THE VALUATION LAW REVIEW

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Corporate/Securities Decisions and Certain Canadian Regulatory Developments

The Valuation Law Review is a joint publication of The Canadian Institute of Chartered Business Valuators and Miller Thomson LLP and this issue summarizes corporate/securities decisions and certain canadian regulatory developments as of December 31, 2011 of interest to business valuators. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to them. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court.

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I. CANADIAN CASES

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Reference re: Securities Act
Supreme Court of Canada
December 22, 2011

The Supreme Court of Canada rejected the federal government's attempt to create a national regulator on the basis that it was unconstitutional. Securities have always been regulated by the provinces in accordance with the *Constitution Act*, 1867 and the proposed legislation overreached federal jurisdiction because the federal government cannot comprehensively regulate securities on a national level under its power to regulate trade and commerce.

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Penner v. Uptown Gourmet Catering Ltd.
Ontario Superior Court of Justice
November 15, 2011

The Ontario Superior Court of Justice granted an oppression remedy and ultimately determined that the applicant should be paid the fair value of his shares without the application of either a risk discount or a minority discount. In rejecting the respondent's argument for a minority discount, the Court noted that the respondent had the burden of proof to demonstrate that the applicant's conduct leading to his dismissal was of such a grave character that he deserved to be excluded from the company.

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Pitney Bowes v. Belmonte et al.
Ontario Superior Court of Justice
June 15, 2011

The Court allowed the applicant to obtain an oppression remedy against two corporations related to a judgment debtor corporation which owed money to the applicant. The Court also made an order against the directors of the related corporations personally as the directors had been the directing minds and benefitted from diverting the judgment debtor corporation's revenues to themselves.

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1338121 Ontario Inc. v. FDV Inc.
Ontario Superior Court of Justice
October 13, 2011

The Court dismissed an application pleading oppression and held that a shareholder should be able to exercise his own business judgement in deciding whether or not to contribute more capital by way of further shareholder loans. A shareholder exercising his discretion to refuse to contribute additional capital does not necessarily mean that the shareholder has acted oppressively.

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Boffo Family Holdings Ltd. v. Garden Construction Ltd.
Supreme Court of British Columbia
September 19, 2011

The Court held that the removal of the petitioner's representative from a company's board of directors did not amount to oppression or unfair prejudice. The petitioner's application for an order that the company be liquidated and dissolved was also dismissed. The Court ordered a shotgun sale of another company that was held jointly between the petitioner and one of the respondents because a deadlock between the parties could not be resolved.

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Heaney v. The Queen
Tax Court of Canada
October 3, 2011

The Tax Court of Canada found the directors of DSL Communications Inc. personally liable for certain amounts owing by the corporation pursuant to the *Income Tax Act* (Canada) and the *Excise Tax Act* (Canada) as they were not able to establish a defence of care, diligence and skill in preventing the failure to remit. In particular, the directors made a deliberate decision to have the corporation pay a supplier instead of meeting remittance obligations at which point they ceased to meet the due diligence standard required of them.

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Chan v. City Commercial Realty Group
Ontario Superior Court of Justice
May 10, 2011

The defendants owned a company which lost in litigation to the plaintiffs and subsequently wound-up the first corporation and transferred the business to a new corporation in order to avoid paying the costs awarded in the litigation. The Court reaffirmed that the corporate veil will be pierced and personal liability will be imposed on individual directors where: (i) the corporation's affairs are completely dominated by the individual directors; and (ii) the directors' improper conduct unjustly deprives the plaintiffs of their rights.

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Globex Foregin Exchange Corp. v. Launt
Nova Scotia Court of Appeal
July 15, 2011
The plaintiff brought an action against the defendant corporation and its sole shareholder claiming that the individual shareholder should be personally liable since the corporation was acting as the shareholder's agent when it entered into the foreign exchange contract at issue. The Court drew a distinction between situations in which: (i) the Court finds that the corporation is acting as an agent on behalf of a shareholder; and (ii) the Court pierces the corporate veil and imposes personal liability. In the former situation, the Court recognizes two distinct legal persons but finds an agency relationship whereas in the latter situation, the Court imposes personal liability as it effectively ignores the legal persona of the corporation.

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Cameron Seafoods (2005) Ltd. v. Jumelet
Supreme Court of Nova Scotia
October 13, 2011
The Court affirmed that the determining factor in deciding whether a fiduciary duty is owed to a corporate employer is the substance of the relationship and not a particular title. As an officer, director and key employee of the applicant, the respondent had a fiduciary duty not to disclose confidential information to a competitor regardless of the respondent's contention that the information was stored on his computer and the respondent thought it was therefore permissible.

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Vengrowth Funds (Special Committee of Directors), Re
Ontario Securities Commission
June 14, 2011
Growthworks Canadian Fund Ltd. commenced a hostile merger proposal to acquire various VenGrowth Funds. The special committee of independent directors of the VenGrowth Funds brought an application to challenge GrowthWork's solicitation of support agreements which would, among other things, give GrowthWorks an irrevocable power of attorney to: (i) requisition meetings of the VenGrowth shareholders; and (ii) vote the VenGrowth shares that became subject to the support agreements. The Ontario Securities Commission concluded that the solicitation of the support agreements and the voting of the subject shares under the support agreements was contrary to the public interest and the Ontario Securities Commission therefore engaged its public interest jurisdiction to order that any issuance of securities by any GrowthWorks entity in connection with the GrowthWorks proposal be cease traded until certain conditions are met.

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R. v. Niko Resources Ltd.
Alberta Court of Queen's Bench
June 23, 2011
Niko Resources Ltd. pled guilty to charges under *Canada's Corruption of Foreign Public Officials Act* in connection with the payment for and delivery of a Toyota Land Cruiser to the Bangladesh Minister of Energy and Ministerial Resources. Niko Resources was forced to pay a $9.5 million fine in Canada's first high profile case dealing with bribery of foreign officials.

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Marcotte, Re
Alberta Securities Commission
May 18, 2011
The Alberta Securities Commission found Marcotte was not registered to sell securities and made materially misleading statements in order to entice investors. In determining appropriate sanctions, the Alberta Securities Commission considered the relevant factors including, the seriousness of the findings against Marcotte, the risk to investors and the capital market if Marcotte were to continue to operate unimpeded in the capital market and the mitigating factors. The Alberta Securities Commission ultimately imposed a sanction prohibiting Marcotte from trading in securities and using exemptions otherwise available under Alberta securities laws for 20 years and ordered a fine of $75,000 and costs of $17,000.

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Trautwien v. Telsco Security Systems Inc.
Court of Appeal of Alberta
October 6, 2011
The Alberta Court of Appeal confirmed that if a shareholder has not waived the requirement to receive audited financial statements of the corporation, the shareholder has a prima facie right to the production of audited financial statements and there is no onus on the shareholder to prove that the financial statements are relevant and material to any kind of litigation claim.

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Zhang v. Chik and ZC Enterprises Ltd.
Court of Queen's Bench of Manitoba
November 1, 2011
The applicant sought an order for the sale to her of the majority shareholder's shares. The Court granted the order because the respondent's actions and an irreconcilable difference that had arisen between the parties was likely to adversely affect the operation of the corporation's restaurant business and was inconsistent with the reasonable expectations of the parties upon entering into the venture.

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Gidzinski v. Lake Simcoe Aeropark Inc. et al
Ontario Superior Court of Justice
July 11, 2011
The Court rejected a shareholder's application for an Order to wind-up Lake Simcoe Aeropark Inc. In considering the application, the Court reviewed the case

law in Ontario for the test to be employed by a Court in considering such an application for a winding up order pursuant to the *Business Corporations Act* (Ontario). The Court also provided reasons for authorizing the respondents to secure additional financing secured by a mortgage on the corporation's properties without the consent or signature of the applicant.

II NON-CANADIAN CASES

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Air Products and Chemicals, Inc. v. Airgas, Inc.

Delaware Chancery Court

February 15, 2011

The Delaware Court of Chancery upheld the target company board's continued use of a shareholder rights plan (commonly known as a poison pill) to prevent a hostile takeover. In its decision, the Court held that the board of the target company had perceived a legally cognizable danger and that the board's action of maintaining the poison pill was reasonable in relation to the threat posed by what the board believed was an inadequate offer, notwithstanding the fact that the board had adequate time to explore other alternatives and stockholders had been given all relevant information necessary to make an informed investment decision.

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Southern Peru Copper Corp. Shareholder Litigation

Delaware Chancery Court

October 14, 2011

The Delaware Court of Chancery had to review a transaction with a controlling stockholder and determine whether the transaction was entirely fair to the company and its minority stockholders. Although the board of Southern Peru Copper Corp. ("**Southern Peru**") created a special committee to evaluate the proposed transaction with the controlling stockholder, the Court found significant shortcomings on the part of the committee when assessing whether the transaction was subject to a fair process and involved a fair price. In finding that the transaction failed the entire fairness standard of review, the damages award of USD $1.2 billion which was later amended to USD $1.3 billion represents one of the largest awards granted by the Court of Chancery.

III. CERTAIN CANADIAN REGULATORY DEVELOPMENTS

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Use of Mass Advertising by Issuers

On September 13, 2011, the Canadian Securities Administrators (the "**CSA**") released Staff Notice 51-336 — *Issuers Using Mass Advertising*. In the staff notice, the CSA cautioned issuers who advertise by way of television, radio, internet, social media and/or print of the need to be particularly vigilant that such advertising is compliant with applicable continuous disclosure requirements and is not misleading to investors. The CSA announced that it will be monitoring issuers' advertising activities for breaches of applicable securities laws to determine whether such advertisements are misleading to investors or generally contrary to the public interest. If required, the CSA will take appropriate regulatory action, including a review of an issuer's continuous disclosure and/or the issuance of securities by the issuer.

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Improper Reliance on Accredited Investor Exemption

On May 13, 2011, the Ontario Securities Commission published OSC Staff Notice 33-735 — *Sale of Exempt Securities to Non-Accredited Investors*. In the staff notice, the Ontario Securities Commission stated the following 2 findings raised significant investor protection concerns: (i) some issuers (including companies and investment funds) and dealers are improperly relying on the accredited investor exemption to sell exempt securities to individual investors who do not actually satisfy the applicable requirements of the exemption; and (ii) many dealers do not collect adequate "know your client" (commonly referred to as KYC) information to be able to reasonably determine whether the investor is in fact an accredited investor. The Ontario Securities Commission indicated its intent to closely monitor the activities of issuers and dealers that sell exempt securities, including conducting compliance reviews of those firms.

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Continuous Disclosure Review Programme

On July 15, 2011, the Canadian Securities Administrators (the "**CSA**") issued CSA Staff Notice 51-334 — *Continuous Disclosure Review Program Activities* for the fiscal year ended March 31, 2011. The CSA outlined their review of the disclosure documents of listed issuers with a view to identifying material disclosure deficiencies for the dual purposes of ensuring listed issuer compliance and educating listed issuers on best disclosure practices. The CSA's review of listed issuer continuous disclosure in 2011 resulted in 70% of the issuers reviewed being required to take action to improve their continuous disclosure. The staff notice canvasses issues and best practices in respect of various areas of continuous disclosure including IFRS transition disclosure, certification, oil & gas technical disclosure, material contracts, mining technical disclosure, press releases, common management's discussion & analysis deficiencies, financial statement deficiencies and regulatory compliance disclosure.

Summary of Caselaw, Legislative and Regulatory Developments 2011

The year 2011 included a number of instructive decisions involving oppression remedy claims, director liability issues, fiduciary issues and proxy battles. A few noteworthy cases also made it clear that Canada has strict anti-bribery legislation and the sales of securities by individuals who are not properly registered will be dealt with severely.

Partially answering the question of whether Canada will ever have a federal securities regulator similar to the Securities and Exchange Commission in the United States, in the Reference re: *Securities Act* decision, the Supreme Court of Canada rejected the federal government's attempt to create a national regulator on the basis that it was unconstitutional. Securities are regulated by the provinces in accordance with the *Constitution Act*, 1867 and the proposed legislation overreached the federal government's jurisdiction by attempting to comprehensively regulate securities on a national level under the federal government's trade and commerce power.

In respect of cases dealing with the applicability of the oppression remedy, the Ontario Superior Court of Justice granted an oppression remedy in the *Penner* decision to ensure that a minority shareholder would be paid the fair value of his shares without the application of either a risk discount or a minority discount. In the *Pitney Bowes* case, the Ontario Superior Court of Justice also confirmed that creditors can avail themselves of the oppression remedy as the applicant creditor was ultimately entitled to an order against a corporation related to the original debtor corporation as well as the directors of the related corporations personally.

In contrast, in the *1338121 Ontario Inc.* case, the Ontario Superior Court of Justice made it clear that a shareholder should be able to exercise his own business judgement in deciding whether or not to contribute more capital by way of further shareholder loans and the fact that a shareholder refuses to contribute additional capital does not necessarily mean that the shareholder has acted oppressively.

Similarly, in the *Boffo* decision, the Supreme Court of British Columbia established that the oppression remedy will not be granted in respect of every grievance as it held that the removal of the petitioner's representative from a company's board of directors did not amount to oppression or unfair prejudice.

The *Heaney* case should be fair warning to directors that they cannot forget their individual liability with respect to certain tax remittance obligations as the Tax Court of Canada found the directors of DSL Communications Inc. personally liable for certain amounts owing by the corporation pursuant to the *Income Tax Act* (Canada) and the *Excise Tax Act* (Canada) as they were not able to establish a defence of care, diligence and skill in preventing the failure to remit.

In a couple of cases involving the question of whether the corporate veil should be pierced, the Ontario Superior Court of Justice reaffirmed in the *Chan* case that the corporate veil will be pierced and personal liability will be imposed on individual directors where: (i) the corporation's affairs are completely dominated by the individual directors; and (ii) the directors' improper conduct unjustly deprives the plaintiffs of

their rights. In contrast, in the *Globex* case, the Nova Scotia Court of Appeal drew a distinction between situations in which: (i) the Court finds that the corporation is acting as an agent on behalf of a shareholder; and (ii) the Court has to determine whether it should ignore the separate persona of the corporation and impose personal liability.

With respect to fiduciary duties, in the *Cameron Seafoods* decision, the Supreme Court of Nova Scotia affirmed that the determining factor in deciding whether a fiduciary duty is owed to a corporate employer is the substance of the relationship and not a particular title. As an officer, director and key employee of the applicant, the respondent had a fiduciary duty not to disclose confidential information to a competitor regardless of the fact the information was stored on his computer.

In the Vengrowth Funds hearing, the Ontario Securities Commission demonstrated that it is prepared to engage its public interest jurisdiction when the form and operation of support agreements in the context of a proxy battle undermine one of the fundamental principles of the *Securities Act* (Ontario) with respect to a shareholder's ability to make an informed decision as to how to vote, and the ability to change that decision.

The *Niko* decision proved to be Canada's first high profile case dealing with bribery of foreign officials as Niko pled guilty to charges under Canada's *Corruption of Foreign Public Officials Act* for its actions of paying for and delivering a Toyota Land Cruiser to the Bangladesh Minister of Energy and Ministerial Resources. Niko Resources was forced to pay a substantial fine of $9.5 million.

In the *Marcotte* hearing, the Alberta Securities Commission made it clear that substantial sanctions will be ordered where an individual who is not registered to sell securities does so and makes materially misleading statements in order to entice investors.

