A COMPARATIVE STUDY OF RECENT DEVELOPMENTS OF THE OPPRESSION REMEDY IN CANADA AND THE UNITED STATES

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Thesis Statement

During the last decade in North America the paradigm of accountability for the controllers of business corporations has undergone a metamorphosis. The transformation is occurring as a result of the establishment of new criteria of accountability through the test of the "reasonable expectations" of the participants of the corporation. This test shifts the focal point of the oppression remedy from an examination of the type of behaviour to be controlled to the effect of the questionable behaviour on the aggrieved party. Its primary tenet is that judicial supervision of the corporate controllers should be conducted in accordance with the principles of contract law. These principles reflect the true nature of the corporate entity as well as greater objectivity than the nebulous rules of equitable justice which have traditionally governed the application of the oppression remedy.

The consequences of the transformation of the criteria of accountability are not yet clear. In Canada the Alberta Court of Appeal has recently endorsed the "reasonable expectations" test while in the United States, many courts, including the New York Court of Appeals, have done so. As a result of the decisions of these courts, the test of the "reasonable expectations" of the participants is coming under intense scrutiny. From this scrutiny it is clear that the judiciary could needs legislative guidance. The experience in the United States with this new "reasonable expectations" test provides an example of legislative and judicial cooperation which can easily be a model to guide the application of the oppression remedy in Canada.

This study consists of a comparative analysis of the recent developments in the area of American and Canadian corporate law generally described as the "oppression" remedy. The primary material it relies on for the recent developments in this area are the decisions of the courts of New York, Ontario and Alberta as well as articles in law periodicals in the United States and Canada. For the historical perspective which it adopts, a brief excursus into the decisions of English courts in the area of the oppression remedy is essential. Throughout, its methodology is a comparative one in that the parallel paths of the American and Canadian courts is the underlying theme. Accordingly this study is divided into the following chapters:

1) the English legacy of the oppression remedy
2) the American experience with the oppression remedy
3) the Canadian experience with the oppression remedy and
4) a comparison of the recent developments in the Canadian and American experiences and of the adequacy of their respective recent developments.

ABSTRACT

Keeping the controllers of a corporation accountable for their actions has been a primary concern of corporate governance. In Canada almost all provinces have joined the trend to adopt a statutory oppression remedy basically identical to the oppression remedy in the Canada Business Corporations Act. Of the fifty state jurisdictions in the United States, only thirteen have resisted the movement to a statutory oppression remedy. Even American federal "corporation law" under the Securities Acts of 1933 and 1934 has attempted to join the trend to protect the rights of minority shareholders.

Both Canada and the United States have looked to the English oppression remedy as the basis for their own solutions. Courts in both countries have applied nearly identical, pragmatic solutions to the factual situations as they have arisen. However the theoretical justifications of the courts' decisions have differed greatly. Canadian courts, until recently, have for the most part been content to rely on the original English "lack of probity" test for the application of the oppression remedy. American courts also originally followed the English "lack of probity" test blending with it at times their version of fiduciary duty. In the United States discontent arose over the vagueness and uncertainties associated with the "lack of probity" test.

Although over thirty years ago this discontent appeared in law journal articles, it was not until legislative reform that the New York Court of Appeals adopted a different test, the "reasonable expectations" of the shareholders.

While more satisfactory than the earlier test for the invocation of the oppression remedy, the new "reasonable expectations" test does not provide the full legislative guidance required for the courts' exercise of "sound judicial discretion". Leaving such matters to the hazards of litigation produces a great deal of uncertainty in business arrangements. There are two primary aspects to the needed legislative guidance: a provision making the courts' intervention mandatory if the "reasonable expectations" of the minority have been violated and a provision allowing for the majority to buy out the minority when the oppression remedy can be invoked.

Dedicated to my wife, Juli, my son, Christopher, and my daughter, Catherine, for tolerating my absences.

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INTRODUCTION

The Problem

Over the last century and a half the corporate form of business organization has succeeded in mustering capital on unheard of scales, in providing facilities for the concentration and management of capital and in acquiring great power over resource allocation in society. It has been an important instrument of economic and social development.

The very object of corporate charters is to give power to members of companies which they do not possess in their individual capacity. Corporate law has provided a type of constitutional law whose dominant function has been to regulate the manner in which the corporation was constituted and to define the relative rights and duties of those participating in the institution.

At the top of the governance hierarchy within the corporation are the shareholders. They, as the highest institutional authority, decide fundamental matters involving structural changes in the company and elect and dismiss the directors, with or without cause, at the annual meeting. Their decisions are made in accordance with the will of the majority of the shareholders.

The board of directors within the classical corporate law framework represents the top of the company's internal decision hierarchy and it is the only executive body whose structure and operation are explicitly regulated by corporation law. The shareholders monitor the board's efficiency and reward board members through re-election or punish them by removal.

This traditional structure has suffered from two functional deficiencies. The first is illustrated by the widely known theory of separation of ownership and control which was postulated by Berle and Means.[1] Their thesis asserts that the growing diffusion of ownership in the large, modern corporation increasingly has vested control in the managers as opposed to the owners of the corporation.

The second deficiency is demonstrated by the potential of the controlling shareholders to use the principle of the "rule of the majority" as a means to defraud the minority shareholders. Controlling shareholders have at their disposal:

> "all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another..."[2]

These multifarious means have included using their position to determine exorbitant salaries for themselves, withholding information from other shareholders, conducting transactions in the corporation's name without obtaining necessary authority from board of directors, preventing the corporation

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[1] A. A. Berle and G. C. Means, The Modern Corporation and Private Property, (New York: Harcourt, Brace & World, Inc., 1968).

[2] Henry Campbell Black, Black's Law Dictionary, 6th edition (St. Paul, Minnesota: West Publishing Company, 1990):788 -- definition of "fraud".

from declaring dividends, "freezing out" minority sharehclders from the active operation of the corporation in which they had previously participated and using corporate property for their own purposes.[3]

Elected pursuant to the charter and by-laws of the corporation, the controllers enjoy the support of the majority shareholders. If the controllers themselves are also the majority shareholders, to whom are the majority shareholders accountable? The evolution of the business corporation presents a challenge to the constitutional ideal that all forms of private and public power, all institutions with power, must be accountable to others than the powerholders.[4]

Accountability of the Controllers

Historically the controllers of the corporation have been accountable to the judgment of a "court of equity" through the "common law oppression remedy". In enforcing accountability the courts of equity have refused to be bound by previous

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[3] 19 American Jurisprudence (2d) 569 at §2767; Proof of Facts 2d (Rochester, New York: The Lawyers' Cooperative Publishing Company): 5 - 659 ff; F. H. O'Neal, "Oppression of Minority Shareholders: Protecting Minority Rights." (1986/87) 35 Cleveland State Law Review 121 at 125; M. W. Carnahan, "Relief to Oppressed Minorities in Close Corporations: Partnership Precepts and Related Considerations." (1974) Arizona State Law Journal 409 at 415ff.

[4] See J. W. Hurst, The Legitimacy of the Business Corporation in the Laws of the United States 1780 - 1970, (Charlottesville: The University Press of Virginia, 1970) for an elaboration of this theme in the realm of corporation law.

court decisions or to define the criteria which they will use in any given situation.

> Were a Court of Equity once to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species of evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's intervention would contrive.[5]

This refusal to set down any precise equitable rules led to severe criticism of the courts.[6] The minority shareholders have had few, if any, guidelines on which to base a claim against the majority. On the other hand, the majority are unaware of the specific conduct for which they would be held accountable. The absence of precise criteria can greatly restrict director freedom of action.[7] The result has been judicial restraint and reluctance of the courts to ensure the accountability of the controllers.[8]

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[5] P. V. Baker and P. St. J. Langan, Snell's Principles of Equity, 28th edition (London: Sweet and Maxwell, 1982): 538 - 539.(hereinafter "Snell")

[6] See for example J. O. Tingle, The Shareholder's Remedy of Corporate Dissolution, (Missoula, Montana: Montana State University Press, 1959): 175ff; Note, "Oppression as a Statutory Ground for Corporate Dissolution." (1965) Duke Law Journal 128 at 129.

[7] Note, "Corporate Dissolution for Illegal, Oppressive or Fraudulent Acts: The Maryland Solution." (1968) 28 Maryland Law Review 360 at 363.

[8] "Social policy" also seemed to justify a decision not to intervene. For example:

1) It is not the role of the courts to extinguish legislatively created entities. (This rationale was especially strong in many American states.)
2) Under the doctrine of majority rule, an investor impliedly consents to corporate policies as deter-

(continued...)

Statutory Oppression Remedy

The courts' reticence led to legislative intervention, an intervention which was opposed by several criticisms. It was argued legislative enactments would add nothing to the power of the courts because the courts already had the requisite power.[9] Setting forth a rigid, unprogressive rule, would encourage unprincipled individuals to get around the law.[10] A legislative solution, it was argued, would make it too easy for an obstreperous minority to interfere with the majority's

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[8](...continued)
mined by majority.

3) Management decisions are traditionally protected by the business judgment rule which affords corporate management wide discretion in decision making.
4) Dissolution may have adverse effects on the community, eliminating corporate jobs and depriving consumers of essential goods and services.

Willingness to invoke these reasons of social policy has led to a perception of an arbitrariness on the part of the judiciary which has usually been oriented to protection of management rights and neglect of the plight of the minority shareholder. (V. Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract." (1985) 85 Columbia Law Review 1403 at 1409. See also S. C. Bahls, "Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy." (1990) 15 The Journal of Corporation Law 285 at 296; H. J. Haynsworth, "The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension." (1987) 35 Cleveland State Law Review 25; C. L. Israels, "The Sacred Cow of Corporate Existence Problems of Deadlock and Dissolution." (1951 - 52) 19 University of Chicago Law Review 778; J.A.C. Hetherington, M. P. Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem." (1977) 63 Virginia Law Review 1 at 19.)

[9] R. T. Banta, "Involuntary Corporate Dissolution: A Comparison of Statutory Methods in California, Delaware, New York and Oregon." (1969) 5 Williamette Law Journal 639 at 659.

[10] G. Hornstein, "A Remedy for Corporate Abuse - Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder." (1940) 40 Columbia Law Review 220 at 250.

legitimate control and management of the corporation by creating a cash nuisance value.[11] Despite these objections legislative intervention occurred in most jurisdictions in the United States and Canada. The statutory "oppression" remedy was born.

The common law oppression remedy presented the courts with three major issues:

1) a determination of the criteria by which the court is to judge whether or not conduct which is "oppressive"/ "unfair" to the minority has occurred,

2) a determination of the criteria by which to measure whether or not this conduct is sufficiently "oppressive"/ "unfair" to warrant the intervention of the court,

and

3) a determination of which remedy is appropriate for the specific circumstances in front of the court.

The statutory oppression remedy did not change the three major issues. Its focus was on the appropriate remedies the court could use once the court had decided to intervene. The most important unanswered issue remained the determination of the criteria of accountability to be used by the courts in deciding whether or not to intervene. There could be no true

[11] C. W. Murdock, "Remedies for and Valuation of Minority Shares." (1990) 65 Notre Dame Law Review 425 at 461.

accountability of the corporate controllers or rights of the minority if the criteria of accountability were unknown.

In attempting to establish criteria of accountability under both the statutory and common law oppression remedies, the courts are required to use their "sound judicial discretion". The problem of formulating the criteria of accountability has provided the greatest challenges to the American and Canadian courts:

> It is not enough for the Court...to have, in the familiar phrase of a decree-arbitral, "God and a good conscience" before its eyes; grounds must be given which can be examined and justified.[12]

To answer this challenge, the courts have sought guidance from the same British decisions.[13] In both countries the governing

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[12] Lord Clyde in Baird v. Lees 1924 S. C. 83 at 90. (J.C.P.C.)

[13] Elder v. Elder and Watson Ltd. [1952] S. C. 49 (Court of Session); Scottish Co-operative Wholesale Society Ltd. v. Meyer [1958] 3 All. E.R. 66; (House of Lords and Privy Council); Ebrahami v. Westbourne Galleries Limited [1973] A. C. 360.(House of Lords)

A. W. Currie, "The First Dominion Companies Act." ((1962) 28 Canadian Journal of Economics and Political Science 387) relates how the first Canadian corporate statute was modelled on that of New York State which in turn served as a model for many other American jurisdictions.

The original assumption behind the statutory oppression remedy, enunciated in the philosophy of the Dickerson Task Force (R. W. V. Dickerson et al. Proposals for a New Business Corporations Law for Canada, (Ottawa: Information Canada, 1971) (hereinafter "Dickerson Report")) and of the British Cohen Committee (Great Britain, Report of the Committee on Company Law Amendment (Cohen Committee) Cmnd. 6695 London: Her Majesty's Stationary Office, 1964. (hereinafter "Cohen Committee")) was to delegate to the judiciary unfettered discretion to intervene. This assumption has become increasingly suspect, even in Great Britain. The British Parliament has for the third time been forced to enact (continued...)

criteria have undergone an incremental metamorphosis from the paradigm of majority shareholder rule to one premised on "fairness" to all.[14] The increase in the number of court ordered buy-outs, the use of remedies other than dissolution of the corporation and liberalized judicial interpretation of the meaning of statutory "oppressive" conduct have been interconnected trends.[15]

The American and Canadian judiciaries have exhibited a similar practical bent in applying their respective versions of the statutory oppression remedy to specific fact situations. Regardless of the purported theoretical underpinnings of the decisions, the reported cases illustrate

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[13](...continued) legislation which instructs its judiciary how not to enforce the English oppression remedy. (See D. Bouchier, "The Companies Act 1989 -- Yet Another Attempt to Remedy Unfair Prejudice." (1991) Business Law 132.)

[14] This paradigm was foreseen by A.A.Berle in the 1920's:

> ...[All] powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears...in every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a cestui que trust to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary. (A. A. Berle Jr., "Corporate Powers as Powers in Trust." (1931) 44 Harvard Law Review 1049.)

[15] F. H. O'Neal, R.B. Thompson and F. L. Katt, F. H. O'Neal's Close Corporations Volume 2 ((3d) (Wilmette, Illinois: Callaghan and Company, 1990) at 135 paragraph 9.29; Murdock, supra, note 11 at 427.

that, given certain facts, the courts' decisions have been predictably similar.[16]

The significant difference between the decisions of Canadian courts and some American courts has been in the justification of their decisions. Canadian courts have generally accepted the original test of oppression -- the "lack of probity" test -- first developed in Scotland but adopted in England.[17] Recent decisions in Ontario and Alberta, however, have confirmed a shift of emphasis from this "lack of probity" threshold test to a threshold test which is separated from morality and is objectively fairer to all parties concerned.[18] American courts, even while looking to the English experience with oppression for guidance, have intermingled the concept of the fiduciary duty of the majority shareholders with the "lack of probity" test.

Re-examination of the adequacy of the "lack of probity" test combined with statutory reform in many states has led to the development in the United States of the test of the

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[16] Infra. page 82 footnote 240.

[17] Based on Elder v. Elder and Watson Ltd. supra, note 13 and Scottish Co-operative Wholesale Society supra, note 13.

[18] See for example Brant Investments Ltd. et al. and KeepRite Inc. et al. (1991), 3 O. R. (3d) 289. (Ontario Court of Appeal) Westfair Foods and Watt et al. (1991), 79 D. L. R. (4th) 48 (Alberta Court of Appeal) Leave to appeal to the Supreme Court of Canada refused [1992] 1 W.W.R. lxv (S.C.C.). See infra. page 73ff and P. Anisman, "Majority-Minority Relations in Canadian Corporation Law: An Overview." (1986-87) 12 Canadian Business Law Journal 473 at 483 and J. P. Lowry, "The Oppression Remedy -- A Canadian Approach." (1991) The Journal of Business Law 196.

"reasonable expectations" of the parties[19] as the criteria of accountability. In states without a statutory oppression remedy, a revitalized application of the common law fiduciary duty test has emerged.[20] The New York Court of Appeal has led the development and implementation of the "reasonable expectations" test[21]. Other courts in Iowa, Montana, North Dakota, North Carolina, West Virginia, Texas, New Jersey, New Mexico, Pennsylvania and Alaska[22] and legislative reform in North Dakota, and Minnesota[23] have followed the New York example. While demonstrating a keen awareness of the failings

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[19] One example is Kemp & Beatley Inc. 484 N. Y. S. 2d 799 (1984 Court of Appeals of New York); others are Exadaktilos v. Cinnaminson Realty Co., Inc. 400 A. 2d 554 (1979 New Jersey Superior Court) and Meiselman v. Meiselman 307 S. E. 2d 551 (1983 Supreme Court of North Carolina), Stefano v. Coppock 705 P. 2d 443 (1985 Supreme Court of Alaska); McCauley v. Tom McCauley & Son, Inc. 724 P. 2d 232 (1986 Court of Appeals of New Mexico). See Re Broadcasting Station 2 G. B. Pty Ltd. [1964 - 65] N. S. W. R. 1648 at 1662 (Supreme Court of New South Wales) for an example of Australian dissatisfaction with the lack of probity test.

[20] For the fiduciary duty test, see Donahue v. Rodd Electrotype Co. of New England Inc. 328 N.E. 2d 505 (1975 Massachusetts Supreme Court). Balvik v. Sylvester 411 N.W. 2d 383 (1987 Supreme Court of North Dakota) blended fiduciary duty test with reasonable expectations.

[21] Kemp & Beatley Inc. supra, note 19.

[22] Stefano v. Coppock supra, note 19; McCauley v. Tom McCauley & Son, Inc. supra, note 19; Maschmeier v. Southside Press Ltd. 435 N.W. 2d 377 (1988 Iowa Court of Appeals), Davis v. Sheerin 754 S. W. 2d 375 (1988 Texas Court of Appeal), Exadaktilos supra, note 19, Balvik v. Sylvester supra, note 20, Meiselman supra, note 19, Masinter v. Webco Company et al. 262 S.E. 2d (1980 Supreme Court of Appeals of West Virginia) 433, Fox v. 7L Bar Ranch Co. 645 P.2d 929 (1982 Supreme Court of Montana), Gee v. Blue Stone Heights Hunting Club 604 A.2d 1141 (1992 Pennsylvania Commonwealth Court).

[23] Minnesota Statutes Annotated §302A 751 (West 1985); North Dakota Centennial Code §19.1 - 115 (1985).

of the "lack of probity" test, others, such as those in Illinois, Oregon, Virginia and Missouri,[24] remain committed to the "lack of probity" test.

Focus of This Study

The evolution of the theory of the "reasonable expectations" of the parties and the metamorphosis of the "lack of probity" test to one of "fairness" form the focus of this study. Using a comparative and historical methodology, this study will firstly trace the evolution of the criteria of accountability of the controllers of corporations in the United States and in Canada. Then it will assess the sufficiency of these tests in providing the criteria of accountability. Drawing on the American experience, this study will conclude with some suggestions for the improvement of the statutory oppression remedy in Canada.

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[24] Central Standard Life Insurance Company v. Davis 141 N. E. 2d 45 (1957 Supreme Court of Illinois); Gidwitz v. Lanzit Corrugated Box Co. et al. 170 N.E. 2d 131 (1960 Supreme Court of Illinois); Polikoff v. Dole & Clark Building Corp.184 N.E. 2d 792 (1962 Appellate Court of Illinois); Compton v. Paul K. Harding Realty Co. 285 N.E. 2d 574 (1972 Appellate Court of Illinois); White v. Perkins 189 S.E. 2d 315 (1972 Supreme Court of Virginia); Baker v. Commercial Body Builders, Inc. 507 P. 2d 387 (1973 Supreme Court of Oregon)(blended with fiduciary duty test); Herbik v. Rand 732 S.W. 2d 232 (1987 Missouri Court of Appeals); Whale Art Co. v. Docter 743 S. W. 2d 511 (1987 Mo. Court of Appeal); Fix v. Fix Material Company, Inc. 538 S.W. 2d 351 (1976 Missouri Court of Appeals) (blended with fiduciary duty test)

CHAPTER 1 THE ENGLISH LEGACY

CHAPTER FOCUS

The theme of this chapter is to show the English origins of the recent developments of the oppression remedy in Canada and the United States.

English Influence

The English version of the statutory oppression remedy has been the cornerstone of the Canadian and American statutory oppression remedies. From the Canadian perspective, the use of English law as a precedent is not surprising. Canadian corporation law is founded on English law and the judiciary has been strongly dependent on courts of England for the development of substantive law.[25] Canadian courts before 1950 were bound to follow decisions of the Privy Council and the English Court of Appeal.[26] Therefore it was a natural reaction for the Canadian courts to look to the British experience for guidance.

From the American perspective, resort to English law for guidance, especially in the area of minority shareholder rights, has been a gradual process. During the nineteenth century and up until the 1960's, the inheritance of common law

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[25] H. E. Read, "The Judicial Process in Common Law Canada." (1959) 37 Canadian Bar Review 265 at 266.

