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Directors and Standards: The Problem of Insufficient Guidance

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Abstract

This thesis identifies two areas within Canadian corporate law where the case law has provided insufficient guidance, and tests the usefulness of an American theory of director liability as an aid to understanding this case law and the legislation it interprets. This theory has been termed the "implied contract approach", and was developed by Robert J. Rhee. The two areas concern: if and when directors must consider the interests of stakeholder groups, otherwise known as the "stakeholder debate", and when directors should be protected from personal liability when acting in the course of their duties.

Keywords

Law, Corporate Law, Director Liability, Stakeholders, Business Judgment Rule, Personal Liability, Tort Law.

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1 Introduction

A fundamental function of the corporation is to limit the liability of its shareholders by operating as a separate legal person, capable of incurring liability of its own, and with its own distinct interests.[1] A consequence of creating a separate legal entity is that, even though the corporation is undoubtedly capable of incurring liability of its own, natural persons must still act on the corporation's behalf in order for this entity to operate. Determining when and if these natural persons should also be held liable, when they were acting in the name of the corporation, becomes a difficult matter that requires clear guiding principles, separate from the principles protecting shareholders from liability.[2] Another consequence of creating a separate legal entity is that this entity has its own interests, separate from any particular shareholder or agent.[3] The process for identifying these interests will ultimately affect which types of individuals and groups will benefit, and which types of individuals and groups can demand that they should benefit, from the existence of a particular corporation.

This thesis identifies two areas within current Canadian corporate law where the case law has provided insufficient guidance, and tests the usefulness of an American theory of director liability as an aid to understanding this case law and the legislation it interprets. This theory has been termed the "implied contract approach," and was developed by Robert J. Rhee.[4] The two areas concern: (1) if and when directors must consider the interests of particular stakeholder groups, and (2) under what circumstances should directors be personally liable when acting in the course of their duties. The standards to which directors of corporations are held, pursuant to the *Canada Business Corporations Act* (the "*CBCA*"),[5] are statutory standards. To be of use, the implied contract approach

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[1] *Salomon v A Saloman & Co*, [1897] AC 22 (HL) at 30, [*Salomon*].
[2] Christopher C Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (April 2001) 35:1 Can Bus LJ 1 [Nicholls], at 2.
[3] *Salomon*, *supra* note 1 at 30.
[4] Robert J Rhee, "The Tort Foundation of Duty of Care and Business Judgment" (2013) 88:3 Notre Dame L Rev 1139 [Rhee].
[5] *Canada Business Corporations Act*, RSC 1985, c C-44, [*CBCA*].

should be helpful to courts and academics when seeking to interpret the intentions of Parliament.[6]

The first area under analysis is the stakeholder debate. The term "stakeholder" refers to any individual or group affected by the activities of the corporation in question, and can include groups such as employees, creditors, local communities, and of course shareholders. The stakeholder debate is framed around the question: when determining what is best for the corporation, what should be taken into account? Particularly, how important are the interests of various types of stakeholder groups, such as (but not limited to) shareholders and creditors when determining what is best for the corporation? More particularly, the stakeholder debate arises from the tension that exists between the shareholder primacy theory of corporate governance and the stakeholder theory. Shareholder primacy requires directors to prioritize the interests of shareholders over other stakeholders when determining what is best for the corporation, while the stakeholder theory suggests that it is permissible, and at times necessary, to prioritize the interests of other stakeholders over those of shareholders when determining what is best for the corporation.[7]

The second area under analysis is the exemption of directors from personal liability. This exemption immunizes directors from personal liability for torts of the corporation that they were personally involved in, so long as the conduct in question occurred in the course of their duties, and was in the best interests of the corporation. Case law has provided insufficient guidance regarding the appropriate scope of this exemption.[8] The factor of voluntariness is particularly important for this area, specifically whether the tort claimant voluntarily chose to deal with a corporation, and how this should affect the claimant's ability to hold other parties liable through the courts.[9]

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[6] On the topic of legislative intent and the use of legal theory in uncovering that intent, see: R Graham, *Statutory Interpretation: Theory and Practice* (Toronto: E Montgomery Publications, 2001).
[7] For a description of the stakeholder debate in general, and its place in current Canadian corporate law, see: Claudio R Rojas, "An Indeterminate Theory of Canadian Corporate Law" (2014) 47:1 UBC L Rev 59 [Rojas], at 60, 68.
[8] Nicholls, *supra* note 2 at 8; Edward M lacobucci, "Unfinished Business: An Analysis of Stones Unturned in *Adga Systems International v Valcom Ltd*" (2001) 35 Can Bus LJ 39 [Iacobucci], at 48.
[9] *Adga Systems International Ltd v Valcom Ltd*, 1999 CanLII 1527 (ON CA) at para 43, [*Adga*].

2 The law of director liability, and related academic perspectives

Before testing the implied contract approach, a brief summary of the relevant law and how it operates will be helpful. Regarding the stakeholder debate, the *CBCA* is the focus, specifically sections that define what is expected from directors as they manage the corporation.[10] Regarding the liability of directors for torts of the corporation, the focus is on how courts have justified immunity for directors from this liability under particular circumstances.[11]

While the case law has not provided sufficient guidance on the issue of stakeholder rights and directors' personal liability, there has been speculation on the future of these issues, and efforts to better define these legal concepts, by Canadian legal scholars. Researchers have attempted to determine whether stakeholders are likely to receive more or less protection of their interests, insofar as business decisions by directors are concerned, as a result of the Supreme Court of Canada's decision in *Re BCE Inc*.[12] There has also been a discussion regarding the appropriate scope of the immunity of directors from personal liability, particularly in reference to the policy justifications for reducing risk aversion.[13]

2.1 The duty of loyalty, the duty of care, and the oppression remedy

The *CBCA* establishes two specific duties for directors: the duty of loyalty and the duty of care. Section 122(1) of the *CBCA* reads:

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[10] *CBCA*, *supra* note 5 ss 122(1), 241.
[11] *Said v Butt*, [1920] 3 KB 497, (Eng. KB); *Adga*, *supra* note 9 at para 15.
[12] *Re BCE Inc*, 2008 SCC 69, [*BCE*]; Rojas, *supra* note 7 at 62.
[13] Iacobucci, *supra* note 8 at 48.

> **(1)** Every director and officer of a corporation in exercising their powers and discharging their duties shall
>
> > **(a)** act honestly and in good faith with a view to the best interests of the corporation; and
> >
> > **(b)** exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[14]

Section 122(1)(a) establishes the duty of loyalty, which is primarily concerned with protecting the corporation from opportunism, and establishes a statutory fiduciary duty owed by the directors to the corporation itself.[15] Its application is more concerned with the motives behind the actions taken by directors than the content of such actions.[16] An honest and good faith attempt to act in the best interests of the corporation fulfills this duty.[17] It has also been made clear by courts that directors owe their loyalty to the corporation itself, rather than any group of stakeholders (such as shareholders). When determining what is best for the corporation, however, directors are free to take into account the interests of many different stakeholder groups, but the purpose of taking such interests into account must be to further the best interests of the corporation itself.[18]

Section 122(1)(b) establishes the duty of care, which creates a minimum level of competence and effort that directors must use when managing the corporation.[19] In assessing whether a director has met the duty of care, the emphasis is on the actual content of their actions, particularly the level of competence involved in business decisions. However, a court typically shows deference to directors when it comes to assessing how good or bad a business decision was. Perfection is not demanded, and if directors act on a prudent and informed basis, they will typically be held to have fulfilled this duty.[20]

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[14] *CBCA*, *supra* note 5 s 122(1).
[15] *CBCA*, *supra* note 5 s 122(1)(a); *People's Department Stores Ltd. (1992) Inc, Re*, 2004 SCC 68 at para 43, [*People's*].
[16] *People's, supra* note 15 at para 63.
[17] *Ibid* at para 46.
[18] *People's, supra* note 15 at paras 42-43.
[19] *CBCA*, *supra* note 5 s 122(1)(b).
[20] *People's, supra* note 15 at para 67.

The result of the process of making business decisions seems to be less important than the process itself when a court is determining if directors have met their duty of care. This approach has been justified by the Supreme Court of Canada based on the notion that courts are not well suited to judge the application of business expertise by coming to their own conclusions about what the result should have been. What courts are suited for is determining if a sufficient level of care was applied to the decision-making process, assuming that the final decision was within a range of reasonable options available at the time.[21]

In addition to the above duties, the *CBCA* creates the oppression remedy, pursuant to section 241, which reads:

> **(1)** A complainant may apply to a court for an order under this section.
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> **(2)** If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates
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> > **…**
> >
> > **(c)** the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
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> 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.[22]

The oppression remedy creates an expectation that directors will act in accordance with the reasonable expectations of parties that deal with the corporation, such as creditors and shareholders.[23] Courts have interpreted this as a two-part test: (1) a complainant must first have a reasonable expectation, and (2) that reasonable expectation must have been violated to the extent of, at least, unfair disregard.[24] The *CBCA* gives courts substantial

[21] *Ibid* at para 67.
[22] *CBCA, supra* note 5 at section 241.
[23] *BCE, supra* note 12 at para 45.
[24] *Ibid* at para 56.

remedial powers to protect complainants in the event that such a complainant can successfully demonstrate that conduct by the directors has met the two-part test.[25]

2.2 The stakeholder debate

Interpreting the duties and expectations to which directors are held will determine whether directors are required to protect the interests of any particular stakeholder group as the directors manage the corporation. In assessing whether a breach of any of these duties or expectations has occurred, courts are guided by the concept of "the best interests of the corporation".[26] For the duty of loyalty, this concept is mentioned explicitly in the relevant section of the *CBCA*.[27] For the oppression remedy, directors will often be protected from a finding that their conduct was oppressive if they were acting in the best interests of the corporation, having regard to all relevant considerations, such as long-term profit, but also the fair treatment of affected stakeholders.[28] For the stakeholder debate, the question is: are directors permitted, or even required, to take particular stakeholder interests into account in order to be found to be acting in the best interests of the corporation? The Supreme Court of Canada, in *People's*, held that directors are permitted to take the interests of many stakeholder groups into account when determining what is in the best interests of the corporation.[29] However, the language used by the Court in *People's*, and subsequently in *BCE*, established that the duty of loyalty is permissive of directors considering stakeholder interests, rather than the duty of loyalty requiring that such interests must be considered. The Court in *BCE* held: "in considering what is in the best interests of the corporation, directors <u>may</u> look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions".[30] Both the ability of directors to prioritize a particular

[25] *CBCA*, *supra* note 5 at s 241.
[26] *People's*, *supra* note 15 at paras 42-43.
[27] *CBCA*, *supra* note 5 at s 122(1).
[28] *BCE*, *supra* note 12 at para 82.
[29] *People's*, *supra* note 15 at para 42.
[30] *BCE*, *supra* note 12 at para 40 [emphasis added].

stakeholder group above shareholders, and the question of if and when a stakeholder group must have their interests taken into account, remains unclear.[31]

The mention of so many different types of potential stakeholder groups by the Court in *People's* and *BCE* was not meant to suggest that directors owe duties to those stakeholder groups directly. Rather, the consideration and protection of such stakeholder groups may be a legitimate method by which the directors fulfill their duties to the corporation itself.[32] With this in mind, the stakeholder debate is not a debate about whether directors owe duties to any particular stakeholder group, but is instead a debate about how the best interests of the corporation, and only the corporation, should be determined, and whether this might entail the consideration and protection of stakeholders.

When it comes to discussions of the duties of directors, and the stakeholder debate generally, the case of *BCE* tends to be the centrepiece. *BCE* is the most recent case where the Supreme Court of Canada provided any significant analysis of the duty of loyalty, the oppression remedy, and (although indirectly) the statutory duty of care.[33] *BCE* involved a planned buyout of all the shares of BCE, a large telecommunications corporation, by the Ontario Teachers' Pension Plan Board. The buyout was to be leveraged, meaning that BCE would take on a large amount of debt in the process. The debentureholders of Bell Canada (a wholly owned subsidiary of BCE) objected to this buyout on the grounds that it would reduce the value of their bonds.[34] At the time of the trial, the bonds' investment grade had already begun to decline, illustrating that the concerns of the debentureholders were well-founded.[35]

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[31] Sarah P Bradley, "BCE Inc. v 1976 Debentureholders: The New Fiduciary Duties of Fair Treatment, Statutory Compliance and Good Corporate Citizenship?" (2009-2010) 41 Ottawa L Rev 325 [Bradley], at 332-333.
[32] *BCE*, *supra* note 12 at para 66.
[33] The Supreme Court of Canada has discussed *BCE* in two subsequent cases: *Indalex Ltd, Re*, 2013 SCC 6, and *Chevron Corp v Yaiguaje*, 2015 SCC 42. Neither of these cases required a significant analysis of the duties directors owe to the corporation.
[34] *BCE*, *supra* note 12 at para 1.
[35] *Ibid* at para 21.

One of the arguments put forth by the debentureholders was that, in moving forward with the buyout, the directors of BCE acted in an oppressive manner, contrary to section 241 of the *CBCA*;[36] the debentureholders sought the oppression remedy.[37] To decide the matter, the Court was required to determine whether there was a breach of the reasonable expectations of the debentureholders. Essentially, the Court needed to determine whether the debentureholders could reasonably expect the directors of BCE to protect the value of their bonds, or at least consider their interests when making the decision whether to proceed with the buyout (the debentureholders argued the latter in the alternative).[38]

Regarding the argument that the debentureholders had reasonable expectations that the directors would protect the value of their bonds, the Supreme Court of Canada agreed with the finding made at the trial level.