South of the border, in the *Airgas* Case, the Delaware Chancery Court clarified that shareholder rights plans will be permitted to continue if the board of the target company perceives a legally cognizable danger to the operation of the corporation in the form of an inadequate offer and the maintenance of the poison pill is viewed as a proportionate action against that threat.

In another highly publicized U.S. case, the Delaware Chancery Court highlighted in the *Southern Peru* decision that a special committee has a duty to ensure that a related party transaction is subject to a fair process and involves a fair price. In finding that the transaction failed the entire fairness standard of review, the damages award of USD $1.2 billion represents one of the largest awards granted by the Court of Chancery.

On the regulatory developments side, the Canadian Securities Administrators cautioned issuers who advertise by way of television, radio, Internet, social media and/or print of the need to be particularly vigilant that such advertising is compliant with applicable continuous disclosure requirements and is not misleading to investors.

The Ontario Securities Commission also made it clear that it is concerned about improper reliance on the accredited investor private placement exemption and stated the following 2 findings raised significant investor protection concerns: (i) some issuers (including companies and investment funds) and dealers are improperly relying on the accredited investor exemption to sell exempt securities to individual investors who do not actually satisfy the applicable requirements of the exemption; and (ii) many dealers do not collect adequate "know your client" information to be able to reasonably determine whether the investor is in fact an accredited investor.

The Canadian Securities Administrators also published their Continuous Disclosure Review Program Activities for the 2011 fiscal year and noted that 70% of the issuers reviewed were required to take action to improve their continuous disclosure. The notice canvassed issues and best practices in respect of various areas of continuous disclosure.

Certain Caselaw Developments

I. CANADIAN CASES

Reference re: Securities Act
2011 SCC 66
Supreme Court of Canada
December 22, 2011

On December 22, 2011, the Supreme Court of Canada (the "**Supreme Court**") released its highly anticipated decision as to whether or not the Canadian federal government could create a national body to regulate securities across Canada. The Supreme Court rejected the federal government's attempt to create a national regulator on the basis that it was unconstitutional.

Background
Unlike the United States of America which has a national regulator in the form of the Securities and Exchange Commission, Canada does not have a centralized federal regulator and instead, each province has its own securities regulator, which is either a self-funded commission or an entity funded within a larger government department. Each local securities regulator administers the province's securities legislation and, correspondingly, promulgates its own set of rules and regulations.

Although there is no central regulator, the various provincial and territorial regulators do work together to attempt to co-ordinate and harmonize regulation of the Canadian capital markets through the Canadian Securities Administrators (the CSA).

However, notwithstanding the Canadian Securities Administrators' attempts to harmonize certain fundamental securities issues such as prospectus exemptions through national instruments (e.g. National Instrument 45-106 — *Prospectus and Registration Exemptions*), there are differences across the provinces. Concerns with the provincial system of securities regulation has resulted in repeated calls from the public and lobbyists to form a national securities system in Canada.

Constitutional Issues
Securities have always been regulated by the provinces, in accordance with the *Constitution Act*, 1867. It is well established that the provinces, and not the federal government, have the power to regulate securities within their borders.

The Federal Government's Proposal
The federal government proposed a comprehensive national regime of securities regulation that would have governed all aspects of securities. The proposed scheme would have applied only to provinces which opt-in to it, with the ultimate goal of eventually harmonizing existing provincial legislation by creating a single securities statute to reflect both domestic and international best practises.

The federal government's goal was to provide investor protection, to foster fair, efficient and competitive capital markets, and to contribute to the integrity and stability of Canada's financial system. The federal government drafted legislation that proposed to regulate all aspects of securities, including the registration and conduct of dealers,

prospectus and disclosure requirements, take-over bids and issuer bids, insider trading and self-dealing, investigations, enforcement, and civil liability for both primary and secondary market disclosure. The scheme would have created a national commission responsible for the administration of Canadian securities law and an independent adjudicative tribunal.

The proposal to regulate securities at a national level, a marked departure from the status quo, was not universally well received. While Ontario supported the proposed legislation, Alberta, Québec, Manitoba, New Brunswick, British Columbia, and Saskatchewan opposed it. Alberta, Québec, Manitoba, and New Brunswick submitted that the proposed legislation encroached upon provincial jurisdiction to regulate contracts, property, and professions. British Columbia and Saskatchewan supported the idea of a national securities regulator if it could be achieved in a manner that respected the division of powers between the federal and provincial governments.

Challenges to the Proposed Legislation

Both Québec and Alberta submitted a Reference to their respective Courts of Appeal for an opinion on the constitutionality of the proposed scheme. Both Courts of Appeal found that the legislation was unconstitutional.

A Reference directly to the Supreme Court is a more efficient method of ultimately determining the constitutionality of federal legislation since References from provincial Courts of Appeal are subject to a final appeal to the Supreme Court in any event. The federal government submitted a reference to the Supreme Court of Canada to determine the constitutionality of the proposed legislation. The question referred to the Supreme Court was narrowly framed as follows — the Supreme Court was asked to determine whether the federal government has the ability to regulate securities as part of its jurisdiction over "trade and commerce" under section 91(2) of the *Constitution Act*, 1867. The federal government, seven provinces, and eight interest groups all made submissions to the Court at a hearing in April, 2011.

The Decision

The Supreme Court held that the federal government could not comprehensively regulate securities on a national level under its power to regulate trade and commerce. Specifically, the Supreme Court stated that the proposed act overreaches federal jurisdiction because it attempts to regulate all aspects of securities on an exclusive basis.

Portions of the statute would fall under federal jurisdiction and would otherwise be valid, such as the regulation of systemic risks that threaten the marketplace as a whole. These include provisions relating to derivatives, short-selling, credit ratings, urgent regulations, and on data collection and sharing. However, the Supreme Court held that the validity of the proposed legislation should be judged as a whole. In short, the Supreme Court refused to approve some portions of the proposed legislation and reject other portions.

In addition, the Supreme Court expressly stated that it would not determine whether a single federal regulator was preferable to multiple provincial schemes. Efficaciousness and policy considerations are not relevant to the constitutionality of legislation and were not considered by the Supreme Court. The legal challenge thus turned solely on the interpretation of the *Constitution Act*, 1867.

The Supreme Court held that, while the proposed statute was unconstitutional, a more co-operative approach remains available — one that recognizes the provincial

nature of securities regulation (i.e. licensing traders) while allowing Parliament to deal with genuinely national concerns (i.e. systemic risks). Therefore, it remains to be seen whether the federal government will try again by pursuing a less comprehensive federal securities regime to address systemic risks.

Penner v. Uptown Gourmet Catering Ltd.
2011 ONSC 6172
Ontario Superior Court of Justice
November 15, 2011

The Ontario Superior Court of Justice (the "**Court**") granted an oppression remedy under section 248 of the *Business Corporations Act* (Ontario). In particular, the Court had to determine the fair value of shares held by the applicant and found that the applicant was entitled to be paid in full for the shares without the application of either a risk discount or minority discount.

The Facts
Uptown Gourmet Catering Ltd. ("**Uptown**"), owned by Edmund Duarte and Valerie Duarte, was a kosher caterer that had a contract as the exclusive caterer at the Beth Emeth Bais Yehuda Synagogue (the "**Synagogue**"). In order to become a kosher caterer, it was necessary for Uptown to be certified by the Kashruth Council of Canada (the "**Kashruth Council**").

As a condition of the certification, the Kashruth Council required Uptown to have religious supervision of the preparation and sale of kosher food products by a "Mashgiach" and have ownership by a person of the Orthodox Jewish faith who was "shomer Shabbos". The Duartes were not of the Jewish faith. With the goal of meeting the ownership test in order to receive certification from the Kashruth Council, they issued shares representing 25% of the issued capital in Uptown to Ofer Penner, who was shomer Shabbos.

The Duartes acted as the officers and directors of Uptown. Mr. Penner was not an officer or director. Each of the three shareholders received a working salary for work actually performed, and the remaining corporate income was then divided among the shareholders based upon their shareholding interests.

In January 2010, Mr. Penner's employment position with Uptown was terminated for cause. Although Mr. Penner was not replaced, Uptown had a working Mashgiach to ensure that it complied with the kosher regulations. Mr. Penner had not served as Uptown's Mashgiach at any time.

The Duartes agreed to purchase the shareholding interest of Mr. Penner in Uptown and the shareholders all agreed that a valuation would be carried out to establish the purchase price. Two valuation reports were prepared and the parties asked the Court to determine the fair value. Both experts involved in the valuations agreed that the value of the actual operating business was fixed at $459,000.00. However, the valuators disagreed on whether a risk discount and/or a minority discount should be applied in fixing the value of Mr. Penner's shares.

The Claim
Mr. Penner claimed that he should be paid the undiscounted amount of $115,000 for his shares representing 25% of the shareholdings in Uptown. The Duartes claimed that

Mr. Penner should be paid $44,000.00, taking into account both a risk discount and a minority discount for Mr. Penner's portion.

The Decision

The Duartes submitted that the calculation of the share value must take into account the fact that any change in control of Uptown required the prior written consent of the Synagogue, as stated in the catering agreement between Uptown and the Synagogue. The Duartes believed that a 50% risk discount should therefore be applied to the company's value, since the Synagogue may or may not provide consent to the sale of shares.

The Court rejected the application of a risk discount to reflect the risk that the Synagogue would not approve a share transfer to a new investor. The Court held that no investor would blindly accept such risk when investing in the business, given the physical and economic link of Uptown to the Synagogue.

Additionally, the Synagogue was aware of the dispute with Mr. Penner and had renewed the catering agreement in spite of the ongoing issues between the shareholders. The Court found that the Synagogue wanted to work with the Duartes so long as kosher certification was in place. The Court also noted that the Kashruth Council was no longer insistent on the requirement for a shomer Shabbos partner in the business.

The Duartes also took the position that it was appropriate to apply an additional minority discount in respect of Mr. Penner's 25% holding of the company's shares. Their argument for application of the minority discount was based on the following four factors: (i) the fair market value of the minority interest to a third party purchaser would be less than the *en bloc* fair market value due to the amount and timing of income earned from the investment; (ii) risks to an outside investor in the family control of Uptown; (iii) the lack of a formal shareholder agreement in place to govern the business relationship between the shareholders; and (iv) the kosher certification by the Kashruth Council required that the owner of the 25% of Uptown's issued shares be shomer Shabbos. Further, the Duartes argued that the minority discount was appropriate because Mr. Penner deserved to be fired and his employment was terminated for cause.

The Court followed the relevant principles set out in *Re: Mason and Intercity Properties Ltd.*, [1987] O.J. No. 448, 59 O.R. (2d) 631, 38 D.L.R. (4th) 681 (C.A.) that, in order to justify a minority discount in the valuation of the minority shares, the Duartes had the burden of proof to establish that Mr. Penner's conduct leading to his dismissal was of such a grave character that he deserved to be excluded from the company. Ultimately, the Court was not satisfied by the evidence submitted by the Duartes with respect to Mr. Penner's conduct.

Accordingly, the Court declined to accept the arguments for a risk discount and minority discount in determining the correct price to be paid by the Duartes to Mr. Penner and the value was fixed at the undiscounted amount of $115,000.00.

Pitney Bowes v. Belmonte et al.
2011 ONSC 3755
Ontario Superior Court of Justice
June 15, 2011

The Ontario Superior Court of Justice allowed the applicant, Pitney Bowes of Canada Ltd. ("**Pitney Bowes**") to obtain an oppression remedy against two corporations related

to a judgment debtor corporation which owed money to Pitney Bowes. The Court also made an order against the directors of the related corporations personally as the directors had been the directing minds and benefitted from diverting the judgment debtor corporation's revenues to themselves.

The Facts

Aldo Belmonte and his wife Lisa Belmonte were the sole directors of three corporate entities being 1140311 Ontario Inc., 1601080 Ontario Inc. and 1734385 Ontario Inc. 1140311 Ontario Inc. (the "**First Related Corporation**") carried on business under the name of "MINI STICKS", its principal business being the sale of miniature hockey sticks and other products displaying various NHL team logos and other designs. The sole director and controlling mind of the First Related Corporation was Aldo Belmonte.

1601089 Ontario Inc. (the "**Second Related Corporation**") was the owner of a large inventory of NHL logo stickers. The Second Related Corporation supplied logo stickers to the First Related Corporation which applied them to various items and then sold them as novelty goods. The sole director of the Second Related Corporation was Lisa Belmonte.

1734385 Ontario Inc. (the "**Third Related Corporation**") (the First Related Corporation, the Second Related Corporation and the Third Related Corporation being collectively referred to as the "**Three Related Corporations**") also registered "MINI STICKS" as its business name and its sole director and operating mind was Aldo Belmonte.

In carrying on its business, the First Related Corporation leased certain photocopying and related equipment from Pitney Bowes. The First Related Corporation subsequently defaulted on its lease obligations and also failed to pay Pitney Bowes' invoices for services and supplies. Pitney Bowes ultimately obtained a judgment against the First Related Corporation in the amount of $25,107.09, inclusive of pre-judgment interest.

The Oppression Application

Pitney Bowes, as a creditor, applied to the Ontario Superior Court of Justice seeking an oppression remedy under the Ontario *Business Corporations Act* against the Three Related Corporations and Aldo Belmonte and Lisa Belmonte personally in respect of the judgment debt owed by the First Related Corporation.

The Court was faced with determining whether: (i) the abandonment by the director of the First Related Corporation as an active business and the transfer of its assets amounted to oppressive conduct; and (ii) an order against the directors of the Three Related Corporations, Aldo Belmonte and Lisa Belmonte personally, was appropriate in the circumstances.

The First Issue — Was there Oppressive Conduct?

The Court noted that from the affidavit sworn and filed by Mr. Belmonte and from his cross-examination, that the exclusive purpose for incorporating the Third Related Corporation was to enable the transfer of the business of the First Related Corporation to the Third Related Corporation in order to avoid liabilities or potential liabilities which attached to the First Related Corporation. In particular, the Court highlighted Mr. Belmonte's statement that it became necessary to "abandon" the First Related Corporation and "the decision was made to allow default judgment" to be granted in favour of Pitney Bowes against the First Related Corporation.

The Court also highlighted the fact that significant business revenues (including approximately $366,000 in sales revenues generated by sales of products on eBay)

which would normally have been available to the First Related Corporation were deposited directly into the joint bank account of Aldo Belmonte and Lisa Belmonte.

The Court commented that a creditor has status to bring an application as a complainant and that oppression is any act or omission by the corporation that is unfairly prejudicial to or unfairly disregards the interests of the complainant. The Court reasoned that while some degree of bad faith or lack of probity in the conduct may be the norm, they are not essential to a finding of oppression. The oppression remedy is designed to address the imbalance of power between those in control of the corporation and those who are vulnerable as a result of having a stake in the corporation, but no control.

Moreover, the Court reviewed the jurisprudence and espoused that not every conduct that harms a stakeholder is oppressive and that the conduct must fall outside the reasonable expectations of the complainant according to the arrangements between it and the corporation. Although the following factors are not exhaustive, the Court indicated that the test for oppression should encompass: (i) the protection of the underlying expectation of a creditor in its arrangement with the corporation; (ii) the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts; and (iii) the detriment to the interests of the creditor.