[26] Trimble v. Hill (1879) 5 App Cas 342 (P.C.) and M. MacGuigan, "Precedent and Policy in the Supreme Court." (1967) 15 Canadian Bar Review 627 at 628.

principles in both the United States and England did not lead to common solutions in corporate law. American and English corporate law followed different lines of development[27]. The cross fertilization of ideas and the existence of comparative studies of English and American corporate law topics were scarce.[28] As L.C.B. Gower pointed out, an American lawyer in Massachusetts was more likely to try to find an applicable precedent under New Mexico or Arizona law than to look to English law. Similarly it was a rare situation when an English court or English lawyer looked to American law for guidance.[29]

Some influence of English corporate law did manage to penetrate into the United States during the latter part of the nineteenth century[30]. After the Second World War in the academic sphere considerably more interaction between leading jurists of the two countries occurred, even to the extent of submissions by American academics to the Jenkins committee for the reform of English Company law.[31] By the late 1960's the

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[27] A.J. Boyle, "The Minority Shareholder in the Nineteenth Century: A Study in Anglo-American Legal History." (1965) 28 Modern Law Review 317 at 317ff.

[28] L. C. B. Gower, "Some Contrasts between British and American Corporation Law." (1955 - 56) 69 Harvard Law Review 1369.

[29] Ibid. 1401.

[30] Boyle, supra, note 27 at 323 - 324.

[31] See A. J. Boyle, "The Sale of Controlling Shares: American Law and the Jenkins Committee." (1964) 13 International and Comparative Law Quarterly 185.

conceptual barriers between American corporate law and English corporate law had dwindled.[32]

In theory both in the United States and England a company could be wound up if oppressive behaviour were present.[33] By the end of the 1950's, in the United States, though almost all states provided a statutory remedy for an oppressed minority and the ABA-Ali Model Business Corporation Act even incorporated such a provision, the oppression remedy had received scant academic or judicial attention[34]. The vacuum in American state law on this subject left the courts with very little judicial support from within the United States.[35]

The major area of influence in the United States was found in articles in law journals[36] and the 1958 treatise by F. H. O'Neal[37], all of which analyzed the English experience with section 210 of the English Companies Act of 1948[38]. The twin pillars of the English experience with the statutory oppression remedy were section 210 and the trilogy of British

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32 Gower, supra, note 28 at 1374 and 1383ff.

33 Ibid. 1386.

34 Note, "Oppression as a Statutory Ground for Corporate Dissolution." supra, note 6.

35 Note, "Corporate Dissolution for Illegal, Oppressive or Fraudulent Acts: The Maryland Solution." supra, note 7 at 365. By the end of the 1950's only sixteen cases on the dissolution of the corporation existed, and only two on oppression.

36 Note, "Oppression as a Statutory Ground for Corporate Dissolution." supra, note 6 at 128; A. B. Afterman, "Statutory Protection for Oppressed Minority Shareholders: A Model for Reform." (1969) 55 Virginia Law Review 1043.

37 F. H. O'Neal, supra, note 15.

38 11 & 12 Geo 6, chapter 38.

cases -- Elder v. Elder and Watson Ltd.,[39] Scottish Co-operative Wholesale Society Ltd. v. Meyer[40] and Ebrahami v. Westbourne Galleries Limited.[41] Section 210 was an attempt to codify the then existing common law oppression remedy based on the "just and equitable" rule and the Foss v. Harbottle[42] exceptions. The Elder and Scottish Co-operative Wholesale Society Ltd. decisions were the first attempts of the House of Lords to analyze the meaning of the new statutory oppression remedy. Ebrahami, although not a section 210 case, was the culmination of the evolution of the "just and equitable" rule, a crucial component of the oppression remedy.

Common Law Oppression

The first question to be answered under section 210 was what constituted "oppressive" behaviour? The concept of "oppressive" corporate behaviour was not new to English common law. Its development had occurred through the "just and equitable" rule and attempts of the English courts to circumvent the severity of the Foss v. Harbottle[43] rule.

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39 Supra, note 13.
40 Supra, note 13.
41 Supra, note 13.
42 Foss v. Harbottle (1843) Ch. 2 Hare 461 (Chancery Division
43 Ibid.

Foss v. Harbottle

In this famous case the actions of the directors had harmed the company but a majority of the shareholders ratified their actions. The court refused to intervene into the affairs of the company. The court held that the individual members of the company were not able to seek a remedy. Only the company could.[44]

The courts blended early partnership rules with the principle of majority rule and with the principle that the individual members of a corporation are quite distinct from the metaphysical body called the corporation.[45] The Foss v. Harbottle rule gained widespread acceptance such that by the turn of the century, English and Canadian courts still accepted it.[46] The decision in Northwest Transportation Co. v. Beatty[47] consolidated the scope of the principle of majority rule by holding that unless the articles of the corporation otherwise provided, a shareholder had a perfect right to vote upon any question, as that shareholder wished, regardless of the shareholder's personal interest in the

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44 Mozley v. Alston (1847) 1 Phillips 790.

45 I. M. Cameron, "Majority Rule: The Development of General Principle in Cases on Chartered Corporations." (1985 - 86) 15 Melbourne University Law Review 116 at 119; S. M. Beck, "An Analysis of Foss v. Harbottle." in J. S. Ziegel, Studies in Canadian Company Law, volume 1 (Toronto: Butterworths, 1967) 545 at 550; K. W. Wedderburn, "Shareholders' Rights and the Rule in Foss v. Harbottle." (1957) Cambridge Law Journal 194 at 196.

46 Burland v. Earle [1901] A.C. 91 at 93 (Privy Council)

47 12 A.C. 589 (House of Lords and Privy Council)

subject matter. Thus, as long as an act was within the powers of the company, the majority could ratify it so as to make it valid and binding on the minority. The majority also owed no fiduciary obligation to the minority.[48] The result was the creation of a governing paradigm for inter-shareholder relationships which espoused a rule of non-interference by courts in the internal affairs of a corporation and a rule that a conflict of interest will not invalidate a shareholder ratification.

Fraud on the Minority

The harshness of the Foss v. Harbottle rule led the courts to create exceptions to it in order to avoid serious injustice. Jenkins L. J. in Edwards v. Halliwell[49] summarized the four main exceptions:

a) any act which is wholly ultra vires the company or which is illegal;

b) a "fraud" on the minority by those in control of the company;

c) any act which requires a qualified majority but which has been passed by only a simple majority;

and

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[48] Phillips v. Manufacturer's Securities Limited (1917) 116 L.T. 290 (Chancery Appeal)

[49] [1950] 2 All E.R. 1064 at 1067 (Chancery Division)

d) any act which invades the personal and individual rights of membership.[50]

The key to the "fraud on the minority" exception lay in the flexibility of the concept of "fraud". Its vagueness left it essentially undefinable and unascertainable.[51] It referred to equitable fraud and included common law fraudulent misrepresentations.[52] It included cases in which there had been a fraud "upon a power" or a "breach of a fiduciary duty".[53] It was used generally to cover a variety of cases in which the exercise of the majority power or the breach of a fiduciary duty had been so abusive that the intervention of the courts was necessary in order to establish justice.[54]

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[50] Wedderburn, supra, note 45 at 215 states that there is simply one exception: any situation in which there is no chance of confirmation by the majority. The most comprehensive suggestion is that a fifth exception exists -- "when the interests of justice requires the court to intervene." O. A. Osunbor, "A Critical Appraisal of the "Interests of Justice" as an Exception to the Rule in Foss v. Harbottle." 36 International and Comparative Law Quarterly 1.

[51] Beck, supra, note 45 at 569; Wedderburn, supra, note 45, Part II at 96. No clear principle guides the courts. They have preferred to consider the nature of the transaction in each case.

[52] Nocton v. Ashburton [1914] A.C. 932 (House of Lords and Privy Council); Snell, supra, note 5 at 538 - 539.

[53] Harris v. Harris Limited (1936) S. C. 185 (Court of Sessions)

[54] Snell, supra, note 5 at 538:

> In equity, the term "fraud" embraces not only actual fraud,...but also certain other conduct which falls below the standards demanded by equity. Courts of equity did not even stop at "moral fraud in the ordinary sense" but took account of any "breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience."

The courts would intervene under the "fraud on the minority exception" if the majority did not act in the interest of the company (as opposed to the interest of a particular group of the shareholders even if they were the majority)[55] or if the majority expropriated the company's property.[56] If the majority did not govern fairly and

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[55] The seminal case on the subject, the judgment of Lindley M.R. in Allen v. Gold Reefs of West Africa, Limited ([1900] 1 Ch. 656 at 671)(Chancery Division), held that the power of the majority in a corporation

> must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied and are seldom, if ever, expressed.

See also Sidebottom v. Kershaw, Leese & Co. Ltd. [1920] 1 Ch. 154 (Chancery Division) and Shuttleworth v. Cox Bros & Co. (Maidenhead) Ltd. [1927] 2 K. B. 14 at 18 (King's Bench Division). However the exact scope of the Allen test has led to prolific debate. See J. G. MacIntosh "Corporations" in Fiduciary Duties Special Lectures of the Law Society of Upper Canada 1990 (Toronto: Richard De Boo, 1991): 225 ff.

[56] Several Privy Council decisions provide illustrations of the type of situation covered under this behaviour. The Privy Council cites the case of Menier v. Hooper's Telegraph Works ([1874] 9 L. R. 350 (Chancery Appeals)) as the prototype of a situation in which a fraud on the minority was held to have occurred through the majority's attempt to appropriate for itself, directly or indirectly, money, advantages or property of the company. The Menier case provided the precedent for the Cook v. Deeks ([1916] 1 A. C. 555 (Privy Council)) case. In Cooks v. Deeks the majority directors diverted to themselves a contract which was supposed to have gone to the company. Because of their majority position, they used their controlling votes to pass a resolution at a shareholders' meeting to declare that the company had no interest in the contract. The actions of the majority in making a present to themselves constituted, the court held, "oppression" of the minority. Burland v. Earle (supra, note 46), a further Privy Council decision,

(continued...)

honestly the courts would also intervene. Equitable justice required that "fairness" be present. When the test of "fairness" was not met, the court intervened in order to prevent or to remedy the injustice.[57]

In intervening, the courts frequently used the term "oppression" to describe behaviour which had to be corrected. An attempt by the majority shareholders to appropriate company property or the minority's assets to themselves, or behaviour of the majority which was unconscionable in the eyes of the court, could find itself labelled as "oppressive" behaviour.[58]

The two leading cases, Burland v. Earle[59] and Menier v. Hooper's Telegraph Works[60] set the basic parameters of the "oppression" concept.[61] A milder version of the term

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[56](...continued) restricted the instances falling under "fraud on the minority: to those where the acts complained of are of a fraudulent character or beyond the powers of the company. For a more recent use of the fraud on the minority exception, see Estmanco (Kilner House) Ltd. v. Greater London Council [1982] 1 All E.R. 439 (Chancery Division)

[57] The court will not override the decision of the majority of shareholders unless no reasonable man could regard it as exercised fairly in the interest of the company. (Harris v. Harris Limited supra, note 53)

[58] Cook v. Deeks supra, note 56.

[59] Supra, note 46.

[60] Supra, note 56.

[61] Brown v. British Abrasive Wheel Company Ltd. ((1919), 1 Ch. 290 (Chancery Division)) cast the issue in the framework of the "oppressive" nature of the amendment of the articles even in the absence of bad faith as judged by the rules of "natural justice": if "fair and just in the interest of the company and the shareholders generally," the court has no right to interfere. If on the contrary, the action is (continued...)

"oppression", the terms "unfair" and "inequitable" were used on occasion to describe the kind of conduct which would induce the court to intervene on behalf of the minority.[62]

"Just and Equitable" Rule

The evolution of the rules of partnership law during the eighteenth century produced the "just and equitable" rule.[63]

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[61](...continued) "oppressive", the court ought to intervene on behalf of the minority. Other decisions such as and Dafen Tinplate Company Limited v. Llanelly Steel Company (1907) Limited ([1920] 2 Ch. 124 (Chancery Division)), Greenhalgh v. Arderne Cinemas Ltd. ([1951] 1 Ch. 286 (Chancery Division)), Shuttleworth v. Cox (supra, note 54 and Sidebottom v. Kershaw Leese & Co. Ltd. (supra, note 54) continued the use of such terminology, albeit with different results.

[62] Dominion Cotton Mills Company Limited v. Amyot ([1912] A.C. 546 (Privy Council)).

[63] By the beginning of the nineteenth century courts of equity would intervene in the internal affairs of a business entity usually for the purpose of ordering the partnership dissolved and wound up. If dissolution would be to the advantage only of the wrongdoer, then the Chancellor would remedy the wrong without the use of dissolution. (Carlen v. Drury (1812) 1 V. & B. 154; see also N. Lindley, Law of Partnership, 1st edition, (Philadelphia: T. & J. W. Johnson & Company, 1860): 754 and Boyle, supra, note 27 at 318; Wallworth v. Holt [1841] Ch. 4 My. & Cr. 637.) English legislation provided statutory authority to dissolve joint stock companies and other partnerships if it was "just and equitable", in the words of the statute, if "any other Matter or Thing shall be shown which in the Opinion of the Court shall render it just and equitable that the company should be dissolved". This wording was incorporated into the English Companies Act, 1862 and into all jurisdictions in Canada.(1848 English Joint Stock Companies Winding Up Act 11 & 12 Victoria c. 89 Section 9 (5); U. K. Companies Act 1948, 11 & 12 Geo VI c. 38, section 222. In the United States the wording varies from state to state (see infra. page 43ff). For Canada see D. Huberman, "Winding-Up of Business Corporations." in Studies in Canadian Company Law volume 2, ed. Ziegel, J. (Toronto: Buttersworth, 1973): 273 at 280.

This rule provided the basic framework for a remedy whenever the courts were able to bypass the Foss v. Harbottle rule and intervene in the internal affairs of a corporation. As with the "fraud on the minority" exception to the Foss v. Harbottle rule, the courts made it abundantly clear that they would not be bound by any outside limits to the exercise of their discretion. They wielded a discretionary power of the widest character with each case to be decided on its own fact situation.[64] The concept of "just and equitable" was to be construed liberally. There was no general rule:

> as to the nature of the circumstances which have to be borne in mind in considering whether the case comes within the phrase".[65]

Even if one were tempted to analyze the decisions and attempt to cull some principle from them, the courts warned there were no set categories which would make it "just and equitable" for a company to be wound up.[66] Flexibility was to be the key in the power of the courts to intervene under this rule such that the courts could expand the rule, where appropriate, into new areas as fresh circumstances and situations dictated.[67]

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64 In re Bleriot Aircraft Mfg Co. Ltd. (1916) 32 T.L.R. 253 at 255 (Chancery Division).

65 Davis & Co. Ltd. v. Brunswick (Australia) Ltd. et al. [1936] 1 All E.R. 299 at 309. (Privy Council)

66 In re Straw Products Pty Ltd. [1941] V.L.R. 139, aff'd. [1941] V.L.R. 222 (Supreme Court of Victoria).

67 Huberman, supra, note 63 at 281. Despite the judicial warnings not to try to categorize the types of situations where this rule has justified the courts in intervening, the basic classification for invoking the just and equitable principle seem to be commonly accepted as:

(continued...)

One consistent theme of the decisions under the "just and equitable" rule emerged as the major cornerstone of section 210 and of Canadian and American oppression remedies. This theme was the "quasi-partnership" situation epitomized by the Loch v. John Blackwood Ltd.[68] decision. In establishing the parameters of the test for the exercise of the court's discretion to intervene in an unjust and inequitable situation, Lord Shaw explained there must be a justifiable lack of confidence in the conduct and management of the company's affairs. This lack of confidence must be grounded on a "lack of probity" of the directors in the conduct of the company's affairs.[69] The rationale for this rule lay in certain fundamental conditions under which a shareholder invested money in the company.[70]

The first condition was that the business was to be limited to certain definite objects. The second was that it must be carried on by certain persons in a specified way. The third was that the business had to be conducted in accordance with certain principles of commercial administration statutorily defined, which provided some guarantee of

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[67](...continued)
(Huberman, supra, note 63 at 283ff)

a) loss of substratum of the corporation,
b) justifiable lack of confidence in the management of the corporation,
c) deadlock, and
d) the "quasi-partnership" doctrine.

[68] [1924] A. C. 783 (House of Lords and Privy Council)

[69] Ibid. 788.

[70] Baird v. Lees supra, note 12 at 92.

commercial probity and efficiency. If the controllers of the corporation did not honour any one of these conditions and if the shareholder was unable to find a recourse through the ordinary rules of the applicable company law statute, there may have been a situation where it was "just and equitable" to wind up the company.[71]

The majority's "lack of probity", by itself, could have been sufficient ground for dissolution, but it was not the only ground.[72] The majority's unfair or unjust conduct towards the minority would be sufficient if this conduct destroyed the minority's confidence in the majority.[73]

Proof of the existence of "lack of probity" on the part of the majority would, according to Lord Shaw, invoke the "just and equitable" rule. The issue then became, how to prove "lack of probity"? Since the "lack of probity" concept originated in the law of dissolution of partnerships, the key was to invoke the application of partnership law by showing

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71 Ibid. 92.

72 In Re Straw Products Pty Ltd. supra, note 66.

73 Under this rule, courts have granted winding up where:

1) directors or controlling shareholders have misappropriated company property;
2) directors have committed breaches of their fiduciary duty to the company by exercising in their own interest a power conferred on them for the benefit of the company;

and

3) failure to observe procedural requirements (B. H. McPherson, "Winding Up on the "Just and Equitable" Ground" (1964) 27 Modern Law Review 282 at 299. Generally see D. Huberman, supra, note 63, at 289ff.)

that despite the corporate form, the specific company was in essence a partnership. The law on dissolution of partnerships would then apply.[74] If the facts presented to the court showed that a "quasi - partnership" existed, the court would apply the partnership law rules of good faith, mutual trust and confidence of each partner in the integrity of every other partner.[75]

In deciding whether or not a specific company was in essence a partnership, the relatively small number of persons involved in the enterprise,[76] the means of sharing profits and the participation of all members on a full time basis in the day - to - day running of the business were considered as indicia of the archetypal partnership.[77] The court's task was to consider the contract between the parties, a concept which included not only the articles of the company, but also anything agreed by them in any other way, including a settled course of conduct which may or may not have been included in the contract.[78]

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[74] In Re Yenidje Tobacco Company Limited [1916] 2 Ch. 426 (Chancery Division).

[75] E. H. Scamell and A. R. C. I. Banker, Lindley on the Law of Partnership 14th edition (London: Sweet and Maxwell, 1984): 704 ff. The similarities with the wording of the just and equitable rule and the wording of the English Partnership Act (1890 section 35(f)) are striking. See also M. R. Chesterman, "The Just and Equitable" Winding Up of Small Private Companies." (1973) 36 Modern Law Review 129 at 132.

[76] Re Wondoflex Textiles Pty. Ltd. [1951] V. L. R. 458. (Supreme Court of Victoria)

[77] Chesterman, supra, note 75 at 132.

[78] Re Fildes Bros. Ltd. [1970] 1 W.L.R. 592 at 596 (Chancery Division).

Section 210 Cases

The provisions of section 210[79] allowed the courts to impose a wider variety of remedies for minority shareholders.[80] Under the common law rules the primary remedy for the wronged minority was to order the dissolution of the company.[81] However the remedy of dissolution did not necessarily aid the wronged minority because the break-up value of the shares might be quite small, or the only purchaser might be the very same majority which was guilty of oppression against the minority. The Cohen Committee, which investigated the necessity of reforming the English laws, recommended that Parliament grant the courts the power to impose whatever settlement the court considered "just and equitable". The courts would be unfettered in using this power because, the Cohen Committee said, it was impossible to lay down a general guide to the solution of what are essentially individual cases.

The first major cases under section 210 formed the reference points for future decisions in both Canada and the United States. These cases drew heavily from the existing common law "just and equitable" remedy and the "fraud on the

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79 See Appendix.

80 Cohen Committee, supra, note 13 at paragraph 60.

81 Other remedies did exist if dissolution would be to the advantage only of the wrongdoer, then the Chancellor would remedy the wrong without the use of dissolution. (Carlen v. Drury supra, note 63.)

minority" exception to Foss v. Harbottle. In Elder v. Elder[82] Lord Cooper set out the process required by section 210.[83] If oppression was to exist, he said, the conduct complained of should involve a "visible departure" from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[84] Oppressive behaviour was present in the cases where the "just and equitable" rule was invoked. However the rule could also apply in the absence of oppressive behaviour.[85] Only if the "just and equitable" rule applied and there was oppressive behaviour would section 210 be applicable. Section 210 would therefore be a restrictive version of the "just and equitable" remedy.

Lord Keith's interpretation was that section 210 applied if there were a lack of confidence between the shareholders. This lack of confidence must have arisen from the majority's oppression of the minority in the management of the company's

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[82] Elder v. Elder and Watson Ltd. supra, note 13. The prototypical fact situation was one of a partnership which subsequently became a private limited company (twelve shareholders in this case) -- a domestic and family concern. While no mismanagement occurred and the business and prospects were commercially sound, a quarrel arose between members of management with the result that one or more of the members was fired from the position of director. Recourse to the courts was then undertaken to resolve the matter claiming the fired director had been oppressed.

