Court File No. CV-12-9594-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE – COMMERCIAL LIST

DUFF & PHELPS CANADA RESTRUCTURING INC. IN ITS CAPACITY AS LIQUIDATOR OF COVENTREE INC.

Applicant

APPLICATION UNDER SECTION 207 OF THE *BUSINESS CORPORATIONS ACT*, R.S.C. 1990, c. B.16, AS AMENDED

IN THE MATTER OF THE WINDING-UP OF COVENTREE INC.

BRIEF OF AUTHORITIES OF THE LIQUIDATOR,
DUFF & PHELPS CANADA RESTRUCTURING INC.
(Motion Returnable December 14, 2012)

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3. *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 (QL)

4. Kevin P. McGuinness, *Canadian Business Corporations Law*, 2d ed. (Markham: LexisNexis, 2007)

5. *Re Hillcrest* Housing *Ltd.*, [1992] P.E.I.J. No. 17 (S.C. (T.D.)) (QL), aff'd [1992] P.E.I.J. No. 83 (C.A.) (QL)

TAB 1

Case Name:
SOUTH SHORE DEVELOPMENT LTD. v. SNOW

[1971] N.S.J. No. 172

19 D.L.R. (3d) 601

4 N.S.R. (2d) 601

Nova Scotia Supreme Court Trial Division

Jones, J.

April 26, 1971

(11 pages) (28 paras.)

CASES JUDICIALLY NOTICED:

The Trustees of School Section No. 16, South District of Pictou County and James Cameron et al., 2 S.C.R. 690, folld.
Mason Development Co. Ltd. v. Gordon (1959), 19 D.L.R. (2d) 465, ref'd to.
Dumart Packing Co. Ltd. v. Dumart, [1928] 1 D.L.R. 640, folld.
The Glace Bay Printing Co. et al. v. Harrington et al., 45 N.S.R. 268, folld.
In re Duomatic Ltd., [1969] 2 Ch. 365; [1969] 2 W.L.R. 114, ref'd to.

STATUTES JUDICIALLY NOTICED:

Companies Act, R.S.N.S. 1967, c. 42, s. 72 and 73.
STEWART McINNES and GEORGE W. MacDONALD, for the plaintiff,
GERALD B. FREEMAN and DOUGLAS A. CALDWELL, for the defendants.

JONES, J.:--

1 This is an action by the plaintiff Company against the defendants for an accounting. The defendants, Alton C. Snow and W. Alton Snow were directors and officers of the plaintiff Company during the period from September 19, 1968, to September 9, 1970. The defendant, Ronald Snow was a director of the Company from December 29, 1969, to September 9, 1970.

2 Medway Enterprises Limited owned fifty-one per cent of the shares in the plaintiff Company. The defendants controlled Medway Enterprises during the period that they were officers of the plaintiff Company. The statement of claim alleges that the defendants improperly appropriated property of the Company to themselves, failed to account for profits and commissions earned while they were directors and credited to their own account fees and expenses which had not been authorized by the Company. [*page603]

3 On April 2, 1971, a motion was made before me in Chambers on behalf of the defendants, for an order staying all further proceedings in this action. The defendants also moved for an order directing the plaintiff Company to convene a general meeting of the Company for the purpose of appointing directors of the Company. The defendants also applied on a second motion for an order restraining Mr. Kenneth L. Crowell of Middleton, Mr. Gerald A. Mosher of Middleton and Mr. C. Bishop Armstrong of Liverpool, from exercising any rights as shareholders, directors or officers of the Company. A pretrial conference in this action was first convened on March 31, 1971 and adjourned by agreement of the parties to April 2, 1971. It was at this conference that the defendants' solicitor indicated that he proposed to make the motions. The action had been previously set down for trial for April 5, 1971. I reserved decision on the motions on April 2 and proceeded with the trial on April 5.

4 On the hearing of the first motion involving the Company, Mr. Stewart McInnes who was acting for the Company acknowledged receipt of the notice of motion. This motion was supported by the affidavit of the defendant, W. Alton Snow. I gave the defendants' solicitor an opportunity to file further affidavits, which was done and I also heard evidence on the trial which is pertinent to the motion. I was not satisfied that the persons referred to in the second motion had been properly served with the notice. However, one of the parties named Mr. Kenneth L. Crowell, was present at the trial and stated in evidence that he is solicitor for Mr. Gerald A. Mosher. I am satisfied that all the shareholders have full knowledge of the proceedings to date.