In light of the foregoing analysis, the Court determined that the Three Related Corporations and the directors acted in a manner that was oppressive, unfairly prejudicial, or unfairly disregarded the interests of Pitney Bowes. The Court cited that it was clear from the evidence that the directors removed the entire operating business in an attempt to escape from the obligations to the First Related Corporation's creditors — namely its landlord, and Pitney Bowes. The earnings of the First Related Corporation were not available to satisfy judgment against it, and were sheltered for the personal use of the directors and the other related corporations controlled by the directors.

The Court held that Pitney Bowes had a reasonable underlying expectation that the First Related Corporation would continue to generate revenue, which would enable it to repay its debt. Pitney Bowes had no reason to expect that the directors would transfer the operating business to another corporation or divert sales revenue to themselves personally.

Accordingly, the Court granted relief against the Three Related Corporations.

The Second Issue — Should the Directors be Liable Personally?

In reviewing the jurisprudence regarding personal liability of the directors, the Court noted that there have been orders made against directors personally in oppression remedy cases, which usually involved small, closely held corporations where the director had been the sole controlling owner and directing mind, and where the conduct had directly benefitted the director.

Aldo Belmonte and Lisa Belmonte, as the directors and directing minds of the Three Related Corporations, benefitted directly from channelling the First Related Corporation's revenues to themselves. The First Related Corporation was left with no assets, and its principals knew that Pitney Bowes was a creditor.

Accordingly, the Court found that the directors of the Three Related Corporations, Aldo Belmonte and Lisa Belmonte were jointly and severally liable to pay the judgment against the First Related Corporation.

1338121 Ontario Inc. v. FDV Inc.
2011 ONSC 6075
Ontario Superior Court of Justice
October 13, 2011

In dismissing an application pleading oppression under s.248 of the *Business Corporations Act* (Ontario), the Ontario Superior Court of Justice held that a shareholder should be able to exercise his own business judgment in deciding whether or not to contribute more capital by way of further shareholder loans and the exercise of a shareholder's discretion to refuse to contribute such additional capital does not necessarily mean that the shareholder has acted oppressively.

Background

Thomas Bitove ("**Bitove**") and Frank de Vries ("**de Vries**") were involved in two related business relationships and two disputes.

Bitove was the sole shareholder and director of 1338121 Ontario Inc. ("**133**") which in turn owned two-thirds of the shares of Powerbev Inc. ("**Powerbev**"). de Vries owned 51% of the shares of FDV Inc. ("**FDV**") which in turn owned the other one-third of the shares of Powerbev. Powerbev was the exclusive distributor of Red Bull energy drinks in Ontario.

In their dispute with respect to Powerbev which was the subject of a separate arbitration proceeding, Bitove claimed that a "triggering event" under a unanimous shareholder agreement had occurred due to unauthorized distributions of Powerbev's funds to deVries and that the triggering event entitled Bitove to FDV's shares in the capital of Powerbev. FDV had also made an offer to purchase 133's shares in Powerbev pursuant to a buy-sell agreement but the time period for 133 to respond under the buy-sell agreement had been suspended by court order. Therefore, either the arbitration proceeding or the buy-sell agreement would ultimately determine who would control Powerbev.

The second relationship and the alleged oppression involved the respondent corporation, Pur Brands Inc. ("**Pur Brands**") which had the exclusive right to distribute Red Bull energy drinks in British Columbia. 133 and FDV were equal shareholders of Pur Brands.

The Oppression Application

The applicants 133 and Bitove brought an application pleading oppression under s.248 of the *Business Corporations Act* (Ontario) on the part of the respondents FDV Inc., de Vries and Pur Brands Inc. due to de Vries' unwillingness to advance shareholder loans to keep Pur Brands operational.

Pur Brands had been operating short of cash and as of the date of the proceeding, required an infusion of working capital to pay its liabilities, including payroll and accounts payable owed to Red Bull Canada. The Court noted that if there were to be a failure to provide working capital in a timely way, the distributorship agreement would be placed in jeopardy.

Bitove and de Vries had been aware of the latent problem of a cash flow shortage since the beginning of 2011. The capital requirement was largely due to an anticipated change in Red Bull's credit arrangements for Pur Brands.

Historically, Pur Brands' financing had been accomplished by way of shareholder loans, with each of the two shareholders contributing $400,000.00.

In obtaining the Red Bull distributorship for Pur Brands in the fall of 2009, the informal shared expectation was that "Responsibility for funding would be shared equally by the shareholders."; however, there was no ongoing contractual obligation in this regard, and de Vries submitted that in his business judgment, it would be preferable to wind-up Pur Brands.

The Court noted that at first impression, it would seem that de Vries was acting contrary to his self-interest in refusing to join with Bitove in contributing more funds by way of another shareholder loan. de Vries took the position that he was concerned about the long term viability of Pur Brands, and his preference was to have an orderly wind-up with the expectation that there would be some funds realized through a liquidation such that the two shareholders would obtain some significant recovery on their existing respective $400,000 shareholder loans to Pur Brands. de Vries submitted that that he was simply exercising his business judgment in declining to contribute more money by way of a shareholder loan. In addition, de Vries submitted that if they raised capital from a third party lender, such action would inevitably place the secured lender in a priority position to his interest as an unsecured shareholder loan creditor.

Conversely, Bitove submitted that his reasonable expectation was that shareholder loan financing would continue, but that de Vries had acted oppressively by refusing since August, 2011 to contribute any additional money and by refusing to permit Pur Brands to borrow funds to keep it viable during the anticipated period of cash flow shortage. Bitove further claimed that de Vries was holding Pur Brands hostage in an attempt to leverage his position in respect of their dispute with respect to Powerbev.

The Court noted that: (i) de Vries was prepared to sell his FDV held shares in Pur Brands to Bitove for only one dollar, provided he was reimbursed for his $400,000.00 shareholder loan as a condition of the sale; and (ii) de Vries took this position recognizing that he had an outstanding offer to purchase Bitove's interest in Powerbev via a buy-sell agreement (which offer was in suspension due to a separate court order regarding the Powerbev dispute). The Court found it worthwhile to highlight that de Vries was desirous of purchasing outright ownership of Powerbev and was prepared to do so without also acquiring outright ownership of Pur Brands.

The Court commented that Pur Brands had been profitable to date, with virtually all its 2010 net income being paid to Powerbev. Consulting fees of $120,000.00 were paid to Mr. Bitove by Pur Brands and over $400,000.00 was paid to Powerbev for management fees with some $150,000.00 thereof being regarded as the market price of Powerbev's management services.

Although financial statements (other than cash flow statements) were not available, the Court found that Pur Brands had some $270,000.00 of net income in 2010 (received by Powerbev). Therefore, de Vries had an indirect benefit of one-third of that profit or about $90,000.00. The Court further noted that if de Vries lent a further $500,000.00 to Pur Brands, as requested, he would arguably have an opportunity cost of 5% or $45,000.00 annually arising from his interest free shareholder loans. In turn, his return on capital (with no increase in sales) would be only approximately $45,000.00 or 5% annually.

The sales and cash flow data for the 2011 year to date revealed sales to be about 1.8% less than for 2010. While there were projections for increased sales for the balance of the year, in the Court's view, the prospect of increased sales was uncertain and the Court ultimately held that de Vries was simply fairly exercising his own business judgment in declining to contribute more capital by way of a further shareholder loan.

Therefore, the Court held that on the basis of the evidentiary record, Bitove had not proven on a balance of probabilities that de Vries has acted oppressively and the oppression application was dismissed.

Boffo Family Holdings Ltd. v. Garden Construction Ltd.
2011 BCSC 1246
Supreme Court of British Columbia
September 19, 2011

The Supreme Court of British Columbia held that the removal of the petitioner's representative from a company's board of directors did not amount to oppression or unfair prejudice. The petitioner's application for an order that the company be liquidated and dissolved was also dismissed. The Court ordered a shotgun sale of another company that was held jointly between the petitioner and one of the respondents because a deadlock between the parties could not be resolved.

The Facts

Two Brothers, Tarcisio Boffo ("**Terry**") and Ottavio Boffo ("**Otto**") immigrated to Canada in the 1960s. For many years they worked together in the construction business. They also entered into a number of investment opportunities relating to real estate development. By 1988, Terry and Otto each held a 50% shareholding interest in Boffo Bros. Construction Limited ("**BBCL**"), a corporation involved in construction and development projects. In the years both preceding and following the formation of BBCL, the brothers participated as shareholders in a number of companies. Two of the respondents, Garden Construction Ltd. ("**Garden**") and Boffo Bros. Developments Inc., ("**BBD**") were examples of such companies.

In 2002, the brothers' relationship began to deteriorate. Terry intended to retire in the near future and wanted his children to assume larger roles in the management and operation of BBCL. Otto believed that the children were not ready for the level of involvement Terry desired and rejected Terry's suggestion. The brothers were unable to come to a resolution so they began separating their many intertwined business interests.

The Claim

The petitioner, Boffo Family Holdings Ltd., ("**BFHL**") was Terry's personal holding company and it owned shares in all of the companies at issue. BFHL sought relief pursuant to ss. 227 of British Columbia's *Business Corporations Act* (the "**BCA**") alleging that the affairs of Garden and BBD were being conducted in a manner that was both oppressive and unfairly prejudicial to BFHL.

BFHL complained that Garden's board of directors (the "**Board**") had unfairly prejudicially excluded Terry and any other BFHL representative. BFHL also argued that a major investment opportunity, the White Rock Project, had been diverted from all Garden shareholders. Finally, it alleged that Garden's directors failed to comply with the company's articles and with the provisions of the BCA. Regarding BBD, a company in which BFHL and Otto were both 50% shareholders, BFHL alleged that Otto was conducting

all of BBD's business without having the authority to do so. BFHL also alleged that Otto had refused to attend BBD's director and/or shareholder meetings if Terry was going to be present and that he refused to communicate with BFHL regarding BBD's business.

BFHL sought declarations that both Garden and BBD were being managed in a manner that was oppressive and/or unfairly prejudicial to BFHL. In the alternative, if BFHL failed on its oppression and unfair prejudice arguments, it sought an order under ss. 324 of the BCA requiring both companies to be valued, liquidated and dissolved.

The Decision

Oppression & Unfair Prejudice Generally

The Supreme Court of British Columbia started its decision by noting that the oppression remedy is an equitable remedy that requires a fact-specific analysis. The "reasonable expectation" of stakeholders in a corporation is the foundation of the remedy. Reasonable expectation is assessed on an objective and contextual basis. A Court will assess factors such as general commercial practice, the nature of the business, the relationship between the parties and past practice to determine whether a reasonable expectation exists. Different standards may apply when the relationships between the parties are rooted in familial ties as in this case. Along with a reasonable expectation, the Court must also find that the impugned conduct amounted to unfair prejudice or oppression. Finally, the petitioner must be able to show that he/she suffered compensable injury as a result of the prejudicial conduct or oppression.

The onus was on BFHL to establish that the affairs of Garden and/or BBD were being conducted in a manner that was unfairly prejudicial or oppressive to BFHL.

The Court has broad discretionary power to order what is "just and equitable" and one of the Court's powers in this regard is the ability to order a wind-up of the corporation regardless of whether there is any finding of oppression or unfair prejudice if the Court nevertheless considers it "just and equitable" to do so.

Garden

In assessing BFHL's reasonable expectations, the Court noted that it was Terry who changed the status quo within Garden. Terry decided to retire and cease active involvement in Garden's business operations. Terry had also openly questioned the honesty of the other Garden shareholders. As a result, Terry (and by extension BFHL) could no longer have a reasonable expectation that he would remain on the Board. BFHL could likewise not have any reasonable expectation that Garden's affairs would be managed in the same fashion as they had been in the past.

Was there unfair Prejudice?

The Court noted that even if BFHL did have a reasonable expectation of having a representative on the Board, that fact alone would not give rise to a finding of unfair prejudice. Garden's shareholders were faced with a personal conflict between Otto and Terry that threatened the viability of the company. They had to release one of the brothers from the Board to ensure that the health of the company was protected. Further, the removal of a BFHL representative from the Board did not cause any compensable injury to BFHL. BFHL still received dividends paid by Garden and there was no evidence of BFHL being mistreated in any fashion by the newly constituted Board. Therefore, the Court held that the decision to not re-nominate a BFHL representative to the Board was not unfairly prejudicial or oppressive.

Did Terry have Standing to Bring the Oppression Claim?

BFHL's petition argued that because Terry was at one point offered the opportunity to invest in the White Rock Project (along with Garden's other shareholders), his later exclusion without notice gave rise to an oppression claim under the BCA. The Court rejected this argument. The Court reasoned that first, the claim did not fall under the oppression section of the BCA because such a claim is only available to petitioners who are affected in their capacity as shareholders. Terry, who was not the petitioner, was also not a shareholder of Garden, only BFHL was. As a result, any claim available to Terry would need to be brought outside of the BCA.

The Court also held that Terry had failed to prove the factual elements of his claim. Terry's evidence that he advised Otto's solicitor of his desire to invest in the project was rejected by the Court. Terry had gone to great lengths to separate his business affairs from those of his brother. The Court held that it did not make sense that Terry would desire to invest substantial funds in a project that his brother would control. BFHL's claims regarding the White Rock Project therefore failed on both a legal and factual basis.

Should Garden be Wound-up?

The Court also had to consider BFHL's argument that, in the event BFHL's oppression and unfair prejudice claims failed, Garden should nonetheless be wound-up. Pursuant to section 324 of the BCA, the Court is empowered to order a wind-up of a company if it feels that it is "just and equitable" to do so. BFHL argued that two grounds made a wind-up of the company just and equitable. First, that BFHL had a justifiable lack of confidence in Garden's management. Second, that BFHL was a partner in the company and its removal from the Board thereby left the Court with no other choice.

The Court held that the facts before it did not justify ordering a wind-up of Garden. Otto and Terry each owned only 17% of Garden's shares. Four other shareholders owned approximately 66.7% of the company. The Court reasoned that the fact that a minority shareholder disagreed with the decisions made by the majority did not in itself justify an order that the company be wound-up. Furthermore, BFHL was unable to tender any examples of mismanagement of Garden's affairs. BFHL's partnership argument also failed. Even if Garden was a quasi-partnership, the removal of a BFHL representative from the Board could only justify the wind-up of the company if it was shown that the removal was not exercised in a *bona fide* fashion or if no reasonable person would believe that the removal of BFHL's representative was in the interests of the company.

Should Boffo Bros. Developments Inc. be Wound-Up?

The Court held that the affairs of BBD did not justify awarding a remedy under the oppression or unfair prejudice sections of the BCA. BBD was always operated by Otto with Terry's acquiescence. Terry had always been (and continued to be) a director of BBD. Terry had always allowed Otto to manage the business. As a result of this established business practice, the Court held that Terry could not reasonably expect to be involved in the company's management.

However, BBD remained in an irreconcilable deadlock. Each of Terry and Otto owned 50% of BBD's shares and no resolution seemed forthcoming. It was therefore determined by the Court that it was just and equitable for BBD to be wound-up. The Court held that a shotgun sale of the shares of BBD was the most appropriate solution. The Court ordered Otto to deliver to Terry an offer to purchase his shares in BBD within

60 days of the release of its decision. Terry then had an additional 60 days to either purchase the shares at the price set out in Otto's offer or sell his shares in BBD to Otto for that same price.

Heaney v. The Queen
2011 TCC 429
Tax Court of Canada
October 3, 2011

The Tax Court of Canada found that the appellants were liable as directors pursuant to the *Income Tax Act* (Canada) (the "**ITA**") and the *Excise Tax Act* (Canada) (the "**ETA**") for amounts that their company, DSL Communications Inc. ("**DSL**") failed to remit as the directors were not able to establish a defence of care, diligence and skill in preventing the failure to remit.