[83] Ibid. 55.

[84] Ibid. 55. See also Lord Shaw in Baird v. Lees supra, note 12.

[85] Elder v. Elder and Watson supra, note 13 at 55. In harmony with Lord Shaw in Loch v. John Blackwood supra, note 68.

affairs. Oppression involved at least an element of "lack of probity" or "fair dealing" in respect of a shareholder's proprietary rights as shareholder.[86] It "connotes an unfair abuse of powers by some person or persons controlling the company, resulting in injury to the rights of some part of its members."[87] The criteria of accountability of the controllers lay in the requirement of "fair dealing" and a "lack of probity" on the part of the controllers. What "fair dealing" or "lack of probity" meant, was left undetermined.

The House of Lords again tackled the meaning of section 210 in the Scottish Co-operative Wholesale Company v. Meyer case.[88] Viscount Simonds adopted the dictionary meaning of the word "oppression", i.e. "burdensome, harsh and wrongful", but did not state any criteria for determining whether or not the behaviour was burdensome, harsh and wrongful.[89] Lord Morton and Lord Denning held that the behaviour in question was oppressive but failed also to set out the criteria used in reaching this conclusion.[90] Lord Keith availed himself of the opportunity to reiterate his views from Elder, stating that oppression suggested a "lack of probity" and fair dealing in

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[86] Elder, supra, note 13 at 60.

[87] Ibid. 55.

[88] Scottish Co-operative Wholesale Society Ltd. v. Meyer supra, note 13. The facts showed that three directors, in a conflict of interest position, attempted to acquire the shares of the minority at an unfair price. The means employed involved undermining the company's business in the hope that the minority would be forced to sell.

[89] Ibid. 71.

[90] Ibid. 86 - 87.

the affairs of the company to the prejudice of some portion of its members.[91]

While these two early cases were decided under Scottish law, the English decisions, In Re Harmer,[92] Re Lundie Brothers [93] and In Re Five Minute Car Wash Service Ltd.,[94] did little but repeat the earlier position of the House of Lords. The result of the early English cases was therefore the adoption of two general definitions of "oppression" and "oppressive conduct": the narrow dictionary meaning of Viscount Simonds in Scottish Co-operative Wholesale Society Ltd. -- "burdensome, harsh, and wrongful" -- and the broader meaning from Lord Cooper in Elder intermingled with the "just and equitable" rule -- "an element of lack of probity and fair dealing", "a visible departure from the standards of fair

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[91] Ibid. 86.

[92] In Re H. R. Harmer Ltd. [1958] 3 All E.R. 689 (Court of Appeal) A family corporation was run by the father who disregarded other shareholder/directors' views and unilaterally dismissed staff. The court held that the father's behaviour constituted oppression of the sons as "members" and not merely as directors because the father's behaviour was damaging to the company as well as to the directors.

[93] Re Lundie Brothers, Ltd. [1965] 2 All E.R. 692 (Chancery Division). The facts from the Lundie Brothers case were similar with those in Re H. R. Harmer Ltd.: a private company had a falling out of the directors with the result that one director/shareholder was fired from his position as a director because of the influence of the majority shareholder. Further actions resulted in the isolation of the terminated director from the affairs of the company.

[94] Re Five Minute Car Wash Service Ltd. [1969] 1 All E.R. (Chancery Division) 242. This case concerned a small private company, however the factual complaints revealed simple differences of opinion on matters of policy between directors -- facts which did not even contain the allegation that there was a lack of probity on the part of the minority.

dealing and a violation of the conditions of fair play". Instead of clarifying the criteria of accountability, the House of Lords left confusion about the exact test to apply.

In 1962 the Jenkins Committee[95], a second commission with a mandate to study the need for reform of English company laws, recommended the statutory adoption of the reasoning in Elder v. Elder as well as Lord Cooper's definition of oppression. Conduct which qualified as "oppression" had, at the very least, to involve a "visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely". But the term "oppression" was uncertain and too restrictive so that the Committee recommended the abolition of this term from the legislation. In response to the recommendations of the Jenkins Report the English legislature revised section 210 (newly numbered as section 459) by substituting the phrase "unfairly prejudicial" for the word "oppressive" conduct.

The last of the trilogy of cases occurred with the House of Lords' decision in Ebrahimi v. Westbourne Galleries Ltd.[96]. A private company, which had been founded as a partnership, was the object of a winding-up petition under the "just and equitable" provisions, and in the Court of Appeal,

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[95] Great Britain, Report on Company Law (Jenkin's Report) Cmnd. 1749, (London: Her Majesty's Stationary Office, 1962.)

[96] Supra, note 13.

a section 210 petition. After the Court of Appeal's decision, the section 210 petition was discontinued. Thus the House of Lords was deciding solely the question of the meaning of the "just and equitable" rule.

The "just and equitable" remedy, it will be remembered, was available if there was a lack of confidence in management. This lack of confidence was easily proved if there was a "lack of probity" on the part of the majority. If it could be shown that the company was really a partnership, then the rules of partnership law applied to the dissolution of the company and the existence of the "lack of probity" was sufficient to have the court intervene to dissolve the company. Approved at the Court of Appeal level, this reasoning was accepted by the House of Lords. Thus, although not a section 210 case, the ramifications of Ebrahimi for developments in Canada and the United States were significant because of the intermeshing of the "just and equitable" rule with the meaning of oppression.

The House of Lords also held that even if there had been a strict adherence to the valid powers conferred by the articles of incorporation of the company, a court might still look through to the essential partnership nature of the entity such that:

> Acts which, in law, are a valid exercise of powers conferred by the articles may nevertheless be entirely outside what can fairly be regarded as having been in the

> contemplation of the parties when they became members of the company...[97]

It perceived the words "just and equitable" as a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own. The court could look behind the fact that the corporation was a separate entity to recognize that there are individuals with rights, expectations and obligations _inter se_ which are not necessarily submerged in the company structure. The exercise of legal rights is subject to equitable considerations.[98]

The House of Lords set down some guidelines by which the courts could judge whether or not to invoke the quasi-partnership analogy:

> Certainly the fact that a company is a small one, or a private company, is not enough....The superimposition of equitable considerations requires something more, which typically may include one, or probably more of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence--this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company--so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.[99]

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[97] _Ibid_. 378 quoting from _Wondoflex Textiles_ _supra_, note 76.

[98] _Ibid_. 379.

[99] _Ibid_. 379.

With the Ebrahami decision the major components of the English legacy were complete. This legacy, which was to have such a strong influence on the Canadian and American developments, was susceptible to differing interpretations. It could be used to justify and to develop the American concept of fiduciary duty of the majority to the minority, the "reasonable expectations" theory, the paradigm of "fairness" or the "lack of probity" theory. Which interpretation a specific court would adopt, often depended on the precise wording of the applicable statutory version of the oppression remedy.

Subsequent English cases have had little relevance to North American statutory oppression remedies because of the differences in the English statute. Although some of these cases have mirrored developments in North America, the House of Lords has not been involved with them and they have been mostly restricted to interpreting specific provisions of the English legislation.[100] In 1989 the English Parliament once

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[100] After section 210 was amended to clarify that Parliament wished the oppression remedies to encompass "unfairly prejudicial" behaviour, the English Court of Appeal in Re Jermyn Street Turkish Baths Ltd. [1971] 3 All E.R. 184 at 199 (Court of Appeal) perpetuated the semantic confusion by adopting Lord Keith's views to apply to the term "unfairly prejudicial". There were thus four elements required for unfairly prejudicial behaviour: a) the existence of some imbalance of power b) this imbalance was used in some behaviour c) the behaviour must have been unfair to the other members of the company and (d) the behaviour must have been lacking in the degree of probity which the other members of the company were entitled to expect in the conduct of the company's affairs. Blurring the distinction between (continued...)

again clarified its views and passed an amendment to section 459 such that the words "unfairly prejudicial to the interests of some part of the members" were changed to read "unfairly prejudicial to the interests of its members generally or of some part of its members.[101] For the third time in recent history, the English legislature has attempted to enlarge the scope of the statutory oppression remedy in the face of judicial conservatism in the interpretation of the statutory remedy.

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[100](...continued) "oppression" and "unfairly prejudicial" conduct, the court concluded that "oppression" meant that the oppressed were being constrained to submit to something which is unfair to them as the result of some overbearing act or attitude on the part of the oppressor. Hence "oppression", it would seem, now meant "unfair".

[101] Companies Act 1989 (c. 40) Schedule 19 paragraph 11.

CHAPTER 2 THE OPPRESSION REMEDY IN THE UNITED STATES

CHAPTER FOCUS

The goal of this chapter is to trace the development in the United States of the English legacy and to examine the evolution of the recent developments of the oppression remedy.

American Background

The English legacy was imported into a corporate law tradition with its own unique evolution. Indigenous American constitutional factors, a strong common law rule of the majority shareholders' fiduciary obligation to the minority and the business judgment rule combined to produce an American oppression remedy. These factors resulted in a sceptical application of the English "lack of probity" test and most recently, in the search for criteria of accountability of the corporate controllers which are in harmony with the essential nature of the corporate structure.

Constitutional Distribution of Powers

Evolution of the oppression remedy in the United States occurred within the constitutional framework of state common law and state statutory attempts to supplement the common law position. According to the American Constitution's distribution of powers each state possesses the power to create corporations. The federal government is not granted any express power to incorporate corporations but possesses nevertheless the implied power to incorporate when "necessary and proper" to its expressly granted powers.[102]

Federal judicial activism attempted to create its own federal "oppression" remedy[103]. The primary tool of the federal courts in fashioning a federal oppression remedy lay in Section 10(b) of the 1934 Securities Exchange Act and its Rule 10(b)-5.[104] Shareholders claiming oppression were able to launch an attack against the majority shareholders under Rule 10(b)-5. The basis of the attack on the action of the majority was a claim of a breach of fiduciary duty owed by the majority to the minority. Three types of "oppression" were delineated: fraudulent transactions in securities, going private transactions and mismanagement of the corporation. Mismanagement was occasionally suggested.[105] The intervention

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[102] R. G. Handler and T. F. Liotti "An Historical Survey of Federal Incorporation." (1976-77) 1 The Delaware Journal of Corporate Law 370 at 375. Article 1 §8 of the American Constitution -- when "necessary and proper" to carry out the powers expressly granted to Congress under the fiscal, war and interstate commerce clause -- and 378ff for an account of the reluctance of the federal government to exercise this power. See Chief Justice Marshall's decision in McCullock v. Maryland (17 U.S. (4 Wheat) 316 at 407 - 411 (United States Supreme Court). The major area of federal corporate law has been the federal securities legislation, the Securities Acts of 1933 and 1934. (Securities Act of 1933, 15 USC §77a - 77bbb; Securities Exchange Act of 1934, 15 USC §78a - 78hh. See Handler and Liotti, at 378ff for an example of the attempts to establish federal corporation law.)

[103] Generally see H. F. O'Neal and R. B. Thompson, Oppression of Minority Shareholders volume 2, 2nd edition, (Wilmette, Illinois: Callaghan & Company, 1987) Chapter 8.

[104] See Appendix for text.

[105] Note, "Rule 10b - 5" (1978) 8 Memphis State University Law Review 501: 525 - 526; H. J. Haynsworth, supra, note 8 at 35 and O'Neal supra, note 103 Chapter 8 at 52.

of the United States Supreme Court has severely restricted the scope of this federal oppression remedy.[106] The Supreme Court resisted the trend toward creating a federal corporation law and insisted that the federal courts look to state corporation law for an appropriate oppression remedy.[107]

State Common Law Oppression Remedy

Initially the general rule under state common law was that in the absence of statutory authority, a court had no jurisdiction to grant dissolution at the request of a minority shareholder[108]. The jurisdiction of a court to exercise its

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[106] The question of whether or not the Supreme Court curtailed totally this federal judicial activism remains unclear. Its decision in Santa Fe Industries Inc. v. Green ((1977) 430 U.S. 462 (1977) (the elimination of a minority shareholder by means of a short form corporate merger) largely put an end to the use of federal corporate law to augment or to alter the state law oppression remedy. Despite the Supreme Court's attempts to return corporate law to the states, there have been some cogent arguments to the effect that there might still be a form of federal recourse under rule 10b - 5 in very specific circumstances. (See C.S. Krendl, "The Progeny of Santa Fe v. Green; An Analysis of the Elements of a Fiduciary Duty Claim Under Rule 10b-5 and a Case for a Federal Corporation Law." (1980/81) 59 North Carolina Law Review 231 at 315ff and E. J. Malkin, "Santa Fe Industries v. Green Revisited. A Critique of Circuit Court Application of Rule 10b - 5 Breaches of a Fiduciary Duty to Minority Shareholders." (1980/81) 28 U.C.L.A. Law Review 564 at 572 ff.

[107] Erie Railroad Co. v. Thompkins 305 U.S. 64 (1938) U.S. Supreme Court) and Santa Fe industries Inc. v. Green ibid.

[108] L. L. Shapiro, "Involuntary Dissolution of Close Corporations for Mistreatment of Minority Shareholders." (1982) 60 Washington University Law Quarterly 1119 at 1125. Judicial reluctance to intervene in the corporation lay in the political and constitutional doctrine of the separation of powers between the judiciary and the executive. Since the (continued...)

general equitable powers to dissolve a corporation became accepted as a result of the 1892 Miner v. Belle Isle Ice Co. decision.[109] The criteria for the exercise of equitable jurisdiction was whether or not controlling shareholders were operating the corporation in good faith to advance its purposes and best interests.

The fiduciary duty of the majority shareholders formed the basis of the state statutory oppression remedy.[110] The terms "oppression" and "breach of fiduciary duty" were closely related. Identical conduct could be deemed "oppressive" in one

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[108](...continued) creation of a corporation was an act of the executive branch and since the judiciary had no jurisdiction to intervene in the activities of the executive branch without a legislative grant of jurisdiction, a court had no jurisdiction to intervene into the internal workings of a corporation.

[109] Miner v. Belle Isle Ice Co. 53 N.W. 218 ((1892) Supreme Court of Michigan). Pound argued that a visitatorial jurisdiction existed in so far as the state could proceed against a corporation to have it dissolved. (R. Pound, "Visitatorial Jurisdiction over Corporations in Equity." (1936) 49 Harvard Law Review 369 at 378); C. Rohrlich, Law and Practice in Corporate Control (New York: Baker Voorhis and Company, 1933 at 97) takes the lack of jurisdiction as an absolute rule; G. Hornstein, "A Remedy for Corporate Abuse" (1940) 40 Columbia Law Review 220, gives an overview of the evolution of the debate.

[110] Miner v. Belle Isle Ice Co. ibid. Domus Realty Corporation v. 3440 Realty Co., Inc. 40 N.Y.S. 2d 69 (1943 Supreme Court of New York); Sulinski v. Humboldt and Wabansia Bldg. Corporation 43 N.E. 2d 181 (1942 Appellate Court of Illinois), Marnik v. Northwestern Packing Co. 82 N.E. 2d 195 (1948 Appellate Court of Illinois), Lush'us Brand Distribution, Inc. v. Fort Dearborn Lithograph Co., N.E. 2d 737 (1946 Appellate Court of Illinois); also see J. O. Tingle, The Shareholder's Remedy of Corporate Dissolution. (Missoula, Montana: State University Press, 1959): 26 for a list of cases from other jurisdictions.

opinion and a "breach of fiduciary duty" in another.[111] In other decisions the terms were used interchangeably. The fiduciary duty also permitted the courts to minimize the effects of the American equivalent of the Foss v. Harbottle rule.[112] Justice Brandeis summarized the approach of the fiduciary duty:[113]

> The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority; as much as the corporation itself or its officers and directors...It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation.

A fiduciary relation arose in a situation where one person held a position of superiority and influence over the interests of another such that the latter was forced to rely on the good faith and fair dealing of the former. In such a situation, "not honesty alone, but the punctilio of an honor the most sensitive" was required.[114] The Supreme Court of the United States established a fiduciary duty on the controlling groups towards shareholders.[115] Soon the Supreme Court extended this duty to the majority in respect of all

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[111] Tingle, ibid. 41ff.

[112] See A. J. Boyle supra, note 27.

[113] Southern Pacific Co. v. Bogert, 250 U.S. 483 at 487 and 492. ((1918) United States Supreme Court)

[114] Judge Cardozo in Meinhard v. Salmon 164 N. E. 545 at 546.((1928) United States Supreme Court)

[115] Jackson v. Ludeling 88 U.S. 616 ((1874) United States Supreme Court)

shareholders.[116] This fiduciary duty required the majority to show that its dealings with the corporation were in good faith and were inherently fair toward the corporation and the shareholders.[117]

The Massachusetts Supreme Court's decision, Donahue v. Rodd Electrotype Co. of New England[118] revealed the suppleness of the fiduciary duty concept in the context of a state which still does not have a statutory oppression remedy. The majority shareholder of a close corporation had the corporation redeem some of his shares in order to complete a transfer of the rest of his shares to members of his family. By doing so, his family would also retain control of the corporation. In the absence of a statutory oppression remedy, the Massachusetts Supreme Court adopted the view that the minority shareholder of a close corporation was really like a partner in a partnership:

> Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the

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116 Southern Pacific Co., supra, note 113 and Jones v. A. F. Ahamson & Co. 460 P2d 464 ((1969) California Supreme Court)

117 "[T]he essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."(Pepper v. Litton 308 U.S. 295 (1939) United States Supreme Court: 306 - 307)

118 Supra, note 20.

> operation of the enterprise that partners owe to one another.[119]

In doing so the court perceived a close connection between the common law fiduciary duty and the statutory oppression remedy of other jurisdictions. No fraudulent behaviour of the majority was required nor any abuse of discretion. The test was, did the majority shareholder, or in this case, the controlling group, honour its fiduciary duty to the minority shareholder? It was clear to the Massachusetts Supreme Court that the fiduciary duty had been breached.

The major problem with the application of the common law fiduciary duty rule was its interaction with the business judgment rule. The American equivalent of the Foss v. Harbottle rule, the business judgment rule had developed as an accepted precept of American corporate law doctrine by the mid 1800's. The rule was based on the principle that the majority of shareholders have a right to manage the corporation as they see fit as long as they keep within the scope of the corporation's charter. Therefore a director who diligently performed the duties of a director and used his or her best business judgment on the questions facing the board, would not be held liable even if the judgment were faulty. A court would not interfere to prevent unwise or improvident acts.

For the business judgment rule to apply, there must have been:

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[119] Ibid. 515.

a) an absence of personal interest or self-dealing on the part of a director,

b) an actual decision made which was informed and which reflected a reasonable effort (subject to permitted reliance upon the advice and efforts of others) to become familiar with the relevant and available facts,

(c) a reasonable belief that the decision served the interests of the corporation, and

(d) good faith on the part of the director.

The disadvantage of the fiduciary duty is that it is still subordinated to the business judgement rule. If the latter applies, the fiduciary duty rule does not apply.[120] The practical effect of the business judgment rule from the minority's perspective is that it removes most transactions within the corporation from effective judicial scrutiny. The wide scope of the business judgment rule and the liberal application of it by the courts have provided a more than ample justification for the exercise of a court's discretion not to intervene into the internal affairs of a corporation and a severe curtailment of the common law oppression remedy. Although equity theoretically provided relief, the minority shareholder has been seldom successful in acquiring a dissolution order solely on equitable grounds.[121] Even courts

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[120] Wilkes v. Springside Nursing Home, Inc. 353 N.E. 2d 657. (1978 Supreme Judicial Court of Massachusetts)

[121] Shapiro, supra, note 108 at 1126.

which did recognize their equitable power to dissolve corporations have hesitated to do so in the absence of complementary statutory support. Only three courts since 1950 have done so.[122] In the same time period over ten times as many courts dissolved corporations on statutory grounds.[123]

State Legislative Oppression Remedy

State legislatures enacted legislation to complement the common law oppression remedy. In 1933 Illinois and Pennsylvania expressly included the oppression concept in legislation as a grounds for dissolution of a corporation.[124] In 1950 the Model Business Corporation Act adopted the Illinois approach,[125] an approach which has been repeated in the 1960, 1969 and 1984 Model Business Corporation Acts.[126] By 1965 twelve states had enacted some form of oppression remedy legislation.[127] That number had risen to twenty-six by 1982.[128] To date thirty-seven jurisdictions have adopted the

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122 Bellevue Gardens Inc. v. Hill 297 F. 2d 185 (1961 D.C. Circuit) Liebert v. Clapp 196 N. E. 2d 540 ((1963) N.Y. Court of Appeals)

123 Shapiro, supra, note 108 at 1126 footnote 40.

124 Illinois Revised Statutes §157.86(a) (3) (4) 1953; 1933 Pennsylvania Laws §106, §§1107, PL 364. California had used the term "persistent unfairness" since 1931.