> The absence of a reasonable expectation that the investment grade of the debentures would be maintained was confirmed, in the trial judge's view, by the overall context of the relationship, the nature of the corporation, its situation as the target of a bidding war, as well as by the fact that the claimants could have protected themselves against reduction in market value by negotiating appropriate contractual terms.[39]

Regarding the latter argument, the Court agreed that the debentureholders did have reasonable expectations that the directors would take their interests into account when deciding whether to proceed with the buyout. However, the Court held that the directors had fulfilled this expectation.

> It is apparent that the directors considered the interests of the debentureholders and, having done so, concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. This fulfilled the duty of the directors to consider the debentureholders' interests. It did not amount to "unfair disregard" of the interests of the debentureholders. As discussed above, it may be impossible to satisfy all stakeholders in a given situation. In this case, the Board considered the interests of the claimant stakeholders. Having done so, and having considered its options in the difficult circumstances it faced, it made

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[36] *CBCA*, *supra* note 5 at s 241(2).
[37] *BCE*, *supra* note 12 at para 50.
[38] *Ibid* at paras 56, 96.
[39] *Ibid* at para 98.

> its decision, acting in what it perceived to be the best interests of the corporation.[40]

Ultimately, the Court concluded that the directors owed their duties to the corporation itself, but that in determining the best interests of the corporation, the directors were required to take into consideration the position of the debentureholders. The directors had done so, and had therefore fulfilled their duties.[41]

The central issue for the following research surveyed on the stakeholder debate in Canadian corporate law is whether the Supreme Court of Canada's reasoning in *BCE* is likely to result in increased or reduced protection for the interests of stakeholders. Regarding the tension between shareholder primacy and stakeholder theory, discussed above, it has become clear that shareholder primacy is not the current state of the law. In *People's*, the Supreme Court of Canada held that, "it is clear that the phrase the 'best interests of the corporation' should be read not simply as the 'best interests of the shareholders'."[42] Subsequently, the Court in *BCE* held:

> on these appeals, it was suggested on behalf of the corporations that the "*Revlon* line" of cases from Delaware support the principle that where the interests of shareholders conflict with the interests of creditors, the interests of shareholders should prevail.[43]
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> …
>
> What is clear is that the *Revlon* line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces.[44]

What is contentious is how far the law has shifted towards stakeholder theory. Put differently, while it is clear that shareholders will not automatically rank first in priority amongst stakeholders, the Court's decision in *BCE* has made it more difficult to predict how any particular stakeholder group will have their interests treated by Canadian courts.

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[40] *Ibid* at para 104.
[41] *BCE*, *supra* note 12 at paras 66, 104.
[42] *People's*, supra note 15 at para 42.
[43] *BCE*, *supra* note 12 at para 85.
[44] *Ibid* at para 87.

Once again, it is not being suggested that the duty of loyalty creates any direct duty to stakeholders. Rather, the duty of loyalty may require the consideration and balancing of stakeholder interests as part of seeing to the best interests of the corporation.

Claudio R. Rojas, in "An Indeterminate Theory of Canadian Corporate Law," has suggested that stakeholders are entitled only to have their interests considered, rather than protected, in light of how the Court in *BCE* framed the fiduciary duty of directors and the oppression remedy.[45] The Court in *BCE* held the following.

> Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincides with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.[46]

The Court's description of the concept of the good corporate citizen, namely the importance of fair treatment of stakeholders when determining what is in the best interests of the corporation, results in a fairness owed to stakeholders that is procedural in nature, meaning that their interests may need to be considered, but without a requirement that action be taken to protect those interests. However, Rojas is careful to point out that this duty was held to only be procedural largely because such stakeholders had the opportunity to negotiate for additional protection, but failed to do so.[47] Reasonable expectations may be different where there was no opportunity to negotiate for protection

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[45] Rojas, *supra* note 7 at 67.
[46] *BCE*, *supra* note 12 at para 66.
[47] Rojas, *supra* note 7 at 79.

in the first place, or where the relationship between a stakeholder and the corporation cannot be defined purely through the provisions of a contract.[48]

Ed Waitzer and Johnny Jaswal, in “Peoples, BCE, and the Good Corporate ‘Citizen’,” also argue that when the Court in *BCE* interpreted the oppression remedy to include the concept of the good corporate citizen, while also failing to clarify other aspects of both the duty of loyalty and the oppression remedy, the Court enhanced the deference that directors would be given through the business judgment rule (discussed in sections 4.1 and 4.2).[49] The result is that stakeholders are less able to prove oppressive conduct, as directors need only demonstrate that they acted in a reasoned and informed manner to meet the current test.[50]

Sarah P. Bradley, in “BCE Inc. v. 1976 Debentureholders,” presents an opposite conclusion, namely that the vagueness created by the reasoning in *BCE* will result in more being owed to stakeholders. The source of the vagueness is the same conceptual overlap between the oppression remedy and the duty of loyalty, but the result being argued for is that the notion of fair treatment of stakeholders is now present within the duty of loyalty.[51] Bradley argues that a result of the Court in *BCE* finding a duty of fair treatment within the duty of loyalty is that a new cause of action against directors has been created.[52] This could increase the protection that stakeholder interests receive if a breach of the duty of loyalty is a consideration under the oppression remedy. As Bradley says:

> In the course of its decision, the Supreme Court discussed what it referred to as the "'fair treatment' component" of the fiduciary duty and asserted that the fiduciary duty to act in the best interests of the corporation "comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly." The Court described this "'fair treatment' component" as "fundamental to the

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[48] Rojas, *supra* note 7 at 80.
[49] Ed Waitzer and Johnny Jaswal, “Peoples, BCE, and the Good Corporate ‘Citizen’” (Fall 2009) 47 Osgoode Hall LJ 439 [Waitzer], at 459-460.
[50] *Ibid* at 442.
[51] Bradley, *supra* note 31 at 337.
[52] *Ibid* at 338. “…incorporating the “duty of fair treatment” into the fiduciary duty owed to the corporation serves only to create a new cause of action in the corporation against its directors, and raises a new source of potential personal liability for directors.”

> reasonable expectations of stakeholders claiming an oppression remedy," but did not describe the legal or logical basis upon which it merged this expectation on the part of stakeholders with its interpretation of the director's duty to act honestly and in good faith with a view to the best interests of the corporation.[53]

If a duty of fairness is required under the duty of loyalty, the reasonable expectations of stakeholders may be less relevant than this concept of fairness, resulting in oppressive conduct being easier to prove by showing merely unfairness, which would be a breach of the duty of loyalty.[54] As Bradley puts it.

> The imposition of the new "'fair treatment' component" of the fiduciary duty also makes the breach of fiduciary duty now potentially easier to prove, and available to a broader range of litigants. In an oppression case, reasonable expectation must be demonstrated. If the fiduciary duty now includes a specific duty to treat stakeholders fairly, then, presumably, a breach of fiduciary duty can be established if unfair treatment is demonstrated, regardless of the reasonable expectations of the stakeholder.[55]

Vagueness is a recurring theme in much of the research on the stakeholder debate in Canada. Even before *BCE*, Mohamed F. Khimji, in "*Peoples v. Wise* – Conflating Directors' Duties, Oppression, and Stakeholder Protection," demonstrated that *People's* also presented a description of the duty of care, the duty of loyalty, and the oppression remedy that failed to adequately distinguish each of these concepts.[56] Rather than precisely define the function and content of each of these concepts, the Supreme Court of Canada justified not expanding the duty of loyalty by noting that stakeholders are adequately protected by the other two concepts. This created the assumption that these concepts, taken together, must serve as a complete set of legal rules for protecting stakeholders, and that these three concepts all share this function of protecting stakeholders.[57] Khimji argued that the three concepts have distinct functions, and are not meant to serve a shared a purpose.[58] Given the problems created in *BCE* by the

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[53] *Ibid* at 337.
[54] *Ibid* at 339.
[55] *Ibid* at 339.
[56] Mohamed F Khimji, "Peoples v Wise - Conflating Directors' Duties, Oppression, and Stakeholder Protection" (2006) 39 UBC L Rev 209 [Khimji], at 211.
[57] *Ibid* at 211.
[58] *Ibid* at 232.

conceptual overlap between the duty of loyalty and the oppression remedy, discussed above, it appears the issue of vagueness in the stakeholder debate has been a problem that has persisted for some time.

Overall, the above research on the stakeholder debate provides perspectives that interpret leading cases as both strengthening and diminishing the protection afforded to stakeholder interests under the relevant provisions of the *CBCA*. While divergent on that issue, the research surveyed appears to predominantly support the argument that leading cases have provided inadequate instruction for interpreting the duties of directors towards the corporation and its stakeholders.

2.3 The exemption of directors from personal liability in tort

The exemption of directors from personal liability refers to the conditions for when, despite being personally involved in torts of the corporation, directors will not be found personally liable. The corporation remains liable, but directors will not be, assuming they were acting *bona fide* in the best interests of the corporation. This exemption is currently available only when the tortious conduct in question is inducing breach of contract.[59] That this particular type of tortious conduct can be subject to protection is clear within the current law. What is less clear is whether other conduct may eventually be included in such protection as new fact situations present themselves to the courts. The possibility of the scope of the exemption being enlarged to include other tortious conduct was noted in *Adga Systems International Ltd v Valcom Ltd*.[60] In *Adga*, the Ontario Court of Appeal noted that it may be appropriate to distinguish between parties that voluntarily deal with a corporation, and those that find themselves involuntarily dealing with such a corporation. Director immunity from personal liability applies to the former, as an existing contract with the corporation is required for directors to be protected. The question of whether

[59] *Adga*, *supra* note 9 at para 35.
[60] *Ibid.*

such director immunity could apply to future fact situations that also involve voluntarily dealing with a corporation was left open.[61]

One example of such a situation could be a claim of negligent misrepresentation, made by a tort claimant against the corporation, within the context of the claimant negotiating for, and subsequently purchasing services from the corporation. The claimant would have voluntarily entered into such negotiations with the corporation. Using voluntariness as a distinguishing factor for determining the personal liability of directors would result in the claimant being able to claim against the corporation, but not against any of its directors, assuming the directors were acting in the course of their duties.

The research surveyed below deals with the exemption of directors from personal liability, and is primarily concerned with what the appropriate scope should be for the exemption, with one argument being that wider protection would be justified by the principle that over-deterrence should be avoided in tort law. The particular concern is that when directors are faced with the possibility of personal liability for tort damages, they may take more care than is efficient, meaning that directors are likely to have the corporation take excessive care, as directors would only bear a fraction of this cost versus the full cost of tort damages.[62] Other arguments focus on the distinction between voluntary and involuntary creditors to provide a justification for expanding the scope.

Edward M. Iacobucci, in "Unfinished Business: An Analysis of Stones Unturned in *Adga Systems International v. Valcom Ltd.*," observes that the Ontario Court of Appeal, when explaining the justifications for the scope of director immunity from tort liability, failed to fully consider the impact these justifications should have on the scope. Namely, when the Court accepted that costly over-deterrence of torts was a premise through which to justify protecting directors when they induce breach of contract for the benefit of the corporation, the Court failed to consider that this premise may not be limited to inducing breach of contract.[63] A wider exemption that captured more situations that would

[61] *Ibid* at para 43.
[62] lacobucci, *supra* note 8 at 47-48.
[63] *Ibid* at 39.

otherwise create such inefficiency would be a more correct application of the premise that over-deterrence of torts should be avoided, according to Iacobucci.

The distinction between parties that deal with the corporation on a voluntary basis and parties that deal with the corporation on an involuntary basis is the source for another line of research.[64] Christopher C. Nicholls, in "Liability of Corporate Officers and Directors to Third Parties,"[65] observes that a wider exemption from personal liability may be appropriate for situations where the party seeking tort damages voluntarily dealt with the corporation, such as by forming some sort of business arrangement prior to the tortious act. Under such circumstances, a consequence of choosing to deal with a corporation should be that damages for tortious conduct can only be sought from the corporation itself.[66] Parties that deal with a corporation would not have the option of collecting from directors personally for damages when the tortious conduct was committed by directors, acting in the best interests of the corporation. Generally, it appears that there are multiple justifications available for enlarging the scope of the protection from personal liability.

3 Selecting an approach that can provide guidance, and limiting scope

The interpretation of both the stakeholder debate and the exemption of directors from personal liability relies on cases that have provided insufficient guidance. The ability of stakeholders to know if their interests require protection in some circumstances is made difficult by the vagueness present in the Supreme Court of Canada's definition of the duty of loyalty, the oppression remedy, and the best interests of the corporation.[67] The scope of the exemption of directors from personal liability is also subject to a lack of clarity because the justification for this exemption have been used to describe particular

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[64] Nicholls, *supra* note 2 at 23.
[65] Nicholls, *supra* note 2.
[66] *Ibid* at 37.
[67] Bradley, *supra* note 31 at 346-348.

instances where the exemption is appropriate, but without further guidance as to when and if the scope of this exemption would extend to other fact situations.[68]

New perspectives will be helpful in aiding the future interpretation of these issues. The goal of this thesis is to identify a foreign perspective that may be of use in this respect, and to determine what, if any, value such a perspective actually provides.

American scholarship was the source from which a research perspective was selected because of the volume and quality of the legal research available in that jurisdiction, particularly in Delaware**.** Additional search criteria included that the research perspective should provide concepts that have at least some applicability to both the stakeholder debate and the exemption of directors from personal liability, and should generally provide a framework for determining the standards to which directors should be subject.

When it comes to applying an approach to the problem of case law providing insufficient guidance, particularly within the stakeholder debate, this thesis limits the application of such an approach to the duties and expectations for directors established by Parliament pursuant to the *CBCA*. Provincial corporate statutes are not included in this application. Additionally, it should be noted that the case law being cited and analysed deals mostly with the management of large, widely-held corporations. For this reason, any observations regarding the reasonable expectations of stakeholders, in the context of the oppression remedy, may not be appropriate for situations involving small or closely-held corporations.