The Facts

The appellants were directors of DSL, an internet service provider that resold high-speed internet connections from Bell Canada ("**Bell**") to the public in Ontario and Québec.

The appellants became aware of two significant problems facing DSL in September 2000, being: (i) it had network and billing issues with Bell; and (ii) its external financial assistance was in jeopardy. The appellants took immediate action to reduce DSL's costs and to locate new financing sources; however, efforts to find new financing were unsuccessful.

Due to its financial difficulties, DSL failed to remit the net Goods and Services Tax ("**GST**") it had collected on October 31, 2000, and in mid-December 2000, DSL failed to remit payroll source deductions.

On December 20, 2000, Bell demanded payment of over $145,000 from DSL on several overdue accounts, with a first instalment due on December 22, 2000. Given the pressures from Bell, the directors made a conscious decision to pay Bell as opposed to making the necessary remittances to the Canada Revenue Agency.

Bell again demanded payment of $195,000 in November and December of 2001 and threatened to disconnect DSL's services. The appellants continued to search for new financing and ultimately agreed to a merger between DSL and Wiznet Inc. ("**Wiznet**") in November 2002, whereby Wiznet acquired the assets of DSL and its parent company, Velocet Communications Inc.

The Claim

If a corporation fails to remit GST and payroll source deductions, the directors are jointly and severally liable unless they can establish a defence of care, diligence and skill in preventing the failure to remit.

Accordingly, the appellants were assessed pursuant to section 227.1 of the *ITA* and section 323 of the *ETA* for the amounts DSL failed to remit, together with penalties and interest. The issue was whether the appellants as directors of DSL were liable for the amounts that DSL failed to remit or whether they could avail themselves of the due diligence defence contained in the directors' liability provisions of the *ITA* and *ETA*.

The Decision

Subsections 227.1(1) of the ITA and 323(1) of the ETA both provide that where a corporation has failed to remit amounts, the directors of the corporation will be jointly

and severally liable, together with the corporation, to pay those required amounts. Subsections 227.1(2) and (3) of the ITA and subsection 323(3) of the ETA allow directors to avoid this liability if they are able to establish a defence of care, diligence and skill in preventing the failure to remit.

The Court found that there was no dispute that the appellants were directors throughout the relevant periods, as they were personally involved in the daily management of DSL's corporate activities and therefore, the only question at issue was whether the appellants could benefit from the due diligence defence.

The Court referred to the Supreme Court of Canada decision in *Peoples Department Stores Inc. (Trustee of) v. Wise* wherein the Supreme Court of Canada held that the standard of care imposed is an objective standard. However, the Court also noted that the use of the objective standard does not imply that the particular circumstances of a director should be ignored.

The Court found that until the end of 2000, the appellants were pursuing measures to deal with DSL's remittances and they exercised care and diligence with a view to preventing DSL's failure to remit these amounts. However, the Court importantly found that after 2000, the conduct of the appellants no longer met the standard required by subsections 227.1(3) and 323(3) because their efforts then turned away from remedying DSL's remittance failures.

In particular, the appellants lost the benefit of the due diligence defence at the end of 2000 when the appellants made the decision to cause DSL to pay Bell instead of meeting its tax remittance obligations. At the end of 2000, the appellants' efforts were no longer directed toward avoiding failures to remit to the Canada Revenue Agency and instead, had shifted to curing the payment demands from Bell.

Therefore, although they were unlikely aware of the consequences at the time the decision was made, the appellants' critical decision to use the monies that should have been remitted to the Canada Revenue Agency to pay its supplier/creditor Bell instead (presumably in order to keep the business operational) was made at the future cost of the appellants' loss of any ability to avoid personal liability based on a defence of care, diligence and skill in preventing the failure to remit.

Chan v. City Commercial Realty Group
2011 ONSC 2854
Ontario Superior Court of Justice
May 10, 2011

The plaintiffs sought to enforce a costs award ordered in litigation between the plaintiffs and a predecessor of the defendant corporation. The plaintiffs argued that the current corporate entity, and the two directors of the corporations, should be liable for the outstanding costs. The Court acknowledged that the litigation had been commenced by a predecessor corporation, which was a distinct legal entity; however, the Court held that since: (i) the corporations' affairs were completely dominated by the individual directors; and (ii) the defendants engaged in improper conduct which unjustly deprived the plaintiffs of their rights, the Court would pierce the corporate veil and impose personal liability such that the two individual directors became jointly and severally liable to the plaintiffs for the costs award.

The Facts

Several years prior to this action, Mr. Stephen Chan, Combi Capital Group Limited, Mr. Zoran Bakich and John Faraci (collectively referred to as the "**Plaintiffs**)", were named as defendants in a lawsuit commenced by City Commercial Realty Services (Canada) Ltd. ("**City Canada**"). City Canada was unsuccessful at trial, and the judge awarded the Plaintiffs $104,000 in legal costs, to be paid by City Canada. City Canada appealed this decision and lost which resulted in the Plaintiffs being awarded a further $15,000 in costs.

The Plaintiffs subsequently learned that shortly before the appeal was heard, City Canada had taken steps to wind down its business. Since its inception in 1982, two brothers being Martin Wygodny and Samuel Wygodny (the "**Individual Defendants**") were the directors, shareholders and officers of City Canada. Immediately prior to the appeal, one of the Individual Defendants resigned as director, shareholder and officer, and incorporated a new entity called City Commercial Reality Group Ltd. ("**City Commercial**"). Importantly, City Canada also allowed its Real Estate Counsel of Ontario license to lapse, and City Commercial applied for a licence in its stead.

The Plaintiffs brought an action against City Commercial claiming that City Commercial was incorporated for the sole purpose of enabling City Canada to avoid payment of the outstanding costs award. Accordingly, the Plaintiffs sought to pierce the corporate veil of City Commercial and impose liability for the outstanding costs award on City Commercial, and on the Individual Defendants personally.

The Decision

In his decision, Justice Grace stated the basic legal principle that a corporation is a separate legal person, entirely distinct from its shareholders and directors. However, the Court went on to espouse that where it would be "too flagrantly opposed to justice", the Courts may find that a corporation has acted as an *alter ego* for the directors and shareholders, and therefore impose direct personal liability on those individuals.

Justice Grace enumerated the following four main principles drawn from case law:

(1) The separate legal personality of a corporation will not be disregarded lightly;

(2) The analysis is largely fact specific;

(3) Typically the corporate veil is lifted when incorporation occurs for a purpose that is illegal, fraudulent or improper; and

(4) Even if that is not the case, personal liability may be imposed on a person who controls a corporation and uses it as a shield for fraudulent or wrongful conduct, provided that conduct is the reason for the complaining party's injury or loss.

The Court held that in order to impose personal liability on the Individual Defendants, the Plaintiffs had to prove the following two elements: (i) that the activities of both City Canada and City Commercial were completely dominated by the Individual Defendants; and (ii) that the Individual Defendants engaged in improper conduct which unjustly deprived the Plaintiffs of their rights.

The Court found that the first criterion was easily satisfied, since the Individual Defendants were the sole shareholders, directors and officers of both City Canada and City Commercial.

With respect to the second criterion, Justice Grace noted that prior to the hearing of the appeal on the merits, the Plaintiffs unsuccessfully brought a motion at the Court of Appeal, requesting that City Canada pay the anticipated costs of the appeal into Court. It was after this motion that the Individual Defendants restructured their business and incorporated City Commercial. Thus, by the time the appeal was argued the Individual Defendants ostensibly "had nothing to lose" as they would either: (i) succeed on appeal; or (ii) the Plaintiffs would not be able to enforce the costs award as the original corporation City Canada had been wound down and the underlying business had been migrated to the new corporation City Commercial.

The Court found that the new corporation City Commercial was incorporated to carry on "precisely the same business" as City Canada. While there technically had been no transfer of assets between the two corporations, the Individual Defendants continued to benefit from the reputation of City Canada. In particular, the Court held that the Individual Defendants were not entitled to "quietly organize their corporate affairs in a way which provided them with all the benefits of their real estate activities and none of the burdens". The Court further commented that the reorganization would purportedly have enabled the Individual Defendants to continue their real estate business without interruption and without adverse financial consequences.

Accordingly, the Court allowed the corporate veil to be pierced and found the Individual Defendants to be jointly and severally liable to the Plaintiffs for the outstanding costs awards.

Globex Foreign Exchange Corp. v. Launt
2011 NSCA 67
Nova Scotia Court of Appeal
July 15, 2011

The plaintiff contracted to sell £1,198,000 to the defendant corporation and the defendant corporation refused to close the transaction which resulted in the plaintiff bringing an action against the defendant corporation and its sole shareholder. As against the sole shareholder, the plaintiff claimed that the individual should be personally liable, since the corporation was acting as the shareholder's agent when it entered into the contract at issue.

The defendant successfully brought a motion for summary judgment, dismissing the claim against the individual shareholder; however, the Nova Scotia Court of Appeal overturned the Motion Judge's decision, holding that a decision regarding whether an agency relationship exists between a corporation and an individual shareholder involves a complex factual analysis, which is properly left for a trial judge.

The Facts
Globex Foreign Exchange Corporation ("**Globex**") contracted to sell £1,198,000 pound sterling to the defendant 3077860 Nova Scotia Limited (the "**Corporate Defendant**") at an agreed upon exchange rate. The individual defendant, Carl Launt ("**Launt**") was the sole director and shareholder of the Corporation Defendant. Launt advanced $125,000 to the Corporate Defendant to be paid as a deposit to Globex. The Corporate Defendant did not have any assets, and was inactive for the four years preceding the transaction.

Globex purchased the pounds sterling, but the Corporate Defendant subsequently refused to complete the transaction. Globex sold the currency back to the market at

what amounted to a $90,000 loss and proceeded to commence an action against the Corporate Defendant and Launt personally. It is important to note that in its pleadings, Globex claimed that the Corporate Defendant had acted as a duly authorized agent, servant or employee of Launt.

The Corporate Defendant did not enter a defence in the action, and Globex was successful in obtaining default judgment against it. With respect to Globex's action against Launt personally, prior to the discoveries, the Corporate Defendant brought a motion for summary judgment to dismiss the entirety of the claim. In an affidavit filed in support of the summary judgment motion, Launt swore that the Corporate Defendant was not his agent, nor did he ever make such a representation. The Motions Judge accepted this evidence and granted the motion for summary judgment dismissing the claim. Globex then appealed the judgment to the Nova Scotia Court of Appeal.

The Decision

Writing on behalf of the majority, Justice Farrar overturned the decision of the Motions Judge. With respect to the law of agency, Justice Farrar drew a distinction between situations in which: (i) the Court finds that the corporation is acting as an agent on behalf of a shareholder; and (ii) the Court pierces the corporate veil. In the former situation, the Court recognizes that the corporation and the individual shareholder are separate legal persons, but on the facts, the corporation is acting in an agency relationship on behalf of the shareholder. In the latter situation, the Court will choose to ignore the legal persona of the corporation. In both situations, the Court will impose personal liability on a shareholder for what appear to be corporate actions.

Justice Farrar went on to comment that the question of whether or not an agency relationship exists between a corporation and a sole shareholder is a question of fact, which in turn requires a complex contextual analysis. Justice Farrar noted that in the present case, the Court would have to hear evidence on, among other things: (i) the business rationale for Launt having the Corporate Defendant enter into the contract with Globex; (ii) the previous business of the Corporate Defendant; and (iii) the reason that the Corporate Defendant entered into the contract in the first place. The Court held that these facts were appropriately determined at trial, rather than on a summary judgment motion.

The Dissenting Opinion

In the dissenting opinion, Justice Bryson conceded that the Motions Judge had improperly worded her decision, such that she decided the question of agency, rather than determining whether there was a triable issue with respect to agency. Nonetheless, Justice Bryson held that on the evidence adduced on the summary judgment motion, there could not be a finding that an agency relationship existed; therefore, the Motions Judge correctly concluded that the action should be dismissed.

In an exhaustive review of the authorities, Justice Bryson began with the proposition that an agency relationship exists between two persons, principal and agent, whereby an agent agrees to transact on the principal's behalf. The law recognizes that in certain situations, the agent may enter into a contract with a third party on behalf of an undisclosed principal, and that principal may later be liable to the third party. However, the cases that acknowledge an undisclosed principal-agency relationship will rest on the intention of the parties.

Since Globex did not allege that it was aware of the agency relationship at the time of the transactions, Justice Bryson held that these cases were inapplicable to the facts at hand.

Justice Bryson further held that Courts are sometimes willing to "lift the corporate veil" and infer an agency relationship between a shareholder and a shell corporation acting on the shareholder's behalf; however, in order to lift the corporate veil, the Court must be presented with evidence that the shareholder was using the corporate vehicle improperly. Mere evidence of control by a sole shareholder is not wrongful; moreover, using a corporation to shield a shareholder from personal liability is also not fraudulent or illegal. Justice Bryson concluded that since Globex had not put forward evidence to substantiate that the corporation was behaving illegally or improperly, no agency relationship could be established and the action should therefore be dismissed.

Cameron Seafoods (2005) Ltd. v. Jumelet
2011 NSSC 365
Supreme Court of Nova Scotia
October 13, 2011

In a summary judgment, the Supreme Court of Nova Scotia held that the respondent Machiel Jumelet ("**Jumelet**") who was an officer, director and employee of the plaintiff lobster exporting company breached duties of good faith and fiduciary duties as an officer and director by disclosing certain confidential information regarding the plaintiff to a competitor notwithstanding that the confidential information was stored on Jumelet's computer.

The Facts

The plaintiff company Cameron Seafoods (2005) Ltd. ("**Cameron Seafoods**") operated a business of purchasing lobsters and exporting them to purchasers in Europe from its premises in Meteghan, Nova Scotia.

In the 1990s, Jumelet visited Canada on a number of occasions while operating his own lobster purchasing business in Europe. Jumelet became familiar with Rodger Cameron ("**Cameron**") while buying lobsters from Cameron, one of a number of Canadian suppliers from whom Jumelet purchased lobsters during this period.

Jumelet had discussions with Cameron about working for Cameron Seafoods in a management role. However, before leaving Holland, Jumelet learned that Cameron had sold the export business to another company, the Barry Group.

Jumelet and his wife decided to proceed with their plan to emigrate to Canada, and he accepted employment with the Barry Group as an export manager.

In 2005, Cameron advised Jumelet that the Barry Group was ending its lobster export operation in Hall's Harbour, Nova Scotia, and had offered to sell it back to him. At that time, Hope Shanks ("**Shanks**"), Cameron and Jumelet were employees of the Barry Group.

Cameron incorporated Cameron Seafoods for the purpose of the repurchase of the assets, goodwill and receivables of the Barry Group's lobster export operation. Jumelet and Shanks were made minority shareholders, and Jumelet became a vice president and director of Cameron Seafoods. Notwithstanding his title, Jumelet claimed that he was not aware of his role and responsibilities as a director at the time and that the

position of a “director” has a different meaning in Nova Scotia than in Europe, where it does not necessarily apply to senior officers, but often to department heads.

Notwithstanding his claims of ignorance however, Jumelet acknowledged that he identified himself as the second-in-command to Cameron, and therefore was viewed as a key employee.