125 Model Business Corp. Act para 90, in 6 Business Law Journal No. 1 (Nov. 1950).

126 See Appendix for text.

127 Note, supra, note 6 at 128.

128 Shapiro, supra, note 108 at 1132.

concept of oppression or a similar term.[129] Seventeen states allow dissolution on grounds other than oppression but do not include mistreatment or oppression of minority.[130] Five states allow for dissolution for additional and more specific grounds than oppression but also retain oppression.[131] These states all accept "unfairness" toward minority shareholders as the only ground for dissolution.[132] No jurisdiction has yet developed a statutory standard for determining what constitutes an unfair act. While there is no uniformity in state legislative content, the 1969 Model Business Corporation Act reflects the prevalent attitude in the United States. Only minor changes occurred in the 1984 Revised Model Business Corporation Act.[133]

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[129] R. B. Thompson, "Corporate Dissolution and Shareholders' Reasonable Expectations." (1988) 66 Washington University Quarterly 193 at 206 footnote 175 and R. B. Thompson, "The Shareholder's Cause of Action for Oppression." (1993) 48 The Business Lawyer 699 at 709 footnote 70.

[130] Shapiro, supra, note 108 at 1129.

[131] Michigan:"wilfully unfair and oppressive", New Jersey oppressively and unfairly; South Carolina "oppressive or unfairly prejudicial"; Minnesota: directors or those in control of the corporation have acted fraudulently or illegally, mismanaged the corporation, or abused their authority as officers or directors or have acted oppressively or unfairly toward one or more of minority shareholders in their capacities as shareholders, directors, officers, or employees; California: persistent and pervasive fraud, mismanagement or abuse of authority or persistent unfairness toward any shareholders.

[132] Shapiro, supra, note 108 at 1144 ftnt 139.

[133] See Appendix for text. Several states have complemented the Revised Model Business Corporations Act with a Close Corporation Statute:

Alabama Code §§10-2A-300 to 313 (1980); Arizona Revised Statutes Annotated §§10-201 to 218 (1977); Delaware Code

(continued...)

Development of State Case Law

The characteristic of the development of state law on the oppression remedy is the blending of the English legacy with the fiduciary duty of the majority shareholders to the minority. The first American precedent on the meaning of the statutory word "oppression" occurred in 1957.[134]

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[133](...continued)
Annotated title 8, §341 - 356 (1974 & Supp. 1980); Illinois Annotated Statutes ch. 32, §§1201 - 1216 (1981); Kansas Statutes Annotated §§17-7201 - 7216 (1981); Maryland Corporations & Associations Code Annotated §§4-1-1 to 603 (1975 & Supp. 1981); Pennsylvania Statutes Annotated title 15 §§1371 - 1386 (1982); Rhode Island General Laws §7-1.1-.51 (1969); Texas Business Corporations Act Annotated articles 12.01 - 12.54 (1981).

States with close corporation articles in an integrated corporation statute:

California Corporations Code §§300, 1800(b)(5) (1977 and Supp. 1982); Florida Statutes Annotated §607.107 (1977); Georgia Code Annotated §22-611 (1977); Michigan Company Laws Annotated §§450.1463, to 1466 (1973 and Supp. 1982); New Jersey Statutes Annotated §§14A:5-21, 14A:12-7(1)(c) (1969 and Supp. 1981); New York Business Corporations Law §§620, 1104-a 1963 and Supp. 1981); North Carolina General Statutes §55-73 (1975); South Carolina Code Annotated §§33-11-220, 33-21-130 (1976 & Supp. 1982); Tennessee Code Annotated §48-714 (1979).

26 states have adopted provisions identical or similar to those of the Model Act. (Shapiro, supra, note 108 at 1132, footnote 72.)

[134] Central Standard Life Insurance Company, supra, note 24. The Illinois Supreme Court was faced with a claim by preferred shareholders that the desire of the common shareholders to continue the existence of the corporation constituted oppressive behaviour because it was impossible for the corporation to make any profits. The lack of profits meant that only the common shareholders could possibly benefit from the business activities of the corporation, because the preferred shareholders would have no possibility of any dividends. The preferred shareholders argued they should be (continued...)

The Illinois Supreme Court resorted to the Elder v. Elder decision[135] to guide it in deciding the meaning of the statutory term "oppression". It held that "oppression" did not require an inference of imminent disaster, "necessarily savor of fraud," or require "mismanagement, or misapplication of assets".[136] While using the English legacy to help it decide what oppression did not mean, it applied the essentials of the common law fiduciary duty by maintaining the lower court's holding that a "clear abuse of trust" was sufficient to establish oppressive conduct without showing mismanagement or misapplication of assets.

The Illinois courts added two other decisions, Gidwitz v. Lanzit Corrugated Box Co.[137] and Polikoff v. Dole & Clark

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[134](...continued) able to withdraw their investments and sought liquidation of the corporation.

[135] Supra, note 13.

[136] Central Standard Life Insurance Company, supra, note 24 at 52.

[137] Supra, note 24. The Court ordered the dissolution of the corporation because of the majority shareholders' denial of some of the rights of the minority shareholders' to participate in the running of the corporation. The majority shareholder ran the corporation as a one-man operation. His actions included refusing to submit reports of the corporation's operations to the directors or to the shareholders, hiring a person who was to be paid an excessive salary, refusing to call an annual meeting of the shareholders for ten years, and increasing and decreasing the salaries of corporate employees and officers without the approval of the board of directors. The court rejected the claim that the cumulative effect of the majority shareholder's actions denied the minority shareholders their right to participate in the management of the corporation and constituted "oppression". For a Louisiana example of a similar fact pattern decided without the benefit of the "oppression" remedy, see Gooding v. (continued...)

Building Corp..[138] The Illinois Appellate Court reiterated its understanding of "oppression" to mean that the behaviour complained of must be in violation of the corporation's charter, some public law, or be corruptly and fraudulently subversive of the rights and interests of a shareholder.[139] Within these parameters, the Illinois Appellate Court also applied the English precedent in deciding on the meaning of the word "oppression"[140].

In 1972 the Supreme Court of Virginia also dealt with the meaning of the "oppression".[141] While governed by the Virginia statute, the court could find only the Illinois cases to guide it. The court also turned to the British experience which was now bolstered by the Scottish Co-operative Wholesale Society Ltd. decision.[142] The court adopted both approaches holding that:

> oppressive means...a visible departure from the standards of fair dealing, and a violation

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[137](...continued) Millet 430 So. 2d 742 ((1983) Louisiana Court of Appeal). See also Valerine v. Little 490 A.2d 756 (1985 Maryland Appeals Court)

[138] Supra, note 24. See also Compton v. Paul K. Harding Realty Co. supra, note 24. The majority shareholder had mortgaged the major corporate property to his spouse in return for a loan from the spouse. The corporation had not produced a profit more than once in the last seven years. Shares of the corporation had been redeemed. Improvements were made to the corporation's major asset when the corporation was unable to pay for them. A class of shares should have been redeemed but were not. Management, in essence, was simply inefficient.

[139] Gidwitz, supra, note 24 at 135.

[140] Polikoff, supra, note 24.

[141] White v. Perkins supra, note 24.

[142] Supra, note 13.

> of fair play on which every shareholder who entrusts his money to a company is entitled to rely" as well as "a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members.

"Oppression" was considered next by the Oregon Supreme Court in Baker v. Commercial Body Builders, Inc.[143] The Oregon Supreme Court adopted the test from Scottish Co-operative Wholesale Society Ltd. decision[144], concluding that an abuse of corporate position for private gain at the expense of the stockholders was oppressive behaviour. In coming to this decision, the court introduced the concept of "fiduciary duty" into the discussion of the meaning of the statutory word oppression.[145] The court maintained that the question of what was "oppressive" conduct by those in control of a "close" corporation (its majority stockholders) was closely related to the fiduciary duty of good faith and fair dealing owed by them to its minority stockholders.[146] It did not, however, clarify its perception of the differences between the two.

The dual themes of fiduciary duty and oppression were next expressed by the Missouri Court of Appeals' decision in

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[143] Supra, note 24. The majority shareholder terminated the employment of the minority shareholder, voted out the minority shareholder as a director, and prevented the minority from examining the records of the corporation and from receiving notices of meetings.

[144] Ibid. 391.

[145] Ibid. 392.

[146] Ibid. 392.

Fix v. Fix Material Company, Inc.[147] While adopting the English version of the "oppression" theme as set out by the Illinois courts, the Missouri Court of Appeals expressed its frustrations with the vagueness in the English "lack of probity" test. Consequently it looked to the general concepts of fiduciary law to establish the test for determining the meaning of oppression within the context of the close corporation.[148] While stating that the conduct of the majority shareholders came "narrowly close to a level of oppressive or illegal conduct within the meaning of the statute", the court failed to set down any criteria under the oppression test to determine exactly what level of oppressive conduct had to exist in order for the court to intervene. The vagueness of the criteria set down by the "lack of probity" test was still not perceived as a failing of the test.

The Supreme Court of Appeals of West Virginia in Masinter v. Webco Co.[149] continued the American metamorphosis of the

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[147] Supra, note 24.

[148] See also Kirtz v. Grossman 463 S.W. 2d 541 (1971 Missouri Appeal Court). The Court found oppression to exist but not sufficient to cause the court to intervene. See also Whale Art Co. v. Docter supra, note 24. (fiduciary duty and oppression remedy blended into one test)

> Though controlling shareholders are not fiduciaries in the strict sense, the general concepts of fiduciary law are useful in measuring conduct by those in control that entitles the minority to relief, particularly in the context of a closely-held corporation. (Fix v. Fix Material supra, note 24 at 358.)

This decision was followed in Jackson v. St. Regis Apartments Inc. 565 S.W. 2d 178 (1978 Missouri Court of Appeals)

[149] Supra, note 22.

"lack of probity" test. In the factual situation of an alleged freezeout of the minority shareholders, the court looked to the common law fiduciary duty of the majority shareholders to the minority shareholders in order to decide whether or not the statutory oppression remedy should apply. The court adroitly combined the fiduciary duty concept with the statutory oppressive conduct rule to produce a "fiduciary duty oppression remedy".

> Most states have adopted the view that a dissolution statute does not provide the exclusive remedy for injured shareholders and that the courts have equitable powers to fashion appropriate remedies where the majority shareholders have breached their fiduciary duty to the minority by engaging in oppressive conduct. ...we conclude that our cases involving the fiduciary duty owed by majority shareholders, officers and directors of a corporation embrace the <u>same standard which other courts have evolved under the term "oppressive conduct"</u>.[150] (emphasis added)

<u>"Reasonable Expectations" Theory</u>

The early stage of the statutory oppression remedy fused the concepts from the English legacy with the fiduciary duty of the majority to the minority. However the criteria to apply to the accountability of the corporate controllers still seemed too vague for some courts. Accordingly, when faced with the first case under New Jersey's statutory oppression remedy,

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[150] <u>Ibid</u>. 439 - 440. See also <u>Balvik</u> v. <u>Sylvester</u> <u>supra</u>, note 20.

the New Jersey Supreme Court set out on a different route.[151] The problem with the other states' decisions, the New Jersey court felt, was that there was no test given which the court could use to decide what behaviour was oppressive or unfair.[152] The Illinois court had said what oppression did not consist of. It had omitted to say what oppression consisted of.[153] In the opinion of the New Jersey Supreme Court, the courts of Oregon and Virginia had not appreciably added to the contribution of the Illinois' court.

Legislative reform in New Jersey provided the justification the court needed to look to a different set of criteria of accountability. Given that the New Jersey legislation was aimed at the dilemmas faced by minority shareholders in a close corporation, the New Jersey Supreme Court stated:

> The special circumstances, arrangements and personal relationships that frequently underly the formation of close corporations generate certain expectations among the shareholders concerning their respective roles in corporate affairs,including management and earnings. These expectations preclude the drawing of any conclusions about the impact of a particular course of corporate conduct on a shareholder without taking into consideration the role that he is expected to play. Accordingly, a court must determine initially the understanding of the parties in this regard. Armed with this information, the court can then decide whether the controlling

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151 Exadaktilos v. Cinnaminson Realty Co. Inc.,supra, note 19.

152 Ibid. 560.

153 Ibid. 559.

> shareholders have acted in a fashion that is contrary to this understanding or in the language of the statute, "have acted oppressively...toward one or more minority shareholders".[154]

The New York Supreme Court followed the New Jersey Supreme Court's approach. On the meaning of "oppression" under the New York statutory oppression remedy, the New York Supreme Court concluded that the definition of "oppressive" in a typical close corporation "freezeout" scenario, depended on the special nature of close corporations.[155] The shareholders of close corporations were "partners" who owed each other the highest degree of fidelity, loyalty, trust, faith, and confidence.[156] As part of the arrangement between the parties of a close corporation, there often existed "expectations" between them as to their respective rights and duties. These "reasonable expectations" constituted the bargain of the parties in light of which subsequent conduct had to be

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[154] Ibid. 561.

[155] In the Matter of Topper 433 N.Y.S.2d 359 at 364 (1980 Supreme Court of New York). Minority shareholder fired as an employee; minority's total savings invested in the corporation; evidence showed that at the beginning of the relationship with the majority shareholder there was an expectation that the minority would be an active participant in the management of the corporation; dividends cut off; transfer of the shares of the corporation was possible only on death of the shareholder. Since New York had initially adopted as its common law standard the English meaning of "oppressive" (i.e. conduct that is unjustly burdensome, harsh or merciless) this case marked a change in the law of New York. (See Domus Realty Corporation v. 3440 Realty Co. supra, note 110 at 75: "oppressive" means conduct that is unjustly burdensome, harsh or merciless.)

[156] Topper, ibid. 364 - 366.

appraised.[157] The rights and interests of minority shareholders were derived from the expectations of the parties and the special circumstances of the close corporation. If the controlling shareholders had acted contrary to these expectations, they were guilty of oppressive conduct.[158]

The New York courts were not ready to reject the English approach.[159] Only where the "reasonable expectations" test was found inapplicable, was the English view applied. Where the question of oppressiveness could not be resolved by comparing the conduct of the majority to the "reasonable expectations" of the parties, the court must look to the "lack of probity" test.[160]

In the first decision on the North Carolina statutory oppression remedy, Meiselman v. Meiselman,[161] the North Carolina Supreme Court decision demonstrated an eagerness to accept the concept of "reasonable expectations". In a "freezeout" situation,[162] the North Carolina Supreme Court

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157 Ibid. 363.

158 Ibid. 366.

159 Matter of Beshar, 440 N.Y.S.2d 803 (1981 New York Supreme Court); Mardikos v. Arger 457 N.Y.S.2d 371 (1982 New York Supreme Court); In re Taines and Gene Barry One Hour Photo Process, Inc., 444 N.Y.S. 2d 540.(1983 Supreme Court of New York); Matter of Gordon and Weiss Inc. 301 N.Y.S.2d 839 (1983 New York Supreme Court). See also Capitol Toyota, Inc. v. Gervin 381 So. 2d 1038 (1980 Supreme Court of Mississippi).

160 Gimpel v. Bolstein 477 N.Y.S. 2d 1014 at 1019 and 1020 (1984 New York Supreme Court).

161 Supra, note 19.

162 The minority shareholder was terminated as an employee of a close corporation, with loss of all rights to profit sharing which were based on performance as an employee.

applied the "reasonable expectations" approach and echoed the analysis of the New York and New Jersey courts:

> ...we hold that a complaining shareholder's "rights or interests" in a close corporation include the "reasonable expectations" the complaining shareholder has in the corporation. These "reasonable expectations" are to be ascertained by examining the entire history of the participants' relationship. That history will include the "reasonable expectations" created at the inception of the participants' relationship; those "reasonable expectations" as altered over time; and the "reasonable expectations" which develop as the participants engage in a course of dealing in conducting the affairs of the corporation. The interests and views of the other participants must be considered in determining "reasonable expectations". The key is "reasonable". In order for plaintiff's expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them. Privately held expectations which are not made known to the other participants are not "reasonable". Only expectations embodied in understandings, express or implied, among the participants should be recognized by the court...Also, only substantial expectations should be considered and this must be determined on a case-by-case basis.[163]

State Appellate Courts were divided in their reactions to these developments. Montana, as early as 1982, adopted the Exadaktilos view.[164] Missouri[165] and Oregon[166] did not go beyond the English approach while Illinois reiterated its

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[163] Supra, note 19 at 563.

[164] Fox v. 7L Bar Ranch supra, note 22.

[165] Herbik v. Rand supra, note 24.

[166] Iwasaki v. Iwasaki Bros. Inc. 649 P.2d 598 (1982 Court of Appeals of Oregon).

acceptance of it.[167] None of these decisions contained any substantial analysis of the threshold test for the oppression remedy and merely repeated the broad generalities concerning the English "lack of probity" test.

The New York Appellate Court, in the Kemp & Beatley Inc. decision,[168] shifted the balance in favour of the "reasonable expectations" test. The court explained that prior to the statutory oppression remedy, the common law remedy had been the route to follow in instances of oppression. In the absence of a legislative remedy for oppression, the courts would exercise their equitable discretion based on whether or not the fiduciary duty of the majority shareholders to the minority had been breached. Under the statutory provision, the rules were different.

> The statutory concept of "oppressive actions" can, perhaps, best be understood by examining the characteristics of close corporations and the Legislature's general purpose in creating this involuntary-dissolution statute. ... Defining oppressive conduct as distinct from illegality in the present context has been

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[167] Compton v. Paul K. Harding Realty Co. supra, note 24; Coduti v. Hellwig 469 N.E.2d 220 (1984 Appellate Court of Illinois) and Notzke v. Art Gallery, Inc. 405 N. E. 2d 839 (1980 Appellate Court of Illinois)

[168] Kemp & Beatley Inc. supra, note 19. The problem lay in the termination of employment of a minority shareholder. The controlling shareholder revised the method of granting extra compensation bonuses which had been determined on the basis of stock ownership in the company, such that only employees of the company, not shareholders, received the extra compensation. The result was to exclude the minority shareholder from receipt of this return on investment through the re-characterization of the distributions of the corporate income.

> considered in other forums. The question has been resolved by considering oppressive actions to refer to conduct that substantially defeats the "reasonable expectations" held by minority shareholders in committing their capital to the particular enterprise.[169]

The court preferred to look to the "reasonable expectations" of a shareholder as a means of identifying and measuring conduct alleged to be oppressive.

> ...[O]ppression should be deemed to arise only when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner's decision to join the venture. It would be inappropriate, however, for us in this case to delineate the contours of the courts' consideration in determining whether directors have been guilty of oppressive conduct. As in other areas of the law, much will depend on the circumstances in the individual case.[170]

With this New York Court of Appeals decision, one of North America's most important commercial jurisdictions endorsed the "reasonable expectations" test. The trend towards the adoption of "reasonable expectations" had acquired respectability. It spread to the appellate courts of Alaska,[171] New Mexico,[172] Texas[173] and Iowa[174]. It has

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[169] Ibid. 804 and 805.

[170] Ibid. 805.

[171] Stefano v. Coppock supra, note 19.

[172] McCauley v. Tom McCauley & Son,Inc., supra, note 19 For further decisions using the reasonable expectations test, see Wiedy's Furniture Clearance Center Company, Inc. 487 N.Y.S.2d 901 (1985 Supreme Court of New York), Re Burack 524 N.Y. S. 2d 457 app dismd 537 N.Y.S. 495 (1988 Supreme Court of New York), Re Farega Realty Corp 577 N.Y.S. 2d 610 (1987 Supreme Court of New York), Re Imperatore 512 N.Y.S. 2d 904 (1987 Supreme Court of New York), Gunzberg v. Art Lloyd Metal (continued...)

received legislative reinforcement in Minnesota and North Dakota through the enactment of legislation instructing the courts to consider the shareholders' "reasonable expectations" in determining whether or not to intervene in the internal affairs of the corporation and to grant relief.[175]

American jurisdictions are presently split on which test to use. Montana, New York, New Mexico, Iowa, Texas, North Dakota, Pennsylvania and Alaska support the "reasonable expectations" test. Massachusetts, West Virginia and possibly Oregon apply the fiduciary duty test. Illinois, Missouri and Oregon favour the "lack of probity" test. The remaining jurisdictions have yet to take a position.

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[172](...continued) Products Corp. 492 N.Y.S. 2d 83 (1985 Supreme Court of New York), In re Brach 522 N.Y.S. 2d 612 (1987 New York Appellate Division), In re Musilli 523 N. Y. S. 2d 120 (1987 New York Appeal Division), In re Schlacter 546 N.Y.S.2d 891 (1989 New York Appellate Division), In re Smith, 546 N.Y.S. 2d 382 (1989 New York Supreme Court), Matter of Schlachter 546 N.Y.S.2d 891 (1989 New York Supreme Court), Application of Rombusch 533 N.Y.S.2d 423 (1988 Supreme Court of New York). The New York courts seem, however, to be making a sharp distinction between expectations of shareholders and expectations of an employee. (Ingle v. Glamore Motor Sales Inc. 538 N.Y.S.2d 771 (1989 New York Court of Appeal) In the latter case, the principles of the Kemp & Beatley decision did not apply.

[173] Davis v. Sheerin supra, note 22.

[174] Maschmeier v. Southside Press Ltd. supra, note 22.

