposed to lead to a plan of arrangement. One stakeholder group - particular investment funds that have acquired Stelco shares

> during the CCAA itself - have been provided with privileged access to the capital raising process, and voting seats on the Corporation's Board of Directors and Restructuring Committee. No other stakeholder has been treated in remotely the same way. To the contrary, the salaried retirees have been completely excluded from the capital raising process and have no say whatsoever in the Corporation's decision-making process.

**30** The respondents submit that fairness, and the perception of fairness, underpin the CCAA process, and depend upon effective judicial supervision: see Olympia & York Development Ltd. v. Royal Trust (1993), 12 O.R. (3d) 500 (Gen. Div.); Re Ivaco Inc., (2004), 3 C.B.R. (5th) 33, at para. 15-16. The motion judge reasonably decided to remove the appellants as directors in the circumstances, they say, and this court should not interfere.

Jurisdiction

**31** The motion judge concluded that he had the power to rescind the appointments of the two directors on the basis of his "inherent jurisdiction" and "the discretion given to the court pursuant to the CCAA." He was not asked to, nor did he attempt to rest his jurisdiction on other statutory powers imported into the CCAA.

**32** The CCAA is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: Babcock & Wilcox Canada Ltd. (Re), [2000] O.J. No. 786 (Sup. Ct.) at para. 11. See also, Re Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311 (B.C.C.A.) at p. 320; Re Lehndorff General Partners Ltd. (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the CCAA, as the source of judicial power in a CCAA proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see Re Dylex Ltd. (1995), 31 C.B.R. (3d) 106 (Ont. Gen Div. [Commercial List]), Royal Oak Mines Inc. (Re) (1999), 7 C.B.R. (4th) 293 (Ont. Gen Div. [Commercial List]); and Westar Mining Ltd. (Re) (1992), 70 B.C.L.R. (2d) 6 (B.C.S.C.).

**33** It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the CCAA, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the CCAA and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the CCAA.

Inherent Jurisdiction

**34** Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law," permitting the court "to maintain its authority and to prevent its process being obstructed and abused." It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner." See I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970), 23 Current Legal Problems 27-28. In Halsbury's Laws of England, 4th ed. (London: Lexis-Nexis UK, 1973 -) vol. 37, at para. 14, the concept is described as follows:

> In sum, it may be said that the inherent jurisdiction of the court is a virile and viable doctrine, and has been defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or

> equitable to do so, in particularly to ensure the observation of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.

**35** In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the Legislature has acted. As Farley J. noted in Royal Oak Mines, supra, inherent jurisdiction is "not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play" (para. 4). See also, Baxter Student Housing Ltd. v. College Housing Cooperative Ltd., [1976] 2 S.C.R. 475 (S.C.C.) at 480; Richtree Inc. (Re), [2005] O.J. No. 251 (Sup. Ct.).

**36** In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., [2003] B.C.J. No. 1335 (B.C.C.A.), (2003) 43 C.B.R. (4th) 187 at para. 46, that:

> ... the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA. ... This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above,[2] rather than the integrity of their own process.

**37** As Jacob observes, in his article "The Inherent Jurisdiction of the Court," supra, at p. 25:

> The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.

**38** I do not mean to suggest that inherent jurisdiction can never apply in a CCAA context. The court retains the ability to control its own process, should the need arise. There is a distinction, however - difficult as it may be to draw - between the court's process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the company's process, on the other hand. The court simply supervises the latter process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose."[3] Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a CCAA proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process.

The Section 11 Discretion

**39** This appeal involves the scope of a supervisory judge's discretion under s. 11 of the CCAA, in the context of corporate governance decisions made during the course of the plan negotiating and approval

process and, in particular, whether that discretion extends to the removal of directors in that environment. In my view, the s. 11 discretion - in spite of its considerable breadth and flexibility - does not permit the exercise of such a power in and of itself. There may be situations where a judge in a CCAA proceeding would be justified in ordering the removal of directors pursuant to the oppression remedy provisions found in s. 241 of the CBCA, and imported into the exercise of the s. 11 discretion through s. 20 of the CCAA. However, this was not argued in the present case, and the facts before the court would not justify the removal of Messrs. Woollcombe and Keiper on oppression remedy grounds.

**40** The pertinent portions of s. 11 of the CCAA provide as follows:

| | |
|---|---|
| Powers of court | 11(1) Notwithstanding anything in the Bankruptcy and Insolvency Act or the Winding-up Act, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section. |
| Initial application court orders | (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days.<br>(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);<br>(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and<br>(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company. |
| Other than initial application court orders | (4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose.<br>(a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);<br>(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and<br>(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company. |

Burden of proof on application

(6) The court shall not make an order under subsection (3) or (4) unless

(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
(b) in the case of an order under subsection (4), the applicant also satisfied the court that the applicant has acted, and is acting, in good faith and with due diligence.

**41** The rule of statutory interpretation that has now been accepted by the Supreme Court of Canada, in such cases as R. v. Sharpe, [2001] 1 S.C.R. 45, at para. 33, and Rizzo & Rizzo Shoes Ltd. (Re), [1998] 1 S.C.R. 27, at para. 21 is articulated in E.A. Driedger, The Construction of Statutes, 2nd ed. (Toronto: Butterworths, 1983) as follows:

> Today, there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See also Ruth Sullivan, Sullivan and Driedger on the Construction of Statutes, 4th ed. (Toronto: Butterworths, 2002) at page 262.

**42** The interpretation of s. 11 advanced above is true to these principles. It is consistent with the purpose and scheme of the CCAA, as articulated in para. 38 above, and with the fact that corporate governance matters are dealt with in other statutes. In addition, it honours the historical reluctance of courts to intervene in such matters, or to second-guess the business decisions made by directors and officers in the course of managing the business and affairs of the corporation.

**43** Mr. Leon and Mr. Swan argue that matters relating to the removal of directors do not fall within the court's discretion under s. 11 because they fall outside of the parameters of the court's role in the restructuring process, in contrast to the company's role in the restructuring process. The court's role is defined by the "on such terms as may be imposed" jurisdiction under subparagraphs 11(3)(a)-(c) and 11 (4)(a)-(c) of the CCAA to stay, or restrain, or prohibit proceedings against the company during the "breathing space" period for negotiations and a plan. I agree.

**44** What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in Lehndorff, supra, at para. 5, "to make order[s] so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors." But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance the company's restructuring efforts.

**45** With these principles in mind, I turn to an analysis of the various factors underlying the

interpretation of the s. 11 discretion.

**46** I start with the proposition that at common law directors could not be removed from office during the term for which they were elected or appointed: London Finance Corporation Limited v. Banking Service Corporation Limited (1923), 23 O.W.N. 138 (Ont. H.C.); Stephenson v. Vokes (1896), 27 O.R. 691 (Ont. H.C.). The authority to remove must therefore be found in statute law.

**47** In Canada, the CBCA and its provincial equivalents govern the election, appointment and removal of directors, as well as providing for their duties and responsibilities. Shareholders elect directors, but the directors may fill vacancies that occur on the board of directors pending a further shareholders meeting: CBCA, ss. 106(3) and 111.[4] The specific power to remove directors is vested in the shareholders by s. 109(1) of the CBCA. However, s. 241 empowers the court - where it finds that oppression as therein defined exists - to "make any interim or final order it thinks fit," including (s. 241 (3)(e)) "an order appointing directors in place of or in addition to all or any of the directors then in office." This power has been utilized to remove directors, but in very rare cases, and only in circumstances where there has been actual conduct rising to the level of misconduct required to trigger oppression remedy relief: see, for example, Catalyst Fund General Partner I Inc. v. Hollinger Inc., [2004] O.J. No. 4722.

**48** There is therefore a statutory scheme under the CBCA (and similar provincial corporate legislation) providing for the election, appointment, and removal of directors. Where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. There is no legislative "gap" to fill. See Baxter Student Housing Ltd. v. College Housing Cooperative Ltd., supra, at p. 480; Royal Oak Mines Inc. (Re), supra; and Richtree Inc. (Re), supra.

**49** At paragraph 7 of his reasons, the motion judge said:

> The board is charged with the standard duty of "manage[ing], [sic] or supervising the management, of the business and affairs of the corporation": s. 102(1) CBCA. *Ordinarily the Court will not interfere with the composition of the board of directors. However, if there is good and sufficient valid reason to do so, then the Court must not hesitate to do so to correct a problem.* The directors should not be required to constantly look over their shoulders for this would be the sure recipe for board paralysis which would be so detrimental to a restructuring process; thus interested parties should only initiate a motion where it is reasonably obvious that there is a problem, actual or poised to become actual. [emphasis added]

**50** Respectfully, I see no authority in s. 11 of the CCAA for the court to interfere with the composition of a board of directors on such a basis.

**51** Court removal of directors is an exceptional remedy, and one that is rarely exercised in corporate law. This reluctance is rooted in the historical unwillingness of courts to interfere with the internal management of corporate affairs and in the court's well-established deference to decisions made by directors and officers in the exercise of their business judgment when managing the business and affairs of the corporation. These factors also bolster the view that where the CCAA is silent on the issue, the court should not read into the s. 11 discretion an extraordinary power - which the courts are disinclined to exercise in any event - except to the extent that that power may be introduced through the application of other legislation, and on the same principles that apply to the application of the provisions of the other legislation.

The Oppression Remedy Gateway

**52** The fact that s. 11 does not itself provide the authority for a CCAA judge to order the removal of directors does not mean that the supervising judge is powerless to make such an order, however. Section 20 of the CCAA offers a gateway to the oppression remedy and other provisions of the CBCA and similar provincial statutes. Section 20 states:

> The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

**53** The CBCA is legislation that "makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them." Accordingly, the powers of a judge under s. 11 of the CCAA may be applied together with the provisions of the CBCA, including the oppression remedy provisions of that statute. I do not read s. 20 as limiting the application of outside legislation to the provisions of such legislation dealing specifically with the sanctioning of compromises and arrangements between the company and its shareholders. The grammatical structure of s. 20 mandates a broader interpretation and the oppression remedy is, therefore, available to a supervising judge in appropriate circumstances.

**54** I do not accept the respondents' argument that the motion judge had the authority to order the removal of the appellants by virtue of the power contained in s. 145(2)(b) of the CBCA to make an order "declaring the result of the disputed election or appointment" of directors. In my view, s. 145 relates to the procedures underlying disputed elections or appointments, and not to disputes over the composition of the board of directors itself. Here, it is conceded that the appointment of Messrs. Woollcombe and Keiper as directors complied with all relevant statutory requirements. Farley J. quite properly did not seek to base his jurisdiction on any such authority.

The Level of Conduct Required

**55** Colin Campbell J. recently invoked the oppression remedy to remove directors, without appointing anyone in their place, in Catalyst Fund General Partner I Inc. v. Hollinger Inc., supra. The bar is high. In reviewing the applicable law, C. Campbell J. said (para. 68):

> Director removal is *an extraordinary remedy* and certainly should be *imposed most sparingly*. As a starting point, I accept the basic proposition set out in Peterson, "Shareholder Remedies in Canada"[5]:
>
> > SS. 18.172 *Removing and appointing directors to the board is an extreme form of judicial intervention.* The board of directors is elected by the shareholders, vested with the power to manage the corporation, and appoints the officers of the company who undertake to conduct the day-to-day affairs of the corporation. [Footnote omitted.] It is clear that the board of directors has control over policymaking and management of the corporation. *By tampering with a board, a court directly affects the management of the corporation.* If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of directors should be *a measure of last resort*. The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or

> directors would remedy the oppressive conduct without a receiver or receiver-manager. [emphasis added]

**56** C. Campbell J. found that the continued involvement of the Ravelston directors in the Hollinger situation would "significantly impede" the interests of the public shareholders and that those directors were "motivated by putting their interests first, not those of the company" (paras. 82-83). The evidence in this case is far from reaching any such benchmark, however, and the record would not support a finding of oppression, even if one had been sought.

**57** Everyone accepts that there is no evidence the appellants have conducted themselves, as directors - in which capacity they participated over two days in the bid consideration exercise - in anything but a neutral fashion, having regard to the best interests of Stelco and all of the stakeholders. The motion judge acknowledged that the appellants "may well conduct themselves beyond reproach." However, he simply decided there was a risk - a reasonable apprehension - that Messrs. Woollcombe and Keiper would not live up to their obligations to be neutral in the future.

**58** The risk or apprehension appears to have been founded essentially on three things: (1) the earlier public statements made by Mr. Keiper about "maximizing shareholder value"; (2) the conduct of Clearwater and Equilibrium in criticizing and opposing the Stalking Horse Bid; and (3) the motion judge's opinion that Clearwater and Equilibrium - the shareholders represented by the appellants on the Board - had a "vision" that "usually does not encompass any significant concern for the long-term competitiveness and viability of an emerging corporation," as a result of which the appellants would approach their directors' duties looking to liquidate their shares on the basis of a "short-term hold" rather than with the best interests of Stelco in mind. The motion judge transposed these concerns into anticipated predisposed conduct on the part of the appellants as directors, despite their apparent understanding of their duties as directors and their assurances that they would act in the best interests of Stelco. He therefore concluded that "the risk to the process and to Stelco in its emergence [was] simply too great to risk the wait and see approach."

**59** Directors have obligations under s. 122(1) of the CBCA (a) to act honestly and in good faith with a view to the best interest of the corporation (the "statutory fiduciary duty" obligation), and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (the "duty of care" obligation). They are also subject to control under the oppression remedy provisions of s. 241. The general nature of these duties does not change when the company approaches, or finds itself in, insolvency: Peoples Department Stores Inc (Trustee of). v. Wise, [2004] S.C.J. No. 64 (S.C.C.) at paras. 42-49.

**60** In Peoples the Supreme Court noted that "the interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders" (para. 43), but also accepted "as an accurate statement of the law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (para. 42). Importantly as well - in the context of "the shifting interest and incentives of shareholders and creditors" - the court stated (para. 47):

> In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.

**61** In determining whether directors have fallen foul of those obligations, however, more than some

risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. Although the motion judge concluded that there was a risk of harm to the Stelco process if Messrs Woollcombe and Keiper remained as directors, he did not assess the level of that risk. The record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression. The motion judge was not asked to make such a finding, and he did not do so.

**62** The respondents argue that this court should not interfere with the decision of the motion judge on grounds of deference. They point out that the motion judge has been case-managing the restructuring of Stelco under the CCAA for over fourteen months and is intimately familiar with the circumstances of Stelco as it seeks to restructure itself and emerge from court protection.

**63** There is no question that the decisions of judges acting in a supervisory role under the CCAA, and particularly those of experienced commercial list judges, are entitled to great deference: see Algoma Steel Inc. v. Union Gas Limited (2003), 63 O.R. (3d) 78 (C.A.), at para. 16. The discretion must be exercised judicially and in accordance with the principles governing its operation. Here, respectfully, the motion judge misconstrued his authority, and made an order that he was not empowered to make in the circumstances.

**64** The appellants argued that the motion judge made a number of findings without any evidence to support them. Given my decision with respect to jurisdiction, it is not necessary for me to address that issue.

The Business Judgment Rule

**65** The appellants argue as well that the motion judge erred in failing to defer to the unanimous decision of the Stelco directors in deciding to appoint them to the Stelco Board. It is well-established that judges supervising restructuring proceedings - and courts in general - will be very hesitant to second-guess the business decisions of directors and management. As the Supreme Court of Canada said in Peoples, supra, at para. 67:

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making ...

**66** In Brant Investments Ltd. v. KeepRite Inc. (1991), 3 O.R. (3d) 289 (C.A.) at 320, this court adopted the following statement by the trial judge, Anderson J.:

> Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority.[6]

**67** McKinlay J.A then went on to say:

> There can be no doubt that on an application under s. 234[7] the trial judge is required to consider the nature of the impugned acts and the method in which they were carried out. That does not meant that the trial judge should substitute his own business judgment for that of managers, directors, or a committee such as the one involved in assessing this transaction. Indeed, it would generally be impossible for him to do so, regardless of the amount of evidence before him. He is dealing with the matter at a different time and place; it is unlikely that he will have the background knowledge and expertise of the individuals involved; he could have little or no

> knowledge of the background and skills of the persons who would be carrying out any proposed plan; and it is unlikely that he would have any knowledge of the specialized market in which the corporation operated. In short, he does not know enough to make the business decision required.

**68** Although a judge supervising a CCAA proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. See also Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., supra, Sammi Atlas Inc. (Re) (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div.); Olympia & York Developments Ltd. (Re), supra; Re Alberta Pacific Terminals Ltd. (1991), 8 C.B.R. (3d) 99 (B.C.S.C.). The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.

**69** Here, the motion judge was alive to the "business judgment" dimension in the situation he faced. He distinguished the application of the rule from the circumstances, however, stating at para. 18 of his reasons:

> With respect I do not see the present situation as involving the "management of the business and affairs of the corporation," but rather as a quasi-constitutional aspect of the corporation entrusted albeit to the Board pursuant to s. 111(1) of the CBCA. I agree that where a board is actually engaged in the business of a judgment situation, the board should be given appropriate deference. However, to the contrary in this situation, I do not see it as a situation calling for (as asserted) more deference, but rather considerably less than that. With regard to this decision of the Board having impact upon the capital raising process, as I conclude it would, then similarly deference ought not to be given.

**70** I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (CBCA, s. 102) - which describes the directors' overall responsibilities - and their role with respect to a "quasi-constitutional aspect of the corporation" (i.e. in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 1 of the CBCA as meaning "the relationships among a corporation, it affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate." Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business and affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

**71** This is not to say that the conduct of the Board in appointing the appellants as directors may never come under review by the supervising judge. The court must ultimately approve and sanction the plan of compromise or arrangement as finally negotiated and accepted by the company and its creditors and stakeholders. The plan must be found to be fair and reasonable before it can be sanctioned. If the Board's decision to appoint the appellants has somehow so tainted the capital raising process that those criteria are not met, any eventual plan that is put forward will fail.

**72** The respondents submit that it makes no sense for the court to have jurisdiction to declare the process flawed only after the process has run its course. Such an approach to the restructuring process would be inefficient and a waste of resources. While there is some merit in this argument, the court

cannot grant itself jurisdiction where it does not exist. Moreover, there are a plethora of checks and balances in the negotiating process itself that moderate the risk of the process becoming irretrievably tainted in this fashion - not the least of which is the restraining effect of the prospect of such a consequence. I do not think that this argument can prevail. In addition, the court at all times retains its broad and flexible supervisory jurisdiction - a jurisdiction which feeds the creativity that makes the CCAA work so well - in order to address fairness and process concerns along the way. This case relates only to the court's exceptional power to order the removal of directors.

The Reasonable Apprehension of Bias Analogy

**73** In exercising what he saw as his discretion to remove the appellants as directors, the motion judge thought it would be useful to "borrow the concept of reasonable apprehension of bias ... with suitable adjustments for the nature of the decision making involved" (para. 8). He stressed that "there was absolutely no allegation against [Mr. Woollcombe and Mr. Keiper] of any actual 'bias' or its equivalent" (para. 8). He acknowledged that neither was alleged to have done anything wrong since their appointments as directors, and that at the time of their appointments the appellants had confirmed to the Board that they understood and would abide by their duties and responsibilities as directors, including the responsibility to act in the best interests of the corporation and not in their own interests as shareholders. In the end, however, he concluded that because of their prior public statements that they intended to "pursue efforts to maximize shareholder value at Stelco," and because of the nature of their business and the way in which they had been accumulating their shareholding position during the restructuring, and because of their linkage to 40% of the common shareholders, there was a risk that the appellants would not conduct themselves in a neutral fashion in the best interests of the corporation as directors.

**74** In my view, the administrative law notion of apprehension of bias is foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general. Apprehension of bias is a concept that ordinarily applies to those who preside over judicial or quasi-judicial decision-making bodies, such as courts, administrative tribunals or arbitration boards. Its application is inapposite in the business decision-making context of corporate law. There is nothing in the CBCA or other corporate legislation that envisages the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment.

**75** Instead, the conduct of directors is governed by their common law and statutory obligations 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 (CBCA, s. 122(1)(a) and (b)). The directors also have fiduciary obligations to the corporation, and they are liable to oppression remedy proceedings in appropriate circumstances. These remedies are available to aggrieved complainants - including the respondents in this case - but they depend for their applicability on the director having engaged in conduct justifying the imposition of a remedy.

**76** If the respondents are correct, and reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders is sufficient for removal, all nominee directors in Canadian corporations, and all management directors, would automatically be disqualified from serving. No one suggests this should be the case. Moreover, as Iacobucci J. noted in Blair v. Consolidated Enfield Corp., [1995] 4 S.C.R. 5 (S.C.C.) at para. 35, "persons are assumed to act in good faith unless proven otherwise." With respect, the motion judge approached the circumstances before him from exactly the opposite direction. It is commonplace in corporate/commercial affairs that there are connections between directors and various stakeholders and that conflicts will exist from time to time. Even where there are conflicts of interest, however, directors are not removed from the board of directors; they are simply obliged to disclose the conflict and, in

appropriate cases, to abstain from voting. The issue to be determined is not whether there is a connection between a director and other shareholders or stakeholders, but rather whether there has been some conduct on the part of the director that will justify the imposition of a corrective sanction. An apprehension of bias approach does not fit this sort of analysis.

PART V - DISPOSITION

**77** For the foregoing reasons, then, I am satisfied that the motion judge erred in declaring the appointment of Messrs. Woollcombe and Keiper as directors of Stelco of no force and effect.

**78** I would grant leave to appeal, allow the appeal and set aside the order of Farley J. dated February 25, 2005.

**79** Counsel have agreed that there shall be no costs of the appeal.

R.A. BLAIR J.A.
S.T. GOUDGE J.A. - I agree.
K.N. FELDMAN J.A. - I agree.

cp/ln/e/qljxh/qlkjg/qlgxc/qlmlt

1 R.S.C. 1985, c. C-36, as amended.

2 The reference is to the decisions in Dyle, Royal Oak Mines, and Westar, cited above.

3 See paragraph 43, infra, where I elaborate on this distinction.

4 It is the latter authority that the directors of Stelco exercised when appointing the appellants to the Stelco Board.

5 Dennis H. Peterson, Shareholder Remedies in Canada (Markham: LexisNexis ' Butterworths ' Looseleaf Service, 1989) at 18-47.

6 Or, I would add, unpopular with other stakeholders.

7 Now s. 241.

# Royal Bank of Canada v. Soundair Corp., Canadian Pension Capital Ltd. and Canadian Insurers Capital Corp. Indexed as: Royal Bank of Canada v. Soundair Corp. (C.A.)

**4 O.R. (3d) 1**

[1991] O.J. No. 1137

Action No. 318/91

ONTARIO
Court of Appeal for Ontario

**Goodman, McKinlay and Galligan JJ.A.**

July 3, 1991

*Debtor and creditor -- Receivers -- Court-appointed receiver accepting offer to purchase assets against wishes of secured creditors -- Receiver acting properly and prudently -- Wishes of creditors not determinative -- Court approval of sale confirmed on appeal.*

Air Toronto was a division of Soundair. In April 1990, one of Soundair's creditors, the Royal Bank, appointed a receiver to operate Air Toronto and sell it as a going concern. The receiver was authorized to sell Air Toronto to Air Canada, or, if that sale could not be completed, to negotiate and sell Air Toronto to another person. Air Canada made an offer which the receiver rejected. The receiver then entered into negotiations with Canadian Airlines International (Canadian); two subsidiaries of Canadian, Ontario Express Ltd. and Frontier Airlines Ltd., made an offer to purchase on March 6, 1991 (the OEL offer). Air Canada and a creditor of Soundair, CCFL, presented an offer to purchase to the receiver on March 7, 1991 through 922, a company formed for that purpose (the 922 offer). The receiver declined the 922 offer because it contained an unacceptable condition and accepted the OEL offer. 922 made a second offer, which was virtually identical to the first one except that the unacceptable condition had been removed. In proceedings before Rosenberg J., an order was made approving the sale of Air Toronto to OEL and dismissing the 922 offer. CCFL appealed.

Held, the appeal should be dismissed.

Per Galligan J.A.: When deciding whether a receiver has acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer, and should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. The decision to sell to OEL was a sound one in the circumstances faced by the receiver on March 8, 1991. Prices in other offers received after the receiver has agreed to a sale have relevance only if they show that the price contained in the accepted offer was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. If they do not do so, they should not be considered upon a motion to confirm a sale recommended by a

court-appointed receiver. If the 922 offer was better than the OEL offer, it was only marginally better and did not lead to an inference that the disposition strategy of the receiver was improvident.

While the primary concern of a receiver is the protecting of the interests of creditors, a secondary but important consideration is the integrity of the process by which the sale is effected. The court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

The failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto did not result in the process being unfair, as there was no proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL.

The fact that the 922 offer was supported by Soundair's secured creditors did not mean that the court should have given effect to their wishes. Creditors who asked the court to appoint a receiver to dispose of assets (and therefore insulated themselves from the risks of acting privately) should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale by the receiver. If the court decides that a court-appointed receiver has acted providently and properly (as the receiver did in this case), the views of creditors should not be determinative.

Per McKinlay J.A. (concurring in the result): While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the assets involved, it was not a procedure which was likely to be appropriate in many receivership sales.

Per Goodman J.A. (dissenting): The fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. The creditors in this case were convinced that acceptance of the 922 offer was in their best interest and the evidence supported that belief. Although the receiver acted in good faith, the process which it used was unfair insofar as 922 was concerned and improvident insofar as the secured creditors were concerned.

Cases referred to

Beauty Counsellors of Canada Ltd. (Re) (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.); British Columbia Development Corp. v. Spun Cast Industries Inc. (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.); Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.); Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 67 C.B.R. (N.S.) 320 (note), 39 D.L.R. (4th) 526 (H.C.J.); Salima Investments Ltd. v. Bank of Montreal (1985), 41 Alta. L.R. (2d) 58, 65 A.R. 372, 59 C.B.R. (N.S.) 242, 21 D.L.R. (4th) 473 (C.A.); Selkirk (Re) (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.); Selkirk (Re) (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.)

Statutes referred to

Employment Standards Act, R.S.O. 1980, c. 137 Environmental Protection Act, R.S.O. 1980, c. 141

APPEAL from the judgment of the General Division, Rosenberg J., May 1, 1991, approving the sale of an airline by a receiver.

J.B. Berkow and Steven H. Goldman, for appellants.

John T. Morin, Q.C., for Air Canada.

L.A.J. Barnes and Lawrence E. Ritchie, for Royal Bank of Canada.

Sean F. Dunphy and G.K. Ketcheson for Ernst & Young Inc., receiver of Soundair Corp., respondent.

W.G. Horton, for Ontario Express Ltd.

Nancy J. Spies, for Frontier Air Ltd.

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**GALLIGAN J.A.**:-- This is an appeal from the order of Rosenberg J. made on May 1, 1991 (Gen. Div.). By that order, he approved the sale of Air Toronto to Ontario Express Limited and Frontier Air Limited and he dismissed a motion to approve an offer to purchase Air Toronto by 922246 Ontario Limited.

It is necessary at the outset to give some background to the dispute. Soundair Corporation (Soundair) is a corporation engaged in the air transport business. It has three divisions. One of them is Air Toronto. Air Toronto operates a scheduled airline from Toronto to a number of mid-sized cities in the United States of America. Its routes serve as feeders to several of Air Canada's routes. Pursuant to a connector agreement, Air Canada provides some services to Air Toronto and benefits from the feeder traffic provided by it. The operational relationship between Air Canada and Air Toronto is a close one.

In the latter part of 1989 and the early part of 1990, Soundair was in financial difficulty. Soundair has two secured creditors who have an interest in the assets of Air Toronto. The Royal Bank of Canada (the Royal Bank) is owed at least $65,000,000. The appellants Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively called CCFL) are owed approximately $9,500,000. Those creditors will have a deficiency expected to be in excess of $50,000,000 on the winding-up of Soundair.

On April 26, 1990, upon the motion of the Royal Bank, O'Brien J. appointed Ernst & Young Inc. (the receiver) as receiver of all of the assets, property and undertakings of Soundair. The order required the receiver to operate Air Toronto and sell it as a going concern. Because of the close relationship between Air Toronto and Air Canada, it was contemplated that the receiver would obtain the assistance of Air Canada to operate Air Toronto. The order authorized the receiver:

> (b) to enter into contractual arrangements with Air Canada to retain a manager or operator, including Air Canada, to manage and operate Air Toronto under the supervision of Ernst & Young Inc. until the completion of the sale of Air Toronto to Air Canada or other person ...

Also because of the close relationship, it was expected that Air Canada would purchase Air Toronto. To that end, the order of O'Brien J. authorized the receiver:

> (c) to negotiate and do all things necessary or desirable to complete a sale of Air Toronto to Air Canada and, if a sale to Air Canada cannot be completed, to negotiate and sell Air Toronto to another person, subject to terms and conditions approved by this Court.

Over a period of several weeks following that order, negotiations directed towards the sale of Air Toronto took place between the receiver and Air Canada. Air Canada had an agreement with the receiver that it would have exclusive negotiating rights during that period. I do not think it is necessary to review those negotiations, but I note that Air Canada had complete access to all of the operations of Air Toronto and conducted due diligence examinations. It became thoroughly acquainted with every aspect of Air Toronto's operations.

Those negotiations came to an end when an offer made by Air Canada on June 19, 1990, was considered unsatisfactory by the receiver. The offer was not accepted and lapsed. Having regard to the tenor of Air Canada's negotiating stance and a letter sent by its solicitors on July 20, 1990, I think that the receiver was eminently reasonable when it decided that there was no realistic possibility of selling Air Toronto to Air Canada.

The receiver then looked elsewhere. Air Toronto's feeder business is very attractive, but it only has value to a national airline. The receiver concluded reasonably, therefore, that it was commercially necessary for one of Canada's two national airlines to be involved in any sale of Air Toronto. Realistically, there were only two possible purchasers whether direct or indirect. They were Air Canada and Canadian Airlines International.

It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1991. On March 6, 1991, the receiver received an offer from Ontario Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

In the meantime, Air Canada and CCFL were having discussions about making an offer for the purchase of Air Toronto. They formed 922246 Ontario Limited (922) for the purpose of purchasing Air Toronto. On March 1, 1991, CCFL wrote to the receiver saying that it proposed to make an offer. On March 7, 1991, Air Canada and CCFL presented an offer to the receiver in the name of 922. For convenience, its offers are called the 922 offers.

The first 922 offer contained a condition which was unacceptable to the receiver. I will refer to that condition in more detail later. The receiver declined the 922 offer and on March 8, 1991, accepted the OEL offer. Subsequently, 922 obtained an order allowing it to make a second offer. It then submitted an offer which was virtually identical to that of March 7, 1991, except that the unacceptable condition had been removed.

The proceedings before Rosenberg J. then followed. He approved the sale to OEL and dismissed a motion for the acceptance of the 922 offer. Before Rosenberg J., and in this court, both CCFL and the Royal Bank supported the acceptance of the second 922 offer.

There are only two issues which must be resolved in this appeal. They are:

(1) Did the receiver act properly when it entered into an agreement to sell Air Toronto to OEL?

(2) What effect does the support of the 922 offer by the secured creditors have on the result?

I will deal with the two issues separately.

## I. DID THE RECEIVER ACT PROPERLY IN AGREEING TO SELL TO OEL?

Before dealing with that issue there are three general observations which I think I should make. The first is that the sale of an airline as a going concern is a very complex process. The best method of selling an airline at the best price is something far removed from the expertise of a court. When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. Therefore, the court must place a great deal of confidence in the actions taken and in the opinions formed by the receiver. It should also assume that the receiver is acting properly unless the contrary is clearly shown. The second observation is that the court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The third observation which I wish to make is that the conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court.

The order of O'Brien J. provided that if the receiver could not complete the sale to Air Canada that it was "to negotiate and sell Air Toronto to another person". The court did not say how the receiver was to negotiate the sale. It did not say it was to call for bids or conduct an auction. It told the receiver to negotiate and sell. It obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially in the discretion of the receiver. I think, therefore, that the court should not review minutely the process of the sale when, broadly speaking, it appears to the court to be a just process.

As did Rosenberg J., I adopt as correct the statement made by Anderson J. in Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.), at pp. 92-94 O.R., pp. 531-33 D.L.R., of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.

2. It should consider the interests of all parties.

3. It should consider the efficacy and integrity of the process by which offers are obtained.

4. It should consider whether there has been unfairness in the working out of the process.

I intend to discuss the performance of those duties separately.

1. Did the receiver make a sufficient effort to get the best price and did it act providently?

Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

When the receiver got the OEL offer on March 6, 1991, it was over ten months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

On March 8, 1991, the date when the receiver accepted the OEL offer, it had only two offers, the OEL offer which was acceptable, and the 922 offer which contained an unacceptable condition. I cannot see how the receiver, assuming for the moment that the price was reasonable, could have done anything but accept the OEL offer.

When deciding whether a receiver had acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer. In this case, the court should look at the receiver's conduct in the light of the information it had when it made its decision on March 8, 1991. The court should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. To do so, in my view, would derogate from the mandate to sell given to the receiver by the order of O'Brien J. I agree with and adopt what was said by Anderson J. in Crown Trust v. Rosenberg, supra, at p. 112 O.R., p. 551 D.L.R.:

> Its decision was made as a matter of business judgment on the elements then available to it. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.
>
> If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

(Emphasis added)

I also agree with and adopt what was said by Macdonald J.A. in Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), at p. 11 C.B.R., p. 314 N.S.R.:

> In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement.

(Emphasis added)

On March 8, 1991, the receiver had two offers. One was the OEL offer which it considered satisfactory but which could be withdrawn by OEL at any time before it was accepted. The receiver also had the 922 offer which contained a condition that was totally unacceptable. It had no other offers. It was faced with the dilemma of whether it should decline to accept the OEL offer and run the risk of it being withdrawn, in the hope that an acceptable offer would be forthcoming from 922. An affidavit filed by the president of the receiver describes the dilemma which the receiver faced, and the judgment made

in the light of that dilemma:

> 24. An asset purchase agreement was received by Ernst & Young on March 7, 1991 which was dated March 6, 1991. This agreement was received from CCFL in respect of their offer to purchase the assets and undertaking of Air Toronto. Apart from financial considerations, which will be considered in a subsequent affidavit, the Receiver determined that it would not be prudent to delay acceptance of the OEL agreement to negotiate a highly uncertain arrangement with Air Canada and CCFL. Air Canada had the benefit of an "exclusive" in negotiations for Air Toronto and had clearly indicated its intention to take itself out of the running while ensuring that no other party could seek to purchase Air Toronto and maintain the Air Canada connector arrangement vital to its survival. The CCFL offer represented a radical reversal of this position by Air Canada at the eleventh hour. However, it contained a significant number of conditions to closing which were entirely beyond the control of the Receiver. As well, the CCFL offer came less than 24 hours before signing of the agreement with OEL which had been negotiated over a period of months, at great time and expense.

(Emphasis added)
I am convinced that the decision made was a sound one in the circumstances faced by the receiver on March 8, 1991.

I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after ten months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer. Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

It is my opinion that the price contained in the 922 offer is relevant only if it shows that the price obtained by the Receiver in the OEL offer was not a reasonable one. In Crown Trust v. Rosenberg, supra, Anderson J., at p. 113 O.R., p. 551 D.L.R., discussed the comparison of offers in the following way:

> No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

In two judgments, Saunders J. considered the circumstances in which an offer submitted after the receiver had agreed to a sale should be considered by the court. The first is Re Selkirk (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.), at p. 247:

> If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property.

The second is Re Beauty Counsellors of Canada Ltd. (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.), at p. 243:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate.

In Re Selkirk (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.), at p. 142, McRae J. expressed a similar view:

> The court will not lightly withhold approval of a sale by the receiver, particularly in a case such as this where the receiver is given rather wide discretionary authority as per the order of Mr. Justice Trainor and, of course, where the receiver is an officer of this court. Only in a case where there seems to be some unfairness in the process of the sale or where there are substantially higher offers which would tend to show that the sale was improvident will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

(Emphasis added)

What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered bona fide into an agreement with the receiver, can only lead to chaos, and must be discouraged.

If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.

It is necessary to consider the two offers. Rosenberg J. held that the 922 offer was slightly better or marginally better than the OEL offer. He concluded that the difference in the two offers did not show that the sale process adopted by the receiver was inadequate or improvident.

Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was, that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a significantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed

from arguing that the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

The 922 offer provided for $6,000,000 cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of five years up to a maximum of $3,000,000. The OEL offer provided for a payment of $2,000,000 on closing with a royalty paid on gross revenues over a five-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

The receiver studied the two offers. It compared them and took into account the risks, the advantages and the disadvantages of each. It considered the appropriate contingencies. It is not necessary to outline the factors which were taken into account by the receiver because the manager of its insolvency practice filed an affidavit outlining the considerations which were weighed in its evaluation of the two offers. They seem to me to be reasonable ones. That affidavit concluded with the following paragraph:

> 24. On the basis of these considerations the Receiver has approved the OEL offer and has concluded that it represents the achievement of the highest possible value at this time for the Air Toronto division of SoundAir.

The court appointed the receiver to conduct the sale of Air Toronto and entrusted it with the responsibility of deciding what is the best offer. I put great weight upon the opinion of the receiver. It swore to the court which appointed it that the OEL offer represents the achievement of the highest possible value at this time for Air Toronto. I have not been convinced that the receiver was wrong when he made that assessment. I am, therefore, of the opinion that the 922 offer does not demonstrate any failure upon the part of the receiver to act properly and providently.

It follows that if Rosenberg J. was correct when he found that the 922 offer was in fact better, I agree with him that it could only have been slightly or marginally better. The 922 offer does not lead to an inference that the disposition strategy of the receiver was inadequate, unsuccessful or improvident, nor that the price was unreasonable.

I am, therefore, of the opinion that the receiver made a sufficient effort to get the best price and has not acted improvidently.

2. Consideration of the interests of all parties

It is well established that the primary interest is that of the creditors of the debtor: see Crown Trust Co. v. Rosenberg, supra, and Re Selkirk (1986, Saunders J.), supra. However, as Saunders J. pointed out in Re Beauty Counsellors, supra, at p. 244 C.B.R., "it is not the only or overriding consideration".

In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser ought to be taken into account. While it is not explicitly stated in such cases as Crown Trust Co. v. Rosenberg, supra, Re Selkirk (1986, Saunders J.), supra, Re Beauty Counsellors, supra, Re Selkirk (1987, McRae J.), supra, and Cameron, supra, I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

In this case, the interests of all parties who would have an interest in the process were considered by the receiver and by Rosenberg J.

3. Consideration of the efficacy and integrity of the process by which the offer was obtained

While it is accepted that the primary concern of a receiver is the protecting of the interests of the creditors, there is a secondary but very important consideration and that is the integrity of the process by which the sale is effected. This is particularly so in the case of a sale of such a unique asset as an airline as a going concern.

The importance of a court protecting the integrity of the process has been stated in a number of cases. First, I refer to Re Selkirk (1986), supra, where Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in Cameron v. Bank of N.S. (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:
>
> > In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a finding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard -- this would be an intolerable situation.
>
> While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

In Salima Investments Ltd. v. Bank of Montreal (1985), 41 Alta. L.R. (2d) 58, 21 D.L.R. (4th) 473 (C.A.), at p. 61 Alta. L.R., p. 476 D.L.R., the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

Finally, I refer to the reasoning of Anderson J. in Crown Trust Co. v. Rosenberg, supra, at p. 124 O.R., pp. 562-63 D.L.R.:

> While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. Certainly it is not to be found in loosening the entire foundation of the system. Thus to compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither

logical nor practical.

(Emphasis added)

It is my opinion that the court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

Before this court, counsel for those opposing the confirmation of the sale to OEL suggested many different ways in which the receiver could have conducted the process other than the way which he did. However, the evidence does not convince me that the receiver used an improper method of attempting to sell the airline. The answer to those submissions is found in the comment of Anderson J. in Crown Trust Co. v. Rosenberg, supra, at p. 109 O.R., p. 548 D.L.R.:

> The court ought not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

It would be a futile and duplicitous exercise for this court to examine in minute detail all of the circumstances leading up to the acceptance of the OEL offer. Having considered the process adopted by the receiver, it is my opinion that the process adopted was a reasonable and prudent one.

4. Was there unfairness in the process?

As a general rule, I do not think it appropriate for the court to go into the minutia of the process or of the selling strategy adopted by the receiver. However, the court has a responsibility to decide whether the process was fair. The only part of this process which I could find that might give even a superficial impression of unfairness is the failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto.

I will outline the circumstances which relate to the allegation that the receiver was unfair in failing to provide an offering memorandum. In the latter part of 1990, as part of its selling strategy, the receiver was in the process of preparing an offering memorandum to give to persons who expressed an interest in the purchase of Air Toronto. The offering memorandum got as far as draft form, but was never released to anyone, although a copy of the draft eventually got into the hands of CCFL before it submitted the first 922 offer on March 7, 1991. A copy of the offering memorandum forms part of the record and it seems to me to be little more than puffery, without any hard information which a sophisticated purchaser would require in order to make a serious bid.

The offering memorandum had not been completed by February 11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

The receiver did not proceed with the offering memorandum because to do so would violate the spirit, if not the letter, of its letter of intent with OEL.

I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I do so in the context that Air Canada and CCFL are identified with it. I start by saying that the receiver acted reasonably when it entered into exclusive negotiations with OEL. I find it strange that a company, with which Air Canada is closely and intimately involved, would say that it was unfair for the

receiver to enter into a time-limited agreement to negotiate exclusively with OEL. That is precisely the arrangement which Air Canada insisted upon when it negotiated with the receiver in the spring and summer of 1990. If it was not unfair for Air Canada to have such an agreement, I do not understand why it was unfair for OEL to have a similar one. In fact, both Air Canada and OEL in its turn were acting reasonably when they required exclusive negotiating rights to prevent their negotiations from being used as a bargaining lever with other potential purchasers. The fact that Air Canada insisted upon an exclusive negotiating right while it was negotiating with the receiver demonstrates the commercial efficacy of OEL being given the same right during its negotiations with the receiver. I see no unfairness on the part of the receiver when it honoured its letter of intent with OEL by not releasing the offering memorandum during the negotiations with OEL.

Moreover, I am not prepared top find that 922 was in any way prejudiced by the fact that it did not have an offering memorandum. It made an offer on March 7, 1991, which it contends to this day was a better offer than that of OEL. 922 has not convinced me that if it had an offering memorandum its offer would have been any different or any better than it actually was. The fatal problem with the first 922 offer was that it contained a condition which was completely unacceptable to the receiver. The receiver properly, in my opinion, rejected the offer out of hand because of that condition. That condition did not relate to any information which could have conceivably been in an offering memorandum prepared by the receiver. It was about the resolution of a dispute between CCFL and the Royal Bank, something the receiver knew nothing about.

Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested, as a possible resolution of this appeal, that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within seven days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, it would have told the court that it needed more information before it would be able to make a bid.

I am satisfied that Air Canada and CCFL have, and at all times had, all of the information which they would have needed to make what to them would be a commercially viable offer to the receiver. I think that an offering memorandum was of no commercial consequence to them, but the absence of one has since become a valuable tactical weapon.

It is my opinion that there is no convincing proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL. Therefore, the failure to provide an offering memorandum was neither unfair nor did it prejudice the obtaining of a better price on March 8, 1991, than that contained in the OEL offer. I would not give effect to the contention that the process adopted by the receiver was an unfair one.

There are two statements by Anderson J. contained in Crown Trust Co. v. Rosenberg, supra, which I adopt as my own. The first is at p. 109 O.R., p. 548 D.L.R.:

> The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 O.R., p. 550 D.L.R.:

> It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in

> an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

In this case the receiver acted reasonably, prudently, fairly and not arbitrarily. I am of the opinion, therefore, that the process adopted by the receiver in reaching an agreement was a just one.

In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this [at p. 31 of the reasons]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

I agree.

The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale to OEL.

## II. THE EFFECT OF THE SUPPORT OF THE 922 OFFER BY THE TWO SECURED CREDITORS

As I noted earlier, the 922 offer was supported before Rosenberg J., and in this court, by CCFL and by the Royal Bank, the two secured creditors. It was argued that, because the interests of the creditors are primary, the court ought to give effect to their wish that the 922 offer be accepted. I would not accede to that suggestion for two reasons.

The first reason is related to the fact that the creditors chose to have a receiver appointed by the court. It was open to them to appoint a private receiver pursuant to the authority of their security documents. Had they done so, then they would have had control of the process and could have sold Air Toronto to whom they wished. However, acting privately and controlling the process involves some risks. The appointment of a receiver by the court insulates the creditors from those risks. But insulation from those risks carries with it the loss of control over the process of disposition of the assets. As I have attempted to explain in these reasons, when a receiver's sale is before the court for confirmation the only issues are the propriety of the conduct of the receiver and whether it acted providently. The function of the court at that stage is not to step in and do the receiver's work or change the sale strategy adopted by the receiver. Creditors who asked the court to appoint a receiver to dispose of assets should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale made by the receiver. That would take away all respect for the process of sale by a court-appointed receiver.

There can be no doubt that the interests of the creditor are an important consideration in determining whether the receiver has properly conducted a sale. The opinion of the creditors as to which offer ought to be accepted is something to be taken into account. But, if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

The second reason is that, in the particular circumstances of this case, I do not think the support of

CCFL and the Royal Bank of the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtors' assets.

The support by the Royal Bank requires more consideration and involves some reference to the circumstances. On March 6, 1991, when the first 922 offer was made, there was in existence an interlender agreement between the Royal Bank and CCFL. That agreement dealt with the share of the proceeds of the sale of Air Toronto which each creditor would receive. At the time, a dispute between the Royal Bank and CCFL about the interpretation of that agreement was pending in the courts. The unacceptable condition in the first 922 offer related to the settlement of the interlender dispute. The condition required that the dispute be resolved in a way which would substantially favour CCFL. It required that CCFL receive $3,375,000 of the $6,000,000 cash payment and the balance, including the royalties, if any, be paid to the Royal Bank. The Royal Bank did not agree with that split of the sale proceeds.

On April 5, 1991, the Royal Bank and CCFL agreed to settle the interlender dispute. The settlement was that if the 922 offer was accepted by the court, CCFL would receive only $1,000,000 and the Royal Bank would receive $5,000,000 plus any royalties which might be paid. It was only in consideration of that settlement that the Royal Bank agreed to support the 922 offer.

The Royal Bank's support of the 922 offer is so affected by the very substantial benefit which it wanted to obtain from the settlement of the interlender dispute that, in my opinion, its support is devoid of any objectivity. I think it has no weight.

While there may be circumstances where the unanimous support by the creditors of a particular offer could conceivably override the proper and provident conduct of a sale by a receiver, I do not think that this is such a case. This is a case where the receiver has acted properly and in a provident way. It would make a mockery out of the judicial process, under which a mandate was given to this receiver to sell this airline, if the support by these creditors of the 922 offer were permitted to carry the day. I give no weight to the support which they give to the 922 offer.

In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the Employment Standards Act, R.S.O. 1980, c. 137, and the Environmental Protection Act, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose to deal with those receivers should know that if those receivers act properly and providently their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements with court-appointed receivers, following a disposition procedure that is appropriate given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

The process is very important. It should be carefully protected so that the ability of court-appointed receivers to negotiate the best price possible is strengthened and supported. Because this receiver acted properly and providently in entering into the OEL agreement, I am of the opinion that Rosenberg J. was right when he approved the sale to OEL and dismissed the motion to approve the 922 offer.

I would, accordingly, dismiss the appeal. I would award the receiver, OEL and Frontier Airlines Limited their costs out of the Soundair estate, those of the receiver on a solicitor-and-client scale. I would make no order as to the costs of any of the other parties or interveners.

MCKINLAY J.A. (concurring in the result):-- I agree with Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.). While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

I should like to add that where there is a small number of creditors who are the only parties with a real interest in the proceeds of the sale (i.e., where it is clear that the highest price attainable would result in recovery so low that no other creditors, shareholders, guarantors, etc., could possibly benefit therefrom), the wishes of the interested creditors should be very seriously considered by the receiver. It is true, as Galligan J.A. points out, that in seeking the court appointment of a receiver, the moving parties also seek the protection of the court in carrying out the receiver's functions. However, it is also true that in utilizing the court process the moving parties have opened the whole process to detailed scrutiny by all involved, and have probably added significantly to their costs and consequent shortfall as a result of so doing. The adoption of the court process should in no way diminish the rights of any party, and most certainly not the rights of the only parties with a real interest. Where a receiver asks for court approval of a sale which is opposed by the only parties in interest, the court should scrutinize with great care the procedure followed by the receiver. I agree with Galligan J.A. that in this case that was done. I am satisfied that the rights of all parties were properly considered by the receiver, by the learned motions court judge, and by Galligan J.A.

GOODMAN J.A. (dissenting):-- I have had the opportunity of reading the reasons for judgment herein of Galligan and McKinlay JJ.A. Respectfully, I am unable to agree with their conclusion.

The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto two competing offers were placed before Rosenberg J. Those two offers were that of Frontier Airlines Ltd. and Ontario Express Limited (OEL) and that of 922246 Ontario Limited (922), a company incorporated for the purpose of acquiring Air Toronto. Its shares were owned equally by Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively CCFL) and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, viz., CCFL and the Royal Bank of Canada (the Bank). Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to nor am I aware of any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

In British Columbia Development Corp. v. Spun Cast Industries Inc. (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.), Berger J. said at p. 95 B.C.L.R., p. 30 C.B.R.:

> Here all of those with a financial stake in the plant have joined in seeking the court's approval of the sale to Fincas. This court does not having a roving commission to decide what is best for investors and businessmen when they have agreed among themselves what course of action they should follow. It is their money.

I agree with that statement. It is particularly apt to this case. The two secured creditors will suffer a shortfall of approximately $50,000,000. They have a tremendous interest in the sale of assets which

form part of their security. I agree with the finding of Rosenberg J., Gen. Div., May 1, 1991, that the offer of 922 is superior to that of OEL. He concluded that the 922 offer is marginally superior. If by that he meant that mathematically it was likely to provide slightly more in the way of proceeds it is difficult to take issue with that finding. If on the other hand he meant that having regard to all considerations it was only marginally superior, I cannot agree. He said in his reasons [pp. 17-18]:

> I have come to the conclusion that knowledgeable creditors such as the Royal Bank would prefer the 922 offer even if the other factors influencing their decision were not present. No matter what adjustments had to be made, the 922 offer results in more cash immediately. Creditors facing the type of loss the Royal Bank is taking in this case would not be anxious to rely on contingencies especially in the present circumstances surrounding the airline industry.

I agree with that statement completely. It is apparent that the difference between the two offers insofar as cash on closing is concerned amounts to approximately $3,000,000 to $4,000,000. The Bank submitted that it did not wish to gamble any further with respect to its investment and that the acceptance and court approval of the OEL offer, in effect, supplanted its position as a secured creditor with respect to the amount owing over and above the down payment and placed it in the position of a joint entrepreneur but one with no control. This results from the fact that the OEL offer did not provide for any security for any funds which might be forthcoming over and above the initial downpayment on closing.

In Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), Hart J.A., speaking for the majority of the court, said at p. 10 C.B.R., p. 312 N.S.R.:

> Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that the contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily available for the property the chambers judge was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

This statement is apposite to the circumstances of the case at bar. I hasten to add that in my opinion it is not only price which is to be considered in the exercise of the judge's discretion. It may very well be, as I believe to be so in this case, that the amount of cash is the most important element in determining which of the two offers is for the benefit and in the best interest of the creditors.

It is my view, and the statement of Hart J.A. is consistent therewith, that the fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. I agree completely with the views expressed by McKinlay J.A. in that regard in her reasons.

It is my further view that any negotiations which took place between the only two interested creditors in deciding to support the approval of the 922 offer were not relevant to the determination by the presiding judge of the issues involved in the motion for approval of either one of the two offers nor are they relevant in determining the outcome of this appeal. It is sufficient that the two creditors have

decided unanimously what is in their best interest and the appeal must be considered in the light of that decision. It so happens, however, that there is ample evidence to support their conclusion that the approval of the 922 offer is in their best interests.

I am satisfied that the interests of the creditors are the prime consideration for both the receiver and the court. In Re Beauty Counsellors of Canada Ltd. (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.) Saunders J. said at p. 243:

> This does not mean that a court should ignore a new and higher bid made after acceptance where there has been no unfairness in the process. The interests of the creditors, while not the only consideration, are the prime consideration.

I agree with that statement of the law. In Re Selkirk (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.) Saunders J. heard an application for court approval for the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interests of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with the commercial efficacy and integrity.

I am in agreement with that statement as a matter of general principle. Saunders J. further stated that he adopted the principles stated by Macdonald J.A. in Cameron, supra, at pp. 92-94 O.R., pp. 531-33 D.L.R., quoted by Galligan J.A. in his reasons. In Cameron, the remarks of Macdonald J.A. related to situations involving the calling of bids and fixing a time limit for the making of such bids. In those circumstances the process is so clear as a matter of commercial practice that an interference by the court in such process might have a deleterious effect on the efficacy of receivership proceedings in other cases. But Macdonald J.A. recognized that even in bid or tender cases where the offeror for whose bid approval is sought has complied with all requirements a court might not approve the agreement of purchase and sale entered into by the receiver. He said at pp. 11-12 C.B.R., p. 314 N.S.R.:

> There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic; or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method); or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner. Court approval must involve the delicate balancing of competing interests and not simply a consideration of the interests of the creditors.

The deficiency in the present case is so large that there has been no suggestion of a competing interest between the owner and the creditors.

I agree that the same reasoning may apply to a negotiation process leading to a private sale but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership proceedings. Each case must be decided on its own merits and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

It is important to note at the outset that Rosenberg J. made the following statement in his reasons [p. 15]:

> On March 8, 1991 the trustee accepted the OEL offer subject to court approval. The receiver at that time had no other offer before it that was in final form or could possibly be accepted. The receiver had at the time the knowledge that Air Canada with CCFL had not bargained in good faith and had not fulfilled the promise of its letter of March 1. The receiver was justified in assuming that Air Canada and CCFL's offer was a long way from being in an acceptable form and that Air Canada and CCFL's objective was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada.

In my opinion there was no evidence before him or before this court to indicate that Air Canada with CCFL had not bargained in good faith and that the receiver had knowledge of such lack of good faith. Indeed, on this appeal, counsel for the receiver stated that he was not alleging Air Canada and CCFL had not bargained in good faith. Air Canada had frankly stated at the time that it had made its offer to purchase which was eventually refused by the receiver that it would not become involved in an "auction" to purchase the undertaking of Air Canada and that, although it would fulfil its contractual obligations to provide connecting services to Air Toronto, it would do no more than it was legally required to do insofar as facilitating the purchase of Air Toronto by any other person. In so doing Air Canada may have been playing "hard ball" as its behaviour was characterized by some of the counsel for opposing parties. It was nevertheless merely openly asserting its legal position as it was entitled to do.

Furthermore there was no evidence before Rosenberg J. or this court that the receiver had assumed that Air Canada and CCFL's objective in making an offer was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada. Indeed, there was no evidence to support such an assumption in any event although it is clear that 922 and through it CCFL and Air Canada were endeavouring to present an offer to purchase which would be accepted and/or approved by the court in preference to the offer made by OEL.

To the extent that approval of the OEL agreement by Rosenberg J. was based on the alleged lack of good faith in bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

I would also point out that, rather than saying there was no other offer before it that was final in form, it would have been more accurate to have said that there was no unconditional offer before it.

In considering the material and evidence placed before the court I am satisfied that the receiver was at all times acting in good faith. I have reached the conclusion, however, that the process which he used was unfair insofar as 922 is concerned and improvident insofar as the two secured creditors are concerned.

Air Canada had been negotiating with Soundair Corporation for the purchase from it of Air Toronto for a considerable period of time prior to the appointment of a receiver by the court. It had given a letter of intent indicating a prospective sale price of $18,000,000. After the appointment of the receiver, by agreement dated April 30, 1990, Air Canada continued its negotiations for the purchase of Air Toronto with the receiver. Although this agreement contained a clause which provided that the receiver "shall not negotiate for the sale ... of Air Toronto with any person except Air Canada", it further provided that the receiver would not be in breach of that provision merely by receiving unsolicited offers for all or any of the assets of Air Toronto. In addition, the agreement, which had a term commencing on April 30, 1990,

could be terminated on the fifth business day following the delivery of a written notice of termination by one party to the other. I point out this provision merely to indicate that the exclusivity privilege extended by the Receiver to Air Canada was of short duration at the receiver's option.

As a result of due diligence investigations carried out by Air Canada during the month of April, May and June of 1990, Air Canada reduced its offer to 8.1 million dollars conditional upon there being $4,000,000 in tangible assets. The offer was made on June 14, 1990 and was open for acceptance until June 29, 1990.

By amending agreement dated June 19, 1990 the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement the receiver had put itself in the position of having a firm offer in hand with the right to negotiate and accept offers from other persons. Air Canada in these circumstances was in the subservient position. The receiver, in the exercise of its judgment and discretion, allowed the Air Canada offer to lapse. On July 20, 1990 Air Canada served a notice of termination of the April 30, 1990 agreement.

Apparently as a result of advice received from the receiver to the effect that the receiver intended to conduct an auction for the sale of the assets and business of the Air Toronto Division of Soundair Corporation, the solicitors for Air Canada advised the receiver by letter dated July 20, 1990 in part as follows:

> Air Canada has instructed us to advise you that it does not intend to submit a further offer in the auction process.

This statement together with other statements set forth in the letter was sufficient to indicate that Air Canada was not interested in purchasing Air Toronto in the process apparently contemplated by the receiver at that time. It did not form a proper foundation for the receiver to conclude that there was no realistic possibility of selling Air Toronto to Air Canada, either alone or in conjunction with some other person, in different circumstances. In June 1990 the receiver was of the opinion that the fair value of Air Toronto was between $10,000,000 and $12,000,000.

In August 1990 the receiver contacted a number of interested parties. A number of offers were received which were not deemed to be satisfactory. One such offer, received on August 20, 1990, came as a joint offer from OEL and Air Ontario (an Air Canada connector). It was for the sum of $3,000,000 for the good will relating to certain Air Toronto routes but did not include the purchase of any tangible assets or leasehold interests.

In December 1990 the receiver was approached by the management of Canadian Partner (operated by OEL) for the purpose of evaluating the benefits of an amalgamated Air Toronto/Air Partner operation. The negotiations continued from December of 1990 to February of 1991 culminating in the OEL agreement dated March 8, 1991.

On or before December, 1990, CCFL advised the receiver that it intended to make a bid for the Air Toronto assets. The receiver, in August of 1990, for the purpose of facilitating the sale of Air Toronto assets, commenced the preparation of an operating memorandum. He prepared no less than six draft operating memoranda with dates from October 1990 through March 1, 1991. None of these were distributed to any prospective bidder despite requests having been received therefor, with the exception of an early draft provided to CCFL without the receiver's knowledge.

During the period December 1990 to the end of January 1991, the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution.

He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

By late January CCFL had become aware that the receiver was negotiating with OEL for the sale of Air Toronto. In fact, on February 11, 1991, the receiver signed a letter of intent with OEL wherein it had specifically agreed not to negotiate with any other potential bidders or solicit any offers from others.

By letter dated February 25, 1991, the solicitors for CCFL made a written request to the Receiver for the offering memorandum. The receiver did not reply to the letter because he felt he was precluded from so doing by the provisions of the letter of intent dated February 11, 1991. Other prospective purchasers were also unsuccessful in obtaining the promised memorandum to assist them in preparing their bids. It should be noted that exclusivity provision of the letter of intent expired on February 20, 1991. This provision was extended on three occasions, viz., February 19, 22 and March 5, 1991. It is clear that from a legal standpoint the receiver, by refusing to extend the time, could have dealt with other prospective purchasers and specifically with 922.

It was not until March 1, 1991 that CCFL had obtained sufficient information to enable it to make a bid through 922. It succeeded in so doing through its own efforts through sources other than the receiver. By that time the receiver had already entered into the letter of intent with OEL. Notwithstanding the fact that the receiver knew since December of 1990 that CCFL wished to make a bid for the assets of Air Toronto (and there is no evidence to suggest that at any time such a bid would be in conjunction with Air Canada or that Air Canada was in any way connected with CCFL) it took no steps to provide CCFL with information necessary to enable it to make an intelligent bid and, indeed, suggested delaying the making of the bid until an offering memorandum had been prepared and provided. In the meantime by entering into the letter of intent with OEL it put itself in a position where it could not negotiate with CCFL or provide the information requested.

On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

By letter dated March 1, 1991 CCFL advised the receiver that it intended to submit a bid. It set forth the essential terms of the bid and stated that it would be subject to customary commercial provisions. On March 7, 1991 CCFL and Air Canada, jointly through 922, submitted an offer to purchase Air Toronto upon the terms set forth in the letter dated March 1, 1991. It included a provision that the offer was conditional upon the interpretation of an interlender agreement which set out the relative distribution of proceeds as between CCFL and the Royal Bank. It is common ground that it was a condition over which the receiver had no control and accordingly would not have been acceptable on that ground alone. The receiver did not, however, contact CCFL in order to negotiate or request the removal of the condition although it appears that its agreement with OEL not to negotiate with any person other than OEL expired on March 6, 1991.

The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately three months the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining:

> ... a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate

> this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period.

The purchaser was also given the right to waive the condition.

In effect the agreement was tantamount to a 45-day option to purchase excluding the right of any other person to purchase Air Toronto during that period of time and thereafter if the condition was fulfilled or waived. The agreement was, of course, stated to be subject to court approval.

In my opinion the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991 to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result no offer was sought from CCFL by the receiver prior to February 11, 1991 and thereafter it put itself in the position of being unable to negotiate with anyone other than OEL. The receiver, then, on March 8, 1991 chose to accept an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of three months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of three months notwithstanding the fact that it knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

In his reasons Rosenberg J. stated that as of March 1, CCFL and Air Canada had all the information that they needed and any allegations of unfairness in the negotiating process by the receiver had disappeared. He said [p. 31]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

If he meant by "acceptable in form" that it was acceptable to the receiver, then obviously OEL had the unfair advantage of its lengthy negotiations with the receiver to ascertain what kind of an offer would be acceptable to the receiver. If, on the other hand, he meant that the 922 offer was unacceptable in its form because it was conditional, it can hardly be said that the OEL offer was more acceptable in this regard as it contained a condition with respect to financing terms and conditions "acceptable to them".

It should be noted that on March 13, 1991 the representatives of 922 first met with the receiver to review its offer of March 7, 1991 and at the request of the receiver withdrew the inter-lender condition from its offer. On March 14, 1991 OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991 to submit a bid and on April 5,

1991, 922 submitted its offer with the interlender condition removed.

In my opinion the offer accepted by the receiver is improvident and unfair insofar as the two creditors are concerned. It is not improvident in the sense that the price offered by 922 greatly exceeded that offered by OEL. In the final analysis it may not be greater at all. The salient fact is that the cash down payment in the 922 offer constitutes approximately two-thirds of the contemplated sale price whereas the cash down payment in the OEL transaction constitutes approximately 20 to 25 per cent of the contemplated sale price. In terms of absolute dollars, the down payment in the 922 offer would likely exceed that provided for in the OEL agreement by approximately $3,000,000 to $4,000,000.

In Re Beauty Counsellors of Canada Ltd., supra, Saunders J. said at p. 243 C.B.R.:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate. In such a case the proper course might be to refuse approval and to ask the trustee to recommence the process.

I accept that statement as being an accurate statement of the law. I would add, however, as previously indicated, that in determining what is the best price for the estate the receiver or court should not limit its consideration to which offer provides for the greater sale price. The amount of down payment and the provision or lack thereof to secure payment of the balance of the purchase price over and above the down payment may be the most important factor to be considered and I am of the view that is so in the present case. It is clear that that was the view of the only creditors who can benefit from the sale of Air Toronto.

I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J. the stated preference of the two interested creditors was made quite clear. He found as a fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is reasonable to expect that a receiver would be no less knowledgeable in that regard and it is his primary duty to protect the interests of the creditors. In my view it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors who have already been seriously hurt more unnecessary contingencies.

Although in other circumstances it might be appropriate to ask the receiver to recommence the process, in my opinion, it would not be appropriate to do so in this case. The only two interested creditors support the acceptance of the 922 offer and the court should so order.

Although I would be prepared to dispose of the case on the grounds stated above, some comment should be addressed to the question of interference by the court with the process and procedure adopted by the receiver.

I am in agreement with the view expressed by McKinlay J.A. in her reasons that the undertaking being sold in this case was of a very special and unusual nature. As a result the procedure adopted by the receiver was somewhat unusual. At the outset, in accordance with the terms of the receiving order, it dealt solely with Air Canada. It then appears that the receiver contemplated a sale of the assets by way of auction and still later contemplated the preparation and distribution of an offering memorandum inviting bids. At some point, without advice to CCFL, it abandoned that idea and reverted to exclusive

negotiations with one interested party. This entire process is not one which is customary or widely accepted as a general practice in the commercial world. It was somewhat unique having regard to the circumstances of this case. In my opinion the refusal of the court to approve the offer accepted by the receiver would not reflect on the integrity of procedures followed by court-appointed receivers and is not the type of refusal which will have a tendency to undermine the future confidence of business persons in dealing with receivers.

Rosenberg J. stated that the Royal Bank was aware of the process used and tacitly approved it. He said it knew the terms of the letter of intent in February 1991 and made no comment. The Royal Bank did, however, indicate to the receiver that it was not satisfied with the contemplated price nor the amount of the down payment. It did not, however, tell the receiver to adopt a different process in endeavouring to sell the Air Toronto assets. It is not clear from the material filed that at the time it became aware of the letter of intent, it knew that CCFL was interested in purchasing Air Toronto.

I am further of the opinion that a prospective purchaser who has been given an opportunity to engage in exclusive negotiations with a receiver for relatively short periods of time which are extended from time to time by the receiver and who then makes a conditional offer, the condition of which is for his sole benefit and must be fulfilled to his satisfaction unless waived by him, and which he knows is to be subject to court approval, cannot legitimately claim to have been unfairly dealt with if the court refuses to approve the offer and approves a substantially better one.

In conclusion I feel that I must comment on the statement made by Galligan J.A. in his reasons to the effect that the suggestion made by counsel for 922 constitutes evidence of lack of prejudice resulting from the absence of an offering memorandum. It should be pointed out that the court invited counsel to indicate the manner in which the problem should be resolved in the event that the court concluded that the order approving the OEL offer should be set aside. There was no evidence before the court with respect to what additional information may have been acquired by CCFL since March 8, 1991 and no inquiry was made in that regard. Accordingly, I am of the view that no adverse inference should be drawn from the proposal made as a result of the court's invitation.

For the above reasons I would allow the appeal with one set of costs to CCFL-922, set aside the order of Rosenberg J., dismiss the receiver's motion with one set of costs to CCFL-922 and order that the assets of Air Toronto be sold to numbered corporation 922246 on the terms set forth in its offer with appropriate adjustments to provide for the delay in its execution. Costs awarded shall be payable out of the estate of Soundair Corporation. The costs incurred by the receiver in making the application and responding to the appeal shall be paid to him out of the assets of the estate of Soundair Corporation on a solicitor-and-client basis. I would make no order as to costs of any of the other parties or interveners.

Appeal dismissed.

*Case Name:*
**Nortel Networks Corp. (Re)**

**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 Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, Applicants
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended**

[2009] **O.J. No. 3169**

55 C.B.R. (5th) 229

2009 CarswellOnt 4467

Court File No. 09-CL-7950

Ontario Superior Court of Justice
Commercial List

**G.B. Morawetz J.**

Heard: June 29, 2009.
Judgment: June 29, 2009.
Released: July 23, 2009.

(59 paras.)

*Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Application of Act -- Debtor company -- Motion by applicants for approval of bidding procedure and Sale Agreement allowed -- Applicants had been granted CCAA protection and were involved in insolvency procedures in four other countries -- Bidding procedures set deadline for entry and involved auction -- Sale Agreement was for some of applicants' business units -- Neither proposal involved formal plan of compromise with creditors or vote, but CCAA was flexible and could be broadly interpreted to ensure objective of preserving business was met -- Proposal was warranted, beneficial and there was no viable alternative.*

Motion by the applicants for the approval of their proposed bidding process and Sale Agreement. The applicants had been granted CCAA protection and were involved in insolvency proceedings in four other countries. The Monitor approved of the proposal. The bidding process set a deadline for bids and involved an auction. The Sale Agreement was for some of the applicants' business units. The applicants argued the proposal was the best way to preserve jobs and company value. The purchaser was to assume

both assets and liabilities. There was no formal plan for compromise with creditors or vote planned.

HELD: Motion allowed. The CCAA was flexible and could be broadly interpreted to ensure that its objectives of preserving the business were achieved. The proposal was warranted and beneficial and there was no viable alternative. A sealing order was also made with respect to Appendix B, which contained commercially sensitive documents.

**Statutes, Regulations and Rules Cited:**

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11(4)

**Counsel:**

Derrick Tay and Jennifer Stam, for Nortel Networks Corporation, et al.

Lyndon Barnes and Adam Hirsh, for the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited.

J. Carfagnini and J. Pasquariello, for Ernst & Young Inc., Monitor.

M. Starnino, for the Superintendent of Financial Services and Administrator of PBGF.

S. Philpott, for the Former Employees.

K. Zych, for Noteholders.

Pamela Huff and Craig Thorburn, for MatlinPatterson Global Advisors LLC, MatlinPatterson Global Opportunities Partners III L.P. and Matlin Patterson Opportunities Partners (Cayman) III L.P.

David Ward, for UK Pension Protection Fund.

Leanne Williams, for Flextronics Inc.

Alex MacFarlane, for the Official Committee of Unsecured Creditors.

Arthur O. Jacques and Tom McRae, for Felske and Sylvain (de facto Continuing Employees' Committee).

Robin B. Schwill and Matthew P. Gottlieb, for Nortel Networks UK Limited.

A. Kauffman, for Export Development Canada.

D. Ullman, for Verizon Communications Inc.

G. Benchetrit, for IBM.

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## ENDORSEMENT

G.B. MORAWETZ J.:--

## INTRODUCTION

**1** On June 29, 2009, I granted the motion of the Applicants and approved the bidding procedures (the "Bidding Procedures") described in the affidavit of Mr. Riedel sworn June 23, 2009 (the "Riedel Affidavit") and the Fourteenth Report of Ernst & Young, Inc., in its capacity as Monitor (the "Monitor") (the "Fourteenth Report"). The order was granted immediately after His Honour Judge Gross of the United States Bankruptcy Court for the District of Delaware (the "U.S. Court") approved the Bidding Procedures in the Chapter 11 proceedings.

**2** I also approved the Asset Sale Agreement dated as of June 19, 2009 (the "Sale Agreement") among Nokia Siemens Networks B.V. ("Nokia Siemens Networks" or the "Purchaser"), as buyer, and Nortel Networks Corporation ("NNC"), Nortel Networks Limited ("NNL"), Nortel Networks, Inc. ("NNI") and certain of their affiliates, as vendors (collectively the "Sellers") in the form attached as Appendix "A" to the Fourteenth Report and I also approved and accepted the Sale Agreement for the purposes of conducting the "stalking horse" bidding process in accordance with the Bidding Procedures including, the Break-Up Fee and the Expense Reimbursement (as both terms are defined in the Sale Agreement).

**3** An order was also granted sealing confidential Appendix "B" to the Fourteenth Report containing the schedules and exhibits to the Sale Agreement pending further order of this court.

**4** The following are my reasons for granting these orders.

**5** The hearing on June 29, 2009 (the "Joint Hearing") was conducted by way of video conference with a similar motion being heard by the U.S. Court. His Honor Judge Gross presided over the hearing in the U.S. Court. The Joint Hearing was conducted in accordance with the provisions of the Cross-Border Protocol, which had previously been approved by both the U.S. Court and this court.

**6** The Sale Agreement relates to the Code Division Multiple Access ("CMDA") business Long-Term Evolution ("LTE") Access assets.

**7** The Sale Agreement is not insignificant. The Monitor reports that revenues from CDMA comprised over 21% of Nortel's 2008 revenue. The CDMA business employs approximately 3,100 people (approximately 500 in Canada) and the LTE business employs approximately 1,000 people (approximately 500 in Canada). The purchase price under the Sale Agreement is $650 million.

## BACKGROUND

**8** The Applicants were granted CCAA protection on January 14, 2009. Insolvency proceedings have also been commenced in the United States, the United Kingdom, Israel and France.

**9** At the time the proceedings were commenced, Nortel's business operated through 143 subsidiaries, with approximately 30,000 employees globally. As of January 2009, Nortel employed approximately 6,000 people in Canada alone.

**10** The stated purpose of Nortel's filing under the CCAA was to stabilize the Nortel business to maximize the chances of preserving all or a portion of the enterprise. The Monitor reported that a thorough strategic review of the company's assets and operations would have to be undertaken in consultation with various stakeholder groups.

**11** In April 2009, the Monitor updated the court and noted that various restructuring alternatives were being considered.

