

# Extending Fiduciary Principles to the Director-Creditor Relationship: A Canadian Perspective

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## I. INTRODUCTION

DIRECTORS OF CORPORATIONS HAVE GOOD reason to be concerned about their responsibilities and potential liabilities.<sup>1</sup> Society has become increasingly interested in corporate accountability and in particular, the accountability of individuals who direct corporate behaviour. Courts, regulators, legislators, and shareholders are scrutinising more closely the ways in which directors discharge their responsibilities. Directors are realising that in order to discharge their duties with the necessary degree of care they need to catalogue these responsibilities and the risk of liability associated with them. Every director of every corporation should be aware and cognisant on an ongoing basis of liability exposure.

Significant changes have occurred in corporate laws relating to directors. Such changes have increased the risk that the competence and perhaps the integrity of the directors will be called into question in litigation, regulatory action, or the media. The principal development is that the standard of care, diligence, and skill to which directors are held has been substantially increased. Directors are now accountable not only to the corporation and its shareholders but also under certain circumstances to employees, creditors, customers, suppliers, and governments.

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<sup>1</sup> There are over 200 federal, and 126 Ontario Statutes which, in one way or another, impose personal liability on directors or officers. D. Palmateer *et al.*, *Statutory Liabilities and Offences of Directors and Officers in Ontario* (Draft Memorandum 9 October 1990).

After providing an overview of the many duties Canadian directors must consider in discharging their office, this paper will examine the specific duties owed by a director to a corporation's creditors when the corporation is approaching or has realised a state of insolvency. A recurring theme will be the implication of attaching a fiduciary standard to the director-creditor relationship. Finally, an introduction to the concurrency theory provides a practical approach to balancing a director's statutorily imposed duty to the corporation and the imposition of an equitable remedy demanding a duty to creditors.

## II. DIRECTORS DUTIES: AN OVERVIEW

DIRECTORS HAVE FIDUCIARY DUTIES TO THE CORPORATION they serve. This long-standing common law principle governs all aspects of the directors' relationship with the corporation and is codified in the corporate statutes which require directors to act in good faith with a view to the best interests of the corporation. The fiduciary relationship dictates a strict standard of conduct which includes loyalty and good faith, and requires directors to avoid putting themselves in a position where their duty to act in the best interests of the corporation does, or may, conflict with their self-interest.

Directors are required by corporate statutes to discharge their duties with a view to the best interests of the corporation. Traditionally, this phrase has been interpreted to extend only to the corporation as a whole. However, in reaching many decisions, directors will be confronted with a number of competing interests, in addition to those of the corporation. The courts recognise that acting with a view to the best interests of the corporation does not mean that directors must disregard the interests of other parties or "stakeholders" who may be affected by the actions of the corporation. Stakeholders include a corporation's shareholders, but may also include its employees, creditors, and the community or country in which the corporation carries on business.<sup>2</sup>

Fiduciary law is based in legal principles, which may not lead us down the track to a single right answer, but they do offer guidance, isolate wrong answers, and inform us of the values at stake between competing solutions. Different assumptions will be made. The traditional doctrinal conception of the fiduciary does not provide much support for the hypothetical regulations. Corporate fiduciary law, as traditionally conceived, rests on an ethical case against abuses of position by self-interested managers.

To determine directors' liability, the responsibilities of directors and the authority for those responsibilities must be examined. Care should be exercised in the use of the word "directors," when "board" is meant.<sup>3</sup> A corporation cannot

<sup>2</sup> See *Teck Corp. v. Millar et al.* (1972), 33 D.L.R. (3d) 288, 2 W.W.R. 385 (B.C.S.C.) [hereinafter *Teck* cited to D.L.R.].

<sup>3</sup> *Automatic Self Cleaning v. Cunninghame*, [1906] 2 Ch. 34, 42.

act through its own person for it has no person.<sup>4</sup> While it is true that individual directors are not agents of the corporation<sup>5</sup> unless authorised for a specific purpose,<sup>6</sup> directors acting as a board are agents of the corporation for all purposes.<sup>7</sup>

Directors act as both agents and trustees.<sup>8</sup> They owe duties to the corporation, the shareholders, their fellow directors, creditors, employees, and the public.<sup>9</sup> As agents they are charged with the responsibility of managing the assets in such a way as to gain profits. As trustees, they are charged with the responsibility of preserving assets, but they are not the owners of the assets. Corporate directors are "trustees" in the sense that in the performance of their duties they stand in a fiduciary relationship to the company. They are bound by the rules of conscientious fairness, morality, and honesty in purpose. These rules are imposed as guides for those who are under fiduciary obligations and responsibilities and who are held, in official action, to the extreme measure of candour, unselfishness, and good faith.<sup>10</sup>

Directors are not trustees of the corporation in the strict sense. The status of being a director does not in and of itself give rise to a property interest in the corporation. There are situations however, in which a director will be considered a trustee and can be held personally responsible for a breach of trust. Directors can be considered trustees of company funds. If the funds are misapplied or used for an illegal purpose, or a purpose beyond the powers of the company, then the directors are liable. They must recoup the loss or compensate the company.<sup>11</sup> Furthermore, when the corporation itself is a trustee the directors may be held liable for any breach of trust occurring with their knowledge.<sup>12</sup>

Directors must maintain a level of conduct at a level higher than that of the market place. They must conform to the general standards of loyalty, good faith, and avoidance of conflict of duty and self-interest.<sup>13</sup>

Directors and officers, although agents for the corporation and not for the creditors, may be liable to creditors and employees even after resigning from the

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<sup>4</sup> *Ferguson v. Wilson* (1866), L.R. II Ch. App. 77.

<sup>5</sup> *Country Club of Montreal v. Bell Telephone Co.* (1920), Q.R. 58 S.C. 56.

<sup>6</sup> *Allen v. Ontario Rainy River Ry. Co.* (1898), 29 O.R. 510.

<sup>7</sup> *Aberdeen Railway Co. v. Blaikie Bros.* (1854), 1 Marcq. 461 at 473 [hereinafter *Aberdeen*].

<sup>8</sup> *Re City Equitable Fire Insurance Co.*, [1925] Ch. 407. [hereinafter *City Equitable*].

<sup>9</sup> *Foss v. Harbottle* (1843), 2 Hare. 460.

<sup>10</sup> *Litwin v. Allen* (1940), 25 N.Y.S. (2d) 667.

<sup>11</sup> *Angus et al. v. R. Angus Alberta Ltd. et al.* (1988), 39 B.L.R. 1 (Alta. C.A.).

<sup>12</sup> *Re Air Canada and M & L Travel Ltd. et al.* (1993), 108 D.L.R. (4th) 592 (S.C.C.).

<sup>13</sup> *Canadian Aero Service v. O'Malley* (1973), 40 D.L.R. (3d) 371 at 391 (S.C.C.) [hereinafter *CanAero*].

corporation or even after the corporation has amalgamated with another.<sup>14</sup> Directors can face personal liability if the corporation does not make the payments to or on behalf of employees that are normally made in the course of business.

Although directors and officers owe their primary duty to the company, in certain situations they may also owe a duty to act fairly toward shareholders or employees. Through the use of common law principles, the oppression remedy and other statutory obligations, directors and officers can be held to account for acts that a court finds unduly prejudicial to a class of shareholders or employees.

While the duties of the directors do not generally change upon insolvency of the corporation, directors should be particularly conscious of the actions they take when the financial stability of the corporation is in question. This is especially true where the directors move assets out of the corporation into the hands of shareholders. For example, any dividends paid or shares redeemed may be reviewed by the receiver to ensure that such action did not precipitate the insolvency. The *Bankruptcy and Insolvency Act* ("BIA"),<sup>15</sup> imposes absolute liability on directors if a company is insolvent when a dividend is paid. In some jurisdictions, notably many of the American states, the directors can be considered constructive trustees of the assets of the corporation for the creditors as insolvency approaches.<sup>16</sup>

Where the receiver is able to demonstrate that such actions did precipitate insolvency, the receiver will have the authority to bring an action to hold the directors personally liable to return the expended funds to the corporation. Similarly, any payment made to a creditor may be scrutinised to determine whether such payment constituted a fraudulent preference.

The *Canada Business Corporations Act* ("CBCA") states, "[s]ubject to any unanimous shareholder agreement, the directors shall manage or supervise the management of, the business and affairs of a corporation."<sup>17</sup> This section was one of the many recent amendments to the *CBCA*. The inclusion of the words "or supervise the management of" takes into account the reality that in certain circumstances the directors do not manage the day-to-day affairs of the operation, but rather supervise its management. The directors, however, provide advice to management and approve the corporation's financial objectives and strategic directions.

The directors' ultimate objective is to increase the value of the company, but they have other responsibilities imposed on them by various statutes. For example, they must deal with corporate filings and audits, provide information

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<sup>14</sup> *R. v. Black & Decker Manufacturing Co. Ltd.* (1974), 43 D.L.R. (3d) 393 (S.C.C.).

<sup>15</sup> R.S.C. 1985, c. B-3, s. 101(2), as amended [hereinafter *BIA*].

<sup>16</sup> G.V. Varallo & J.A. Finkelstein, "Fiduciary Obligations of Directors of the Financially Troubled Company" (1992) 48 *Bus. Law*. 239.

<sup>17</sup> R.S.C. 1985, c. C-44, s. 102, as amended [hereinafter *CBCA*].

to shareholders or government, and they must ensure compliance with regulatory standards. In carrying out these responsibilities, however, directors have two general overarching duties that are defined by the corporate statutes. The Ontario provisions give broad, general guidelines. It contains such expressions as "honesty," "good faith," "best interests," and "prudent person." These terms are arguably subjective and can be given meaning by the courts, but may not provide workable guidelines for directors.