[175] Minnesota Statutes Annotated §302A.751 subd. 3a (West 1985); N.D. Cent. Code §9.1-115 (1985). See R. B. Thompson, supra, note 129 at 215ff.

CHAPTER 3 SURVEY OF THE OPPRESSION REMEDY IN CANADA

CHAPTER FOCUS

The intention of this chapter is to trace the development in Canada of the English legacy and to examine the evolution of the recent developments of the oppression remedy.

Canadianization of the English Legacy

The impact of the English legacy has been particularly strong in Canada. An identical tradition under the common law oppression remedy and strong similarity in the legislative wording led courts in Canada to look to the English legacy for guidance. Adapting the English legacy left the lower courts of various provinces in disagreement with each other. Only recently have provincial Appeal Courts become involved with the application of their respective statutory oppression remedies while to date the Supreme Court has not yet been involved. In doing so the Appeal Courts have shifted away from the "lack of probity" test to a more objectively based one.

Differences in the statutory wording in Canada have enabled the courts to apply the "lack of probity" test to oppressive behaviour while establishing the Ebrahami test to unfairly prejudicial behaviour. They have adroitly included the totality of the "fraud on the minority" exception and the "just and equitable" rule into the Canadian statutory oppression remedy. Through the difference in statutory wording the Canadian courts are apparently in the process of incrementally establishing the "reasonable expectations" approach as the criteria of accountability applicable to the actions of the controllers of the corporation.

Constitutional Distribution of Powers

Under the Canadian Constitution each province and the federal government have the power to legislate an oppression remedy.[176] While the list of federal powers does not include a power of incorporation, Citizens' Insurance Co. v. Parsons[177] held that the federal parliament had an incorporating power by virtue of the residuary character of the Peace, Order and Good Government power which extended to all matters not assigned to the provinces.

The provinces also have the power to incorporate companies but only companies with provincial objects.[178] The incorporation of companies whose objects are not provincial lies within the competence of the federal government.[179] The delineation of the precise powers of incorporation therefore depends upon the meaning of "provincial objects" and the rules of constitutional interpretation regarding the relationship of

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176 There has only been one challenge to the constitutionality of the federal statutory oppression remedy. It failed. (Montel v. Groupe de Consultants P. G. L. Inc. (15 B.L.R. 208) reversed in the Quebec Court of Appeal ((1982), 20 B.L.R. 159)

177 [1881] 7 A.C. 96. (House of Lords)

178 Constitution Act, 1867 section 92(11).

179 P. Hogg, Constitutional Law of Canada 3rd edition (Toronto: Carswell Company Limited, 1992) Chapter 23: 23ff.

the federal and provincial powers. The result of the Canadian distribution of powers is that provinces and the federal government have the constitutional ability to legislate in the field of corporate law.

Legislative Oppression Remedy in Canada

The Province of British Columbia became the statutory innovator in Canada.[180] Drawing on the English and British Columbian experiences with the statutory oppression remedy, the Dickerson Report[181] recommended that Canada also adopt a statutory delegation of wide authority to the judiciary to intervene in the internal affairs of a corporation.[182] Subsequently Sections 207 and 234 of the Canada Business Corporations Act were adopted in 1975.[183]

The Province of Ontario initially rejected the Canadian and the English approaches.[184] Ontario did eventually enact a similar provision, as did Alberta, Saskatchewan, Manitoba,

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180 See Appendix for contents of the British Columbia version.

181 Dickerson Report, supra, note 13 at 1658 - 1659.

182 Ibid. at paragraphs 1471 - 1487.

183 See Appendix for contents.

184 Interim Report of the Select Committee on Company Law (5th Session 27th Legislature, Ontario 15 - 16 Elizabeth II, 1967), paragraph 7.3.12. The Lawrence Committee disagreed with the philosophy of the Dickerson Committee. It felt that the solution of the Dickerson Committee was abandoning the problem of the accountability of the controllers to the judiciary.

Newfoundland, Nova Scotia and New Brunswick.[185]. At the time of writing only Quebec and Prince Edward Island have resisted the trend in Canada to implement a statutory oppression remedy.[186]

Canadian Common Law Oppression Remedy

The Canadian courts adopted the perspective of the English courts[187] and the terminology of "oppression" found in Burland v. Earle[188] and Menier v. Hooper's Telegraph Works.[189] The classic decision, Carr v. British Columbia Nickel Mines Limited verdict[190] and Waddell v. Ontario

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[185] Ontario Business Corporations Act 1982, Revised Statutes of Ontario 1990 chapter B.16, Section 248, Alberta Corporations Act, Statutes of Alberta 1981, chapter B-15 section 207 and 234, Saskatchewan Business Corporations Act, Revised Statutes of Saskatchewan 1978, chapter B - 10 section 234, Manitoba Corporations Act, Statutes of Manitoba 1976, chapter 40 section 234, New Brunswick Corporations Act, Statutes of New Brunswick 1981, chapter B-9.1 section 166(2), Nova Scotia Companies Act, Revised Statutes of Nova Scotia chapter 81 (Third Schedule #5(2)) as amended by 1990 chapter 15 and Corporations Act of Newfoundland, 1990 chapter C - 36 section 343 (1) and section 371, all of which are essentially the same as the federal statute.

[186] Prince Edward Island and Quebec find themselves in essentially the same position as England prior to the enactment of section 210. For Quebec, see R. Crête, "Les actionnaires minoritaires des compagnies québecoises: Qu'en est-il de leurs recours en cas d'oppression?" (1991) 19 Canadian Business Law Journal 47. The adoption of the new civil code on January 1, 1994 (Articles 6 and 7) brought in an all encompassing duty of "good faith" in the exercise of civil rights. This "good faith" requirement will apply to "legal" persons and to the actions of members of these persons.

[187] Supra, page 20ff.

[188] Supra, note 46.

[189] Supra, note 56.

[190] (1937), 3 W. W. R. 61 at 67 (B.C. Supreme Court).

Canning Company[191] ensured the terminology of oppression and fairness would be planted in Canada. Similarly the "quasi-partnership" situation epitomized by the Loch v. John Blackwood Ltd.[192] decision and its criteria of "lack of probity" were accepted in Canada. The similarity of the "just and equitable" rule to the Canadian oppression remedy was so striking that it has been argued that there is a substantial identity between the two.[193] Consequently the common law oppression remedy in Canada was equivalent to the English legacy.

Interpretations of Oppression

As the first jurisdiction in Canada to enact a statutory oppression remedy, British Columbia's courts were also the first in Canada to try to figure out how to apply it. As a replica of the English section 210, the British Columbia statute was interpreted in light of the Elder[194] and the Scottish Co-operative Wholesale Society[195] decisions. In National Building Maintenance Ltd.[196] Aikins J. was faced with a situation of the misappropriation of funds. He adopted

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191 (1889), 18 O. R. 49 (Ontario Supreme Court).

192 Supra, note 68.

193 Re R. Jowsey Manufacturing Co. Ltd. (1969), 6 D.L.R. (3d) 97 (Ontario Court of Appeal)

194 Supra, note 13.

195 Supra, note 13.

196 Re National Building Maintenance Ltd., [1971] 1 W.W.R. 8 (B.C. Supreme Court);[1972] 5 W.W.R. 411. (B.C. Court of Appeal)

the "lack of probity" or fair dealing approach set down in Scottish Co-operative Wholesale Society, Ltd.[197]. The British Columbia Court of Appeal upheld his decision without commenting on the meaning of the word "oppression".[198]

National Building Maintenance Ltd. was followed in B.C. Aircraft Propeller & Engine Co.,[199] In arriving at its conclusion, the court adopted the tests for oppression set out in Elder[200] and Scottish Co-operative Wholesale Society[201].

In 1973 the British Columbia statute was amended to expand the scope of the statutory remedy to include "unfairly prejudicial" behaviour.(Unlike the English statute where "oppressive" behaviour was replaced by "unfairly prejudicial" behaviour.) In the first case decided after the amendment, the Diligenti v. RMWMD Operations Kelowna decision[202] incorporated the "just and equitable" holding from Ebrahimi[203] into the British Columbian concept of statutory oppression.[204] This was achieved, however, through the use of

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197 Supra, note 13.

198 [1973] 5 W.W.R. 411.

199 Re B.C. Aircraft Propeller & Engine Co. Ltd., (1968), 63 W.W.R. 80.(B.C. Supreme Court)

200 Supra, note 13

201 Supra, note 13.

202 Diligenti v. RWMD Operations Kelowna Ltd., RWMD Operations Prince George Ltd., McConachie, Radcliffe and Welter (1976), 1 B.C.L.R. 36.(B.C. Supreme Court)

203 Supra, note 13.

204 The majority shareholders of a private corporation removed a minority shareholder from his position as director of several private companies. The majority also authorized, without the proper corporate authorization, payment of management fees to a corporation controlled by them. The (continued...)

the words "unfairly prejudicial" and not under the terminology of "oppression". Fulton J. held that "unfairly prejudicial" behaviour was different from "oppressive" behaviour. "Unfairly prejudicial" behaviour, not "oppressive" behaviour, included the "just and equitable" remedy from the common law. A breach of equitable rights of the shareholder may not "oppress" the shareholder but it may be "unfairly prejudicial" to the shareholder.[205]

Other jurisdictions soon became involved in developing the statutory oppression remedy. Consistently the main issue was the difference between "oppressive" and "unfairly prejudicial" behaviour. The criteria of accountability for the controllers would differ if a difference existed because "unfairly prejudicial" behaviour might not be as difficult to show as "oppressive" behaviour. The essence of the dispute centred on whether or not the controllers had to be acting in "bad faith" as the "lack of probity" test required.

In Brant Investments Ltd. et al. and KeepRite Inc. et al.[206] the Ontario Supreme Court stated categorically that in all cases in Canada and England, where the oppression remedy

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[204](...continued) effect of these actions was to deprive the minority shareholder of his compensation by way of management fees. The questions the court had to address were whether or not the majority's actions were oppressive or unfairly prejudicial, did they affect the rights, position or interests of the minority as a member, i.e. shareholder, of the companies, and did they necessitate the intervention of the court?

[205] Diligenti, supra, note 202 at 51.

[206] (1987), 60 O. R. (2d) 737 (Ontario Supreme Court)

had been granted, there had always been a finding of conduct clearly inconsistent with good faith and honesty. The Alberta Queen's Bench in Bank of Montreal v. Dome Petroleum Limited, held that a finding of bad faith or "lack of probity" was a necessary prerequisite for the intervention of the court under the oppression remedy.[207]

In Nystad v. Harcrest Apartments Limited et al., the British Columbia Supreme Court distinguished between "oppressive" conduct and "unfairly prejudicial" conduct. Conduct which was "oppressive" required a showing of bad faith while "unfairly prejudicial conduct" did not. The gravamen was whether or not the conduct had an "unfairly prejudicial" effect on the injured shareholder. The shareholder will not be unfairly prejudiced solely because he or she has been adversely affected by the business operation. Did the behaviour complained of, affect the shareholder in a manner which was unjust or inequitable? The criteria for what was unfair, unjust or inequitable, was left undetermined.[208]

Ascertaining the principles for the threshold test of the statutory oppression remedy became increasingly difficult as

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[207] Bank of Montreal v. Dome Petroleum Limited and Amoco Canada Petroleum Company Ltd. (1987), 54 Alta. L. R. (2d) 289.(Alberta Queen's Bench)

[208] (1986), 3 B.C.L.R. (2d) 39. (B. C. Supreme Court); Goldstream Resources Ltd.; Dicore Resources Ltd., Jupe and Downey v. Goldstream Resources Ltd. et al., Re, 2 B.C.L.R. (2d) 244.(B.C. Supreme Court); Johnston et al. and West Fraser Timber Co. Ltd. et al. Re, (1981), 29 B.C.L.R. 379; 133 D.L.R. (3d) 77.(B.C. Supreme Court)

a result of differing lower court decisions. The Ontario Divisional Court complicated matters in Re Palmer and Carling O'Keefe Breweries of Canada Ltd.[209] where it disagreed with the Re Brant Investments Ltd. and KeepRite Inc. decision. It held there need not be bad faith in order for oppression to be present. In Low and Anderson v. Ascot Jockey Club Limited[210] the British Columbia Supreme Court opted for a test which ignored whether or not the behaviour was deliberate with a view to harming the minority, as did the Quebec Superior Court in Sparling v. Javelin International Ltd.[211] Stech v. Davies[212] and Hamilton v. Sartorio added a new twist to the debate by underlining the expansion of the statutory oppression to behaviour which "unfairly disregards" the minority's interest.[213]

The Alberta Queen's Bench decision of First Edmonton Place Limited v. 315888 Alberta Limited[214] provided a fairly broad examination of the new statutory remedy and of the legislative policy and purposes behind it. The court went beyond the scope of the statutory meaning of "oppression" and

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209 (1987), 41 B. L. R. 128. (Ontario Supreme Court)

210 Low and Anderson v. Ascot Jockey Club Limited et al. (1986), 1 B.C.L.R.(2d) 123.(B.C. Supreme Court)

211 Sparling v. Javelin International Ltd. (1987), 37 B.L.R. 265.(Quebec Superior Court) affd [1992] R.J.Q. 11 (C.A.)

212 (1987), 53 Alta L. R. (2d) 373. (Alberta Queen's Bench)

213 [1991] 3 W.W.R. 670.(Queen's Bench)

214 First Edmonton Place Limited v. 315888 Alberta Ltd. (1988), 60 Alta L. R. (2d) 122. (Alberta Queen's Bench)

adopted the test instead for behaviour which was "unfairly prejudicial":

> The court should seek to balance protection of the minority's interest against the policy of preserving freedom of action for management and the right of the members to back up their investment by their vote. The fair view of the majority should carry considerable weight, but should not be critically important. The history, nature and structure of the company, the essential nature of the association, the type of rights affected and general company practice should all be material.
>
> More concretely, the test of unfair prejudice should encompass the following considerations: the protection of underlying expectation of shareholders in closely held companies, and the detriment to the member's proprietary interests as a shareholder.[215]

This reformulation of the threshold test for the application of the statutory remedy was quite significant because it moved away from the concept of "oppression" and established the Ebrahimi test in a different context. The breach of an underlying expectation combined with a detriment to the shareholder in itself constituted "unfairly prejudicial" behaviour.

At the lower court level in British Columbia, Quebec and Alberta there appeared to be a distinction between "oppressive" behaviour and "unfairly prejudicial" behaviour. At the Appellate Court level several decisions have dealt with the same issue. The Ontario Court of Appeal in Re Ferguson and

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[215] Ibid. at 145 quoting from G. Shapira, "Minority Shareholders' Protection -- Recent Developments." (1982/83) 10 New Zealand Universities Law Review 134.

Imax System Corp[216] approached the question of whether or not the majority had acted oppressively. The majority had decided not to declare dividends and to amend the articles of the company in order to reorganize the company's capital so that the company could redeem the minority's shares. The consequences of this behaviour were that the company could avoid paying the minority any dividends. The court held that this behaviour constituted "oppression".

The impugned behaviour of the majority, that of amending the articles of incorporation, was the culminating event in a course of conduct which, the court held, was "oppressive and unfairly prejudicial" to the minority. In reaching this conclusion the Court of Appeal successfully blurred the distinction between "oppressive" and "unfairly prejudicial" behaviour.[217] The significance of this confusion was seen in the court's requirement of bad faith of the majority in order for there to be "oppressive" conduct. The question then arose whether or not the concept of "oppressive" conduct, as used by the court in encompassing both "unfairly prejudicial" conduct

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[216] Re Ferguson and Imax Systems Corp., (1983), 150 D.L.R. (3d) 718. (Ontario Court of Appeal)

[217] "Accordingly, when dealing with a close corporation, the court may consider the relationship between the shareholders and not simply legal rights as such. In addition the court must consider the bona fides of the corporate transaction in question to determine whether the act of the corporation or directors effects a result which is oppressive or unfairly prejudicial to the minority shareholder." ibid. at 727.

and "oppressive" conduct, meant that bad faith was necessary in order for there to be "unfairly prejudicial" conduct as well.

The Alberta Court of Appeal produced a comprehensive examination of the oppression remedy in Keho Holdings Ltd and Oliver v. Noble et al.[218] but it too failed to distinguish between oppressive behaviour and unfairly prejudicial behaviour.[219] In his analysis of the law and of the test for the presence of oppression, Haddad J. A. adopted the "lack of probity" test, the Ebrahimi test of underlying expectations and followed the Ontario Court of Appeal's guidelines set out in Re Ferguson and Imax Systems.[220] The essence of the tests was that the court would intervene if the majority breached some underlying obligation to the aggrieved shareholder.[221] Like the Ontario Court of Appeal, the Alberta Court of Appeal ran the gamut of available threshold tests, but unfortunately it too did not differentiate between the test required in

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218 (1987), 52 Alta. L.R. (2d) 195. (Alberta Court of Appeal)

219 This case involved an application for the dissolution of a private company initially with twenty shareholders. The application was granted in the court of first instance. The complainants alleged they had been excluded from management, that the majority had illegally misappropriated assets of the company by granting a loan to a company which was wholly owned by the majority and that the majority had granted itself an option to purchase shares of the company at a value which was below fair market value.

220 Supra, note 218 at 201.

221 Ibid. 202.

order for there to be "oppressive" conduct as opposed to "unfairly prejudicial" conduct.

The Saskatchewan Court of Appeal added its voice to the refinement of the statutory oppression remedy in the Eiserman v. Ara Farms Ltd. and Eiserman decision.[222] Relying on the Keho Holdings and Diligenti decisions, the Saskatchewan Court of Appeal applied the partnership analogy and ordered the majority to buy the shares of the minority. In reaching this decision, the court stated the conduct complained of need not be deliberate. It sufficed if it had the effect of being unfairly prejudicial.[223]

Metamorphosis of "Lack of Probity" Test

The Ontario Court of Appeal has recently focused its attention again on the oppression remedy in Brant Investments Ltd. v. KeepRite Inc.[224] The court was asked to rule on

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222 Eiserman v. Ara Farms Ltd. and Eiserman (1988), 44 Sask. R. 61. (Saskatchewan Court of Appeal). In a family corporation, one of the shareholders found himself increasingly isolated from the running of the corporation, and was further deprived of some of the benefits incidental to his participation in the corporation. As a result of a personality conflict with the majority shareholder, the minority shareholder resigned as a director and employee of the corporation but did not take advantage of his right to have the majority buy out his shares in the corporation. Instead he requested that the court order the corporation to transfer certain of its properties to him and pay him on a "quantum meruit" basis for his past services.

223 347883 Alberta Ltd. v. Producers Pipelines Inc. followed the Eiserman decision.[1991] 4 W.W.R. 577. (Saskatchewan Court of Appeal)

224 Supra, note 18.

whether or not an objective test of "fairness" was to be applied to the impugned conduct. In particular the issue was whether it was necessary for there to be a "want of probity" or bad faith in order for there to be oppression.

In answering this question the Court of Appeal distinguished between pre-1980 cases in England and those subsequent to the amendment of the English company law statute.[225] The court's reasoning was that after the amendment of section 210 in England, the wording of the statute was "unfairly prejudicial" and not "oppressive conduct". The English Parliament had clearly intended that there be a difference between the two. This difference lay in the requirement that there be bad faith. Before the amendments in England it was unlikely that conduct could be oppressive without an element of bad faith or want of probity.[226] After the amendment, under the "unfairly prejudicial" standard, no bad faith was required. The court concluded that no evidence of bad faith or want of probity was required by the terminology of "unfairly prejudicial to" or "unfairly disregards the interests" in the Canadian statutory version of the oppression remedy.

The court then explained that in the _Ferguson_ v. _Imax_ decision, it had not stated that the good faith of the corporate transaction must in all cases be examined. The rule

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225 _Ibid_. 303.
226 _Ibid_. 305 - 306.

in Ferguson v. Imax was that, in the context of closely held corporations involving friends and spouses where there was evidence of bad faith, there must be consideration of the bad faith or want of probity of the parties. The "quality" or "propriety" of the conduct complained of was relevant in deciding whether or not the conduct was oppressive or unfair. But that did not mean that there had to be bad faith or lack of probity in order for the court to intervene.[227] The broad objectives and the actual wording of the legislation did not require a finding of lack of good faith be made in every case, the court concluded.[228]

The Ontario Court of Appeal confirmed the difference between "oppressive" conduct and "unfairly prejudicial" conduct and the criteria of accountability under each of them. By doing so it clarified the new threshold test for the statutory oppression remedy: that of the "fairness" of the impugned conduct as opposed to the subjective requirement of

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227 Ibid. 307 In testing whether or not a certain behaviour "unfairly affects" a complainant's rights, evidence of bad faith might be relevant but there could be cases where behaviour has produced an unfair result with no bad faith present. An interesting comparison may be the logic of the House of Lords under section 210. There the just and equitable rule could be invoked when "oppression" was present but it would still be invoked when it was not. Section 210 would be applicable when the just and equitable rule applied and when oppression (lack of probity or fairness) existed. Essentially the Court of Appeal followed the logic, but has simply exchanged the terminology of "oppression" for "unfairly prejudicial" and "unfair" for "just and equitable". It also has failed to address the issue of what "unfair behaviour" consists of.