During 2006 and 2007, Cameron Seafoods entered into negotiations with BMC Seafoods Limited (“**BMC**”) with respect to engaging in a joint venture whereby Cameron Seafoods would be the marketing arm of an air freight lobster business and BMC would maintain lobster inventory and pack the lobsters for the purpose of direct delivery to foreign markets.

In 2008 Jumelet entered into his own computer program particulars of the sales of lobsters made by Cameron Seafoods during the year. Although his records did not encompass all the information maintained in the company database, it included the weight and value of lobsters sold. Other information obtained from, or adjusted from, Cameron Seafoods’ sales invoices was also included in the sales records maintained by Jumelet.

At the same time, Jumelet became increasingly dissatisfied with his position at Cameron Seafoods. Jumelet claimed that in 2008, BMC’s principal, Cedric Robichau (“**Robichau**”) contacted him and invited him to join BMC in the event that the joint venture did not come to fruition.

At about the same time, Jumelet provided BMC with confidential information and subsequently, in 2009 when Jumelet notified Cameron of his intention to leave Cameron Seafoods and join BMC, Jumelet’s employment was immediately terminated. Cameron Seafoods then brought an action against Jumelet claiming breach of fiduciary duty.

The Issue

The Court framed the issue as whether Cameron Seafoods was entitled to summary judgment on the evidence on the issue of whether Jumelet breached his fiduciary duty and duty of good faith as an officer and director.

The Decision

The Court found that Jumelet did owe a fiduciary duty by virtue of his position as an officer, director and key employee. Jumelet did not deny that figures he provided to BMC originated with the plaintiff, but argued that the information became his by virtue of being transferred to his own database. The Court rejected this argument.

The Court also espoused that the situation was not comparable to a disclosure of information by the plaintiff for its own purposes. Jumelet also acknowledged assisting BMC with the application for government assistance and in dealing with the Export Development Corporation.

In deciding in favour of Cameron Seafoods, the Court reviewed the law relating to fiduciaries and noted that a fiduciary relationship will be found where: (i) the fiduciary has scope for the exercise of some discretion or power; (ii) the fiduciary can unilaterally exercise that power or discretion affecting the beneficiary’s legal or practical interests; and (iii) the beneficiary is particularly vulnerable to the fiduciary.

The Court found that Jumelet owed a fiduciary duty to Cameron Seafoods and rejected Jumelet’s argument that he did not realize the meaning of the titles he held

at Cameron Seafoods. The Court emphasized that the substance of the relationship was determinative of a fiduciary relationship and not a particular title. It is commonly accepted that a director of a corporation or a senior officer has a duty to act in the best interests of the corporation including protecting confidential information from competitors and not competing with the corporation.

The Court found that in the fall of 2008 Robichau contacted Jumelet seeking sales projections for BMC's accountant. The Court noted that despite there being a suggestion that Jumelet was told the projections were to be used by BMC to obtain bank support for its contemplated venture into the lobster airfreight business, Robichau's intended use for the figures does not determine whether there was a breach. Rather, what is relevant is whether Jumelet breached his fiduciary duty by providing this information to BMC, knowing the basis for his projections was the information he had of the sales by Cameron Seafoods. The Court held that Jumelet knew that BMC was considering entering the lobster airfreight business, and had participated in discussions, whether initiated by himself or by Robichau, about leaving Cameron and joining BMC.

The Court also held that for Jumelet to give the sales figures to Robichau, knowing that these figures were taken from the plaintiff's invoices, was clearly a breach of his fiduciary duty. He was the vice-president, a member of the Board of Directors, and by his own description, the second-in-command of the company. Jumelet was lending assistance to a potential competitor and notwithstanding Jumelet's evidence that he did not feel he did anything wrong, his feelings did not change the fact that, while in a senior position and holding an executive office, he used information from Cameron Seafoods' records to assist BMC. The Court also rejected Jumelet's assertion that once the sales records were entered into his own database, they became his own records.

VenGrowth Funds (Special Committee of Directors), Re
34 O.S.C.B. 6755
Ontario Securities Commission
June 14, 2011

The GrowthWorks Proposal
In March 2011 GrowthWorks Canadian Fund Ltd. ("**GrowthWorks**") commenced a hostile merger proposal (the "**GrowthWorks Proposal**") to acquire The VenGrowth Investment Fund Inc., The VenGrowth II Investment Fund Inc., The VenGrowth III Investment Fund Inc., The VenGrowth Advanced Life Sciences Fund Inc. and The VenGrowth Traditional Industries Fund Inc. (collectively, the "**VenGrowth Funds**") by making a proposal directly to the shareholders of the VenGrowth Funds (the "**VenGrowth Shareholders**").

GrowthWorks solicited VenGrowth Shareholders to enter into support agreements (the "**Support Agreements**") which would, among other things, give GrowthWorks an irrevocable power of attorney: (i) to requisition meetings of the VenGrowth Shareholders; (ii) to vote the VenGrowth shares that become subject to the Support Agreements (the "**Subject Shares**") in favour of the GrowthWorks Proposal; (iii) to vote the Subject Shares to elect certain directors of the VenGrowth Funds and to make certain amendments to the articles of the VenGrowth Funds; and (iv) to vote against any transaction competing with the GrowthWorks Proposal. In connection with the solicitation of the Support Agreements, GrowthWorks sent an information circular dated March 14, 2011 (the "**GrowthWorks Circular**") to VenGrowth Shareholders, together with the form of the Support Agreement being solicited.

At the time of the Ontario Securities Commission ("**OSC**") hearing, GrowthWorks had received over 10,500 signed support agreements from VenGrowth Shareholders, totaling approximately 7.5% to 10.8% of the shares of the VenGrowth Funds. The special committee of independent directors of the VenGrowth Funds (the "**Special Committee**") brought an application pursuant to subsection 127(1) of the *Securities Act* (Ontario) (the "**Securities Act**") to challenge GrowthWorks' solicitation of the Support Agreements and its right to vote the Subject Shares. At the OSC hearing the OSC noted that the application raised a serious question as to whether GrowthWorks breached, and was continuing to breach, the proxy solicitation rules under Ontario securities law intended for the protection of shareholders and whether GrowthWorks had acted contrary to the public interest.

The Support Agreements

GrowthWorks made the GrowthWorks Proposal directly to the VenGrowth Shareholders by mailing the GrowthWorks Circular and soliciting the Support Agreements. The GrowthWorks Circular described the transaction as follows:

> *The Merger will be completed through an asset purchase transaction whereby GrowthWorks Canadian Fund buys the net assets of each of the VenGrowth Funds in exchange for one or more newly created series of Class A shares of GrowthWorks Canadian Fund ... that would then be distributed to Class A shareholders of the VenGrowth Funds. This is the structure commonly used by mutual funds in Canada to complete mergers. The Merger is expected to be completed pursuant to terms and conditions set out in a merger agreement.... and/or court-approved plan of arrangement....*

The Support Agreements were generally irrevocable by VenGrowth Shareholders. The Support Agreements provided for their suspension to enable VenGrowth Shareholders to accept a "superior proposal"; however, the determination of whether a transaction was a "superior proposal" was to be made by three individuals designated by GrowthWorks (who GrowthWorks maintained were independent of GrowthWorks and VenGrowth), not by the VenGrowth Shareholders party to the Support Agreements.

The Positions of the Parties

The Special Committee submitted that:

- The Support Agreement deprived the VenGrowth Shareholders of rights that they would have in a take-over bid or proxy contest to decide whether to accept the GrowthWorks Proposal or any competing transaction.
- The GrowthWorks Circular and other documents distributed by GrowthWorks contained incomplete and materially misleading disclosure.
- The Support Agreements constitute "proxies" within the meaning of Ontario securities law and that such proxies do not comply with applicable securities and corporate law.
- Under applicable corporate law, a proxy must authorize a holder to vote only at a specified shareholders' meeting and must be revocable by the shareholder and that the Support Agreements did not comply with these requirements.
- GrowthWorks' actions contravened the proxy solicitation requirements of the Securities Act and of the *Canada Business Corporations Act* (the "**CBCA**") and were inconsistent with the animating principles underlying the Security Act's

requirements for take-over bids and proxy contests and is contrary to the public interest.

- For the aforementioned reasons, GrowthWorks' solicitation of the Support Agreements was both illegal and contrary to the public interest.

GrowthWorks refuted these claims and submitted that "by signing the Support Agreements in its favour, an "overwhelming" number of VenGrowth Shareholders have sent "a clear message" that they have lost confidence in the VenGrowth board and are not prepared to entrust the fate of their VenGrowth investments to the exclusive control of that board."

Prior to the OSC hearing, GrowthWorks also announced its intention to alter the Support Agreements in order to make the power of attorney revocable which would have been more akin to a standard proxy solicitation.

At the OSC hearing, Staff of the Ontario Securities Commission (the "**OSC Staff**") contended that the solicitation of Support Agreements constituted an illegal proxy solicitation under the Securities Act. OSC Staff further alleged that the GrowthWorks Circular did not, at that stage of the process, contain sufficient information to permit the VenGrowth Shareholders to make an informed decision with respect to the GrowthWorks Proposal. OSC Staff also submitted that the Support Agreements should be revocable by VenGrowth Shareholders and that GrowthWorks should not be permitted to vote the Subject Shares on any vote related to the GrowthWorks Proposal or any competing transaction. Moreover, OSC Staff submitted that if GrowthWorks wished to vote VenGrowth shares on the approval of the GrowthWorks Proposal, it should carry out a subsequent proxy solicitation, pursuant to a new circular with improved disclosure, in accordance with applicable law.

The Analysis and Findings of the Ontario Securities Commission

The OSC had to determine whether the Support Agreements constituted a solicitation of a "proxy" from the holders of VenGrowth Shares within the meaning of subsection 86(1) of the Securities Act. After examining the relatively fine distinctions between the nature and legal effect of a "proxy", the nature and legal effect of a power of attorney to vote shares and grant proxies, and the right of shareholders to agree with other shareholders or a third party as to how they will vote their shares, the OSC determined that the Support Agreements did not constitute proxies.

The OSC commented that the Support Agreements purported to authorize GrowthWorks, among other things, to execute proxies as attorney for VenGrowth Shareholders to vote at shareholders' meetings; however, the Support Agreements were not themselves proxies. The OSC indicated that the Support Agreements did not comply with the form requirements for a proxy and were not documents intended to be lodged at a meeting of shareholders as a proxy. Instead, the OSC viewed the Support Agreements as agreements between the parties constituting GrowthWorks as attorney for the VenGrowth Shareholders for certain purposes. Therefore, the OSC found the Support Agreements were not illegal or contrary to Ontario securities law.

The OSC further determined that the solicitation of support agreements is essentially a solicitation of the right to vote the Subject Shares at a VenGrowth Shareholders' meeting in support of the GrowthWorks Proposal or a competing transaction; however, the solicitation was very different from the usual process pursuant to which lock-up agreements are entered into.

The OSC noted that if a shareholder enters into a Support Agreement, that shareholder would be precluded from voting the Subject Shares at a VenGrowth meeting, whether in support of the GrowthWorks Proposal or a competing transaction. As the Support Agreements were irrevocable, they prevented shareholders from changing their mind on how to vote, and deprived the shareholder of the opportunity to support any competing bid.

The OSC commented that the take-over bid rules in the Securities Act permit a security holder to withdraw securities deposited under a bid at any time before the securities have been taken up by the bidder. As a result, security holders have a broad right to change their decision whether to deposit their securities pursuant to a take-over bid. The OSC also highlighted that the right of withdrawal is crucial where a competing take-over bid is made.

The OSC then went on to comment that the comparable right in the context of a merger or acquisition transaction requiring shareholder approval is the right of shareholders to change their vote by revoking any proxy they may have granted. The OSC similarly highlighted that this right is crucial to shareholders in circumstances in which there may be competing proposals or transactions.

The OSC Order

Viewing the right of shareholders to revoke a proxy or other voting authority, such as the Support Agreements as being fundamental to protecting the interests of shareholders, the OSC espoused that the principles underlying the take-over bid and proxy solicitation provisions of the Securities Act require that a shareholder be able to make an informed decision as to how to vote, and that a shareholder be able to change that decision, if the shareholder wishes to do so. Noting that the Support Agreements by their terms prevented a VenGrowth Shareholder from choosing between competing proposals or transactions, the OSC found that the solicitation of the Support Agreements and the terms of the Support Agreements undermined one of the animating principles of the Securities Act. Accordingly, the OSC concluded that the solicitation of the Support Agreements and the voting of the Subject Shares under the Support Agreements was contrary to the public interest and the OSC therefore engaged their public interest jurisdiction under section 127 of the *Act* to order that any issuance of securities by any GrowthWorks entity in connection with the GrowthWorks Proposal be cease traded (including all acts, advertisements, solicitations, conduct or negotiations directly or indirectly in furtherance of any such trade) unless and until:

(i) such time as GrowthWorks ceases to have any right, power or authority to vote, on any matter, the shares of the VenGrowth Funds that are or may become subject to the Support Agreements, and

(ii) GrowthWorks publicly announces that it has ceased to have any such voting rights.

However, the OSC's Order was subject to the provision that the Order not affect:

(i) the ability of GrowthWorks to requisition a shareholders' meeting or meetings of the VenGrowth Funds pursuant to the authority granted under the Support Agreements; or

(ii) the ability of GrowthWorks to solicit, in accordance with applicable law, proxies for use at any shareholders' meeting or meetings of the VenGrowth Funds.

R. v. Niko Resources Ltd.
2011 CarswellAlta 2521
Alberta Court of Queen's Bench
Judgment: June 23, 2011

In the first high profile Canadian case dealing with bribery, Niko Resources pleaded guilty to offences under the *Corruption of Foreign Public Officials Act* and was forced to pay a $9.5 million fine.

The Background

Canada's *Corruption of Foreign Public Officials Act* (the "**Act**") has been in force for approximately a decade; however, prior to the Niko Resources Ltd. ("**Niko Resources**") case, there had been only one prosecution which resulted from a Royal Canadian Mounted Police (RCMP) investigation. As a result of international criticism relating to the lack of enforcement, Canada established the RCMP International Anti-Corruption Unit which has officers based in Ottawa and Calgary.

Niko Resources is a publicly traded corporation with its head office in Calgary, Alberta. Niko Resources conducted international business operations in countries outside of Canada through its wholly owned subsidiaries.

Niko Resources owned 100% of a holding company, which in turn owned 100% of Niko Bangladesh. Niko Bangladesh was funded solely by Niko Resources. The flow of money from Canada to support Niko Bangladesh was monitored from Canada and the Chief Executive Officer of Niko Resources sat on the Board of Directors of Niko Bangladesh.

In 2003, Niko Bangladesh entered into a joint venture agreement with the Bangladesh Petroleum Exploration & Production Company Limited ("**BAPEX**") to conduct petroleum operations in gas fields in Bangladesh. In early 2005, a blow-out occurred at a Niko Bangladesh gas well which left a massive crater in the earth, resulting in significant damage to a surrounding village.

Niko Bangladesh had to deal with significant pressures as a result of the blow-out. In addition, the Niko Group received negative press coverage and the Bangladeshi government launched an inquiry. A government committee provided a report to the Bangladesh Minister for Energy and Mineral Resources. It alleged that Niko Resources was responsible for the explosion and triggered a legal proceeding. This proved to be especially problematic as Niko Bangladesh had not yet concluded a gas purchase and sales agreement with its joint venture partner BAPEX.