5 The present directors of the Company, Kenneth L. Crowell, C. Bishop Armstrong and Gerald A. Mosher were elected at a meeting of the Company held on October 1, 1970, at Middleton. These directors then convened a directors meeting which purportedly authorized the present action. The defendants contend that the meeting of the Company was not properly convened and therefore the Directors were not duly elected and had no power to act. [*page604]

6 The prime movers behind the plaintiff Company were the defendants on the one hand and Mr. C. Bishop Armstrong and Mr. Gerald A. Mosher on the other hand. The association between these parties through the Company started in 1968, but apparently did not develop as had been planned, with the result that Mosher and Armstrong ceased to be directors on December 29, 1969. They continued as substantial but minority shareholders. On September 9, 1970, a special general meeting of the shareholders of the Company was held at Liverpool. Mr. W. Alton Snow, Mr. Ronald Snow and Mr. C. Bishop Armstrong attended this meeting. Following a discussion of the Company's affairs over the preceding two year period the following resolution was passed,

"Upon motion of Gerald Mosher, seconded by Bishop Armstrong, it was resolved that effective upon passage of this resolution that in accordance with the provisions of the Companies Act, R.S.N.S., 1967, Chapter 42, Section 39(4), the transfer book and share register of South Shore Development Limited be closed for a period of thirty days and that the appropriate advertisement be published in a newspaper circulated within the district of the registered office of the Company. (carried)"

7 The three defendants who were the only directors of the Company resigned as of that date. The written resignation of the directors is appended to the minutes of the meeting. No new directors were appointed at that meeting. Only two shareholders attended the meeting of the Company held on October 1, 1970, namely, Gerald A. Mosher and C. Bishop Armstrong. These shareholders held thirty-six shares. One share was held by a Mr. James Creaser. Thirty-eight shares were owned or controlled by the defendants. The minutes of this meeting record that notice of the meeting was given to all registered shareholders and that all registered shareholders had consented to the convening of the meeting on one day's notice. The meeting elected Gerald A. Mosher, C. Bishop Armstrong and Kenneth L. Crowell as directors of the Company. The Board of Directors was authorized to issue one share in [*page605] the Company to Kenneth L. Crowell, one hundred shares of the Company to Gerald A. Mosher and fifty shares to C. Bishop Armstrong. The shareholders also passed the following resolution,

"Resolved that the Board of Directors be authorized to engage legal counsel to investigate the Company's affairs, and to take any and all actions necessary to protect the interests of the Company."

8 A meeting of the new Board was convened following the annual meeting. The Board authorized the issuance of the new shares and elected officers. The following resolution was passed,

"In accordance with the authorization of the shareholders, the law firm of McInnes, Cooper & Robertson of Halifax, was to be engaged to investigate the various matters pertaining to the affairs of the Company, to report and if necessary and upon authorization, to commence legal proceedings."

9 There is no further resolution of the directors authorizing the action in this case.

10 In his affidavit dated April 1, 1971, Mr. W. Alton Snow states that the defendants received no notice of the meeting held on October 1, 1970. He also stated that his first knowledge of this meeting was on March 10, 1971. The defendants appeared in the records of the Company as directors and officers. While share certificates had been issued to Alton C. Snow and W. Alton Snow by the Company on September 19, 1968, these defendants were never registered as shareholders in the Company's share register. Gerald Mosher and C. Bishop Armstrong were both present at the meeting which authorized the issuance of certificates to the defendants, Alton C. Snow and W. Alton Snow. The certificates are signed by Gerald Mosher as president of the Company.

11 The authorities establish that where an action has been brought without authority, the proper course is to apply for a stay of proceedings. In The Trustees of School Section No. 16, South [*page606] District of Pictou County and James Cameron et al., 2 S.C.R. 690, it was stated that when an action is brought in the name of a corporation without due authority, it is not sufficient for the defendants to plead that the plaintiffs did not legally constitute the corporation, but in such a case the defendants should apply to the summary jurisdiction of the Court to stay proceedings.

12 In Macson Development Co. Ltd. v. Gordon (1959), 19 D.L.R. (2d) 465, MacDonald, J., heard a motion to strike out the name of the plaintiff Company. The issue was whether the action had been properly authorized by the Company. Mr. Justice MacDonald found that the action had in fact been authorized by the directors. In his view this was sufficient authority for the solicitor to commence the proceedings.

13 Dumart Packing Co. Ltd. v. Dumart, [1928] 1 D.L.R. 640, is a decision of Middleton, J.A., of the Ontario Supreme Court. The motion was to dismiss the action. Middleton, J.A., stated at p. 641,

"Where the motion is made by the defendant, he must notify not only the solicitor who is alleged have acted without authority, but he must also notify the plaintiff. The object of this is, among other things, to enable the plaintiff to affirm or repudiate the action of the solicitors. If there was originally no authority, the plaintiff, on being notified, might elect to affirm that which had been done without authority in his name, and this ratification would then relate back, and, generally speaking, would be equivalent to antecedent authority.

Motions of this kind are somewhat frequent in company cases in which there is some internecine warfare between factions in the company, each claiming to be entitled to represent the company. In these cases the practice of the Court is to direct that the proceedings be stayed until a meeting of the shareholders of the company can be called so as to enable the will of the shareholders, or of the majority, [*page607] to be ascertained. These cases are collected in Buckley's Companies Acts, 9th ed., p. 614, and in 1928 Yearly Practice, p. 46."