**12** On June 19, 2009, Nortel announced that it had entered into the Sale Agreement with respect to its assets in its CMDA business and LTE Access assets (collectively, the "Business") and that it was pursuing the sale of its other business units. Mr. Riedel in his affidavit states that Nortel has spent many months considering various restructuring alternatives before determining in its business judgment to pursue "going concern" sales for Nortel's various business units.

**13** In deciding to pursue specific sales processes, Mr. Riedel also stated that Nortel's management considered:

(a) the impact of the filings on Nortel's various businesses, including deterioration in sales; and
(b) the best way to maximize the value of its operations, to preserve jobs and to continue businesses in Canada and the U.S.

**14** Mr. Riedel notes that while the Business possesses significant value, Nortel was faced with the reality that:

(a) the Business operates in a highly competitive environment;
(b) full value cannot be realized by continuing to operate the Business through a restructuring; and
(c) in the absence of continued investment, the long-term viability of the Business would be put into jeopardy.

**15** Mr. Riedel concluded that the proposed process for the sale of the Business pursuant to an auction process provided the best way to preserve the Business as a going concern and to maximize value and preserve the jobs of Nortel employees.

**16** In addition to the assets covered by the Sale Agreement, certain liabilities are to be assumed by the Purchaser. This issue is covered in a comprehensive manner at paragraph 34 of the Fourteenth Report. Certain liabilities to employees are included on this list. The assumption of these liabilities is consistent with the provisions of the Sale Agreement that requires the Purchaser to extend written offers of employment to at least 2,500 employees in the Business.

**17** The Monitor also reports that given that certain of the U.S. Debtors are parties to the Sale Agreement and given the desire to maximize value for the benefit of stakeholders, Nortel determined and it has agreed with the Purchaser that the Sale Agreement is subject to higher or better offers being obtained pursuant to a sale process under s. 363 of the U.S. Bankruptcy Code and that the Sale Agreement shall serve as a "stalking horse" bid pursuant to that process.

**18** The Bidding Procedures provide that all bids must be received by the Seller by no later than July 21, 2009 and that the Sellers will conduct an auction of the purchased assets on July 24, 2009. It is anticipated that Nortel will ultimately seek a final sales order from the U.S. Court on or about July 28, 2009 and an approval and vesting order from this court in respect of the Sale Agreement and purchased assets on or about July 30, 2009.

**19** The Monitor recognizes the expeditious nature of the sale process but the Monitor has been advised that given the nature of the Business and the consolidation occurring in the global market, there are likely to be a limited number of parties interested in acquiring the Business.

**20** The Monitor also reports that Nortel has consulted with, among others, the Official Committee of Unsecured Creditors (the "UCC") and the bondholder group regarding the Bidding Procedures and is of

the view that both are supportive of the timing of this sale process. (It is noted that the UCC did file a limited objection to the motion relating to certain aspects of the Bidding Procedures.)

**21** Given the sale efforts made to date by Nortel, the Monitor supports the sale process outlined in the Fourteenth Report and more particularly described in the Bidding Procedures.

**22** Objections to the motion were filed in the U.S. Court and this court by MatlinPatterson Global Advisors LLC, MatlinPatterson Global Opportunities Partners III L.P. and Matlin Patterson Opportunities Partners (Cayman) III L.P. (collectively, "MatlinPatterson") as well the UCC.

**23** The objections were considered in the hearing before Judge Gross and, with certain limited exceptions, the objections were overruled.

**ISSUES AND DISCUSSION**

**24** The threshold issue being raised on this motion by the Applicants is whether the CCAA affords this court the jurisdiction to approve a sales process in the absence of a formal plan of compromise or arrangement and a creditor vote. If the question is answered in the affirmative, the secondary issue is whether this sale should authorize the Applicants to sell the Business.

**25** The Applicants submit that it is well established in the jurisprudence that this court has the jurisdiction under the CCAA to approve the sales process and that the requested order should be granted in these circumstances.

**26** Counsel to the Applicants submitted a detailed factum which covered both issues.

**27** Counsel to the Applicants submits that one of the purposes of the CCAA is to preserve the going concern value of debtors companies and that the court's jurisdiction extends to authorizing sale of the debtor's business, even in the absence of a plan or creditor vote.

**28** The CCAA is a flexible statute and it is particularly useful in complex insolvency cases in which the court is required to balance numerous constituents and a myriad of interests.

**29** The CCAA has been described as "skeletal in nature". It has also been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 45 C.B.R. (5th) 163 (Ont. C.A.), at paras. 44, 61, leave to appeal refused, [2008] S.C.C.A. No. 337. ("ATB Financial").

**30** The jurisprudence has identified as sources of the court's discretionary jurisdiction, *inter alia*:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;

(b) the specific provision of s. 11(4) of the CCAA which provides that the court may make an order "on such terms as it may impose"; and

(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects. *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.) at para. 43; *Re PSINet Ltd.* (2001), 28 C.B.R. (4th) 95 (Ont. S.C.J.) at para. 5, *ATB Financial, supra*, at paras. 43-52.

**31** However, counsel to the Applicants acknowledges that the discretionary authority of the court under s. 11 must be informed by the purpose of the CCAA.

> Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. *Re Stelco Inc.* (2005), 9 C.B.R. (5th) 135 (Ont. C.A.) at para. 44.

**32** In support of the court's jurisdiction to grant the order sought in this case, counsel to the Applicants submits that Nortel seeks to invoke the "overarching policy" of the CCAA, namely, to preserve the going concern. *Re Residential Warranty Co. of Canada Inc.* (2006), 21 C.B.R. (5th) 57 (Alta. Q.B.) at para. 78.

**33** Counsel to the Applicants further submits that CCAA courts have repeatedly noted that the purpose of the CCAA is to preserve the benefit of a going concern business for all stakeholders, or "the whole economic community":

> The purpose of the CCAA is to facilitate arrangements that might avoid liquidation of the company and allow it to continue in business to the benefit of the whole economic community, including the shareholders, the creditors (both secured and unsecured) and the employees. *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3rd) 165 (Ont. Gen. Div.) at para. 29. *Re Consumers Packaging Inc.* (2001) 27 C.B.R. (4th) 197 (Ont. C.A.) at para. 5.

**34** Counsel to the Applicants further submits that the CCAA should be given a broad and liberal interpretation to facilitate its underlying purpose, including the preservation of the going concern for the benefit of all stakeholders and further that it should not matter whether the business continues as a going concern under the debtor's stewardship or under new ownership, for as long as the business continues as a going concern, a primary goal of the CCAA will be met.

**35** Counsel to the Applicants makes reference to a number of cases where courts in Ontario, in appropriate cases, have exercised their jurisdiction to approve a sale of assets, even in the absence of a plan of arrangement being tendered to stakeholders for a vote. In doing so, counsel to the Applicants submits that the courts have repeatedly recognized that they have jurisdiction under the CCAA to approve asset sales in the absence of a plan of arrangement, where such sale is in the best interests of stakeholders generally. *Re Canadian Red Cross Society, supra*, *Re PSINet, supra*, *Re Consumers Packaging, supra*, *Re Stelco Inc.* (2004), 6 C.B.R. (5th) 316 (Ont. S.C.J.) at para. 1, *Re Tiger Brand Knitting Co.* (2005) 9 C.B.R. (5th) 315, *Re Caterpillar Financial Services Ltd. v. Hardrock Paving Co.* (2008), 45 C.B.R. (5th) 87 and *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3rd) 24 (Ont. Gen. Div.).

**36** In *Re Consumers Packaging, supra*, the Court of Appeal for Ontario specifically held that a sale of a business as a going concern during a CCAA proceeding is consistent with the purposes of the CCAA:

> The sale of Consumers' Canadian glass operations as a going concern pursuant to the Owens-Illinois bid allows the preservation of Consumers' business (albeit under new ownership), and is therefore consistent with the purposes of the CCAA.
>
> ... we cannot refrain from commenting that Farley J.'s decision to approve the Owens-Illinois bid is consistent with previous decisions in Ontario and elsewhere that have emphasized the broad remedial purpose of flexibility of the CCAA and have approved the sale and disposition of assets during CCAA proceedings prior to a formal plan being tendered. *Re Consumers Packaging, supra, at paras. 5, 9.*

**37** Similarly, in *Re Canadian Red Cross Society, supra*, Blair J. (as he then was) expressly affirmed the court's jurisdiction to approve a sale of assets in the course of a CCAA proceeding before a plan of

arrangement had been approved by creditors. *Re Canadian Red Cross Society, supra*, at paras. 43, 45.

**38** Similarly, in *PSINet Limited, supra*, the court approved a going concern sale in a CCAA proceeding where no plan was presented to creditors and a substantial portion of the debtor's Canadian assets were to be sold. Farley J. noted as follows:

> [If the sale was not approved,] there would be a liquidation scenario ensuing which would realize far less than this going concern sale (which appears to me to have involved a transparent process with appropriate exposure designed to maximize the proceeds), thus impacting upon the rest of the creditors, especially as to the unsecured, together with the material enlarging of the unsecured claims by the disruption claims of approximately 8,600 customers (who will be materially disadvantaged by an interrupted transition) plus the job losses for approximately 200 employees. *Re PSINet Limited, supra*, at para. 3.

**39** In *Re Stelco Inc., supra*, in 2004, Farley J. again addressed the issue of the feasibility of selling the operations as a going concern:

> I would observe that usually it is the creditor side which wishes to terminate CCAA proceedings and that when the creditors threaten to take action, there is a realization that a liquidation scenario will not only have a negative effect upon a CCAA applicant, but also upon its workforce. Hence, the CCAA may be employed to provide stability during a period of necessary financial and operational restructuring - and if a restructuring of the "old company" is not feasible, then there is the exploration of the feasibility of the sale of the operations/enterprise as a going concern (with continued employment) in whole or in part. *Re Stelco Inc, supra*, at para. 1.

**40** I accept these submissions as being general statements of the law in Ontario. The value of equity in an insolvent debtor is dubious, at best, and, in my view, it follows that the determining factor should not be whether the business continues under the debtor's stewardship or under a structure that recognizes a new equity structure. An equally important factor to consider is whether the case can be made to continue the business as a going concern.

**41** Counsel to the Applicants also referred to decisions from the courts in Quebec, Manitoba and Alberta which have similarly recognized the court's jurisdiction to approve a sale of assets during the course of a CCAA proceeding. *Re Boutique San Francisco Inc.* (2004), 7 C.B.R. (5th) 189 (Quebec S. C.), *Re Winnipeg Motor Express Inc.* (2008), 49 C.B.R. (5th) 302 (Man. Q.B.) at paras. 41, 44, and *Re Calpine Canada Energy Limited* (2007), 35 C.B.R. (5th) 1, (Alta. Q.B.) at para. 75.

**42** Counsel to the Applicants also directed the court's attention to a recent decision of the British Columbia Court of Appeal which questioned whether the court should authorize the sale of substantially all of the debtor's assets where the debtor's plan "will simply propose that the net proceeds from the sale ... be distributed to its creditors". In *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.* (2008), 46 C.B.R. (5th) 7 (B.C.C.A.) ("*Cliffs Over Maple Bay*"), the court was faced with a debtor who had no active business but who nonetheless sought to stave off its secured creditor indefinitely. The case did not involve any type of sale transaction but the Court of Appeal questioned whether a court should authorize the sale under the CCAA without requiring the matter to be voted upon by creditors.

**43** In addressing this matter, it appears to me that the British Columbia Court of Appeal focussed on whether the court should grant the requested relief and not on the question of whether a CCAA court has the jurisdiction to grant the requested relief.

**44** I do not disagree with the decision in *Cliffs Over Maple Bay*. However, it involved a situation where the debtor had no active business and did not have the support of its stakeholders. That is not the case with these Applicants.

**45** The *Cliffs Over Maple Bay* decision has recently been the subject of further comment by the British Columbia Court of Appeal in *Asset Engineering L.P. v. Forest and Marine Financial Limited Partnership*, 2009 BCCA 319.

**46** At paragraphs 24-26 of the *Forest and Marine* decision, Newbury J.A. stated:

> 24. In *Cliffs Over Maple Bay*, the debtor company was a real estate developer whose one project had failed. The company had been dormant for some time. It applied for CCAA protection but described its proposal for restructuring in vague terms that amounted essentially to a plan to "secure sufficient funds" to complete the stalled project (Para. 34). This court, per Tysoe J.A., ruled that although the Act can apply to single-project companies, its purposes are unlikely to be engaged in such instances, since mortgage priorities are fully straight forward and there will be little incentive for senior secured creditors to compromise their interests (Para. 36). Further, the Court stated, the granting of a stay under s. 11 is "not a free standing remedy that the court may grant whenever an insolvent company wishes to undertake a "restructuring" ... Rather, s. 11 is ancillary to the fundamental purpose of the CCAA, and a stay of proceedings freezing the rights of creditors should only be granted in furtherance of the CCAA's fundamental purpose". That purpose has been described in Meridian Developments Inc. v. Toronto Dominion Bank (1984) 11 D.L.R. (4th) 576 (Alta. Q.B.):
>
>> The legislation is intended to have wide scope and allow a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors. [at 580]
>
> 25. The Court was not satisfied in *Cliffs Over Maple Bay* that the "restructuring" contemplated by the debtor would do anything other than distribute the net proceeds from the sale, winding up or liquidation of its business. The debtor had no intention of proposing a plan of arrangement, and its business would not continue following the execution of its proposal - thus it could not be said the purposes of the statute would be engaged ...
>
> 26. In my view, however, the case at bar is quite different from *Cliffs Over Maple Bay*. Here, the main debtor, the Partnership, is at the centre of a complicated corporate group and carries on an active financing business that it hopes to save notwithstanding the current economic cycle. (The business itself which fills a "niche" in the market, has been carried on in one form or another since 1983.) The CCAA is appropriate for situations such as this where it is unknown whether the "restructuring" will ultimately take the form of a refinancing or will involve a reorganization of the corporate entity or entities and a true compromise of the rights of one or more parties. The "fundamental purpose" of the Act - to preserve the *status quo* while the debtor prepares a plan that will enable it to remain in business to the benefit of all concerned - will be furthered by granting a stay so that the <u>means</u> contemplated by the Act - a compromise or arrangement - can be developed, negotiated and voted on if

necessary ...

**47** It seems to me that the foregoing views expressed in *Forest and Marine* are not inconsistent with the views previously expressed by the courts in Ontario. The CCAA is intended to be flexible and must be given a broad and liberal interpretation to achieve its objectives and a sale by the debtor which preserves its business as a going concern is, in my view, consistent with those objectives.

**48** I therefore conclude that the court does have the jurisdiction to authorize a sale under the CCAA in the absence of a plan.

**49** I now turn to a consideration of whether it is appropriate, in this case, to approve this sales process. Counsel to the Applicants submits that the court should consider the following factors in determining whether to authorize a sale under the CCAA in the absence of a plan:

(a) is a sale transaction warranted at this time?
(b) will the sale benefit the whole "economic community"?
(c) do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?
(d) is there a better viable alternative?

I accept this submission.

**50** It is the position of the Applicants that Nortel's proposed sale of the Business should be approved as this decision is to the benefit of stakeholders and no creditor is prejudiced. Further, counsel submits that in the absence of a sale, the prospects for the Business are a loss of competitiveness, a loss of value and a loss of jobs.

**51** Counsel to the Applicants summarized the facts in support of the argument that the Sale Transaction should be approved, namely:

(a) Nortel has been working diligently for many months on a plan to reorganize its business;
(b) in the exercise of its business judgment, Nortel has concluded that it cannot continue to operate the Business successfully within the CCAA framework;
(c) unless a sale is undertaken at this time, the long-term viability of the Business will be in jeopardy;
(d) the Sale Agreement continues the Business as a going concern, will save at least 2,500 jobs and constitutes the best and most valuable proposal for the Business;
(e) the auction process will serve to ensure Nortel receives the highest possible value for the Business;
(f) the sale of the Business at this time is in the best interests of Nortel and its stakeholders; and
(g) the value of the Business is likely to decline over time.

**52** The objections of MatlinPatterson and the UCC have been considered. I am satisfied that the issues raised in these objections have been addressed in a satisfactory manner by the ruling of Judge Gross and no useful purpose would be served by adding additional comment.

**53** Counsel to the Applicants also emphasize that Nortel will return to court to seek approval of the most favourable transaction to emerge from the auction process and will aim to satisfy the elements

established by the court for approval as set out in *Royal Bank v. Soundair* (1991), 7 C.B.R. (3rd) 1 (Ont. C.A.) at para. 16.

**DISPOSITION**

**54** The Applicants are part of a complicated corporate group. They carry on an active international business. I have accepted that an important factor to consider in a CCAA process is whether the case can be made to continue the business as a going concern. I am satisfied having considered the factors referenced at [49], as well as the facts summarized at [51], that the Applicants have met this test. I am therefore satisfied that this motion should be granted.

**55** Accordingly, I approve the Bidding Procedures as described in the Riedel Affidavit and the Fourteenth Report of the Monitor, which procedures have been approved by the U.S. Court.

**56** I am also satisfied that the Sale Agreement should be approved and further that the Sale Agreement be approved and accepted for the purposes of conducting the "stalking horse" bidding process in accordance with the Bidding Procedures including, without limitation the Break-Up Fee and the Expense Reimbursement (as both terms are defined in the Sale Agreement).

**57** Further, I have also been satisfied that Appendix B to the Fourteenth Report contains information which is commercially sensitive, the dissemination of which could be detrimental to the stakeholders and, accordingly, I order that this document be sealed, pending further order of the court.

**58** In approving the Bidding Procedures, I have also taken into account that the auction will be conducted prior to the sale approval motion. This process is consistent with the practice of this court.

**59** Finally, it is the expectation of this court that the Monitor will continue to review ongoing issues in respect of the Bidding Procedures. The Bidding Procedures permit the Applicants to waive certain components of qualified bids without the consent of the UCC, the bondholder group and the Monitor. However, it is the expectation of this court that, if this situation arises, the Applicants will provide advance notice to the Monitor of its intention to do so.

G.B. MORAWETZ J.

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2004 SCC 68, 244 D.L.R. (4th) 564, 326 N.R. 267 (Eng.), 326 N.R. 267 (Fr.), 4
C.B.R. (5th) 215, 49 B.L.R. (3d) 165, [2004] 3 S.C.R. 461, REJB 2004-72160,
J.E. 2004-2016

2004 CarswellQue 2862

People's Department Stores Ltd. (1992) Inc., Re
In the Matter of the Bankruptcy of Peoples Department Stores Inc./Magasins à rayons Peoples inc.
Caron Bélanger Ernst & Young Inc., in its capacity as Trustee to the bankruptcy of Peoples Department Stores Inc./Magasins à rayons Peoples inc. (Appellant) v. Lionel Wise, Ralph Wise and Harold Wise (Respondents) and Chubb Insurance Company of Canada/Compagnie d'assurance Chubb du Canada (Respondent)
Supreme Court of Canada
Iacobucci,[FN*] Major, Bastarache, Binnie, LeBel, Deschamps, Fish JJ.
Heard: May 11, 2004
Judgment: October 29, 2004
Docket: 29682

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Proceedings: affirming *People's Department Stores Ltd. (1992) Inc., Re* (2003), 2003 CarswellQue 145, (sub nom. *Peoples Department Stores Inc. (Trustees of) v. Wise)* 224 D.L.R. (4th) 509, [2003] R.J.Q. 796, 41 C.B.R. (4th) 225 (Que. C.A.); reversing *People's Department Stores Ltd. (1992) Inc., Re* (1998), (sub nom. *Peoples Department Stores Inc./Magasin à rayons Peoples inc. (Syndic de))* [1999] R.R.A. 178, 1998 CarswellQue 3442, 23 C.B.R. (4th) 200 (Que. S.C.)

Counsel: Gerald F. Kandestin, Gordon Kugler, Gordon Levine for Appellant

Éric Lalanne, Martin Tétreault for Respondents, Lionel Wise, Ralph Wise, Harold Wise

Ian Rose, Odette Jobin-Laberge for Respondent, Chubb Insurance Company of Canada

Subject: Corporate and Commercial; Insolvency; Income Tax (Federal)

Business associations --- Specific corporate organization matters -- Directors and officers -- Fiduciary duties -- General principles

Even though directors implemented new inventory procurement policy that played part in corporation's bankruptcy, directors did not breach fiduciary duty under s. 122(1)(a) of Canada Business Corporations Act, which duty is not owed to creditors, in view of lack of personal interest or illegal purpose of new policy and directors' desire to make corporation better business -- Duty of care under s. 122(1)(b) of Act can be owed to creditors by way of art. 1457 of Civil Code of Québec, but in case at bar evidence established directors had not breached duty of care towards corporation's creditors because implementation of new policy was reasonable business decision made in order to remedy serious and pressing commercial problem -- Several other factors contributed in more direct manner to corporation's bankruptcy.

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy -- Fraudulent and illegal transactions -- Reviewable transactions under Act

Test for determining whether difference in consideration is "conspicuously greater or less" is whether difference is conspicuous to court having regard to all relevant factors, such as percentage difference -- Disparity slightly over 6 per cent between fair market value and consideration received by bankrupt corporation did not constitute conspicuous difference within meaning of s. 100(2) of Bankruptcy and Insolvency Act.

Associations d'affaires --- Questions spécifiques relatives à l'organisation de la société -- Administrateurs et dirigeants -- Obligations fiduciaires -- Principes généraux

En instaurant une nouvelle politique d'approvisionnement ayant joué un rôle dans la faillite d'une société, les administrateurs de celle-ci n'ont pas manqué à leur obligation fiduciaire en vertu de l'art. 122(1)a) de la Loi canadienne sur les sociétés par actions, obligation qui ne vise pas les créanciers, vu l'absence d'un intérêt personnel ou d'une fin illégitime dans cette nouvelle politique et vu leur volonté de faire de la société une meilleure entreprise -- Obligation de diligence de l'art. 122(1)b) de la Loi peut viser les créanciers par le biais de l'art. 1457 du Code civil du Québec, mais, en l'espèce, la preuve démontrait que les administrateurs n'avaient pas manqué à leur obligation de diligence envers les créanciers de la société puisque l'instauration de la nouvelle politique constituait une décision d'affaires raisonnable prise dans le but de remédier à un problème commercial grave et urgent -- Plusieurs autres facteurs avaient contribué de façon plus directe à la faillite de la société.

Faillite et insolvabilité --- Annulation de transactions antérieures à la faillite -- Transactions frauduleuses et illégales -- Transactions révisables en vertu de la Loi

Critère applicable pour déterminer si la différence entre la contrepartie et sa juste valeur marchande est « manifestement supérieure ou inférieure » est celui de savoir si la différence est manifeste pour le tribunal eu égard à tous les facteurs pertinents, le pourcentage de différence étant un tel facteur -- Écart d'un peu plus de 6 pour cent entre la juste valeur du marché et la contrepartie reçue par la société en faillite ne constituait pas une différence manifeste au sens de l'art. 100(2) de la Loi sur la faillite et l'insolvabilité.

Three brothers were directors of W Inc., a chain of stores: W Inc. purchased from M & S Inc. its chain of stores, P. Prior to the purchase, P had annual losses of about $10 million. W Inc. guaranteed solidarily the purchase in favour of M & S Inc. and paid about a sixth of the purchase price. To guarantee the balance, M & S Inc. included security measures and restrictive clauses in the contract of sale: W Inc. had to maintain strict financial ratios and P could not provide any financial assistance to W Inc. P became P Inc. after being merged with the W Inc. subsidiary that had bought it.

To solve the logistic and administrative problems that had followed the extension of W Inc.'s accounting systems to P Inc., the brothers implemented a domestic inventory procurement policy for both corporations, which became effective on February 1, 1994. Both corporations' warehouses were merged. P Inc. made the continental purchases for both corporations and transferred and charged out to W Inc. all the domestic merchandise shipped to its stores. W Inc. made the overseas purchases and transferred and charged the merchandise out to P Inc. and entered the merchandise immediately into P Inc.'s warehouse records as if they had been received. P Inc. charged W Inc. for the transfers of imported merchandise to W Inc.'s stores. In autumn 1994, W Inc. had not paid P Inc. for the merchandise, which increased the inter-company charge owed by W Inc. to over $18 million. W Inc. lost its financing and both corporations filed notices of intent to file a proposal. P Inc. and W Inc. were retroactively declared bankrupt following a petition filed by M & S Inc. The brothers all had directors' liability

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insurance.

P Inc.'s bankruptcy trustee brought a motion based on s. 122 of the Canada Business Corporations Act (CBCA) and s. 100 of the Bankruptcy and Insolvency Act (BIA). The trial judge found the three brothers to be liable and that the procurement policy was a reviewable transaction and ordered the brothers to personally pay about $4.5 million to the trustee. The brothers, their insurer and the trustee appealed. The Court of Appeal found the brothers were not liable. The trustee appealed.

**Held:** The appeal was dismissed.

Per Major, Deschamps JJ.: The trial judge neither applied nor examined separately the two duties imposed by s. 122(1) to directors, the fiduciary duty and the duty of care. As for the fiduciary duty, the directors and officers must act with integrity and good faith in the best interest of the corporation. They must serve the corporation in a disinterested manner, with loyalty and integrity. Since the trial judge in this case found lack of fraud and dishonesty on the part of the brothers, one could not conclude that the brothers had breached their fiduciary duty. The brothers implemented a policy to deal with the serious inventory management problem they were facing. Absent any proof of personal interest or an illegitimate purpose of the new policy, and considering the desire to make the corporations better businesses, one could only conclude the brothers had not breached their fiduciary duty stated in s. 122(1)(a) of the CBCA. The expression "best interests of the corporation" should be read as meaning the maximization of the corporation's value. The interest of the corporation should not be confused with that of the shareholders, the creditors or any other stakeholder. The directors' fiduciary duty remains the same, even if the corporation is in the "vicinity of insolvency". In assessing the actions of the directors, any honest and good faith attempt to redress the corporation's problem situation will, if successful, retain value for the shareholders while improving the creditors' position. Should the attempt fail, it would not qualify as a breach of the statutory fiduciary duty. There was no need to read the interests of creditors into the fiduciary duty. Creditors are stakeholders and their interest are protected in several ways. Stakeholders have viable remedies at their disposal, such as the oppression remedy provided by s. 241 of the CBCA and an action based on the duty of care.

Since the CBCA did not provide a specific remedy for creditors, art. 1457 of the Civil Code of Québec could be used as suppletive so as to include creditors in the expression "every person" found in s. 122(1)(b) of the CBCA. But the standard of conduct to apply was the one stated in s. 122(1)(b). It is an objective standard, since it is not the subjective reasons of the directors and officers that are important, but rather the factual elements of the context in which they operate. Directors and officers are not considered to have not done their fiduciary duty under s. 122(1)(b) of the CBCA if they acted with caution and based on the information they had. Business decisions must be reasonable given what directors knew or should have known. Directors are not required to act perfectly. Courts should not substitute their opinion for that of the directors who used their business expertise to assess factors that are considered by corporations in making decisions. Courts must determine, with the facts of each case, whether the directors used the necessary degree of caution and diligence in making what is alleged to be a reasonable decision at the time it was made. In this case, a review of the evidence as a whole led to the conclusion that the implementation of the new procurement policy was a reasonable business decision made for the purpose of remedying a serious and pressing commercial problem in a situation where there might be no solution whatsoever. By concluding the new policy had inexorably led to P Inc.'s decline and bankruptcy, the trial judge misinterpreted the facts and made a palpable and overriding error. Many other factors contributed more directly to P Inc.'s bankruptcy. Consequently, the brothers did not breach the duty of care they owed to P Inc.'s creditors by implementing the procurement policy.

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The Court of Appeal wrongly concluded s. 44(2) of the CBCA could serve to generally legitimize financial aid provided by a wholly-owned subsidiary to its parent corporation. Even if s. 44(2) did authorize some financial aid formulas between corporations, that section did not remove directors and officers from possible liability under s. 122(1) for any financial aid provided by a subsidiary to a parent corporation. Moreover, the brothers could not invoke the defence provided by s. 123(4)(b) of the CBCA. They could not claim to have relied on the judgment of a professional when they accepted the procurement policy proposed as solution by the vice-president of finance. That vice-president was an employee of W Inc., not a professional. He was not an accountant, his actions were not regulated by a professional corporation and he had no professional liability insurance.

As for s. 100(1) of the BIA, the test for determining whether the difference in consideration is "conspicuously greater or less" is whether the difference is conspicuous to the court having regard to all the relevant factors, and the percentage difference is such a factor. The transactions made during the whole time the policy was applied had to be examined. The trial judge concluded P Inc. had not received anything in exchange for the transferred inventory since the accounts receivable had not been collected and could not be collected, but he then reduced the difference to 6 per cent after taking into consideration, among other things, the transfers from W Inc. to P Inc. His findings were contradictory and the Court of Appeal properly found the judge had committed a palpable and overriding error in that respect. A disparity of slightly more than 6 per cent between fair market value and consideration received did not constitute a conspicuous difference within the meaning of s. 100(2) of the BIA. In that respect, the trustee's claim had to fail.

The disagreement between the trial judge and the Court of Appeal on the interpretation of "privy" in s. 100(2) of the BIA warranted some observations. Section 100 of the BIA mainly seeks to cancel the effects of a transaction, which reduced the value of the bankrupt's assets. The word "privy" should be given a broad meaning so as to include those who benefit directly or indirectly from and have knowledge of a transaction occurring for less than fair market value, and mostly when the persons who benefit are the controlling minds behind the transaction. Concluding that a person is privy to a reviewable transaction does not mean that the court will necessarily exercise its discretion to order a remedy against that person, since some conditions must be complied with.

Trois frères étaient les administrateurs de W inc., une chaîne de magasins. Ils ont acheté la chaîne de magasins P de M & S inc. Avant l'acquisition, P subissait des pertes d'à peu près 10 millions de dollars par année. W inc. a garanti solidairement l'achat en faveur de M & S inc. et n'a payé qu'environ le sixième du prix de vente. Afin de garantir le solde du prix de vente, M & S inc. a inclus dans le contrat de vente des mesures de sécurité et des clauses restrictives: W inc. devait maintenir des ratios financiers stricts et P ne devait fournir aucune assitance financière à W inc. P est devenue P inc. après avoir été fusionnée avec la filiale de W inc. qui l'avait achetée.

Afin de résoudre les problèmes de logistique et d'administration découlant de l'extension des systèmes informatiques de W inc. à P inc, les frères ont instauré un système d'approvisionnement commun pour les deux sociétés qui a pris effet le 1er février 1994. Les entrepôts des deux sociétés ont été fusionnés. P inc. faisait les achats à sur le continent pour les deux sociétés, puis transférait et facturait à W inc. tous les biens expédiés aux magasins de W inc. Quant à elle, W inc. faisait les achats outre-mer, puis transférait et facturait à P inc. la marchandise, qui était immédiatement inscrite dans les livres d'entrepôt de P inc. comme si elle avait été reçue. P inc. facturait à W inc. les transferts de marchandises importées aux magasins de W inc. À l'automne 1994, W inc. n'avait pas encore payé à P inc. la marchandise, faisant ainsi que les sommes qu'elle devait à P inc. dépassaient 18 millions de dollars. W inc. a perdu son financement et les deux sociétés ont dû déposer un avis d'intention. W inc. et P inc. ont été déclarées faillies rétroactivement à la suite d'une requête présentée par M & S inc. Les frères détenaient une assurance-responsabilité à titre d'administrateurs.

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Le syndic de faillite de P inc. a présenté, contre les frères et leur assureur, une requête fondée sur l'art. 122 de la Loi canadienne sur les sociétés par action et sur l'art. 100 de la Loi sur la faillite et l'insolvabilité.

Le premier juge a conclu à la responsabilité des frères, que le système d'approvisionnement commun constituait une transaction révisable et les a condamnés à payer au syndic environ 4,5 millions de dollars. Les frères, leur assureur et le syndic ont interjeté appel. La Cour d'appel a conclu à la non-responsabilité des frères. Le syndic a interjeté appel.

**Arrêt:** Le pourvoi a été rejeté.

Major, Deschamps, JJ.: Le premier juge n'a pas appliqué ni examiné séparément les deux obligations imposées par l'art. 122(1) aux administrateurs, soit l'obligation fiduciaire et l'obligation de diligence. En ce qui concerne l'obligation fiduciaire, les administrateurs et les dirigeants sont tenus d'agir avec intégrité et bonne foi aux mieux des intérêts de la société. Ils doivent servir la société de manière désintéressée, avec loyauté et intégrité. Dans ce cas-ci, on ne pouvait conclure que les frères avaient manqué à leur obligation fiduciaire, puisque le premier juge a conclu à l'absence de fraude et de malhonnêteté de leur part. Au prise avec un grave problème de gestion des stocks, les frères ont mis en application une politique visant à le régler. En l'absence de preuve de l'existence d'un intérêt personnel ou d'une fin illégitime de la nouvelle politique, et vu la volonté de faire des sociétés de meilleures entreprise, il fallait conclure que les administrateurs n'avaient pas manqué à leur obligation fiduciaire énoncée à l'art. 122(1)a) LCSA. L'expression « au mieux des intérêts de la société » doit être interprétée comme signifiant la maximisation de la valeur de l'entreprise. Les intérêts de la société ne doivent pas se confondre avec ceux des actionnaires, des créanciers ou ceux de toute autre partie intéressée. L'obligation fiduciaire des administrateurs reste la même, même si la société est « au bord de l'insolvabilité ». Dans l'évaluation des mesures prises par les administrateurs, toute tentative faite avec intégrité et bonne foi pour redresser la situation financière de la société aura, si elle réussit, conservé une valeur pour les actionnaires tout en améliorant la situation des créanciers. En cas d'échec, on ne pourrait y voir un manquement à l'obligation fiduciaire prévue par la loi. Il n'était pas nécessaire d'interpréter les intérêts des créanciers comme étant visés par l'obligation fiduciaire. Les créanciers sont une partie intéressée et leurs intérêts sont protégés de plusieurs manières. Les parties intéressées ont la possibilité d'exercer des recours efficaces, soit le recours en cas d'abus de droit prévu par l'art. 241 LCSA ainsi que l'action fondée sur l'obligation de diligence.

Puisque la LCSA ne prévoyait aucun recours exprès pour les créanciers, l'art. 1457 du Code civil du Québec pouvait servir à titre supplétif afin d'intégrer les créanciers dans l'expression « toute personne » de l'art. 122(1)b) LCSA. Par ailleurs, la norme de conduite à respecter était celle énoncée à l'art. 122(1)b). Il s'agit d'une norme objective, puisque ce sont les éléments factuels du contexte dans lequel agissent l'administrateur ou le dirigeant qui sont importants plutôt que leurs motifs subjectifs. Les administrateurs et les dirigeants ne sont pas considérés comme ayant manqué à leur obligation de diligence en vertu de l'art. 122(1)b) LCSA s'ils ont agi avec prudence et en s'appuyant sur les renseignements dont ils disposaient. Les décisions d'affaires doivent être raisonnables compte tenu de ce que les administrateurs savaient ou auraient dû savoir. La perfection n'est pas exigée des administrateurs. Les tribunaux ne doivent pas substituer leur opinion à celle des administrateurs qui ont utilisé leur expertise commerciale pour évaluer des considérations qui entrent dans la prise de décisions des sociétés. Ils doivent déterminer, à partir des faits de chaque cas, si les administrateurs ont exercé le degré de prudence et de diligence nécessaire pour en arriver à ce qu'on prétend être une décision d'affaires raisonnable au moment où elle a été prise. Dans ce cas-ci, l'examen de l'ensemble de la preuve menait à la conclusion que l'instauration de la nouvelle politique d'approvisionnement était une décision d'affaires raisonnable prise en vue de corriger un problème d'ordre commercial grave et urgent dans un cas où il n'y avait peut-être aucune solution. En concluant

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que la nouvelle politique avait inexorablement entraîné le déclin et la faillite de P inc., le premier juge a mal interprété les faits et a commis une erreur manifeste et dominante. Plusieurs autres facteurs avaient contribué de façon plus directe à la faillite de P inc. Ainsi, en adoptant la politique d'approvisionnement, les frères n'ont pas manqué à leur obligation de diligence à l'égard des créanciers de P inc.

Par ailleurs, la Cour d'appel a conclu à tort que l'art. 44(2) LCSA servait à légitimer de façon générale l'aide financière fournie par une filiale à part entière à sa société mère. Même si l'art. 44(2) autorisait certaines formules d'aide financière entre sociétés, il ne soustrayait cependant pas les administrateurs et les dirigeants à leur responsabilité éventuelle en vertu de l'art. 122(1) pour toute aide financière fournie par une filiale à sa société-mère. De plus, les frères ne pouvaient se servir du moyen de défense prévu à l'art. 123(4)b). Ils ne pouvaient faire valoir qu'ils s'étaient fiés au jugement d'un professionnel en retenant la solution proposée par le vice-président aux finances, soit la politique d'approvisionnement. Ce vice-président était un employé de W inc. et non un professionnel. Il n'était pas comptable, ses activités n'étaient pas réglementées par un ordre professionnel et il n'avait pas souscrit à une assurance-responsabilité professionnelle.