The *CBCA* and the *Ontario Business Corporations Act* ("*OBCA*")<sup>18</sup> state:

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.<sup>19</sup>

The first element of the director's duty is to "act honestly and in good faith with a view to the best interests of the corporation." This provides for a strict fiduciary standard of behaviour. It recognises that directors are stewards of capital and are required to put aside their own self-interests and be loyal to the interests of another entity, the corporation. This standard does not vary according to the size of the corporation or the sophistication of the director. In all cases, it requires the director to follow the high standard of a trustee with respect to dealing honestly, in good faith, and without conflict of interest.<sup>20</sup>

A number of duties are imposed on directors by the *CBCA* and *OBCA*, including general compliance with all the requirements of the *Acts*. Directors who knowingly authorise, permit, or acquiesce in breaches of the corporate *Acts* can be held personally liable and are subject to penal sanctions. Where liabilities exist under the corporate *Acts* for the directors personally, such as those for wages or improper payment of dividends or purchase of shares, the *Acts* themselves identify the procedures that will relieve the directors of liability.

Directors owe a duty, fiduciary in nature to the corporation. This duty is not owed to shareholders, even a majority shareholder that is responsible for a director's appointment to the board.<sup>21</sup> In *Ballard* the court suggests that the best

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<sup>18</sup> R.S.O. 1990, c. B.16, as amended [hereinafter *OBCA*].

<sup>19</sup> *CBCA*, *supra* note 17 at s. 122; *Ibid.* at s. 134.

<sup>20</sup> See *CanAero*, *supra* note 13; *Aberdeen*, *supra* note 7; and *Regal Hastings Ltd. v. Gulliver et al.*, [1942] All E.R. 378 (H.L.).

<sup>21</sup> *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.) [hereinafter *Ballard*].

way for a director to deal with competing interests of various shareholders is to act in the best interests of the corporation and have the shareholders derive their benefit from a "better" corporation.<sup>22</sup> However, the interests of the shareholders as a whole are *usually* synonymous with the interests of the corporation.

The directors must have a proper purpose for the exercise of their powers and responsibilities. The proper purpose relates to the best interests of the corporation, not a so-called collateral interest.<sup>23</sup> Thus, while the directors have the power to issue shares, they cannot do so in order to reduce a shareholder to a minority status.<sup>24</sup> Directors may recommend a reorganisation of capital or refuse to pay dividends, but not in order to force a shareholder out of the corporation.<sup>25</sup> Directors may authorise the purchase of property, but may not do so to enhance the position of one shareholder.<sup>26</sup> To determine if a power is exercised for a proper purpose the question to ask is, "what was the primary or governing purpose of the action?"

In *Francis v. United Jersey Bank*,<sup>27</sup> the court held that directors should acquire at least a basic understanding of the corporation's business. Directors are required to fulfil a role of general monitoring of the corporate affairs and policies although they are not required to conduct a detailed inspection of the corporation's day-to-day activities. Directors should be familiar with the financial status of the corporation by regularly reviewing the financial statements. To reiterate, as directors, they have a relationship, fiduciary in nature, with the corporation and shareholders.

In delivering his judgement in *City Equitable*, Lord Justice Romer stated that in discharging the duty owed to the company a director must act honestly, and must exercise such degree of skill and diligence as would amount to the reasonable care which an ordinary man might be expected to take, in the circumstances, on his own behalf. However, he need not exhibit in the performance of his duties a greater degree of skill than may be reasonably expected from a person of his knowledge and experience. In other words, a director is not liable for mere errors of judgement. Legislation and regulation have changed this to some extent. The test is now more objective rather than subjective and sensibly, failure to participate, or lack of diligence will no longer shield a director from liability.

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<sup>22</sup> *Ibid.*

<sup>23</sup> *Re Smith and Fawcett Ltd.*, [1942] Ch. 304.

<sup>24</sup> *Howard Smith v. Ampol Petroleum Ltd. et al.*, [1974] 1 All E.R. 1126 (P.C.).

<sup>25</sup> *Re Ferguson and Imax Systems Corp.* (1983), 150 D.L.R. (3d) 718.

<sup>26</sup> See *supra* note 20.

<sup>27</sup> 432 A. 2d 814 (N.J.S.C. 1981).

A number of propositions that are of fundamental importance to shareholders have emerged from decided cases and are codified in statute. Directors owe a duty of loyalty and a duty of care to the corporation, which has long been recognised in the common law and has been codified for close to 30 years. The statutory obligations under ss. 122 of the *CBCA* and 134 of the *OBCA* set forth the content of directors' obligations to the company, thereby displacing a similar obligation to shareholders, and perhaps creditors as well. While a fiduciary duty is *generally* not owed to management, other directors, workers, creditors, or society at large,<sup>28</sup> there are situations in which some of these groups, particularly creditors, may rightly expect that directors will specifically address their interests.

### III. INSOLVENCY

A CORPORATION IS INSOLVENT WHEN IT IS UNABLE to pay its liabilities as they come due. Insolvency does not normally occur unexpectedly and there should, therefore, be time for the board of directors to recognise the problem as it develops.

When a corporation becomes insolvent several courses of action are possible. In Canada, the corporation may continue to operate with the indulgence of its creditors for a period of time. This is different from some jurisdictions outside of Canada, where a corporation that is insolvent must stop carrying on business to prevent it from incurring further liabilities. Alternatively, the corporation's creditors may require the corporation to restructure its operation or to divest certain assets to generate additional cash, under either a private agreement or under the restructuring provisions of the *BIA* or the *Companies' Creditors Arrangement Act*.<sup>29</sup> Finally, secured creditors may take steps to have a receiver appointed, with a view to realising on and liquidating assets. Ultimately, the corporation may be declared bankrupt.

The increased leverage which creditors may have over the corporation in this situation may align the interests of the corporation quite closely with the interests of the creditors. If a receiver-manager is appointed by one or more of the creditors, the responsibilities and powers of the directors are suspended until the receiver-manager is discharged. Until that time, the receiver-manager will have the power to carry on the business of the corporation in order to protect the security interest of those creditors on whose behalf it has been appointed. The appointment of a trustee in bankruptcy usually signals the end of corporate existence.

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<sup>28</sup> *Brant Investments Ltd. v. KeepRight Inc.* (1991), 80 D.L.R. (4th) 161 (Ont. C.A.).

<sup>29</sup> R.S.C. 1970, c. C-25, s. 1.

The *BIA* expanded the previous definition of insolvency by deeming that a company is insolvent not only if it is unable to pay its debts as they fall due but also if the value of its assets is less than that of its liabilities, including contingent and prospective liabilities.<sup>30</sup>

If it appears that the business has been carried on with the intention of defrauding creditors or for any other fraudulent purpose, a party knowingly carrying on of the business in that manner: can be held liable to make such contributions to the company's assets as the court thinks proper; and, is liable to imprisonment or a fine, or both.

As for what constitutes fraudulent trading, it is clearly fraud for a person who knows that they cannot pay for goods to induce a supplier to deliver them.<sup>31</sup> The prospect of non-payment need only be reasonably certain. If a company continues to carry on business and incur debts at a time when there is, to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that the company is carrying on business with the intent to defraud.<sup>32</sup>

#### IV. A JURISDICTIONAL EXAMINATION

HAVING EXPLORED IN GENERAL THE MANY DUTIES and obligations of Canadian corporate directors to various interests, it is not surprising that some of these interests may conflict. For example, since statute requires that a director act in the best interests of the corporation,<sup>33</sup> does that necessarily mean that the director can disregard the interests of creditors to fulfil the statutory requirements? This section will narrow the focus of directors duties to determine what duty, if any, directors owe to creditors during insolvency or pending insolvency of the corporation.

For most of the twentieth century Canadian courts held that directors owed no duty to a corporation's creditors.<sup>34</sup> However, in 1994 the Alberta Court of Queen's Bench in *Re Trizec Corp.* stated:

A specific duty to shareholders becomes intermingled with a duty to creditors when the ability of a company to pay its debts becomes questionable. However, a wholesale

<sup>30</sup> *BIA*, *supra* note 15 at s. 518.

<sup>31</sup> *R. v. Grantham*, [1984] Q.B. 675.

<sup>32</sup> *Re William C. Leitch Bros. Ltd.*, [1932] 2 Ch. 71.

<sup>33</sup> *CBCA*, *supra* note 17 at s. 122.

<sup>34</sup> See *Bank of Toronto v. Cobourg, Peterborough and Marmora Railway Co.* (1885), 10 O.R. 376 (Ch.); *A.G. (Canada) v. Standard Trust Company of New York*, [1911] A.C. 498; *Western Finance Co. Ltd. and Rennard v. Tasker Enterprises Ltd.*, [1980] 1 W.W.R. 323 at 331 (Man. C.A.); *Royal Bank of Canada v. First Pioneer Investments Ltd. et al.* (1980), 27 O.R. (2d) 352 (Ont. H.C.J.) [hereinafter *First Pioneer*].



transfer of fiduciary duty to creditors likely does not occur at the stage of proceedings where an arrangement is sought as opposed to a case where liquidation occurs.<sup>35</sup>

This decision marked a significant departure from then settled law,<sup>36</sup> and suggests that a director may be required to shift their duty from the corporation to the creditors, or at least balance the interests of both during insolvency. Regrettably, this decision offers little insight into its practical application as such a transfer of fiduciary duty to the creditors may place the directors in breach of their statutory duty to act in the best interests of the corporation.

One of the most recent Canadian cases to address whether a director has a duty to a creditor is *Peoples Department Stores v. Wise*<sup>37</sup> (it should be noted that the authority of *Peoples* is limited by the fact that it is a trial level decision).