14 The following passage appears at page 714 of Masten & Fraser, Company Law of Canada 4th Ed.,

"Where it is claimed that the action has been brought without authority, the proper course is to apply at an early stage to have the action stayed, where questions of fact have to be considered on which it is necessary to decide the existence or non-existence of the authority: Richmond v. Branson & Son, [1914] 1 Ch. 968, 974; Russian Commercial and Industrial Bank v. Comptoir d'Escompte de Mulhouse, [1923] 2 K.B. 630, 672, [1925] A.C. 112, 148; as explained in John Shaw

& Sons (Salford) Ld. v. Shaw, [1935] 2 K.B. 113, at p. 145. However, the court has inherent jurisdiction to order an action to be struck out if it is established that the action has been brought without authority: Daimler Company Limited v. Continental Tyre and Rubber Company (Great Britain) Limited, [1916] 2 A.C. 307; John Shaw & Sons (Salford) Ld. v. Shaw, supra, at pp. 131, 145."

15 The first contention of the defendants is that the resolution passed on September 9, 1970, had the effect of freezing all shareholders' rights in the Company. The resolution was passed pursuant to Section 39 of the Companies Act. It is difficult to understand the purpose of this resolution, unless as stated by Mr. W. Alton Snow, that it was to prevent any further action on the part of the shareholders or directors of the Company for the stated period. The contentious meeting was held within thirty days. In my view the only effect which could be given to the resolution was that provided under Section 39 of the Act. I do not think that the resolution prevented the calling of a meeting of the Company.

16 The defendants argued further that the meeting of October 1, was not convened in accordance with the provisions of the Act or the articles [*page608] of association of the Company and therefore was a nullity. That meeting purported to be the annual meeting of the Company. The directors had resigned as of September 9, 1970. There were no directors to convene a meeting. Article 108 of the articles provides that the office of director is vacated if a director resigns his office in writing. There is no evidence to show that the meeting was convened in accordance with the provisions of Sections 72 and 73 of the Companies Act or the Articles of Association of the Company. The meeting was in fact called by Mr. Crowell acting for one shareholder. The solicitor for the Company took the position that the defendants were not entitled to notice as they were not registered as shareholders. While under the Act only registered shareholders are entitled to notice, I am unable to find that the minority shareholders acted in good faith in convening this meeting. This is particularly true where additional shares were issued to the prejudice of the defendants rights.

17 In The Glace Bay Printing Company et al. v. Harrington et al., 45 N.S.R. 268, the Court of Appeal restrained the issuance of shares where the directors were not acting in good faith.

18 The following statement appears in the first edition of Lindley's Law of Companies at p. 304,

"If matters are in such a state that nothing can be done without a meeting, and there is no express power to call one, it would seem necessary to imply a power in any shareholder to convene one."

19 The author cites no authority in support of his position, which was expressed many years ago. Similarly, there are cases which suggest that all members of the Company can assent to any action taken by the Company. The most recent case in this regard in In re Duomatic Ltd., [1969] 2 Ch. 365; [1969] 2 W.L.R. 114. Buckley, J., refers to two earlier English decisions. These cases involve rights of third parties not associated with the Company. I am unable to say that the presence of all the registered shareholders at the meeting of October 1, 1970, had the effect of [*page609] overcoming the failure to comply with the explicit requirement of the Companies Act for the convening of a meeting in this instance. Any action taken at that meeting was therefore a nullity and this action was not properly authorized.

20 It is to be noted that the resolution of the directors employing the McInnes firm did not explicitly authorize the present action. In fact the resolution contemplated a further resolution by the Directors.

21 In view of my findings there was no annual meeting of the Company in 1970. I am satisfied that this Court has power to direct the holding of a meeting of the Company and I will issue an order to that effect. The following passage appears in Wegenast on Canadian Companies at p. 200.

"A meeting may also be called on the order of the Court, which has inherent jurisdiction to intervene where there is a deadlock or where it is not clear what is the wish of the majority; and such a meeting may be directed and controlled by the Court."

22 Pending the meeting of the Company, I am satisfied that an order should be issued prohibiting the Company from registering the shares issued on October 1, 1970. I will entertain a motion prohibiting the exercise of any rights with respect to these shares if it is necessary to do so in the meantime. The order should provide that the meeting will be held before the 15th day of May, 1971. I presume that counsel can agree on the terms for holding the meeting.

23 I will also issue an order staying the proceedings until this action is properly authorized by the Company. Having regard to all the circumstances, I do not think that it would be appropriate for me to deal with the merits of the action in this decision until the Company has approved of the action. In the event that the Company authorizes the action, I will determine the issues raised by the pleadings. I may say that there are issues raised in this action which prima facie cannot be ratified by the shareholders. [*page610] I refer specifically to contracts between the directors and the Company and conveyances of Company property to the directors.

24 I would also direct counsels attention to the following passage on p. 378 of Ziegel on Companies in connection with the subject of competition,

"It should be borne in mind, however, that before any liability to account attaches the profit must have been obtained 'by reason and in the course of their office of directors'."