En ce qui concerne l'art. 100(1) LFI, le critère applicable pour déterminer si la différence entre la contrepartie et sa juste valeur marchande est « manifestement supérieure ou inférieure » est celui de savoir si la différence est manifeste pour le tribunal eu égard à tous les facteurs pertinents, le pourcentage de différence en étant un. Dans ce cas-ci, il fallait analyser les transactions effectuées au cours de toute la période d'application de la nouvelle politique. Le premier juge a conclu que P inc. n'avait reçu aucune contrepartie pour les transferts de stock puisque les comptes recevables n'avaient pas été recouvrés et n'étaient pas recouvrables, mais il a ramené la différence à environ 6 pour cent après avoir notamment tenu compte des transferts de W inc. à P inc. Ses conclusions se contredisaient et la Cour d'appel a eu raison de conclure que le juge avait commis à cet égard une erreur manifeste et dominante. Un écart d'un peu plus de 6 pour cent entre la juste valeur du marché et la contrepartie reçue ne constituait pas une différence « manifeste » au sens de l'art. 100(2) LFI. La réclamation du syndic à cet égard devait échouer.

Le désaccord entre le premier juge et la Cour d'appel sur l'interprétation des mots « ayant intérêt » à l'art. 100(3) LFI justifiait de faire certaines observations. L'article 100 LFI vise principalement à annuler les effets d'une transaction ayant diminué la valeur des actifs d'un failli. Les termes « ayant intérêt » doivent recevoir un sens large afin de s'appliquer aux personnes qui tirent un avantage direct ou indirect d'un transaction tout en sachant que la contrepartie est inférieure à la juste valeur du marché, surtout lorsque les personnes touchant l'avantage sont les instigatrices de la transaction. Par ailleurs, le fait de conclure qu'une personne a un « intérêt » dans une transaction révisable ne veut pas dire que le tribunal va nécessairement exercer son pouvoir discrétionnaire pour rendre une ordonnance réparatrice contre cette personne, étant donné que certaines conditions doivent être respectées.

**Cases considered by *Major, Deschamps JJ.*:**

*Automatic Self Cleansing Filter Syndicate Co. v. Cunninghame* (1906), [1906] 2 Ch. 34 (Eng. Ch.) -- referred to

*B. (K.L.) v. British Columbia* (2003), 18 B.C.L.R. (4th) 1, 19 C.C.L.T. (3d) 66, 230 D.L.R. (4th) 513, [2003] 11 W.W.R. 203, 309 N.R. 306, [2003] 2 S.C.R. 403, [2003] R.R.A. 1065, 44 R.F.L. (5th) 245, 187 B.C.A.C. 42, 307 W.A.C. 42, 38 C.P.C. (5th) 199, 2003 SCC 51, 2003 CarswellBC 2405, 2003 CarswellBC 2406, 2004 C.L.L.C. 210-014 (S.C.C.) -- considered

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*Brasserie Labatt ltée c. Lanoue* (1999), 1999 CarswellQue 1121 (Que. C.A.) -- referred to

*Brazilian Rubber Plantation & Estates Ltd., Re* (1911), [1911] 1 Ch. 425 (Eng. Ch. Div.) -- referred to

*Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592, 40 D.L.R. (3d) 371, 11 C.P.R. (2d) 206, 1973 CarswellOnt 236, 1973 CarswellOnt 236F (S.C.C.) -- considered

*City Equitable Fire Insurance Co., Re* (1924), 40 T.L.R. 664, [1925] 1 Ch. 407 (Eng. C.A.) -- referred to

*Dovey v. Cory* (1901), [1901] A.C. 477 (Eng. H.L.) -- referred to

*Hôpital Notre-Dame de l'Espérance c. Laurent* (1977), (sub nom. *Laurent v. Theoret)* [1978] 1 S.C.R. 605, 17 N.R. 593, 3 C.C.L.T. 109, 1977 CarswellQue 35, 1977 CarswellQue 33 (S.C.C.) -- referred to

*Lister v. McAnulty* (1944), [1944] S.C.R. 317, [1944] R.L. 425, [1944] 3 D.L.R. 673, 1944 CarswellQue 30 (S.C.C.) -- referred to

*Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254, 37 D.L.R. (4th) 193, 1986 CarswellOnt 1050 (Ont. Div. Ct.) -- followed

*Pente Investment Management Ltd. v. Schneider Corp.* (1998), 1998 CarswellOnt 4035, 113 O.A.C. 253, (sub nom. *Maple Leaf Foods Inc. v. Schneider Corp.)* 42 O.R. (3d) 177, 44 B.L.R. (2d) 115 (Ont. C.A.) -- considered

*Regent Taxi & Transport Co. v. Congrégation des petits frères de Marie* (1929), [1929] S.C.R. 650, [1930] 2 D.L.R. 353, 1929 CarswellQue 42 (S.C.C.) -- considered

*Regent Taxi & Transport Co. v. Congrégation des petits frères de Marie* (1932), [1932] A.C. 295, 38 R.L.N.S. 261, [1932] 2 D.L.R. 70, 53 Que. K.B. 157 (Que. K.B.) -- referred to

*Skalbania (Trustee of) v. Wedgewood Village Estates Ltd.* (1989), 37 B.C.L.R. (2d) 88, 74 C.B.R. (N.S.) 97, [1989] 5 W.W.R. 254, 60 D.L.R. (4th) 43, 44 C.R.R. 341, 1989 CarswellBC 344 (B.C. C.A.) -- followed

*Soper v. R.* (1997), [1997] 3 C.T.C. 242, 1997 CarswellNat 853, (sub nom. *Soper v. Canada)* 149 D.L.R. (4th) 297, 97 D.T.C. 5407, (sub nom. *Soper v. Minister of National Revenue)* 215 N.R. 372, (sub nom. *Soper v. Canada)* [1998] 1 F.C. 124, 1997 CarswellNat 2675 (Fed. C.A.) -- considered

*Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1995), 36 C.B.R. (3d) 1, 129 D.L.R. (4th) 18, 26 O.R. (3d) 1, (sub nom. *Standard Trustco Ltd. (Bankrupt) v. Standard Trust Co.)* 86 O.A.C. 1, 1995 CarswellOnt 932 (Ont. C.A.) -- followed

*Teck Corp. v. Millar* (1972), [1973] 2 W.W.R. 385, 33 D.L.R. (3d) 288, 1972 CarswellBC 284 (B.C. S.C.) -- considered

*373409 Alberta Ltd. (Receiver of) v. Bank of Montreal* (2002), [2002] 4 S.C.R. 312, 2002 SCC 81, 2002 CarswellAlta 1573, 2002 CarswellAlta 1574, [2003] 2 W.W.R. 1, 29 B.L.R. (3d) 1, (sub nom. *Bank of Montreal v. Ernst & Young Inc.)* 220 D.L.R. (4th) 193, (sub nom. *373409 Alberta Ltd. v. Bank of*

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*Montreal)* 296 N.R. 244, 8 Alta. L.R. (4th) 199, 317 A.R. 349, 284 W.A.C. 349, [2003] R.R.A. 1 (S.C.C.) -- distinguished

*820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123, 1991 CarswellOnt 142 (Ont. Gen. Div.) -- considered

*820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113, 1991 CarswellOnt 141 (Ont. Div. Ct.) -- referred to

**Statutes considered:**

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

Generally -- referred to

s. 100 -- considered

s. 100(1) -- considered

s. 100(2) -- referred to

*Canada Business Corporations Act*, R.S.C. 1985, c. C-44

Generally -- referred to

s. 44 -- referred to

s. 44(1) -- considered

s. 44(2) -- considered

s. 44(2)(c) -- considered

s. 102 -- considered

s. 102(1) -- considered

s. 121 -- considered

s. 122(1) -- considered

s. 122(1)(a) -- considered

s. 122(1)(b) -- considered

s. 123(4) -- considered

s. 123(4)(b) -- referred to

s. 185 -- referred to

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s. 238 "complainant" -- considered

s. 238 "complainant" (a) -- considered

s. 238 "complainant" (d) -- considered

s. 241 -- referred to

s. 241(2)(c) -- considered

*Code civil du Québec*, L.Q. 1991, c. 64

en général -- referred to

art. 300 -- referred to

art. 311 -- referred to

art. 1457 -- considered

art. 2501 -- referred to

*Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

Generally -- referred to

*Interpretation Act*, R.S.C. 1985, c. I-21

s. 8.1 [en. 2001, c. 4, s. 8] -- referred to

**Words and phrases considered**

**best interests of the corporation**

From an economic perspective, the "best interests of the corporation" [in s. 122(1)(a) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44] means the maximization of the value of the corporation: see E.M. Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39(3) *Can. Bus. L.J.* 398, at pp. 400-1.

**vicinity of insolvency**

That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability.

**Termes et locutions cités**

**au mieux des intérêts de la société**

D'un point de vue économique, l'expression « au mieux des intérêts de la société » [dans l'art. 122(1)a) de la *Loi canadienne sur les sociétés par actions*, L.R.C. 1985, c. C-44] s'entend de la maximisation de la valeur de

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l'entreprise : voir E.M. Iacobucci, « Directors' Duties in Insolvency: Clarifying What Is at Stake » (2003), 39(3) *Rev. can. D. comm.* 398, p. 400-401

**au bord de l'insolvabilité**

Cette expression n'a pas été définie; elle ne peut être définie et n'a aucune signification en droit. Elle vise manifestement à illustrer une détérioration de la stabilité financière de la société.

APPEAL by bankruptcy trustee from judgment reported at *People's Department Stores Ltd. (1992) Inc., Re* (2003), 2003 CarswellQue 145, (sub nom. *Peoples Department Stores Inc. (Trustees of) v. Wise)* 224 D.L.R. (4th) 509, [2003] R.J.Q. 796, 41 C.B.R. (4th) 225 (Que. C.A.), allowing appeal by directors of bankrupt corporation from judgment allowing trustee's motion to recover funds of corporation and finding directors personally liable.

POURVOI du syndic de faillite à l'encontre de l'arrêt publié à *People's Department Stores Ltd. (1992) Inc., Re* (2003), 2003 CarswellQue 145, (sub nom. *Peoples Department Stores Inc. (Trustees of) v. Wise)* 224 D.L.R. (4th) 509, [2003] R.J.Q. 796, 41 C.B.R. (4th) 225 (C.A. Qué), qui a accueilli le pourvoi des administrateurs d'une société en faillite à l'encontre du jugement qui avait accueilli la requête en recouvrement des fonds de la société présentée par le syndic et condamné personnellement les administrateurs.

***Major, Deschamps JJ.*:**

**I. Introduction**

1 The principal question raised by this appeal is whether directors of a corporation owe a fiduciary duty to the corporation's creditors comparable to the statutory duty owed to the corporation. For the reasons that follow, we conclude that directors owe a duty of care to creditors, but that duty does not rise to a fiduciary duty. We agree with the disposition of the Quebec Court of Appeal. The appeal is therefore dismissed.

2 As a result of the demise in the mid-1990s of two major retail chains in eastern Canada, Wise Stores Inc. ("Wise") and its wholly-owned subsidiary, Peoples Department Stores Inc. ("Peoples"), the indebtedness of a number of Peoples' creditors went unsatisfied. In the wake of the failure of the two chains, Caron Bélanger Ernst & Young Inc., Peoples' trustee in bankruptcy (the "trustee"), brought an action against the directors of Peoples. To address the trustee's claims, the extent of the duties imposed by s. 122(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA"), upon directors with respect to creditors must be determined; we must also identify the purpose and reach of s. 100 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA").

3 In our view, it has not been established that the directors of Peoples violated either the fiduciary duty or the duty of care imposed by s. 122(1) of the CBCA. As for the trustee's submission regarding s. 100 of the BIA, we agree with the Court of Appeal that the consideration received in the impugned transactions was not "conspicuously" less than fair market value. The BIA claim fails on that basis.

**II. Background**

4 Wise was founded by Alex Wise in 1930 as a small clothing store on St-Hubert Street in Montreal. By 1992, through expansion effected by a mix of internal growth and acquisitions, it had become an enterprise operating at 50 locations with annual sales of approximately $100 million, and it had been listed on the Montreal Stock Exchange in 1986. The stores were, for the most part, located in urban areas in Quebec. The founder's three

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sons, Lionel, Ralph and Harold Wise (the "Wise brothers"), were majority shareholders, officers, and directors of Wise. Together, they controlled 75 percent of the firm's equity.

5 In 1992, Peoples had been in business continuously in one form or another for 78 years. It had operated as an unincorporated division of Marks & Spencer Canada Inc. ("M & S") until 1991, when it was incorporated as a separate company. M & S itself was wholly owned by the large British firm, Marks & Spencer plc. ("M & S plc."). Peoples' 81 stores were generally located in rural areas, from Ontario to Newfoundland. Peoples had annual sales of about $160 million, but was struggling financially. Its annual losses were in the neighbourhood of $10 million.

6 Wise and Peoples competed with other chains such as Canadian Tire, Greenberg, Hart, K-Mart, M-Stores, Metropolitan Stores, Rossy, Woolco and Zellers. Retail competition in eastern Canada was intense in the early 1990s. In 1992, M-Stores went bankrupt. In 1994, Greenberg and Metropolitan Stores followed M-Stores into bankruptcy. The 1994 entry of Wal-Mart into the Canadian market, with its acquisition of over 100 Woolco stores from Woolworth Canada Inc., exerted significant additional competitive pressure on retail stores.

7 Lionel Wise, the eldest of the three brothers and Wise's executive vice-president, had expressed an interest in acquiring the ailing Peoples chain from M & S as early as 1988. Initially, M & S did not share Wise's interest for the sale, but by late 1991, M & S plc., the British parent company of M & S, had decided to divest itself of all its Canadian operations. At this point, M & S incorporated each of its three Canadian divisions to facilitate the anticipated divestiture thereof.

8 The new-found desire to sell coincided with Wise's previously expressed interest in acquiring its larger rival. Although M & S had initially hoped to sell Peoples for cash to a large firm in a solid financial condition, it was unable to do so. Consequently, negotiations got underway with representatives of Wise. A formal share purchase agreement was drawn up in early 1992 and executed in June 1992, with July 16, 1992 as its closing date.

9 Wise incorporated a company, 2798832 Canada Inc., for the purpose of acquiring all of the issued and outstanding shares of Peoples from M & S. The $27- million share acquisition proceeded as a fully leveraged buyout. The portion of the purchase price attributable to inventory was discounted by 30 percent. The discount was designed to inject equity into Peoples in the fiscal year following the sale and to make use of some of the tax losses that had accumulated in prior years.

10 The amount of the down payment due to M & S at closing, $5 million, was borrowed from the Toronto Dominion Bank (the "TD Bank"). According to the terms of the share purchase agreement, the $22-million balance of the purchase price would be carried by M & S and would be repaid over a period of eight years. Wise guaranteed all of 2798832 Canada Inc.'s obligations pursuant to the terms of the share purchase agreement.

11 To protect its interests, M & S took the assets of Peoples as security (subject to a priority in favour of the TD Bank) and negotiated strict covenants concerning the financial management and operation of the company. Among other requirements, 2798832 Canada Inc. and Wise were obligated to maintain specific financial ratios, and Peoples was not permitted to provide financial assistance to Wise. In addition, the agreement provided that Peoples could not be amalgamated with Wise until the purchase price had been paid. This prohibition was presumably intended to induce Wise to refinance and pay the remainder of the purchase price as early as possible in order to overcome the strict conditions imposed upon it under the share purchase agreement.

12 On January 31, 1993, 2798832 Canada Inc. was amalgamated with Peoples. The new entity retained

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Peoples' corporate name. Since 2798832 Canada Inc. had been a wholly-owned subsidiary of Wise, upon amalgamation the new Peoples became a subsidiary directly owned and controlled by Wise. The three Wise brothers were Peoples' only directors.

13 Following the acquisition, Wise had attempted to rationalize its operations by consolidating the overlapping corporate functions of Wise and Peoples, and operating as a group. The consolidation of the administration, accounting, advertising and purchasing departments of the two corporations was completed by the fall of 1993. As a consequence of the changes, many of Wise's employees worked for both firms but were paid solely by Wise. The evidence at trial was that because of the tax losses carried-forward by Peoples, it was advantageous for the group to have more expenses incurred by Wise, which, if the group was profitable as a whole, would increase its after-tax profits. Almost from the outset, the joint operation of Wise and Peoples did not function smoothly. Instead of the expected synergies, the consolidation resulted in dissonance.

14 After the acquisition, the total number of buyers for the two companies was nearly halved. The procurement policy at that point required buyers to deal simultaneously with suppliers on behalf of both Peoples and Wise. For the buyers, this nearly doubled their administrative work. Separate invoices were required for purchases made on behalf of Wise and Peoples. These invoices had to be separately entered into the system, tracked and paid.

15 Inventory, too, was separately recorded and tracked in the system. However, the inventory of each company was handled and stored, often unsegregated, in shared warehouse facilities. The main warehouse for Peoples, on Cousens Street in Ville St-Laurent, was maintained for and used by both firms. The Cousens warehouse saw considerable activity, as it was the central distribution hub for both chains. The facility was open 18 hours a day and employed 150 people on two shifts who handled a total of approximately 30,000 cartons daily through 20 loading docks. It was abuzz with activity.

16 Before long, the parallel bookkeeping combined with the shared warehousing arrangements caused serious problems for both Wise and Peoples. The actual situation in the warehouse often did not mirror the reported state of the inventory in the system. The goods of one company were often inextricably commingled and confused with the goods of the other. As a result, the inventory records of both companies were increasingly incorrect. A physical inventory count was conducted to try to rectify the situation, to little avail. Both Wise and Peoples stores experienced numerous shipping disruptions and delays. The situation, already unsustainable, was worsening.

17 In October 1993, Lionel Wise consulted David Clément, Wise's (and, after the acquisition, Peoples') vice-president of administration and finance, in an attempt to find a solution. In January 1994, Clément recommended and the three Wise brothers agreed that they would implement a joint inventory procurement policy (the "new policy") whereby the two firms would divide responsibility for purchasing. Peoples would make all purchases from North American suppliers and Wise would, in turn, make all purchases from overseas suppliers. Peoples would then transfer to Wise what it had purchased for Wise, charging Wise accordingly, and vice versa. The new policy was implemented on February 1, 1994. It was this arrangement that was later criticized by certain creditors and by the trial judge.

18 Approximately 82 percent of the total inventory of Wise and Peoples was purchased from North American suppliers, which inevitably meant that Peoples would be extending a significant trade credit to Wise. The new policy was known to the directors, but was neither formally implemented in writing nor approved by a board

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meeting or resolution.

19 On April 27, 1994, Lionel Wise outlined the details of the new policy at a meeting of Wise's audit committee. A partner of Coopers & Lybrand was M & S's representative on Wise's board of directors and a member of the audit committee. He attended the April 27th meeting and raised no objection to the new policy when it was introduced.

20 By June 1994, financial statements prepared to reflect the financial position of Peoples as of April 30, 1994 revealed that Wise owed more than $18 million to Peoples. Approximately $14 million of this amount resulted from a notional transfer of inventory that was cancelled following the period's end. M & S was concerned about the situation and started an investigation, as a result of which M & S insisted that the new procurement policy be rescinded. Wise agreed to M & S's demand but took the position that the former procurement policy could not be reinstated immediately. An agreement was executed on September 27, 1994, effective July 21, 1994, and it provided that the new policy would be abandoned as of January 31, 1995. The agreement also specified that the inventory and records of the two companies would be kept separate, and that the amount owed to Peoples by Wise would not exceed $3 million.

21 Another result of the negotiations was that M & S accepted an increase in the amount of the TD Bank's priority to $15 million and a new repayment schedule for the balance of the purchase price owed to M & S. The parties agreed to revise the schedule to provide for 37 monthly payments beginning in July 1995. Each of the Wise brothers also provided a personal guarantee of $500,000 in favour of M & S.

22 In September 1994, in light of the fragile financial condition of the companies and the competitiveness of the retail market, the TD Bank announced its intention to cease doing business with Wise and Peoples as of the end of December 1994. Following negotiations, however, the bank extended its financial support until the end of July 1995. The Wise brothers promised to extend personal guarantees in favour of the TD Bank, but this did not occur.

23 In December 1994, three days after the Wise brothers presented financial statements showing disappointing results for Peoples in its third fiscal quarter, M & S initiated bankruptcy proceedings against both Wise and Peoples. A notice of intention to make a proposal was filed on behalf of Peoples the same day. Nonetheless, Peoples later consented to the petition by M & S, and both Wise and Peoples were declared bankrupt on January 13, 1995, effective December 9, 1994. The same day, M & S released each of the Wise brothers from their personal guarantees. M & S apparently preferred to proceed with an uncontested petition in bankruptcy rather than attempting to collect on the personal guarantees.

24 The assets of Wise and Peoples were sufficient to cover in full the outstanding debt owed to the TD Bank, satisfy the entire balance of the purchase price owed to M & S, and discharge almost all the landlords' lease claims. The bulk of the unsatisfied claims were those of trade creditors.

25 Following the bankruptcy, Peoples' trustee filed a petition against the Wise brothers. In the petition, the trustee claimed that they had favoured the interests of Wise over Peoples to the detriment of Peoples' creditors, in breach of their duties as directors under s. 122(1) of the CBCA. The trustee also claimed that the Wise brothers had, in the year preceding the bankruptcy, been privy to transactions in which property had been transferred for conspicuously less than fair market value within the meaning of s. 100 of the BIA.

26 Pursuant to art. 2501 of the *Civil Code of Québec*, S.Q. 1991, c. 64 ("C.C.Q."), the trustee named Chubb

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Insurance Company of Canada ("Chubb"), which had provided directors' insurance to Wise and its subsidiaries, as a defendant in addition to the Wise brothers.

27 The trial judge, Greenberg J., relying on decisions from the United Kingdom, Australia and New Zealand, held that the fiduciary duty and the duty of care under s. 122 (1) of the CBCA extend to a company's creditors when a company is insolvent or in the vicinity of insolvency. Greenberg J. found that the implementation, by the Wise brothers qua directors of Peoples, of a corporate policy that affected both companies, had occurred while the corporation was in the vicinity of insolvency and was detrimental to the interests of the creditors of Peoples. The Wise brothers were therefore found liable and the trustee was awarded $4.44 million in damages. As Chubb had provided insurance coverage for directors, it was also held liable. Greenberg J. also considered the alternative grounds under the BIA advanced by the trustee and found the Wise brothers liable for the same $4.44 million amount on that ground as well. All the parties appealed.

28 The Quebec Court of Appeal, *per* Pelletier J.A., with Robert C.J.Q. and Nuss J.A. concurring, allowed the appeals by Chubb and the Wise brothers. The Court of Appeal expressed reluctance to follow Greenberg J. in equating the interests of creditors with the best interests of the corporation when the corporation was insolvent or in the vicinity of insolvency, stating that an innovation in the law such as this is a policy matter more appropriately dealt with by Parliament than the courts. In considering the trustee's claim under s. 100 of the BIA, Pelletier J.A. held that the trial judge had committed a palpable and overriding error in concluding that the amounts owed by Wise to Peoples in respect of inventory "were neither collected nor collectible". He found that the consideration received for the transactions had been approximately 94 percent of fair market value, and he was not convinced that this disparity could be characterized as being "conspicuously" less than fair market value. Moreover, he did not accept the broad meaning the trial judge gave to the word "privy". Pelletier J.A. declined to exercise his discretion under s. 100(2) of the BIA to make an order in favour of the trustee. In view of his conclusion that the Wise brothers were not liable, Pelletier J.A. allowed the appeal with respect to Chubb.

**III. Analysis**

29 At the outset, it should be acknowledged that according to art. 300 of the C.C.Q. and s. 8.1 of the *Interpretation Act*, R.S.C. 1985, c. I-21, the civil law serves as a supplementary source of law to federal legislation such as the CBCA. Since the CBCA does not entitle creditors to sue directors directly for breach of their duties, it is appropriate to have recourse to the *Civil Code of Québec* to determine how rights grounded in a federal statute should be addressed in Quebec, and more specifically how s. 122(1) of the CBCA can be harmonized with the principles of civil liability: see R. Crête and S. Rousseau, *Droit des sociétés par actions: principes fondamentaux* (2002), at p. 58.

30 This case came before our Court on the issue of whether directors owe a duty to creditors. The creditors did not bring a derivative action or an oppression remedy application under the CBCA. Instead, the trustee, representing the interests of the creditors, sued the directors for an alleged breach of the duties imposed by s. 122(1) of the CBCA. The standing of the trustee to sue was not questioned.

31 The primary role of directors is described in s. 102(1) of the CBCA:

> **102.** (1) Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation.

As for officers, s. 121 of the CBCA provides that their powers are delegated to them by the directors:

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121. Subject to the articles, the by-laws or any unanimous shareholder agreement,

(a) the directors may designate the offices of the corporation, appoint as officers persons of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in subsection 115(3);

(b) a director may be appointed to any office of the corporation; and

(c) two or more offices of the corporation may be held by the same person.

Although the shareholders are commonly said to own the corporation, in the absence of a unanimous shareholder agreement to the contrary, s. 102 of the CBCA provides that it is not the shareholders, but the directors elected by the shareholders, who are responsible for managing it. This clear demarcation between the respective roles of shareholders and directors long predates the 1975 enactment of the CBCA: see *Automatic Self Cleansing Filter Syndicate Co. v. Cunninghame*, [1906] 2 Ch. 34 (Eng. Ch.); see also art. 311, C.C.Q.

32 Subsection 122(1) of the CBCA establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, the corporation:

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

The first duty has been referred to in this case as the "fiduciary duty". It is better described as the "duty of loyalty". We will use the expression "statutory fiduciary duty" for purposes of clarity when referring to the duty under the CBCA. This duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The second duty is commonly referred to as the "duty of care". Generally speaking, it imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation's affairs.

33 The trial judge did not apply or consider separately the two duties imposed on directors by s. 122(1). As the Court of Appeal observed, the trial judge appears to have confused the two duties. They are, in fact, distinct and are designed to secure different ends. For that reason, they will be addressed separately in these reasons.

*A. The Statutory Fiduciary Duty: Section 122(1)(a) of the CBCA*

34 Considerable power over the deployment and management of financial, human, and material resources is vested in the directors and officers of corporations. For the directors of CBCA corporations, this power originates in s. 102 of the Act. For officers, this power comes from the powers delegated to them by the directors. In deciding to invest in, lend to or otherwise deal with a corporation, shareholders and creditors transfer control over their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation's resources to make reasonable business decisions that are to the corporation's advantage.

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35 The statutory fiduciary duty requires directors and officers to act honestly and in good faith *vis-à-vis* the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally: see K.P. McGuinness, *The Law and Practice of Canadian Business Corporations* (1999), at p. 715.

36 The common law concept of fiduciary duty was considered in *B. (K.L.) v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51 (S.C.C.). In that case, which involved the relationship between the government and foster children, a majority of this Court agreed with McLachlin C.J. who stated, at paras. 40-41 and 49:

> ...Fiduciary duties arise in a number of different contexts, including express trusts, relationships marked by discretionary power and trust, and the special responsibilities of the Crown in dealing with aboriginal interests....
>
> What ... might the content of the fiduciary duty be if it is understood ... as a private law duty arising simply from the relationship of discretionary power and trust between the Superintendent and the foster children? In *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, at pp. 646-47, La Forest J. noted that there are certain common threads running through fiduciary duties that arise from relationships marked by discretionary power and trust, such as loyalty and "the avoidance of a conflict of duty and interest and a duty not to profit at the expense of the beneficiary". <u>However, he also noted that "[t]he obligation imposed may vary in its specific substance depending on the relationship" (p. 646)</u>....
>
> ...concern for the best interests of the child informs the parental fiduciary relationship, as La Forest J. noted in *M. (K.) v. M. (H.), supra*, at p. 65. But the duty imposed is to act loyally, and not to put one's own or others' interests ahead of the child's in a manner that abuses the child's trust.... The parent who exercises undue influence over the child in economic matters for his own gain has put his own interests ahead of the child's, in a manner that abuses the child's trust in him. The same may be said of the parent who uses a child for his sexual gratification or a parent who, wanting to avoid trouble for herself and her household, turns a blind eye to the abuse of a child by her spouse. The parent need not, as the Court of Appeal suggested in the case at bar, be consciously motivated by a desire for profit or personal advantage; nor does it have to be her own interests, rather than those of a third party, that she puts ahead of the child's. It is rather a question of disloyalty -- of putting someone's interests ahead of the child's in a manner that abuses the child's trust. <u>Negligence, even aggravated negligence, will not ground parental fiduciary liability unless it is associated with breach of trust in this sense</u>. [Emphasis added.]

37 The issue to be considered here is the "specific substance" of the fiduciary duty based on the relationship of directors to corporations under the CBCA.

38 It is settled law that the fiduciary duty owed by directors and officers imposes strict obligations: see *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592 (S.C.C.), at pp. 609-10, *per* Laskin J. (as he then was), where it was decided that directors and officers may even have to account to the corporation for profits they make that do not come at the corporation's expense:

> The reaping of a profit by a person at a company's expense while a director thereof is, of course, an ad-

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> equate ground upon which to hold the director accountable. Yet there may be situations where a profit must be disgorged, although not gained at the expense of the company, on the ground that a director must not be allowed to use his position as such to make a profit even if it was not open to the company, as for example, by reason of legal disability, to participate in the transaction. An analogous situation, albeit not involving a director, existed for all practical purposes in the case of *Phipps v. Boardman* [[1967] 2 A.C. 46], which also supports the view that liability to account does not depend on proof of an actual conflict of duty and self-interest. Another, quite recent, illustration of a liability to account where the company itself had failed to obtain a business contract and hence could not be regarded as having been deprived of a business opportunity is *Industrial Development Consultants Ltd. v. Cooley* [[1972] 2 All E.R. 162], a judgment of a Court of first instance. There, the managing director, who was allowed to resign his position on a false assertion of ill health, subsequently got the contract for himself. That case is thus also illustrative of the situation where a director's resignation is prompted by a decision to obtain for himself the business contract denied to his company and where he does obtain it without disclosing his intention. [Emphasis added.]

A compelling argument for making directors accountable for profits made as a result of their position, though not at the corporation's expense, is presented by J. Brock, "The Propriety of Profitmaking: Fiduciary Duty and Unjust Enrichment" (2000), 58 *U.T. Fac. L. Rev.* 185, at pp. 204-5.

39 However, it is not required that directors and officers in all cases avoid personal gain as a direct or indirect result of their honest and good faith supervision or management of the corporation. In many cases the interests of directors and officers will innocently and genuinely coincide with those of the corporation. If directors and officers are also shareholders, as is often the case, their lot will automatically improve as the corporation's financial condition improves. Another example is the compensation that directors and officers usually draw from the corporations they serve. This benefit, though paid by the corporation, does not, if reasonable, ordinarily place them in breach of their fiduciary duty. Therefore, all the circumstances may be scrutinized to determine whether the directors and officers have acted honestly and in good faith with a view to the best interests of the corporation.

40 In our opinion, the trial judge's determination that there was no fraud or dishonesty in the Wise brothers' attempts to solve the mounting inventory problems of Peoples and Wise stands in the way of a finding that they breached their fiduciary duty. Greenberg J. stated, at para. 180:

> We hasten to add that in the present case, the Wise Brothers derived no direct personal benefit from the new domestic inventory procurement policy, albeit that, as the controlling shareholders of Wise Stores, there was an indirect benefit to them. Moreover, as was conceded by the other parties herein, in deciding to implement the new domestic inventory procurement policy, there was no dishonesty or fraud on their part.

The Court of Appeal relied heavily on this finding by the trial judge, as do we. At para. 84, Pelletier J.A. stated that:

> [TRANSLATION] In regard to fiduciary duty, I would like to point out that the brothers were driven solely by the wish to resolve the problem of inventory procurement affecting both the operations of Peoples Inc. and those of Wise. [This is a] motivation that is in line with the pursuit of the interests of the corporation within the meaning of paragraph 122(1)(*a*) C.B.C.A. and that does not expose them to

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any justified criticism.

41 As explained above, there is no doubt that both Peoples and Wise were struggling with a serious inventory management problem. The Wise brothers considered the problem and implemented a policy they hoped would solve it. In the absence of evidence of a personal interest or improper purpose in the new policy, and in light of the evidence of a desire to make both Wise and Peoples "better" corporations, we find that the directors did not breach their fiduciary duty under s. 122(1)(*a*) of the CBCA. See *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 (Ont. Gen. Div.) (aff'd (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.)), in which Farley J., at p. 171, correctly observes that in resolving a conflict between majority and minority shareholders, it is safe for directors and officers to act to make the corporation a "better corporation".

42 This appeal does not relate to the non-statutory duty directors owe to shareholders. It is concerned only with the statutory duties owed under the CBCA. Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders". From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation: see E.M. Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39(3) *Can. Bus. L.J.* 398, at pp. 400-1. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. For example, in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C. S.C.), Berger J. stated, at p. 314:

> A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders.
>
> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v. Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

The case of *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Ont. Div. Ct.), approved, at p. 271, the decision in *Teck, supra.* We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

43 The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.

44 The interests of shareholders, those of the creditors and those of the corporation may and will be consistent with each other if the corporation is profitable and well capitalized and has strong prospects. However, this can

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change if the corporation starts to struggle financially. The residual rights of the shareholders will generally become worthless if a corporation is declared bankrupt. Upon bankruptcy, the directors of the corporation transfer control to a trustee, who administers the corporation's assets for the benefit of creditors.

45 Short of bankruptcy, as the corporation approaches what has been described as the "vicinity of insolvency", the residual claims of shareholders will be nearly exhausted. While shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation.

46 The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty.

47 For a discussion of the shifting interests and incentives of shareholders and creditors, see W.D. Gray, "*Peoples v. Wise* and *Dylex*: Identifying Stakeholder Interests upon or near Corporate Insolvency -- Stasis or Pragmatism?" (2003), 39 *Can. Bus. L.J.* 242, at p. 257; E. M. Iacobucci & K.E. Davis, "Reconciling Derivative Claims and the Oppression Remedy" (2000), 12 *S.C.L.R.* (2d) 87, at p. 114. In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders. If the stakeholders cannot avail themselves of the statutory fiduciary duty (the duty of loyalty, *supra*) to sue the directors for failing to take care of their interests, they have other means at their disposal.

48 The Canadian legal landscape with respect to stakeholders is unique. Creditors are only one set of stakeholders, but their interests are protected in a number of ways. Some are specific, as in the case of amalgamation: s. 185 of the CBCA. Others cover a broad range of situations. The oppression remedy of s. 241(2)(*c*) of the CBCA and the similar provisions of provincial legislation regarding corporations grant the broadest rights to creditors of any common law jurisdiction: see D. Thomson, "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000), 58(1) *U.T. Fac. L. Rev.* 31, at p. 48. One commentator describes the oppression remedy as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world": S.M. Beck, "Minority Shareholders' Rights in the 1980s" in *Corporate Law in the 80s* (1982), 311, at p. 312. While Beck was concerned with shareholder remedies, his observation applies equally to those of creditors.

49 The fact that creditors' interests increase in relevancy as a corporation's finances deteriorate is apt to be relevant to, *inter alia*, the exercise of discretion by a court in granting standing to a party as a "complainant" under s. 238(*d*) of the CBCA as a "proper person" to bring a derivative action in the name of the corporation under ss. 239 and 240 of the CBCA, or to bring an oppression remedy claim under s. 241 of the CBCA.

50 Section 241(2)(*c*) authorizes a court to grant a remedy

> if the powers of the directors of the corporation or any of its affiliates are or have been exercised in a

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manner

> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer...

A person applying for the oppression remedy must, in the court's opinion, fall within the definition of "complainant" found in s. 238 of the CBCA:

> (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
>
> (b) a director or an officer or a former director or officer of a corporation or any of its affiliates,
>
> (c) the Director, or
>
> (d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.

Creditors, who are not security holders within the meaning of para. (*a*), may therefore apply for the oppression remedy under para. (*d*) by asking a court to exercise its discretion and grant them status as a "complainant".

51 Section 241 of the CBCA provides a possible mechanism for creditors to protect their interests from the prejudicial conduct of directors. In our view, the availability of such a broad oppression remedy undermines any perceived need to extend the fiduciary duty imposed on directors by s. 122(1)(*a*) of the CBCA to include creditors.