*Peoples* arose out of the bankruptcy of Wise Stores Inc. and its wholly owned subsidiary Peoples Department Stores Inc. Wise Stores had acquired Peoples Department Stores in 1992 from Marks & Spencer. The purchase price was \$27 million, of which five million was paid at closing with the balance payable over an eight year period. In the first two years after the acquisition, Wise Stores and Peoples Department Stores began to realise certain operational synergies, especially with respect to warehouse space and purchasing staff. Separate computerised inventory systems were maintained, however, until early in 1994, when a new inventory procurement policy was instituted. Under this policy, Peoples Department Stores made all domestic and most overseas purchases for both companies, charging Wise Stores for transferring and shipping the merchandise to its stores. There was no written agreement outlining the terms and conditions under which Wise Stores would repay Peoples Department Stores. At the same time, Wise Stores was experiencing cash flow problems, with the result that its indebtedness to Peoples Department Stores began to grow. Marks & Spencer became alarmed at this development, asserting that the inventory procurement policy constituted financial assistance to Wise Stores in breach of the terms of the share purchase agreement of 1992. Throughout the remainder of 1994, the directors of the two businesses made a few furtive efforts to refinance the enterprise, but in December 1994 both Wise Stores and Peoples Department Stores filed for bankruptcy.

The trustee in bankruptcy of Peoples Department Stores brought a petition to recover funds in reviewable transactions and to recover property that was transferred to Wise Stores as a result of the inventory procurement policy. This petition was framed both as an action under s. 100 of the *BIA* and as a breach of the statutory duty of directors under s. 122 of the *CBCA*. The Wise brothers,

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<sup>35</sup> [1994] 10 W.W.R. 127 at 139 (Alta. Q.B.).

<sup>36</sup> See *supra* note 34.

<sup>37</sup> [1998] Q.J. No. 3571 (Que. Sup. Ct.), online: QL (QJ) [hereinafter *Peoples*].

the three directors of Peoples Department Stores, were also directors of Wise Stores.<sup>38</sup>

In deciding *Peoples*, Greenberg J., relied heavily on an article by Professor Ziegel titled "Creditors as Corporate Stakeholders: The Quiet Revolution,"<sup>39</sup> and Professor Ziegel's interpretation of the common law and authorities from Australia, New Zealand, and the United Kingdom. Based on Professor Ziegel's conclusions, Greenberg J., found that the Wise brothers, as directors of the subsidiary Peoples Department Stores, had failed to discharge their fiduciary duty, and accordingly rendered judgement against them.

The holding of Greenberg J., suggests a new approach in Canadian jurisprudence regarding directors duties to creditors. However, after a close analysis of the Ziegel article and supporting case law referred to by Greenberg, J., it will be shown that there is no authority for the wholesale transfer of a fiduciary obligation from the corporation to creditors. Rather, "insolvency requires directors to discharge their fiduciary duty to the corporation in a manner that does not prejudice or disregard creditor interests."<sup>40</sup>

Professor Ziegel writes:

British, Australian and New Zealand courts have repeatedly held, at least where a company is insolvent or near to insolvency, that the directors' duties lie not only towards the company's shareholders, but that they are also bound to act in the best interests of the company's creditors. ... The aggregate effect of these developments is to change radically the traditional corporate law doctrine that the directors' duty is to promote the welfare of the company's shareholders and that creditors must be expected to look after themselves.

He continues,

... it is not unreasonable, in exchange for the benefit of limited liability, to impose a duty on directors not to sacrifice creditors' interests when the going gets rough. Only the creditors still have a meaningful stake in its assets. This will be obvious if the company has been formally declared bankrupt. Why should it make a difference that bankruptcy has been delayed for a period of time? If we accept the paramountcy of creditors' interest when the company is insolvent, it must likewise be wrong, and a waste of economic resources, for the directors to continue to buy goods and services on credit knowing there is no reasonable prospect of the creditors ever being paid.<sup>41</sup>

It is trite to point out that Professor Ziegel does not contemplate how the courts should reconcile that the directors' duty lies not only towards the company's shareholders, but that they are also bound to act in the best interests of

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<sup>38</sup> 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 para. 9, online: QL (UTLJ).

<sup>39</sup> J. Ziegel, "Creditors as Corporate Stakeholders: The Quiet Revolution—An Anglo-Canadian Perspective" (1993), 43 U.T.L.J. 511.

<sup>40</sup> Thomson, *supra* note 38 at para. 12.

<sup>41</sup> Ziegel, *supra* note 39 at 529–530.

the company's creditors. Not providing such an insight makes the application of this statement in practical terms apparently unworkable where these duties conflict.

If there is no reasonable prospect of creditors ever being paid and the directors, on behalf of the corporation, are still accepting goods from them, then this would be a fraudulent, misleading transaction. As I will show, creditors may have the ability to launch a fiduciary claim against directors where a fraudulent transaction has taken place.

Nonetheless, to suggest that "when the going gets tough" only the creditors have a meaningful stake in the assets fails to contemplate fundamental business cycles. Corporations and their boards are continually faced with financial upturns, and downward trends. It is during the downward trends or "when the going gets tough," that the interests of the corporation must be paramount if it is to continue as a going concern. As long as that risk is managed prudently, and absent fraud, the directors shall be held to their statutory duty to act in the best interests of the corporation.

Although Greenberg J. did not consider *Walker v. Wimborne*<sup>42</sup> in deciding *Peoples*, the Australian High Court considered whether directors could owe a fiduciary duty to creditors, upon a corporation becoming insolvent. Mason J., stated that the directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them.<sup>43</sup>

As Thomson correctly notes in his article, this statement does not impose a fiduciary duty on directors to act in the best interests of creditors; rather, it expressed a broad understanding of the manner in which directors should discharge their duty to the corporation. Specifically, Mason J. stated that it was no longer appropriate to give effect only to shareholder interests.<sup>44</sup>

Mason J. concluded that the actions of the directors constituted a breach of fiduciary duty in that they fell within the definition of "misfeasance," which he explained as "something which the officer has done wrongly by misapplying or retaining in his own hands any moneys of the company, or by which the company's property has been wasted, or the company's credit improperly pledged." Thus, the High Court of Australia held that in discharging their duty to the corporation, directors should have regard for the interests both of the company and of its creditors. Their fiduciary duty, however, was owed only to the corpo-

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<sup>42</sup> (1975-1976), 137 C.L.R. 1.

<sup>43</sup> *Ibid.* at 7.

<sup>44</sup> *Ibid.*

ration.<sup>45</sup> What is important to note at this point is that a general fiduciary duty is owed only to the corporation.

Greenberg J. also referred to the New Zealand Court of Appeal's decision in *Nicholson v. Permakraft (NZ) Ltd.*, where Cooke, J. declared:

The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider *inter alia* the interests of creditors. For instance creditors are entitled to *consideration*, in my opinion, if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency.<sup>46</sup>

Greenberg J., continued with reference to an Australian case, *Kinsela v. Russel Kinsela Property Ltd.*, where Street, C.J. wrote:

It should be emphasised that the directors of a company in discharging their duty to the company *must take account of the interest of its shareholders* and its creditors. Any failure by the directors to take into account the interests of the creditors will have adverse consequences for the company as well as for them.<sup>47</sup>

Greenberg J. also drew upon an English House of Lords decision. In *Winkworth v. Edward Baron Development Co. Ltd. et al.*,<sup>48</sup> Lord Templeman stated:

A company owes a duty to its creditors, present and future. The company is not bound to pay off every debt as soon as it is incurred and the company is not obliged to avoid all ventures which involve an element of risk, but the company owes a duty to its creditors to keep its property inviolate and available for the repayment of its debts. The conscience of the company, as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors.<sup>49</sup>

Greenberg J. stated:

[E]ven though in *Winkworth* the director's actions were motivated by the wish to benefit themselves, and while that was not the case with the Wise Brothers here, the general rationale of that judgement applies in the present case.<sup>50</sup>

As I will show, it will make a difference in determining fiduciary obligation where there is fraud, "misfeasance," or a self-interested act on behalf of a director. However, with respect, Professor Ziegel's article failed to contemplate how the courts, or more importantly directors, are to reconcile competing interests

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<sup>45</sup> *Ibid.*

<sup>46</sup> [1985] 1 N.Z.L.R. 242 at 249-250 (C.A.) [emphasis added].

<sup>47</sup> [1986] 4 N.S.W.L.R. 722 at 732 [emphasis added].

<sup>48</sup> [1987] 1 All E.R. 114.

<sup>49</sup> *Ibid.* at 118.

<sup>50</sup> *Peoples*, *supra* note 37 at para. 198.

between the corporation and creditors. Failing to do so suggests that they owe a duty to both which is unworkable in a practical sense. Further, a proper reading of relevant case law would suggest that directors are required to, at least, consider creditors interests, and at most, not to disregard those interests.

The Ontario Superior Court of Justice is the most recent Canadian court to comment on the issue of breach of fiduciary duty to a creditor by a corporation. In deciding on a motion for summary judgement in *Canbook Distribution Corp. v. Borins*,<sup>51</sup> Ground J., stated:

Canadian law appears to be moving in the direction of recognizing such fiduciary duty, particularly in situations where the corporation was insolvent when it entered into the challenged transaction or the challenged transaction rendered the corporation insolvent.<sup>52</sup>

However, Ground J., based his entire conclusion on Professor Ziegel's article, and the reasoning used in *Peoples, Nicholson, Winkworth, and Walker*. As already noted, Professor Ziegel's reasoning may be sound, but it is quite unworkable in a practical sense as it necessarily creates conflict between statutory duties and court imposed duties. The creation of this conflict is not addressed in *Peoples*. In *Walker* the court simply stated that directors must take the interests of creditors into account. In *Nicholson*, Cooke J., held that directors must consider the interests of creditors and in *Winkworth* it was decided that directors owed a duty to creditors not to engage in self-interested acts.

To be obliged to consider the interests of creditors is far from imposing a fiduciary obligation upon directors to act in the best interests of creditors at the expense of the corporation. And even if this was the case, as in *Peoples*, the relevant sections of the *CBCA* and its corresponding provincial legislative initiatives must be addressed.

Having reviewed Canadian, British, Australian, and New Zealand case law and statutory requirements regarding director's duties to creditors, I will now consider the influence of American jurisprudence.