25 The author states further on page 382,

"One area where little has been done to evaluate the position of the director is with respect to his duty not to enter into competition with his employer. The normal rule is that a trustee cannot enter into competition with his cestui que trust; but apparently this rule does not apply to directors.

This result is both incongruous and unfair. The incongruity arises from the fact that the case law seems to hold that a servant may not be permitted to enter into competition with his master. Thus, as the law now stands, a director can enter into competition with his company but a subordinate official may not. The unfairness in many situations is so obvious as not to require comment. What therefore seems to be required is a statutory prohibition against directors engaging in competition with their company without the consent of its shareholders. This would avoid difficulties where common directorates are desirable and yet still protect the company's interests."

26 In a recent article in Vo. XLIX of the Canadian Bar Review, Mr. Stanley M. Beck writes at p. 107,

"It is this concept of use of the position [*page611] of director, or use of knowledge that comes to a director by reason of his position to gain advantage for himself when the interests of the company call for protection, that underlies the holding in Regal. If the facts of Regal were that one of the directors heard of an available theatre and personally took a lease of it when he knew the company was looking for another location, can it be seriously contended that he would not be liable to account? It is submitted that he should be liable even if the knowledge of the availability of the theatre did not come to him in his capacity as a director, although it is recognized that the cases do not go that far."

27 In view of the issues raised in the action, I expect that the Company will ratify the proceedings. In the event that no action is taken by the Company, the minority shareholders will be authorized to bring an action in the Company's name.

28 As the motions were made on the eve of the trial, no costs of the motions will be awarded to either party.

Motion granted.

TAB 2

Shareholders' Remedies in Canada

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Karine de Champlain is a lawyer with Chaitons LLP in Toronto. She has experience in a variety of corporate law matters, including bankruptcy and insolvency, mergers and acquisitions and securities. She recently co-authored a paper entitled "Debtor-in-Possession Financing: The Dark Lending Hole" which appeared in the *Commercial Insolvency Reporter*.

Introduction

When advising business clients about doing business in Canada[1] lawyers must turn their minds not only to the kinds of corporate vehicles which Canadian law permits but also the remedies permitted if disputes arise. In this paper, we highlight the range of remedies available in the common law jurisdictions of Canada to protect shareholders and others from abusive corporate action.

Canadian corporate statutes[2] place few hurdles in the way of achieving incorporation. Any individual over 18 years of age who is of sound mind and is not a bankrupt, or any corporation, may incorporate a company simply by signing articles of incorporation and presenting them to the appropriate government ministry for stamping and registration.

In the face of this enabling philosophy, corporate law has been described as a form of constitutional law that attempts to regulate the rights and obligations of those who participate in or who are affected by the corporation[3]. A central theme of this regulation is "the struggle to balance the protection of corporate stakeholders and the ability of

[1] Canada is divided into 10 provinces and three territories. Corporate law statutes have been enacted by each of the Canadian provinces and by the federal Parliament of Canada. These include Business Corporations Act(s) and Securities Acts. Many of these are may be accessed online at www.canlii.org. The Ontario Business Corporations Act to which reference is made in this paper is found online at www.canlii.org/on/laws/sta/b-16/index.html. The Ontario Securities Act is online at www.canlii.org/on/laws/sta/s-5/index.html. Anglo-Canadian common law principles are applicable throughout Canada except for the province of Quebec, which has a Civil Code. Statutes enacted by the federal Parliament are applicable across Canada. Provincial statutes in the common law provinces are not fully harmonized but tend to be similar. The caution readers to verify the applicable law in Quebec.

[2] See f.n. 1.

[3] J.S. Ziegel et al., Cases and Materials on Partnerships and Canadian Business Corporations, 3rd ed. (Toronto: Carswell, 1994) at 925

management to conduct the affairs of the company in an efficient manner without undue interference".[4]

We will begin by discussing the various sources of shareholder rights, including corporate statutes, articles of incorporation and by-laws, and shareholder agreements. Although securities laws will also be briefly mentioned, the securities regime is exceedingly complex and it is beyond the scope of this paper to address it in detail.[5]

We will then move on to a discussion of the remedies provided by corporate statute to shareholders who are aggrieved by the manner in which management conducts the business and affairs of the corporation, including voting, court-ordered meetings, derivative actions, the oppression remedy, investigations, appraisals and court-ordered winding-up on the "just and equitable principle".

The oppression remedy, widely acknowledged to be the most powerful weapon in the shareholder's arsenal of remedies will focus on two particular points: the broad definition of "complainant" under corporate statutes, and the manner in which the courts have defined the legitimate expectations of shareholders and other "proper persons" under the oppression remedy.

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[4] D.H. Peterson, Shareholder Remedies in Canada (Toronto: Butterworths,1989) at 1.6

[5] See reference to Securities Acts online at www.e-laws.gov.on.ca/DBLaws/Statutes/English/90s05_e.htm for the Ontario Securities Act and for the other provinces and territories at www.canlii.org.