4 The implied contract approach

The American perspective to be applied in the Canadian context will be referred to as the implied contract approach. This American perspective identifies an apparent distinction,

[68] Janis Sarra, "The Corporate Veil Lifted: Director and Officer Liability to Third Parties" (2001) 35 Can Bus LJ 55 [Sarra], at 68; Iacobucci, *supra* note 8 at 68.

regarding the establishment of standards of care in American law, between tort law generally and corporate law specifically. The apparent distinction, which this American perspective refutes, is that the standard of care in tort law will be determined based on a negligence standard, whereas the standard of care, created by statute, to which directors are held in corporate law will not. Based on such a distinction, it would appear that normal tort principles would not be very helpful in explaining the standard of care to which directors are held.[69] The implied contract approach overcomes this by highlighting the importance of industry custom when determining the standard of care in tort law generally, and argues that, when this is considered, it is possible to still conceptualize the standard of care to which directors are held as being grounded in a negligence standard.[70] Standards of care in corporate law follow the same underlying principles as those in tort law generally, if this approach is followed.[71]

An understanding of the standard of care to which directors are held that is grounded in tort principles provides a framework that can be applied to both the stakeholder debate and the exemption from personal liability. The latter is already an issue to be determined through general tort law, but now the former issue has also been conceptualized through the same tort principles. Overall, the implied contract approach, if it can be transposed to the Canadian context, could provide a valuable perspective on both the stakeholder debate and the exemption of directors from personal liability by providing a shared framework grounded in tort law, that can help to establish what can reasonably be expected from directors.

4.1 The duty of care for directors in Canada

The starting point for determining the standard of care to which directors of *CBCA* corporations are held is section 122(1)(b) of the *CBCA*. This section says that directors

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[69] Rhee, *supra* note 4 at 1157.
[70] Ibid at 1165.
[71] *Ibid* at 1142-1143.

must "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances".[72]

The required content of this duty is affected by an additional concept which is not obvious from the mere wording of the statute, namely, a concept known as the business judgment rule, a term borrowed from American corporate law, will be applied when assessing if the decisions of directors were in breach of their duties of care.[73] This rule calls for general deference to be shown to directors when a court is determining if their decisions met the required standard. How this deference manifests is through a focus on the process, rather than the result, regarding the decisions in question. Specifically, a court will look to the facts to decide if an appropriate level of "prudence and diligence" was applied to the decision-making process.[74] In *People's*, the Supreme Court of Canada held the following.

> Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(b) of the *CBCA* if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.[75]

The actual result of the process of making business decisions seems to be less important than the process itself when a court is determining if directors have met their duty of care. This approach has been justified by the Supreme Court of Canada based on the notion that courts are not well suited to judge the application of business expertise by coming to their own conclusions about what the result should have been. What courts are suited for

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[72] *CBCA*, *supra* note 5 s 122(1)(b).
[73] *People's*, *supra* note 15 at para 64.
[74] *Ibid* at para 67.
[75] *Ibid* at para 67.

is determining if a sufficient level of care was applied to the decision-making process.[76] Therefore, the standard of care for directors, created by the *CBCA* (as interpreted by Canadian courts), is a standard that focuses more on process than result.

This particular standard of care affects two other areas, in addition to creating a duty of care owed to the corporation by each director. The first is tort law in general, while the second is the oppression remedy available through section 241 of the *CBCA*.[77] Regarding tort law, the standard of care created by section 122(1)(b) of the *CBCA* may be the basis for the liability of directors to stakeholders of the corporation, if such stakeholders have an existing cause of action available through tort. Section 122(1)(b) does not, however, create an independent foundation for claims that stakeholders can pursue to hold directors liable for a breach of this standard.[78] In *BCE*, the Court held the following:

> This duty, unlike the s. 122(1)(a) fiduciary duty, is not owed solely to the corporation, and thus may be the basis for liability to other stakeholders in accordance with principles governing the law of tort and extracontractual liability: *Peoples Department Stores*. Section 122(1)(b) does not provide an independent foundation for claims.[79]

The content of this standard of care for a director created by the *CBCA* will therefore be relevant to not only the duties owed by directors to the corporation, but will also be relevant to what protection stakeholders can expect to receive in general when directors engage in allegedly-tortious behaviour while managing the corporation. In addition to informing the standard of care in tort, section 122(1)(b) of the *CBCA* will also be relevant when a court is determining if conduct by directors was oppressive for the purposes of the section 241 oppression remedy.

> **(1)** A complainant may apply to a court for an order under this section.
>
> **(2)** If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates
>
> **…**

[76] *Ibid* at para 67.
[77] *CBCA, supra* note 5 s 241.
[78] *BCE, supra* note 12 at para 44.
[79] *Ibid* at para 44.

> **(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.[80]

This remedy is meant to protect the reasonable expectations of parties that deal with the corporation, such as creditors, shareholders, and other stakeholders. What counts as reasonable expectations for this purpose will vary for each fact situation.[81] Actions by directors do not need to be unlawful to be considered in violation of reasonable expectations, and a range of factors can be used to determine if reasonable expectations exist, such as commercial practice, the nature of the corporation, and steps the claimant could have taken to protect itself.[82] In *BCE*, it was also held that the standard of care created by section 122(1)(b) of the *CBCA* can be taken into account when determining reasonable expectations regarding actions taken by directors.

> Section 122(1)(b) does not provide an independent foundation for claims. However, applying the principles of *Saskatchewan Wheat Pool v. Canada*, [1983] 1 S.C.R. 205 (S.C.C.), courts may take this statutory provision into account as to the standard of behaviour that should reasonably be expected.[83]

Therefore, factors that inform the interpretation of this standard of care will have an impact beyond the duty of care created by this section because the content of this standard will affect the interpretation of reasonable expectations within the context of the oppression remedy. In other words, stakeholders seeking to protect their perceived rights through the oppression remedy will be affected by factors that inform the determination of the duty of care of directors.

In situations where the interests of stakeholders conflict, stakeholders can only reasonably expect directors to act in the best interests of the corporation itself when resolving such conflicts. In *BCE*, the Court held,

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[80] *CBCA*, *supra* note 5 s 241.
[81] *BCE*, *supra* note 12 at para 59.
[82] *Ibid* at para 71-72.
[83] *Ibid* at para 44.

> … cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.[84]

At first glance, this would seem to limit the ability of stakeholders to prove reasonable expectations in the context of an oppression remedy claim where stakeholder interests conflict.[85] However, the standard of care created by section 122(1)(b) of the *CBCA* may still play a role in such circumstances of conflict. As mentioned above, this standard can be a consideration for courts when determining the reasonable expectations of stakeholders.[86] If stakeholders can establish that they had a reasonable expectation that the directors would fulfill their statutory duties to the corporation, which would not be a difficult argument, a breach of this standard of care could be argued as a breach of such reasonable expectations. One example of a situation of stakeholder conflict was described in *People's*.

> Short of bankruptcy, as the corporation approaches what has been described as the "vicinity of insolvency", the residual claims of shareholders will be nearly exhausted. While shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation.[87]

In the above situation, the directors would not be able to protect the best interests of the corporation by seeing to the best interests of both shareholders and creditors, as such interests would be mutually exclusive. The directors would need to pick one interest, or none. If the directors decided that the best interests of the corporation, in this situation, coincided with the best interests of shareholders, but not the best interests of creditors, such creditors would not be able to claim that the directors breached the reasonable expectations of the creditors simply because the creditors were not prioritized above

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[84] *Ibid* at para 66.
[85] Rojas, *supra* note 7 at 79.
[86] *BCE*, *supra* note 12 at para 44.
[87] *People's*, *supra* note 15 at para 45.

shareholders.[88] However, if the directors failed to properly inform themselves about how important the corporation's deals with its creditors were to the continued success of the corporation, to the extent that such a failure violated the directors' statutory duty of care, then the creditors may have another argument for the use of the oppression remedy. The creditors could argue that they had reasonable expectations that the directors would fulfill their statutory duties to the corporation when dealing with the creditors, and that a breach of these reasonable expectations amounted to, at least, unfair disregard.

The above argument does not require stakeholders to demonstrate that the directors should have protected any interest other than that of the corporation, as it was an expectation about the directors fulfilling their duties to the corporation itself. Therefore, even in a situation of stakeholder conflict, where all that can be expected of directors (in terms of balancing different interests) is to act in the best interests of the corporation, it may still be possible for stakeholders to protect their interests by showing a violation of this standard in order to make use of the oppression remedy. Factors that determine this standard will therefore be relevant to the oppression remedy even in situations of stakeholder conflict.

The section 122(1)(b) duty of care plays a role in the stakeholder debate in multiple ways, and is particularly representative of what the stakeholder debate is meant to address, namely, to determine which interests should be considered when determining what is in the best interests of the corporation.[89] The duty of care is owed to an open-ended group of potential claimants, including the corporation itself, but the content of the duty is the requirement that directors take sufficient care while managing the corporation.[90] The duty is owed to many, while its content is concerned only with the protection of the corporation. Put differently, third parties can, if the elements of a tort can be demonstrated, invoke a duty meant to protect the corporation, but for the benefit of themselves.

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[88] *BCE*, *supra* note 12 at para 87.
[89] Khimji, *supra* note 56 at 211.
[90] *BCE*, *supra* note 12 at para 44.

The stakeholder debate includes the argument that various stakeholder groups should benefit from corporations being managed effectively, and the section122(1)(b) duty of care contributes to this understanding of corporate governance by holding directors liable to stakeholder groups if the directors fail to manage the corporation to the required standard (assuming a tort occurred). Overall, this duty of care, both on its own and through its influence on the determination of other standards, is a critical component when analysing the stakeholder debate in Canadian corporate law.

4.2 The business judgment rule in Canada

The business judgment rule was touched on briefly in the previous section, and is a key concept that determines the duty of care created by the *CBCA*. Stated simply, the business judgment rule is a principle of corporate law that acknowledges the complexity of corporate operations, and presumes that directors have the expertise to understand this complexity and reach appropriate decisions. This combination of complexity and expertise is the reason courts will show deference towards the decisions of directors, as courts will not typically have the same expertise.[91]

While the principle is an acknowledgment that courts are ill-suited to determine what the best business decision may have been for a given fact situation, courts are suited to determine if an appropriate level of care was applied to the decision-making process.[92] The particular wording used to describe compliance with this principle, from *People's*, is that directors must,

> … act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known.[93]

[91] PM Vasudev, "Corporate Stakeholders in Canada – An Overview and a Proposal" 45:1 Ottawa L Rev 137 [Vasudev], at 156.
[92] *People's*, *supra* note 15 at para 67.
[93] *Ibid* at para 67.

The principle also affects considerations regarding the duty of loyalty and the oppression remedy, through its connection to the concept of the best interests of the corporation.[94] Therefore, any change to the understanding and interpretation of the business judgment rule would affect not only the duty of care, but also the duty of loyalty, the oppression remedy, and the stakeholder debate generally. For this reason, understanding the origins and operation of the business judgment rule is a necessary step in analysing how the stakeholder debate is influenced by the standards to which directors are held when they are managing the corporation.

The term "business judgment rule" was explicitly adopted from American corporate law,[95] but more importantly, much of the content of the concept can be seen as imported from, or at least heavily influenced by, Delaware case law. While that jurisdiction is typically considered to be management-friendly, and the business judgment rule is certainly in line with this considering the deference it calls for, there are nonetheless fact situations that call for a more rigorous examination of the decisions of directors. In the context of changes in corporate control, the so-called business judgment rule is applied by Delaware courts using the enhanced scrutiny standard.[96] In this context, rather than merely looking at the process that was used to reach a business decision, a Delaware court will consider the adequacy of the decision-making process, the information relied on, and the reasonableness of the final decision.[97]

The application of the business judgment rule by Canadian courts follows a method similar to that of the enhanced scrutiny standard used by Delaware courts.[98] However, the application of the rule in Canada does not vary in the context of changes in corporate control, but rather is always applied by looking at two factors: the decision-making process, to determine if it was properly informed, and the reasonableness of the final decision. In addition to adopting the name from American corporate law, it is apparent

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[94] *BCE*, *supra* note 12 at para 40.
[95] *People's*, *supra* note 15 at para 64.
[96] Vasudev, *supra* note 91 at 158.
[97] *Ibid* at 158.
[98] *Ibid* at 158.

that Canadian courts have also adopted the substance of the business judgment rule, in its enhanced scrutiny form, from Delaware case law.[99] It is possible for directors to comply with this requirement and still reach a bad business decision, but in such circumstances a court will not find the directors to be in breach of their duties.[100] Essentially, perfection is not demanded of directors, but there is an expectation that they will make appropriate efforts to inform themselves of the available options, and then choose one of the reasonable courses of action available to them at the time.[101] The case of *People's* is one example of a mediocre business decision not being a breach of the directors' duty of care.

> Arguably, the Wise brothers could have been more precise in pursuing a resolution to the intractable inventory management problems, having regard to all the troublesome circumstances involved at the time the new policy was implemented. But we, like the Court of Appeal, are not satisfied that the adoption of the new policy breached the duty of care under s. 122(1)(b) of the CBCA.[102]

While the business judgment rule will determine what is required from directors in terms of the competence of business decisions, through the duty of care established by section 122(1)(b) of the *CBCA*, the rule also determines what is required from directors when they are determining what is in the best interests of the corporation. This, in turn, affects how the duty of loyalty and the oppression remedy will be applied.