American jurisprudence can be of little assistance to the Canadian lawyer advising their client on the duties of directors to creditors during insolvency. To assume that American and Canadian corporate structures and legal remedies are substantially the same, and thereby analogous to one another would be to overlook the fundamental differences of corporate ownership and the substantial dichotomy of legal remedies available to creditors in these two nations.<sup>53</sup>

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<sup>51</sup> 45 O.R. (3d) 565.

<sup>52</sup> *Ibid.* at para. 16.

<sup>53</sup> For further reading see C.R. Spector, "Takeovers and the Duties of the Board of Directors: Comparative Aspects of American and Canadian Standards" (1989) 20 R.D.U.S. 131; and G.V. Varallo & J.A. Finkelstein, "Fiduciary Obligations of Directors of the Financially Troubled Company" 48:1 Bus. Law. 239.

Certain American jurisdictions have statutes permitting directors to consider interests other than those of the corporation or the shareholders as a whole. Some states permit, and in circumstances, such as take over bids, require directors to consider the interests of employees, suppliers, creditors, and consumers. At present, there is no equivalent Canadian legislation.<sup>54</sup>

Perhaps the most notable difference between American and Canadian approaches to the creditor-director relationship is the availability of the oppression remedy to creditors in Canada. The oppression remedy was introduced as part of the *Canada Business Corporations Act* in 1975<sup>55</sup> and has been described as "the broadest, most comprehensive and most open-ended remedy in the common law world ... unprecedented in its scope."<sup>56</sup> The introduction of the oppression remedy changed what conduct by a corporation, its affiliates, and their respective directors gives rise to a claim for relief, who may claim relief, and what remedies may be sought. Indeed more traditional remedies such as the shareholders' derivative action have been significantly displaced by the flexible and procedurally simple oppression action.<sup>57</sup>

Judicial response to shareholder activism has been largely influenced by the oppression remedy, a remedy imported from the United Kingdom and not the United States. In fact, the Supreme Court of Delaware has held that Court of Chancery has no jurisdiction to grant relief arising under the oppression remedy contained in Canadian corporate statutes.<sup>58</sup> That remedy is founded on the legitimate expectations originally derived from relationships inherent in partnerships and corporations.

Section 241 of the *CBCA* states that if on an application to a court, the court is satisfied that

the powers of the directors of the corporation have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any secu-

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<sup>54</sup> C. Hansell & S. Obal eds., *Director's Duties—A Guide to the Responsibilities of Corporate Directors in Canada* at 11. In 1998, the General Division of the Ontario Court held in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 160 D.L.R. (4th) 131 [hereinafter *WIC*], that *in the context of a take-over bid*, boards must seek to maximise shareholder value by conducting an auction, thereby placing the duty to shareholders potentially above the duty to the corporation.

<sup>55</sup> The *CBCA* was proclaimed in force effective 15 December 1975. See *supra* note 17 at ss. 238, 241, and 242. Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario, and Saskatchewan have provincial corporate statutes which provide for an oppression remedy on substantially the same terms as the *CBCA*.

<sup>56</sup> S.M. Beck, "Minority Shareholders' Rights in the 1980's" (1982) Spec. Lect. L.S.U.C. 311 at 312.

<sup>57</sup> J.A. VanDuzer, *The Law of Partnerships and Corporations* (Concord, Ontario: Irwin Law, 1997) at 257.

<sup>58</sup> *Taylor v. LSI Logic Corporation* (1998), 715 A. (2d) 837.

riety holder, creditor ... the court may make an order to rectify the matters complained of.

Section 241 of the *CBCA* and s. 248 of the *OBCA* expressly include creditors in the classes of persons who may claim relief from oppression.

The Dickerson Committee, which was responsible for drafting the new federal legislation in 1975, did not contemplate extending protection to creditors by giving them access to the oppression remedy.<sup>59</sup> Perhaps the driving force for providing such relief has more to do with the pattern of corporate ownership in Canada, which according to the following figures is dramatically different than the American experience.

THE 500 LARGEST CANADIAN AND U.S. COMPANIES,  
CLASSIFIED BY OWNERSHIP AND CONTROL<sup>60</sup>

Type of Company	Canada	United States
Privately Owned	20%	3%
Control Block	50%	18%
Widely-Held	15%	70%
Public Utility	10%	9%
Government Owned/Controlled	5%	—
Total	100%	100%

There are examples of U.S. style, widely held, companies in Canada, and they are important in key industries such as banking, but proportionately they play a much smaller role in Canadian industry.<sup>61</sup> The result is that the Canadian business landscape is dominated by companies in which a major shareholder can control corporate direction to the point of potentially oppressing minority shareholders. Creditors have become the unforeseen beneficiary of this legislation and are *pari passu* to shareholders in applying for relief that the statutory scheme in s. 241 of the *CBCA* provides.

In contrast to the U.S., Canadian capital markets in the post WWII era saw the development of public companies with dual-class share structures, that is, non-voting, subordinated, or restricted voting shares. A dual-class share structure has common equity that has been divided into two classes of shares with different voting rights. Such shares allow control to be disproportionate to the amount of equity invested, reducing or eliminating the power of the vote, the foundation upon which corporate democracy is based. Such shares were origi-

<sup>59</sup> VanDuzer, *supra* note 57 at 260; and Ziegel, *supra* note 39 at 527.

<sup>60</sup> *Financial Post* (FP 500, 1996) and *Fortune 500* (29 April 1996).

<sup>61</sup> D. Leighton & D. Thain, *Making Boards Work* (Toronto: McGraw Hill Ryerson Ltd., 1997) at 71.

nally introduced primarily as a way for family controlled Canadian companies to retain control while seeking external equity capital.

It has been recognised in the U.S. that when a company is insolvent a fiduciary relationship exists between its directors and creditors. The underlying principles for this are found in what has been termed "the trust fund doctrine." In *Wood v. Drummer*, it was held that the capital stock of a corporation comprises a trust fund for the payment of all the debts of the corporation.

The bill-holders and other creditors have the first claims upon it; and the stockholders have no rights, until all the other creditors are satisfied .... on a dissolution of the corporation, the bill-holders and the stockholders have each equitable claims, but those of the bill-holders possess ... a prior exclusive equity.<sup>62</sup>

The effect of this decision is that directors of insolvent U.S. corporations occupy a fiduciary position towards the creditors. This notion has been considered by several American jurisdictions and has been continuously upheld.<sup>63</sup>

While U.S. courts recognise a fiduciary obligation of directors to creditors during insolvency, Canadian directors are bound by s. 122 of the *CBCA*, and s. 134 of the *OBCA*<sup>64</sup> (and other applicable provincial legislation). As we have seen, these corporate statutes require every director to act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.<sup>65</sup>

The implication of ss. 122 and 134 is of course, that the director will be held to a fiduciary standard of behaviour, *to the corporation*. The absence of an oppression remedy and its unavailability to creditors in the U.S has prompted courts there to protect creditor's legitimate claims by shifting this fiduciary duty from the corporation to the creditors upon insolvency. This shifting is not provided for in Canadian statute or common law in the context of insolvency but with the availability of the oppression remedy in Canada such a shift is not necessary for creditors to have their interests realised.

At the Supreme Court of Canada in *Geurin v. The Queen*, Dickson J. (as he then was) referred to a passage from Professor Weinrib's article, "The Fiduciary Obligation," wherein the fiduciary obligation is described as equity's blunt tool. In the opinion of Professor Weinrib, "equity's blunt tool must be reserved

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<sup>62</sup> 30 F. Cas. 435 at 436-437 (C.C.D. Me. 1824).

<sup>63</sup> See *Bovay v. H.M. Bylesby & Co.*, 38 A. (2d) 808 at 813 (Del. 1944); *Geyer v. Ingersoll Publications*, 621 A. (2d) 784 (Del. Ch. 1992); *Credit Lyonnais Bank Netherland, N.V. v. Pathe Communications Corp.*, [1991] WL 277613, online: WL (ALLSTATES).

<sup>64</sup> *OBCA*, *supra* note 18.

<sup>65</sup> *CBCA*, *supra* note 17 at s. 122; *Ibid.* at s. 134.



for situations that are truly in need of the special protection that equity affords.”<sup>66</sup> In *CIBC v. Finlan*, Crane J., stated that:

It is to be observed there is some case law in which courts, in an effort to provide assistance to a party perceived at a disadvantage, have creatively invoked principles of fiduciary relationship and have unwittingly, in my view, diluted what is a very powerful remedy to a remedy weak in the sense of uncertainty of analytical principle.<sup>67</sup>

The differing corporate ownership structures in Canada and the U.S. have prompted the development of separate remedial options available to classes of applicants in these two countries. Directors of insolvent Canadian corporations may owe duties of a contractual nature, and owe a duty not to oppress the interests of creditors by completely disregarding their interests. However, the availability of the oppression remedy to creditors in Canada negates the need for the court to invoke “equity’s blunt tool” on Canadian corporate directors. Where legislative means are available to protect the legitimate interests of creditors it would be repugnant to the spirit of equitable law to further impose upon directors a cause of action reserved for situations that are truly in need of the special protection that equity affords.

In reviewing whether or not directors owe any duty to creditors during or pending insolvency of the corporation, case law from British, Australian, and New Zealand courts have held that, *generally*, at all times the directors’ fiduciary duty is owed to the company; there is no separate duty to creditors. However, directors’ duty must be discharged in a manner that does not disregard creditor interests.

The *Winkworth* decision clarified that a fiduciary relationship does not *normally* exist between directors and creditors. Under some conditions, directors may owe a duty to creditors that is contractual in nature or that is implied in order to protect a creditor who relies upon a representation. But these duties are separate and distinct from the fiduciary duty owed by directors to the corporation, and would arise whether or not the company became insolvent. In *Nicholson*, Cooke J., came to a similar conclusion. Suggestions such as Professor Ziegel has put forth, which imply a shift of duty from the corporation to the creditor, fail to provide how this shift can be reconciled with statutory requirements that a director act in the best interests of the corporation, not the creditors.