Shareholder Rights

Corporate Statutes

In Canada, a company may be incorporated under either federal or provincial legislation.[6] Although the statutes cover broadly the same categories of rights and remedies of shareholders, there are minor variations between the statutes. For the purposes of this paper, we will use the Ontario Business Corporations Act[7] (the "OBCA")[8] as our model. However, counsel should be sure to consult the corporate statute under which the company was incorporated for the appropriate provisions.[9]

The rights provided to shareholders under corporate statute can be broadly divided into three categories: Voting rights, rights with respect to meetings, and rights pertaining to access to information. Each is discussed below.

Voting

The right to vote is the most fundamental right accorded to shareholders under Canadian corporate law statutes. Through voting, shareholders can control the makeup of the board of directors[10], which is by statute responsible for the management of the corporation[11], and participate in major business decisions affecting the company[12]. Further, the articles of

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[6] See f.n. 1.

[7] D.H. Peterson, ibid. p. 18.1

[8] R.S.O. 990, c.B-16. online at www.e-laws.gov.on.ca/DBLaws/Statutes/English/90b16_e.htmat.

[9] It is beyond the scope of this paper to address the strategic and tax considerations which affect the selection of the most favourable jurisdiction in which to incorporate.

[10] OBCA s.119(4)

[11] OBCA s.115

[12] See for example OBCA s.184(3), which requires shareholders to vote on a sale of "all or substantially all" of the assets of the corporation.

incorporation and by-laws may impose limits on corporate and intra-shareholder activities.

Meetings

A corollary of the right to vote is the right of the shareholder to attend at meetings. Corporate statutes provide for the calling of an annual meeting of shareholders not later than fifteen months following the last held annual meeting, as well as special meetings at any time.[13]

The annual meeting usually involves the election of directors, the appointment of the auditor and the presentation of the company financials, although other business may also be transacted. Business requiring shareholder approval can be transacted between annual meetings by the calling of a special meeting of shareholders. The statutes also provide for shareholders who hold not less than 5% of the voting shares of a corporation to requisition the directors to call a meeting for any purpose stated in the requisition.[14]

Access to Information

Key to a shareholder's ability to exercise the right to vote is access to information about the business and affairs of the company. The OBCA, as with other corporate statutes, provides that a corporation shall prepare and maintain in a designated place certain types of records. These include:

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[13] OBCA s.94(1)

[14] OBCA s.105(1)

(a) the articles and by-laws of the corporation and all amendments thereto;

(b) copies of any unanimous shareholders agreements known to the directors;

(c) minutes of meetings and resolutions of shareholders;

(d) a register of directors setting out specified information; and

(e) a securities register setting out certain specified information.[15]

In addition, the corporation is to prepare adequate accounting records and a record of directors' meetings and meetings of any committee thereof.[16] Shareholders and creditors and their agents and legal representatives are to be provided access to the books and records maintained by the corporation during the usual business hours of the corporation and are permitted to take extracts of the records where appropriate.[17]

Shareholders are also entitled to be provided with notice of meetings and related information. Such notices and materials, including proxy forms and circulars, must describe the nature of the business to be conducted at the meeting "in sufficient detail to permit the shareholder to form a reasoned judgment thereon".[18] For example, it was held in *Pace Savings & Credit Union Ltd. v. Cu-Connection Ltd.* [19] that a notice was insufficient where a draft agreement had been provided to shareholders. The draft, it was

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[15] OBCA s.140(1)

[16] OBCA s.140(2)

[17] OBCA s.145(1), (2), 146(1)

[18] See OBCA s.96(6) for notice of meetings and s.30(31) of O. Reg. 62 regarding information circulars.

[19] [2000] O.J. No. 3830 (Ont. S.C.)

held, could change substantially throughout the course of negotiation, and could not form the basis on which a reasoned judgment could be formed as to the impact of the transaction. In Giannotti et al. v. Wellington Enterprises Ltd.,[20] the Ontario Superior Court held that the transfer of a principal asset of a corporation was invalid when the notice of the meeting failed to specify in detail the full nature of the transaction and the proposed agreement of purchase and sale.

Articles of Incorporation and By-Laws

The articles of incorporation and by-laws of the corporation may trump the statutory provisions in some circumstances. Articles of incorporation and by-laws set out the types and classes of shares the corporation is authorized to issue and the rights of shareholders relative to both the corporation and to owners of other types of shares. They may set out voting rights, rights to dividends and rights upon dissolution of the company. They may also contain restrictions on the ability of the shareholder to transfer shares.

Shareholder Agreements

Shareholders' agreements may take many forms, from a simple agreement to vote shares in a particular way through to unanimous shareholders' agreements, which restricts the powers of the directors of the corporation and transfers those rights and responsibilities to the shareholders. Such agreements may embellish or supplement rights provided under corporate law statute. For example, shareholders' agreements could include provisions

[20] *Giannotti v. Wellington Enterprises Ltd.* [1997] O.J. No. 574 (Ont. Gen. Div.)

such as buyout mechanisms, pre-emptive rights, drag-along and tag-along provisions on sale of shares. They may also set out definitions of who can be a shareholder and provide for restrictions on transfer of shares.