52 The Court of Appeal, at paras. 99-100, referred to *373409 Alberta Ltd. (Receiver of) v. Bank of Montreal*, [2002] 4 S.C.R. 312, 2002 SCC 81 (S.C.C.), as an indication by this Court that the interests of creditors do not have any bearing on the assessment of the conduct of directors. However, the receiver in that case was representing the corporation's rights and not the creditors' rights; therefore, the case has no application in this appeal. *373409 Alberta Ltd.* involved an action taken by the receiver on behalf of the corporation against a bank for the tort of conversion. The sole shareholder, director and officer of 373409 Alberta Ltd., who was also the sole shareholder, director and officer of another corporation, Legacy Holdings Ltd., had deposited a cheque payable to 373409 Alberta Ltd. into the account of Legacy. While it was recognized, at para. 22, that the diversion of money from 373409 Alberta Ltd. to Legacy "may very well have been wrongful vis-à-vis [373409 Alberta Ltd.]'s creditors" (none of whom were involved in the action), no fraud had been committed against the corporation itself and the bank, acting on proper authority, had not wrongfully interfered with the cheque by carrying out the deposit instructions. The statutory duties of the directors were not at issue, nor were they considered, and no assessment of the creditors' rights was made. With respect, Pelletier J.A.'s broad reading of *373409 Alberta Ltd.* was misplaced.

53 In light of the availability both of the oppression remedy and of an action based on the duty of care, which will be discussed below, stakeholders have viable remedies at their disposal. There is no need to read the interests of creditors into the duty set out in s. 122(1)(*a*) of the CBCA. Moreover, in the circumstances of this case, the Wise brothers did not breach the statutory fiduciary duty owed to the corporation.

***B. The Statutory Duty of Care: Section 122(1)(b) of the CBCA***

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54 As mentioned above, the CBCA does not provide for a direct remedy for creditors against directors for breach of their duties and the C.C.Q. is used as suppletive law.

55 In Quebec, directors have been held liable to creditors in respect of either contractual or extra-contractual obligations. Contractual liability arises where the director personally guarantees a contractual obligation of the company. Liability also arises where the director personally acts in a manner that triggers his or her extra-contractual liability. See P. Martel, "Le 'voile corporatif' -- l'attitude des tribunaux face à l'article 317 du Code civil du Québec" (1998), 58 R. du B. 95, at pp. 135-36; *Brasserie Labatt ltée c. Lanoue*, [1999] J.Q. No. 1108 (Que. C.A.), *per* Forget J.A., at para. 29. It is clear that the Wise brothers cannot be held contractually liable as they did not guarantee the debts at issue here. Extra-contractual liability is the remaining possibility.

56 To determine the applicability of extra-contractual liability in this appeal, it is necessary to refer to art. 1457 of the C.C.Q.:

> Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another.
>
> Where he is endowed with reason and fails in this duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature.
>
> He is also liable, in certain cases, to reparation for injury caused to another by the act or fault of another person or by the act of things in his custody. [Emphasis added]

Three elements of art. 1457 of the C.C.Q. are relevant to the integration of the director's duty of care into the principles of extra-contractual liability: who has the duty ("every person"), to whom is the duty owed ("another") and what breach will trigger liability ("rules of conduct"). It is clear that directors and officers come within the expression "every person". It is equally clear that the word "another" can include the creditors. The reach of art. 1457 of the C.C.Q. is broad and it has been given an open and inclusive meaning. See *Regent Taxi & Transport Co. v. Congrégation des petits frères de Marie* , [1929] S.C.R. 650 (S.C.C.), *per* Anglin C.J., at p. 655 (rev'd on other grounds, [1932] 2 D.L.R. 70 (Que. K.B.)):

> ...to narrow the prima facie scope of art. 1053 C.C. [now art. 1457] is highly dangerous and would necessarily result in most meritorious claims being rejected; many a wrong would be without a remedy.

This liberal interpretation was also affirmed and treated as settled by this Court in *Lister v. McAnulty*, [1944] S.C.R. 317 (S.C.C.), and *Hôpital Notre-Dame de l'Espérance c. Laurent* (1977), [1978] 1 S.C.R. 605 (S.C.C.).

57 This interpretation can be harmoniously integrated with the wording of the CBCA. Indeed, unlike the statement of the fiduciary duty in s. 122(1)(*a*) of the CBCA, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in s. 122(1)(*b*) of the CBCA does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that "[e]very director and officer of a corporation in exercising his powers and discharging his duties shall ... exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors. This result is clearly consistent with the civil law interpretation of the word "another". Therefore, if breach of the standard of care, causation and damages are established, creditors can resort to art. 1457 to

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have their rights vindicated. The only issue thus remaining is the determination of the "rules of conduct" likely to trigger extracontractual liability. On this issue, art. 1457 is explicit.

58 The first paragraph of art. 1457 does not set the standard of conduct. Instead, it incorporates by reference s. 122(1)(*b*) of the CBCA. The statutory duty of care is a "duty to abide by [a rule] of conduct which lie[s] upon [them], according to the ... law, so as not to cause injury to another". Thus, for the purpose of determining whether the Wise brothers can be held liable, only the CBCA is relevant. It is therefore necessary to outline the requirements of the duty of care embodied in s. 122(1)(*b*) of the CBCA.

59 That directors must satisfy a duty of care is a long-standing principle of the common law, although the duty of care has been reinforced by statute to become more demanding. Among the earliest English cases establishing the duty of care were *Dovey v. Cory*, [1901] A.C. 477 (Eng. H.L.); *Brazilian Rubber Plantation & Estates Ltd., Re*, [1911] 1 Ch. 425 (Eng. Ch. Div.); and *City Equitable Fire Insurance Co., Re* (1924), [1925] 1 Ch. 407 (Eng. C.A.). In substance, these cases held that the standard of care was a reasonably relaxed, subjective standard. The common law required directors to avoid being grossly negligent with respect to the affairs of the corporation and judged them according to their own personal skills, knowledge, abilities and capacities. See McGuinness, *supra*, at p. 776: "Given the history of case law in this area, and the prevailing standards of competence displayed in commerce generally, it is quite clear that directors were not expected at common law to have any particular business skill or judgment".

60 The 1971 report entitled *Proposals for a New Business Corporations Law for Canada* (1971) ("Dickerson Report") culminated the work of a committee headed by R.W. V. Dickerson which had been appointed by the federal government to study the need for new federal business corporations legislation. This report preceded the enactment of the CBCA by four years and influenced the eventual structure of the CBCA.

61 The standard recommended by the Dickerson Report was objective, requiring directors and officers to meet the standard of a "reasonably prudent person" (vol. II, at. p. 74):

> **9.19**
>
> (1) Every director and officer of a corporation in exercising his powers and discharging his duties shall
>
> . . . . .
>
> (b) exercise the care, diligence and skill of a reasonably prudent person.

The report described how this proposed duty of care differed from the prevailing common law duty of care (vol. I, at p. 83):

> **242.** The formulation of the duty of care, diligence and skill owed by directors represents an attempt to upgrade the standard presently required of them. The principal change here is that whereas at present the law seems to be that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him, having regard to his knowledge and experience -- *Re City Equitable Fire Insurance Co.*, [1925] Ch. 425 -- under s. 9.19(1)(b) he is required to conform to the standard of a reasonably prudent man. Recent experience has demonstrated how low the prevailing legal standard of care for directors is, and we have sought to raise it significantly. We are aware of the argument that raising the standard of conduct for directors may

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> deter people from accepting directorships. The truth of that argument has not been demonstrated and we think it is specious. The duty of care imposed by s. 9.19(1)(b) is exactly the same as that which the common law imposes on every professional person, for example, and there is no evidence that this has dried up the supply of lawyers, accountants, architects, surgeons or anyone else. It is in any event cold comfort to a shareholder to know that there is a steady supply of marginally competent people available under present law to manage his investment. [Emphasis added.]

62 The statutory duty of care in s. 122(1)(*b*) of the CBCA emulates but does not replicate the language proposed by the Dickerson Report. The main difference is that the enacted version includes the words "in comparable circumstances", which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care. It is clear that s. 122(1)(*b*) requires more of directors and officers than the traditional common law duty of care outlined in, for example, *City Equitable Fire Insurance Co., Re, supra.*

63 The standard of care embodied in s. 122(1)(*b*) of the CBCA was described by Robertson J.A. of the Federal Court of Appeal in *Soper v. R.* (1997), [1998] 1 F.C. 124 (Fed. C.A.), at para. 41, as being "objective subjective". Although that case concerned the interpretation of a provision of the *Income Tax Act*, it is relevant here because the language of the provision establishing the standard of care was identical to that of s. 122(1)(*b*) of the CBCA. With respect, we feel that Robertson J.A.'s characterization of the standard as an "objective subjective" one could lead to confusion. We prefer to describe it as an objective standard. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(*b*) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(*a*) of the CBCA.

64 The contextual approach dictated by s.122(1)(*b*) of the CBCA not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders. Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand, have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.

65 In *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.), Weiler J.A. stated, at p. 192:

> The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. 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

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> 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 [references omitted]. This formulation of deference to the decision of the Board is known as the "business judgment rule". The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction
>
> [reference omitted]. [Emphasis added; italics in original.]

66 In order for a plaintiff to succeed in challenging a business decision he or she has to establish that the directors acted (i) in breach of the duty of care and (ii) in a way that caused injury to the plaintiff: W.T. Allen, J.B. Jacobs, and L.E. Strine, Jr., "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law" (2001), 26 *Del. J. Corp. L.* 859, at p. 892.

67 Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

68 The trustee alleges that the Wise brothers breached their duty of care under s. 122(1)(*b*) of the CBCA by implementing the new procurement policy to the detriment of Peoples' creditors. After considering all the evidence, we agree with the Court of Appeal that the implementation of the new policy was a reasonable business decision that was made with a view to rectifying a serious and urgent business problem in circumstances in which no solution may have been possible. The trial judge's conclusion that the new policy led inexorably to Peoples' failure and bankruptcy was factually incorrect and constituted a palpable and overriding error.

69 In fact, as noted by Pelletier J.A., there were many factors other than the new policy that contributed more directly to Peoples' bankruptcy. Peoples had lost $10 million annually while being operated by M & S. Wise, which was only marginally profitable and solvent with annual sales of $100 million (versus $160 million for Peoples), had hoped to improve the performance of its new acquisition. Given that the transaction was a fully leveraged buyout, for Wise and Peoples to succeed, Peoples' performance needed to improve dramatically. Unfortunately for both Wise and Peoples, the retail market in eastern Canada had become very competitive in the early 1990s, and this trend continued with the arrival of Wal-Mart in 1994. At paras. 153 and 155, Pelletier J.A. stated:

> [TRANSLATION] In reality, it was that particularly unfavourable financial situation in which the two corporations found themselves that caused their downfall, and it was M. & S. that, to protect its own interests, sounded the charge in December, rightly or wrongly judging that Peoples Inc.'s situation would only worsen over time. It is crystal-clear that the bankruptcy occurred at the most propitious time for M. & S.'s interests, when inventories were high and suppliers were unpaid. In fact, M. & S. recovered the entire balance due on the selling price and almost all of the other debts it was owed.

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. . . . .

> ...the trial judge did not take into account the fact that the brothers derived no direct benefit from the transaction impugned, that they acted in good faith and that their true intention was to find a solution to the serious inventory management problem that each of the two corporations was facing. Because of an assessment error, he also ignored the fact that Peoples Inc. received a sizable [sic]consideration for the goods it delivered to Wise. Lastly, I note that the act for which the brothers were found liable, i.e. the adoption of a new joint inventory procurement policy, is not as serious as the trial judge made it out to be and that, in opposition to his view, the act was also not the true cause of the bankruptcy of Peoples Inc. [Emphasis added.]

70 The Wise brothers treated the implementation of the new policy as a decision made in the ordinary course of business and, while no formal agreement evidenced the arrangement, a monthly record was made of the inventory transfers. Although this may appear to be a loose business practice, by the autumn of 1993, Wise had already consolidated several aspects of the operations of the two companies. Legally they were two separate entities. However, the financial fate of the two companies had become intertwined. In these circumstances, there was little or no economic incentive for the Wise brothers to jeopardize the interests of Peoples in favour of the interests of Wise. In fact, given the tax losses that Peoples had carried forward, the companies had every incentive to keep Peoples profitable in order to reduce their combined tax liabilities.

71 Arguably, the Wise brothers could have been more precise in pursuing a resolution to the intractable inventory management problems, having regard to all the troublesome circumstances involved at the time the new policy was implemented. But we, like the Court of Appeal, are not satisfied that the adoption of the new policy breached the duty of care under s. 122(1)(*b*) of the CBCA. The directors cannot be held liable for a breach of their duty of care in respect of the creditors of Peoples.

72 The Court of Appeal relied on two additional provisions of the CBCA that in its view could rescue the Wise brothers from a finding that they breached the duty of care: ss. 44(2) and 123(4).

73 Section 44 of the CBCA, which was in force at the time of the impugned transactions but has since been repealed, permitted a wholly-owned subsidiary to give financial assistance to its holding body corporate:

> 44.(1) Subject to subsection (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise
>
> . . . . .
>
> (2) A corporation may give financial assistance by means of a loan, guarantee or otherwise
>
> . . . . .
>
> (c) to a holding body corporate if the corporation is a wholly-owned subsidiary of the holding body corporate;

74 While s. 44(2) as it then read qualified the prohibition under s. 44(1), it did not serve to supplant the duties of the directors under s. 122(1) of the CBCA. The Court of Appeal erred in concluding that s. 44(2) served as a blanket legitimization of financial assistance given by wholly-owned subsidiaries to parent corporations. In our opinion, it is incumbent upon directors and officers to exercise their powers in conformity with the duties of s. 122(1).

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75 Although s. 44(2) authorized certain forms of financial assistance between corporations, this cannot exempt directors and officers from potential liability under s. 122(1) for any financial assistance given by subsidiaries to the parent corporation.

76 When faced with the serious inventory management problem, the Wise brothers sought the advice of the vice-president of finance, David Clément. The Wise brothers claimed as an additional argument that in adopting the solution proposed by Clément, they were relying in good faith on the judgment of a person whose profession lent credibility to his statement, in accordance with the defence provided for in s. 123(4)(*b*) (now s. 123(5)) of the CBCA. The Court of Appeal accepted the argument. We disagree.

77 The reality that directors cannot be experts in all aspects of the corporations they manage or supervise shows the relevancy of a provision such as s. 123(4)(*b*). At the relevant time, the text of s. 123(4) read:

> **123.** ...
>
> .....
>
> (4) A director is not liable under section 118, 119 or 122 if he relies in good faith on
>
> > (a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or
> >
> > (b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him.

78 Although Clément did have a bachelor's degree in commerce and 15 years of experience in administration and finance with Wise, this experience does not correspond to the level of professionalism required to allow the directors to rely on his advice as a bar to a suit under the duty of care. The named professional groups in s. 123(4)(*b*) were lawyers, accountants, engineers, and appraisers. Clément was not an accountant, was not subject to the regulatory overview of any professional organization and did not carry independent insurance coverage for professional negligence. The title of vice-president of finance should not automatically lead to a conclusion that Clément was a person "whose profession lends credibility to a statement made by him." It is noteworthy that the word "profession" is used, not "position". Clément was simply a non-professional employee of Wise. His judgment on the appropriateness of the solution to the inventory management problem must be regarded in that light. Although we might accept for the sake of argument that Clément was better equipped and positioned than the Wise brothers to devise a plan to solve the inventory management problems, this is not enough. Therefore, in our opinion, the Wise brothers cannot successfully invoke the defence provided by s. 123(4)(*b*) of the CBCA but must rely on the other defences raised.

***C. The Claim under Section 100 of the BIA***

79 The trustee also claimed against the Wise brothers under s. 100 of the BIA. That section reads:

> **100.**(1) Where a bankrupt sold, purchased, leased, hired, supplied or received property or services in a reviewable transaction within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the trustee, inquire into whether the bankrupt gave or received, as

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the case may be, fair market value in consideration for the property or services concerned in the transaction.

(2) Where the court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, against any other person being privy to the transaction with the bankrupt or against all those persons for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.

80 The provision has two principal elements. First, subs. (1) requires the transaction to have been conducted within the year preceding the date of bankruptcy. Second, subs. (2) requires that the consideration given or received by the bankrupt be "conspicuously greater or less" than the fair market value of the property concerned.

81 The word "may" is found in both ss. 100(1) and 100(2) of the BIA with respect to the jurisdiction of the court. In *Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1995), 26 O.R. (3d) 1 (Ont. C.A.), a majority of the Ontario Court of Appeal held that, even if the necessary preconditions are present, the exercise of jurisdiction under s. 100(1) to inquire into the transaction, and under s. 100(2) to grant judgment, is discretionary. Equitable principles guide the exercise of discretion. We agree.

82 Referring to s. 100(2) of the BIA, in *Standard Trustco, supra*, at p. 23, Weiler J.A. explained that:

> When a contextual approach is adopted it is apparent that although the conditions of the section have been satisfied the court is not obliged to grant judgment. The court has a residual discretion to exercise. The contextual approach indicates that the good faith of the parties, the intention with which the transaction took place, and whether fair value was given and received in the transaction are important considerations as to whether that discretion should be exercised.

We agree with Weiler J.A. and adopt her position; however, this appeal does not turn on the discretion to ultimately impose liability. In our view, the Court of Appeal did not interfere with the trial judge's exercise of discretion in reviewing the facts and finding a palpable and overriding error.

83 Within the year preceding the date of bankruptcy, Peoples had transferred inventory to Wise for which the trustee claimed Peoples had not received fair market value in consideration. The relevant transactions involved, for the most part, transfers completed in anticipation of the busy holiday season. Given the non-arm's length relationship between Wise and its wholly-owned subsidiary Peoples, there is no question that these inventory transfers could have constituted reviewable transactions.

84 We share the view of the Court of Appeal that it is not only the final transfers that should be considered. In fairness, the inventory transactions should be considered over the entire period from February to December 1994, which was the period when the new policy was in effect.

85 In *Skalbania (Trustee of) v. Wedgewood Village Estates Ltd.* (1989), 37 B.C.L.R. (2d) 88 (B.C. C.A.), the test for determining whether the difference in consideration is "conspicuously greater or less" was held to be not whether it is conspicuous to the parties at the time of the transaction, but whether it is conspicuous to the court having regard to all the relevant factors. This is a sound approach. In that case, a difference of $1.18 million

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between fair market value and the consideration received by the bankrupt was seen as conspicuous, where the fair market value was $6.6 million, leaving a discrepancy of more than 17 percent. While there is no particular percentage that definitively sets the threshold for a conspicuous difference, the percentage difference is a factor.

86 As for the factors that would be relevant to this determination, the court might consider, inter alia: evidence of the margin of error in valuing the types of assets in question; any appraisals made of the assets in question and evidence of the parties' honestly held beliefs regarding the value of the assets in question; and other circumstances adduced in evidence by the parties to explain the difference between the consideration received and fair market value: see L.W. Houlden and G.B. Morawetz, *Bankruptcy and Insolvency Law of Canada* (3rd ed. (loose-leaf)), vol. 2, at p. 4-114.1.

87 Over the lifespan of the new policy, Peoples transferred to Wise inventory valued at $71.54 million. As of the date of bankruptcy, it had received $59.50 million in property or money from Wise. As explained earlier, the trial judge adjusted the outstanding difference down to a balance of $4.44 million after taking into account, *inter alia*, the reallocation of general and administrative expenses, and adjustments necessitated by imported inventory transferred from Wise to Peoples. Neither party disputed these figures before this Court. We agree with the Court of Appeal's observation that these findings directly conflict with the trial judge's assertion that Peoples had received no consideration for the inventory transfers on the basis that the outstanding accounts were "neither collected nor collectible" from Wise. Like Pelletier J.A., we conclude that the trial judge's finding in this regard was a palpable and overriding error, and we adopt the view of the Court of Appeal.

88 We are not satisfied that, with regard to all the circumstances of this case, a disparity of slightly more than six percent between fair market value and the consideration received constitutes a "conspicuous" difference within the meaning of s. 100(2) of the BIA. Accordingly, we hold that the trustee's claim under the BIA also fails.

89 In addition to permitting the court to give judgment against the other party to the transaction, s. 100(2) of the BIA also permits it to give judgment against someone who was not a party but was "privy" to the transaction. Given our finding that the consideration for the impugned transactions was not "conspicuously less" than fair market value, there is no need to consider whether the Wise brothers would have been "privy" to the transaction for the purpose of holding them liable under s. 100(2). Nonetheless, the disagreement between the trial judge and the Court of Appeal on the interpretation of "privy" in s. 100(2) of the BIA warrants the following observations.

90 The trial judge in this appeal had little difficulty finding that the Wise brothers were privy to the transaction within the meaning of s. 100(2). Pelletier J.A., however, preferred a narrow construction in finding that the Wise brothers were not privy to the transactions. He held, at para. 136, that:

> [TRANSLATION] ... the legislator wanted to provide for the case in which a person other than the co-contracting party of the bankrupt actually received all or part of the benefit resulting from the lack of equality between the respective considerations.

To support this direct benefit requirement, Pelletier J.A. also referred to the French version which uses the term *ayant intérêt*. While he conceded that the respondent brothers received an indirect benefit from the inventory transfers as shareholders of Wise, Pelletier J.A. found this too remote to be considered "privy" to the transactions (paras. 140-41).

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91 The primary purpose of s. 100 of the BIA is to reverse the effects of a transaction that stripped value from the estate of a bankrupt person. It makes sense to adopt a more inclusive understanding of the word "privy" to prevent someone who might receive indirect benefits to the detriment of a bankrupt's unsatisfied creditors from frustrating the provision's remedial purpose. The word "privy" should be given a broad reading to include those who benefit directly or indirectly from and have knowledge of a transaction occurring for less than fair market value. In our opinion, this rationale is particularly apt when those who benefit are the controlling minds behind the transaction.

92 A finding that a person was "privy" to a reviewable transaction does not of course necessarily mean that the court will exercise its discretion to make a remedial order against that person. For liability to be imposed, it must be established that the transaction occurred: (a) within the past year; (b) for consideration conspicuously greater or less than fair market value; (c) with the person's knowledge; and (d) in a way that directly or indirectly benefited the person. In addition, after having considered the context and all the above factors, the judge must conclude that the case is a proper one for holding the person liable. In light of these conditions and of the discretion exercised by the judge, we find that a broad reading of "privy" is appropriate.

**IV. Disposition**

93 For the foregoing reasons, we would dismiss the appeal with costs to the respondents.

*Appeal dismissed.*

*Pourvoi rejeté.*

FN*. Iacobucci J. took no part in the judgment.

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Oppression Remedy

available to creditors; focusses on harm to interests of stakeholders affected by oppressive acts of a corp or its directors

2 stages (objective)

1. reasonable expectations breached
2. Conduct amounts to oppression, unfair prejudice, unfair disregard

prior to insolvency duty to consider impact of corporate decisions on a particular stakeholder group - in this case creditors (BCE Inc v. 1976

En

Duty of directors is to treat individual stakeholders affected by corp. acting equitably & fairly

Neg Misrep

*Indexed as:*

# BCE Inc. v. 1976 Debentureholders

**BCE Inc. and Bell Canada, Appellants/Respondents on cross-appeals;**
**v.**
**A Group of 1976 Debentureholders composed of: Aegon Capital Management Inc., Addenda Capital Inc., Phillips, Hager & North Investment Management Ltd., Sun Life Assurance Company of Canada, CIBC Global Asset Management Inc., Her Majesty the Queen in Right of Alberta, as represented by the Minister of Finance, Manitoba Civil Service Superannuation Board, TD Asset Management Inc. and Manulife Financial Corporation;**
**A Group of 1996 Debentureholders composed of: Aegon Capital Management Inc., Addenda Capital Inc., Phillips, Hager & North Investment Management Ltd., Sun Life Insurance (Canada) Limited, CIBC Global Asset Management Inc., Manitoba Civil Service Superannuation Board and TD Asset Management Inc.;**
**A Group of 1997 Debentureholders composed of: Addenda Capital Management Inc., Manulife Financial Corporation, Phillips, Hager & North Investment Management Ltd., Sun Life Assurance Company of Canada, CIBC Global Asset Management Inc., Her Majesty the Queen in Right of Alberta, as represented by the Minister of Finance, Wawanesa Life Insurance Company, TD Asset Management Inc., Franklin Templeton Investments Corp. and Barclays Global Investors Canada Limited, Respondents/Appellants on cross-appeals, and**
**[page561]**
**Computershare Trust Company of Canada and CIBC Mellon Trust Company, Respondents, and**
**Director Appointed Pursuant to the CBCA, Catalyst Asset Management Inc. and Matthew Stewart, Interveners.**
**And**
**6796508 Canada Inc., Appellant/Respondent on cross-appeals;**
**v.**
**A Group of 1976 Debentureholders composed of: Aegon Capital Management Inc., Addenda Capital Inc., Phillips, Hager & North Investment Management Ltd., Sun Life Assurance Company of Canada, CIBC Global Asset Management Inc., Her Majesty the Queen in Right of Alberta, as represented by the Minister of Finance, Manitoba Civil Service Superannuation Board, TD Asset Management Inc. and Manulife Financial Corporation;**

**A Group of 1996 Debentureholders composed of: Aegon Capital Management Inc., Addenda Capital Inc., Phillips, Hager & North Investment Management Ltd., Sun Life Insurance (Canada) Limited, CIBC Global Asset Management Inc., Manitoba Civil Service Superannuation Board and TD Asset Management Inc.;**
**A Group of 1997 Debentureholders composed of: Addenda Capital Management Inc., Manulife Financial Corporation, Phillips, Hager & North Investment Management Ltd., Sun Life Assurance Company of Canada, [page562] CIBC Global Asset Management Inc., Her Majesty the Queen in Right of Alberta, as represented by the Minister of Finance, Wawanesa Life Insurance Company, TD Asset Management Inc., Franklin Templeton Investments Corp. and Barclays Global Investors Canada Limited, Respondents/Appellants on cross-appeals, and**
**Computershare Trust Company of Canada and CIBC Mellon Trust Company, Respondents, and**
**Director Appointed Pursuant to the CBCA, Catalyst Asset Management Inc. and Matthew Stewart, Interveners.**

[2008] 3 S.C.R. 560

[2008] S.C.J. No. 37

2008 SCC 69

File No.: 32647.

Supreme Court of Canada

Heard: June 17, 2008;
Judgment: June 20, 2008;
Reasons delivered: December 19, 2008.

**Present: McLachlin C.J. and Bastarache*, Binnie, LeBel, Deschamps, Abella and Charron JJ.**

(167 paras.)

**Appeal From:**

ON APPEAL FROM THE COURT OF APPEAL FOR QUEBEC

**Subsequent History:**

* Bastarache J. joined in the judgment of June 20, 2008, but took no part in these reasons for judgment.

**Catchwords:**

*Commercial law -- Corporations -- Oppression -- Fiduciary duty of directors of corporation to act in accordance with best interests of corporation -- Reasonable expectation of security holders of fair treatment -- Directors approving change of control transaction which would affect economic interests of security holders -- Whether evidence supported reasonable expectations [page563] asserted by security holders -- Whether reasonable expectation was violated by conduct found to be oppressive, unfairly prejudicial or that unfairly disregards a relevant interest -- Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 122(1)(a), 241.*

*Commercial law -- Corporations -- Plan of arrangement -- Proposed plan of arrangement not arranging rights of security holders but affecting their economic interests -- Whether plan of arrangement was fair and reasonable -- Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 192.*

**Summary:**

At issue is a plan of arrangement that contemplates the purchase of the shares of BCE Inc. ("BCE") by a consortium of purchasers (the "Purchaser") by way of a leveraged buyout. After BCE was put "in play", an auction process was held and offers were submitted by three groups. All three offers contemplated the addition of a substantial amount of new debt for which Bell Canada, a wholly owned subsidiary of BCE, would be liable. BCE's board of directors found that the Purchaser's offer was in the best interests of BCE and BCE's shareholders. Essentially, the arrangement provides for the compulsory acquisition of all of BCE's outstanding shares. The price to be paid by the Purchaser represents a premium of approximately 40 percent over the market price of BCE shares at the relevant time. The total capital required for the transaction is approximately $52 billion, $38.5 billion of which will be supported by BCE. Bell Canada will guarantee approximately $30 billion of BCE's debt. The Purchaser will invest nearly $8 billion of new equity capital in BCE.

The plan of arrangement was approved by 97.93 percent of BCE's shareholders, but was opposed by a group of financial and other institutions that hold debentures issued by Bell Canada. These debentureholders sought relief under the oppression remedy under s. 241 of the *Canada Business Corporations Act* ("*CBCA*"). They also alleged that the arrangement was not "fair and reasonable" and opposed court approval of the arrangement under s. 192 of the *CBCA*. The crux of their complaints is that, upon the completion of the arrangement, the short-term trading value of the debentures would decline by an average of 20 percent and could lose investment grade status.

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The Quebec Superior Court approved the arrangement as fair and dismissed the claim for oppression. The Court of Appeal set aside that decision, finding the arrangement had not been shown to be fair and held that it should not have been approved. It held that the directors had not only the duty to ensure that the debentureholders' contractual rights would be respected, but also to consider their reasonable expectations which, in its view, required directors to consider whether the adverse impact on debentureholders' economic interests could be alleviated. Since the requirements of s. 192 of the *CBCA* were not met, the court found it unnecessary to consider the oppression claim. BCE and Bell Canada appealed the overturning of the trial judge's approval of the plan of arrangement, and the debentureholders cross-appealed the dismissal of the claims for oppression.

*Held*: The appeals should be allowed and the cross-appeals dismissed.

The s. 241 oppression action and the s. 192 requirement for court approval of a change to the corporate

structure are different types of proceedings, engaging different inquiries. The Court of Appeal's decision rested on an approach that erroneously combined the substance of the s. 241 oppression remedy with the onus of the s. 192 arrangement approval process, resulting in a conclusion that could not have been sustained under either provision, read on its own terms. [para. 47] [para. 165]

1. *The Section 241 Oppression Remedy*

The oppression remedy focuses on harm to the legal and equitable interests of a wide range of stakeholders affected by oppressive acts of a corporation or its directors. This remedy gives a court a broad jurisdiction to enforce not just what is legal but what is fair. Oppression is also fact specific: what is just and equitable is judged by the reasonable expectations of the stakeholders in the context and in regard to the relationships at play. [para. 45] [paras. 58-59]

In assessing a claim of oppression, a court must answer two questions: (1) Does the evidence support the reasonable expectation asserted by the claimant? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice" or "unfair disregard" [page565] of a relevant interest? For the first question, useful factors from the case law in determining whether a reasonable expectation exists include: general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and agreements; and the fair resolution of conflicting interests between corporate stakeholders. For the second question, a claimant must show that the failure to meet the reasonable expectation involved unfair conduct and prejudicial consequences under s. 241. [para. 68] [para. 72] [para. 89] [para. 95]

Where conflicting interests arise, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation. The cases on oppression, taken as a whole, confirm that this duty comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly. There are no absolute rules and no principle that one set of interests should prevail over another. In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including -- but not confined to -- the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen. Where it is impossible to please all stakeholders, it will be irrelevant that the directors rejected alternative transactions that were no more beneficial than the chosen one. [paras. 81-83]

Here, the debentureholders did not establish that they had a reasonable expectation that the directors of BCE would protect their economic interests by putting forth a plan of arrangement that would maintain the investment grade trading value of their debentures. The trial judge concluded that this expectation was not made out on the evidence, given the overall context of the relationship, the nature of the corporation, its situation as the target of a bidding war, the fact that the claimants could have protected themselves against reductions in market value by negotiating appropriate contractual terms, and that any statements by Bell Canada suggesting a commitment to retain investment grade ratings for the debentures were accompanied by warnings precluding such expectations. The trial judge recognized that the content of the directors' fiduciary duty to act in the best interests of the corporation was affected by the various interests at stake in the context of the auction process, and that they might have to approve transactions that were in the best interests of the corporation [page566] but which benefited some groups at the expense of others. All three competing bids required Bell Canada to assume additional debt. Under the business judgment rule, deference should be accorded to the business decisions of directors acting in good faith in performing the functions they were elected to perform. In this case, there was no error in the principles applied by the trial judge nor in his findings of fact. [paras. 96-100]

The debentureholders had also argued that they had a reasonable expectation that the directors would consider their economic interests in maintaining the trading value of the debentures. While the evidence, objectively viewed, supports a reasonable expectation that the directors would consider the position of the debentureholders in making their decisions on the various offers under consideration, it is apparent that the directors considered the interests of debentureholders, and concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. This fulfilled the duty of the directors to consider the debentureholders' interests and did not amount to "unfair disregard" of the interests of debentureholders. What the claimants contend is, in reality, an expectation that the directors would take positive steps to restructure the purchase in a way that would provide a satisfactory price to shareholders and preserve the high market value of the debentures. There was no evidence that it was reasonable to suppose this could be achieved, since all three bids involved a substantial increase in Bell Canada's debt. Commercial practice and reality also undermine their claim. Leveraged buyouts are not unusual or unforeseeable, and the debentureholders could have negotiated protections in their contracts. Given the nature and the corporate history of Bell Canada, it should not have been outside the contemplation of debentureholders that plans of arrangements could occur in the future. While the debentureholders rely on the past practice of maintaining the investment grade rating of the debentures, the events precipitating the leveraged buyout transaction were market realities affecting what were reasonable practices. No representations had been made to debentureholders upon which they could reasonably rely. [para. 96] [para. 102] [paras. 104-106] [paras. 108-110]

[page567]

With respect to the duty on directors to resolve the conflicting interests of stakeholders in a fair manner that reflected the best interests of the corporation, the corporation's best interests arguably favoured acceptance of the offer at the time. The trial judge accepted the evidence that Bell Canada needed to undertake significant changes to be successful, and the momentum of the market made a buyout inevitable. Considering all the relevant factors, the debentureholders failed to establish a reasonable expectation that could give rise to a claim for oppression. [paras. 111-113]

2. *The Section 192 Approval Process*

The s. 192 approval process is generally applicable to change of control transactions where the arrangement is sponsored by the directors of the target company and the goal is to require some or all shareholders to surrender their shares. The approval process focuses on whether the arrangement, viewed objectively, is fair and reasonable. Its purpose is to permit major changes in corporate structure to be made while ensuring that individuals whose rights may be affected are treated fairly, and its spirit is to achieve a fair balance between conflicting interests. In seeking court approval of an arrangement, the onus is on the corporation to establish that (1) the statutory procedures have been met; (2) the application has been put forth in good faith; and (3) the arrangement is "fair and reasonable". [para. 119] [para. 126] [para. 128] [para. 137]

To approve a plan of arrangement as fair and reasonable, courts must be satisfied that (a) the arrangement has a valid business purpose, and (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way. Whether these requirements are met is determined by taking into account a variety of relevant factors, including the necessity of the arrangement to the corporation's continued existence, the approval, if any, of a majority of shareholders and other security holders entitled to vote, and the proportionality of the impact on affected groups. Where there has been no vote, courts may consider whether an intelligent and honest business person, as a member of the class concerned and acting in his or her own interest, might reasonably approve of the

plan. Courts must focus on the terms and impact of the arrangement itself, rather than the process by which it was reached, and must be satisfied that the burden imposed by the arrangement on security holders is justified by the interests of the corporation. Courts on a [page568] s. 192 application should refrain from substituting their views of the "best" arrangement, but should not surrender their duty to scrutinize the arrangement. [para. 136] [para. 138] [para. 145] [para. 151] [paras. 154-155]

The purpose of s. 192 suggests that only security holders whose legal rights stand to be affected by the proposal are envisioned. It is the fact that the corporation is permitted to alter individual rights that places the matter beyond the power of the directors and creates the need for shareholder and court approval. However, in some circumstances, interests that are not strictly legal could be considered. The fact that a group whose legal rights are left intact faces a reduction in the trading value of its securities generally does not, without more, constitute a circumstance where non-legal interests should be considered on a s. 192 application. [paras. 133-135]

Here, the debentureholders no longer argue that the arrangement lacks a valid business purpose. The debate focuses on whether the objections of those whose rights are being arranged were resolved in a fair and balanced way. Since only their economic interests were affected by the proposed transaction, not their legal rights, and since they did not fall within an exceptional situation where non-legal interests should be considered under s. 192, the debentureholders did not constitute an affected class under s. 192, and the trial judge was correct in concluding that they should not be permitted to veto almost 98 percent of the shareholders simply because the trading value of their securities would be affected. Although not required, it remained open to the trial judge to consider the debentureholders' economic interests, and he did not err in concluding that the arrangement addressed the debentureholders' interests in a fair and balanced way. The arrangement did not fundamentally alter the debentureholders' rights, as the investment and return they contracted for remained intact. It was well known that alteration in debt load could cause fluctuations in the trading value of the debentures, and yet the debentureholders had not contracted against this contingency. It was clear to the judge that the continuance of the corporation required acceptance of an arrangement that would entail increased debt and debt guarantees by Bell Canada. No superior arrangement had been put forward and BCE had been assisted throughout by expert legal and financial advisors. Recognizing that there is no such thing as a perfect arrangement, the trial judge correctly concluded that the arrangement [page569] had been shown to be fair and reasonable. [para. 157] [para. 161] [paras. 163-164]

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*Medical Carriers Ltd.* (2001), 17 B.L.R. (3d) 280, 2001 MBQB 229; *Alberta Treasury Branches v. Seven Way Capital Corp.* (1999), 50 B.L.R. (2d) 294, aff'd (2000), 8 B.L.R. (3d) 1, 2000 ABCA 194; *Lyall v. 147250 Canada Ltd.* (1993), 106 D.L.R. (4th) 304; *Tsui v. International Capital Corp.*, [1993] 4 W.W.R. 613, aff'd (1993), 113 Sask. R. 3; *Deutsche Bank Canada v. Oxford Properties Group Inc.* (1998), 40 B.L.R. (2d) 302; *Themadel Foundation v. Third Canadian Investment Trust Ltd.* (1995), 23 O.R. (3d) 7, var'd (1998), 38 O.R. (3d) 749; *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (1985); *Trizec Corp., Re* (1994), 21 Alta. L.R. (3d) 435; [page570] *Pacifica Papers Inc. v. Johnstone* (2001), 15 B.L.R. (3d) 249, 2001 BCSC 1069; *Abitibi-Consolidated Inc. (Arrangement relatif à)*, [2007] Q.J. No. 16158 (QL), 2007 QCCS 6830; *Canadian Pacific Ltd. (Re)* (1990), 73 O.R. (2d) 212; *Cinar Corp. v. Shareholders of Cinar Corp.* (2004), 4 C.B.R. (5th) 163; *PetroKazakhstan Inc. v. Lukoil Overseas Kumkol B.V.* (2005), 12 B.L.R. (4th) 128, 2005 ABQB 789; *St. Lawrence & Hudson Railway Co. (Re)*, [1998] O.J. No. 3934 (QL); *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co.*, [1891] 1 Ch. 213; *Stelco Inc., Re* (2006), 18 C.B.R. (5th) 173; *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496, aff'd (2004), 42 B.L.R. (3d) 34.