In supporting the reasoning used in *Peoples* and *Canbook*, the courts have relied on cases that have referred to a *duty* being owed by directors to creditors. While such examples provide convenient analogy on their face, a closer examination of those decisions referred to clearly suggest a duty quite different from a fiduciary one. It is not surprising that there are varying degrees of duty. The law

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<sup>66</sup> E. Weinrib, “The Fiduciary Obligation” (1975) 25 U.T.L.J. 1 at 4.

<sup>67</sup> [1999] O.J. No. 54 at 58 [hereinafter *Finlan*].

of contract will demand good faith whereas fiduciary law will demand *uberrima fides*. The duty not to disregard creditor's interests is not analogous to directors owing a fiduciary duty to creditors.

A fiduciary relationship may be found to exist by:

- (1) way of one of the parties intentions—if one party expressly accepts or undertakes a fiduciary relationship;
- (2) mutual intention between the parties. Mutual intention between parties to enter into a type of a relationship that ought to be characterised as a fiduciary, *e.g.* a partnership agreement;
- (3) operation of law, *e.g.* *OBCA*;
- (4) a courts imposition;
- (5) unilateral action of one party without any intent; and
- (6) through the nature of the interaction between parties.

Even with these general guidelines, it must be remembered that determining whether a fiduciary relationship exists is fact specific. Simply because a relationship has never been described as a fiduciary relationship before does not mean it is not a fiduciary relationship. That is, the categories of a fiduciary relationship are not closed. One aspect that is essential to finding a fiduciary relationship, however, is the vulnerability of the beneficiary at the hands of the fiduciary.

## V. VULNERABILITY

THIS SECTION WILL CONSIDER THE VULNERABILITY, or lack thereof, of creditors to the actions of directors within the context of commercial relations. If creditors are found not to be vulnerable to the actions of directors, courts will be hard pressed to conclude that a fiduciary relationship could exist between a director of an insolvent corporation and its creditors.

Determining vulnerability in relationships is essential to find a fiduciary obligation and, while the categories of a fiduciary relationship are not closed, without vulnerability it can be generally said that a fiduciary relationship will not and cannot exist. This assertion found support in *Authorson v. Canada (Attorney General)*. Brockenshire J. of the Ontario Superior Court of Justice stated that case law has emphasised the necessity of vulnerability of the beneficiary at the hands of the fiduciary.<sup>68</sup>

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<sup>68</sup> [2000] O.J. No. 3768 at para. 24.

Some Canadian commentators have suggested that there is no support whatsoever for a full or partial exemption of fiduciary responsibility in commercial relations.<sup>69</sup> The following case law will show the courts tend not to agree with this assertion. The benefit of narrowing the scope of this paper to a creditor-director relationship within a broader commercial setting allows for a specific and contextual based analysis of the creditor-director relationship. Such an analysis resists the temptation to make broad generalisations about the underlying basis of vulnerability in fiduciary theory, and, as will be shown, if a creditor-director relationship is void of vulnerability the relationship will indeed be exempt from the reaches of this equitable remedy. It is far beyond the boundaries of this paper to discuss an exemption of fiduciary responsibility in commercial relations generally and I do not purport to suggest an analogy between creditor-director responsibility and other commercial relationships.

Early case law suggests that no part of the director-creditor relationship can be characterised as a fiduciary relationship. In *Bank of Toronto v. Cobourg, Peterborough and Marmora Railway Co.*, the master in ordinary stated:

[T]here is no fiduciary or trust relation between the plaintiff, and the directors, which would entitle the plaintiffs to invoke the equitable jurisdiction of the Court.<sup>70</sup>

In 1980, it was also held that the director-creditor relationship was non-fiduciary. In *Royal Bank of Canada v. First Pioneer Investments Ltd.* it was decided that there was no authority to support the idea that a fiduciary duty extended to the creditors of the company and that "were it so there could often result in a conflict, a director finding himself unable to act in the interests of both the company and the creditors."<sup>71</sup>

In dissent in *Frame v. Smith et al.*, Wilson J. of the Supreme Court of Canada, opined that there is no definition of the concept "fiduciary" apart from the contexts in which it has been held to arise and, indeed, it may be more accurate to speak of relationships as having a fiduciary component to them rather than to speak of fiduciary relationships as such.<sup>72</sup>

Wilson J., stated that relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:

- (1) The fiduciary has scope for the exercise of some discretion or power.
- (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.

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<sup>69</sup> See R. Flannigan, "Commercial Fiduciary Obligation" (1998) 36:4 Alta. L. Rev. 905.

<sup>70</sup> (1885), 10 O.R. 376 (Ch.) at 378.

<sup>71</sup> *First Pioneer*, *supra* note 34.

<sup>72</sup> (1987), 42 D.L.R. (4th) 81 (S.C.C.) [hereinafter *Frame*].

- (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.<sup>73</sup>

With regard to the third characteristic of the above and oft-quoted rough and ready guide:

Vulnerability arises from the inability of the beneficiary (despite his or her best efforts) to prevent the injurious exercise of the power or discretion combined with the grave inadequacy or absence of other legal or practical remedies to redress the wrongful exercise of the discretion or power.<sup>74</sup>

Where vulnerability is not found to exist, as will be shown is generally the case between creditors and directors, a fiduciary relationship and corresponding duty will not be found to exist. Wilson J., makes a similar conclusion stating that:

Because of the requirement of vulnerability of the beneficiary at the hands of the fiduciary, fiduciary obligations are seldom present in the dealings of experienced businessmen of similar bargaining strength acting at arm's length. The law takes the position that such individuals are perfectly capable of agreeing as to the scope of the discretion or power to be exercised, *i.e.*, any "vulnerability" could have been prevented through the more prudent exercise of their bargaining power and the remedies for the wrongful exercise or abuse of that discretion or power, namely damages, are adequate in such a case.<sup>75</sup>

In *Lac Minerals Ltd. v. International Corona Resources Ltd.*, three of the five members of the Supreme Court of Canada (McIntyre, Lamer and Sopinka JJ.) held that the imposition of a fiduciary duty was inappropriate in light of the commercial nature of the relationship (although they split on the appropriate remedy). Sopinka J., agreed with the enumeration of the features made by Wilson J., in *Frame*, decided two years earlier. Sopinka J. stated that it is possible for a fiduciary relationship to be found although not all three of these characteristics are present, nor will the presence of all these ingredients invariably identify the existence of a fiduciary relationship. The one feature which is considered to be indispensable to the existence of this type of relationship, is that of dependency or vulnerability.<sup>76</sup>

Sopinka J. continued:

There was a kind of physical or psychological dependency which attracted fiduciary duty. Illustrations of this type are not hard to find. They include parent and child, priest and penitent and the like. Clearly, a dependency of this type did not exist here. While it is perhaps possible to have a dependency of this sort between corporations, that can not be so when, as here, we are dealing with experienced mining promoters who have ready access to geologists, engineers and lawyers. The fact that they were

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<sup>73</sup> *Ibid.* at 99.

<sup>74</sup> *Ibid.* at 100.

<sup>75</sup> *Ibid.*

<sup>76</sup> (1989), 61 D.L.R. (4th) 14 (S.C.C.) [hereinafter *Lac Minerals*].

anxious to make a deal with a senior mining company surely cannot attract the special protection of equity.<sup>77</sup>

As enunciated by the Supreme Court of Canada in *Norberg v. Weinrib*<sup>78</sup> in 1992 and followed by the Ontario Superior Court of Justice decision of *Welch v. Doré* in 2000, the fiduciary relationship has trust, *not self-interest* at its core.<sup>79</sup>

Business dealings between creditors and a corporation are most often rooted in self-interest on both sides. That is, the creditor's interest is to conduct their affairs to maximise benefits to themselves, while the corporation will enter into agreements with the intent of realising or maximising benefit to itself.

In *Hodgkinson v. Simms*, LaForest J., writing for the majority considered the application of fiduciary concepts in a commercial setting and found that:

Commercial interactions between parties at arm's length normally derive their social utility from the pursuit of self-interest, and the courts are rightly circumspect when asked to enforce a duty (*i.e.*, the fiduciary duty) that vindicates the very antithesis of self-interest.<sup>80</sup>

LaForest also stated that in sharp contrast to arm's length commercial relationships, which are characterised by self-interest, the essence of professional advisory relationships is precisely trust, confidence, and independence.<sup>81</sup>

In 1999, the Supreme Court of Canada once again had an opportunity to address the issue of vulnerability within the context of commercial relations and as a characteristic of fiduciary principles. In *Cadbury Schweppes Inc. v. FBI Foods Ltd.*,<sup>82</sup> Binnie J., delivering the judgement of the court held:

[I]n this case there is nothing in the relationship between a juice manufacturer and its licensee to suggest that the former surrendered its self-interest or rendered itself "vulnerable" to a discretion conferred on the latter.<sup>83</sup>

In *Bokhari v. Ottawa Customs Consulting Ltd.*,<sup>84</sup> Cunningham J., of the Ontario Court of Justice (General Division) found that an arms-length commercial relationship existed between the litigants who were well experienced in their particular area of endeavour. Because of this, and drawing again on the

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<sup>77</sup> *Ibid.* at 68.

<sup>78</sup> (1992), 92 D.L.R. (4th) 449 (S.C.C.).

<sup>79</sup> *Welch v. Doré*, [2000] O.J. No. 737.

<sup>80</sup> [1994] 3 S.C.R. 377 at 414 [hereinafter *Hodgkinson*].

<sup>81</sup> *Ibid.* at 381.

<sup>82</sup> [1999] 1 S.C.R. 142 [hereinafter *Cadbury*].

<sup>83</sup> *Ibid.* at para. 30.

<sup>84</sup> [1998] O.J. No. 4087.