In closely-held corporations, shareholder agreements often include provisions describing or limiting the scope of some shareholders' management functions; plans for succession and undertaking of new corporate opportunities. Abuse of these provisions by shareholders active in the management of the corporation form the genesis of assertion of shareholders' rights by the minority or other aggrieved shareholders. How the assertion of rights by minority or aggrieved shareholders is limited by a mandatory arbitration clause is an important consideration which will be considered later in this paper.

Securities Laws

Securities Acts in each province enact an entire regime regulating public companies and their actions in relation to the Canadian securities market.[21] These statutes contain a set of complex rules and regulations overseen by provincial regulatory bodies. These include rules on voting and access to information, much like the corporate statutes described above, as well as rules regarding disclosure of information to shareholders. It is beyond the scope of this paper to discuss these statutes in detail.

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[21] See reference to Securities Acts online at www.e-laws.gov.on.ca/DBLaws/Statutes/English/90s05_e.htm for the *Ontario Securities Act* and for the other provinces at www.canlii.org. Securities legislation is enforced and administered in Ontario by the Ontario Securities Commission. Information about the OSC is available online at http://www.osc.gov.on.ca/. Securities commissions also exist in the other provinces. Links to websites of other securities commissions are found at www.osc.gov.on.ca/RelatedLinks/rl_links_index.jsp. The securities and investment dealer/broker industry is also administered by several self-regulating organizations, including the Investment Dealers Association of Canada, Market Regulation Services Inc. and the stock exchanges in Toronto Montreal and Vancouver. Links to the sites of these organization are also found at the above page on the OSC site..

Shareholders' Remedies

If the rights given to shareholders are to be effective and worthwhile, it is clear that corresponding remedies must be available to the shareholder to cure their breach. In the following sections of the paper, we examine some of the remedies made available to shareholders and their application.

Court Ordered Meetings

As discussed above, the shareholder meeting plays an important role in the successful exercise of voting rights by shareholders. The corporate statutes therefore provide the Court with discretion to order a shareholder meeting where a meeting is impeded by lack of quorum or other disruptive action by one or a group of shareholders.

In particular, section 106(1) of the OBCA states that the court may "order a meeting to be called, held and conducted in such manner as the court directs" where it is "impracticable" to call a meeting of shareholders or to conduct a meeting in the manner provided for under the articles and by-laws of the corporation or under statute or "for any other reason the court thinks fit".[22] The remedy is available on application by a director or shareholder entitled to vote at a meeting. The classic statement of what is meant by

[22] OBCA s.106(1)

"impracticable" in the context of section 106(1) comes from the judgment of the English Court of Appeal in *Re El Sombrero Ltd.*[23]:

> *It is to be observed that the section opens with the words "If for any reason," and therefore it follows that the section is intended to have, and, indeed, has by reason of its language, a necessarily wide scope. The next words are "...it is impracticable to call a meeting of a company..." The question then arises, what is the scope of the word "impracticable"? It is conceded that the word "impracticable" is not synonymous with the word "impossible"; and it appears to me that the question necessarily raised by the introduction of that word "impracticable" is merely this: examine the circumstances of the particular case and answer the question whether, as a practical matter, the desired meeting of the company can be conducted, there being no doubt, of course, that it can be convened and held.*

"Impracticability" must be interpreted broadly in order "to govern the affairs of practical men engaged in business."[24] In addition, the courts have held that "the right of the shareholders to democratically determine the future course of the company is paramount consideration, even when there is ongoing litigation" between the parties.[25] The fact that the application is opposed should not preclude the calling of the shareholders' meeting.

In appropriate circumstances, the Court may order a meeting to be "called held and conducted in such manner as the court directs", which provides broad jurisdiction to the court in terms of the types of orders granted under section 106(1) of the OBCA. The legislation also provides for ancillary orders that may be granted in the context of the meeting. For example, the court may order that the quorum required by the articles of

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[23] [1958] 1 Ch. 900 (U.K. C.A.)

[24] *B. Love Ltd. v. Bulk Steel & Salvage Ltd.* (No. 2) (1982), 40 O.R. (2d) 1 (H.C.J.) (QL)

[25] *FTS Worldwide Corp. v. Unique Broadband Systems Inc.* [2001] O.J. No. 5126 (Ont. Sup. Ct.) (QL)

incorporation and by-laws of the corporation or by the statute "be varied or dispensed with" at a meeting ordered pursuant to section 106.[26]

Derivative Action

The powerful but infrequently-used remedy of "derivative action' permits a shareholder or other "complainant" to advance an action on behalf of the corporation when the corporation refuses to bring the action itself. The action is available to rectify wrongs done to the corporation itself rather than to the individual shareholder. The intent of the remedy is to circumvent the problem of management not taking action to rectify a wrong where they may have been involved in or responsible for the wrong sustained by the corporation.