In *BCE*, the Supreme Court of Canada held that the business judgment rule is an acknowledgment that directors are typically better suited to determine what is in the best interest of the corporation than a court. The Court goes on to explain that, because of this, the deference created by the business judgment rule should apply to directorial decisions generally.[103] Based on this reasoning, the rule is not limited to determining whether the duty of care was met, but will be relevant to a range of legal issues connected to the management of corporations. The examples of concern for the Court in *BCE* were the

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[99] Stephane Rousseau, "Directors' Duty of Care after *Peoples*: Would it be Wise to Start Worrying about Liability" (2004-2005) 41 Can Bus LJ 223 [Rousseau], at 233.
[100] *Ibid* at 233.
[101] *People's*, *supra* note 15 at para 67.
[102] *Ibid* at para 71.
[103] *BCE, supra* note 12 at para 40.

duty of loyalty and the oppression remedy, and particularly how the best interest of the corporation should be assessed for the purposes of these two concepts.

More specifically, the Court in *BCE* was focused on finding what is required from directors when the directors are determining what is in the best interests of the corporation, in situations where there are multiple, conflicting stakeholder interests that will be significantly impacted. Those stakeholders were shareholders and debentureholders. Shareholders would have benefited from the acceptance of a proposed, leveraged buyout of BCE, while debentureholders would have been put in a worse position because of the additional debt BCE would have to take on as part of the deal.[104]

The Court cited *People's* to reaffirm that directors may, when determining the best interests of the corporation, consider the interests of a wide range of stakeholders, including shareholders and creditors, but in no way limited to just those groups. The Court was also clear in stating that the business judgment rule calls for deference to be shown to directors when they are taking different stakeholder interests into account in order to determine which of such interests should be favoured when a conflict exists between such interests.[105] The same enhanced scrutiny standard regarding the business judgment rule is applied, but in the context of the best interests of the corporation. What this means is that, so long as directors take the relevant stakeholder interests into account, meaning they inform themselves about such interests and consider the potential impact of business decisions on such interests, and so long as the final decision is among a range of reasonable options available at the time, the directors will be considered to have been acting in the best interest of the corporation.[106] There is no requirement that any specific type of stakeholder must be protected under specific circumstances. However, there is arguably the requirement, if a particular stakeholder will be affected by a decision, that the directors must consider what that affect will be as part of their decision-making process.[107]

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[104] *Ibid* at para 1.
[105] *Ibid* at para 40.
[106] *Ibid* at paras 40, 104.
[107] *Ibid* at para 84.

A finding by a court that directors were acting in the best interests of the corporation will put to rest any challenge that the directors were in breach of their duty of loyalty, established by section 122(1)(a) of the *CBCA*. This was exactly what happened in *BCE*.[108] Such a finding will also make it difficult for the oppression remedy to be successfully argued (against directors) in situations where there are multiple, conflicting stakeholder interests in play. This is because, as the court makes clear in *BCE*, all that stakeholders can reasonably expect in such situations is that directors will act in the best interests of the corporation.[109] As the establishment of a reasonable expectation is the first necessary step in demonstrating conduct that could justify the oppression remedy,[110] a finding that the directors were acting in the best interests of the corporation would shut down this line of argument at this stage, assuming it is a situation of conflicting stakeholder interests. A breach of the duty of loyalty is not a prerequisite to a finding of oppression,[111] and a finding that the directors were acting in the best interests of the corporation is not a bar to a finding of oppression. However, when it comes to balancing different stakeholder interests in situations where not all, or perhaps not even many, of those interests can be satisfied at once, it will be difficult for stakeholders to successfully claim that their interests required protection, rather than (or in addition to) the interests that actually were favoured by the directors. The directors have discretion to determine which interests best align with the best interests of the corporation, and courts will be hesitant to interfere with this discretion.[112]

The deference afforded by courts when applying the business judgment rule, particularly in the context of the oppression remedy, may have also been increased as a result of the *BCE* decision. In addition to affirming the fact that broad deference is already afforded to directors when they make business decisions, the Court also provided a long list of factors that may influence what a reasonable expectation of a stakeholder could be. The

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[108] *Ibid* at para 104.
[109] *Ibid* at para 66.
[110] *Ibid* at para 56.
[111] *Ibid* at para 71.
[112] *Ibid* at para 87.

balancing of these factors was left to directors.[113] When this is considered alongside the fact that the Court explicitly said that, in situations where stakeholder interests conflict, all stakeholders can reasonably expect is for the directors to act in the best interests of the corporation, it seems as though boards of directors may be practically insulated from review by courts, so long as they can demonstrate that they acted on an informed basis, at least in regards to balancing different interests.[114]

Put differently, by going into detail about the range of factors which may be considered in relation to the best interests of the corporation and the reasonable expectations of stakeholders, without providing further guidance as to how those factors should be balanced, the Court increased the deference granted by the business judgment rule by leaving it to directors to decide how to balance such factors.

To recap, the business judgment rule has an impact on all three standards of interest to this thesis regarding the stakeholder debate in Canadian corporate law, namely the duty of loyalty, the duty of care, and the oppression remedy. The rule is a component of the section 122(1)(b) duty of care, and will determine what is a breach of this standard.[115] The rule is also the reason courts will show significant deference towards directors when directors are determining what is in the best interests of the corporation, assuming they are acting honestly and in good faith,[116] which in turn will affect decisions regarding the oppression remedy. A decision regarding what is in the best interests of the corporation will often be the overriding consideration for the duty of loyalty and the oppression remedy, making the business judgment rule a critical factor in such situations.[117] Part of the reason for this high level of deference is the lack of specific guidelines regarding how the consideration of stakeholder interests should be handled, other than a need to be informed about them.[118]

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[113] Waitzer, *supra* note 49 at 459.
[114] Poonam Puri, "The Future of Stakeholder Interests in Corporate Governance" (2009) 48 Can Bus LJ 427 [Puri], at 430; Waitzer, *supra* note 49 at 459.
[115] *People's*, *supra* note 15 at para 67.
[116] *CBCA*, *supra* note 5 s 122(1)(a).
[117] *BCE*, *supra* note 12 at para 82.
[118] Waitzer, *supra* note 49 at 459.

New perspectives on the business judgment rule may help to provide clarity regarding what stakeholders can expect from directors in any given situation, notably when the three standards of the duty of care, the duty of loyalty, and the oppression remedy are under consideration, as the rule will be relevant to all of these issues.

4.3 Rhee's implied contract approach

Robert J. Rhee, in his article "The Tort Foundation of Duty of Care and Business Judgment," sets out to identify and apply the underlying legal principles that explain the existence of the business judgment rule in American corporate law.[119] His "implied contract approach" is the new perspective to be assessed by this thesis, and subsequently tested within the Canadian context. This section, and the next section, will detail Rhee's approach, while the following section will provide a critical analysis and modification of Rhee's approach before it is applied to the Canadian context. Rhee's approach requires significant modification before it can be used as a tool for explaining concepts in Canadian corporate law. However, before modifying Rhee's approach, I must explain the approach in its original form.

The starting point for Rhee's analysis is the observation that directors of corporations are not held to the same standard of care as would be applied outside the corporate law context in an action for the tort of negligence, and that this is the result of the application of the business judgment rule. Rhee's comment on the case of *Kamin v American Express Co*[120] illustrates his point on this.

> In spite of the demonstrably wrong decision, the court properly dismissed the plaintiff's complaint per the application of the business judgment rule. Since the board was reasonably informed and engaged in a proper process, care was given; the board's mistake "presents no basis for the superimposition of judicial judgment, so long as it appears that the directors have been acting in good faith." Once applied, the business judgment rule precludes a substantive review of a

[119] Rhee, *supra* note 4.
[120] *Kamin v American Express Co*, 383 NYS (2d) 807 (1976).

> board's action, irrespective of the correctness or the intelligence of a decision. The business judgment rule is striking in that not only does it protect risky decisions, but as courts and scholars cheerfully (and correctly) tell us it also protects foolish, awful, and egregious decisions, whereas tort law would never countenance the stupid person defense.[121]

Rhee seeks to answer why corporate law and tort law apply different standards to determine if parties have breached their duties of care.[122] The answer is that both standards are grounded in principles of tort, with the tort concept of industry custom playing a critical role in explaining the standards that directors are held to in corporate law, particularly the existence of the business judgment rule, which is the reason for this distinction between standards.[123]

Before analysing the distinction between corporate law and tort law that Rhee is concerned with, it should be noted that this distinction is less extreme in the Canadian context than it is in the American. This is because the Canadian business judgment rule is not the same as the normal American business judgment rule. As was explained in the previous section, Canadian courts have adopted the more rigorous "enhanced scrutiny" version of the American rule (used in cases of changes in corporate control in Delaware).[124] Typically, the American business judgment rule is a process-focused rule. This means that a court will look to see if due care was applied in the process of coming to a business decision, and if due care was applied, the directors will not be in beach of their duties of care even if the final decision was not a reasonable one.[125] The distinction between this standard and that of negligence in tort law is quite marked, and it is this distinction that Rhee sets out to explain. Despite the extent of the distinction not being as notable in Canada, there is still a distinction because of the clear deference that courts give directors when determining what was within the range of reasonable business decisions available to them.[126]

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[121] Rhee, *supra* note 4 at 1150.
[122] *Ibid* at 1141.
[123] *Ibid* at 1144.
[124] Vasudev, *supra* note 91 at 158.
[125] *Brehm v Eisner*, 746 A (2d) 244 at 264 (Del 2000).
[126] *People's*, *supra* note 15 at para 67.

The explanation for the business judgment rule in Canada is that courts are not well suited to determine what a good business decision would have been, and will therefore show deference towards directors on this issue.[127] The same justification exists in American case law, but Rhee is not satisfied with this explanation. If courts are competent to decide matters related to the economics of antitrust law, and competent to assess complex business decisions for the purpose of assigning liability in tort, then it would seem they should also be competent to determine whether a business decision was a good or bad one at the time it was made.[128] The lack of a satisfactory set of principles for explaining the business judgment rule appears to be a shared problem between American and Canadian corporate law, if Rhee's analysis is accepted.

4.4 Rhee's use of industry custom

Industry custom is the concept used by Rhee to justify the existence of the business judgment rule. Following this approach, Rhee's method of justification also means that the standard of care in tort law and the standard of care in corporate law share the same underlying tort principles. In Canadian tort law, it has been accepted by courts that custom and industry practice can determine what the standard of care will be for a given fact situation. The Supreme Court of Canada in *Ryan v Victoria (City)* said,

> The measure of what is reasonable depends on the facts of each case, including the likelihood of a known or foreseeable harm, the gravity of that harm, and the burden or cost which would be incurred to prevent the injury. In addition, one may look to external indicators of reasonable conduct, such as custom, industry practice, and statutory or regulatory standards.[129]

Industry custom is a relevant consideration for Canadian courts when they need to determine what conduct will be a breach of the standard of care in tort law generally. Therefore, industry custom has the potential to label particular behaviour as reasonable, if

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[127] *BCE*, *supra* note 12 at para 40.
[128] Rhee, *supra* note 4 at 1152.
[129] *Ryan v Victoria (City)*, [1991] 1 SCR 201, at para 28.

it is within particular industry situations, when that behaviour would not be reasonable outside those situations. This is exactly what Rhee argues in his article, namely, that industry custom is the source of the deference that courts show directors, through the business judgment rule, when determining if the directors have breached the corporate law standard of care.[130]

The next question to be answered is: where did this industry custom come from? More precisely, there needs to be an explanation for why this custom exists that limits the liability of directors by focusing their standard of expected care on the process of making decisions, rather than the actual result of making decisions. Rhee's answer to this is that, because the corporate law standard of care is thrust upon directors as a result of a voluntary undertaking, the content of this standard can be determined through an implied contract analysis.[131]

The ability of contract analysis to determine what the custom is, for the purpose of determining the standard of care, is possible in situations where the parties involved are in a market relationship. In such situations, Rhee argues that the market itself fixes a standard of care that reflects the preferences of the involved parties.[132] One example of this, Rhee notes, is cases involving professional malpractice. In such situations, industry standards will often be dispositive when it comes to establishing what the standard of care was for a given situation. The business judgment rule can be explained using a similar application of industry custom, in this case, the expectations between corporations and directors.[133]

In terms of the corporate law duty of care, the industry custom will be what directors and corporations would have bargained for in terms of a standard of care for directors in their management of the corporation. Directors, when entering into a voluntary agreement (meaning that neither party had the arrangement imposed on them) whereby they agree to

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[130] Rhee, *supra* note 4 at 1165.
[131] *Ibid* at 1167.
[132] *Rodi Yachts, Inc. v Nat'l Marine, Inc*, 984 F (2d) 880 at 888-889 (7th Cir 1993), in Rhee, *supra* note 4 at 1166.
[133] Rhee, *supra* note 4 at 1165-1166.

exercise the appropriate level and type of care, implicitly agree with the corporation that this industry custom will determine the standard of care.[134] The business judgment rule, under this reasoning, is the result of an implied contract between directors and corporations regarding the type of care that is expected from directors.

The corporate law duty of care, while different from the duty of care found in tort law, still shares underlying principles when the influence of industry custom is taken into account. Unlike the role of industry custom in professional malpractice, which will vary the standard of care from case to case, and typically relies on expert evidence,[135] the role of industry custom in corporate law has effected a general difference in how the standard of care is determined for directors of corporations. Directors and corporations voluntarily enter into arrangements that give rise to directors owing this different type of duty of care, and this difference reflects the expectations of the parties affected.

The next stage of analysis is to determine what, exactly, are the expectations of the parties affected. The end result is the existence of the business judgment rule, which is a reflection of these expectations, and is the source of the difference that exists between the corporate law duty of care and the tort law duty of care. Rhee uses an implied contract analysis, mentioned previously, to determine what these expectations are that culminate into the business judgment rule.