“guide” as articulated by Wilson J., in *Frame*, the plaintiff’s claim for damages under the heading of breach of fiduciary relationship was summarily dismissed.

The Ontario Court of Justice (General Division) in *Finlan* decided that:

... in commercial relationships a very strong case indeed must be found to establish that a commercial party is obliged in law to set aside its own interest and in that commercial dealing act solely on behalf of another (except for established fiduciary relationships such as a trustee to a *cestui que* trust and an executrix to an estate).<sup>85</sup>

In *Finlan*, the respondent had obtained independent legal advice and had voluntarily and knowingly elected to take no interest in the degree of risk of the agreements that she executed. Drawing on the established principles set out in *Frame*, *Lac Minerals* and *Hodgkinson*, Crane J., stated that an essential and crucial element that must be present for the court to find a fiduciary relationship is that the fiduciary must, in the circumstances, be held to have set aside his, hers, or its, own best interest and be obliged to act only in the best interest of the beneficiary or perhaps as in *Lac Minerals*, in their mutual best interest.<sup>86</sup>

In *155569 Canada Limited v. 248524 Alberta Ltd.*, Veit J., of the Alberta Court of Appeal found that vulnerability is often seen to be lacking in commercial settings, so that the courts invoke the fiduciary concept sparingly, opting instead to uphold the inviolability of business enterprise.<sup>87</sup> In considering the role of the fiduciary concept in commercial settings, Veit J. agreed with the finding of the British Columbia Court of Appeal in *Litwin Construction (1973) Ltd. v. Pan (1989)*, which found that in a commercial relationship:

Where the parties have different interests which they both seek to carry forward by entering into a contract or contracts with each other, it would be a most exceptional case where the law would impose a fiduciary obligation which the parties themselves did not make a term of their contracts, either expressly, or by implication through the officious bystander or business efficacy rules.<sup>88</sup>

In dissent, Wilson J. in *Frame* provided what many subsequent court decisions have referred to as a “rough and ready guide” to determining if a relationship gives rise to fiduciary obligations and responsibilities. However the characterisation of this three part determination as a mere guide would appear to be a gross understatement in the context of a creditor-director relationship. In fact, the third element of vulnerability in this “guide” can be seen as *the* test, for without vulnerability the grounds upon which to base a fiduciary obligation do not exist. In *Frame*, Wilson J., refers to vulnerability as a “requirement.”<sup>89</sup> In

<sup>85</sup> *Finlan*, *supra* note 67 at 59.

<sup>86</sup> *Ibid.* at 57.

<sup>87</sup> [2000] A.J. No. 101.

<sup>88</sup> (1989), 52 D.L.R. (4th) 459 at 472–473 (B.C. C.A.).

<sup>89</sup> *Frame*, *supra* note 72.

*Lac Minerals*, Sopinka J. states that vulnerability, as a feature of a fiduciary relationship is “indispensable.”<sup>90</sup> In *Cadbury*, Binnie J. dismissed the claim of breach of fiduciary duty simply due to the lack of vulnerability. In a recent decision of the Ontario Superior Court of Justice, vulnerability as a characteristic of a fiduciary relationship was considered to be “indispensable.”<sup>91</sup> Since vulnerability is a requirement, indispensable and essential to a finding of fiduciary obligation, we must examine the possibility of whether vulnerability exists between a creditor and a director.

Wilson J., in *Frame* stated “[f]iduciary obligations are seldom present in the dealings of experienced businessmen of similar bargaining strength acting at arm’s length.”<sup>92</sup> In *Lac Minerals* the majority of the Supreme Court of Canada decided that the imposition of a fiduciary duty was inappropriate in light of the commercial nature of the relationship. In *Hodgkinson*, LaForest J., stated:

Commercial interactions between parties at arm’s length normally derive their social utility from the pursuit of self-interest, and the courts are rightly circumspect when asked to enforce a duty (*i.e.*, the fiduciary duty) that vindicates the very antithesis of self-interest.<sup>93</sup>

It would be a rare situation indeed where a board of directors, who have a statutory duty to act in the best interest of the corporation, put aside those interests to act only in the best interest of the beneficiary, insofar as this paper is concerned, the creditors. Since creditors and the corporation are ultimately concerned with self-interest it is proper to characterise the creditor-director relationship as commercial in nature.

Based on the Supreme Court of Canada decisions in *Frame*, *Lac Minerals*, *Hodgkinson*, and *Cadbury*, and influential decisions of lower courts in several Canadian jurisdictions, it is clear that the creditor-director relationship, insofar as it is defined as part of a broader commercial relationship will not generally be fiduciary in nature since the requirement of vulnerability is not present in commercial transactions. According to the reasoning of Binnie J., in *Cadbury*, in order to turn the creditor-director relationship into one of a fiduciary relationship the former would have to surrender its self-interest to the latter, thereby rendering itself vulnerable to the actions of the directors.<sup>94</sup>

As we have seen, for the purpose of determining fiduciary responsibility, creditors are generally not considered to be in a fiduciary relationship with the

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<sup>90</sup> *Lac Minerals*, *supra* note 76.

<sup>91</sup> *Valentine v. Toronto-Dominion Bank*, [2000] O.J. No. 2683.

<sup>92</sup> *Frame*, *supra* note 72 at 100.

<sup>93</sup> *Hodgkinson*, *supra* note 80 at 414.

<sup>94</sup> *Cadbury*, *supra* note 82.

directors of a corporation. This is because of the commercial nature of business and lack of vulnerability.

Some scholars have proposed that during the process of negotiating a contract there may be relative equality between the parties because of access to lawyers or other professional opinions, but once the contract is signed the creditor becomes vulnerable to the corporation. This is so because the creditor may be relying on future orders and a revenue stream as a consequence of the contract. However, the corporation may also be vulnerable to the creditor for which it may be relying equally on the supply of product or financing from the creditor.

If a corporation enters into an agreement with a creditor who is in a financially precarious position, but has contracted to supply certain goods, and payment has been made in advance for those goods by the corporation, would the corporation have a fiduciary claim against that creditor if the creditor subsequently becomes insolvent prior to delivery? According to the Supreme Court of Canada and all the foregoing case references, the corporation would not have a claim, so it stands to reason that if the situation were reversed, the creditor should also be barred from successfully claiming breach of fiduciary duty. To suggest otherwise would be repugnant to the very nature of equity. Remedies such as breach of contract or oppression would be more appropriate. Indeed Sopinka J., in *Lac Minerals* stated that when two business entities negotiate at arms-length in a commercial context, common law remedies are sufficient protection for those litigants.<sup>95</sup>

As Wilson J., rightly stated in *Frame*, the law takes the position that such individuals are perfectly capable of agreeing as to the scope of the discretion or power to be exercised. That is to say, any vulnerability can be prevented through the prudent exercise of bargaining power, thereby eliminating any inherent risk that either party may be exposed to in the ensuing creditor-director relationship.

The issue of vulnerability and contractually negotiated terms within the context of a fiduciary relationship was also addressed in *Stewart v. CBC*.<sup>96</sup> It is important to note that this case involves real persons as opposed to corporate entities. However, the reasoning of the court provides some insight as to what is required for vulnerability to exist in the context of contractual negotiations to the extent that the equitable remedy will be applied. Such requirements may be analogous to corporate entities involved in a commercial transaction.

In 1978 Stewart ran over a woman with his car and was convicted of criminal negligence causing death. Edward L. Greenspan, Q.C. represented Stewart at his sentencing and on his appeal, which was dismissed. He was released on

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<sup>95</sup> *Lac Minerals*, *supra* note 76.

<sup>96</sup> [1997] O.J. No. 2271.



parole after serving 11 months of a three year sentence. In 1991, Stewart was the subject of an episode of a CBC television program entitled *The Scales of Justice*, which re-enacted the crime and trial. Greenspan appeared as host and narrator of the show. Stewart claimed that Greenspan breached implied contractual terms of confidentiality and the fiduciary duty of loyalty owed to him, both of which survived the termination of the contractual relationship.

In finding that Mr. Greenspan had breached his fiduciary duty to Stewart, J. MacDonald J., opined that:

If there is anything about the law of fiduciaries which may be described as settled, it is that the elements of a breach of fiduciary duty claim must be considered carefully in the light of all relevant evidence. In this sense, such claims are contextual. The existence of a contract is part of the contextual circumstances which should be considered in determining whether the parties to the contract are in a fiduciary relationship.<sup>97</sup>

In finding Stewart vulnerable to the extent necessary to attract and not exclude a fiduciary duty, MacDonald J., noted that Mr. Stewart had no ability to negotiate the scope of discretion or power to be exercised by Mr. Greenspan and that no vulnerability could have been prevented by a more prudent exercise of bargaining by Stewart. Facing imminent sentencing for a shocking crime, Mr. Stewart's circumstances (aggravated by the trial tactics of his first counsel) placed him in difficult and vulnerable circumstances when Mr. Greenspan visited him in jail to consider whether he would act. Mr. Justice MacDonald continued, stating:

[B]arring mental incapacity, it is difficult to conceive of a person more reduced and constrained in his circumstances than Mr. Stewart was when he negotiated the retainer with Mr. Greenspan. In fact Mr. Stewart said he looked upon Mr. Greenspan as the only chance he had.<sup>98</sup>

In his concluding remarks, MacDonald J., found that Mr. Stewart's vulnerability or dependency could not have been prevented through his exercise of bargaining power in negotiating for Mr. Greenspan's professional services. His circumstances gave him almost no such power. To the extent his vulnerability or dependency arose from the operation of law, it was beyond his ability to change it except through the retainer.<sup>99</sup>

While it remains a question of fact in each case whether the relationship of the parties, one to the other, is such as to create a fiduciary relationship it has often been found that an advisory relationship, such as lawyer-client, will be held to the high standards of *uberrima fides*. The purpose of including the Stewart case is to illustrate the type of vulnerability that may be required for attract-

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<sup>97</sup> *Ibid.* at para. 247.