Standing to begin a derivative action is given to a "complainant", a defined term under the OBCA. Section 245 of the OBCA defines a "complainant" as:

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

A person with standing may seek leave to do one of two things: to "bring an action in the name and on behalf of a corporation or any of its subsidiaries", or to "intervene in an

[26] OBCA s.106(2)

action to which any such body corporate is a party" in order to prosecute, defend or discontinue the action on behalf of the body corporate.[27]

The four statutory pre-conditions necessary to bring a statutory derivative action may be summarized as follows:

(a) the directors of the corporation or its subsidiary will not bring, diligently prosecute or defend or discontinue the action;

(b) the complainant has given reasonable notice to the directors of the corporation or its subsidiary of his or her intention to seek leave to commence a derivative action;

(c) the complainant is acting in good faith; and

(d) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.[28]

With respect to the notice provision, it was held by the British Columbia Supreme Court in *Re Daon Development Corp.*[29] that the condition could not be waived, in part because the "condition can be easily performed without undue expense of effort".

In *Re Loeb and Provigo Inc.*,[30] Steele J. of the Supreme Court of Ontario discussed the onus of proof for leave to begin an action, stating that "There is an onus on an applicant to bring before the court more than mere suspicion to warrant the granting of leave." The requirement has been interpreted broadly, and it has been decided that the notice is not

[27] OBCA s.246(1)

[28] See OBCA s.246(2) and Peterson, supra note 2 at 17.35

[29] (1984) 54 B.C.L.R. 235 (S.C.) (QL)

[30] (1978), 88 D.L.R. (3d) 139 (Ont. H. C.)

required to contain every cause of action that is eventually brought in the derivative action. The notice should, however, contain enough information to permit the directors to determine the nature and extent of the complaint and it must be delivered to the appropriate parties.[31]

"Good faith" is not a defined term in the in corporate law statutes. Each case is therefore analyzed on its own terms for indications of bad faith. Where the Court finds indications bad faith on the part of majority shareholders, leave to commence the derivative action will be granted if the other pre-conditions are met. The Court must be satisfied that the derivative action is likely to benefit the corporation and that the corporation will not be unduly exposed to legal costs.

Under Canadian common law procedure, "costs" refers to the power of the Court to award some or substantially all of a successful party's legal expenses to be paid by the losing party. In a complex action, an allegation of shareholder or management fraud or other abuse will result in expensive legal proceedings.

In these circumstances, the Court must assess whether the corporation should fund the action and whether the applicant should be obliged to indemnify the corporation for legal costs, including those payable to the impugned by party if the action does not succeed. Further, if the derivative action is against the controlling shareholder or principal

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[31] D.H. Peterson, supra note 4 at 17.37

manager of the corporation, the Court must assess the impact on the continued operation of the corporation's business.

The final pre-condition to obtaining leave to commence a derivative action is that it "appear" to be in the interests of the corporation" that the action move forward. This differs from other provisions of the OBCA which require the courts to be "satisfied" that certain conduct has been carried out. This pre-condition affords the Court a mechanism to provide relief to a deserving complainant where access to all the relevant information was not possible at the time of bringing the motion for leave to bring the action.

It is also worth noting that while the typical claim for leave to commence a derivative action, a majority shareholder or senior management has abused his or her power and usurped the right of the corporation. However, the derivative action is not limited to claims against other shareholders or management.

Where a complainant is successful in persuading the Court that leave to commence a derivative action should be given, the Court may make "any order it thinks fit," including, but are not limited to:[32]

- an order authorizing the complainant or any other person to control the conduct of the action;
- an order giving directions for the conduct of the action;
- an order requiring that any amount adjudged payable by the defendant in the action shall be paid, in whole or in part, directly to former and

[32] OBCA, s.247

present security holders of the corporation or its subsidiary instead of to the corporation or its subsidiary; and

- an order requiring the corporation or its subsidiary to pay reasonable legal fees and any other costs reasonably incurred by the complainant in connection with the action.[33]

The Oppression Remedy

The oppression remedy[34] is widely acknowledged as being one of the most powerful weapons in the arsenal of the shareholder. The remedy was introduced largely in response to the difficulties encountered by minority shareholders in a corporate environment that runs by majority rules.

Nearly 80 years ago, the Ontario Court of Appeal enunciated the dilemma of minority shareholders in these words in *Re Jury Gold Mine Development Co.*:[35]

> *He is a minority shareholder and must endure the unpleasantness incident to that situation. If he chooses to risk his money by subscribing for shares, it is part of his bargain that he will submit to the rule of the majority. In the absence of fraud or transactions ultra vires, the majority must govern, and there should be no appeal to the Courts for redress.*

Where one group of shareholders abuses their power over another group, inequitable results can occur. The result was the introduction of the oppression remedy. Since its introduction, and since the coming into force of the oppression remedy provision of the *Business Corporation Acts*, in July 1983, the remedy has gained prominence and has developed a large body of jurisprudence across Canada.

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[33] See OBCA s.247

[34] See OBCA s.248

[35] [1928] 4 D.L.R. 735 (Ont. C.A.)