Subsequently, Niko Bangladesh paid for and delivered a Toyota Land Cruiser to the Minister of Energy and Ministerial Resources. Niko Canada was aware of the purchase and had funded Niko Bangladesh's acquisition costs. A Niko Bangladesh Vice-President wrote a letter to the Managing Director of BAPEX indicating that the vehicle had been turned over to the Minister and he was being thanked for the support that Niko management had received in the past and hoped to continue to receive in the future.

An investigation was commenced after a Bangladesh newspaper published an article entitled "Niko gifts minister luxurious car" which in turn triggered action on the part of the Canadian Diplomatic Corps and the RCMP.

The Case

Niko Bangladesh was charged in respect of offences under the Act and the prosecution alleged that Niko Resources directly and indirectly, provided improper benefits to a foreign public official in Bangladesh in order to further its business objectives and that of its subsidiaries.

Section 3 of Canada's *Corruption of Foreign Public Officials Act* describes what constitutes the offence of bribery of a foreign public official as follows:

> *Every person commits an offence who, in order to obtain or retain an advantage in the course of business, directly or indirectly gives, offers or agrees to give or offer a loan, reward, advantage or benefit of any kind to a foreign public official or to any person for the benefit of a foreign public official:*
>
> *(a) as consideration for an act or omission by the official in connection with the performance of the official's duties or functions; or*
>
> *(b) to induce the official to use his or her position to influence any acts or decisions of the foreign state or public international organization for which the official performs duties or functions.*

Niko pled guilty to the charges and was convicted. The Court imposed a fine of $9.5 million and a significant probation order in order to reflect the degree of planning, duration and complexity of the offence. The fine also reflected the fact that Niko Resources made these payments in order to persuade the Bangladeshi Minister to exercise his influence to secure a gas purchase and sales agreement acceptable to Niko Resources and to ensure that it was fairly dealt with in regards to compensation claims.

Although in certain parts of the world, the practice of making payments to induce public officials to use their positions to the benefit of companies might be described as normal and the "cost of doing business", the Niko Resources decision highlights the serious prosecution approach that will be brought to bear from the Canadian perspective. In order to protect themselves from the risk of prosecution, companies doing business abroad ought to implement anti-corruption programs which might include among other things: (i) a review of internal audit and accounting systems to ensure they meet OECD Convention standards for recordkeeping, disclosure, accounting and auditing; (ii) a robust code of conduct, educating employees about what constitutes a bribe; (iii) adoption of a code of conduct regarding improper payments; (iv) monitoring and auditing activities that are subject to the code of conduct; (v) implementing a policy requiring that employees report suspicious payments; (vi) determining where sales agents' businesses are located, who their partners are, their agents' histories, track record and reputations; (vii) reviewing agents' background references and connections; (viii) reviewing ordinary commissions, fees or payments to unrelated offshore accounts; (ix) examining distribution agreements; and (x) considering the use of organizations that provide appropriate due diligence services.

Marcotte, Re
2011 ABASC 287
Alberta Securities Commission
May 18, 2011

The Alberta Securities Commission (the "**Commission**") previously found Patricia Frances Marcotte ("**Marcotte**") to have contravened Alberta securities laws and to

have been acting contrary to the public interest in the February 9, 2011 decision of the Commission (the "**Merits Decision**") as Marcotte was not registered to sell securities and made materially misleading statements in order to entice investors. At the second phase of the hearing which dealt with sanctions to Marcotte, the Commission considered the relevant factors including, the seriousness of the findings against Marcotte, the risk to investors and the capital market if Marcotte were to continue to operate unimpeded in the capital market and the mitigating factors.

The Facts

Marcotte met and was engaged by Vimal Iyer ("**Iyer**") who would become the sole owner and principal of Trident Properties Ltd. ("**Trident**"). Iyer held himself out to Marcotte as a land developer. Iyer's plan was to develop parcels of farmland known as the "Sienna Sands Land" and the "Prairie Rose Land" into residential housing. Money to fund the development was sought from investors through the sale, by Trident, of undivided interests or "units" in the respective parcels of land. Investors would not be acquiring identifiable plots, but rather they would be purchasing fractional interests in the entirety of the relevant parcel.

Marcotte was engaged to sell units in the Sienna Sands Land and the Prairie Rose Land to potential investors. She reported to Iyer and to one of his relatives. Marcotte made sales to friends and members of her family, among others, and some of her friends and relatives also became involved in selling for Trident. Ultimately, Marcotte brought in investments totalling $3,469,000.

Marcotte informed investors that the Sienna Sands Land and the Prairie Rose Land would be developed into residential lots and that the investors could make a large profit (up to double the amount they invested) in a few months, and a buyer was lined up to buy one or both of the Sienna Sands and Prairie Rose Lands. Marcotte was in turn told these things by Iyer whom, at that point, she had no reason not to believe. Unfortunately, these representations turned out to be false.

The Merits Decision

The Commission held that the undivided interests in land were investment contracts, and therefore were securities for the purposes of Alberta securities laws which for the reasons described below, would require Marcotte to have been properly registered to sell securities.

Trident's actions of selling the securities though Marcotte (among others) constituted "trades" and "distributions" under Alberta securities laws which in turn triggered the registration and prospectus requirements under Alberta securities laws. The Commission noted that the lack of compliance deprived investors of the corresponding protections to which they were entitled. Moreover, the Commission found that the advice provided to investors that: (i) the lands were to be developed into residential lots; (ii) there was an interested buyer for the lands; and (iii) a large profit could be made in a few months constituted materially misleading or untrue statements made in order to entice investors.

Sanctions and Costs

The Commission reiterated the premise that sanctions are intended to protect investors and capital markets from future harm. To determine the appropriate sanctions in any particular case, both specific deterrence (with regard to the particular individual

involved) and general deterrence (directed at the capital markets as a whole) must be considered. The Commission summarized the following relevant factors previously enumerated by the Commission in other hearings:

- the seriousness of the findings against the respondent and the respondent's recognition of that seriousness;
- characteristics of the respondent, including capital market experience and activity and any prior sanctions;
- any benefits received by the respondent and any harm to which investors or the capital market generally were exposed by the misconduct found;
- the risk to investors and the capital market if the respondent were to continue to operate unimpeded in the capital market or if others were to emulate the respondent's conduct;
- decisions or outcomes in other matters; and
- any mitigating considerations.

Seriousness and recognition of seriousness

The Commission held that Marcotte's actions were quite serious as investors were deprived of key protections under securities laws and the situation was aggravated by Marcotte's misrepresentations. Although the Commission recognized that Marcotte was initially a dupe of Iyer, she nonetheless carried on with her actions after she should have had misgivings about the situation.

The Commission recognized that Marcotte expressed contrition, but found that she thought herself to be the principal victim in the whole affair and did not genuinely recognize that what she did was seriously wrong. The Commission held that the seriousness of her misconduct and her wilful blindness to the situation militated toward a significant sanction.

Marcotte's characteristics and capital market history

The Commission noted that Marcotte had no capital markets background or experience, but pointed out that she should have been aware of the securities law implications of her actions when she met with a securities lawyer in 2007. The Commission found that Marcotte made misleading or untruthful statements to investors after she ought to have known the truth. Additionally, the Commission found her to be enthusiastic and have a strong sense of self-worth which the Commission felt were traits that contributed to her carelessness and wilful blindness in selling securities of Trident. This led the Commission to believe that she posed a continuing risk, warranting protective and deterrent sanctions.

Benefits received and harm done

The Commission noted that the investors suffered significant harm as most lost all of the money they had invested, including some who had borrowed to finance their investments at Marcotte's suggestion. Factoring these particulars into its decision, the Commission held that the capital markets were harmed in addition to the individual investors. The Commission also found that Marcotte benefitted from her improper selling in the form of commissions totalling over $254,000 which warranted significant sanctions.

Mitigating Factors

Marcotte submitted a number of factors she felt should be considered to reduce the sanctions against her. The Commission was not entirely sympathetic and found

grounds to reduce sanctions only moderately. The Commission cited the following factors leading to moderation:

- Marcotte having acted in good conscience and having not believed she was lying at the time she made the misrepresentations; and
- Marcotte enabled a few investors to avoid or reduce their losses and played a part in shutting down Iyer and Trident's operation by alerting investors and the Canadian authorities to the scheme.

The Commission rejected several claims Marcotte argued should mitigate sanctions including:

- the fact that Marcotte herself suffered from the scheme;
- hardships suffered by her on a trip to Dubai where she confronted Iyer; and
- the fact that she was financially ruined by her encounter with Trident and Iyer.

Notwithstanding Marcotte's additional submission that she had lost her job and all of her assets including her house, the Commission held that given the overall circumstances, poverty would not be considered a mitigating factor.

The Sanctions
In light of the foregoing, the Commission issued an order: (i) prohibiting Marcotte from trading in securities and from using exemptions otherwise available under Alberta securities laws for 20 years; and (ii) requiring her to pay a penalty of $75,000 and costs of $17,000.

Trautwien v. Telsco Security Systems Inc.
2011 ABCA 282
Court of Appeal of Alberta
October 6, 2011

On October 6, 2011, the Alberta Court of Appeal released a decision confirming that if a shareholder has not waived the requirement to receive audited financial statements of the corporation, the shareholder has a *prima facie* right to the production of audited financial statements and there is no onus on the shareholder to prove that the financial statements are relevant and material to any kind of litigation claim.

The Facts
Ms. Trautwien was employed by Telsco Security Systems Inc. ("**Telsco**") for over twenty years commencing her work with the corporation in 1987. In 1995 Ms. Trautwein became a minority shareholder when she was issued 10 shares as part of her employment arrangement.

On August 1, 2007, Ms. Trautwien was given working notice that her employment would end on November 1, 2008.

During a number of years when Ms. Trautwien was a minority shareholder, she had signed shareholders' resolutions waiving the need for the corporation to produce audited financial statements; however, Ms. Trautwien did not sign any such shareholders' resolutions after 2004.

Ms. Trautwien and Telsco had agreed that Telsco would buy Ms. Trautwien's shares from her, but they were unable to agree on: (i) the fair market value of her shares; and (ii) the appropriate valuation date. As part of the dispute over the fair market value,

Ms. Trautwien applied to a Master for an order that Telsco produce audited financial statements for the corporation's 2003 to 2009 fiscal years. The Master directed that Telsco produce audited financial statements for 2006, 2007 and 2008, as the Master had concluded that "that is the relevant and material time in question."

Ms. Trautwien then appealed the Master's decision to a judge in chambers and sought the preparation of audited financial statements for 2009 and 2010. The judge varied the Master's order, deleting the requirement to produce the 2006 statements, but ordering production of the one from 2009 as those statements would cover the possible valuation days for the shares.

Ms. Trautwien then appealed to the Court of Appeal, seeking an order to produce the audited 2010 financial statements in addition to those already ordered.

The Court of Appeal Decision

The Court of Appeal referred to the submissions in the Court of Appeal application that there are three ways in which a minority shareholder might potentially establish an entitlement to audited financial statements, namely: (i) the minority shareholder may have a substantive right to audited financial statements pursuant to the *Business Corporations Act* (Alberta) (the "**Business Corporations Act**"); (ii) the minority shareholder might be entitled to the production of audited financial statements as a remedy for oppression under the *Business Corporations Act*; and (iii) the minority shareholder as a litigant might be entitled to production of audited financial statements under the Rules of Court if they are relevant and material to the litigation.

In analysing the submissions, the Court of Appeal noted that the substantive right arising from the *Business Corporation Act* requires that financial statements and the report of the auditor be placed before every annual meeting of the shareholders; however, the *Business Corporation Act* also provides that a corporation may resolve not to appoint an auditor, but only by a unanimous vote of all of its shareholders entitled to vote. The Court of Appeal then highlighted the fact that Ms. Trautwien had not agreed to waive the audit requirement in respect of any of the years that were in dispute.

Accordingly, the Court of Appeal held that Ms. Trautwien had a *prima facie* right to the production of audited financial statements and she did not have to prove that they were "relevant and material" to the litigation. In short, so long as Ms. Trautwien was a shareholder and she had not waived the requirement for the production of audited financial statements, she had a statutory right to them.

In respect of the question as to whether Ms. Trautwien was a shareholder and Telsco's argument that she was a shareholder in name only, the Court of Appeal found that there was no transfer of her shares, there was no agreement for the purchase and sale of those shares which would deem them to have been transferred notwithstanding non-payment of a purchase price and there was also a lack of agreement as to the valuation date and price in the first place; therefore, the Court held that Ms. Trautwien was indeed a shareholder who had not waived her statutory right to receive audited financial statements.

Given that analysis, the Court of Appeal did not find it necessary evaluate the other arguments presented in the application and did not discuss whether Ms. Trautwien had any remedial right pursuant to an oppression claim or procedural right under the Rules of Court to receive audited financial statements.

Ultimately, the Court of Appeal confirmed the order to produce the 2007-2009 financial statements, and in addition, it ordered Telsco to produce and deliver the 2010 audited financial statements to Ms. Trautwien.

Zhang v. Chik and ZC Enterprises Ltd.
2011 MBQB 262
Court of Queen's Bench of Manitoba
November 1, 2011

The Manitoba Court of Queen's Bench heard an application from a minority shareholder who sought an order of the Court for the sale to her of the majority shareholder's shares. The Court ordered the Respondent to sell his majority stake in the corporation to the minority shareholder because the Respondent's actions and an irreconcilable difference that had arisen between the parties was likely to adversely affect the operation of the corporation's restaurant business and was inconsistent with the reasonable expectations of the parties upon entering into the venture.

The Facts
The respondent Stanley Chik ("**Chik**") was the majority shareholder of six corporations, each of which operated a different sushi restaurant in the City of Winnipeg.

The Applicant, Li-Mei Zhang ("**Zhang**") was an employee at the Sushi Train, one of the restaurants which Chik owned. In 2004, Zhang and her husband Wei Feng ("**Feng**") proposed to Chik that they open a new sushi restaurant together and Chik agreed. The parties incorporated ZC Enterprises Ltd. (the "**Corporation**") to run the business with Chik and Zhang being the sole directors. The parties signed a ten-year lease, gave personal covenants and put up the required funds. Upon incorporation, Chik owned 55% of the common shares of the Corporation and Zhang owned the remaining 45%.

From the beginning, Chik had made it clear to Zhang and Feng that he would not be involved in the operation of the business due to time constraints. The intention of the parties was that Zhang and Feng would manage and operate the restaurant on their own although one or more members of Chik's family provided some preliminary book keeping and serving assistance.

By 2010, the restaurant was considered one of the most profitable sushi restaurants in Winnipeg and both Chik and Zhang received significant dividends. Around this time the parties began negotiations for the sale of Chik's shares to Zhang and Feng. Chik offered to sell some, but not all of his shares at one point, and all of his shares at prices ranging from $230,000.00 to $280,000.00 at others. Winding up the business was not a realistic option because the parties' lease had a full five year term remaining. In June 2010, Chik offered to sell all of his shares for $230,000.00 with a condition that the business be kept running without significant change until closing. The parties were unable to finalize the sale as Chik was out of the country at the time. Although Chik raised his price around this time, Zhang and Feng believed they had a deal in place and terminated the employment of Chik's daughter.

On August 27, 2010, Zhang was served with notice of a shareholder's meeting to be held on September 3, 2010 at 2:30 p.m. (the "**Meeting**"). The Meeting took place during the restaurant's busiest time of the week and Zhang was unable to attend. Zhang was not requested to provide, nor did she provide, a waiver of notice of the Meeting.