For the sake of clarity, it should be noted that when Rhee employs an implied contract analysis, the analysis is not meant to provide a different standard of care for different fact situations involving the corporate law duty of care. The analysis is meant to describe the implied, general expectations that all directors and corporations accept when directors take on their role.[136] The expectations are not explicitly negotiated terms of an employment contract, but part of the implicit understanding between directors and

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[134] *Ibid* at 1167-1168.
[135] *Johansson v General Motors of Canada Ltd,* 2012 NSCA 120 at paras 108-110.
[136] Rhee, *supra* note 4 at 1167.

corporations that exists in corporate law generally. This type of analysis yields an objective standard for directors.[137]

With the previous point in mind, the next step is to ask what directors and corporations have bargained for regarding the terms of the standard of care that directors agree to take on. These terms result in the business judgment rule, and offer insight into why such a rule exists. The ideal situation for directors would be a standard that completely protects the directors from liability, while the ideal standard for corporations would be a standard that held directors liable for any and all corporate losses with which the directors were involved**.** Bargaining would result in a standard somewhere between these two. The key factor is how much risk can a corporation ask directors to take on through the corporate law duty of care, while still being able to convince directors to take on the role.[138] The content of this bargain, according to Rhee, and in reference to the American business judgment rule, appears to be that directors agree to take affirmative care of the corporation, meaning that they will take action to make business decisions and monitor the corporation.[139] Phrased differently, directors agree to put the appropriate amount of effort and care into making business decisions. Evidence of affirmative steps taken by directors to inform themselves about a business decision, and then making that decision, will satisfy the standard based on this understanding.[140] Directors must act on an informed basis, and be aware of any special circumstances for which they ought to be aware.[141] Directors do not, however, agree to be liable for bad business decisions, so long as the requisite care was put into reaching that decision. Directors do not agree to be liable for all losses the corporation may suffer because of the actions of that director. In other words, directors do not agree to be insurers for the value of the corporation. They agree to inform themselves about business decisions before making such decisions, and to generally take affirmative steps to care for the corporation.[142] The manifestation of all

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[137] In Canada, the statutory duty of care under the *CBCA* is also accepted as an objective standard. *People's*, *supra* note 15 at para 63.
[138] Rhee, *supra* note 4 at 1167.
[139] *Ibid* at 1168.
[140] *Ibid* at 1169.
[141] *People's*, *supra* note 15 at para 67.
[142] Rhee, *supra* note 4 at 1167.

of this is the business judgment rule; the business judgment rule reflects this implicit bargain.[143]

Rhee also points out that this line of thinking is not a novel approach to explaining the business judgment rule in American corporate law. Courts have in the past remarked that the standard of care in corporate law is imposed because of a voluntary undertaking by directors, and because of this, the terms of this standard can be understood as what the directors would have implicitly agreed to when they took on their role. Specifically, American courts have remarked that: “such persons would rarely ever accept a directorship if they could be held liable for every 'bad' account or every mistake of judgment” and “no man would undertake to render a service to another on such severe conditions”.[144] One of the terms identified by courts is that the corporation agrees to take on the risk of bad business decisions by not holding the directors liable for them (assuming the directors followed an appropriate decision-making process). Specifically, from *Joy v North*: “the business judgment rule merely recognizes a certain voluntariness in undertaking the risk of bad business decisions”.[145] Rhee’s implied contract approach to explaining the source and functioning of the business judgment rule appears to be at least somewhat grounded in corporate case law when this is taken into account.

4.5 Modifying the implied contract approach

Rhee’s approach makes use of numerous, complex concepts to describe how the standards to which directors are held should be interpreted. The statutory duty of care is, as I just said, a standard created by statute, rather than the common law. The use of concepts such as industry custom and implied contract analysis to interpret a standard that was created by Parliament, when Parliament has not made any mention of such

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[143] *Ibid* at 1169.
[144] *Smith v Brown-Borhek Co*, 200 A (2d) 398 at 401 (Pa 1964), in Rhee, *supra* note 4 at 1167 note 164; *Percy v Millaudon*, 8 Mart (NS) 68 at 78 (La 1829), in Rhee, *supra* note 4 at 1167 note 164.
[145] *Joy v North*, 692 F (2d) 880 at 885 (1982), in Rhee, *supra* note 4 at 1167.

concepts in the statute, and when the courts have not interpreted the intention of Parliament to include such concepts, is likely an inappropriate method by which to explain the creation of standards to which directors are held, at least in reference to the *CBCA*.

What the statutory duty of care requires is that a court determine what is expected from directors of corporations, based on the wording of the statute, and keeping in mind the business judgment rule, which has long been recognized as part of the statutory standard.[146] The result of this standard is risk allocation between the corporation and its directors regarding business decisions. Rhee's approach, while complex, and inappropriate for directly defining statutory standards, still provides a useful framework for explaining why risk has been allocated the way it has by this standard, and the business judgment rule that operates as part of it. The idea of directors and corporations bargaining with each other is odd; corporations are not living things capable of engaging in independent action. When the corporation acts, it is always through the actions of individuals, and these individuals are often the directors.

However, the exercise of imagining this bargaining is a helpful way of explaining why risk has been allocated the way it has between directors and the corporation itself. A corporation must retain competent directors, and therefore cannot ask too much from them in terms of risk, lest no one suitable is willing to take the position. Directors will want to limit their exposure to risk as much as possible but still must recognize that they need to be accountable to the corporation on some level, or the benefits of having directors begin to disappear. Imagining such bargaining between corporations and directors helps explain why directors agree to make informed, prudent business decisions, but do not agree to be liable for a decision that turned out to be a poor course of action in hindsight, assuming the decision was indeed informed and prudent at the time.[147] Directors are not insurers for the corporation's value, but the corporation can hold directors accountable if they fail to take proper care in the decision-making process. A

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[146] *People's, supra* note 15 at paras 64-65.
[147] *Ibid* at para 67.

balancing of risk is required for competent directors to agree to take on that role while still being accountable. This balance is reflected in the business judgment rule. The statutory duty of care was not created as the result of directors and corporations reaching a bargained agreement. However, in the abstract, thinking about such an agreement helps to explain why this allocation of risk exists as it does.

The implied contract approach can also be viewed as an aid to statutory interpretation when it is focused on explaining the allocation of risk. Assumedly, Parliament intended an efficient, rather than an inefficient, allocation of risk between directors and corporations. The exercise of determining the result of bargaining between the directors and the corporation helps to identify the details of what an efficient allocation of risk looks like, and therefore helps to identify the details of what Parliament intended.

Connected to this issue of the allocation of risk is the concept of reasonableness. Both the statutory duty of care and the oppression remedy require a determination about what can be reasonably expected from directors as they manage the business of the corporation.[148] Understanding how risk is allocated between the directors and the corporation, and why it is allocated as it is, by going through the exercise of working out what the directors and the corporation would have bargained for, will in turn help to determine what stakeholders can reasonably expect from directors. Generally, stakeholders can reasonably expect that directors will be liable for the risks they have been assigned, but not for the risks that they have not. The risks that directors have been assigned are that, if the directors fail to inform themselves when making decisions, they will be liable for that failure. Directors have not been assigned the risk of informed decisions turning out to be a poor course of action for the corporation. Overall, directors have taken on the risks related to the process of reaching decisions, but have not taken on the risks associated with informed decisions turning out to be detrimental to the corporation.

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[148] *Ibid* at para 67*; BCE*, *supra* note 12 at para 5.

5 Applying the modified implied contract approach to Canada

Both the American and Canadian versions of the business judgment rule require that deference be shown to the business decisions of directors. In order for the implied contract approach to be applicable to the Canadian context, the implied contract analysis should be revisited and analysed within the context of Canadian legislation and case law to once again explain the allocation of risk between directors and corporations. The same question of what directors and corporations have implicitly bargained for when directors take on their duties should be answered, but the answer should explain the Canadian context.

5.1 Application to the duty of care

The Canadian business judgment rule mimics the enhanced scrutiny version of the American business judgment rule.[149] What this means is that Canadian courts will not only look at the process of making business decisions, as American courts would when applying the standard American version of the business judgment rule, but will also look to the decision in terms of its rationality.[150] This second component is less rigorous than it seems at first glance, however, as Canadian courts will only need to see that the decision was within a range of reasonable alternatives, and will generally show deference towards the application of business expertise by directors.[151]

Despite the above, the similarities between the American and Canadian business judgment rule are more significant than the differences. Both affect the terms of a standard of care that is imposed on directors because of a voluntary undertaking between the directors and the corporation. Since the application of the standard of care requires

[149] Rousseau, *supra* note 99 at 233.
[150] Vasudev, *supra* note 91 at 158.
[151] *People's*, *supra* note 15 at para 67.

that the parties involved agreed to be bound by it, by the director taking on that role, then an implied contract analysis is still possible in the Canadian context as a tool for explaining the allocation of risk. The content of this voluntary agreement includes, like it does in the American version, an undertaking by the corporation to take on the risk of bad business decisions by directors by not holding the directors liable for them.[152] The particular qualifiers for this part of the agreement differ in the Canadian version. This undertaking requires that, in making business decisions, directors follow appropriate decision-making processes, as the American version requires, but additionally requires that the final decision be among a range of reasonable alternatives. As mentioned, meeting the threshold of reasonable in this context is not overly onerous. If the decision was within a range of reasonable options then this decision is reasonable for the purpose of the Canadian business judgment rule.[153] This additional requirement, while not putting directors under a dramatically higher amount of scrutiny, is still an extra requirement of the voluntary agreement between the corporation and the directors.

One peculiarity about the statutory duty of care under the *CBCA* is that, despite the above analysis, the duty is actually owed to a wider group of potential parties than merely the corporation. Unlike the duty of loyalty, the duty of care can be owed to parties such as creditors and other persons that may be affected by the exercise of the directors' business judgment.[154] This does not, however, create an independent cause of action; such parties need to have some type of tort claim (or a claim based on extracontractual liability) for which the statutory standard of care in corporate law is the appropriate standard of care. A mere breach of the standard, without the other necessary elements of a tort claim, would not give rise to a cause of action by a stakeholder against the directors. This is what the Court in *BCE* meant when it held that this standard does not provide an independent foundation for claims:[155]

> This duty, unlike the s. 122(1)(a) fiduciary duty, is not owed solely to the corporation, and thus may be the basis for liability to other stakeholders in

[152] *Ibid* at para 64.
[153] *Ibid* at para 67.
[154] *BCE*, *supra* note 12 at para 44.
[155] *Ibid* at para 44.

> accordance with principles governing the law of tort and extracontractual liability: *Peoples Department Stores*. Section 122(1)(b) does not provide an independent foundation for claims.[156]

Despite the fact that the duty is owed to parties beyond merely the corporation, this is not problematic to explaining the allocation of risk through an implied contract analysis. While the duty is owed to multiple parties, the actual content of the duty itself is based on terms that only involve the parties to the voluntary undertaking. The implied agreement is still between corporations and directors regarding the level and type of care that corporations expect directors to exercise. When parties other than the corporation make a claim in tort that alleges a breach of this standard, they are claiming that directors violated their agreement with the corporation, not an agreement with the claimant, and that this violation caused the claimant harm.[157] The standard concerns the relationship between directors and corporations, but a breach of it can still harm other parties, who may have an action in tort. The point is that, despite the duty being owed to parties beyond merely the corporation, the content of the standard of care in corporate law is still only concerned with the expectations of corporations and directors when they enter into a voluntary agreement. Therefore, looking to an implied contract analysis to explain the allocation of risk, which in turn will inform reasonable expectations, remains possible.

5.2 Application to the duty of loyalty

While the description of Rhee's implied contract analysis has been focused on the corporate law standard of care, Rhee also incorporates the duty of loyalty into the implied terms of the voluntary agreement between directors and corporations that results in the standards that directors are held to.[158] In American corporate law, the business judgment rule carries with it a presumption of loyalty. This means that, in order for directors to

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[156] *Ibid* at para 44.
[157] *BCE*, *supra* note 12 at para 44; *BAE-Newplan Group Ltd v Altius Minerals Corp*, 2012 NLCA 21 at para 36.
[158] Rhee, *supra* note 4 at 1168.

benefit from the deference that the rule creates, the directors must have been acting *bona fide* for the best interests of the corporation. In other words, to benefit from the business judgment rule when the corporate law duty of care is being analyzed by a court, directors must not have breached their duty of loyalty.[159]

Canadian corporate law operates to the same effect. In relation to the corporate law duty of care, the business judgment rule creates deference regarding decisions by directors, but the process through which that decision is made must still meet certain criteria.[160] One of these criteria is that the business decision in question must have been made in good faith, with a view to the best interests of the corporation.[161]

The business judgment rule also affects the duty of loyalty itself regarding the determination of whether directors were acting in the best interests of the corporation. Essentially, when directors are determining which course of action would benefit the corporation most, so long as their intentions were ultimately to benefit the corporation, and not some ulterior motive, directors are free to favour long-term goals over short-term, or to prioritize the interests of various groups that deal with the corporation in the way they see most fit.[162]

The necessary components for an implied contract analysis to be useful in determining risk allocation are also present in the duty of loyalty. The terms that both parties implicitly agree to can be determined by asking what directors and corporations have generally bargained for regarding the terms for directors taking on their role. The content of this agreement is simpler than the terms for how directors must care for the corporation. For the duty of loyalty, the terms of the agreement are that directors must make business decisions in good faith, meaning that decisions must be made with the best interests of the corporation in mind, rather than the best interests of directors, or some other party.[163] The duty is worded as follows.