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**History and Disposition:**

APPEALS and CROSS-APPEALS from judgments of the Quebec Court of Appeal (Robert C.J.Q. and Otis, Nuss, Pelletier and Dalphond JJ.A.), [page571] [2008] R.J.Q. 1298, 43 B.L.R. (4th) 157, [2008] Q.J. No. 4173 (QL), 2008 CarswellQue 4179, 2008 QCCA 935; [2008] Q.J. No. 4170 (QL), 2008 QCCA 930; [2008] Q.J. No. 4171 (QL), 2008 QCCA 931; [2008] Q.J. No. 4172 (QL), 2008 QCCA 932;

[2008] Q.J. No. 4174 (QL), 2008 QCCA 933; [2008] Q.J. No. 4175 (QL), 2008 QCCA 934, setting aside decisions by Silcoff J., [2008] R.J.Q. 1029, 43 B.L.R. (4th) 39, [2008] Q.J. No. 4376 (QL), 2008 CarswellQue 1805, 2008 QCCS 898; (2008), 43 B.L.R. (4th) 69, [2008] Q.J. No. 1728 (QL), 2008 CarswellQue 2226, 2008 QCCS 899; [2008] R.J.Q. 1097, 43 B.L.R. (4th) 1, [2008] Q.J. No. 1788 (QL), 2008 CarswellQue 2227, 2008 QCCS 905; (2008), 43 B.L.R. (4th) 135, [2008] Q.J. No. 1789 (QL), 2008 CarswellQue 2228, 2008 QCCS 906; [2008] R.J.Q. 1119, 43 B.L.R. (4th) 79, [2008] Q.J. No. 1790 (QL), 2008 CarswellQue 2229, 2008 QCCS 907. Appeals allowed and cross-appeals dismissed.

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*Markus Koehnen, Max Mendelsohn, Paul Macdonald, Julien Brazeau* and *Erin Cowling*, for the respondent/appellant on cross-appeals Group of 1997 Debentureholders.

Written submissions only by *Robert Tessier* and *Ronald Auclair*, for the respondent Computershare Trust Company of Canada.

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*Raynold Langlois, Q.C.*, and *Gerald Apostolatos*, for the intervener Matthew Stewart.

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The following is the judgment delivered by

THE COURT:--

I. Introduction

**1** These appeals arise out of an offer to purchase all shares of BCE Inc. ("BCE"), a large telecommunications corporation, by a group headed by the Ontario Teachers Pension Plan Board ("Teachers"), financed in part by the assumption by Bell Canada, a wholly owned subsidiary of BCE, of a $30 billion debt. The leveraged buyout was opposed by debentureholders of Bell Canada on the ground that the increased debt contemplated by the purchase agreement would reduce the value of their bonds. Upon request for court approval of an arrangement under s. 192 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("*CBCA*"), the debentureholders argued that it should not be found to be fair. They also opposed the arrangement under s. 241 of the *CBCA* on the ground that it was oppressive to them.

**2** The Quebec Superior Court, *per* Silcoff J., approved the arrangement as fair under the *CBCA* and

dismissed the claims for oppression. The Quebec Court of Appeal found that the arrangement had not been shown to be fair and held that it should not have been approved. Thus, it found it unnecessary to consider the oppression claim.

**3** On June 20, 2008, this Court allowed the appeals from the Court of Appeal's disapproval of the arrangement and dismissed two cross-appeals from the dismissal of the claims for oppression, with reasons to follow. These are those reasons.

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II. Facts

**4** At issue is a plan of arrangement valued at approximately $52 billion, for the purchase of the shares of BCE by way of a leveraged buyout. The arrangement was opposed by a group, comprised mainly of financial institutions, that hold debentures issued by Bell Canada. The crux of their complaints is that the arrangement would diminish the trading value of their debentures by an average of 20 percent, while conferring a premium of approximately 40 percent on the market price of BCE shares.

**5** Bell Canada was incorporated in 1880 by a special Act of the Parliament of Canada. The corporation was subsequently continued under the *CBCA*. BCE, a management holding company, was incorporated in 1970 and continued under the *CBCA* in 1979. Bell Canada became a wholly owned subsidiary of BCE in 1983 pursuant to a plan of arrangement under which Bell Canada's shareholders surrendered their shares in exchange for shares of BCE. BCE and Bell Canada are separate legal entities with separate charters, articles and bylaws. Since January 2003, however, they have shared a common set of directors and some senior officers.

**6** At the time relevant to these proceedings, Bell Canada had $7.2 billion in outstanding long-term debt comprised of debentures issued pursuant to three trust indentures: the 1976, the 1996 and the 1997 trust indentures. The trust indentures contain neither change of control nor credit rating covenants, and specifically allow Bell Canada to incur or guarantee additional debt subject to certain limitations.

**7** Bell Canada's debentures were perceived by investors to be safe investments and, up to the time of the proposed leveraged buyout, had maintained an investment grade rating. The debentureholders are some of Canada's largest and most reputable financial institutions, pension funds and insurance [page574] companies. They are major participants in the debt markets and possess an intimate and historic knowledge of the financial markets.

**8** A number of technological, regulatory and competitive changes have significantly altered the industry in which BCE operates. Traditionally highly regulated and focused on circuit-switch line telephone service, the telecommunication industry is now guided primarily by market forces and characterized by an ever-expanding group of market participants, substantial new competition and increasing expectations regarding customer service. In response to these changes, BCE developed a new business plan by which it would focus on its core business, telecommunications, and divest its interest in unrelated businesses. This new business plan, however, was not as successful as anticipated. As a result, the shareholder returns generated by BCE remained significantly less than the ones generated by its competitors.

**9** Meanwhile, by the end of 2006, BCE had large cash flows and strong financial indicators, characteristics perceived by market analysts to make it a suitable target for a buyout. In November 2006, BCE was made aware that Kohlberg Kravis Roberts & Co. ("KKR"), a United States private equity firm,

might be interested in a transaction involving BCE. Mr. Michael Sabia, President and Chief Executive Officer of BCE, contacted KKR to inform them that BCE was not interested in pursuing such a transaction at that time.

**10** In February 2007, new rumours surfaced that KKR and the Canada Pension Plan Investment Board were arranging financing to initiate a bid for BCE. Shortly thereafter, additional rumours began to circulate that an investment banking firm was assisting Teachers with a potential transaction involving BCE. Mr. Sabia, after meeting with [page575] BCE's board of directors ("Board"), contacted the representatives of both KKR and Teachers to reiterate that BCE was not interested in pursuing a "going-private" transaction at the time because it was set on creating shareholder value through the execution of its 2007 business plan.

**11** On March 29, 2007, after an article appeared on the front page of the *Globe and Mail* that inaccurately described BCE as being in discussions with a consortium comprised of KKR and Teachers, BCE issued a press release confirming that there were no ongoing discussions being held with private equity investors with respect to a "going-private" transaction for BCE.

**12** On April 9, 2007, Teachers filed a report (Schedule 13D) with the United States Securities and Exchange Commission reflecting a change from a passive to an active holding of BCE shares. This filing heightened press speculation concerning a potential privatization of BCE.

**13** Faced with renewed speculation and BCE having been put "in play" by the filing by Teachers of the Schedule 13D report, the Board met with its legal and financial advisors to assess strategic alternatives. It decided that it would be in the best interests of BCE and its shareholders to have competing bidding groups and to guard against the risk of a single bidding group assembling such a significant portion of available debt and equity that the group could preclude potential competing bidding groups from participating effectively in an auction process.

**14** In a press release dated April 17, 2007, BCE announced that it was reviewing its strategic alternatives with a view to further enhancing shareholder value. On the same day, a Strategic Oversight Committee ("SOC") was created. None of its members had ever been part of management at BCE. Its [page576] mandate was, notably, to set up and supervise the auction process.

**15** Following the April 17 press release, several debentureholders sent letters to the Board voicing their concerns about a potential leveraged buyout transaction. They sought assurance that their interests would be considered by the Board. BCE replied in writing that it intended to honour the contractual terms of the trust indentures.

**16** On June 13, 2007, BCE provided the potential participants in the auction process with bidding rules and the general form of a definitive transaction agreement. The bidders were advised that, in evaluating the competitiveness of proposed bids, BCE would consider the impact that their proposed financing arrangements would have on BCE and on Bell Canada's debentureholders and, in particular, whether their bids respected the debentureholders' contractual rights under the trust indentures.

**17** Offers were submitted by three groups. All three offers contemplated the addition of a substantial amount of new debt for which Bell Canada would be liable. All would have likely resulted in a downgrade of the debentures below investment grade. The initial offer submitted by the appellant 6796508 Canada Inc. (the "Purchaser"), a corporation formed by Teachers and affiliates of Providence Equity Partners Inc. and Madison Dearborn Partners LLC, contemplated an amalgamation of Bell Canada that would have triggered the voting rights of the debentureholders under the trust indentures. The Board informed the Purchaser that such an amalgamation made its offer less competitive. The Purchaser submitted a revised offer with an alternative structure for the transaction that did not involve

an amalgamation of Bell Canada. Also, the Purchaser's revised offer increased the initial price per share from $42.25 to $42.75.

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**18** The Board, after a review of the three offers and based on the recommendation of the SOC, found that the Purchaser's revised offer was in the best interests of BCE and BCE's shareholders. In evaluating the fairness of the consideration to be paid to the shareholders under the Purchaser's offer, the Board and the SOC received opinions from several reputable financial advisors. In the meantime, the Purchaser agreed to cooperate with the Board in obtaining a solvency certificate stating that BCE would still be solvent (and hence in a position to meet its obligations after completion of the transaction). The Board did not seek a fairness opinion in respect of the debentureholders, taking the view that their rights were not being arranged.

**19** On June 30, 2007, the Purchaser and BCE entered into a definitive agreement. On September 21, 2007, BCE's shareholders approved the arrangement by a majority of 97.93 percent.

**20** Essentially, the arrangement provides for the compulsory acquisition of all of BCE's outstanding shares. The price to be paid by the Purchaser is $42.75 per common share, which represents a premium of approximately 40 percent to the closing price of the shares as of March 28, 2007. The total capital required for the transaction is approximately $52 billion, $38.5 billion of which will be supported by BCE. Bell Canada will guarantee approximately $30 billion of BCE's debt. The Purchaser will invest nearly $8 billion of new equity capital in BCE.

**21** As a result of the announcement of the arrangement, the credit ratings of the debentures by the time of trial had been downgraded from investment grade to below investment grade. From the perspective of the debentureholders, this downgrade was problematic for two reasons. First, it caused the debentures to decrease in value by an average of approximately 20 percent. Second, the downgrade could oblige debentureholders with credit-rating restrictions on their holdings to sell their debentures at a loss.

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**22** The debentureholders at trial opposed the arrangement on a number of grounds. First, the debentureholders sought relief under the oppression provision in s. 241 of the *CBCA*. Second, they opposed court approval of the arrangement, as required by s. 192 of the *CBCA*, alleging that the arrangement was not "fair and reasonable" because of the adverse effect on their economic interests. Finally, the debentureholders brought motions for declaratory relief under the terms of the trust indentures, which are not before us: (2008), 43 B.L.R. (4th) 39, 2008 QCCS 898; (2008), 43 B.L.R. (4th) 69, 2008 QCCS 899.

III. Judicial History

**23** The trial judge reviewed the s. 241 oppression claim as lying against both BCE and Bell Canada, since s. 241 refers to actions by the "corporation or any of its affiliates". He dismissed the claims for oppression on the grounds that the debt guarantee to be assumed by Bell Canada had a valid business purpose; that the transaction did not breach the reasonable expectations of the debentureholders; that the

transaction was not oppressive by reason of rendering the debentureholders vulnerable; and that BCE and its directors had not unfairly disregarded the interests of the debentureholders: (2008), 43 B.L.R. (4th) 79, 2008 QCCS 907; (2008), 43 B.L.R. (4th) 135, 2008 QCCS 906.

**24** In arriving at these conclusions, the trial judge proceeded on the basis that the BCE directors had a fiduciary duty under s. 122 of the *CBCA* to act in the best interests of the corporation. He held that while the best interests of the corporation are not to be confused with the interests of the shareholders or other stakeholders, corporate law recognizes fundamental differences between shareholders and debt security holders. He held that these differences affect the content of the directors' fiduciary duty. As a result, the directors' duty to act in the best interests of the corporation might require them to approve transactions that, while in the interests [page579] of the corporation, might also benefit some or all shareholders at the expense of other stakeholders. He also noted that in accordance with the business judgment rule, Canadian courts tend to accord deference to business decisions of directors taken in good faith and in the performance of the functions they were elected to perform by shareholders.

**25** The trial judge held that the debentureholders' reasonable expectations must be assessed on an objective basis and, absent compelling reasons, must derive from the trust indentures and the relevant prospectuses issued in connection with the debt offerings. Statements by Bell Canada indicating a commitment to retaining investment grade ratings did not assist the debentureholders, since these statements were accompanied by warnings, repeated in the prospectuses pursuant to which the debentures were issued, that negated any expectation that this policy would be maintained indefinitely. The reasonableness of the alleged expectation was further negated by the fact that the debentureholders could have guarded against the business risks arising from a change of control by negotiating protective contract terms. The fact that the shareholders stood to benefit from the transaction and that the debentureholders were prejudiced did not in itself give rise to a conclusion that the directors had breached their fiduciary duty to the corporation. All three competing bids required Bell Canada to assume additional debt, and there was no evidence that the bidders were prepared to treat the debentureholders any differently. The materialization of certain risks as a result of decisions taken by the directors in accordance with their fiduciary duty to the corporation did not constitute oppression against the debentureholders or unfair disregard of their interests.

**26** Having dismissed the claim for oppression, the trial judge went on to consider BCE's application for approval of the transaction under s. 192 of the *CBCA*: (2008), 43 B.L.R. (4th) 1, 2008 QCCS 905. [page580] He dismissed the debentureholders' claim for voting rights on the arrangement on the ground that their legal interests were not compromised by the arrangement and that it would be unfair to allow them in effect to veto the shareholder vote. However, in determining whether the arrangement was fair and reasonable -- the main issue on the application for approval -- he considered the fairness of the transaction with respect to both the shareholders and the debentureholders, and concluded that the arrangement was fair and reasonable. He considered the necessity of the arrangement for Bell Canada's continued operations; that the Board, comprised almost entirely of independent directors, had determined the arrangement was fair and reasonable and in the best interests of BCE and the shareholders; that the arrangement had been approved by over 97 percent of the shareholders; that the arrangement was the culmination of a robust strategic review and auction process; the assistance the Board received throughout from leading legal and financial advisors; the absence of a superior proposal; and the fact that the proposal did not alter or arrange the debentureholders' legal rights. While the proposal stood to alter the debentureholders' economic interests, in the sense that the trading value of their securities would be reduced by the added debt load, their contractual rights remained intact. The trial judge noted that the debentureholders could have protected themselves against this eventuality through contract terms, but had not. Overall, he concluded that taking all relevant matters into account, the arrangement was fair and reasonable and should be approved.

**27** The Court of Appeal allowed the appeals on the ground that BCE had failed to meet its onus on the test for approval of an arrangement under s. 192, by failing to show that the transaction was fair and reasonable to the debentureholders. Basing its analysis on this Court's decision in *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, 2004 SCC 68, the Court of Appeal found that the directors were required to consider [page581] the non-contractual interests of the debentureholders. It held that representations made by Bell Canada over the years could have created reasonable expectations above and beyond the contractual rights of the debentureholders. In these circumstances, the directors were under a duty, not simply to accept the best offer, but to consider whether the arrangement could be restructured in a way that provided a satisfactory price to the shareholders while avoiding an adverse effect on the debentureholders. In the absence of such efforts, BCE had not discharged its onus under s. 192 of showing that the arrangement was fair and reasonable. The Court of Appeal therefore overturned the trial judge's order approving the plan of arrangement: (2008), 43 B.L.R. (4th) 157, 2008 QCCA 930, 2008 QCCA 931, 2008 QCCA 932, 2008 QCCA 933, 2008 QCCA 934, 2008 QCCA 935.

**28** The Court of Appeal found it unnecessary to consider the s. 241 oppression claim, holding that its rejection of the s. 192 approval application effectively disposed of the oppression claim. In its view, where approval is sought under s. 192 and opposed, there is generally no need for an affected security holder to assert an oppression remedy under s. 241.

**29** BCE and Bell Canada appeal to this Court arguing that the Court of Appeal erred in overturning the trial judge's approval of the plan of arrangement. While formally cross-appealing on s. 241, the debentureholders argue that the Court of Appeal was correct to consider their complaints under s. 192, such that their appeals under s. 241 became moot.

IV. Issues

**30** The issues, briefly stated, are whether the Court of Appeal erred in dismissing the debentureholders' s. 241 oppression claim and in overturning the Superior Court's s. 192 approval of the plan [page582] of arrangement. These questions raise the issue of what is required to establish oppression of debentureholders in a situation where a corporation is facing a change of control, and how a judge on an application for approval of an arrangement under s. 192 of the *CBCA* should treat claims such as those of the debentureholders in these actions. These reasons will consider both issues.

**31** In order to situate these issues in the context of Canadian corporate law, it may be useful to offer a preliminary description of the remedies provided by the *CBCA* to shareholders and stakeholders in a corporation facing a change of control.

**32** Accordingly, these reasons will consider:

(1) the rights, obligations and remedies under the *CBCA* in overview;
(2) the debentureholders' entitlement to relief under the s. 241 oppression remedy;
(3) the debentureholders' entitlement to relief under the requirement for court approval of an arrangement under s. 192 .

**33** We note that it is unnecessary for the purposes of these appeals to distinguish between the conduct of the directors of BCE, the holding company, and the conduct of the directors of Bell Canada. The same directors served on the boards of both corporations. While the oppression remedy was directed at both BCE and Bell Canada, the courts below considered the entire context in which the directors of BCE made their decisions, which included the obligations of Bell Canada in relation to its debentureholders. It was not found by the lower courts that the directors of BCE and Bell Canada should have made

different decisions with respect to the two corporations. Accordingly, the [page583] distinct corporate character of the two entities does not figure in our analysis.

V. Analysis

A. *Overview of Rights, Obligations and Remedies Under the CBCA*

**34** An essential component of a corporation is its capital stock, which is divided into fractional parts, the shares: *Bradbury v. English Sewing Cotton Co.*, [1923] A.C. 744 (H.L.), at p. 767; *Zwicker v. Stanbury*, [1953] 2 S.C.R. 438. While the corporation is ongoing, shares confer no right to its underlying assets.

**35** A share "is not an isolated piece of property ... [but] a 'bundle' of interrelated rights and liabilities": *Sparling v. Quebec (Caisse de dépôt et placement du Québec)*, [1988] 2 S.C.R. 1015, at p. 1025, *per* La Forest J. These rights include the right to a proportionate part of the assets of the corporation upon winding-up and the right to oversee the management of the corporation by its board of directors by way of votes at shareholder meetings.

**36** The directors are responsible for the governance of the corporation. In the performance of this role, the directors are subject to two duties: a fiduciary duty to the corporation under s. 122(1)(*a*) (the fiduciary duty); and a duty to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances under s. 122(1)(*b*) (the duty of care). The second duty is not at issue in these proceedings as this is not a claim against the directors of the corporation for failing to meet their duty of care. However, this case does involve the fiduciary duty of the directors to the corporation, and particularly the "fair treatment" component of this duty, which, as will be seen, is fundamental to the reasonable expectations of stakeholders claiming an oppression remedy.

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**37** The fiduciary duty of the directors to the corporation originated in the common law. It is a duty to act in the best interests of the corporation. Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear -- it is to the corporation: *Peoples Department Stores*.

**38** The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.

**39** In *Peoples Department Stores*, this Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders. As stated by Major and Deschamps JJ., at para. 42:

> We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments

and the environment.

As will be discussed, cases dealing with claims of oppression have further clarified the content of the fiduciary duty of directors with respect to the range of interests that should be considered in determining what is in the best interests of the corporation, acting fairly and responsibly.

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**40** In considering what is in the best interests of the corporation, directors may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule. The "business judgment rule" accords deference to a business decision, so long as it lies within a range of reasonable alternatives: see *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (C.A.); *Kerr v. Danier Leather Inc.*, [2007] 3 S.C.R. 331, 2007 SCC 44. It reflects the reality that directors, who are mandated under s. 102(1) of the *CBCA* to manage the corporation's business and affairs, are often better suited to determine what is in the best interests of the corporation. This applies to decisions on stakeholders' interests, as much as other directorial decisions.

**41** Normally only the beneficiary of a fiduciary duty can enforce the duty. In the corporate context, however, this may offer little comfort. The directors who control the corporation are unlikely to bring an action against themselves for breach of their own fiduciary duty. The shareholders cannot act in the stead of the corporation; their only power is the right to oversee the conduct of the directors by way of votes at shareholder assemblies. Other stakeholders may not even have that.

**42** To meet these difficulties, the common law developed a number of special remedies to protect the interests of shareholders and stakeholders of the corporation. These remedies have been affirmed, modified and supplemented by the *CBCA*.

**43** The first remedy provided by the *CBCA* is the s. 239 derivative action, which allows stakeholders to enforce the directors' duty to the corporation when the directors are themselves unwilling [page586] to do so. With leave of the court, a complainant may bring (or intervene in) a derivative action in the name and on behalf of the corporation or one of its subsidiaries to enforce a right of the corporation, including the rights correlative with the directors' duties to the corporation. (The requirement of leave serves to prevent frivolous and vexatious actions, and other actions which, while possibly brought in good faith, are not in the interest of the corporation to litigate.)

**44** A second remedy lies against the directors in a civil action for breach of duty of care. As noted, s. 122(1)(*b*) of the *CBCA* requires directors and officers of a corporation to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". This duty, unlike the s. 122(1)(*a*) fiduciary duty, is not owed solely to the corporation, and thus may be the basis for liability to other stakeholders in accordance with principles governing the law of tort and extracontractual liability: *Peoples Department Stores.* Section 122(1)(*b*) does not provide an independent foundation for claims. However, applying the principles of *The Queen in right of Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205, courts may take this statutory provision into account as to the standard of behaviour that should reasonably be expected.

**45** A third remedy, grounded in the common law and endorsed by the *CBCA*, is a s. 241 action for oppression. Unlike the derivative action, which is aimed at enforcing a right of the corporation itself, the oppression remedy focuses on harm to the legal and equitable interests of stakeholders affected by

oppressive acts of a corporation or its directors. This remedy is available to a wide range of stakeholders -- security holders, creditors, directors and officers.

**46** Additional "remedial" provisions are found in provisions of the *CBCA* providing for court [page587] approval in certain cases. An arrangement under s. 192 of the *CBCA* is one of these. While s. 192 cannot be described as a remedy *per se*, it has remedial-like aspects. It is directed at the situation of corporations seeking to effect fundamental changes to the corporation that affects stakeholder rights. The Act provides that such arrangements require the approval of the court. Unlike the civil action and oppression, which focus on the conduct of the directors, a s. 192 review requires a court approving a plan of arrangement to be satisfied that: (1) the statutory procedures have been met; (2) the application has been put forth in good faith; and (3) the arrangement is fair and reasonable. If the corporation fails to discharge its burden of establishing these elements, approval will be withheld and the proposed change will not take place. In assessing whether the arrangement should be approved, the court will hear arguments from opposing security holders whose rights are being arranged. This provides an opportunity for security holders to argue against the proposed change.

**47** Two of these remedies are in issue in these actions: the action for oppression and approval of an arrangement under s. 192. The trial judge treated these remedies as involving distinct considerations and concluded that the debentureholders had failed to establish entitlement to either remedy. The Court of Appeal, by contrast, viewed the two remedies as substantially overlapping, holding that both turned on whether the directors had properly considered the debentureholders' expectations. Having found on this basis that the requirements of s. 192 were not met, the Court of Appeal concluded that the action for oppression was moot. As will become apparent, we do not endorse this approach. In our view, the s. 241 oppression action and the s. 192 requirement for court approval of a change to the corporate structure are different types of proceedings, engaging different inquiries. Accordingly, we find it necessary to consider both the claims [page588] for oppression and the s. 192 application for approval.

**48** The debentureholders have formally cross-appealed on the oppression remedy. However, due to the Court of Appeal's failure to consider this issue, the debentureholders did not advance separate arguments before this Court. As certain aspects of their position are properly addressed within the context of an analysis of oppression under s. 241, we have considered them here.

**49** Against this background, we turn to a more detailed consideration of the claims.

B. *The Section 241 Oppression Remedy*

**50** The debentureholders in these appeals claim that the directors acted in an oppressive manner in approving the sale of BCE, contrary to s. 241 of the *CBCA*.

**51** Security holders of a corporation or its affiliates fall within the class of persons who may be permitted to bring a claim for oppression under s. 241 of the *CBCA*. The trial judge permitted the debentureholders to do so, although in the end he found the claim had not been established. The question is whether the trial judge erred in dismissing the claim.

**52** We will first set out what must be shown to establish the right to a remedy under s. 241, and then review the conduct complained of in the light of those requirements.

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(1) <u>The Law</u>

**53** Section 241(2) provides that a court may make an order to rectify the matters complained of where

> (*a*) any act or omission of the corporation or any of its affiliates effects a result,
>
> (*b*) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
>
> (*c*) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer ... .

**54** Section 241 jurisprudence reveals two possible approaches to the interpretation of the oppression provisions of the *CBCA*: M. Koehnen, *Oppression and Related Remedies* (2004), at pp. 79-80 and 84. One approach emphasizes a strict reading of the three types of conduct enumerated in s. 241 (oppression, unfair prejudice and unfair disregard): see *Scottish Co-operative Wholesale Society Ltd. v. Meyer*, [1959] A.C. 324 (H.L.); *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (S.C.); *Stech v. Davies*, [1987] 5 W.W.R. 563 (Alta. Q.B.). Cases following this approach focus on the precise content of the categories "oppression", "unfair prejudice" and "unfair disregard". While these cases may provide valuable insight into what constitutes oppression in particular circumstances, a categorical approach to oppression is problematic because the terms used cannot be put into watertight compartments or conclusively defined. As Koehnen puts it (at p. 84), "[t]he three statutory components of oppression are really adjectives that try to describe inappropriate conduct... . The difficulty with adjectives is they provide no assistance in formulating principles that should underlie court intervention."

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**55** Other cases have focused on the broader principles underlying and uniting the various aspects of oppression: see *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.), var'd (1989), 45 B.L.R. 110 (Alta. C.A.); *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.); *Westfair Foods Ltd. v. Watt* (1991), 79 D.L.R. (4th) 48 (Alta. C.A.).

**56** In our view, the best approach to the interpretation of s. 241(2) is one that combines the two approaches developed in the cases. One should look first to the principles underlying the oppression remedy, and in particular the concept of reasonable expectations. If a breach of a reasonable expectation is established, one must go on to consider whether the conduct complained of amounts to "oppression", "unfair prejudice" or "unfair disregard" as set out in s. 241(2) of the *CBCA*.

**57** We preface our discussion of the twin prongs of the oppression inquiry by two preliminary observations that run throughout all the jurisprudence.

**58** First, oppression is an equitable remedy. It seeks to ensure fairness -- what is "just and equitable". It gives a court broad, equitable jurisdiction to enforce not just what is legal but what is fair: *Wright v. Donald S. Montgomery Holdings Ltd.* (1998), 39 B.L.R. (2d) 266 (Ont. Ct. (Gen. Div.)), at p. 273; *Re Keho Holdings Ltd. and Noble* (1987), 38 D.L.R. (4th) 368 (Alta. C.A.), at p. 374; see, more generally, Koehnen, at pp. 78-79. It follows that courts considering claims for oppression should look at business

realities, not merely narrow legalities: *Scottish Co-operative Wholesale Society*, at p. 343.

**59** Second, like many equitable remedies, oppression is fact-specific. What is just and equitable is judged by the reasonable expectations of the stakeholders in the context and in regard to the [page591] relationships at play. Conduct that may be oppressive in one situation may not be in another.

**60** Against this background, we turn to the first prong of the inquiry, the principles underlying the remedy of oppression. In *Ebrahimi v. Westbourne Galleries Ltd.*, [1973] A.C. 360 (H.L.), at p. 379, Lord Wilberforce, interpreting s. 222 of the U.K. *Companies Act, 1948*, described the remedy of oppression in the following seminal terms:

> The words ["just and equitable"] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.

**61** Lord Wilberforce spoke of the equitable remedy in terms of the "rights, expectations and obligations" of individuals. "Rights" and "obligations" connote interests enforceable at law without recourse to special remedies, for example, through a contractual suit or a derivative action under s. 239 of the *CBCA*. It is left for the oppression remedy to deal with the "expectations" of affected stakeholders. The reasonable expectations of these stakeholders is the cornerstone of the oppression remedy.

**62** As denoted by "reasonable", the concept of reasonable expectations is objective and contextual. The actual expectation of a particular stakeholder is not conclusive. In the context of whether it would be "just and equitable" to grant a remedy, the question is whether the expectation is reasonable having regard to the facts of the specific case, the relationships at issue, and the entire context, including the fact that there may be conflicting claims and expectations.

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**63** Particular circumstances give rise to particular expectations. Stakeholders enter into relationships, with and within corporations, on the basis of understandings and expectations, upon which they are entitled to rely, provided they are reasonable in the context: see *820099 Ontario*; *Main v. Delcan Group Inc.* (1999), 47 B.L.R. (2d) 200 (Ont. S.C.J.). These expectations are what the remedy of oppression seeks to uphold.

**64** Determining whether a particular expectation is reasonable is complicated by the fact that the interests and expectations of different stakeholders may conflict. The oppression remedy recognizes that a corporation is an entity that encompasses and affects various individuals and groups, some of whose interests may conflict with others. Directors or other corporate actors may make corporate decisions or seek to resolve conflicts in a way that abusively or unfairly maximizes a particular group's interest at the expense of other stakeholders. The corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly. Fair treatment -- the central theme running through the oppression jurisprudence -- is most fundamentally what stakeholders are entitled to "reasonably expect".

**65** Section 241(2) speaks of the "act or omission" of the corporation or any of its affiliates, the conduct of "business or affairs" of the corporation and the "powers of the directors of the corporation or

any of its affiliates". Often, the conduct complained of is the conduct of the corporation or of its directors, who are responsible for the governance of the corporation. However, the conduct of other actors, such as shareholders, may also support a claim for oppression: see Koehnen, at pp. 109-10; *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Ct. (Gen. Div.)). In the appeals before us, the claims for oppression are based on allegations that the directors of BCE and Bell Canada failed to comply with the reasonable [page593] expectations of the debentureholders, and it is unnecessary to go beyond this.

**66** The fact that the conduct of the directors is often at the centre of oppression actions might seem to suggest that directors are under a direct duty to individual stakeholders who may be affected by a corporate decision. Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.

**67** Having discussed the concept of reasonable expectations that underlies the oppression remedy, we arrive at the second prong of the s. 241 oppression remedy. Even if reasonable, not every unmet expectation gives rise to claim under s. 241. The section requires that the conduct complained of amount to "oppression", "unfair prejudice" or "unfair disregard" of relevant interests. "Oppression" carries the sense of conduct that is coercive and abusive, and suggests bad faith. "Unfair prejudice" may admit of a less culpable state of mind, that nevertheless has unfair consequences. Finally, "unfair disregard" of [page594] interests extends the remedy to ignoring an interest as being of no importance, contrary to the stakeholders' reasonable expectations: see Koehnen, at pp. 81-88. The phrases describe, in adjectival terms, ways in which corporate actors may fail to meet the reasonable expectations of stakeholders.

**68** In summary, the foregoing discussion suggests conducting two related inquiries in a claim for oppression: (1) Does the evidence support the reasonable expectation asserted by the claimant? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest?

**69** Against the background of this overview, we turn to a more detailed discussion of these inquiries.

(a) *Proof of a Claimant's Reasonable Expectations*

**70** At the outset, the claimant must identify the expectations that he or she claims have been violated by the conduct at issue and establish that the expectations were reasonably held. As stated above, it may be readily inferred that a stakeholder has a reasonable expectation of fair treatment. However, oppression, as discussed, generally turns on particular expectations arising in particular situations. The question becomes whether the claimant stakeholder reasonably held the particular expectation. Evidence of an expectation may take many forms depending on the facts of the case.

**71** It is impossible to catalogue exhaustively situations where a reasonable expectation may arise due to their fact-specific nature. A few generalizations, however, may be ventured. Actual unlawfulness is [page595] not required to invoke s. 241; the provision applies "where the impugned conduct is wrongful,

even if it is not actually unlawful": Dickerson Committee (R. W. V. Dickerson, J. L. Howard and L. Getz), *Proposals for a New Business Corporations Law for Canada* (1971), vol. I, at p. 163. The remedy is focused on concepts of fairness and equity rather than on legal rights. In determining whether there is a reasonable expectation or interest to be considered, the court looks beyond legality to what is fair, given all of the interests at play: *Re Keho Holdings Ltd. and Noble*. It follows that not all conduct that is harmful to a stakeholder will give rise to a remedy for oppression as against the corporation.

**72** Factors that emerge from the case law that are useful in determining whether a reasonable expectation exists include: general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and agreements; and the fair resolution of conflicting interests between corporate stakeholders.

(i) Commercial Practice

**73** Commercial practice plays a significant role in forming the reasonable expectations of the parties. A departure from normal business practices that has the effect of undermining or frustrating the complainant's exercise of his or her legal rights will generally (although not inevitably) give rise to a remedy: *Adecco Canada Inc. v. J. Ward Broome Ltd.* (2001), 12 B.L.R. (3d) 275 (Ont. S.C.J.); *SCI Systems Inc. v. Gornitzki Thompson & Little Co.* (1997), 147 D.L.R. (4th) 300 (Ont. Ct. (Gen. Div.)), var'd (1998), 110 O.A.C. 160 (Div. Ct.); *Downtown Eatery (1993) Ltd. v. Ontario* (2001), 200 D.L.R. (4th) 289 (Ont. C.A.), leave to appeal refused, [2002] 1 S.C.R. vi.