<sup>98</sup> *Ibid.* at para. 248.

<sup>99</sup> *Ibid.* at para. 249.

attracting equitable remedies where creditors and a corporation have set out their intentions and defined their relationship in a contract.

While the circumstances in *Stewart* may seem extreme, it is likely that such a degree of shocking vulnerability will be required for the courts to make such a finding in an arms-length commercial transaction. Because commercial actors are perfectly capable of agreeing as to the scope of the discretion or power to be exercised, when the parties have reduced their understandings to writing, it is obviously the proper course for courts to be extremely circumspect in adding to the bargain they have set down.<sup>100</sup>

In *Visagie et al. v. TVX Gold Inc.*, Charron J.A., delivering the judgement of the court went so far as to state:

The vulnerability described by the trial judge simply flows from the terms of the agreement freely entered into by the parties. This is not the kind of vulnerability that will serve to elevate the relationship between the parties to one that is fiduciary in nature.<sup>101</sup>

Charron, J.A., continued stating:

[I]t would have been open to Alpha, if it had chosen to do so, to negotiate greater or different protection for itself.<sup>102</sup>

The implication of this unanimous decision of the Court of Appeal of Ontario in June 2000, suggests that even if vulnerability does arise after the parties have reduced their intentions to writing, in the corporate arena such vulnerability is not sufficient to invoke equitable claims for breach of fiduciary duty.

Aside from mitigating vulnerability through contractual negotiation, creditors to a corporation can prevent vulnerability developing at the hands of directors in other ways. In the case of public issuers, Part XVIII of the *Securities Act* (Ontario) outlines the various types of information that must be continually disclosed by a corporation and which are readily available to creditors.<sup>103</sup> These include the publication of news releases where there has been a material change in the affairs of the reporting issuer, the filing of interim and annual financial statements, the filing of comparative financial statements and the delivery of annual financial statements to shareholders. Creditors have access to these documents that may effectively reveal the financial stability of a corporation and its ability to meet its obligations to creditors.

In the case of both private and public companies, simple ratios are commonly used to analyse financial statements. For example, the debt/equity ratio of a corporation may be quickly calculated by dividing the total debt out-

<sup>100</sup> *Lac Minerals*, *supra* note 76.

<sup>101</sup> [1998] 49 O.R. (3d) 198 at para. 29.

<sup>102</sup> *Ibid.*

<sup>103</sup> R.S.O. 1990, c. S-5.

standing by the book value of shareholders equity. The higher the debt/equity ratio, the higher the financial risk. The cash flow/total debt outstanding ratio is equally useful to creditors as it gauges a company's ability to repay the funds it has borrowed. As a general rule of thumb, annual cash flow in each of the last fiscal five years should be at least 20% for utilities or at least 30% for industrials, of total debt outstanding in each respective year.<sup>104</sup> The purpose of providing these ratios here is to illustrate that determining risk is neither complicated nor a foreign concept to investors or creditors.

Finally, creditors can further protect themselves from vulnerability by insisting deliveries will be only "cash on delivery" when, for example, a certain debt to equity ratio is realised.<sup>105</sup>

There has been reluctance throughout the common law world to affirm the existence of and give content to a general fiduciary principle that can be applied in appropriate circumstances.<sup>106</sup> Some have aptly observed that "the fiduciary relationship is a concept in search of a principle."<sup>107</sup> However, since the decision in *Frame*, courts have, *de facto*, held that vulnerability is a principal requirement that is indispensable and essential to a finding of fiduciary obligation. Courts have also continued to find that the presence of an arms-length commercial transaction will rarely attract a fiduciary duty as the actors are generally self-motivated and not willing to relinquish such self-interest to the other. Further, any vulnerability that may exist may be addressed in a freely negotiated contract. Because the creditor-director relationship is commercial in nature and generally lacks the requisite vulnerability that may now be considered a general fiduciary principle applicable to creditor-director relations, directors owe no general fiduciary duty to creditors.

Directors owe a fiduciary relationship to the corporation and a duty to the creditors not to disregard their interests. But *could* directors also owe a fiduciary duty to creditors? The answer is, as we have seen, generally no, yet determining if a fiduciary duty does exist is a question of law and fact.

## VI. CONCURRENCY THEORY

PREVIOUS SECTIONS OF THIS ARTICLE, have attempted to demonstrate that directors generally owe no general fiduciary duty to creditors in Canada. However, since determining if a fiduciary relationship exists is fact specific, is it pos-

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<sup>104</sup> The Canadian Securities Institute, *The Canadian Securities Course* (1996) 3-1-3-25.

<sup>105</sup> See R.I. Thornotn & M. Uttamchandani, "Supplying Goods and Services To An Insolvent Company" (C.B.A.O., Institute 2000, 27-29 January 2000) for a full discussion.

<sup>106</sup> *Frame*, *supra* note 72.

<sup>107</sup> Sir A. Mason, "Themes and Prospects" in P. Finn, ed., *Essays in Equity* (North Ryde, New South Wales: Law Book Co. Ltd., 1985) at 246.

sible to conceive of any specific situations between a director and a creditor that could give rise to a fiduciary duty? If so, how is the court to reconcile the imposition of such a duty to creditors with the director's statutory duty to the corporation?

Similar to negligence in tort law, the categories of a fiduciary relationship are not closed. For example the doctor-patient relationship may be fiduciary in nature as it relates to the health of the patient, but the doctor could not be held to fiduciary standards regarding, for example, stock market tips made to a patient. Not every aspect of a fiduciary relationship is fiduciary in nature. By analogy, parts of the creditor-director may be fiduciary where other parts may not. I have already illustrated that, generally, a director owes no fiduciary duty to a creditor.

The courts can not, in a practical sense or application, impose a fiduciary obligation on a director to a creditor because by doing so would likely put the director in conflict with his or her duties to the corporation, which, as we have seen, are demanded by statute in the *OBCA*, the *CBCA* and common law.

In *First Pioneer*, it was decided that there was no authority to support the idea that a fiduciary duty extended to the creditors of the company because were it so, there could often result a conflict, a director finding himself unable to act in the interests of both the company and the creditors.<sup>108</sup> Where the best interests of the corporation are not in the best interests of the creditor, a director's fiduciary obligation belongs solely to the corporation.

However, where it can be shown that the interests of the creditor are concurrent with those of the corporation, and where the corporation would be entitled to bring a breach of fiduciary duty claim against a director or directors, the creditor should be entitled to bring a fiduciary action as well. Where such concurrent liability exists, whether it is in tort, contract, or in equity, creditors should be able to sue in whatever manner they find most advantageous.<sup>109</sup>

For example, a fiduciary duty will be owed by a director to a creditor if that same duty is owed by the director to the corporation, and the duty owed to both the creditor and corporation by the director do not conflict.

In his article "Directors, Creditors and Insolvency," David Thomson states that "[a] breach of fiduciary duty requires a showing of bad faith."<sup>110</sup> I respectfully disagree. The fiduciary has power and the discretion and must therefore act *uberrima fides*. A beneficiary need only demonstrate a *prima facie* fiduciary relationship and then a *prima facie* breach. A beneficiary does not need to prove bad faith. Deterrence plays a significant role in fiduciary law. There is a power imbalance as a result of the relationship, so the beneficiary does not need

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<sup>108</sup> *First Pioneer*, *supra* note 34.

<sup>109</sup> See *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534.

<sup>110</sup> Thomson, *supra* note 38 at para. 12.

to prove bad faith. The beneficiary may not know everything the fiduciary was doing to the extent necessary to prove to the point of the civil standard.

If a creditor is able to show that his or her interests do not conflict with those of the corporation in bringing an action for breach of fiduciary duty, then the creditor should be entitled to this remedy since the courts would not be putting the director in conflict with his or her duties to the corporation in granting equitable relief. A creditor should be entitled to a fiduciary remedy when a breach occurs outside the normal working relationship expected between the two parties, and a concurrent breach has been made against the corporation.

A creditor or corporation cannot be expected to ascertain their degree of risk accurately where there is fraud, misfeasance, or a self-interested act on behalf of a director or directors. In *Stewart, J. MacDonald J.*, quoted La Forest J. in *Hodgkinson* where he held that the degree of vulnerability does not depend on some hypothetical ability to protect oneself from harm, but rather on the nature of the parties' reasonable expectations.<sup>111</sup> Fraud, misfeasance or a self-interested act by a director is not to be reasonably expected by either a corporation or a creditor. Therefore, if such a breach occurs it will render both the corporation and the creditor vulnerable, making the breach concurrent to the corporation and the creditor.

While I disagree with the reasoning used in *People's*, by Greenberg J., I agree with the resultant holding. What Greenberg J., and Professor Ziegel fail to do, is reconcile the competing interests between the director-corporation relationship and the director-creditor relationship. However, in that case, the interests of the creditor were in fact concurrent with the interests of the corporation. That is, the creditor could certainly argue that the Wise brothers were self-interested in their dealings. That self-interest was not in the best interests of the corporation or the creditor. How does the creditor show it was not in the best interests of the corporation? Simple, the corporation went bankrupt. Why was it not in the best interests of the creditor? Obviously, the corporation had no realisable assets to pay the creditor. Here the interests of the creditor and the corporation were concurrent. The Wise brothers did breach a fiduciary duty to the company, the nature of which permitted and caused a breach of fiduciary duty to the creditors as well.

Of course, if the Wise brothers did not breach a fiduciary duty to the corporation, they could not have breached a fiduciary duty to the creditors. To suggest that if they did not breach a duty to the corporation, and they did breach a duty to the creditors would again be raising and imposing a conflict, which as I have shown is not a reasonable decision or practical imposition.

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<sup>111</sup> *Hodgkinson*, *supra* note 80.