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[159] *Cede & Co v Technicolor, Inc*, 634 A (2d) 345 at 358 (Del 1993).
[160] *People's*, *supra* note 15 at para 67.
[161] *Unique Broadband Systems Inc, Re*, 2014 ONCA 538 at para 72, [*Unique*].
[162] *People's, supra* note 15 at para 47.
[163] *BCE, supra* note 12 at paras 37-38.

> **(1)** Every director and officer of a corporation in exercising their powers and discharging their duties shall
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> > **(a)** act honestly and in good faith with a view to the best interests of the corporation;[164]

Unlike the corporate law duty of care, the duty of loyalty set out in section 122(1)(a) is only ever owed to the corporation,[165] making both the content of the duty, and the parties it is owed to, centred on the parties to the voluntary agreement being used to explain risk allocation. Corporations place trust in directors to manage for the benefit of the corporation. Without a guarantee of this intention to act for the corporation, rather than other parties, there would be enormous risk to the corporation in allowing directors to exercise control over its management. The terms that directors and corporations implicitly agree to when directors take on their role clearly include good faith. In terms of risk allocation, corporations are not willing to accept the risks associated with directors managing the corporation for the benefit of other parties, and therefore demand that directors be accountable if they fail to act in good faith.

5.3 Application to the oppression remedy

Using the implied contract analysis employed by Rhee to explain the oppression remedy runs into two fundamental problems. The first is that the oppression remedy is a Canadian concept. Canadian courts have remarked that the protection afforded by the oppression remedy is a feature of corporate law that is unique to Canada, particularly in reference to the types of parties it can protect.[166] The Supreme Court of Canada has gone so far as to cite commentary that describes the oppression remedy as the broadest and most comprehensive shareholder remedy in the world (although it is not limited to shareholders).[167] American courts have not been forced to analyze and apply something

[164] *CBCA*, *supra* note 5 s 122.
[165] *BCE*, *supra* note 12 at para 44.
[166] Bradley, *supra* note 31 at 330.
[167] *People's*, *supra* note 15 at para 48.

quite like the oppression remedy, as it does not exist in American corporate statutes nor American common law. As Rhee's implied contract analysis was aimed at explaining the duty of care and the business judgment rule in American corporate law, such an analysis did not take into consideration where the oppression remedy might fit into such an understanding.

The second problem, and far more significant, is the content of the expectations created by the oppression remedy, and the parties to whom these expectations belong. The expectations created by the existence of the remedy are that directors (or the corporation) are not to engage in behaviour that amounts to oppression, unfair prejudice, or unfair disregard, in relation to the reasonable expectations of the claimant.[168] The content of these expectations is concerned with the relationship between the claimant and the directors (although the corporation itself can also be held liable under the oppression remedy).[169] The list of potential claimants is open-ended, and has included shareholders and creditors in the past, but virtually any party that may have reasonable expectations regarding how directors will conduct business can ask a court to grant leave, and a court may do so.[170] The oppression remedy is concerned with the relationship between a potential claimant and the directors (or the corporation), while the statutory duty of care and the duty of loyalty are focused on the relationship between the corporation and the directors. Even the duty of care, which can be owed to parties other than the corporation, is still based on the relationship between the directors and the corporation.

The corporate law duty of care and the duty of loyalty both lend themselves to an implied contract analysis because both duties are placed on directors as a result of a voluntary agreement between the directors and the corporation. The oppression remedy does not, however, involve the same two parties. A party can be an appropriate claimant if that party was in a position to have reasonable expectations regarding the behaviour of the directors, and those reasonable expectations were sufficiently thwarted to the extent of, at

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[168] *BCE*, *supra* note 12 at para 56.
[169] *CBCA, supra* note 5 at ss 241(1-2)
[170] *CBCA, supra* note 5 s 238(d); Jassmine Girgis, "Deepening Insolvency in Canada" (Spring 2008) 53 McGill LJ 167 [Girgis], at 185; Khimji, *supra* note 56 at 227.

least, unfair disregard.[171] Reasonable expectations exist when they are objectively reasonable based on the many factors outlined in *BCE*, and this can include the nature of the relationship between the claimant and the corporation, in addition to other related relationships.[172]

With all of these considerations, it is safe to say that, while it may be possible to use an implied contract analysis to determine the terms of the relationship between the directors and a claimant, those terms would not be identical to the terms of the agreement between the directors and the corporation regarding the directors taking on their role. There are many categories of claimant that can make use of the oppression remedy, which makes it difficult to argue that, for all of these categories, the general expectations about the level and type of care expected from the directors will be the same. The expectations relevant to the oppression remedy are to be determined pursuant to the factors in *BCE*, and are meant to be adaptive to different fact situations.[173]

The oppression remedy does not lend itself to the same implied contract analysis that would be useful for the corporate law duty of care and the duty of loyalty. The expectations created by the remedy are concerned with the relationships between a large potential pool of claimants and the directors. Such expectations look to what is expected from directors in regard to the interests of these potential claimants, rather than what is expected from directors in regard to the interests of the corporation.[174] With all that said, the implied contract analysis for the duty of care and the duty of loyalty will still have an impact on the practical application of the oppression remedy (covered in section 6.3).

[171] *BCE*, *supra* note 12 at para 56.
[172] *Ibid* at para 75.
[173] *Ibid* at paras 71-80.
[174] *Ibid* at para 45.

6 Applying the modified implied contract approach to the stakeholder debate in Canada

6.1 The duty of care and the stakeholder debate

For the corporate law duty of care, it is clear that this duty can be owed to stakeholders if such stakeholders have a tort claim against the directors where the corporate law standard is the appropriate standard.[175] The fact that such a duty can be owed is not overly helpful to the stakeholder, however, if the content of the duty does not take into account the interests of the stakeholder. The corporate law duty of care concerns itself with the management of the corporation for the benefit of the corporation; the standard it demands is aimed at ensuring that directors demonstrate a sufficient level of care when making business decisions. While the duty can be owed to various stakeholders, the content of the duty is concerned with protecting the corporation, not stakeholders, and will provide little help unless the interests of the stakeholders align with those of the corporation.

An implied contract analysis helps to frame this problem. The corporate law duty of care is placed upon directors when they agree to take on that role. The terms of this duty of care, particularly in regard to how reasonableness will be determined, can be explained by looking to how risk has been allocated between the directors and the corporation. What is reasonable should reflect the expectations that were created regarding which party would take on the risk for particular failures. Explaining how and why risk was allocated can be accomplished using Rhee's implied contract analysis, which results in the process-oriented accountability of directors. Such a determination does not look to the expectations of any third-party stakeholder group. Such groups were not parties to the voluntary agreement, therefore their expectations do not constitute or influence the terms that the directors and the corporation implicitly agreed to. Stakeholder groups can still hold directors to this duty of care, assuming a breach of this standard harmed stakeholder groups in the form of a tort, but the interests of stakeholder groups have no place in a

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[175] *Ibid* at para 44.

determination of reasonableness under this standard. The nature of the corporate law duty of care does not lend itself to the protection of stakeholder interests, and invoking this duty would be a poor strategy for stakeholders wishing to further their interests, unless those interests align with those of the corporation. Stakeholders cannot require that their interests are owed any protection through this duty that they may be owed because they are not among the parties whose interests the duty is meant to protect, as they were not parties to the voluntary agreement that placed the duty on the directors. What directors do owe stakeholders, as a result of this duty, is to not cause them harm by failing to adequately care for the interests of the corporation.

6.2 The duty of loyalty and the stakeholder debate

The duty of loyalty presents a similar problem to stakeholders, but with the added complication of the impact of the business judgment rule on the concept of the best interests of the corporation. Both the content of the duty of loyalty and the party the duty is owed to are solely concerned with the directors and the corporation. Stakeholders are clearly not owed the duty of loyalty, and only the corporation itself can enforce the duty of loyalty,[176] although stakeholders can compel such enforcement through a derivative action.[177] All of the previous analysis regarding how stakeholders cannot make a claim that their interests are owed protection through the duty of care applies equally to the duty of loyalty. The risk allocation that occurs through the duty of loyalty can be explained by the exercise of using an implied contract analysis to determine what the directors and the corporation bargained for as part of their voluntary agreement (discussed in section 5.2). As stakeholders are not among these parties, any expectations they have regarding the protection of their interests will not be reflected in this allocation of risk. The content of the duty never took their interests into consideration.

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[176] *People's*, *supra* note 15 at para 43.
[177] *CBCA*, *supra* note 5 ss 239-240.

A remaining strategy for stakeholders wishing to protect their interests is the argument that the duty of loyalty requires, as a necessary component of seeing to the best interests of the corporation, the fair treatment of stakeholders.[178] This notion of fair treatment is grounded in protecting the interests of the corporation, which gives it the potential to be part of the expectations of the parties to the voluntary agreement that places directors under this duty. In other words, the notion of the fair treatment of stakeholders could, in theory, be part of the implied contract analysis regarding the duty of loyalty, as it would form part of the expectations of the corporation, rather than the expectations of stakeholders, and would affect the allocation of risk between the directors and the corporation. Determining what amounts to fair treatment will be critical for stakeholders wishing to protect their interests through this strategy, but while the interpretation of this concept as part of the duty of loyalty, along with terms like "good corporate citizen," may seem like useful tools for stakeholders,[179] the business judgment rule will temper the impact of such concepts, and limit their usefulness to stakeholders.

The business judgment rule, both the Canadian and American version, is a rule informed by the allocation of risk between directors and corporations, which itself can be explained through an implied contract analysis.[180] A result of this allocation is that directors will be held to standards that emphasize process more than result. An informed decision-making process that lead to a result that was within a range of reasonable alternatives will satisfy such standards, including the matter of deciding which stakeholder interests are most important to the corporation in situations where those interests cannot all be satisfied.[181] This, arguably, makes it difficult for any particular stakeholder group to argue that their interests require protection based on the fair treatment component of the duty of loyalty, rather than whatever combination of other stakeholder groups benefited from the business decision in question. In the event that stakeholder interests conflict, the Court in *BCE* made it clear that the only thing stakeholders can reasonably expect from directors is to

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[178] *BCE*, *supra* note 12 at para 82.
[179] Bradley, *supra* note 31 at 338, 344.
[180] Rhee, *supra* note 4 at 1168.
[181] *BCE*, *supra* note 12 at para 40.

protect the interests of the corporation, albeit while treating stakeholders fairly.[182] However, fairness has not been equated to a duty to protect stakeholder interests. A failure to protect any stakeholder interest would likely be a difficult position to defend, but a choice to favour a particular selection of interests will be shown deference under the business judgment rule.[183]

More important to this issue, however, is that fair treatment is likely to be satisfied by a mere consideration of stakeholder interests, rather than taking steps to protect such interests.[184] Such was the case in *BCE*, in terms of the Court's analysis of what a particular stakeholder could reasonably expect for the purposes of the oppression remedy, based on the factors in play at that time.[185] While this analysis was not in direct reference to the concept of fair treatment, such an analysis, when considered along with the business judgment rule, makes for an argument that fair treatment will typically only require consideration of stakeholder interests, rather than affirmative steps to protect such interests. A choice by directors to protect the interests of one stakeholder group but not another will be shown deference by a court, pursuant to the business judgment rule, if the decision was informed, and the decision was among a range of reasonable alternatives.[186] The process for becoming informed would likely entail considering the interests of stakeholders that are affected by, and will affect, corporate operations.[187] The process for becoming informed, purely from a logical standpoint, would not likely entail taking steps to protect stakeholder interests; such steps would be part of the final decision, not the process. Stakeholder groups, therefore, would need to argue that every decision, within the range of reasonable alternatives available, must include affirmative steps to protect their interests if such protection is required by the duty of loyalty. Unless the corporation agreed to protect such interests beforehand, making this argument would likely be difficult if there were conflicting stakeholder interests.[188]

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[182] *Ibid* at paras 82, 87.
[183] *Ibid* at para 87.
[184] *Ibid* at para 66.
[185] *Ibid* at para 113.
[186] Waitzer, *supra* note 49 at 459; *BCE*, *supra* note 12 at para 40.
[187] *BCE*, *supra* note 12 at para 104.
[188] *Ibid* at para 163.

The process-oriented terms of the business judgment rule will likely demand the consideration of stakeholder interests, but if such a process is correctly followed, the resulting deference towards the final decision of directors will make it difficult for any particular group of stakeholders to argue that their interests required protection, as part of the best interests of the corporation. Directors have been tasked with weighing such interests, and courts will typically defer to such decisions.[189] This comports with the allocation of risk between the directors and the corporation. The corporation expects the directors to make informed business decisions, while the directors do not expect to be held liable for making imperfect business decisions after becoming informed.[190] The result is that many acceptable options will likely exist for directors to choose from, while still fulfilling their duty of loyalty. The more options exist, the more difficult it will be for any particular stakeholder group to claim that protection of their interests is required among all of them. Generally, it appears that the concept of fair treatment may be a poor strategy for stakeholders trying to claim that they reasonably expected the protection of their interests under the duty of loyalty.

6.3 The oppression remedy and the stakeholder debate

The oppression remedy is concerned with the relationship between the directors (assuming the directors are the defendants, and not the corporation) and the claimant stakeholder.[191] It is the reasonable expectations of the claimant stakeholder that determine whether the oppression remedy is available,[192] rather than the allocation of risk between the directors and the corporation. Overall, the relationship of importance for the oppression remedy is not of the same nature as the relationship of importance for the duty of care and the duty of loyalty. For this reason, the implied contract analysis applied to the duty of care and the duty of loyalty is not applicable to the oppression remedy, and

[189] Waitzer, *supra* note 49 at 459.
[190] Rhee, *supra* note 4 at 1167; *People's*, *supra* note 15 at para 67.
[191] *BCE*, *supra* note 12 at para 59.
[192] *Ibid* at para 72.

therefore cannot provide the same type of insight into how risk has been allocated, and what can reasonably be expected from directors.