At the Meeting, Chik declared a quorum and passed a resolution removing Zhang as a director of the Corporation and replaced her with Chik's wife. Zhang was also removed from her position as Secretary of the Corporation by a resolution of the directors on September 9, 2010.

By the end of 2010, Zhang and Feng had been removed as managers of the restaurant and had left their non-managerial positions. Zhang's daughter Sammi had her employment at the restaurant reduced from full-time to part-time and was physically escorted off the premises after a confrontation with Chik's son.

Zhang continued to receive the financial records of the Corporation and her share of the dividends of the business; however, the restaurant was not as profitable after the take-over.

The Application

Zhang sought an order for the sale to her of Chik's shares in the Corporation on the basis that: (i) the Meeting was invalid (as the notice of the meeting was in adequate); (ii) that all action taken after the Meeting was invalid; (iii) that the common understanding of the shareholders in the Corporation was that the business would be managed and operated by Zhang and Feng; (iv) that Zhang and Feng had made the business very profitable; (v) that Chik was willing to sell his shares to them in May or June 2010 and that, as opposed to negotiating a share purchase agreement, Chik "engineered a take-over of the operation of the business, thereby defeating the reasonable expectations" of Zhang and Feng.

Zhang's counsel argued that the original shareholder's meeting removing Zhang was invalid for inadequate notice as *The Corporations Act* (Manitoba) ("**The Corporations Act**") requires 21 days' notice of the meeting and Zhang was only given 5 days' notice. Furthermore, Zhang's counsel submitted that: (i) if the Meeting was invalid, all actions taken at it and by the directors afterwards were also invalid; (ii) the reasonable expectation of the shareholders was that Zhang and Feng would manage and operate the business and that the take-over engineered by Chik was contrary to these expectations; (iii) Zhang and Feng had sacrificed and worked hard to turn the restaurant into a profitable business; (iv) Zhang and Feng had been led to believe that Chik was willing to sell his shares to them; and (v) the hostile take-over therefore made it just and equitable for the Court to make an order under the *Corporations Act* for the sale by Chik of his shares in the Corporation for the sum of $230,000 or in the alternative, that the shares be sold to Zhang for a price to be determined following a valuation by an independent valuator.

The Decision

The Court rejected the validity of the notice of the shareholder's meeting. The statutory 21 day notice period applied and since Chik did not obtain a waiver of notice, the removal of Zhang at the Meeting was declared invalid. The Court also rejected Chik's submission that the Meeting was an organizational meeting, and that 5 days' notice was therefore valid. The Court pointed to the form of notice, and to the substance of the resolutions passed as evidence that the Meeting was not an organizational meeting.

Furthermore, the Court held that the Meeting was "intentionally" scheduled at a time when Zhang could not have been expected to attend. The Court noted that the "bad faith" demonstrated by Chik could have supported a finding of oppressive conduct

under Section 234 of *The Corporations Act*. The Court therefore declared the resolutions passed at the Meeting invalid and ordered the reinstatement of Zhang as director and secretary of the Corporation and manager of the business.

The Court also held that it was just and equitable to order Chik to sell his majority stake in the Corporation to Zhang. The test applied by the Court was whether an irreconcilable difference between the parties had arisen that was likely to adversely affect the operation of the business and was inconsistent with the reasonable expectations of the parties.

The Court noted that Zhang had a reasonable expectation at the commencement of the business relationship that she would continue to manage and operate the business of the Corporation. At the beginning of the relationship, both parties would have considered the conduct of Chik to have been a repudiation of the venture. Although Chik had testified that the parties could continue to work together, the Court held that

> *"The evidence clearly establishes that the reasonable expectation of the parties, from inception, was that Chik would not be involved in the operation of the business and that Zhang and Feng would manage and operate the business. That Chik has changed his mind and wants to manage the business with his wife is contrary to the reasonable expectations of the parties. In essence, Chik wants to renegotiate the compact made by the parties, except that he seized control of the corporation without any attempt at negotiation."*

Therefore, the Court held that the differences between the parties had become irreconcilable, and it was therefore just and equitable to order the sale of Chik's shares to Zhang at a price to be determined by an independent chartered valuator.

Accordingly, Zhang was ordered to pay $250,000.00 into her lawyer's trust account within 30 days of the Court's decision, as security for the purchase of Chik's shares.

Gidzinski v. Lake Simcoe Aeropark Inc. et al
2011 ONSC 4280
Ontario Superior Court of Justice
July 11, 2011

On July 11, 2011 the Ontario Superior Court of Justice rejected a shareholder's application for an Order to wind-up Lake Simcoe Aeropark Inc. The Court reviewed the case law in Ontario for the test to be employed by a Court in considering such an application for a winding up order pursuant to the *Business Corporations Act* (Ontario) (the "**OBCA**"). The Court also provided reasons for authorizing the respondents to secure additional financing secured by a mortgage on the corporation's properties without the consent or signature of the applicant.

The Facts

Lake Simcoe Aeropark Inc. (the "**Corporation**") was created by the applicant Gidzinski, and the respondents Mascioli and Betowski, in order to develop two properties close to Lake Simcoe Regional Airport. The three parties became the shareholders of the Corporation and executed minutes of understanding on October 3, 2007 as well as a unanimous shareholder agreement on October 10, 2007.

A business plan for the Corporation was adopted by all three shareholders on September 18, 2008. The business plan provided for the development of a 77 lot

business park which required the Corporation to obtain a draft plan of approval. The Corporation received final approval for the draft plan of the first phase of development in December 2010. Final approval required the Corporation to meet certain conditions within 3 years including road and utility works, surfacing and surveying. Unfortunately, the work required to be done to satisfy the conditions was significantly delayed for various reasons including the breakdown of relations between the shareholders.

The shareholders' working relationship continued to deteriorate throughout 2010 with the respondents Mascioli and Betowski divided against the applicant Gidzinski. At some point the respondents refinanced the Corporation's property without the consent of the applicant. The applicant also complained of "numerous financial irregularities" committed by the respondents without his consent.

The Application and the Motion for Interim Relief

Due to the inability of the shareholders to work together, the actions taken by the respondents without the applicants consent, and the growing likelihood that the Corporation would not be able to satisfy the conditions of the final approval of the draft plan for the first phase of the development in time, Gidzinski brought an application for an order winding up the Corporation.

In response, Mascioli and Betowski brought a motion for an order permitting the Corporation to obtain additional financing secured by a mortgage on the Corporation's properties without the consent or signature of Gidzinski. The respondents requested that any such additional financing be ordered available for use by the Corporation towards the continued development of the property pending the hearing of the application.

The Decision on the Application

The Court refused to order the winding up of the Corporation. Pursuant to s. 207(1)(b)(iv) of the OBCA, "a corporation may be wound-up by order of the court…where the court is satisfied that…it is just and equitable for some reason other than the bankruptcy or insolvency of the corporation, that it should be wound-up".

The Court noted that the test for winding up a corporation in Ontario contains the following four conditions which must be demonstrated by the applicant:

(1) There are rights, expectations and obligations *inter se* that are not "submerged" in the corporate structure;

(2) Such rights, expectations and obligations were not met;

(3) The resulting circumstance results in unfairness or prejudice to one or more shareholders; and

(4) Such prejudice can only be rectified by a winding up.

In reviewing the circumstances and deciding upon the application to order a wind-up of the Corporation, the Court noted that there was a unanimous shareholder agreement between the parties which contained a compulsory buy-out provision that a single shareholder could trigger. Accordingly, the Court held that there was a clear and available mechanism to resolve the dispute between Gidzinski and the respondents and that a court order to wind-up the Corporation was not necessary to effect a divorce of the corporate relationship amongst the parties. The Court therefore rejected Gidzinski's application and instead directed Gidzinski to invoke the unanimous shareholder agreement's buy-out provision.

The Decision on the Motion for Interim Relief

The Court also granted the respondents' motion for interim relief authorizing the respondents to secure additional financing up to $650,000, secured by a mortgage on the Corporation's properties without the consent or signature of Gidzinski.

The Court accepted the "inescapable conclusion" that only by obtaining additional financing could the Corporation continue to function and carry out the business purpose for which it had been created.

The Corporation's ability to satisfy the conditions of the final approval of the draft plan for the first phase of development was already in jeopardy due to past delays; therefore, the Court ordered that the respondents were permitted to use any additional financing to continue the development of the property and to satisfy the debts and ordinary expenses of the Corporation.

In order to protect Gidzinski's interest in the Corporation the Court also ordered that none of the additional funds could be paid out by the Corporation to the respondents or their companies. Furthermore, all such funds paid out were to be accounted for by the respondents to Gidzinski upon payment.

II. NON-CANADIAN CASES

Air Products and Chemicals, Inc. v. Airgas, Inc.
C.A. No. 5249-CC
Delaware Chancery Court
February 15, 2011

The Delaware Court of Chancery upheld Airgas, Inc.'s board of directors' continued use of a shareholder rights plan (commonly known as a poison pill) to prevent a hostile takeover by Air Products and Chemicals, Inc. In its decision, the Court held that the board of the target company had perceived a legally cognizable danger and that the board's action of maintaining the poison pill was reasonable in relation to the threat posed by what the board believed was an inadequate offer, notwithstanding the fact that the board had adequate time to explore other alternatives and stockholders had been given all relevant information necessary to make an informed investment decision.

The Facts

Airgas, Inc. ("**Airgas**") is the largest U.S. distributor of industrial, medical and specialty gasses and hardgoods, such as welding equipment and supplies. In October 2009, Air Products and Chemicals, Inc. ("**Air Products**") approached Airgas proposing an all stock acquisition transaction.

Following the rejection by Airgas' board of directors of several proposals from Air Products, Air Products launched a $60 per share fully financed, all-cash, all-shares tender offer.

Airgas's board recommended against the offer based on a five-year strategic plan prepared by the company's management in November 2009 and inadequacy opinions from its two financial advisors that stated that Air Products' bid undervalued the company.

Air Products subsequently initiated a proxy contest to elect its slate of three directors to replace the three members of Airgas's nine-director staggered board whose

terms expired at the 2010 annual meeting which was held on September 15, 2010. Air Products also initiated a stockholder proposal to amend Airgas' bylaws to require that all future annual meetings be held in January which had the effect of accelerating the timeframe within which Air Products could obtain control of Airgas' board.

Air Products ultimately made its "best and final" offer of $70 cash per share which Airgas continued to reject. Importantly, following their election to the Airgas board, the three Air Products nominee directors engaged their own independent counsel and retained a third independent financial advisor to review the Air Products offer and Airgas' long term prospects. Ultimately, the Air Products' nominee directors also became convinced that the Air Products' offer price was inadequate and that Airgas' fair market value was at least $78 per share.

The Decision

In analyzing the board's conduct of maintaining Airgas' poison pill, the Court applied the *Unocal* standard of enhanced judicial scrutiny to determine whether Airgas' board had reasonable grounds for believing a danger to corporate policy and effectiveness existed and whether the response to that threat was reasonable in relation to the threat posed.

The Court concluded that the Airgas board had acted in good faith and that it had conducted a reasonable investigation. In particular, the Court noted that Airgas' board was clearly independent and ultimately relied on three independent well respected financial advisors. With respect to the "threat" portion of the test, the Court found that the only "threat" considered by the Airgas board was the perceived inadequate price of the Air Products' offer, together with the concern that a majority of Airgas' shares were held by risk arbitrageurs who might be expected to tender into an inadequate offer in order to realize short-term gains notwithstanding the fact that the offer might not reflect the full fair market value of the shares. Although the significance of the threat may have been questionable, the Court held that price inadequacy had been recognized by Delaware law as a legally recognized threat.

The Court also concluded that the defensive measures adopted by Airgas constituted a proportionate response to the threat as: (i) Airgas' board was not "cramming down" a management-sponsored alternative transaction to Air Products' offer; (ii) Airgas' board had a reasonable basis for sustaining its long term corporate strategy; and (iii) Airgas had not taken any actions that would preclude Air Products from defeating Airgas' defensive measures later if the offer price were to be considered adequate.

Given the foregoing, the Court effectively recognized that Airgas' board could not simply be forced into running an auction process to maximize stockholder value (commonly known as *Revlon* mode) in the face of a tender offer made at a premium to the then current market price of the stock. Interestingly, the Court also emphasized that its decision did not amount to an endorsement that a board can take a "just say never" approach. Rather, the Court's decision reinforced Delaware laws' deference for reasonably exercised managerial discretion so long as the board is found to be acting in good faith and in accordance with their fiduciary duties.

It should also be noted that although this case ostensibly reaffirms a board's ability to maintain a poison pill against a non-coercive inadequate takeover bid, the following case-specific facts may have also played a significant part in the Court's ruling: (i) with the exception of one individual, Airgas' board was comprised of only "independent

directors"; (ii) Airgas' board clearly conducted a thorough investigation and analysis of the Air Products' offer, including obtaining the benefit of three opinions from independent financial advisors; and (iii) Air Products' own nominee directors ultimately agreed with the rest of Airgas' board that the Air Products' offer price was inadequate.

Southern Peru Copper Corp. Shareholder Litigation (Re)
C.A. No. 961-CS
Delaware Chancery Court
October 14, 2011

Finding that Southern Peru Copper Corp. ("**Southern Peru**") overpaid by over a billion dollars when it acquired the controlling stockholder's subsidiary, the Delaware Court of Chancery awarded the plaintiffs $1.263 billion in damages to remedy the breach of the controlling stockholders' fiduciary duties. In finding that the transaction failed the entire fairness standard of review the damages granted in this case represent one of the largest judgments ever awarded by the Court of Chancery.

The Facts

Grupo Mexico, S.A.B. de C.V. ("**Grupo Mexico**") was the controlling stockholder of Southern Peru, a mining company listed on the NYSE. In February 2004, Grupo Mexico held 54.17% of Southern Peru's capital stock and 63.08% of its voting power. Grupo Mexico proposed that Southern Peru acquire its 99.15% ownership interest in a privately-held Mexican mining company, Minera Mexico, S.A. de C.V. ("**Minera**"). Grupo Mexico initially requested that Southern Peru pay approximately $3.05 billion in its common stock for the Minera shares.

Recognizing the self-interest inherent in the proposed acquisition, Southern Peru's board formed a special committee of disinterested directors to evaluate the related party transaction. The special committee retained its own financial and legal advisors, including Goldman Sachs, to review the proposed merger; however, the special committee did not consider alternative transactions.

Goldman Sachs performed an "Illustrative Give/Get Analysis" which determined that Minera was worth no more than $1.7 billion; however, in light of a valuation gap of about $1.4 billion as compared with the purchase price suggested by Grupo Mexico, the special committee and Goldman Sachs subsequently revised the valuation method to include a relative discounted cash flow analysis as opposed to Minera's standalone analysis. Goldman Sachs later presented various "relative DCF analyses" and values based on "contribution analysis at different EBITDA scenarios" at the special committee meeting where the merger was unanimously approved. Goldman Sachs also ultimately issued a written fairness opinion.

Over eight months, the special committee and Grupo Mexico negotiated a deal in which the parties entered into a definitive agreement providing for, among other things: (i) a purchase price of approximately $3.1 billion of Southern Peru's shares; (ii) a fixed exchange ratio without a collar or walk-away rights tied to the price of Southern Peru's shares prior to closing.