228 Ibid. 311.

some form of bad faith/"lack of probity" or moral impropriety on the part of majority. What the Court of Appeal failed to do was to set out the test for determining whether or not the behaviour was "unfair". Did "unfair" include all the factors elaborated in the common law oppression remedy or just some of them i.e. the "fairness" set down in Loch, the "fairness" set down in Elder or the "fairness" set down in Ebrahami? The Court of Appeal seems to have merely transferred onto the concept of "unfairly prejudicial" all the uncertainties which had before been encompassed by the concept of "oppressive" behaviour. Most likely the issue of the meaning of "oppressive" behaviour will now fade away and the only time behaviour will be "oppressive" will be if some aspect of bad faith is present. The major issue will become the determination of the test for "unfairly prejudicial" behaviour.

The Alberta Court of Appeal dealt recently with the determination of the test for "unfairly prejudicial" behaviour. In Westfair Foods and Watt[229] the court applied the test of the "reasonable expectations" of the parties as the criteria for determining whether or not the majority's behaviour was fair:

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[229] Supra, note 18. A dispute arose between the preferred shareholders and common shareholders over a change in the dividend policy of the company. The preferred shareholders claimed that the change in the dividend policy was "unfair" to them.

> The company and the shareholders entered voluntarily, not by duty or by chance, into a relationship. Our guides are the rules in other contexts, such as contract law, equity and partnership law, where the courts have also considered just rules to govern voluntary relationships. In very general terms, one clear principle that emerges is that we regulate voluntary relationships by regard to the expectations raised in the mind of a party by the word or deed of the other, and which the first party ordinarily would realize it was encouraging by its words and deeds. This is what we call reasonable expectations, or expectations deserving of protection.[230]

Nearly two decades of experience with the statutory oppression remedy have culminated in the division of the oppression remedy into three issues. These are: i) the meaning of "unfair", ii) whether "prejudice" has been suffered and iii) whether the prejudice suffered has affected a right of a member of the company unfairly. This last issue may be addressed by application of the principles from the Ebrahimi decision while the test for prejudice requires objective proof of a detriment to the shareholder. The most difficult issue has been determining the actual criteria of accountability. After Westfair it would appear that Canadian courts, like their counterparts in New York and several other states, are heading towards the test of the "reasonable expectations" of the shareholders.

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230 Ibid. at 54. Alldrew Holdings v. NIBRO Holdings (1994), 16 O.R. (3d) 718 (General Division) has adopted the reasonable expectations approach in Ontario.

CHAPTER 4 SEARCHING FOR A THRESHOLD TEST FOR OPPRESSION

CHAPTER FOCUS

This chapter focuses on a comparison of the various "oppression" remedies and assesses the effectiveness of the "reasonable expectations" test as a replacement of the "lack of probity" test.

The Search for Criteria of Accountability

The controllers of a corporation must be held accountable for their actions. Accountability requires the establishment of criteria to judge by. The oppression remedy, both in its common law and its statutory form, represents an effort by the courts to establish these criteria. The search for criteria of accountability transcends the types of "oppression remedies". Only when a court has determined the criteria by which it can judge the actions of the controllers, can it decide whether or not "oppressive" or "unfairly prejudicial" conduct has occurred.

Initially the courts used the "lack of probity" test. Recent developments in the United States and Canada have led to the acceptance of the criteria of the "reasonable expectations" of the shareholders. Statutory oppression remedies, such as section 210 of the English Companies Act, did not clarify the criteria the court was to apply. They focused on providing alternative remedies to the remedy of dissolving the corporation once the court had decided that the controllers had committed a wrong. They came into existence mainly to resolve the difficulties surrounding the remedies of the common law oppression remedy and to supplement the courts' equitable powers. Their usefulness was premised on the existence of "oppressive/unfairly prejudicial" behaviour.

Common Law versus Statutory Oppression

Nevertheless the statutory version of the oppression remedy brought in several improvements over the common law oppression remedy. In Canada, a major difference between the statutory and the common law remedy was the enlargement of the class of persons who could sue to seek redress for a wrong covered by the statute.[231] The statutory oppression remedy in

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[231] Under section 241 of the Canada Business Corporations Act (S. C. 1974 - 75 c. 33, (now Revised Statutes of Canada 1985 C-44 section 229) -- hereinafter "CBCA") only a "complainant" may apply to a court for an order by action or by application. Any person entered on the corporate records as having legal title to a security of the corporation at the time of the action is included as a complainant. (Chilian et al. v. Augdome Corp. Ltd. et al. (1991), 78 D.L.R. (4th) 129 (Ontario Court of Appeal).) The scope of the word "security" has caused some problems, however it seems that a "security" represents equity ownership in the company. (Section 2(1); Sparling v. Royal Trustco Ltd. (1984), 6 D.L.R. (4th) 682 (Ontario High Court of Justice); Miller v. F. Mendel Holdings Ltd. (1984), 26 B.L.R. 85 (Saskatchewan Court of Queen's Bench); Re Abraham and Inter Wide Investments Ltd. (1985), 51 O.R. (2d) 460 (Ontario High Court of Justice).) "beneficial ownership" and "beneficial interest" are defined in the Canadian statute and seem to include a trustee or beneficiary relationship. (See also B.C. Aircraft Propeller and Engine Co. supra, note 199; Re Van-Tel T.V. Ltd. (1974), 44 D.L.R. (3d) 136. (B.C. Supreme Court)). Former security holders, directors or officers of a corporation would presumably have the appropriate standing although they would have to show that they still have a "sufficient interest".(Michalak v. Biotech Electronics Ltd. (1986), 35 B.L.R. 1 (Quebec Superior Court). See also Re Daon Development Corporation (1984), 54 B.C.L.R.

(continued...)

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[231](...continued)
235 (B.C. Supreme Court). But see Lee v. International Consort Industries Inc. [1992] 63 B.C.L.R. (2d) 119. (B.C. Court of Appeal) Warrant holders and option holders (Goldbelt Mines Inc. (NPL) v. New Beginnings (1985) 28 B.L.R. 130; 59 B.C.L.R. 82 (B.C. Court of Appeal)) and debenture holders (Re Daon Development Corporation) have not qualified as "complainants" nor has a person who no longer has an interest in the corporation.(Innocan Inc. v. Canadian Pacific Air Lines Limited, [1987] R. J. Q. 2451 (Quebec Superior Court) [1991] R.J.Q. 2186 (Quebec Court of Appeal); Journet et al. v. Superchef Food Industries Ltd. et al. (1984), 29 B.L.R. (3d) 206. (Quebec Superior Court); Miller v. F. Mendel Holdings Ltd.; Cairney v. Golden Key Holdings (1987), 40 B.L.R. 263 (B.C. Supreme Court); Eiserman v. Ara Farms Limited and Eiserman supra, note 222; Benarroch v. City Resources (Canada) Ltd. [1991] 4 W.W.R. 562 (B.C. Court of Appeal).) A lender has qualified as a complainant (Tsuru v. Montpetit [1989] R. J. Q. 2452 (Quebec Superior Court)) as has a registered holder or beneficial owner of a security of an "affiliate" of the corporation as well as a director or an officer of the affiliate. The Director under the CBCA has intervened in several cases (Sparling v. Javelin International Ltd. (No. 1) (1986), R.J.Q. 1073 (Quebec Superior Court); Sparling v. Javelin International Ltd. (No. 2) (Quebec Superior Court) supra, note 211; Sparling v. Royal Trustco 6 D.L.R. (4th) 682 (Ontario Court of Appeal)) and the Ontario Securities Commission, under Ontario's statute, (Ontario Securities Commission v. McLaughlin O.S.C. Bulletin volume 11, No. 4, January 29, 1988) has qualified as a complainant. The federal Crown in its capacity of a creditor as the Department of National Revenue has been recognized as an appropriate complainant (Regina v. The Sands Motor Hotel Ltd. [1985] 1 W.W.R. 59 (Saskatchewan Court of Queen's Bench) and a creditor of the corporation may be an appropriate complainant (First Edmonton Place Ltd. v. 315888 Ltd., supra, note 214; Bank of Montreal v. Dome Petroleum, supra, note 207. But see Lee v. International Consort Industries Inc..) The majority shareholders might be a complainant.(Re Harmer Ltd., supra, note 92 at 705, but see Vedova v. Garden House Inn Ltd. (1985), 29 B.L.R. 236 (Ontario Supreme Court) where the court held that the oppression remedy is confined to the protection of minorities. See also Re Gandalman Investments Inc. and Fogle (1985), 22 D.L.R. (4th) 638 (Ontario High Court of Justice) where a 50% shareholder was held to be a complainant in the situation where a deadlock existed; see also Testa v. MacDonnell, unreported Ontario High Court #RE 1334/86, 1465/86 November 3, 1986 which disagreed with Vedova.) Re Daon Development Corporation restricted the definition to people

(continued...)

Canada extended the common law remedy to include derivative actions. Under the common law, looting a company constituted damages to the company and not to the individual shareholder. The company, not the shareholder who was wronged, profited from recovery of the damages.[232]

A further change ushered in by the Canadian statutory oppression remedy extended the type of behaviour which allowed the courts to intervene. The courts were able to intervene not only for conduct which was "oppressive" but also which was

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[231](...continued) who "have a direct financial interest in how the company is being managed and are in a position...where they have no legal right to influence or change what they see to be abuses of management or conduct contrary to the company's interest. (at 243. (See also Re T. I. W. Industries Ltd. (1983), 42 O.R. (2d) 333. (Ontario High Court of Justice).) Benarroch v. City Resources (Canada) Ltd. confirmed this restriction. A creditor may be a "complainant" (First Edmonton Place, supra, note 214, Canadian Opera Co. v. 670800 Ontario Inc. (1989), 69 O.R. (2d) 532 (High Court) affd (1990), 75 O.R.(2d) 720) but only if the creditor was a creditor at the time of the oppressive conduct and did not become a creditor as a result of the oppressive conduct. (Trillium Computer Resources Inc. v. Taiwan Communications Inc. (1992), 10 O.R. (3d) 249 (General Division))

[232] Traditionally the derivative action mostly gave rise to the "fraud on the minority" exception under the Foss v. Harbottle rule while the personal action was based in the "just and equitable" rule. See Cini v. Micallef (1987), 60 O. R. (2d) 584 (Ont. H.C.) and J. G. MacIntosh, "The Oppression Remedy: Personal or Derivative?" (1991) 70 The Canadian Bar Review 29 at 35. Section 210 required the shareholder to show that the damage alleged was a damage to that shareholder in the shareholder's capacity as a "member" of the corporation, and was specific to the shareholder. Re Harmer, supra, note 92; Scottish Co-operative Wholesale Society Ltd. v. Meyer supra, note 13. The amendments to section 210 after the Jenkins Report did not clarify the nature of the oppression remedy but the latest amendment in England does clarify that the remedy includes both the personal and derivative action.(D. Bouchier, supra, note 13)

"unfairly prejudicial" to a complainant or which "unfairly disregarded" the interests of a complainant.[233]

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[233] Re Peterson and Kanata Investments Ltd. (1975), 60 D.L.R. (3d) 527 (B. C. Supreme Court); Re Ferguson v. Imax Systems Corp. supra, note 216; Meltzer v. Western Paper Box Co. Ltd. (1978), 3 B.L.R. 85 (Manitoba Queen's Bench). The acts covered include isolated acts as well as a continuing course of conduct. (Miller v. F. Mendel Holdings Ltd. supra, note 231) These acts may have begun before the minority becomes a member of the corporation and may be oppressive if they are continued after the minority is a member of the corporation. (Low and Anderson v. Ascot Jockey Club supra, note 210) Possibly the acts may be covered even if they occurred prior to the enactment of the statutory remedy. (Re Heyl and Lac Minerals Ltd., (1985), 50 O.R. (2d) 535, (High Court of Justice), affd 53 O.R. (2nd) 224n Div. C.)

The acts or the omissions have to be involved in the conduct of the "affairs" of the corporation, that is the relationship among a corporation, its affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate. (CBCA section 2(1).) The preparation of a company's annual financial statements is part of its "affairs" (Re National Building Maintenance Ltd. supra, note 196) while a take-over bid is also part of the affairs of a company. (Sparling v. Royal Trustco Ltd. supra, note 231) The courts have taken on a broad functional perception of the meaning of the word "affairs" but exclude personal disputes between shareholders (Bernard v. Montgomery (1987) 36 B.L.R. 257 (Saskatchewan Supreme Court); Jarman v. Brown and Gulfstream Cruises Ltd., (1979), 5 W.W.R. 673 (B.C. Supreme Court); Stone v. Stonehurst Enterprises Ltd. 80 N.B.R. (2d) 290 (New Brunswick Court of Queen's Bench)) and disputes over mismanagement and corporate policies. (Re Harmer Ltd., supra, note 92) There are some grounds for arguing that the "business or affairs of the corporation" may be restricted to the matters relating to the directors' power to manage the business and affairs of the corporation. (For a broad view see Ferguson v. Imax Systems Corp. (supra, note 216) For a narrow view, see Re Royal Trustco Ltd. (No. 3) (1981), 14 B.L.R. 307 (Ontario High Court of Justice).) The Canadian statute does not appear to encompass a "threat" as a type of corporate conduct which may be oppressive but the Ontario and British Columbia statutes appear to encompass threats (Bowater Canadian Ltd. v. R.L.Crain Inc., (Ontario High Court of Justice) summarized in (1987), 3 A.C.W.S. (3d) 380; see the Ontario Business Corporations Act which includes threats; see also Bank of Montreal v. Dome Petroleum supra, note 207 which (continued...)

The most frequently resorted to remedy under the common law oppression remedy was dissolution of the corporation.[234] In considering the remedies under an oppression action, however, the drastic nature of the dissolution remedy has been frequently foremost in the mind of the court so that dissolution is only to be used under the severest of circumstances. Courts therefore have been reluctant to use it.[235] The statutory remedy supplemented the equitable powers of the courts. Generally, however, none of the statutes provided any guidance or standards in the selection of which remedy to use.[236]

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[233](...continued)
rejected a complainant's petition because the complaint was anticipatory.). While the majority shareholders do not actually owe a duty to the minority under the provisions of the statutory remedy, the practical result of the statutory remedy appears to be that the majority will effectively owe a duty to the minority because any action of the majority, in order to be implemented, will be implemented as an act or omission of the corporation, as the business or affairs of the corporation or as the exercise of the powers of the directors of the corporation.

Under the statutory remedy the type of conduct for which relief could be granted was widened to include unfair prejudice, a single act could give rise to a successful application. Unfairly prejudicial conduct did not have to exist at the time of application for the application to succeed.

[234] Murdock, supra, note 11 at 453.

[235] S. C. Bahls, supra, note 8 at 296; H. J. Haynsworth, supra, note 105; C. L. Israels, supra, note 8; J.A.C. Hetherington, supra, note 8.

[236] It may even be that the legislatures intentionally created a remedy which is designed to be vague:

> The Canadian "oppression" sections depend heavily on judicial conservatism; rather than creating clear-cut definitional requirements that a complainant must meet, the sections require only that some rather vague standard

(continued...)

Determination of Criteria of Accountability

The statutory oppression remedy did not introduce a new form of conduct or a new set of criteria of accountability which would give rise to judicial intervention. Under the common law criteria of accountability, the courts intervened when the behaviour was "oppressive" or "unfair"[237]. Left unresolved was the meaning of these terms and the scope of the criteria applicable.

Under the statutory remedy, a number of definitions of "oppression" or "oppressive conduct" were formulated by the courts but these definitions have been of limited usefulness because of the generality of their terms and because courts have taken a narrow view of the meaning of oppression.[238] The statutory oppression remedy under the terminology of "oppressive" conduct has in practice merely echoed the test

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[236](...continued)
of "unfairness" be proved. The rest depends upon the legislators' hope that judges will, except in the worst cases, be naturally disinclined to exercise the excessively broad powers they are given by the sections. (B. Welling, Corporate Law in Canada -- the Governing Principles 2nd edition (Toronto: Butterworths, 1991): 556)

The State of Minnesota has ventured farther than other jurisdictions in its direction to the judiciary of the type of remedy to choose. It has included in its legislation a direction to the court to consider "the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other." (Minnesota Statutes Annotated §302A.75(2) West 1985 edition)

[237] Supra, page 21ff.

[238] B. R. Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience." (1988) 10 University of Pennsylvania Journal of International Business Law 305 at 321.

for oppression under the common law.[239] Earlier studies of the uses of the statutory oppression remedy confirm that the courts' implementation of it has reflected a judicial reticence to intervene in the affairs of a corporation and a restatement of the common law criteria.[240] While insisting on

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[239] A recent classification of the Canadian courts' use of the criterion of bad faith/lack of probity, done before the decision of the Ontario Court of Appeal in Brant Investments Ltd. decision, reveals both the lack of consistency in the way the courts apply the lack of probity test as well as the consistency of the courts' behaviour in applying the pre-statutory oppression remedy and post-statutory remedy. Not surprisingly, this study also illustrates the confusion of the courts in distinguishing between oppressive behaviour and unfairly prejudicial behaviour as well as the exact nature of the test they are applying. This study claims that, despite the ostensible requirement of bad faith, the substance of the lack of probity test always has really consisted of a test that focuses on the question of whether or not the conduct of the majority produces an unfair result for the minority, rather than on the existence of bad faith of the majority. This argument claims that the lack of probity test includes conduct that is objectively, and not merely subjectively, wrongful. Consequently, for several decades, most courts have misunderstood, or failed to analyze adequately, the test propounded by Lord Cooper. The test is really an objective test which stipulates the existence of a failure to deal fairly as the criteria for "oppression". Such a failure may or may not be accompanied by bad faith or lack of probity but the crucial aspect is the effect it has on the victimized shareholder. The courts must consider the good faith of the corporate transaction only in order to determine whether or not the act impugned effects a result which is oppressive or unfairly prejudicial to the minority shareholders. (J. G. MacIntosh, "Bad Faith and the Oppression Remedy: Uneasy Marriage, or Amicable Divorce?" (1990) 69 Canadian Bar Review 276.)

[240] I. M. Schaef, "The Oppression Remedy for Minority Shareholders" (1985) 23 Alberta Law Review 512. The cases have been grouped into four classifications:

(1) cases of forced amalgamation aimed at squeezing out minorities who refuse to sell their shares in response to a take-over bid;

(continued...)

"fairness" the courts also required an independent element of legal impropriety on the part of the majority. An act, to be oppressive, had to be unscrupulous or unconstitutional.[241] The inquiry did not go beyond the issue of the majority's good faith or a search for a deliberate attempt to harm the minority. Restating the common law interpretations of oppression reduced the statutory concept of oppression to the common law duties of majority shareholders and frustrated the purpose of the statutory reform.

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[240](...continued)

(2) cases concerning wrongs within closely held corporations which succeeded on the analogy between corporate and partnership structure;

(3) cases in which directors have been stopped from misusing corporate property or from neglecting the best interests of the corporation in the exercise of their discretion with a view to their own gain; and

(4) cases where in effect a near "fiduciary duty" of the majority to the minority is breached.

The methodology of American courts in determining whether or not oppression exists under the statutory wording, has not been inspiring. As one study reports, they adopt one of two methods:(Shapiro, supra, note 108 at 1134)

1) The court initially defines or characterizes the general qualities of oppression that trigger dissolution and then proceeding on a case by case basis, determines whether a particular set of facts falls within the terms of the definition. Variations on this methodology occur when a court determines the existence of oppressive conduct without first supplying a general definition or when a court finds the behaviour oppressive but requires an accumulation of oppressive acts before granting dissolution.

2) In the second method a court will award dissolution on the basis of oppression when the actions of controlling shareholder thwart the reasonable expectations of minority shareholders.

Use of the early oppression remedy in the United States reveals nearly identical conclusions.

[241] Shapira, supra, note 215 at 144.

Two American decisions reveal the dissatisfaction with the "lack of probity" standard. One court found that there was objectionable behaviour on the part of the majority. But it was unable to stipulate just how reprehensible the misconduct had to be or for just how long a duration it had to occur in order for it to be considered "oppressive" behaviour.[242] Another court[243] hedged on just how "oppressive" conduct must be before the court would intervene.

Requiring the controllers to act fairly provided little further clarity because neither the British nor the American cases defined "good faith" or elaborated on the elements of "fairness".[244] Left unanswered were issues such as how far matters of mere business policy and mismanagement could amount to "unfairly prejudicial acts" and the precise criteria of how to determine the meaning of "unfair prejudice". As the court in Re Broadcasting Station 2GB Pty. Ltd. pointed out:

> ...the further question arises of determining what conduct falls within the ambit of the word or words used, whether it be the word "oppressive" as used in the section itself or the words used in the synonomyms suggested in the cases...What is "fair dealing" which the member is entitled to expect? When is the conduct "wrongful" or lacking in probity"?[245]

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[242] Fix v. Fix Material supra, note 24.
[243] Masinter v. Webco supra, note 22.
[244] Afterman, supra, note 36 at 1061.
[245] Supra, note 19 at 1662.