With all of that said, the implied contract analysis for the duty of care and the duty of loyalty, and the guidance it provides for explaining risk allocation, actually does affect the oppression remedy in situations of stakeholder conflict because of the role played by the concept of the best interest of the corporation. The *CBCA*, pursuant to section 241, makes the oppression remedy available when directors have exercised their powers in a way “that is oppressive or unfairly prejudicial to or that unfairly disregards” the interests of the stakeholder.[193] Courts have interpreted this as a two-part test: (1) a stakeholder must first have a reasonable expectation, and (2) that reasonable expectation must have been thwarted to the extent of, at least, unfair disregard.[194] The concept of the best interests of the corporation is particularly important to determining reasonable expectations when directors are required to balance conflicting stakeholder interests. The Court in *BCE* held that: “there are no absolute rules. In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations.”[195]

While the relationship of importance for the oppression remedy is between the directors and the claimant stakeholder, the relationship of importance for determining the best interests of the corporation is between the directors and the corporation. The discussion above regarding the concept of fair treatment in the duty of loyalty is premised in part on the clear statement by the Supreme Court of Canada in *BCE* that, when directors must weigh conflicting stakeholder interest to determine the best course of action, all that stakeholders can reasonably expect is that directors will protect the interests of the corporation, not the interests of any particular stakeholder.[196] Given that directors are only required to choose a course of action that is among a range of reasonable alternatives, this would make it difficult for any particular stakeholder to claim that their

[193] *CBCA, supra* note 5 s 241.
[194] *BCE, supra* note 12 at para 56.
[195] *Ibid* at para 82.
[196] *Ibid* at para 66.

interests required protection, rather than mere consideration, short of an agreement by the corporation to protect those interests.[197]

In situations where stakeholder interests conflict, stakeholders run into the same problem regarding the oppression remedy as they do regarding the concept of fair treatment under the duty of loyalty. The business judgment rule, with its focus on process, makes it difficult for a stakeholder to argue that a specific business decision (that protected their interests) was required to the point that it would otherwise violate their reasonable expectations to a sufficient degree to justify the oppression remedy. Stakeholders can reasonably expect to be treated fairly, as this fairness is demanded by the duty of loyalty, but such fairness does not encompass a duty to actually protect the interests of stakeholders. Again, a choice to not protect any stakeholder interests would likely be indefensible, but a choice to protect any particular combination of interests will be shown deference under the business judgment rule.[198]

7 The exemption of directors from personal liability in tort

The implied contract approach has usefulness beyond the stakeholder debate, particularly regarding the personal liability of directors in tort. Here, the focus is on when it is appropriate to hold directors personally liable for independently committed torts, which were committed in the course of their duties for the good of the corporation. The implied contract approach can help address this question, specifically in regard to what effect voluntariness should have on liability. Before applying the implied contract approach, I will review the law of the personal liability of directors in tort, including the problems that have been identified in this area by courts and the academic literature..

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[197] *Ibid* at para 163.
[198] *Ibid* at para 87.

7.1 The personal liability of directors in tort

In order for directors of corporations in Canada to be liable for a tort committed in the course of their duties, and that was committed for the benefit of the corporation, two requirements must be satisfied: there must be an independent basis for holding directors liable, as opposed to merely the corporation, and the tort must not be subject to any special exemption regarding director liability. If these requirements are satisfied, a court would apply the typical *Cooper-Anns* test to determine liability in tort, as they would for non-directors.[199]

The first requirement is that there must be an independent tort, attributable to the directors personally. The mere fact that the corporation engaged in tortious conduct while it had directors does not make those directors liable for such tortious conduct.[200] A foundational concept in corporate law is that corporations are separate legal persons, capable of being liable on their own, and that they exist for the purpose of limiting the liability of their shareholders.[201] In order to give effect to the concept of corporations being separate legal persons, it must be possible for the corporation to incur liability without automatically making others liable. It is recognized that corporations, in order to become liable for a tort, need to have actually committed that tort through the actions of real persons, but this does not automatically make those real persons liable for the tort. The idea of corporations would mean little if actions taken in their name were always attributable to the human persons taking those actions. Essentially, while the corporation must act through human persons in order to be liable in tort, such liability can still belong solely to corporation.[202]

The result of this is that, for directors of a corporation to be personally liable in tort, despite acting in the course of their duties in the interests of the corporation, such liability must be independent of the corporation; the liability cannot merely belong to the

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[199] *Williams v Canada (Attorney General)*, 2009 ONCA 378 at para 12.
[200] *Merit Consultants International Ltd v Chandler*, 2014 BCCA 121 at para 14, [*Merit*].
[201] *Salomon*, *supra* note 1 at 30.
[202] *Hogarth v Rocky Mountain Slate Inc*, 2013 ABCA 57 at paras 113-115, [*Hogarth*].

corporation.[203] The first step to holding directors liable in such a manner is for the claimant to plead some independent and personal basis for the directors' liability in tort. Simply pleading that the corporation committed the tort, and then asking for the directors to share in this liability, will fail.[204] When the independent tort was allegedly committed while the directors were acting in the course of their duties in the interests of the corporation, such a tort must also be distinguishable from the tort committed by the corporation. For example, if the alleged tort was negligent misrepresentation, the claimant would need to demonstrate that the directors made personal representations, rather than merely taking steps to enable the corporation to make those representations.[205] If the alleged tort was defamation, then the claimant would need to establish that the directors published the defamatory material, rather than merely being part of the process that enabled the corporation to publish the material.[206] In summary, the liabilities of the corporation do not automatically equal the liabilities of directors; an independent claim must be established to hold directors liable for torts committed in the course of their duties in the interests of the corporation.

The second requirement, assuming there is in fact an independent basis for holding directors liable, is that the particular alleged tort not be subject to an exemption regarding the liability of corporate directors. The only clear example of this is the tort of inducing breach of contract, assuming it was committed by the directors in the course of their duties in the interests of the corporation. This exemption was established by the case of *Said v Butt*,[207] and is often referred to as the *Said v Butt* principle by Canadian courts when the exemption is applied.[208] If an independent tort is established that is not inducing breach of contract, the Ontario Court of Appeal made it clear that, despite committing the tort in the course of their duties in the interests of the corporation, directors may still be liable for that tort.[209] The justification for this exemption was twofold. First, parties that

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[203] *460635 Ontario Ltd v 1002953 Ontario Inc*, [1999] OJ No 4071 at paras 7-8, ONCA [*460*].
[204] *Merit*, *supra* note 200 at para 23.
[205] *Hogarth*, *supra* note 202 at para 130.
[206] *Merit*, *supra* note 200 at paras 23-25.
[207] *Said v Butt*, *supra* note 11.
[208] *Adga*, *supra* note 9 at paras 12-15.
[209] *Ibid* at para 18.

deal with a corporation and accept that limitation of liability should not have available to them both a claim for breach of contract against the corporation, and a claim for inducing breach of contract against the directors assessed on a different basis. Second, directors should be able to instruct the corporation to breach a contract if it makes economic sense to pay the damages rather than continue the contract, and directors should be able to so instruct without becoming personally liable for the breach.[210] Such liability would discourage economically efficient choices.

The principles enunciated in the case of *Said v Butt*, which Canadian courts have relied on to establish the above exemption, are open to varying interpretations, some of which would justify an exemption wider than merely inducing breach of contract.[211] The exact, appropriate scope of the exemption has yet to be firmly established. Even in the case of *Adga*, where the Ontario Court of Appeal clearly accepted that inducing breach of contract was included in the exemption, did not go so far as to say that this was the limit to the exemption. The Court left it open for the policy on this exemption to include other torts, but concluded that the particular fact situation of the case did not justify delving into such an analysis at that time.[212] Essentially, the Ontario Court of Appeal established the potential for a wider exemption, but did not provide specific guidance as to when and how that would be developed. Courts have subsequently remarked that the law on this exemption, and the issue of the liability of corporate directors for torts committed in the course of their duties generally, remains inconsistent and without clear guiding principles.[213] While there have been efforts by the courts to identify factors that influence whether directors should be liable for particular torts of the corporation, there still remains a concern that the lack of sufficient guidance in the case law may have harmful impacts on the viability of corporate structures.[214] If corporations cannot operate with

[210] *Ibid* at para 15.
[211] Iacobucci, *supra* note 8 at 39.
[212] *Adga*, *supra* note 9 at para 43.
[213] *Hogarth*, *supra* note 202 at para 73.
[214] *Ibid* at para 110.

clear rules regarding when individuals will be liable for corporate actions, directors may become excessively risk averse, to the detriment of the business of the corporation.[215]

7.2 Avoiding over-deterrence in tort law

The Ontario Court of Appeal left the further development of the *Said v Butt* principle for another day because the fact situation it was working with in *Adga* did not present an appropriate context for exploring the possibility of a wider exception.[216] This choice has been met with some criticism. By presenting the policy justification that over-deterrence of torts should be avoided with regard to directors and personal liability for actions taken in the name of the corporation in the interests of the corporation, and then only dealing with the issue of inducing breach of contract, it has been claimed by legal scholars that the Court failed to fully examine the implications of this policy.[217]

The *Said v Butt* principle could have been characterized widely or narrowly. A narrow interpretation would only protect directors in situations where the tort was inducing breach of contract. A wide interpretation would protect directors from personal liability whenever they are acting within the course of their duties and in the best interests of the corporation.[218] The Court in *Adga*, by leaving for another day the decision about whether the principle should be narrow or wide, effectively left the principle in its narrow state by failing to provide additional guidance, beyond that provided for inducing breach of contract. By inadvertently opting for the narrow principle by failing to provide this additional guidance, while providing an underlying policy justification that could support the wider principle, the Court left the matter in an unsatisfactory state. If over-deterrence is accepted as a concern that should limit personal liability, as it was when the Court

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[215] Iacobucci, *supra* note 8 at 47.
[216] *Adga*, *supra* note 9 at para 43.
[217] Iacobucci, *supra* note 8 at 39.
[218] Nicholls, *supra* note 2 at 8.

accepted the exemption for inducing breach of contract, the implications of this basis for limitation would not necessarily end with that narrow exemption.[219]

Edward M. Iacobucci, in "Unfinished Business: An Analysis of Stones Unturned in *Adga Systems International v. Valcom Ltd.,*" argues for the acceptance of the wider scope for the *Said v Butt* principle, grounded in the avoidance of over-deterrence in tort, and particularly in reference to preventing costly, risk-averse behaviour from directors.[220] Holding directors personally liable for torts committed in the course of their duties, while acting in the interests of the corporation, can result in precautions being taken by directors that cost the corporation more than what the damages award against the directors would be. The reason for this is that, while the directors would bear the full cost of a damages award against themselves, they would only bear a fractional cost of any measures taken by the corporation to reduce the risk of such an award.[221] Corporate assets would be put to use to reduce personal risk, not corporate risk, because directors can be held personally liable for acting for the corporation.

One example would be if the corporation needed to deliver a description of the service it provides to a client, and part of the delivery will include the director in charge sitting down with the client one-on-one to assure the client that the service description meets the client's needs. It is determined that there is a slim chance that the contents of this description might constitute negligent misrepresentation, and that there is a risk of the director in charge being independently liable. The corporate legal team concludes that reducing this slim chance to virtually no chance would cost the corporation more than paying damages for negligent misrepresentation. The director in charge, afraid of being held personally liable for this tort, decides to have the corporation reduce the chance to virtually nothing because the corporation will bear this cost, rather than the director. The director is able to reduce his or her personal risk without personal cost, but instead through corporate cost. This results in the absurd scenario of prevention costing more (to

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[219] Iacobucci, *supra* note 8 at 47.
[220] *Ibid* at para 47.
[221] Sarra, *supra* note 68 at 68; Iacobucci, *supra* note 8 at 48.

the corporation) than enduring the harm that the director sought to avoid.[222] Such a scenario is something that the principles underlying director liability, and the policy basis for tort law generally, should prevent.

With the above in mind, clearer operating principles are necessary in regard to the liability of directors for torts committed in the course of their duties in order to prevent excessively risk-averse behaviour, the costs of which would be out of proportion with the harm that the directors sought to avoid.[223] A wider version of the *Said v Butt* principle would seem to be the solution. However, simply exempting directors from personal liability whenever they are acting in the course of their duties for the best interests of the corporation may be a step too far. While the appropriate extent of the *Said v Butt* principle may not have been dealt with by the Court in *Adga*, there has, however, been a general rejection of the idea that individuals should be immune from personal liability merely because they were acting within the scope of their duties.[224] The general principles of tort law are meant to hold tortfeasors accountable, while balancing this against the need to limit the potential reach of tort liability. Somewhere between no liability and unlimited liability lies the correct approach.[225] Excusing directors from liability in all situations where they were acting in the course of their duties for the best interests of the corporation is likely too close to the "no liability" side of this spectrum. Outside of tort law, there are statutory examples of holding directors to account for failures of the corporation, in recognition of the control the directors typically have over the corporation. These examples include liability for certain tax debts, in addition to liability for the wages of employees (within particular time frames), and these are not the only examples.[226] Generally, it is established in Canadian corporate law that acting in the course of their duties for the best interest of the corporation is not a perfect shield against personal liability for directors. A wider interpretation of the *Said v Butt* principle will need to take this into consideration.

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[222] Iacobucci, *supra* note 8 at 46.
[223] Sarra, *supra* note 68 at 71.
[224] Nicholls, *supra* note 2 at 22.
[225] *Hogarth*, *supra* note 202 at para 64.
[226] *Ibid* at para 69.