Another application of this principle may be found in *City Equitable*.<sup>112</sup> The liquidators winding up City Equitable discovered shortages of funds caused in part by the fraudulent activities of the managing director. The liquidators brought an action against the directors of City Equitable for negligence causing losses on investments and loans and for improper payments of dividends. City Equitable's articles of association included a provision stating that none of the directors, auditors or officers would be answerable for acts, receipts, neglects, or defaults of them or of one another, for insufficiency or deficiency of security or for any other loss. Except for the managing director, all the directors acted honestly. In this case the immunity provided in the articles exempted the directors from liability as none, save for the managing director, acted with wilful neglect or default, intending to breach his or her duties.

In this case, the fraudulent activity by the managing director was neither in the best interests of the corporation or the creditor. Therefore, the managing director owed concurrent duties to both the corporation and the creditors, breached those duties, and "but for" the articles of the corporation should be held liable for breach of fiduciary duty to both.

In *Re Brazilian Rubber Plantations and Estates Ltd.*,<sup>113</sup> the corporation's objects as stated in its memorandum of association were *inter alia* to purchase assets in Brazil and to enter into certain contracts. The directors of Brazilian approved a prospectus in connection with a public offering of stock in Brazilian. Unbeknownst to the directors, the prospectus contained fraudulent misrepresentations regarding the property to be acquired by Brazilian. Although the statements were untrue it was deemed that the property was still satisfactory and the directors proceeded with the acquisition. Brazilian was subsequently wound up and the liquidators brought an action against the directors in negligence for misfeasance in issuing the prospectus and executing the contract. Brazilian's articles of incorporation included a provision excluding the directors from liability for any loss or damage which may occur in the execution of his or her duties, unless that loss or damage was caused by dishonest activities.

The court found for the directors. A director has a duty to act with such care as can reasonably be expected based upon his or her knowledge and experience, as measured by what the reasonable person would do in the same circumstances on his or her own behalf. The court concluded that, in the present case, the directors did not act in a negligent manner even after learning of the misrepresentations in the prospectus, largely because their agent confirmed that, notwithstanding these misrepresentations, the property was very satisfactory. Moreover, Brazilians' articles of incorporation excluded liability for negligent acts except in the case of dishonest conduct, which did not occur here.

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<sup>112</sup> *City Equitable*, *supra* note 8.

<sup>113</sup> [1911] 1 Ch. 425, 80 L.J. Ch. 221 (C.A.).

In the case of *Re Brazilian*, under the concurrency theory the creditor would not have a fiduciary claim against the directors. As it was determined that the directors acted in the best interests of the corporation, an action by a creditor claiming breach of fiduciary duty to the creditor would have put the director in conflict with his or her duties to the corporation. In this case, and in the absence of fraud, misfeasance, or self-interested dealing on the part of the board, the interests of the corporation and the creditor were not concurrent.

Where there is a clear case of fraud, misfeasance, or self-interested dealing by a director, it will be easier to prove that the interests of the corporation and the creditor are concurrent. However, where a director acts to the detriment of the corporation and such action is lacking indicia of fraud *etc.*, it may be difficult for the courts to determine if the director was indeed intending to act in the best interests of the corporation. If the director is deemed to believe he acted in the best interests of the corporation, even if such actions were detrimental, a creditor would not have a fiduciary claim.

In assessing whether a director believed that he or she acted in the best interests of the corporation it will be helpful to employ the proper purpose test. In Anglo-Canadian law, there has been a debate about the test to determine whether directors, in response to a take-over bid, have breached their statutory duty to the corporation. English courts have utilised the proper purpose test, under which directors' conduct is examined to determine whether it was taken for a purpose which is proper or improper having regard to the responsibilities which they exercise for the corporation.<sup>114</sup> While there has been some limited approval for this approach in Canada,<sup>115</sup> the Canadian approach has more often been to consider whether the directors satisfied a two-fold test enunciated in *Teck* of acting in good faith and on reasonable grounds.<sup>116</sup> In *Teck*, Berger, J. stated the test as follows:

The directors must act in good faith. There must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company's interests, then there must be reasonable ground for that belief. If there were not, that will justify a finding that the directors were actuated by an improper purpose.<sup>117</sup>

Having shown there is no general fiduciary duty owed to a creditor by a director, but that in some circumstances there may be, it is important to consider if this equitable remedy in such circumstances as fraud, misfeasance, or self-interested dealing is required in light of the ability of creditors to make use of the oppression remedy.

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<sup>114</sup> *Hogg v. Cramphorn*, [1966] 3 All E.R. 420 (Ch. Div.).

<sup>115</sup> *Exco Corporation v. Nova Scotia Savings and Loan Company* (1987), 35 B.L.R. 149 (N.S.T.D.).

<sup>116</sup> *Teck*, *supra* note 2.

<sup>117</sup> *Ibid.* at 315-316.

While many of the leading Ontario cases dealing with the oppression remedy concern private companies,<sup>118</sup> a number of them relate to public companies. Indeed, the battles over *WIC*<sup>119</sup> and *Maple Leaf Foods Inc. v. Schneider Corp.*<sup>120</sup> show how the oppression remedy can be a central element in claims.

Both the *OBCA*<sup>121</sup> and its federal counterpart *CBCA*<sup>122</sup> contain an oppression remedy and both statutes make that remedy available to creditors.<sup>123</sup> The oppression provisions of both statutes are quite general and broad and the concept of oppression is likely to be given a liberal construction. A question does arise as to whether a preference to a creditor or other third party would constitute behaviour that is oppressive to other creditors. The key concept in this regard would be whether the preference given to one creditor was unfairly prejudicial to the remaining creditors. Specifically, the issue under s. 247 of the *OBCA* would be whether the preference was fair or justifiable or, conversely, not unfair or unjust. A corporation and its directors could argue that a preference is not unjust when it possesses sufficient assets to satisfy all creditors but, in the face of insolvency, that position ceases to be available. The decision in *Palmer v. Carling O'Keefe* is some authority in support of the proposition that the preference of one creditor over others would constitute "oppression."<sup>124</sup>

The use of the oppression remedy as a more efficient route for disgruntled creditors to take, as opposed to attempting to show a breach of fiduciary duty, is argued persuasively by Thomson in his article. However, the use of a fiduciary claim is not restricted by statutory limitation periods. Therefore, pursuing a fiduciary claim may be more practicable in some circumstances. Indeed, following *M. (K.) v. M. (H.)*<sup>125</sup> actions for breach of fiduciary duty in Ontario are not subject to any limitations (although certain equitable doctrines such as laches or acquiescence may bar a claim because of delay). This may make fiduciary claims a popular cause of action where an oppression action is statute barred.<sup>126</sup>

<sup>118</sup> *Nanef v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 at 490 (C.A.); *Ferguson v. IMAX Systems Corp.* (1983), 43 O.R. (2d) 128 at 137 (C.A.); *Ballard*, *supra* note 21; *Arthur v. Signum Communications Ltd.*, [1991] O.J. No. 86 (Gen. Div.).

<sup>119</sup> *WIC*, *supra* note 54.

<sup>120</sup> [1998] O.J. No. 4142.

<sup>121</sup> *OBCA*, *supra* note 18 at s. 247.

<sup>122</sup> *CBCA*, *supra* note 17 at s. 241.

<sup>123</sup> *Bank of Montreal v. Dome Petroleum* (1987), 67 C.B.R. (N.S.) 296 (Alta. Q.B.).

<sup>124</sup> *Palmer v. Carling O'Keefe Breweries Canada Limited* (1989), 56 D.L.R. (4th) 128 (Ont. Div. Ct.).

<sup>125</sup> (1992), 96 D.L.R. (4th) 289 (S.C.C.) 377.

<sup>126</sup> The absence of a limitation period in Ontario for fiduciary claims is unique. See *Semiah-moo Indian Band v. Canada* (1997), 148 D.L.R. (4th) 523 for a discussion of limitation periods for fiduciary claims in British Columbia.



Where a creditors' interests are concurrent with those of the corporation, and the corporation could bring a fiduciary cause of action against the director, the creditor should also be permitted to bring a fiduciary action against the director for the same alleged breach of fiduciary duty that the corporation could claim. Where a creditor cannot show that its interests are concurrent with those of the corporation a fiduciary claim should be disallowed on the basis that permitting such a claim would put the director in a court imposed conflict of duty.

## VII. CONCLUSION

COURTS SHOULD NOT SEARCH FOR A FIDUCIARY relationship simply to find a remedy. Fiduciary law promotes action involving integrity and fairness and protects people who have become vulnerable. The creditor who falls victim to a director's fraud, misfeasance, or self-dealing is vulnerable, the same way the corporation is to such conduct by one or more of their directors. For a creditor to be barred from a fiduciary claim in these circumstances, where a corporation has the ability to seek redress from this equitable remedy, is unfair and inequitable. Simply because a director's fiduciary duty to a corporation is codified in statute does not mean that a fiduciary duty must be created by statute.

Do directors owe any duty to creditors during or approaching insolvency? Yes, although as we have seen it is generally a duty not to disregard the interests of the creditor entirely, as opposed to owing a fiduciary duty. But *could* directors also owe a fiduciary duty to creditors? While it was determined that no general fiduciary duty exists because of a lack of vulnerability on the part of the creditor, and a creditors' ability to protect themselves in an arms-length transaction, there may be certain situations where a director could be found to have breached a fiduciary obligation to a creditor.

*Inter alia*, a director has a fiduciary obligation to the corporation not to defraud or self-deal. The director also owes this fiduciary obligation to creditors because such action creates vulnerability that cannot be foreseen or mitigated against in drafting a commercial contract in good faith. Where the impact of such activity by the director deleteriously effects the corporation and the corporation's ability to meet its obligations to the creditor, it will be said that the corporation's interests and the creditors interests are concurrent. Because these interests are concurrent, and the director has breached the same fiduciary duty to both, the court will not be imposing a conflict of interest upon the director in permitting a creditor to seek this equitable remedy. Therefore, extension and application of fiduciary principles to the director-creditor relationship is appropriate where the requirements, as enunciated in the concurrency theory, have been satisfied.