In particular, how far does "oppression" extend when there is no independent element of legal impropriety?[246] The "lack of probity" test fails to provide an answer to these questions. The courts have been granted almost unrestricted discretion to evaluate a minority's complaints.[247] Without knowing the criteria of accountability or the extent of any rights they might have, both plaintiff and defendant have had to act like lobbyists, instead of litigants, arguing for a decision based on a preexisting legal right. In this battle, the majority has been greatly helped and the minority hindered by the common law predisposition to defend the rights of the majority.

In Ontario, the Court of Appeal has attempted to provide a test which functions better than the "lack of probity" test. It distinguished between "oppressive" conduct, "unfairly prejudicial" conduct and conduct which "unfairly disregarded" the interests of the shareholder. The minority no longer needed to show that the majority acted in bad faith in order to obtain relief. The court looked to the impact of the unfair conduct on the victim, that is the effect of the actions of the majority on the minority shareholder's pecuniary interests. Would a "reasonable bystander" have regarded the consequences of the conduct as "unfairly prejudicial" to the petitioner? This test provides for a more objective standard

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[246] K. W. Wedderburn, "Oppression of Minority Shareholders." (1966) 29 Modern Law Review 321 at 324.

[247] Shapira, *supra*, note 215 at 142.

of "fairness" which relates to the effects of the impugned conduct. As a result, the oppression remedy in Ontario is now premised on "fairness" to the minority. The criteria of "fairness", however, are undefined and the threshold test of "fairness" needs to be set out. The term "fairness" perpetuates the vagueness of the "lack of probity" terminology.

The New York Court of Appeal and the Alberta Court of Appeal have gone an extra step in defining the threshold test for "fairness". They have adopted the criteria of the "reasonable expectations" of the participants. If there is a breach of the "reasonable expectations" of the minority, the controllers are accountable to them. "Fairness" may or may not be relevant. The "reasonable expectations" test requires:[248]

1) There must be established a set of expectations held by the dissatisfied shareholder and on which this shareholder relied in becoming a participant in the corporation.
2) It must be shown that the expectations were known to or assumed by the other shareholders, or that the other shareholders ought reasonably to have known of them. The expectations may have been evidenced by an express

[248] Thompson, "Corporate Dissolution", supra, note 129 at 216ff; R. W. Hillman, "The Dissatisfied Participant in the Solvent Business Venture: A Consideration of Relative Permanence of Partnerships and Close Corporations." (1982/83) 67 Minnesota Law Review 1 at 49ff; Kemp & Beatley supra, note 19; and Meiselman v. Meiselman supra, note 19.

agreement among the participants or by tacit agreement. They must be those expectations which a reasonable shareholder in the position of the complainant would normally have, which are not promptly and specifically disputed by the other shareholders or are clearly inapplicable in the circumstances.

3) The entire business agreement is not necessarily found in the corporation's charter or by-laws, or even in a separate signed shareholders' agreement. Sometimes the expectations are "just vague and half-articulated understandings" which are not mentioned in any written agreement. These expectations may be evidenced by the shareholders' actions.

4) The expectations which have been breached must be important to the investor's participation and be objectively established as such to the knowledge of the other parties.

5) The expectations must have been in existence at the commencement of the corporation even though they may develop through a course of conduct during the life of the corporation.

6) It must be unlikely that the expectations will be achieved.

7) The failure to achieve the expectations must have been in large part beyond the control of the complaining

participant. The cause of the failure must be determined by an objective test.

8) The rule of stare decisis is not applicable and the exercise of the courts' discretion must be decided on a case-by-case basis.

Like the new "fairness" test, the "reasonable expectations" test looks to the objective results of the breach of the shareholder's "reasonable expectations". Both shift the focal point of the court's analysis away from the misconduct or wrongdoing of the majority shareholders towards a consideration of whether or not the minority's rights and interests have actually been prejudiced. The intent of the people exercising control becomes less significant. The impact of the actions on the minority shareholders becomes the crucial criterion.

There is one major distinction between the two tests. The test of "reasonable expectations" adopts a contract law paradigm which finds oppression (or in Canada "unfairly prejudicial" behaviour) when there is a breach of an actual reasonable expectation of the aggrieved shareholder.[249] The "equitable rights" perspective still relies on the subjectivity of the court's equitable discretion.

In deciding the "fairness" of the behaviour, the "reasonable expectations" test examines the majority's

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[249] This approach is extremely similar to the approach of the court in First Edmonton Place Limited v. 315888 Alberta Limited supra, note 214.

behaviour in light of whether or not a breach of contractual terms has occurred. Even if the "equitable rights" of the Ebrahimi test are equivalent to the "reasonable expectations",[250] the Ontario Court of Appeal has only used the equitable rights doctrine to determine whether or not a right of the aggrieved member was affected. It must then decide whether or not it was "unfairly" affected. It has not adopted the view that the complete threshold test for unfair prejudice is whether or not a breach of the equitable right has occurred. In their attempt to provide more certainty, the analysis of the New York Court of Appeals and the Alberta Court of Appeal have gone one step farther than the Ontario approach.[251]

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[250] F. H. O'Neal considered them to be the same See O'Neal, F. H. "Close Corporations: Existing Legislation and Recommended Reform." (1977/78) 33 Business Lawyer 873 at 886.

[251] There appears to be ample precedent in Canada should the courts here wish to apply the contractual approach. The breach of a personal right of the shareholder has frequently been thought of as an exception to the Foss v. Harbottle rule. It finds its basis in the contractual effect of the articles and by-laws of the corporation. This contractual effect was stated in the original English Joint Stock Companies Act of 1844 and has survived since then. The Supreme Court of Canada has confirmed the contractual effect of the articles of association in The Theatre Amusement Co,. v. Stone.(1915), 50 S.C.R. 32. Similarly letters patent companies have frequently been treated as though the letters patent had contractual effect. (Palmer and Prentice, Cases and Materials on Company Law (Butterworths Casebook No. 6) 1969: 325 - 327. See R.R. Drury, "The Relative Nature of a Shareholder's Right to Enforce the Company Contract." (1986) 45 Cambridge Law Journal 219 for some of the English background to this perspective and L.S.Sealy, "The Enforcement of Partnership Agreements, Articles of Association and Shareholder Agreements." in Equity and Commercial Relationships ed. P. D. Finn, (Sydney, (continued...)

Conceptual Basis of the "Reasonable Expectations" Approach

The application of a contract paradigm to the corporate structure and relationship between shareholders flows logically and coherently from a specific economic perspective of the corporation as a "nexus of contracts"[252]. More importantly it reintroduces the familiar concepts of classical contract law into the domain of corporate law doctrine.[253]

This economic perspective is rooted in the analysis of the cost efficiency of various forms of business enterprises. It claims that the corporate entity arose as the dominant form of business entity in North America because the transaction costs associated with it were lower than with any other type of business entity.[254] This analysis concludes that the test

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[251](...continued) Australia: The Law Book Company Limited, 1987): 89). Also see Fildes Brothers Ltd. (supra, note 78), Anisman, (supra, note 18 at 482 - 483) and Welling (supra, note 236 at 563) which argue that the reasonable expectations test is or should be a part of Canadian law.

[252] V. Brudney, supra, note 8 at 1403 ff 1 for a comprehensive list of the "nexus of contracts" literature; M. Jensen & W. H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." (1976) 3 Journal of Financial Economics 305.

[253] In many ways it is similar to the doctrine of "frustration" of contract. This is a doctrine whose approach several commentators have found to be appealing in the context of the "just and equitable" rules and the exercise of the court's visitatorial powers. See for example G. Hornstein, supra, note 10 at 224 - 225.

[254] R.H. Coase, "The Nature of the Firm." (1937) 4 Economica 386. Coase's theory claims that differences in the cost of operating institutions ("transaction costs") led to the emergence of the corporation as the dominant form of business entity because of the extremely low costs associated with consensual arrangements.

of the "reasonable expectations" of a member of a corporation is rooted in the essential nature of a corporation and, several authors have argued, represents the most cost effective method of dealing with the allocation costs of running a corporation.[255]

The essence of a corporation, according to contract theory, is a "nexus of contracts" whose terms are dependent partly on the free will of the parties and partly on the statutorily established terms in each jurisdiction. Ownership of the corporation is an irrelevant concept and

> is a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals...are brought into equilibrium within a framework of contractual relations.[256]

The interaction of these contracts, that is corporate law doctrine, must be explained and justified by an economically efficient analysis. The behaviour of the market requires that the efficiency of the corporate structure be judged through an analysis of the cost efficiency of various forms of business enterprises.

With the rules of contract law as its basis, the corporation then must live within the rules of the "market"

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[255] B. R. Cheffins, "An Economic Analysis of the Oppression Remedy: Working towards a more coherent picture of corporate law." (1990) 40 University of Toronto Law Journal 775 and D.D. Prentice "The Theory of the Firm: Minority Shareholder Oppression: Sections 459 - 461 of the Companies Act 1985." (1988) 8 Oxford Journal of Legal Studies 55.

[256] Jansen, supra, note 252 at 310 - 311.

which establish limits on the will of each shareholder. If not happy with the returns on their investment, shareholders may sell their shares in the marketplace. Alternatively, if the management of the corporation is not efficient, the earnings of the company will dwindle and consequently the price of its shares will drop. As the price of the shares drop, the attractiveness of the company as a takeover target will grow until eventually it is taken over and the inefficient management is replaced by new management. Thus the market for shares and for managers will ensure the efficient operation of the corporation.

Under this economic analysis the "reasonable expectations" theory fits in as part of the rhetoric of classical contract law. Classical contract law endeavours to encompass the realization of "reasonable expectations" that have been induced by the making of a promise.[257] Adam Smith rested his theory of property rights on "reasonable expectations", that is, expectations which would be shared by the sympathetic "spectator". The theory of "reasonable expectations" exists as the underlying principle in the first Restatement's comment on good faith, a cardinal element of

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[257] P.S. Atiyah, The Rise and Fall of Freedom of Contract (Oxford: Clarendon Press, 1979): 402. Corbin's classic treatise on contracts, (A. L. Corbin, Corbin on Contracts one volume edition (St. Paul, Minnesota: West Publishing 1952): 1) reads: "The Main Purpose of Contract Law is the Realization of Reasonable Expectations Induced by Promises".

classic contract law.[258] In the United States the Restatement (Second) of Contracts alters this emphasis and moves its focus beyond the terms of the contract to the nature and impact of the performance of the contract on the parties along with a general duty of good faith and fair dealing.[259] The theory of the "reasonable expectations" of the shareholders provides a consistent and coherent paradigm of contract law which explains the functioning of the oppression remedy in light of the economic nature of the corporation.

Sufficiency of the "Reasonable Expectations" Test

While there is a logical consistency between the "reasonable expectations" test and the cost efficient analysis of the corporate entity, the question remains whether or not the "reasonable expectations" test produces a more satisfactory and objective justification of the court's intervention. To a certain extent it does. The introduction of the rigours of contract law analysis into the oppression remedy is a welcome development because the parties in a close corporation are usually engaged in a business venture, one whose essence is the agreement of the various parties. Both the courts and the business world are familiar with the rules

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[258] D. F. Clifford Jr., "Close Corporation Shareholder Reasonable Expectations: the Larger Context." (1986) 22 Wake Forest Law Review 41 at 42.

[259] Restatement (Second) of Contracts paragraph 205 (1981).

of contract law. These rules (in the United States under the Uniform Commercial Code in particular) provide more certainty than the vague "lack of probity" test does. The attempt to refer to the rules of contract law is in harmony with the requirement of good faith performance of the terms of a contract: faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.[260]

Nevertheless there are problems with the "reasonable expectations" test. These problems lie in five areas:

1) uncertainties as to the scope and exact contents of the "reasonable expectations" doctrine,
2) the choice of social values and interests inherent in the test,
3) elements of subjectivity in the application of the test,
4) the fallacy of the premise of the test, that of the equivalency of a close corporation/quasi-partnership and a partnership,

and

5) the unproven nature of the theory of the "essential nature" of the corporation.

Due to its novelty, development of the scope of the "reasonable expectations" test has still to occur. Consequently uncertainty of the scope of the theory abounds. Like the "just and equitable" rule, the "lack of probity"

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[260] Clifford, supra, note 258 at 48.

principle and the "fraud on the minority" exception to the Foss v. Harbottle rule, the "reasonable expectations" test fails to provide any contours to its criteria and refuses to be bound by previous court decisions. It is doubtful that this is an improvement over the English legacy.

A further question relates to the relationship of the "reasonable expectations" test and the business judgment rule. If there is a legitimate business purpose to the actions of the controllers but their actions nevertheless breach the "reasonable expectations" of the minority, which is to apply, the business judgment rule or the "reasonable expectations" test?

What if the initial expectations change? What about the participant who joins after the inception of the enterprise? What about the expectations of a non-shareholder, such as a creditor or other complainant who would be covered under some of the broader statutory oppression remedies? To what extent are the expectations of the shareholders other than the ones seeking relief to be considered? Are the expectations of creditors of the corporation relevant?

The most difficult hurdle for the "reasonable expectations" test is acceptance of its underlying social value. It requires the majority to face the economic consequences arising from behaviour that is neither reprehensible nor lacking in probity. It may have acted within the four corners of the terms of the agreement with the minority. If the majority is unable to raise the money to buy out the minority, why should the majority have to pay the cost of the buy-out when it has not acted reprehensibly? By what criteria are the interests of the minority to be balanced against the preservation of the majority's freedom to govern the corporation? At what point in time does treating the minority as a partner in a partnership and allowing for a forced buy-out by the majority, become oppressive to the majority?

There is, furthermore, a strong subjective element in the application of the "reasonable expectations" test. It applies to a close corporation. What is a close corporation? How large can such a corporation be? The more participants there are, the harder it becomes to determine mutually agreed upon expectations and to justify the analogy of a corporation to a partnership. Corporation statutes have adopted artificial answers ranging from ten shareholders to fifty.[261] If legislatures have had a difficult time in deciding what constitutes a close corporation,[262] what criteria is a court to apply? To date, without legislative guidance, the test has not been applied to a public corporation. In jurisdictions without special close corporation legislation but with broad

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[261] Hochstetler & Svejda, "Empirical Research Project, Statutory Needs of Close Corporations -- An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law?" (1985) The Journal of Corporation Law 849 at 852 and 864ff.

[262] Ibid. at 864.

statutory oppression remedies, there is no distinction between a public and a private/close corporation in so far as the remedy is concerned.[263] Initially the "reasonable expectations" test was proposed for the smaller, close corporation. It may be that the test will be unwieldy for the larger corporations and that the "lack of probity" test will have to used with them.

The two premises underlying the "reasonable expectations" test are questionable. The first premise posits the analogy of the firm organized as a close corporation/quasi - partnership to a partnership. Because close corporations frequently are based on a personal relationship in which individual expectations reasonably extend beyond profit-making, the two types of business entities ought to be treated identically. The similarity of the essential attributes of the close corporation and the partnership has long been perceived by the courts - the "incorporated partnership" is the catch phrase.[264] According to this analogy, there is a functional equivalency between the structures of a partnership and a private corporation, despite their different legal structures.

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[263] Classification of a corporation as "closely held" frequently is based on the lack of marketability of its shares as a result of restrictions on transferability of the shares.

[264] Re Yenidje supra, note 74; Loch v. John Blackwood Limited supra, note 68; Ebrahimi v. Westbourne Galleries supra, note 13; Trimac Ltd. v. C.I.L. Inc (1989), 69 Alta. L.R. (2d) (Alta. Queen's Bench); Carnahan, supra, note 3; Donahue v. Rodd Electrotype Co. supra, note 20; Kemp v. Beatley supra, note 19, just to mention a few of the numerous cases and articles.

The courts do not, however, view size as the determining criterion. The rationale of the analogy lies in the identical personal nature of the two. This element has often been described in terms of the similarity of the expectations of the participants in a partnership with those of the participants in a close corporation. Since the participants view each other as partners, therefore partnership law, including equal sharing rules, automatic buy-out rights and strict fiduciary duties, ought to apply to the close corporation as well. Furthermore, the participants of a partnership and those of a close corporation are usually similar in the degree of participation they have in the ongoing management of the business.

The participants of both generally expect:[265]

1) to share in the active management of the enterprise;
2) to share regularly in the distribution of the profits whether it be by way of salaries or by dividends;
3) to control membership and the transfer of shares subject to management's approval and by right of first refusal
4) to partake in decisions outside the ordinary course of business or which would be in conflict with the basic agreement of the participants; these could only be taken by unanimous consent of the participants;

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[265] Hochstetler, supra, note 261 at 865; Hillman, supra, note 248; G. Hornstein, "Judicial Tolerance of the Incorporated Partnership." 1953 (18) Law and Contemporary Problems 435; L.C.B. Gower, "The English Private Company." (1953) 18 Law and Contemporary Problems 535.

5) to be able to withdraw from the enterprise without too much difficulty should the expectations surrounding the enterprise break down.

On closer examination there are problems in accepting the analogy. Deciding whether or not a particular company is "essentially a partnership" is a rather difficult thing to do. Partnerships come in different shapes and sizes. They may or may not have limited liability partners. Their constitutions may refer to provisions of the Partnership Act or in the United States, to the Uniform Partnership Act.

The courts have imported various broad considerations of good faith, trust and confidence without any detailed examination of the actual state of partnership law. Further, only certain parts of partnership law have been applied because the structure of the corporate entity differs from that of the partnership structure.

> Should the court apply the law which governs the dissolution of "partnerships in general," or the particular rules that would be appropriate for a partnership which in terms of its constitution resembles as closely as possible the particular company with which the court is dealing? Or, to put the point in another way, should or should not the court, in applying partnership law, make appropriate adjustments to take into account of the particular provisions of the company's constitution, notably its articles?[266]

Are the management expectations of partners to be incorporated into corporation law for shareholders? Is the fiduciary duty

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[266] M. R. Chesterman supra, note 75 at 134 - 135.

of the partners to each other to be implied in the corporate law context? If some aspects of partnership law are to be incorporated into corporate law doctrine, why are others not?[267] The law of partnership includes concepts of probity, good faith and mutual confidence, but the analogy falters if the result is to "obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations".[268]

The analogy loses its appeal when the more substantive differences between the two forms of business enterprise are examined. The partnership is a fragile, frequently transient and temporary relationship, the basis of which is that it may be terminated at the will of any one of the partners. It is the result of an implied or express intention, whose wrongful termination entails economic consequences. This type of business enterprise can evolve with few if any formalities. Corporations on the other hand, can arise only by design. There must be an express intention of the participants to create a corporate entity. The parties are willing to take advantage of the tax benefits of incorporation, the benefits of the permanency of the corporate structure and the benefits limited liability. Why should one of them be allowed to plead at some later date that in reality the rules of partnership law ought to apply?

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[267] H. J. Haynsworth, supra, note 8 at 87 footnote 289.
[268] Ebrahimi, supra, note 13.

A consideration of these factors leads to the conclusion that the nature of the corporate entity, as evidenced by the very expectations of the parties upon its creation, is quite different from that of a partnership. How then can the courts continue to apply the analogy of the close corporation to the partnership as a means of justifying the application of partnership law principles to a corporate entity? It is quite ironic that a court which is looking to the "reasonable expectations" of the parties, will often ignore their expressed intentions, that is, to form a corporation rather than a partnership.

The second premise underlying the "reasonable expectations" test is that it provides a set of criteria which are in harmony with the underlying "essential" nature of the corporate structure. Consequently the application of a contractual paradigm to the oppression remedy is very appealing if the corporation is really just a "nexus of contracts". This contractual entity is supposed to be accountable primarily to the functioning of the capital markets. The theory maintains that the modern corporation is uniquely adapted to the exigencies of the efficient accumulation of capital.

The validity of this theory is far from obvious. It posits that the most efficient institution will survive and the inefficient ones will perish. It justifies this statement through the circular argument that because the corporation is the predominant one presently, therefore it must be the most efficient one. In doing so, it ignores the complex interplay of ideology, economic forces and political forces.[269] If the theoretical background of the contractual paradigm is so shaky, the applicability of the "reasonable expectations" theory becomes even more suspect.

Supplementing the "Reasonable Expectations" Test

Clearly the "reasonable expectations" theory needs to be clarified and its conceptual premises subjected to further pragmatic testing. Several American Appellate Courts have used the fiduciary duty test to complement the "reasonable expectations" test.[270] The standards used by some courts to determine a breach of fiduciary duty appear to be essentially the same as those used by other courts to define oppression. This similarity acknowledges the existence of a fiduciary duty between minority and majority shareholders and the need for special treatment of the minority in a close corporation. The combination of the two theories occurs through the expectations of the minority at the time the corporation is formed, that the majority is going to act in a certain

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[269] See the critique in M. Barzelay and R. Smith, "The One Best System? A Political Analysis of Neoclassical Institutionalist Perspectives on the Modern Corporation" in W. J. Samuels and A. S. Miller, Corporations and Society (New York: Greenwood Press, 1987) 81 at 88ff.