7.3 The impact of voluntariness on the personal liability of directors

One factor that has the potential to provide guidance as to how the *Said v Butt* principle should be widened is the nature of the relationship between the tort claimant and the corporation, particularly whether that claimant voluntarily chose to deal with a corporation. The existing exemption under the *Said v Butt* principle, inducing breach of contract, clearly requires the claimant to have entered into a voluntary relationship with the corporation because there needs to be an existing contract between those two parties for such a contract to have been breached. The specific justification for the existing exemption is grounded in such voluntariness. This justification says that, when parties choose to deal with a corporation, they should not have an action against the corporation for breach of contract while also having an action against the directors for inducing the breach, the latter having damages assessed on a different basis. To avoid this scenario, the claimant is only allowed to pursue the former action.[227] The starting premise for this exemption is that the claimant chose to deal with a corporation, and it is this premise that may provide helpful guidance if the *Said v Butt* principle is to be expanded, as the Court in *Adga* suggested it might.[228]

When courts wish to examine the role of voluntariness in the personal liability of directors, or employees, of corporations, Justice La Forest's dissent in the case of *London Drugs Ltd v Kuehne & Nagel International Ltd*[229] is a common starting point. The principle in that analysis was that "different types of claimants against the corporation have differing abilities to benefit from being put on notice with respect to the impact of the limited liability regime".[230] These different types of claimants can be distinguished by where they fall on the voluntariness spectrum in terms of their choice to deal with the

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[227] *Adga*, *supra* note 9 at para 15.
[228] *Ibid* at para 43.
[229] *London Drugs Ltd v Kuehne & Nagel International Ltd*, [1992] 3 SCR 299.
[230] *Ibid* at para 68.

corporation, and their ability to protect themselves as part of this dealing. Justice La Forest described one end of this spectrum as including banks and other sophisticated creditors, that are capable of both understanding the risks of dealing with a corporation and of taking steps to mitigate such risks. The other end of the spectrum would be a tort claimant that was hit by an employee of the corporation while that employee was driving a corporate car for work purposes. The latter had no choice at all in the fact that the corporation now, likely, owes them damages in tort.[231] One particular factor that will suggest a claimant falls more on the voluntary side of the spectrum will be if the tort claim is connected at all with a planned transaction between the claimant and the corporation. Whether the content of the transaction included explicit discussions about the limitation of liability is less important than the fact that the claimant could have had such a discussion if they had put their mind to it.[232] Generally, Justice La Forest expressed the strong view that "courts must be sensitive to the impact that an imposition of tort liability would have on the contractual allocation of risk".[233]

This approach, and the subsequent application of it to other cases, has been met with some criticism. One argument points out that, while Justice La Forest was correct in saying that persons who deal with a corporation implicitly accept that only the corporation can be held liable for its debts, such an acceptance is limited to protecting shareholders, per the principles in *Salomon*, rather than protecting directors and employees. Something more needs to be said, beyond a line of reasoning grounded in *Salomon* regarding limited liability, before a court can rightfully find an implicit agreement to limit liability in regard to directors and employees.[234] To help address this criticism, it is helpful to distinguish between cases where the tortious conduct has nothing to do with the voluntary relationship entered into between the claimant and the corporation, and cases where the tortious conduct could have been among the business risks that the claimant implicitly accepted when they agreed to deal with the corporation.

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[231] *Ibid* at paras 68-69.
[232] *Ibid* at para 70.
[233] *Ibid* at para 24.
[234] Iacobucci, *supra* note 8 at 51.

If a situation falls into the former category, it seems sensible to say that the issue of voluntariness has little to do with the tortious conduct, and should not affect the parties that may be liable for that conduct.[235] If a situation falls into the latter category, it may be appropriate to say that the claimant implicitly accepted that liability would be limited to the corporation, as that was the party with which the claimant was dealing with when decisions were being made about the allocation of risk.

Notwithstanding the possible issues with voluntariness, covered above, courts have clearly been using this concept as a factor in determining whether directors should be personally liable, both in terms of whether there was any independent tort attributable to them at all, and if they should be liable even then. In its decision in *Adga*, the Ontario Court of Appeal cited Justice La Forest's dissent from *London Drugs* regarding the distinction between voluntary and involuntary creditors to help justify the *Said v Butt* principle. Specifically, the Court held that a claimant with an existing contractual relationship with the corporation should not be able to seek damages on a different basis, through the tort of inducing breach of contract, despite having already agreed to a particular allocation of risk through the contract. Such an exemption allows directors to opt for efficient breaches when it is in the best interests of the corporation to pay damages through breach of contract rather than continue the contract.[236] When directors enable the corporation to breach such a contract, such a situation falls under the category of tortious conduct that was among the business risks that the claimant implicitly accepted when they agreed to deal with the corporation. It is perhaps the most obvious example; an implicit risk for any contract is that it may be breached, and it is expected that the breaching party will pay damages according to contract law standards. What is not implicit is that parties not privy to the contract will be liable for its breach.

Outside Ontario, courts have also considered voluntariness to be a factor in determining whether an independent tort existed at all regarding directors acting in the course of their duties for the best interests of the corporation. The Alberta Court of Appeal in *Hogarth v*

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[235] Sarra, *supra* note 68 at 70.
[236] *Adga*, *supra* note 9 at para 15.

Rock Mountain Slate Inc,[237] in deciding on a claim of negligent misrepresentation by the directors of the corporation, held that a number of factors pointed to there being no independent tort; only the corporation was liable, not the directors.[238] The Court specifically referenced both *London Drugs* and *Adga* regarding the relevance of voluntariness.[239] In its analysis, it noted that the claimant had "voluntarily entered into a business arrangement with a limited liability corporation, knowing that there are some business risks involved".[240] This helped persuade the Court that it would be inappropriate to hold the directors liable for the materializing of a risk that was part of the arrangement between the claimant and the corporation.[241] In other words, the claimant accepted this risk as part of its agreement with the corporation, and part of this acceptance was an implicit understanding that only the corporation would be liable if such risks manifested. Such an implicit understanding is a critical feature that allows corporations to function as intended, the Court held.[242] The tort was part of the business risks that the claimant implicitly accepted when they agreed to deal with the corporation, and this resulted in liability for the tort being limited to the corporation itself.

Such distinctions have received some support in the academic analysis of *Adga* and its related cases. Both the distinction between voluntary and involuntary creditors of the corporation, and the further distinction between voluntary creditors that agreed to the risks related to the tortious conduct in question and voluntary creditors that did not, have been identified as helpful frameworks for determining if directors should be held personally liable for acting in the course of their duties in the interests of the corporation.[243] One additional factor that has been identified is that the tort cannot be one that affects the voluntariness of the relationship between the claimant and the corporation. If it does, then the relationship was not voluntary. The example given for this is a corporate officer misleading a creditor to induce them to forebear from enforcing

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[237] *Hogarth*, *supra* note 202.
[238] *Ibid* at para 134.
[239] *Ibid* at para 110.
[240] *Ibid* at para 72.
[241] *Ibid* at para 133.
[242] *Ibid* at para 133.
[243] Nicholls, *supra* note 2 at 23-24.

a debt.[244] The claimant, in that situation, was misled into the agreement itself, rather than receiving misleading information after an agreement was already established, and which may have included an implicit understanding about the quality of communication and the risks involved.

Generally, it appears that voluntariness may be an appropriate deciding factor in terms of the personal liability of directors, assuming they were acting in the course of their duties for the interests of the corporation, and assuming the tortious conduct in question was among the risks the parties implicitly (or explicitly) agreed to when they entered into that voluntary arrangement.

8 The modified implied contract approach and voluntariness

The implied contract approach to the corporate law duty of care and the business judgment rule is a method for explaining the allocation of risk between the directors and the corporation, through the exercise of imagining implicit contractual terms that exist when directors and the corporation agree to have the directors take on their role.[245] In other words, the expectations between the directors and the corporation are what determine the allocation of risk between them, and this in turn explains the standards that directors are held to in their role as directors as they carry out their duties. The standards in question are meant to protect the corporation, not third parties. Even the oppression remedy (covered in section 6.3) will often only create a reasonable expectation that directors meet the standards meant to protect the corporation.

The issue of voluntariness as it relates to holding directors personally liable in tort for acting in the course of their duties for the interests of the corporation can be engaged through the same implied contract analysis, which will help to explain how and why risk

[244] *Ibid* at 29.
[245] Rhee, *supra* note 4 at 1167.

is allocated between parties. Going back to the voluntary agreement between directors and the corporation regarding the directors taking on their role, it was established that, through an implied contract analysis, directors expect to be liable under certain circumstances for certain things. What they expect lies between no liability for anything, and liability for all corporate liabilities. The corporation would never agree to the former, and directors would never agree to the latter.[246] It is uncontroversial to say that the liabilities of the corporation are not automatically the liabilities of directors, and that directors would not agree to such an arrangement. It is also obvious that corporations cannot act on their own, but must act through real persons.[247] Therefore, there is an expectation that directors will take actions to enable the corporation to engage with third parties. As part of the voluntary agreements that third parties enter into with the corporation, those parties take on the risks of dealing with a corporation.[248] The agreements between third parties and the corporation affect how and when the corporation may be liable, but otherwise do not affect the liabilities of directors, unless explicit terms call for it, and to which the directors also agreed.

With the above in mind, it makes sense to refrain from holding directors personally liable for torts committed in the course of their duties while acting in the interests of the corporation. Once again, the implied contract approach, rather than being used to suggest an implicit agreement, is better used to explain risk allocation, which in turn determines reasonable expectations. Returning to the idea of the directors and the corporation bargaining for the terms regarding the directors taking on their role, it is not contentious that one of these terms would be that directors, when acting in the name of the corporation, do not share in the liabilities they incur on behalf of the corporation. There would be little point to corporations operating as separate legal entities if this term did not exist. This is perhaps the most basic element of the allocation of risk between the directors and the corporation, namely, that the directors do not share in the liabilities of the corporation, unlike a general partner would in a partnership.

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[246] *Ibid* at 1167.
[247] *Merit*, *supra* note 200 at para 14.
[248] Nicholls, *supra* note 2 at 23.

When a third party voluntarily deals with a corporation, that party can reasonably expect to be able to hold the corporation liable for any tortious conduct committed by the corporation. Absent an express agreement to the contrary, such a third party should not be able to hold the directors of the corporation liable when the tortious conduct is attributable to the corporation, without a separate foundation for a claim against the directors. Choosing to deal with a corporation should be equated with a choice to accept the allocation of risk between the corporation and its directors, particularly the most basic component of this allocation, namely, that directors do not share in the liability of the corporation.

However, none of the above is an appropriate argument for protecting directors from liability if the tortious conduct was outside the scope of the dealing between the third party and the corporation. If the third party did not voluntarily deal with the corporation in a way that connects the tortious conduct to this dealing, then there was no accompanying acceptance of the allocation of risk between the corporation and its directors in relation to such tortious conduct. In such instances, there is an argument for finding an independent tort, committed by the directors themselves in addition to the corporation, assuming the directors were involved in the conduct.[249] Without an acceptance of the allocation of risk by the third party, the directors are not protected through their relationship with the corporation, and should be held liable for their participation in the tort.

9 Conclusion

The case law for both the stakeholder debate and the exemption of directors from personal liability fails to provide sufficient guidance. The ability of stakeholders to know if their interests require protection in some circumstances is made difficult by the vagueness present in the Supreme Court of Canada's definition of the duty of loyalty, the

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[249] *Ibid* at 23-24.

oppression remedy, and the best interests of the corporation.[250] The scope of the exemption of directors from personal liability is also subject to a lack of clarity because the justifications for this exemption have been used to describe particular instances where the exemption is appropriate, but without further guidance as to when and if the scope of this exemption would extend to other fact situations.[251]

The implied contract approach to the duty of care and the business judgment rule provide a framework for the determination of director liability that assists with the interpretation of the standards to which directors are subject. By engaging in an implied contract analysis in relation to the abstract concept of directors and corporations bargaining for the terms of their relationship, some insights can be gained into how and why risk has been allocated between those two parties.[252] The question of what stakeholders can expect from directors as the directors manage the corporation, and the question of what the appropriate scope should be for exempting directors from personal liability, can both be answered by looking to how and why risk was allocated between the directors and the corporation.

In situations where stakeholder interests conflict, it was made clear in *BCE* that the only reasonable expectation stakeholders can have is that directors will do what is best for the corporation.[253] The allocation of risk between the directors and the corporation tells us that the directors are expected to follow procedures that result in informed decision-making in order to be held to be acting in the best interests of the corporation, but that their final decision will be shown significant deference. This is because the allocation of risk stipulates that directors will not be liable for bad business decisions so long as such decisions were informed, and were among a range of reasonable alternatives.[254] Stakeholders, then, can expect directors to be informed about their interests, but are less

[250] Bradley, *supra* note 31 at 346-348.
[251] Sarra, *supra* note 68 at 68.
[252] Rhee, *supra* note 4 at 1167.
[253] *BCE*, *supra* note 12 at para 66.
[254] *Ibid* at paras 83-87

likely to be successful in claiming that their interests were owed direct protection, as the directors could have had many alternative, reasonable courses of action available to them.

The exemption of directors from personal liability can also be addressed by looking to the allocation of risk between the directors and the corporation. Specifically, such an allocation included that directors would not automatically share in the liability of the corporation. If the claimant voluntarily chose to deal with a corporation, and the tort in question was a type of risk that would have been contemplated as part of the voluntary relationship between the claimant and the corporation,[255] then the claimant can be said to have accepted the allocation of risk between the directors and the corporation regarding director liability. This assumes the directors were acting in the course of their duties for the interests of the corporation,[256] otherwise the allocation of risk between the directors and the corporation ceases to be relevant to such protection from personal liability, as the directors were acting outside of their role.

[255] Nicholls, *supra* note 2 at 29.
[256] *Adga*, *supra* note 9 at para 43.

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