(ii) The Nature of the Corporation

**74** The size, nature and structure of the corporation are relevant factors in assessing reasonable [page596] expectations: *First Edmonton Place*; G. Shapira, "Minority Shareholders' Protection -- Recent Developments" (1982), 10 *N.Z. Univ. L. Rev.* 134, at pp. 138 and 145-46. Courts may accord more latitude to the directors of a small, closely held corporation to deviate from strict formalities than to the directors of a larger public company.

(iii) Relationships

**75** Reasonable expectations may emerge from the personal relationships between the claimant and other corporate actors. Relationships between shareholders based on ties of family or friendship may be governed by different standards than relationships between arm's length shareholders in a widely held corporation. As noted in *Re Ferguson and Imax Systems Corp.* (1983), 150 D.L.R. (3d) 718 (Ont. C.A.), "when dealing with a close corporation, the court may consider the relationship between the shareholders and not simply legal rights as such" (p. 727).

(iv) Past Practice

**76** Past practice may create reasonable expectations, especially among shareholders of a closely held corporation on matters relating to participation of shareholders in the corporation's profits and governance: *Gibbons v. Medical Carriers Ltd.* (2001), 17 B.L.R. (3d) 280, 2001 MBQB 229; *820099 Ontario*. For instance, in *Gibbons*, the court found that the shareholders had a legitimate expectation that all monies paid out of the corporation would be paid to shareholders in proportion to the percentage of shares they held. The authorization by the new directors to pay fees to themselves, for which the shareholders would not receive any comparable payments, was in breach of those expectations.

**77** It is important to note that practices and expectations can change over time. Where valid commercial reasons exist for the change and the [page597] change does not undermine the

complainant's rights, there can be no reasonable expectation that directors will resist a departure from past practice: *Alberta Treasury Branches v. SevenWay Capital Corp.* (1999), 50 B.L.R. (2d) 294 (Alta. Q.B.), aff'd (2000), 8 B.L.R. (3d) 1, 2000 ABCA 194.

(v) Preventive Steps

**78** In determining whether a stakeholder expectation is reasonable, the court may consider whether the claimant could have taken steps to protect itself against the prejudice it claims to have suffered. Thus it may be relevant to inquire whether a secured creditor claiming oppressive conduct could have negotiated protections against the prejudice suffered: *First Edmonton Place*; *SCI Systems*.

(vi) Representations and Agreements

**79** Shareholder agreements may be viewed as reflecting the reasonable expectations of the parties: *Main*; *Lyall v. 147250 Canada Ltd.* (1993), 106 D.L.R. (4th) 304 (B.C.C.A.).

**80** Reasonable expectations may also be affected by representations made to stakeholders or to the public in promotional material, prospectuses, offering circulars and other communications: *Tsui v. International Capital Corp.*, [1993] 4 W.W.R. 613 (Sask. Q.B.), aff'd (1993), 113 Sask. R. 3 (C.A.); *Deutsche Bank Canada v. Oxford Properties Group Inc.* (1998), 40 B.L.R. (2d) 302 (Ont. Ct. (Gen. Div.)); *Themadel Foundation v. Third Canadian Investment Trust Ltd.* (1995), 23 O.R. (3d) 7 (Gen. Div.), var'd (1998), 38 O.R. (3d) 749 (C.A.).

(vii) Fair Resolution of Conflicting Interests

**81** As discussed, conflicts may arise between the interests of corporate stakeholders *inter se* and between stakeholders and the corporation. Where the conflict involves the interests of the corporation, it falls to the directors of the corporation to resolve them in accordance with their fiduciary [page598] duty to act in the best interests of the corporation, viewed as a good corporate citizen.

**82** The cases on oppression, taken as a whole, confirm that the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly. There are no absolute rules. In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.

**83** Directors may find themselves in a situation where it is impossible to please all stakeholders. The "fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction": *Maple Leaf Foods, per* Weiler J.A., at p. 192.

**84** There is no principle that one set of interests -- for example the interests of shareholders -- should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.

**85** On these appeals, it was suggested on behalf of the corporations that the "*Revlon* line" of cases from Delaware support the principle that where the interests of shareholders conflict with the interests of creditors, the interests of shareholders should prevail.

**86** The "*Revlon* line" refers to a series of Delaware corporate takeover cases, the two most important of which are *Revlon, Inc. v. MacAndrews [page599] & Forbes Holdings, Inc.*, 506 A.2d 173 (Del.

1986), and *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). In both cases, the issue was how directors should react to a hostile takeover bid. *Revlon* suggests that in such circumstances, shareholder interests should prevail over those of other stakeholders, such as creditors. *Unocal* tied this approach to situations where the corporation will not continue as a going concern, holding that although a board facing a hostile takeover "may have regard for various constituencies in discharging its responsibilities, ... such concern for non-stockholder interests is inappropriate when ... the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder" (p. 182).

**87** What is clear is that the *Revlon* line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces. In a review of trends in Delaware corporate jurisprudence, former Delaware Supreme Court Chief Justice E. Norman Veasey put it this way:

> [I]t is important to keep in mind the precise content of this "best interests" concept -- that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is usually derivatively good for the stockholders. There are times, of course, when the focus is directly on the interests of stockholders [i.e., as in *Revlon*]. But, in general, the directors owe fiduciary duties to the *corporation*, not to the stockholders. [Emphasis in original.]
>
> (E. Norman Veasey with Christine T. Di Guglielmo, "What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on [page600] Some Key Developments" (2005), 153 *U. Pa. L. Rev.* 1399, at p. 1431)

**88** Nor does this Court's decision in *Peoples Department Stores* suggest a fixed rule that the interests of creditors must prevail. In *Peoples Department Stores*, the Court had to consider whether, in the case of a corporation under threat of bankruptcy, creditors deserved special consideration (para. 46). The Court held that the fiduciary duty to the corporation did not change in the period preceding the bankruptcy, but that if the directors breach their duty of care to a stakeholder under s. 122(1)(*b*) of the *CBCA*, such a stakeholder may act upon it (para. 66).

(b) *Conduct Which Is Oppressive, Is Unfairly Prejudicial or Unfairly Disregards the Claimant's Relevant Interests*

**89** Thus far we have discussed how a claimant establishes the first element of an action for oppression -- a reasonable expectation that he or she would be treated in a certain way. However, to complete a claim for oppression, the claimant must show that the failure to meet this expectation involved unfair conduct and prejudicial consequences within s. 241 of the *CBCA*. Not every failure to meet a reasonable expectation will give rise to the equitable considerations that ground actions for oppression. The court must be satisfied that the conduct falls within the concepts of "oppression", "unfair prejudice" or "unfair disregard" of the claimant's interest, within the meaning of s. 241 of the *CBCA*. Viewed in this way, the reasonable expectations analysis that is the theoretical foundation of the oppression remedy, and the particular types of conduct described in s. 241, may be seen as complementary, rather than representing alternative approaches to the oppression remedy, as has sometimes been supposed. Together, they offer a complete picture of conduct that is unjust and inequitable, to return to the language of *Ebrahimi*.

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**90** In most cases, proof of a reasonable expectation will be tied up with one or more of the concepts of oppression, unfair prejudice, or unfair disregard of interests set out in s. 241, and the two prongs will in fact merge. Nevertheless, it is worth stating that as in any action in equity, wrongful conduct, causation and compensable injury must be established in a claim for oppression.

**91** The concepts of oppression, unfair prejudice and unfairly disregarding relevant interests are adjectival. They indicate the type of wrong or conduct that the oppression remedy of s. 241 of the *CBCA* is aimed at. However, they do not represent watertight compartments, and often overlap and intermingle.

**92** The original wrong recognized in the cases was described simply as oppression, and was generally associated with conduct that has variously been described as "burdensome, harsh and wrongful", "a visible departure from standards of fair dealing", and an "abuse of power" going to the probity of how the corporation's affairs are being conducted: see Koehnen, at p. 81. It is this wrong that gave the remedy its name, which now is generally used to cover all s. 241 claims. However, the term also operates to connote a particular type of injury within the modern rubric of oppression generally -- a wrong of the most serious sort.

**93** The *CBCA* has added "unfair prejudice" and "unfair disregard" of interests to the original common law concept, making it clear that wrongs falling short of the harsh and abusive conduct connoted by "oppression" may fall within s. 241. "Unfair prejudice" is generally seen as involving conduct less offensive than "oppression". Examples include squeezing out a minority shareholder, failing to disclose related party transactions, changing corporate structure to drastically alter debt ratios, adopting a "poison pill" to prevent a takeover bid, paying dividends without a formal declaration, preferring some shareholders with management fees [page602] and paying directors' fees higher than the industry norm: see Koehnen, at pp. 82-83.

**94** "Unfair disregard" is viewed as the least serious of the three injuries, or wrongs, mentioned in s. 241. Examples include favouring a director by failing to properly prosecute claims, improperly reducing a shareholder's dividend, or failing to deliver property belonging to the claimant: see Koehnen, at pp. 83-84.

(2) Application to These Appeals

**95** As discussed above (at para. 68), in assessing a claim for oppression a court must answer two questions: (1) Does the evidence support the reasonable expectation the claimant asserts? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest?

**96** The debentureholders in this case assert two alternative expectations. Their highest position is that they had a reasonable expectation that the directors of BCE would protect their economic interests as debentureholders in Bell Canada by putting forward a plan of arrangement that would maintain the investment grade trading value of their debentures. Before this Court, however, they argued a softer alternative -- a reasonable expectation that the directors would consider their economic interests in maintaining the trading value of the debentures.

**97** As summarized above (at para. 25), the trial judge proceeded on the debentureholders' alleged expectation that the directors would act in a way that would preserve the investment grade status of their debentures. He concluded that this expectation [page603] was not made out on the evidence, since the statements by Bell Canada suggesting a commitment to retaining investment grade ratings were accompanied by warnings that explicitly precluded investors from reasonably forming such

expectations, and the warnings were included in the prospectuses pursuant to which the debentures were issued.

**98** The absence of a reasonable expectation that the investment grade of the debentures would be maintained was confirmed, in the trial judge's view, by the overall context of the relationship, the nature of the corporation, its situation as the target of a bidding war, as well as by the fact that the claimants could have protected themselves against reduction in market value by negotiating appropriate contractual terms.

**99** The trial judge situated his consideration of the relevant factors in the appropriate legal context. He recognized that the directors had a fiduciary duty to act in the best interests of the corporation and that the content of this duty was affected by the various interests at stake in the context of the auction process that BCE was undergoing. He emphasized that the directors, faced with conflicting interests, might have no choice but to approve transactions that, while in the best interests of the corporation, would benefit some groups at the expense of others. He held that the fact that the shareholders stood to benefit from the transaction and that the debentureholders were prejudiced did not in itself give rise to a conclusion that the directors had breached their fiduciary duty to the corporation. All three competing bids required Bell Canada to assume additional debt, and there was no evidence that bidders were prepared to accept less leveraged debt. Under the business judgment rule, deference should be accorded to business decisions of directors taken in good faith and in the performance of the functions they were elected to perform by the shareholders.

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**100** We see no error in the principles applied by the trial judge nor in his findings of fact, which were amply supported by the evidence. We accordingly agree that the first expectation advanced in this case -- that the investment grade status of the debentures would be maintained -- was not established.

**101** The alternative, softer, expectation advanced is that the directors would consider the interests of the bondholders in maintaining the trading value of the debentures. The Court of Appeal, albeit in the context of its reasons on the s. 192 application, accepted this as a reasonable expectation. It held that the representations made over the years, while not legally binding, created expectations beyond contractual rights. It went on to state that in these circumstances, the directors were under a duty, not simply to accept the best offer, but to consider whether the arrangement could be restructured in a way that provided a satisfactory price to the shareholders while avoiding an adverse effect on debentureholders.

**102** The evidence, objectively viewed, supports a reasonable expectation that the directors would consider the position of the debentureholders in making their decisions on the various offers under consideration. As discussed above, reasonable expectations for the purpose of a claim of oppression are not confined to legal interests. Given the potential impact on the debentureholders of the transactions under consideration, one would expect the directors, acting in the best interests of the corporation, to consider their short and long-term interests in the course of making their ultimate decision.

**103** Indeed, the evidence shows that the directors did consider the interests of the debentureholders. A number of debentureholders sent letters to the Board, expressing concern about the proposed leveraged buyout and seeking assurances that their interests would be considered. One of the directors, Mr. Pattison, met with Phillips, Hager & North, [page605] representatives of the debentureholders. The directors' response to these overtures was that the contractual terms of the debentures would be met, but no additional assurances were given.

**104** It is apparent that the directors considered the interests of the debentureholders and, having done so, concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. This fulfilled the duty of the directors to consider the debentureholders' interests. It did not amount to "unfair disregard" of the interests of the debentureholders. As discussed above, it may be impossible to satisfy all stakeholders in a given situation. In this case, the Board considered the interests of the claimant stakeholders. Having done so, and having considered its options in the difficult circumstances it faced, it made its decision, acting in what it perceived to be the best interests of the corporation.

**105** What the claimants contend for on this appeal, in reality, is not merely an expectation that their interests be considered, but an expectation that the Board would take further positive steps to restructure the purchase in a way that would provide a satisfactory purchase price to the shareholders and preserve the high market value of the debentures. At this point, the second, softer expectation asserted approaches the first alleged expectation of maintaining the investment grade rating of the debentures.

**106** The difficulty with this proposition is that there is no evidence that it was reasonable to suppose it could have been achieved. BCE, facing certain takeover, acted reasonably to create a competitive bidding process. The process attracted three bids. All of the bids were leveraged, involving a substantial increase in Bell Canada's debt. It was this factor that posed the risk to the trading value [page606] of the debentures. There is no evidence that BCE could have done anything to avoid that risk. Indeed, the evidence is to the contrary.

**107** We earlier discussed the factors to consider in determining whether an expectation is reasonable on a s. 241 oppression claim. These include commercial practice; the size, nature and structure of the corporation; the relationship between the parties; past practice; the failure to negotiate protections; agreements and representations; and the fair resolution of conflicting interests. In our view, all these factors weigh against finding an expectation beyond honouring the contractual obligations of the debentures in this particular case.

**108** Commercial practice -- indeed commercial reality -- undermines the claim that a way could have been found to preserve the trading position of the debentures in the context of the leveraged buyout. This reality must have been appreciated by reasonable debentureholders. More broadly, two considerations are germane to the influence of general commercial practice on the reasonableness of the debentureholders' expectations. First, leveraged buyouts of this kind are not unusual or unforeseeable, although the transaction at issue in this case is noteworthy for its magnitude. Second, trust indentures can include change of control and credit rating covenants where those protections have been negotiated. Protections of that type would have assured debentureholders a right to vote, potentially through their trustee, on the leveraged buyout, as the trial judge pointed out. This failure to negotiate protections was significant where the debentureholders, it may be noted, generally represent some of Canada's largest and most reputable financial institutions, pension funds and insurance companies.

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**109** The nature and size of the corporation also undermine the reasonableness of any expectation that the directors would reject the offers that had been presented and seek an arrangement that preserved the investment grade rating of the debentures. As discussed above (at para. 74), courts may accord greater latitude to the reasonableness of expectations formed in the context of a small, closely held corporation, rather than those relating to interests in a large, public corporation. Bell Canada had become a wholly owned subsidiary of BCE in 1983, pursuant to a plan of arrangement which saw the shareholders of Bell

Canada surrender their shares in exchange for shares of BCE. Based upon the history of the relationship, it should not have been outside the contemplation of debentureholders acquiring debentures of Bell Canada under the 1996 and 1997 trust indentures, that arrangements of this type had occurred and could occur in the future.

**110** The debentureholders rely on past practice, suggesting that investment grade ratings had always been maintained. However, as noted, reasonable practices may reflect changing economic and market realities. The events that precipitated the leveraged buyout transaction were such realities. Nor did the trial judge find in this case that representations had been made to debentureholders upon which they could have reasonably relied.

**111** Finally, the claim must be considered from the perspective of the duty on the directors to resolve conflicts between the interests of corporate stakeholders in a fair manner that reflected the best interests of the corporation.

**112** The best interests of the corporation arguably favoured acceptance of the offer at the time. BCE had been put in play, and the momentum of the market made a buyout inevitable. The evidence, accepted by the trial judge, was that Bell Canada needed to undertake significant changes to continue to be successful, and that privatization [page608] would provide greater freedom to achieve its long-term goals by removing the pressure on short-term public financial reporting, and bringing in equity from sophisticated investors motivated to improve the corporation's performance. Provided that, as here, the directors' decision is found to have been within the range of reasonable choices that they could have made in weighing conflicting interests, the court will not go on to determine whether their decision was the perfect one.

**113** Considering all the relevant factors, we conclude that the debentureholders have failed to establish a reasonable expectation that could give rise to a claim for oppression. As found by the trial judge, the alleged expectation that the investment grade of the debentures would be maintained is not supported by the evidence. A reasonable expectation that the debentureholders' interests would be considered is established, but was fulfilled. The evidence does not support a further expectation that a better arrangement could be negotiated that would meet the exigencies that the corporation was facing, while better preserving the trading value of the debentures.

**114** Given that the debentureholders have failed to establish that the expectations they assert were reasonable, or that they were not fulfilled, it is unnecessary to consider in detail whether conduct complained of was oppressive, unfairly prejudicial, or unfairly disregarded the debentureholders' interests within the terms of s. 241 of the *CBCA*. Suffice it to say that "oppression" in the sense of bad faith and abuse was not alleged, much less proved. At best, the claim was for "unfair disregard" of the interests of the debentureholders. As discussed, the evidence does not support this claim.

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C. *The Section 192 Approval Process*

**115** The second remedy relied on by the debentureholders is the approval process for complex corporate arrangements set out under s. 192 of the *CBCA*. BCE brought a petition for court approval of the plan under s. 192. At trial, the debentureholders were granted standing to contest such approval. The trial judge concluded that "[i]t seem[ed] only logical and 'fair' to conduct this analysis having regard to the interests of BCE and those of its shareholders and other stakeholders, if any, whose interests are

being arranged or affected": (2008), 43 B.L.R. (4th) 1, 2008 QCCS 905, at para. 151. On the basis of Corporations Canada's *Policy concerning Arrangements Under Section 192 of the CBCA*, November 2003 ("Policy Statement 15.1"), the trial judge held that the s. 192 approval did not require the Board to afford the debentureholders the right to vote. He nonetheless considered their interests in assessing the fairness of the arrangement. After a full hearing, he approved the arrangement as "fair and reasonable", despite the debentureholders' objections that the arrangement would adversely affect the trading value of their securities.

**116** The Court of Appeal reversed this decision, essentially on the ground that the directors had not given adequate consideration to the debentureholders' reasonable expectations. These expectations, in its view, extended beyond the debentureholders' legal rights and required the directors to consider whether the adverse impact on the debentureholders' economic interests could be alleviated or attenuated. The court held that the corporation had failed to discharge the burden of showing that it was impossible to structure the sale in a manner that avoided the adverse economic effect on debentureholdings, and consequently had failed to establish that the proposed plan of arrangement was fair and reasonable.

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**117** Before considering what must be shown to obtain approval of an arrangement under s. 192, it may be helpful to briefly return to the differences between an action for oppression under s. 241 of the *CBCA* and a motion for approval of an arrangement under s. 192 of the *CBCA* alluded to earlier.

**118** As we have discussed (at para. 47), the reasoning of the Court of Appeal effectively incorporated the s. 241 oppression claim into the s. 192 approval proceeding, converting it into an inquiry based on reasonable expectations.

**119** As we view the matter, the s. 241 oppression remedy and the s. 192 approval process are different proceedings, with different requirements. While a conclusion that the proposed arrangement has an oppressive result may support the conclusion that the arrangement is not fair and reasonable under s. 192, it is important to keep in mind the differences between the two remedies. The oppression remedy is a broad and equitable remedy that focuses on the reasonable expectations of stakeholders, while the s. 192 approval process focuses on whether the arrangement, objectively viewed, is fair and reasonable and looks primarily to the interests of the parties whose legal rights are being arranged. Moreover, in an oppression proceeding, the onus is on the claimant to establish oppression or unfairness, while in a s. 192 proceeding, the onus is on the corporation to establish that the arrangement is "fair and reasonable".

**120** These differences suggest that it is possible that a claimant might fail to show oppression under s. 241, but might succeed under s. 192 by establishing that the corporation has not discharged its onus of showing that the arrangement in question is fair and reasonable. For this reason, it is necessary to consider the debentureholders' s. 192 claim on these appeals, notwithstanding our earlier conclusion that the debentureholders have not established oppression.

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**121** Whether the converse is true is not at issue in these proceedings and need not detain us. It might be argued that in theory, a finding of s. 241 oppression could be coupled with approval of an arrangement as fair and reasonable under s. 192, given the different allocations of burden of proof in the two actions and the different perspectives from which the assessment is made. On the other hand,

common sense suggests, as did the Court of Appeal, that a finding of oppression sits ill with the conclusion that the arrangement involved is fair and reasonable. We leave this interesting question to a case where it arises.

### (1) The Requirements for Approval Under Section 192

**122** We will first describe the nature and purpose of the s. 192 approval process. We will then consider the philosophy that underlies s. 192 approval; the interests at play in the process; and the criteria to be applied by the judge on a s. 192 proceeding.

#### (a) *The Nature and Purpose of the Section 192 Procedure*

**123** The s. 192 approval process has its genesis in 1923 legislation designed to permit corporations to modify their share capital: *Companies Act Amending Act, 1923*, S.C. 1923, c. 39, s. 4. The legislation's concern was to permit changes to shareholders' rights, while offering shareholders protection. In 1974, plans of arrangements were omitted from the *CBCA* because Parliament considered them superfluous and feared that they could be used to squeeze out minority shareholders. Upon realizing that arrangements were a practical and flexible way to effect complicated transactions, an arrangement provision was reintroduced in the *CBCA* in 1978: Consumer and Corporate Affairs Canada, *Detailed background paper for an Act to amend the Canada Business Corporations Act* (1977), p. 5 ("Detailed Background Paper").

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**124** In light of the flexibility it affords, the provision has been broadened to deal not only with reorganization of share capital, but corporate reorganization more generally. Section 192(1) of the present legislation defines an arrangement under the provision as including amendments to articles, amalgamation of two or more corporations, division of the business carried on by a corporation, privatization or "squeeze-out" transactions, liquidation or dissolution, or any combination of these.

**125** This list of transactions is not exhaustive and has been interpreted broadly by courts. Increasingly, s. 192 has been used as a device for effecting changes of control because of advantages it offers the purchaser: C. C. Nicholls, *Mergers, Acquisitions, and Other Changes of Corporate Control* (2007), at p. 76. One of these advantages is that it permits the purchaser to buy shares of the target company without the need to comply with provincial takeover bid rules.

**126** The s. 192 process is generally applicable to change of control transactions that share two characteristics: the arrangement is sponsored by the directors of the target company; and the goal of the arrangement is to require some or all of the shareholders to surrender their shares to either the purchaser or the target company.

**127** Fundamentally, the s. 192 procedure rests on the proposition that where a corporate transaction will alter the rights of security holders, this impact takes the decision out of the scope of management of the corporation's affairs, which is the responsibility of the directors. Section 192 overcomes this impediment through two mechanisms. First, proposed arrangements generally can be submitted to security holders for approval. Although there is no explicit requirement for a security holder vote in s. 192, as will be discussed below, these votes are an important feature of the process for approval of plans of arrangement. Second, the plan of arrangement must receive court approval after a hearing in which parties whose rights are being affected may partake.

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(b) *The Philosophy Underlying Section 192*

**128** The purpose of s. 192, as we have seen, is to permit major changes in corporate structure to be made, while ensuring that individuals and groups whose rights may be affected are treated fairly. In conducting the s. 192 inquiry, the judge must keep in mind the spirit of s. 192, which is to achieve a fair balance between conflicting interests. In discussing the objective of the arrangement provision introduced into the *CBCA* in 1978, the Minister of Consumer and Corporate Affairs stated:

> ... the Bill seeks to achieve a fair balance between flexible management and equitable treatment of minority shareholders in a manner that is consonant with the other fundamental change institutions set out in Part XIV.
>
> (Detailed Background Paper, at p. 6)

**129** Although s. 192 was initially conceived as permitting and has principally been used to permit useful restructuring while protecting minority shareholders against adverse effects, the goal of ensuring a fair balance between different constituencies applies with equal force when considering the interests of non-shareholder security holders recognized under s. 192. Section 192 recognizes that major changes may be appropriate, even where they have an adverse impact on the rights of particular individuals or groups. It seeks to ensure that the interests of these rights holders are considered and treated fairly, and that in the end the arrangement is one that should proceed.

(c) *Interests Protected by Section 192*

**130** The s. 192 procedure originally was aimed at protecting shareholders affected by corporate restructuring. That remains a fundamental concern. However, this aim has been subsequently broadened to protect other security holders in some circumstances.

**131** Section 192 clearly contemplates the participation of security holders in certain situations. [page614] Section 192(1)(*f*) specifies that an arrangement may include an exchange of securities for property. Section 192(4)(*c*) provides that a court can make an interim order "requiring a corporation to call, hold and conduct a meeting of holders of securities". The Director appointed under the *CBCA* takes the view that, at a minimum, all security holders whose legal rights stand to be affected by the transaction should be permitted to vote on the arrangement: Policy Statement 15.1, s. 3.08.

**132** A difficult question is whether s. 192 applies only to security holders whose *legal rights* stand to be affected by the proposal, or whether it applies to security holders whose legal rights remain intact but whose *economic interests* may be prejudiced.

**133** The purpose of s. 192, discussed above, suggests that only security holders whose legal rights stand to be affected by the proposal are envisioned. As we have seen, the s. 192 procedure was conceived and has traditionally been viewed as aimed at permitting a corporation to make changes that affect the *rights* of the parties. It is the fact that rights are being altered that places the matter beyond the power of the directors and creates the need for shareholder and court approval. The distinction between the focus on legal rights under arrangement approval and reasonable expectations under the oppression remedy is a crucial one. The oppression remedy is grounded in unfair treatment of stakeholders, rather

than on legal rights in their strict sense.

**134** This general rule, however, does not preclude the possibility that in some circumstances, for example threat of insolvency or claims by certain minority shareholders, interests that are not strictly legal should be considered: see Policy Statement 15.1, s. 3.08, referring to "extraordinary circumstances".

**135** It is not necessary to decide on these appeals precisely what would amount to "extraordinary [page615] circumstances" permitting consideration of non-legal interests on a s. 192 application. In our view, the fact that a group whose legal rights are left intact faces a reduction in the trading value of its securities would generally not, without more, constitute such a circumstance.

(d) *Criteria for Court Approval*

**136** Section 192(3) specifies that the corporation must obtain court approval of the plan. In determining whether a plan of arrangement should be approved, the court must focus on the terms and impact of the arrangement itself, rather than on the process by which it was reached. What is required is that the arrangement itself, viewed substantively and objectively, be suitable for approval.

**137** In seeking approval of an arrangement, the corporation bears the onus of satisfying the court that: (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reasonable: see *Trizec Corp., Re* (1994), 21 Alta. L.R. (3d) 435 (Q.B.), at p. 444. This may be contrasted with the s. 241 oppression action, where the onus is on the claimant to establish its case. On these appeals, it is conceded that the corporation satisfied the first two requirements. The only question is whether the arrangement is fair and reasonable.

**138** In reviewing the directors' decision on the proposed arrangement to determine if it is fair and reasonable under s. 192, courts must be satisfied that (a) the arrangement has a valid business purpose, and (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way. It is through this two-pronged framework that courts can determine whether a plan is fair and reasonable.

**139** In the past, some courts have answered the question of whether an arrangement is fair and reasonable by applying what is referred to as the [page616] business judgment test, that is whether an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own interest would reasonably approve the arrangement: see *Trizec*, at p. 444; *Pacifica Papers Inc. v. Johnstone* (2001), 15 B.L.R. (3d) 249, 2001 BCSC 1069. However, while this consideration may be important, it does not constitute a useful or complete statement of what must be considered on a s. 192 application.

**140** First, the fact that the business judgment test referred to here and the business judgment rule discussed above (at para. 40) are so similarly named leads to confusion. The business judgment *rule* expresses the need for deference to the business judgment of directors as to the best interests of the corporation. The business judgment *test* under s. 192, by contrast, is aimed at determining whether the proposed arrangement is fair and reasonable, having regard to the corporation and relevant stakeholders. The two inquiries are quite different. Yet the use of the same terminology has given rise to confusion. Thus, courts have on occasion cited the business judgment test while saying that it stands for the principle that arrangements do not have to be perfect, i.e. as a deference principle: see *Abitibi-Consolidated Inc. (Arrangement relatif à)*, [2007] Q.J. No. 16158 (QL), 2007 QCCS 6830. To conflate the business judgment test and the business judgment rule leads to difficulties in understanding what "fair and reasonable" means and how an arrangement may satisfy this threshold.

**141** Second, in instances where affected security holders have voted on a plan of arrangement, it seems redundant to ask what an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own interest, would do. As will be discussed below (at para. 150), votes on arrangements are an important indicator of whether a plan is fair and reasonable. [page617] However, the business judgment test does not provide any more information than does the outcome of a vote. Section 192 makes it clear that the reviewing judge must delve beyond whether a reasonable business person would approve of a plan to determine whether an arrangement is fair and reasonable. Insofar as the business judgment test suggests that the judge need only consider the perspective of the majority group, it is incomplete.

**142** In summary, we conclude that the business judgment test is not useful in the context of a s. 192 application, and indeed may lead to confusion.

**143** The framework proposed in these reasons reformulates the s. 192 test for what is fair and reasonable in a way that reflects the logic of s. 192 and the authorities. Determining what is fair and reasonable involves two inquiries: first, whether the arrangement has a valid business purpose; and second, whether it resolves the objections of those whose rights are being arranged in a fair and balanced way. In approving plans of arrangement, courts have frequently pointed to factors that answer these two questions as discussed more fully below: *Canadian Pacific Ltd. (Re)* (1990), 73 O.R. (2d) 212 (H.C.); *Cinar Corp. v. Shareholders of Cinar Corp.* (2004), 4 C.B.R. (5th) 163 (Que. Sup. Ct.); *PetroKazakhstan Inc. v. Lukoil Overseas Kumkol B.V.* (2005), 12 B.L.R. (4th) 128, 2005 ABQB 789.

**144** We now turn to a more detailed discussion of the two prongs.

**145** The valid business purpose prong of the fair and reasonable analysis recognizes the fact that there must be a positive value to the corporation to offset the fact that rights are being altered. In other words, courts must be satisfied that the burden imposed by the arrangement on security holders is justified by the interests of the corporation. [page618] The proposed plan of arrangement must further the interests of the corporation as an ongoing concern. In this sense, it may be narrower than the "best interests of the corporation" test that defines the fiduciary duty of directors under s. 122 of the *CBCA* (see paras. 38-40).

**146** The valid purpose inquiry is invariably fact-specific. Thus, the nature and extent of evidence needed to satisfy this requirement will depend on the circumstances. An important factor for courts to consider when determining if the plan of arrangement serves a valid business purpose is the necessity of the arrangement to the continued operations of the corporation. Necessity is driven by the market conditions that a corporation faces, including technological, regulatory and competitive conditions. Indicia of necessity include the existence of alternatives and market reaction to the plan. The degree of necessity of the arrangement has a direct impact on the court's level of scrutiny. Austin J. in *Canadian Pacific* concluded that

> while courts are prepared to assume jurisdiction notwithstanding a lack of necessity on the part of the company, the lower the degree of necessity, the higher the degree of scrutiny that should be applied. [Emphasis added; p. 223.]

If the plan of arrangement is necessary for the corporation's continued existence, courts will more willingly approve it despite its prejudicial effect on some security holders. Conversely, if the arrangement is not mandated by the corporation's financial or commercial situation, courts are more cautious and will undertake a careful analysis to ensure that it was not in the sole interest of a particular stakeholder. Thus, the relative necessity of the arrangement may justify negative impact on the interests of affected security holders.

**147** The second prong of the fair and reasonable analysis focuses on whether the objections of those whose rights are being arranged are being resolved in a fair and balanced way.

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**148** An objection to a plan of arrangement may arise where there is tension between the interests of the corporation and those of a security holder, or there are conflicting interests between different groups of affected rights holders. The judge must be satisfied that the arrangement strikes a fair balance, having regard to the ongoing interests of the corporation and the circumstances of the case. Often this will involve complex balancing, whereby courts determine whether appropriate accommodations and protections have been afforded to the concerned parties. However, as noted by Forsyth J. in *Trizec*, at para. 36:

> [T]he court must be careful not to cater to the special needs of one particular group but must strive to be fair to all involved in the transaction depending on the circumstances that exist. The overall fairness of any arrangement must be considered as well as fairness to various individual stakeholders.

**149** The question is whether the plan, viewed in this light, is fair and reasonable. In answering this question, courts have considered a variety of factors, depending on the nature of the case at hand. None of these alone is conclusive, and the relevance of particular factors varies from case to case. Nevertheless, they offer guidance.

**150** An important factor is whether a majority of security holders has voted to approve the arrangement. Where the majority is absent or slim, doubts may arise as to whether the arrangement is fair and reasonable; however, a large majority suggests the converse. Although the outcome of a vote by security holders is not determinative of whether the plan should receive the approval of the court, courts have placed considerable weight on this factor. Voting results offer a key indication of whether those affected by the plan consider it to be fair and reasonable: *St. Lawrence & Hudson Railway Co. (Re)*, [1998] O.J. No. 3934 (QL) (Gen. Div.).

**151** Where there has been no vote, courts may consider whether an intelligent and honest business person, as a member of the class concerned and [page620] acting in his or her own interest, might reasonably approve of the plan: *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co.*, [1891] 1 Ch. 213 (C.A.); *Trizec*.

**152** Other indicia of fairness are the proportionality of the compromise between various security holders, the security holders' position before and after the arrangement and the impact on various security holders' rights: see *Canadian Pacific*; *Trizec*. The court may also consider the repute of the directors and advisors who endorse the arrangement and the arrangement's terms. Thus, courts have considered whether the plan has been approved by a special committee of independent directors; the presence of a fairness opinion from a reputable expert; and the access of shareholders to dissent and appraisal remedies: see *Stelco Inc., Re* (2006), 18 C.B.R. (5th) 173 (Ont. S.C.J.); *Cinar*; *St. Lawrence & Hudson Railway*; *Trizec*; *Pacifica Papers*; *Canadian Pacific*.

**153** This review of factors represents considerations that have figured in s. 192 cases to date. It is not meant to be exhaustive, but simply to provide an overview of some factors considered by courts in determining if a plan has reasonably addressed the objections and conflicts between different constituencies. Many of these factors will also indicate whether the plan serves a valid business purpose.

The overall determination of whether an arrangement is fair and reasonable is fact-specific and may require the assessment of different factors in different situations.

**154** We arrive then at this conclusion: in determining whether a plan of arrangement is fair and reasonable, the judge must be satisfied that the plan serves a valid business purpose and that it adequately responds to the objections and conflicts between different affected parties. Whether these requirements are met is determined by taking into account a variety of relevant factors, including the necessity of the arrangement to the corporation's [page621] continued existence, the approval, if any, of a majority of shareholders and other security holders entitled to vote, and the proportionality of the impact on affected groups.

**155** As has frequently been stated, there is no such thing as a perfect arrangement. What is required is a reasonable decision in light of the specific circumstances of each case, not a perfect decision: *Trizec*; *Maple Leaf Foods*. The court on a s. 192 application should refrain from substituting their views of what they consider the "best" arrangement. At the same time, the court should not surrender their duty to scrutinize the arrangement. Because s. 192 facilitates the alteration of legal rights, the Court must conduct a careful review of the proposed transactions. As Lax J. stated in *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496 (Ont. S.C.J.), at para. 153: "Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination."

(2) Application to These Appeals

**156** As discussed above (at paras. 137-38), the corporation on a s. 192 application must satisfy the court that: (1) the statutory procedures are met; (2) the application is put forward in good faith; and (3) the arrangement is fair and reasonable, in the sense that: (a) the arrangement has a valid business purpose; and (b) the objections of those whose rights are being arranged are resolved in a fair and balanced way.

**157** The first and second requirements are clearly satisfied in this case. On the third element, the debentureholders no longer argue that the arrangement lacks a valid business purpose. The debate before this Court focuses on whether the objections of those whose rights are being arranged were resolved in a fair and balanced way.

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**158** The debentureholders argue that the arrangement does not address their rights in a fair and balanced way. Their main contention is that the process adopted by the directors in negotiating and concluding the arrangement failed to consider their interests adequately, in particular the fact that the arrangement, while upholding their contractual rights, would reduce the trading value of their debentures and in some cases downgrade them to below investment grade rating.