[270] The New York Court of Appeals found these tests to complement each other, the "fiduciary duty" being the common law rule and "reasonable expectations" being the statutory test. (Kemp v. Beatley supra, note 19)

specified manner. In a close corporation situation, breach of the majority's fiduciary duty, by itself, can constitute a breach of the minority shareholders' "reasonable expectations".[271]

Canadian courts have diverged from this path. In light of the LAC Minerals[272] decision it appears that this argument would be inapplicable in Canadian jurisdictions.[273] The Supreme Court of Canada has considered the applicability of the fiduciary duty theory in the context of the relationship of the majority shareholders to the minority shareholders. It rejected the view that the "expectations of the parties", in a relationship where fiduciary obligations would not normally be expected, could create a fiduciary obligation.[274] La

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[271] Thompson supra, note 175 at 209; Haynsworth supra, note 8 at 84 - 85 footnote 282.

[272] International Corona v. LAC Minerals Ltd. (1990) 44 B.L. R. 14.(Supreme Court of Canada) There is a list of cases holding that there is no fiduciary duty of shareholders to each other. (See J. G. MacIntosh "Corporations" in Fiduciary Duties Special Lectures of the Law Society of Upper Canada 1990, (Toronto: Richard De Boo Publications, 1991) 189 at 194 footnote 16 for the list of cases.)

[273] At least one author maintains that there is little if no difference between the fiduciary duty of majority shareholders to the minority and the "duty of fair dealing" which has emerged under the oppression remedy. (J. G. MacIntosh, ibid. 222 ff.) This author states that the "fraud on the minority" exception to Foss v. Harbottle is essentially a fiduciary duty and, relying on the Canadian courts' endorsement of Ebrahimi and the International Corona v. LAC Minerals decision, he claims that there is essentially an implied fiduciary duty of the majority to the minority (at 222 - 223).

[274] "But to say that a man is a fiduciary only begins analysis; it gives direction to a further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?

(continued...)

Forest J. differed from the majority. He stated that although the law of fiduciary relations does not ordinarily apply to parties involved in commercial negotiations because they act at arm's length, under certain circumstances the expectations of the parties should be legally protected.[275]

The LAC Minerals decision rejected the attempt to combine the fiduciary duty and the "reasonable expectations" test in the larger context of corporate law. As we have seen, the Ontario Court of Appeal has also rejected such attempts.[276] Thus, in Canada the statutory oppression remedy remains severed from the concept of the fiduciary duty.[277] Whether or

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[274](...continued)
In what respect has he failed to discharge these obligations? And what are the consequences of his deviations from duty?" (Frankfurter, J. in S.E.C. v. Chenery Corp. 318 U.S. 80 at 85 (1943 U.S. Supreme Court)

[275] What must be shown...is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests in and for the purposes of the relationship...The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interests that foundation exists for the "fiduciary expectation". Such a role may generate an actual expectation that that other's interests are being served. (International Corona v. LAC Minerals Ltd. supra, note 272 Laforest J. at 27.)

[276] Brant Investments Ltd. v. KeepRite Inc. et al. supra, note 18.

[277] J. G. MacIntosh, supra, note 272. The end result though, may be rather academic, since shareholders act by resolution and once a resolution has been adopted, any act taken in furtherance of the resolution is an act of the company and subject to the oppression remedy. Consequently a "fiduciary duty" of the majority towards the minority shareholders (or any "complainant") will exist regardless of the terminology used.

not this approach will carry over into the context of the oppression remedy remains to be seen.

In the United States, the argument combining the "reasonable expectations" test and the concept of the fiduciary duty is very much alive. The tie between the two is the fact that "the relative legal positions are such that one party is at the mercy of the other's discretion."[278]

The concept of the fiduciary duty can be applied to the corporate investor[279]. The investor buys an equity interest in the corporation and management is under an obligation to manage the enterprise so as to enhance the value of that interest. The investor is buying a residual claim whose value depends on the discretionary performance of management. A fundamental difference between the close corporation and the public corporation arises because:

1) the risk of mismanagement by controllers in publicly held corporations is taken into account in the purchase price

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[278] E. J. Weinrib, "The Fiduciary Obligation." (1975) 25 University of Toronto Law Journal 1 at 7. See also J. C. Shepherd, The Law of Fiduciaries (The Carswell Company Limited, Toronto, 1981) 35ff. Many commentators have attempted to capture the essentials of this fiduciary relationship. According to one view:

> [the] feature which distinguishes these fiduciaries is that while they are entrusted with discretions to be exercised for another's benefit, they are not subject to the immediate control and supervision of that other in their exercise.(Finn, supra, note 251 at 8)

[279] J. A. C. Hetherington, "Defining the Scope of Controlling Shareholder's Fiduciary Responsibilities." (1986) 22 Wake Forest Law Journal 9 at 15 - 16.

of the shares -- the greater the perceived risk, the greater the discount;

2) investors in publicly traded companies with a majority controlled block of shares, can reduce their exposure to the risk of managerial or majority abuses by holding diversified portfolios; and

3) investors in publicly held companies rely on management's self-interest, market forces and general principles of corporation law to induce management to operate the firm in the investor's interest. Most crucially, if the investor wishes to exit from the company, market forces allow for the purchase of the shares.

In the close corporation the minority investor usually lacks an exit from the corporation. There is no market for the minority's shares. The absence of this market allows for the majority to substantially or totally exclude the minority from sharing economic benefits generated by the business, while keeping and using the minority's investment in the company. While in a public corporation the accumulation of wealth in the corporation proportionately increases the value of its stock, this does not occur in a close corporation. Market forces do not mitigate the self-interest of the majority shareholders and the minority's capital can easily be held hostage by the majority. Within the comfortable limits of the business judgment rule, the majority can effectively use the minority's investment without paying for it. The majority can do anything so long as they break no specific laws and commit no actual fraud.

The minority shareholder's position of vulnerability brings into play the concept of the fiduciary duty because of the lack of liquidity of the minority shareholder. Participants in closely held corporations expect the controlling group to seek to promote the wealth of the corporation. They look to an assumed, shared understanding and mutual interests to assure that they will share proportionately in the success of the firm. Impliedly, the parties' "reasonable expectations" incorporate the assumption that parties who form closely held firms intend an equitable sharing of returns. Those in control will take reasonable compensation for managerial services and their views will prevail when there are disagreements over policy; however, it is not likely the common understanding that, in the event of serious disagreement, they will be free to use their managerial prerogatives to exclude the minority from sharing in gains generated by the business. The fiduciary duty of managers and majority shareholders to minority shareholders is rooted in the implied expectations of the parties to the transaction.[280]

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[280] Ibid. 16; J. Edward Olson, "A Statutory Elixir for the Oppression Malady." (1984/85) 36 Mercer Law Review 627 at 629. See also F. H. O'Neal, R. B. Thompson, F. H. Katt, O'Neal's Close Corporations, Volume 2 (3d) (Willmette, (continued...)

The argument is, therefore, that if fiduciary obligations are perceived as being rooted in the expectations of the parties, the limitations on the scope of these obligations can be seen as logically flowing from the desire of the shareholders to enhance their wealth -- presumably the cardinal expectation and intention of the parties at the time the relationship was created. If the shareholders' "reasonable expectations" are thwarted, the oppression remedy ought to be invoked because the breach of the fiduciary duty is in itself a breach of the minority shareholders' "reasonable expectations".

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[280](...continued)
Illinois: Callagnan and Company, 1990): §9.29 as amended. New Hampshire's new legislation states that a breach of the fiduciary duty occurs where there has been frustration of the reasonable expectations of the minority.

CONCLUSION

In the exercise of their sound discretion under the statutory oppression remedy, Canadian and American courts have avoided providing any concrete definition of "oppression". They have operated on a case-by-case basis and formulated sweeping, abstract generalizations which have left little guidance about exactly what criteria apply to control the behaviour of the corporate controllers. By failing to provide solidly grounded reasons to justify their decisions, the courts have left themselves open to accusations of making retrospective decisions and of handing out justice as the "length of the foot of the Chancellor" decrees.

The test of "fairness" does not clarify the criteria of accountability. It simply reformulates the terminology of the common law oppression remedy in light of the statutory remedy, without providing a specific meaning of "fairness".[281] The most recent development in the oppression remedy, the "reasonable expectations" test, applies a different paradigm to the accountability of the controllers of the corporation. While the infusion of the rigours of contract law principles is a welcome development, the test itself has several serious conceptual flaws. Nevertheless it is the best threshold test the courts have yet developed.

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281 "What we need is a case where the judge determines that the "unfairly prejudicial" threshold was not met and explains why." (Welling, supra, note 236 at 556.)

The uncertainties of the scope of the test, the subjectivity inherent in its application, the arbitrariness of the social values implicit in it, the dubious validity of its "corporation as a nexus of contracts" thesis and its erroneous analogy of the close corporation to a partnership, all lead to the conclusion that the courts are in need of further legislative guidance as the precise criteria of accountability to apply to the corporate controllers.

The experience of the statutory oppression remedy during the last twenty years provides some assistance for the legislatures in the formulation of these guidelines. This experience shows that the oppression of minority shareholders is a problem found mostly in closely held corporations. Only rarely have the courts had an oppression problem with a public corporation.[282] It is the vulnerability of the minority shareholder in the close corporation which must be dealt with.

The factual situations which invoke the use of the oppression remedy are now quite easily classified. Oppressive conduct generally falls into now well-recognized forms.[283] Despite the courts' reluctance to limit their own powers and to avoid classifying the types of situations where they will intervene, a reliable classification of the situations where

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[282] Cheffins, _supra_, note 238 at 319 says that there have been only ten cases involving public corporations.

[283] F. H. O'Neal, _supra_, note 3; M. W. Carnahan, _supra_, note 3 at 415ff.

the courts have intervened is clearly possible.[284] The occurrence of oppressive behaviour leads to court intervention if the impugned conduct has had a detrimental impact on the financial interests of the minority shareholder.

The judicial response to this type of behaviour has been clarified through the various decisions of the courts. Typically the role of the courts in a dispute between the majority and minority shareholders is that of arbitrator of a price dispute. Furthermore, this clarification illustrates the goals of each of the parties in an oppression proceeding.[285] A minority shareholder is usually suing to attempt to withdraw its investment from the company, to induce the other shareholders to sell out to the minority or to use the threat of dissolution to persuade the majority to agree to a change in the policies or in the balance of power in the corporation.

With these findings to work from, some tentative legislative solutions to the type of legislation needed becomes clear. There ought to be a specific legislative provision governing minority shareholders in close corporations. The nature of the close corporation arrangement is precisely the type of arrangement which is not designed for

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[284] For the cases in both Canada and the United States, if the facts are shown to involve the misuse of corporate assets by a controlling person, a "freezeout" situation of the minority or a breach of a "near fiduciary duty" (by whatever terminology the court wishes) the courts' decision to intervene is extremely predictable.

[285] J.A.C. Hetherington and M. P. Dooley, <u>supra</u>, note 8 at 27.

litigation as a means to settle disputes. It is statutory company law, not court made law, which has had as a primary function the provision of a mechanism to adjust the changing rights and interests of the members of the corporation. Classical contract law paradigms are suitable for resolving "discrete transactions" problems.[286]

The oppression remedy is attempting to tackle the problems which arise out of a long-term contractual relationship, a type of relationship whose very essence is premised on the fact that both parties are bound up in the same enterprise for a long period of time. They both have an interest in the continuance of this relationship and their respective rights, obligations, expectations and interests are going to change considerably during the existence of the relationship. [287]

Some American jurisdictions have come to the conclusion that there ought to be specific provisions for the close corporation because of its uniqueness. Others have created a hybrid "limited liability company" which combines elements of the corporation and the partnership and allows for easy

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[286] That is problems which relate to single instance contracts viewed in isolation. See I. A. Macneil "Contracts: Adjustment of Long-Term Economic Relations under Classical, Neo-Classical and Relational Contract Law." (1978) 72 North Western University Law Review 854 at 891.

[287] Cheffins, supra, note 255 at 789ff.

termination of the relationship.[288] Other jurisdictions have amended their partnership laws. Providing a special statutory oppression remedy for close corporations would simply be an extension of these developments.

The legislatures have three policy alternatives to choose from in determining the contents of the legislation. The first is to leave the shareholders or complainants who fail to protect their rights to bear the consequences of that oversight. The second is to decide the rights between the parties on the basis of fault, "lack of probity" or some other moral standard. Finally, the parties, without resorting to fault, can be allowed to withdraw from the venture based on a finding that the common understanding which existed at the origin of the venture, no longer exists.

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[288] See R. R. Keatinge, L.E.Ribstein, S. Pace Hamill, M.L. Gravelle and S. Connaughton, "The Limited Liability Company: A Study of the Emerging Entity." 47 (1992) The Business Lawyer 375. The major state is Delaware (Limited Liabiity Company Act effective October 1, 1992); also Wyoming (Wyoming Statutes §§17-15-101 to 136 (Supplement 1989). Florida (Florida Statutes Annotated §§608.401 - 471, (West Supplement 1991)), Colorado (Colorado Revised Statutes §§7-80-101 to 913 (Supplement 1990)), Kansas (Kansas Statutes Annotated §§17 - 601 to - 7650 (Supplement 1991)), Nevada (Nevada Revised Statutes Annotated §§86.011 - 571 (Michie supp. 1991)), Texas (Texas Revised Civil Statutes Annotated art 1528n, arts. 1.01 - 9.02 (West Supplement 1992)), Utah (Utah Code Annotated §§48-2b-101 to - 156 (Supplement 1991) and Virgina (Virgina Code Annotated §§13.1-1000 to - 1069 (Michie supp. 1991)). Other states have introduced bills: Arizona, Hawaii, Illinois, Maryland, Michigan, Oklahoma, Pennsylvania while California, Georgia, Iowa, Missouri, Minnesota, Montana, New Jersey, New York, Ohio, Rhode Island, South Dakota and Washington are all studying the creation of the limited liability company. (See Keatinge, 379 at footnote 5.)

The first solution seems to have been rejected by the courts because of the potentially inequitable nature of the minority shareholder's position. The second solution reiterates the "lack of probity" test. The third, which would be in accord with generally prevalent views of contracting between businesspeople, seems to be what the "reasonable expectations" theory and the criteria for the "unfairly prejudicial" behaviour in Canada are attempting to accomplish. This solution seems to maximize the ability of all shareholders to realize their "reasonable expectations", minimize the administrative costs associated with the resolution of the dissension, and maximize the value of the corporate unit.

In implementing the third position, the legislative guidelines ought to draw on the Canadian and American courts' experiences with the statutory oppression remedy in order to list specific majority shareholder acts warranting dissolution of the corporation. Broad statutory grounds have only enhanced uncertainty and judicial reluctance by providing the courts with too much discretion in ordering dissolution. For the legislation to be effective, it must be mandatory, requiring dissolution or a buy-out if egregious acts are shown.[289]

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[289] Shapiro, supra, note 108 at 1153. See J. E. Davidian, "Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders." (1981/82) 56 St. John's Law Review 24.

The preferred alternative, as New York State has, is a legislative buy-out provision. (New York requires ownership of twenty per cent or more of the shares in order to initiate an oppression action.) However it is possible for situations to arise in which the buy-out option might not be totally satisfactory. Therefore there ought also to be a provision compelling liquidation of the investment of the minority once it has been shown that "oppression" has occurred. This liquidation would occur on terms which would assure the minority of receiving a fair share of the value of the corporation. This solution could be achieved by the enactment of the right of any shareholder to have all that shareholder's shares bought by the corporation or by the other shareholders at a "fair value" as determined by mandatory arbitration or by a court appointed appraiser[290]. This right would be triggered by the occurrence of a breach of the "reasonable expectations" of that shareholder.[291] The only contentious issue would be the fair value of the shares. Only if the majority refuses to exercise this option would the court have to decide whether or

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[290] As in the California buyout legislation where there are three court appointed appraisers. (O'Neal, supra, note 280 Chapter 9 at 162.)

[291] See Article 1118 of the New Business Corporation Law, Illinois Revised Statutes Ch 32 paragraph 1214(6), Maryland Corporations and Association Code 4 - 603, Wisconsin Statutes §180.995(19)(b)(9) for close corporations and California Corporation Code §200, New Jersey Statutes Annotated §14A:12 - 7(8), West Virginia Code §31-1-134 and Rhode Island General Laws §7.11 - 9.01 for all types of corporations.

not the "reasonable expectations" of the minority had been violated.[292] The decree of liquidation would result only if both the majority and the minority did nothing to avoid the liquidation and the "reasonable expectations" have been breached. Either side could ensure the continued existence of the close corporation by buying out the other or, alternatively, by selling out to the other.

The resolution of the dilemma of the minority shareholder in the close corporation is therefore to restrict the role of the courts in the totality of the process, not to expand the court's role. Legislature and judiciary must act together in this process. New York State's experience approximates the optimal solution. It combines judicial acceptance of the "reasonable expectations" test and the legislative option of a buy-out of the party who has experienced oppression. If Canadian courts are leaning to the approach of the "reasonable expectations" of the participants, then the legislative buy-out is its corollary. This solution accepts the fact that the shareholders' dispute is really part of a negotiation process

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[292] See the contents of the present Minnesota legislation: supra, note 236. See also the article by S. K. Miller where she recommends for Pennsylvania restraint in acceptance of dissolution of corporations because Pennsylvania does not have a buyout provision of the minority which New York has. (S. K. Miller, "A Note on the Definition of Oppressive Conduct by Majority Shareholders: How can the Reasonable Expectation Standard be Reasonably Applied in Pennsylvania?" (1992) 112 Journal of Law and Commerce 51 at 70.

between the majority and the minority to establish a "buy-out" price.

The costs of using the courts to resolve the problems between the majority and the minority are exceedingly high. Such a solution would satisfy the requirements of cost efficiency. Just as importantly, it would provide businesspeople in a close corporation with a stronger degree of certainty that they will not have to be dependent on the uncertainties of judicial discretion in its interpretation of "just and equitable" behaviour and "just and equitable" remedies in order to obtain the return of their investment.

APPENDIX

English Company Act 11 & 12 Geo 6, chapter 38.

(1) Any member who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members, (including himself) or in a case falling within subsection (3) of section one hundred and sixty-nine of this Act, the Board of Trade, may make an application to the court by petition for an order under this section.

(2) If on any such petition the court is of the opinion--

(a) that the company's affairs are being conducted as aforesaid;

and

(b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound- up;

the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

Section 10(b): 17 Code Federal Regulations §240. 10b - 5 (1977)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange...to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10(b) - 5 provides: (15 United States Code §78j (1976))

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

U. S. Model Statutes:

The Model Business Corporations Act Annotated third edition volume 3, Harcourt, Brace, (New Jersey: Jovanovich Clifton, 1987):

The...courts shall have full power to liquidate the assets and business of a corporation:

(a) In an action by a shareholder when it is established:

(2) That the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent;

Revised Model Business Corporations Act 1984 (Martindale-Hubbell Law Digest (Read Publishing (U.S.A.) Inc., 1993) at page UMA - 27. §14.30

The [name or describe court or courts] may dissolve a corporation:

(2) in a proceeding by a shareholder if it is established:

(ii) the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;

Revised Statutes of British Columbia (1960 chapter 67, section 185):

(1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself)... may make an application to the Court by petition for an order under this section.

(2) If on any such petition the Court is of the opinion
   (a) that the company's affairs are being conducted as aforesaid; and
   (b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up,

   the Court may, with a view to bringing to an end the matters complained of, make such orders as it thinks fit, whether for the regulating of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company, and in the case of a purchase by the company, for the reduction accordingly of the company's capital or otherwise.

This section was amended to read (<u>Statutes of British Columbia</u> 1973, chapter 18, section 221):

> A member of a company... may apply to the court for an order on the ground
>
> (a) that the affairs of the company are being conducted, or the powers of the directors are being exercised, in a manner oppressive to one or more of the members, including himself; or
>
> (b) that some act of the company has been done, or is threatened, or that some resolution of the members or any class of members has been passed or is proposed, that is unfairly prejudicial to one or more of the members, including himself.

<u>Canada Business Corporations Act</u> Revised Statutes of Canada 1985 Ch. c - 44:

Section 214 (formerly section 207)

(1) A court may order the liquidation and dissolution of a corporation or any of its affiliated corporations upon the application of a shareholder

(a) if the court is satisfied that in respect of a corporation or any of its affiliates

   (i) any act or omission of the corporation or any of its affiliates effects a result,

   (ii) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(iii) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

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

(b) if the court is satisfied that

(i) a unanimous shareholder agreement entitles a complaining shareholder to demand dissolution of the corporation after the occurrence of a specified event and that event has occurred, or
(ii) it is just and equitable that the corporation should be liquidated and dissolved.

Section 241 (formerly section 234)

(1) A complainant may apply to a court for an order under this section.

(2) If, upon an application under subsection (1). the court is satisfied that in respect of a corporation or any of its affiliates

(a) any act or omission of the corporation or any of its affiliates effects a result,

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

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