While the merger was pending, Southern Peru's share price increased significantly mainly due to the company's performance and copper prices. However, notwithstanding the appreciating Southern Peru share prices subsequent to the execution of the merger agreement, the special committee neglected to request or require an

updated fairness opinion prior to closing. At the company's special meeting, over 90% of Southern Peru's shareholders voted in favour of the merger. Upon the transaction closing in April 2005, Southern Peru shares issuable pursuant to the merger had a market value of approximately $3.75 billion.

Southern Peru shareholders filed a derivative suit challenging the merger on the basis that the merger was "entirely unfair" to Southern Peru and its minority shareholders. The Court characterized the plaintiffs' argument as one in which the controlling stockholder received something "demonstrably worth more than $3 billion … in exchange for something that was not worth nearly that much …."

The Decision

The Court was charged with examining the main issue of whether the merger was entirely fair, satisfying the conditions of both: (i) a fair negotiation and approval process; and (ii) a fair price paid to the stockholders.

In its decision, the Court held that the merger was not entirely fair, in process or in price, and that the defendants breached their duty of loyalty. Although a special committee is usually formed to refute potential claims by minority stockholders that the controlling stockholder acted only in its best interests (and not the best interests of all stockholders), the Court was especially critical of the special committee's actions. The Court espoused that the special committee, while comprised of qualified and competent members, failed to discharge a fair process because it "fell victim to a controlled mindset and allowed Grupo Mexico to dictate the terms and structure of the merger."

The Court enumerated various key areas where the special committee's less than ideal approach negatively affected the fairness of the transaction including: (i) the fact the special committee did not entertain alternative transactions or even put itself up for sale to Grupo Mexico if it concluded, based on the analyses of its financial advisor, that the Southern Peru shares were overvalued in the public market; (ii) endorsing its financial advisor's revised and relative valuation analyses to justify the inflated price being paid for Minera through a series of economic contortions as opposed to standing firm on a price based on the target company's fundamental value; (iii) the failure to insist on some deal terms to protect the minority stockholders, such as a majority-of-the-minority approval provision, a fixed exchange ratio, a collar or a walk-away right; (iv) the failure to require an update of the fairness opinion or an update on the fairness of the transaction, especially given the significant increase in the value of Southern Peru shares subsequent to the execution of the merger agreement; and (v) the failure to exercise its right to change its recommendation given the significant appreciation of the Southern Peru shares from the time the merger agreement was signed and the closing of the transaction.

In particular, the Court noted that the special committee failed to avail itself of its "contractual leverage to stop the deal or renegotiate its terms."

The Court of Chancery awarded damages in the amount of $1.263 billion which is approximately the difference between the value of the Southern Peru stock issued at the closing of the merger and the Court's determination of Minera's value at the relevant time. The Court also noted that Grupo Mexico could satisfy the judgment by returning Southern Peru's stock back to it.

III. CERTAIN CANADIAN REGULATORY DEVELOPMENTS

Canadian Securities Administrators Caution Issuers about Mass Advertising

On September 13, 2011, the Canadian Securities Administrators (the "**CSA**") released CSA Staff Notice 51-336 — *Issuers Using Mass Advertising*

The CSA cautioned issuers who advertise by way of television, radio, internet, social media and/or print of the need to be particularly vigilant that such advertising is compliant with applicable continuous disclosure requirements and is not misleading to investors.

The CSA announced that it will be monitoring issuers' advertising activities for breaches of applicable securities laws to determine whether such advertisements are misleading to investors or generally contrary to the public interest. If required, the CSA will take appropriate regulatory action, including a review of an issuer's continuous disclosure and/or the issuance of securities by the issuer.

The Staff Notice is the result of the CSA's observation of a number of junior issuers purchasing short television advertisements in order to boost interest in their stock. The content of these advertisements tends to focus on the positive prospects of the issuer as well as on other positive aspects of the issuer's business.

Accordingly, the CSA is concerned that advertisements for the purpose of promoting interest in an issuer's securities may not comply with the issuer's continuous disclosure requirements under securities laws and that such advertisements may be misleading to investors.

Additionally, the CSA has expressed the view that advertising to promote trading in an issuer's securities does not reflect positively on issuers or on the Canadian capital markets.

The Staff Notice reminds issuers of the restrictions on marketing and advertising during the distribution of securities, and on advertising conducted in furtherance of a distribution of securities.

The Staff Notice highlights the specific need for securities laws compliance by all issuers, but especially those in the resource industry. In particular, mass advertising and social media pose additional challenges for oil & gas and mining issuers who must ensure that their disclosure is compliant with National Instrument 51-101 — *Standards of Disclosure for Oil and Gas Activities* and National Instrument 43-101 — *Standards of Disclosure for Mineral Projects*, respectively.

The CSA noted that it is not concerned with issuers who use advertising campaigns that are legitimately aimed at promoting the services of an issuer or at raising public awareness about the issuer. While the CSA is primarily focused on advertisements aired on television, the CSA stated that the message of the Staff Notice is equally applicable to advertising conducted via social media, print, radio or the internet.

Ontario Securities Commission Concerned About Improper Reliance on Accredited Investor Exemption

On May 13, 2011, the Ontario Securities Commission published OSC Staff Notice 33-735 — *Sale of Exempt Securities to Non-Accredited Investors*.

High net worth individuals are often presented with opportunities to invest in private placements of debt or equity securities of companies seeking financing for the growth of their businesses. If the investor is interested in subscribing for the securities, the issuer or its agent will generally require that the investor submit its cheque, together

with a completed subscription agreement for review and potential acceptance by the issuer. Furthermore, unless the investment proceeds from the investor are $150,000 or more, the issuer or its agent will also require the investor to indicate how he or she is an "accredited investor" eligible to purchase the securities pursuant to the accredited investor exemption contained in National Instrument 45-106 *Prospectus and Registration Exemptions*.

This requirement generally involves the investor completing an Accredited Investor Certificate by reviewing the definition of "accredited investor" (which is usually attached to the subscription agreement) and checking the appropriate box.

In the staff notice, the Ontario Securities Commission stated the following two findings raised significant investor protection concerns: (i) some issuers (including companies and investment funds) and dealers are improperly relying on the accredited investor exemption to sell exempt securities to individual investors who do not actually satisfy the applicable requirements of the exemption; and (ii) many dealers do not collect adequate "know your client" (commonly referred to as KYC) information to be able to reasonably determine whether the investor is in fact an accredited investor.

Accredited Investors

As a general rule, a company that wants to offer its securities to the public must prepare a detailed disclosure document which provides full, true and plain disclosure about the company and the securities being offered (including the risks of investing in the securities) unless the offering is a private placement. Two commonly used private placement exemptions include: (i) subscriptions for securities with an aggregate subscription price of $150,000 or more; and (ii) subscriptions by "accredited investors" (which does not involve a minimum subscription price).

The law assumes that accredited investors do not require the protections offered by a prospectus because accredited investors can: (i) obtain and analyze the information needed to assess an investment without a prospectus; and (ii) sustain the loss of their entire investment.

Although the definition of "accredited investor" set out in National Instrument 45-106 *Prospectus and Registration Exemptions* provides a number of ways one may qualify as an accredited investor, the most commonly relied upon satisfaction criteria are as follows:

- an individual who, alone or together with a spouse, owns **financial assets** worth more than $1 million before taxes but net of related liabilities;
- an individual who alone or together with a spouse, has **net assets** of at least $5 million;
- an individual whose net income before taxes exceeded $200,000 in both of the last two years and who expects to maintain at least the same level of income this year; and
- an individual whose net income before taxes, combined with that of a spouse, exceeded $300,000 in both of the last two years and who expects to maintain at least the same level of income this year.

In its staff notice, the Ontario Securities Commission indicated that it has come to the commission's attention that in assessing whether clients meet the accredited investor definition, some dealers are not making it clear to their clients that the client's

personal residence or other real estate **cannot** be included in the valuation of their financial assets (which has a much lower threshold than the net assets test which does include a client's personal residence and other real estate). As a result, these issuers and dealers may be improperly selling exempt securities in reliance on the accredited investor exemption to investors who do not, in fact, meet the definition of accredited investor, contrary to securities laws.

OSC expectations for issuers and dealers selling exempt securities to accredited investors

In its staff notice, the Ontario Securities Commission provided a non-exhaustive list of steps that dealers should take in order to meet their obligations under securities laws when selling exempt securities to an accredited investor. Such steps include:

- adequate training and explanation to chief compliance officers and dealing representatives to ensure they understand the definition of an accredited investor and how to determine whether a client meets the definition;
- developing an accurate form for collecting "know your client" information;
- explaining the accredited investor definition to clients and ensuring that their "know your client" forms are properly completed;
- refraining from selling exempt securities if the dealer does not have sufficient information to determine whether the client qualifies as an accredited investor;
- ensuring the exempt security is suitable for the client (as described in Canadian Securities Administrators Staff Notice 33-315 — *Suitability Obligation and Know Your Product*);
- the Chief Compliance Officer reviewing the completed "know your client" form to ensure that the information is complete and consistent with that portion of the accredited investor definition to be relied on and that the trade is suitable for the client;
- dealers maintaining records to support their reliance on the accredited investor definition, including completed "know your client" forms and the dealing representative's notes; and
- dealers establishing appropriate policies and procedures to ensure that exempt securities distributed under the accredited investor exemption are distributed only to investors who actually satisfy the relevant criteria.

Monitoring

The Ontario Securities Commission indicated its intent to closely monitor the activities of issuers and dealers that sell exempt securities, including conducting compliance reviews of those firms. The Ontario Securities Commission further stated that it will take enforcement proceedings or other regulatory action where issuers and dealers are acting contrary to securities laws by selling exempt securities under the accredited investor exemption to investors who do not actually satisfy the relevant criteria.

Canadian Securities Administrators' Continuous Disclosure Review Programme

On July 15, 2011, the Canadian Securities Administrators (the "**CSA**") issued CSA Staff Notice 51-334 — *Continuous Disclosure Review Program Activities for the fiscal year ended March 31, 2011*

The CSA outlined their review of the disclosure documents of listed issuers with a view to identifying material disclosure deficiencies for the dual purposes of ensuring listed issuer compliance and educating listed issuers on best disclosure practices.

The CSA's review of listed issuer continuous disclosure in 2011 resulted in 70% of the issuers reviewed being required to take action to improve their continuous disclosure. The CSA breaks down its continuous disclosure review results into the following five categories:

(1) If the issuer has critical continuous disclosure deficiencies, it may be added to the list of issuers in default, be the subject of a cease trade order or be referred to CSA enforcement;

(2) An issuers may be required to refile amendment continuous disclosure documents;

(3) An issuer may be advised that certain changes are required to be made to its continuous disclosure filings going forward;

(4) An issuer may receive a proactive letter alerting it to certain continuous disclosure enhancements that should be considered for future filings; or

(5) An issuer may be informed that it is not required to take any action or make any future changes to its continous disclosure.

The Staff Notice canvasses issues and best practices in respect of various areas of continuous disclosure, including the following:

IFRS Transition Disclosure
In assessing the sufficiency of this disclosure, the CSA looked at the CSA Staff Notice 52-320 — *Disclosure of Expected Accounting Policies Related to the Changeover to International Financial Reporting Standards* and found that 60% of issuers reviewed provided the details of the key aspects of their changeover to IFRS and that 82% of issuers reviewed provided a description of the identified accounting policy differences between the issuer's current Canadian GAAP financial statements and the IFRS policies the issuer plans to adopt.

The CSA found that in many instances, the issuer's discussion included in the changeover plans and in accounting policy differences was too generic and that the disclosure did not provide specific analysis of the anticipated impact to the issuer's financial statements and operation.

Certification
The CSA reviewed issuers for compliance with National Instrument 52-109 — *Certification of Disclosure in Issuers' Annual and Interim Filings* ("**NI 52-109**") and identified the following common issues with such disclosure: (i) failure to disclose or failure to fully disclosure the certifying officer's conclusion about the effectiveness of ICFR or DC&P in their MD&A or qualification of such conclusions; (ii) the wording on the forms having been amended; and (iii) venture issuers who filed basic certificates voluntarily but did not include the required cautionary language as set out in part 15.3 of the Companion Policy to NI 52-109.

Oil & Gas Technical Disclosure
The CSA found general compliance amongst oil and gas issuers but noted the following deficiencies: (i) the omission of some of the information required under Form 51-101F1 and disclosing units inconsistently; (ii) improper use of terminology set out in the Canadian Oil & Gas Evaluation Handbook; and (iii) the use of boilerplate to discuss important economic factors or significant uncertainties pertaining to components of the issuers' reserves data.

Material Contracts
The CSA assessed whether issuers were complying with Part 12 of National Instrument 51-102 — *Continuous Disclosure Obligations*. Changes to the requirement under Part 12 were made in 2008 which now require the filing of material contracts, even though made in the normal course of business, if such contract is important to understanding the issuer's business. There are now also limits on the extent to which a material contact may be redacted in the event that the terms and conditions are necessary to aid in the understanding of the impact of the material contract on the issuer's business. The CSA's review found that issuers should continually assess whether a contract is material to the issuer and, in the event that a contract becomes material to the issuer, the issuer will become obliged to file.

Mining Technical Disclosure
The CSA noted the following as being areas in need of improvement for mining issuer technical disclosure: (i) the name of the Qualified Person was not always included in scientific and technical documents; (ii) the source and date of historical estimates were often missing; (iii) the consent and certificates of Qualified Persons were sometimes missing; and (iv) some corporate presentations or other content on mining issuer websites did not comply with National Instrument 43-101 — *Standards of Disclosure for Mineral Projects*.

Press Releases
The CSA identified the following common issues in its review of press releases, corporate presentations, websites and other promotional materials: (i) non-compliant reserve and resource calculations; (ii) non-compliant use of oil & gas terminology; (iii) failure to file a press release in compliance with Section 11.5 of NI 51-102 announcing a refilling or restatement on time; and (iv) common issues regarding forward-looking information disclosure obligations.

Common MD&A Deficiencies
The CSA noted the following common continuous disclosure deficiencies in issuers' Management's Discussion & Analysis ("**MD&A**"): (i) the use of non-GAAP financial measures to describe key performance measures; (ii) failure to identify material forward-looking information ("**FLI**") or the use of boilerplate to identify FLI; (iii) failure to analyze operations in the most recently completed financial year by discussing and quantifying all material variances against the previously completed financial year; (iv) failure to sufficiently identify and discuss any known or expected fluctuations and trends in liquidity, taking into account demands, commitments, events or uncertainties; (v) failure to discuss and analyze items or events that have had a material impact on the issuer's fourth quarter; and (vi) for Venture Issuers, failure to provide a detailed breakdown of material components of capitalized or expensed exploration costs if such Venture issuers have not had significant revenue from operations.

Financial Statement Deficiencies
The CSA noted that common problems with financial statements generally relate to disclosure in the notes and measurement issues. The financial statement inventory note disclosure required by law has been harmonized with IFRS, which allows fewer alternatives for the measurement of inventories.

The CSA also found that issuers are often too generic in their disclosure of related third party transactions and when issuers have significant balances owing to related parties, the disclosure in the financial statements is often insufficient.

Regulatory Compliance Disclosure

The CSA also found that many issuers provided insufficient disclosure in the compensation chart required by Form 51-102F6 — *Report on Executive Compensation*, as well as insufficient disclosure of the issuer's performance goals and the benchmarking group used by issuers to compare specific types of compensation.