**159** The first question that arises is whether the debentureholders' economic interest in preserving the trading value of their bonds was an interest that the directors were required to consider on the s. 192 application. We earlier concluded that authority and principle suggest that s. 192 is generally concerned with legal rights, absent exceptional circumstances. We further suggested that the fact that a group whose legal rights are left intact faces a reduction in the trading value of its securities would generally not constitute such a circumstance.

**160** Relying on Policy Statement 15.1, the trial judge in these proceedings concluded that the

debentureholders were not entitled to vote on the plan of arrangement because their legal rights were not being arranged; "[t]o do so would unjustly give [them] a veto over a transaction with an aggregate common equity value of approximately $35 billion that was approved by over 97% of the shareholders" (para. 166). Nevertheless, the trial judge went on to consider the debentureholders' perspective.

**161** We find no error in the trial judge's conclusions on this point. Since only their economic interests were affected by the proposed transaction, not their legal rights, and since they did not fall within an exceptional situation where non-legal interests should be considered under s. 192, the debentureholders did not constitute an affected class under s. 192. The trial judge was thus correct in concluding [page623] that they should not be permitted to veto almost 98 percent of the shareholders simply because the trading value of their securities would be affected. Although not required, it remained open to the trial judge to consider the debentureholders' economic interests in his assessment of whether the arrangement was fair and reasonable under s. 192, as he did.

**162** The next question is whether the trial judge erred in concluding that the arrangement addressed the debentureholders' interests in a fair and balanced way. The trial judge emphasized that the arrangement preserved the contractual rights of the debentureholders as negotiated. He noted that it was open to the debentureholders to negotiate protections against increased debt load or the risks of changes in corporate structure, had they wished to do so. He went on to state:

> ... the evidence discloses that [the debentureholders'] rights were in fact considered and evaluated. The Board concluded, justly so, that the terms of the 1976, 1996 and 1997 Trust Indentures do not contain change of control provisions, that there was not a change of control of Bell Canada contemplated and that, accordingly, the Contesting Debentureholders could not reasonably expect BCE to reject a transaction that maximized shareholder value, on the basis of any negative impact [on] them.
>
> ((2008), 43 B.L.R. (4th) 1, 2008 QCCS 905, at para. 162, quoting (2008), 43 B.L.R. (4th) 79, 2008 QCCS 907, at para. 199)

**163** We find no error in these conclusions. The arrangement does not fundamentally alter the debentureholders' rights. The investment and the return contracted for remain intact. Fluctuation in the trading value of debentures with alteration in debt load is a well-known commercial phenomenon. The debentureholders had not contracted against this contingency. The fact that the trading value of [page624] the debentures stood to diminish as a result of the arrangement involving new debt was a foreseeable risk, not an exceptional circumstance. It was clear to the judge that the continuance of the corporation required acceptance of an arrangement that would entail increased debt and debt guarantees by Bell Canada: necessity was established. No superior arrangement had been put forward, and BCE had been assisted throughout by expert legal and financial advisors, suggesting that the proposed arrangement had a valid business purpose.

**164** Based on these considerations, and recognizing that there is no such thing as a perfect arrangement, the trial judge concluded that the arrangement had been shown to be fair and reasonable. We see no error in this conclusion.

**165** The Court of Appeal's contrary conclusion rested, as suggested above, on an approach that incorporated the s. 241 oppression remedy with its emphasis on reasonable expectations into the s. 192 arrangement approval process. Having found that the debentureholders' reasonable expectations (that their interests would be considered by the Board) were not met, the court went on to combine that finding with the s. 192 onus on the corporation. The result was to combine the substance of the

oppression action with the onus of the s. 192 approval process. From this hybrid flowed the conclusion that the corporation had failed to discharge its burden of showing that it could not have met the alleged reasonable expectations of the debentureholders. This result could not have obtained under s. 241, which places the burden of establishing oppression on the claimant. By combining s. 241's substance with the reversed onus of s. 192, the Court of Appeal arrived at a conclusion that could not have been sustained under either provision, read on its own terms.

[page625]

VI. Conclusion

**166** We conclude that the debentureholders have failed to establish either oppression under s. 241 of the *CBCA* or that the trial judge erred in approving the arrangement under s. 192 of the *CBCA*.

**167** For these reasons, the appeals are allowed, the decision of the Court of Appeal set aside, and the trial judge's approval of the plan of arrangement is affirmed with costs throughout. The cross-appeals are dismissed with costs throughout.

**Solicitors:**

*Solicitors for the appellants/respondents on cross-appeals BCE Inc. and Bell Canada: Davies, Ward, Phillips & Vineberg, Montréal; Ogilvy Renault, Montréal.*

*Solicitors for the appellant/respondent on cross-appeals 6796508 Canada Inc.: Woods & Partners, Montréal.*

*Solicitors for the respondents/appellants on cross-appeals Group of 1976 Debentureholders and Group of 1996 Debentureholders: Fishman, Flanz, Meland, Paquin, Montréal.*

*Solicitors for the respondent/appellant on cross-appeals Group of 1997 Debentureholders: McMillan, Binch, Mendelsohn, Toronto.*

*Solicitors for the respondent Computershare Trust Company of Canada: Miller, Thomson, Pouliot, Montréal.*

*Solicitor for the intervener Catalyst Asset Management Inc.: Christian S. Tacit, Kanata.*

*Solicitors for the intervener Matthew Stewart: Langlois, Kronstrom, Desjardins, Montréal.*

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Ferguson v. Imax Systems Corp.

FERGUSON v. IMAX SYSTEMS CORPORATION et al.

Ontario Supreme Court, Divisional Court

Southey, Krever and Smith JJ.

Heard: May 1-3, 1984
Judgment: July 13, 1984
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Counsel: *H.L. Morphy, Q.C.*, and *S.R. Block*, for appellants, Imax Systems Corporation and Roman Kroiter.

*J.H. Jenkins, Q.C.*, for appellants, Robert Kerr, William Breukelman, C.W. Breukelman and William Shaw.

*S.M. Grant*, for appellant, I. Graeme Ferguson.

*S.N. Lederman, Q.C.*, and *P.F.C. Howard*, for respondent, Laventhol & Horwath, inspector.

*R.D. Manes*, for complainant (respondent), Betty June Ferguson.

Subject: Corporate and Commercial; Insolvency; Civil Practice and Procedure

Corporations --- Shareholders — Shareholders' remedies — Relief from oppression.

Corporations --- Shareholders — Shareholders' remedies — Investigation orders — Appointment of inspector.

Practice --- Practice on interlocutory motions and applications — Conduct of hearing — General.

Corporations — Inspection — Finding by court of oppressive conduct required before investigation ordered — Inspector under duty to act fairly and impartially and to appear impartial — Inspector's report not binding.

Section 222 of the Canada Business Corporations Act requires the court to conclude that it appears that the business or affairs of the corporation have been conducted in a matter that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant before an investigation may be ordered. It is not enough that there has been a complaint made by a security holder, or that there is some evidence of oppressive conduct. The court must examine the evidence and make a finding that it appears that there has been oppressive conduct. The court cannot direct that the investigation be made in order to assist the court in making such finding. The finding must be made before the investigation can be directed.

An inspector is under a duty to act fairly and he should not only be impartial, but should appear to be impartial. A party should not insist on the appointment of a particular person or firm as an inspector over the objection of an adverse party unless the objection is clearly fanciful. Where a member of the firm nominated as inspector has had prior and continuing connection with the complainant in connection with her dispute with the corporation and other shareholders, even though there may not be any reason to suggest that the firm nominated would not act fairly, the appearance of impartiality is not there and therefore some other firm should be appointed as inspector.

The report of the inspector merely gives the minority shareholders information of greater or less value. It may not be accurate, binds no one, and determines nothing.

**Cases considered:**

*Baker v. Hutchinson* (1976), 13 O.R. (2d) 591, 1 C.P.C. 291 (C.A.) — *applied*

*Botiuk, Re* (1975), 9 O.R. (2d) 299, 60 D.L.R. (3d) 227 (Dist. Ct.) — *applied*

*Maynard v. Maynard*, [1951] S.C.R. 346, [1951] 1 D.L.R. 241 — *applied*

*Pergamon Press Ltd., Re*, [1971] 1 Ch. 388, [1970] 3 W.L.R. 792, [1970] 3 All E.R. 535 (C.A.) — *applied*

*Shell Castle Fire Place Ltd., Re* (1927), 33 O.W.N. 195 (C.A.) — *applied*

**Statutes considered:**

Canada Business Corporations Act, 1974-75-76 (Can.), c. 33, ss. 184 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 60; 1980-81-82-83, c. 115, s. 10], 222 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 71], 234 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9 s. 74], 235 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 75].

**Rules considered:**

Ontario Rules of Practice, R. 229.

Appeal from order appointing inspector to investigate financial affairs of corporation.

**The judgment of the court was delivered by *Southey J.*:**

1 This is an appeal by Imax Systems Corporation and all the individual respondents in the court below from an order of O'Brien J. made in Motions Court on 10th February 1984, appointing Laventhol & Horwath as inspector of Imax under s. 222 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 71] of the Canada Business Corporations Act, 1974-75-76 (Can.), c. 33, to investigate the financial affairs of Imax and report to the court its findings.

2 The following were the main grounds of appeal:

3 1. The learned Motions Court judge erred in basing his order on a decision of the Court of Appeal in prior proceedings, because of the doctrine of res judicata.

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4 2. He erred in refusing the request of counsel for Imax and other respondents below for an adjournment to enable them to cross-examine on the affidavits filed on behalf of the complainant, one of which was served only on the afternoon before the motion was heard.

5 3. He erred in imposing a restriction of 40 minutes on the argument of counsel for Imax.

6 4. He erred in appointing Laventhol & Horwath as inspector over the objection of the respondents below that that firm was not impartial, because one of its members had advised the complainant in connection with the prior proceedings and had sworn a one-sided affidavit filed by the complainant on the present motion.

7 In addition, the appellants submitted that, even if the learned Motions Court judge did not err in appointing an inspector, he erred in directing that Imax pay the costs of the investigation and in failing to place limits on the scope of the investigation.

8 The order under appeal dealt with only one of numerous claims for relief made by the complainant against Imax and the individual respondents below under ss. 222, 234 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 74] and 235 [re-en. 1978-79, c. 9, s 1(F); am. 1978-79, c. 9, s. 75] of the Canada Business Corporations Act. The balance of the motion was adjourned by O'Brien J. to a date to be fixed. The other relief claimed included orders restraining the respondents below from engaging in oppressive conduct; removing the complainant's former husband, I. Graeme Ferguson, as a director of Imax and appointing a director in his place; appointing other directors in place of all directors of Imax then in office; compensating the complainant in respect of unpaid dividends; and setting aside as oppressive certain transactions involving the purchase and sale of shares of Imax by the appellants Ferguson, Kerr and Kroiter and the issuance of shares of Imax to the appellant Breukelman.

**Background and Facts**

9 Imax was incorporated in 1967 to exploit a patented film projection system, on application of which is presently in operation at the Cinesphere at Ontario Place in Toronto. The original shareholders were three of the respondents below: I. Graeme Ferguson, Kerr and Kroiter, and their wives, one of whom was the complainant. The three husbands received equal numbers of the common shares and class B shares of the company, and the wives received equal numbers of class B shares only. The class B shares were non-redeemable and participated in dividends and on liquidation, dissolution or winding-up, but were non-voting unless the company failed for two consecutive years to pay a preferred dividend.

10 Unlike the other two wives, the complainant was actively engaged in the business of the company in its early years, largely without compensation. The company was in precarious financial circumstances for a few years, but had become a profitable venture by 1974. In 1972 the complainant and her husband, I. Graeme Ferguson, separated and in 1974 they were divorced.

11 In November 1979 a special meeting of the shareholders of Imax was called to consider a resolution that would cancel all the class B shares and convert them into class A shares. The class A shares would receive a cumulative preferred dividend until 1984, but then would be redeemed at $175 per share. The complainant took the position that the purpose and effect of the resolution was to put her out of the company, as she was the only holder of class B shares without any other share interest, personally or through a spouse, by which she could participate in the growth of the company. She had been discharged from her employment with the company and she alleged that further pressure was being put on her by the refusal of the company to pay dividends. She brought an application under s. 234 of the Canada Business Corporations Act for an injunction to restrain the

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company from holding the meeting at which the resolution was to be considered, on the grounds that the affairs of the company were being conducted in a manner that was oppressive or unfairly prejudicial to her interests as a minority shareholder.

12 There was no trial. The motion was heard by Hollingworth J., who gave judgment on 20th July 1980 (12 B.L.R. 209), holding that there had been no oppression. He refused the injunction, but appointed an appraiser under s. 184(21) [re-en. 1978-79, c. 9 s. 1(F)] of the Canada Business Corporations Act to assist the court to fix a fair value for the shares of the complainant. Both sides appealed. The Divisional Court (38 O.R. (2d) 59, 28 C.P.C. 290, 134 D.L.R. (3d) 519) set aside the order appointing the appraiser on the ground that the learned judge had no jurisdiction to make an order under s. 184 [re-en. 1978-79, c. 9, s. 1(F); am. 1978-79, c. 9, s. 60; 1980-81-82-83, c. 115, s. 10] in dealing with a motion under s. 234. The Court of Appeal (43 O.R. (2d) 128, 150 D.L.R. (3d) 718) held that the conduct of I. Graeme Ferguson and the other directors had been oppressive and unfair to the complainant, and allowed the appeal from the order dismissing the application for an injunction.

13 Brooke J.A., delivering the judgment of the Court of Appeal, drew the following conclusions from the material filed on the motion at p. 135:

> The company could pay dividends. Mr. Ferguson set out to stop the payment because he did not want Mrs. Ferguson to share in the benefits in the growth of the company and wanted to force her to sell her shares to him or to one of the other men in the company. It was argued that he was but one shareholder and one director and alone could not stop the company from the payment of dividends. But the fact is that he did so. Mr. Kerr, Mr. Shaw and Mr. Kroiter were his friends and close to him and from the evidence of Mrs. Ferguson it is clear that they yielded to the pressure that he brought on them to bring about this result. In my opinion this conduct was oppressive and unfair to her.

And at pp. 137-38:

> Here we have a small close corporation that was promoted and is still controlled by the same small related group of individuals. The appellant's part in that group and her work for the corporation is important. Further, the attempt to force her to sell her shares through non-payment of dividends was not simply the act of Mr. Ferguson, but was also the act of the others in the group including the present director, in concert with him. Having regard to the intention of that group to deny the appellant any participation in the growth of the company I think the resolution authorizing the change in the capital of the company is the culminating event in a lengthy course of oppressive and unfairly prejudicial conduct to the appellant.

At p. 138 he said:

> The resolution was a final solution to the problem of the ex-wife shareholder.

14 Notwithstanding the pending appeal to the Court of Appeal, and warnings from the complainant and her solicitors that they were proceeding at their own risk, the respondents below went ahead with a meeting of the shareholders of Imax while the appeal from the order of Hollingworth J. was pending, and the resolution reorganizing the capital of the company was passed. In its reasons for judgment released on 6th September 1983 allowing the appeal, the Court of Appeal referred to the fact that the resolution had been passed, and made an order forever prohibiting the company from implementing the resolution. Leave to appeal to the Supreme Court of Canada was denied on 5th December 1983 [2 O.A.C. 158, 52 N.R. 317n].

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15 The application before O'Brien J. was brought by notice of motion served on 16th January last. The main affidavit of the complainant in support of the motion, and a supporting affidavit of Eric W. Slavens, a chartered accountant with Laventhol & Horwath, were served about a week later. A second affidavit of the complainant, sworn on 9th February, was never served separately, but was simply included in the record prepared by the complainant's solicitors, and served and filed on the afternoon before the motion. The complainant refered to some length in her first affidavit to the decision of the Court of Appeal and the evidence before that court. She then went on to assert that Imax and its directors, after the commencement of the earlier litigation on 28th November 1979, had continued to engage in oppressive conduct towards her, similar to that which had been the subject of the prior proceedings. She gave particulars of pressure brought to bear on her by directors of Imax to sell her shares; of the steps taken by Imax to implement the resolution found by the Court of Appeal to be oppressive; of financial "manipulations" by Imax involving the issuance of shares of Imax to Breukelman with the company lending him the subscription price, and the incurring of extraordinary expenses for salaries and other benefits conferred upon the directors; the failure to pay dividends to her; and the failure to make corporate records readily available for inspection by her or her representatives, as required by law. Her first affidavit concluded with the following paragraph:

> 18. My lawyers and the accountants retained by them have advised me that there is no way of knowing the nature and extent of other actions by the Company which were oppressive to me or carried out in bad faith unless an inspector is appointed by this Honourable Court to determine this. I cannot possibly afford to pay this person if this Honourable Court does not order that this person be paid by the Company, and it will mean that I cannot obtain this inspection and I will never learn the nature and extent of the Company's actions that were taken to my detriment.

16 Mr. Slavens, the chartered accountant with Laventhol & Horwath, gave particulars in his affidavit of the percentages by which a number of expenses of Imax had increased in the years 1980-1982 as compared with the years 1977-1979. The only reference by him to the increase in the revenues of Imax between the two periods was contained in his conclusion, which read as follows:

> 14. Revenues of the Company also rose during the period under review. Notwithstanding this fact, one cannot render an opinion as to the reasons for, or the propriety of, the increases in the expenses referred to above unless one understands the nature of these expenses and verifies the propriety of the underlying transactions by means of an examination of the Company's books and records.
>
> 15. Based upon my reading of the Reasons for Judgment and my examination of the subject Financial Statements, it is my opinion that an independent review is necessary to determine the propriety of these expenses and other transactions which may not be evident from the Financial Statements and which may have been prejudicial to some or all of the shareholders, including Mrs. Ferguson.
>
> 16. I am making this Affidavit in support of an application by Mrs. Ferguson for the appointment of Laventhol & Horwath as an Inspector pursuant to the provisions of The Canada Business Corporations Act and its consent to so act is attached hereto.

17 The respondents below filed seven affidavits on the motion, all sworn on 8th or 9th February, purporting to answer in detail the factual points raised by the complainant. One of them showed that the expenses referred to in Mr. Slavens's affidavit had risen by a smaller percentage than had the revenues of Imax during the same period. it is for this reason that the affidavit of Mr. Slavens appears one-sided on the record as it now stands.

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18 In her second affidavit sworn on 9th February, the complainant dealt with a somewhat technical point that I do not regard as being of any significance, and then concluded:

> 4. I verily believe that without the immediate appointment of an inspector by this Honourable Court, at the Corporation's expense, it will be impossible for me to obtain the information necessary for me to ascertain the true financial standing of the Corporation. I also verily believe that unless an inspector is appointed immediately, the Corporation will not only continue to exclude me from my rightful participation but will also continue to conduct its affairs as it deems fit in spite of the decision of the Court of Appeal and cautions from my solicitors to maintain the status quo until this Honourable Court has the opportunity to finally consider the matter.

19 This was the first mention by the complainant of urgency.

20 The learned Motions Court judge endorsed his decision by hand on the back cover of the record at the conclusion of the hearing on 10th February, last. His endorsement reads as follows:

> Application to proceed only with regard to appointment of inspector under s. 222(2)(*b*) of the Canada Business Corporations Act. Adjournment requested and refused.
>
> In *Ferguson v. Imax*, heard May 1983, the Court of Appeal concluded the president of the respondent company and its directors attempted to force the applicant to sell her shares through non-payment of dividends.
>
> The court also concluded there was an intention to deny the applicant participation in company growth and found the company's conduct to be oppressive and unfairly prejudiced and not bona fides.
>
> In contradicting affidavits, there are allegations of ongoing oppression.
>
> This matter was set down for hearing with an estimate of one hour, by applicant, only one of a number of matters referred to in the notice of motion proceeded. After hearing the contested adjournment and counsel for the applicant, I limited the respondents' counsel to 40 minutes in argument.
>
> Application granted with regard to appointment of inspector to investigate financial affairs of the corporation.
>
> 1. Laventhol & Horwath are appointed.
>
> 2. Inspector's entry on any premises, other than those which would intrude on solicitor-and-client privilege, is authorized and the inspector is permitted to copy documents and records as advised. If solicitor-and-client privilege is claimed, further application to court to be made.
>
> 3. All agents and servants and employees of the corporation having knowledge of this order to co-operate and provide documents to the inspector.
>
> 4. No order at this stage authorizing inspector to conduct hearings or administer oaths — further application may be made in that regard, if advised.
>
> 5. Inspector to report to court with respect to his findings.
>
> 6. No order at this stage permitting inspector to attend meetings of board of directors — further application

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may be made.

7. Corporation to bear inspector's costs to be passed — first passing of accounts to be made at $30,000. Leave to raise matter of reasonableness beyond that level. On basis of decision of Court of Appeal, I am of the view there was good reason to appoint inspector.

8. Costs of this application to the applicant in the cause.

9. Balance of application adjourned to a date to be fixed.

**Res Judicata**

21 The relevant portions of s. 222 of the Canada Business Corporations Act read as follows:

222.(1) A security holder or the Director may apply ex parte or upon such notice as the court may require, to a court having jurisdiction in the place where the corporation has its registered office for an order directing an investigation to be made of the corporation and any of its affiliated corporations.

(2) If, upon an application under subsection (1), it appears to the court that...

(*b*) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder...

the court may order an investigation to be made of the corporation and any of its affiliated corporations.

22 In a case like the one at bar, the section clearly requires the court to conclude that it appears that the business or affairs of the corporation have been conducted in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant before an investigation may be ordered. It is not enough that there has been a complaint made by a security holder, or that there is some evidence of oppressive conduct. The court must examine the evidence and make a finding that it appears that there has been oppressive conduct. The court cannot direct that the investigation be made in order to assist the court in making such finding. The finding must be made before the investigation can be directed.

23 There is no doubt that the learned Motions Court judge relied heavily on the decision of the Court of Appeal in making his decision to appoint an inspector. The only thing he said about conduct occurring after the events that were the subject of the previous litigation was: "In contradicting affidavits, there are allegations of ongoing oppression." All those allegations were disputed in a very substantial way by the respondents below, but it does not appear that the learned Motions Court judge considered the conflicting evidence or made any finding as to whether the allegations of ongoing oppression were well founded. He appears to have based his decision that there be an investigation, as well as his ruling that the company should pay the costs thereof, entirely on the findings made by the Court of Appeal.

24 The interpretation of the endorsement of the learned Motions Court judge that I have suggested is entirely consistent with his refusal of the request of the respondents for an adjournment to cross-examine on the affidavits filed by the complainant, even though one had been served only on the afternoon before the motion was heard, and the fact that he limited counsel for Imax to 40 minutes of argument, despite her statement to him, according to counsel on the argument before us, that she could not complete her argument adequately within that

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time. If the learned Motions Court judge felt he could base his decision entirely on the findings made by the Court of Appeal in the prior proceedings, there would have been no useful purpose served by a cross-examination on the affidavits relating to subsequent conduct, nor would there have been a need for extensive argument.

25 The question then is whether the learned Motions Court judge was entitled to direct an investigation on the basis of the decision of the Court of Appeal, when he had not weighed the evidence of subsequent conduct, or made any findings with respect thereto. In my judgment, the answer is that he was not so entitled because of the doctrine of res judicata.

26 The doctrine of res judicata is stated in the judgment of Cartwright J. in *Maynard v. Maynard*, [1951] S.C.R. 346 at 358-59, [1951] 1 D.L.R. 241, as follows, omitting the reference to the Latin maxim:

The following passage from the judgment of Maugham J., as he then was, in *Green v. Weatherill*, [1929] 2 Ch. 213 at 221, 222, [1929] All E.R. 428, seems to me to state concisely the principles which are applicable:

> the plea of *res judicata* is not a technical doctrine, but a fundamental doctrine based on the view that there must be an end to litigation: see *Re May*, 28 Ch. D. 516, at 518 (C.A.); *Badar Bee v. Habib Merican Noordin*, [1909] A.C. 615 (P.C.). In the leading case of *Henderson v. Henderson* (1843), 3 Hare 100 at 114, 67 E.R. 313, [1843-60] All E.R. 378 (V.C.), there is to be found the following statement of the law by Wigram V.C.: 'I believe I state the rule of the Court correctly when I say that where a given matter becomes the subject of litigation in and of adjudication by a court of competent jurisdiction, the Court requires the parties to that litigation to bring forward their whole case and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of matter which might have been brought forward as part of the subject in contest, but which was not brought forward only because they have from negligence, inadvertence or even accident, omitted part of their case. The plea of *res judicata* applies, except in special cases, not only to points upon which the Court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation and which the parties, exercising reasonable diligence, might have brought forward at the time.' This passage has recently been approved by the Privy Council in the case of *Hoystead v. Taxation Comm.*, [1926] A.C. 155 at 170, [1925] All E.R. 56.

In the judgment of the Judicial Committee in *Hoystead v. Taxation Comm.*, [supra] at page 165 is the following:

> Parties are not permitted to begin fresh litigations because of new views they may entertain of the law of the case, or new versions which they present as to what should be a proper apprehension by the Court of the legal result either of the construction of the documents or the weight of certain circumstances.
>
> If this were permitted litigation would have no end, except when legal ingenuity is exhausted. It is a principle of law that this cannot be permitted, and there is abundant authority reiterating that principle.

27 I do not accept Mr. Morphy's submission that the learned Motions Court judge was not entitled to rely in any way on the conduct that was considered by the Court of Appeal. I think he would have been entitled to assess the significance of subsequent conduct in light of the prior conduct of the respondents below that was considered by the Court of Appeal. But he was not entitled, and I say this with the greatest respect, to rely solely on the conduct that was considered by the Court of Appeal, and I believe that is what he did.

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28 If the complainant was entitled to an investigation and the appointment of an inspector at the time of the prior proceedings, then she was required by the doctrine of res judicata to claim them then. There must be an end to litigation, and she was not entitled to come back later and ask for relief that she could have claimed at the time the earlier proceedings were brought.

29 If the complainant had been unable to satisfy the court that the respondents had appeared to have engaged in oppressive conduct after the period to which the prior proceedings related, then, in my view, the investigation should not have been ordered. In considering whether subsequent conduct appeared to be oppressive, the court was entitled to take into account the decision in the previous proceedings, but it was obliged to satisfy itself that there had been subsequent conduct that appeared oppressive. The court was not required to put the decision of the Court of Appeal out of its mind, but it could not base its order on that decision alone.

**Failure to Permit Cross-Examination**

30 If I am wrong in my interpretation of the endorsement of the learned Motions Court judge, and he did base his decision, at least in part, on evidence of subsequent oppressive conduct contained in the affidavits filed on behalf of the complainant, then I think, with respect, that he erred in refusing the adjournment requested by counsel for Imax so that she might cross-examine on those affidavits.

31 I have not overlooked that no attempt was made to arrange such cross-examinations before the return of the motion, but the respondents below were not idle during that period of about 18 days. The issues were not simple, and I suspect they moved with reasonable dispatch in preparing the affidavits which they served and filed a day or two before the return of the motion. An attempt was made in those affidavits to answer in considerable detail the charges made by the complainant. The letter from the complainant's solicitors that was delivered with her affidavits expressed a wish that the motion proceed on 10th February, but did not state that an adjournment for the purposes of cross-examination would be opposed. I think it would have been reasonable for counsel for the respondents below to have expected to be granted an adjournment on 10th February, and to have thought that she had saved time by delivering her affidavits so that all deponents could have been examined at the same time, assuming, of course, that the court was going to make use of the affidavits.

32 Rule 229 [Ontario Rules of Practice] provides that a person who has made an affidavit to be used upon a motion may be cross-examined thereon. There is a prima facie right to such cross-examination, but the rule does not divest the court of its inherent power to control its own proceedings and, in cases where it appears to be in the interests of justice, to refuse to permit such cross-examination or to restrict its scope (*Re Botiuk* (1975), 9 O.R. (2d) 299 at 303, 60 D.L.R. (3d) 227 (Dist. Ct.)). The Motions Court judge has a discretion to refuse an adjournment to permit cross-examination in cases of urgency, or where the party wishing to examine has not acted with reasonable dispatch. The litigation between these parties had been going on for more than four years, and there was no suggestion of urgency until the second affidavit of the complainant was delivered on the afternoon before the motion. The respondents had had no chance whatsoever to cross-examine the complainant on that affidavit before the return of the motion. With much deference to the learned Motions Court judge, it is my respectful view in these circumstances that, if he was going to make use of the affidavits filed on behalf of the complainant, it was not a proper exercise of his discretion to deny the respondents below the opportunity to cross-examine thereon.

**Limited Argument to 40 Minutes**

33 Counsel for the appellants also submitted that the respondents below had been denied their substantive right

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to present their case fully to the learned Motions Court judge by his imposition on counsel appearing below for Imax and four of the individual respondents there of a limit of 40 minutes on the time for her argument. The general rule is clear: Every litigant is entitled to have his case fully presented and fairly considered (*Baker v. Hutchinson* (1976), 13 O.R. (2d) 591 at 597, 1 C.P.C. 291 (C.A.)). But that does not mean that the court must listen to everything that every counsel (or litigant appearing in person) wishes to say. The court must be able to protect itself from needless repetition and prolixity, and to confine counsel to submissions that are relevant to issues of substance. Furthermore, the effective operation of Motions Court, or any court in which several matters are usually heard at each session, requires that counsel, as a general rule, be held to their estimates of the time required for their own arguments.

34 In this case, counsel for the complainant, at the time he obtained a time and date for the hearing of the motion, had given an estimate of one hour as the time that would be required for hearing all parties on the motion. Counsel for Imax had given no such estimate: The practice does not require counsel for the respondent to do so. In fact, we were informed by counsel, the learned Motions Court judge spent two hours and 20 minutes on the motion, and did not finish the hearing until 5:30 p.m.

35 Imax was represented in Motions Court by counsel of more than ordinary ability. I am sure that she adequately covered a great deal, if not all, of the ground in the 40 minutes given to her. Her presentation was supported by counsel for the respondent I. Graeme Ferguson, who, we were told, argued for 20 minutes.

36 The counsel who argued the motion below were among the counsel who appeared before us on the appeal. This meant that we had no affidavit evidence as to the adequacy of the time permitted. We were faced with conflicting statements from counsel as to what had taken place below. This was awkward and unsatisfactory, even though all counsel conducted themselves before us with a commendable degree of respect for one another. There is no general rule that a court can never impose a time limit on argument. Forty minutes is not necessarily an insufficient time, even in this case which lasted 2 $^{1}/_{2}$ days before us on appeal. In the absence of specific evidence in proper form that the respondents below were prevented by the time limit from putting their case adequately to the learned Motions Court judge, I am not prepared to say that the imposition of such limit prevented the respondents below from having a fair hearing in this case.

**Questioned Impartiality of Laventhol & Horwath**

37 The final ground of appeal was that the learned Motions Court judge erred in appointing Laventhol & Horwath as inspector because that firm was not impartial, or did not appear to be impartial, because Mr. Slavens advised the complainant in connection with the prior proceedings, and filed an affidavit in support of the present application. I have already mentioned that his affidavit appears to me to be one-sided. Counsel for Imax objected to the selection of Laventhol & Horwath as inspector, and went on to inform the learned Motions Court judge that, if an inspector was going to be appointed, Imax would not object to the appointment of any one of a number of large accounting firms in place of Laventhol & Horwath.

38 An inspector is under a duty to act fairly (*Re Pergamon Press Ltd.*, [1971] 1 Ch. 388 at 399, [1970] 3 W.L.R. 792, [1970] 3 All E.R. 535 (C.A.)), and I think he should not only be impartial, but should appear to be impartial. It is difficult to think that a party would ever be well advised to insist on the appointment of a particular person or firm as inspector over the objection of an adverse party, unless the objection was clearly fanciful. In this case, the respondents below, in my judgment, had good reason to object to the appointment of Laventhol & Horwath on the ground of partiality, because of Mr. Slavens's prior and continuing connection with the com-

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plainant in connection with her dispute with the appellants. Although there may have been no reason for the learned Motions Court judge to think that Laventhol & Horwath would not in fact act fairly, the appearance of impartiality was not there, and I think that some other firm should have been appointed as inspector.

**Conclusion**

39 For the foregoing reasons, I find that the learned Motions Court judge erred in appointing Laventhol & Horwath as inspector to investigate the financial affairs of Imax.

**Disposition of Appeal**

40 This appeal was launched on Monday, 13th February last, the next business day after the making of the order below. When Laventhol & Horwath attempted to take up its duties as inspector on that day, representatives of Imax took the position that the order of the learned Motions Court judge was stayed pending disposition of the appeal. Laventhol & Horwath then applied to a judge of the Divisional Court for directions, and on 24th February, Reid J. held that there was no automatic stay and ordered Laventhol & Horwath to proceed forthwith with its investigation under the order of O'Brien J. Reid J. did so on the ground that the report of the inspector might well be of assistance to the court when the balance of the complainant's motion came on for hearing in due course.

41 On 6th March 1984 Reid J. dismissed an application by Imax and Kroiter for a directed stay, notwithstanding that the appeal might become "academic" if the inspector's report was finished before it was heard. That, in fact, is what occurred. Laventhol & Horwath understood it was obliged under the first order of Reid J. to complete its work as soon as possible and report back to the court. The inspector carried out its investigation during March and April, and its report was finished and available for filing with the court on 27th April last, four days before the appeal came on before this court. Mr. Lederman appeared before us on behalf of the inspector, asking for directions regarding the handling of the completed report, and submitting that it should be made available to us on the appeal. We ruled that we should not look at the report pending disposition of the appeal. Mr. Lederman also sought protection for payment of the costs of the inspector, which now amount to $52,000.

42 Mr. Manes urged us to dismiss the appeal on the ground that the court would be deciding only abstract questions of law on the appeal because the order of O'Brien J. had been executed.

43 It is now too late to order that there be no investigation of the financial affairs of Imax, or to limit the scope of that investigation. The investigation has been completed by Laventhol & Horwath and a report prepared at a very substantial cost. Because of the apparent lack of impartiality, the report of Laventhol & Horwath will probably be regarded as tainted, but I think it would be unacceptably wasteful for it not to be made available, for what it is worth, to the court and the parties in connection with the hearing of the balance of the complainant's motion. As Middleton J.A. said in *Re Shell Castle Fire Place Ltd.* (1927), 33 O.W.N. 195 at 196 (C.A.):

> The report of the investigator merely gives the minority shareholders information of greater or less value. It may not be accurate, binds no one, and determines nothing.

If the report of Laventhol & Horwath in this case is incorrect or unfair, the appellants have available to them the evidence to demonstrate on the return of the motion that such is the case. An order will go directing that the report of the inspector be filed with the court in a sealed envelope for use on the return of the balance of the motion, and that a copy of it be served on the complainant with the direction that she shall not disclose its contents

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to anyone except for the purposes of prosecuting the pending motion.

44 The order directing the investigation was made on the application of the complainant, over the vigorous objection of Imax and the other respondents below. I have concluded that it was made in error. It would be quite unjust, in these circumstances, for Imax to be liable for the costs of the inspector in any event. If the balance of the pending motion fails substantially, it may be quite apparent that Imax should never have been put to the expense of the investigation and that the claimant should be liable for the inspector's costs.

45 Were it not for the order of Reid J. of 24th February, directing the inspector to proceed forthwith, I would have held that Laventhol & Horwath had proceeded with the investigation in the face of the appeal at its own risk, and would have left it without recourse for its costs to any person other than the complainant, subject to further order by the judge hearing the balance of the motion. But Laventhol & Horwath was directed by the order of Reid J. to proceed forthwith with its investigation, and I think it should be entitled to look for payment of its costs to someone who is financially capable of paying them. In my view, Imax should be required to pay the costs of the investigation, as provided in para. 8 of the order below, but the order will be varied to reserve to the judge hearing the balance of the motion the power to direct that the complainant reimburse Imax for all or part of the costs paid to the inspector, if the judge deems it just to do so.

46 The learned Motions Court judge provided that the costs of the motion before him should be to the complainant in the cause. In view of my conclusion on the merits of the appeal, I direct that the order below be varied by deleting that provision for costs and replacing it with a direction that the costs below be reserved to the judge hearing the balance of the motion.

47 The appeal is allowed and an order will go varying the order of the learned Motions Court judge as aforesaid. The costs of the appeal, except those of Laventhol & Horwath, are reserved to the judge hearing the balance of the motion. Laventhol & Horwath is entitled to recover its costs of the appeal on a solicitor-and-client basis from Imax, forthwith after taxation thereof, but the right is reserved to the judge hearing the balance of the motion to direct that the complainant reimburse Imax for such costs, if the judge deems it just to do so.

*Order varied.*

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

IN THE MATTER OF THE A PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST GLOBAL COMMUNICATIONS CORP. ET AL.

Court File No. ________________

**COURT OF APPEAL FOR ONTARIO**

Proceeding commenced at Toronto

**BRIEF OF AUTHORITIES**

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