The Ontario Court of Appeal reiterated the state of the law in the recent and oft-referred to case of *Waxman et al. v. Waxman et al.*[36] in which Morris Waxman succeeded in recovering nearly $50 million following his dismissal and exclusion from a family business by his brother, Chester Waxman and others. It was the culmination of a 10-year legal battle, which may see another round as leave to appeal to the Supreme Court of Canada is pending at the time of this paper. The decision applied the principles espoused 20 years earlier by the same Court in *Ferguson v. IMAX Systems Corp.*[37], a case decided under the *Canada Business Corporations Act.*

In essence, the oppression remedy amounts to this: the Court has a broad remedial authority where it finds conduct that qualifies as oppressive. It may make any order it thinks fit to rectify the matters complained of. This explicitly includes setting aside a transaction or contract to which the corporation is a party or amending unanimous shareholder agreements, corporate articles or by-laws. This statutory language is to be given a broad interpretation consistent with its remedial purpose.[38]

Oppressive conduct which occurred before the oppression remedy came into effect and continued may be considered by the Court.[39] This is so because the oppression remedy is

[36] [2002] O.J. No. 2528, (2002) 25 B.L.R. (3d) 1 (Ont. S.C. Sanderson J.) aff'd with minor variations [2004] O.J. No. 1765, (2004) 44 B.L.R. (3d) 165 (Ont. C.A.)

[37] (1983), 43 O.R. (2d) 128 at 137 (C.A.), leave to appeal to S.C.C. refused (1983), 2 O.A.C. 158n.

[38] *Waxman v. Waxman* [2002] O.J. No. 2528 at para. 523 (Ont. C.A.)

[39] *Waxman v. Waxman* [2002] O.J. No. 2528 at para. 529-533 (Ont. C.A.)

considered part of substantive law has been interpreted as having retrospective effect.[40] In Ontario, no specific limitation period applies to an oppression claim.[41]

A "complainant", as defined in s. 245 of the OBCA and referred to above, may apply to a court for an order and where the court is satisfied that

> (a) any act or omission of the corporation or its affiliates effects a result;
>
> (b) the business or affairs of the corporation or its affiliates are or have been carried on or conducted, or
>
> (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised
>
> in a manner that is "oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.[42]

The great flexibility of the oppression remedy stems from the inclusiveness of its language, which allows any type of corporate activity to be the subject of scrutiny, and which makes the remedy available to a broad class of individuals.

For example, it has been held that "the court has jurisdiction to find an action is oppressive, unfairly prejudicial, or unfairly taken in disregard of the interests of a security holder if it is wrongful, even if it is not actually unlawful."[43] In addition, conduct may be isolated or may form a pattern of conduct that is considered oppressive to shareholders.

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[40] *Re Mason and Intercity Properties Ltd.* (1986), 32 A.C.W.S. (2d) 366 (Ont. Div. Ct.), varied on unrelated other grounds (1987), 59 O.R. (2d) 631 (C.A.).

[41] *Waxman v. Waxman* [2002] O.J. No. 2528 at para. 534-535 (Ont. C.A.)

[42] OBCA s.248(1) and (2)

[43] *Maple Leaf Foods Inc. v. Schneider Corp.* (1998) 42 O.R. (3d) 177 (QL)

Importantly, it has been held that no bad faith is required in order to establish conduct as oppressive. It is the effect of the conduct, and not the intention of the party engaging in the conduct, that is of primary importance in oppression remedy cases.[44]

Legitimate Expectations

In *Brant Investments Ltd. v. KeepRite Inc.*,[45] the Ontario Court of Appeal held that the oppression remedy protects only the legitimate expectations of shareholders. Those expectations must be "reasonable under the circumstances and reasonableness is to be ascertained on an objective basis." In the same case, the Court expressed the concept in the following language:

> *Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations that are to be considered are those that a shareholder has as his own individual "wish list". They must be expectations which could be said to have been (or ought to have been considered as) part of the compact with shareholders.*

The legitimate expectations of a shareholder may be affected by the provisions contained in the articles of incorporation and by-laws of the corporation or the provisions of any agreements between shareholders. They may also be affected by the size and nature of the corporation and general commercial practice. On making a finding of oppression, a court may make "an order to rectify the matter complained of".[46] Section 248(3) sets out a number of specific orders that may be made by the court, including, for example:

(a) an order restraining the conduct complained of;

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[44] *Brant Investments Ltd. v. KeepRite Inc.* (1991) 3O.R. (3d) 289 (Ont. C.A.) (QL)

[45] *Brant Investments Ltd. v. KeepRite Inc., supra., f.n. 39*

[46] OBCA s. 248(2)

(b) an order appointing a receiver or receiver-manager;

(c) an order amending the articles or by-laws of the corporation or the provisions of a unanimous shareholders' agreement;

(d) an order appointing directors in place of or in addition to the directors then in office;

(e) an order directing the company or any other person to purchase securities of a security holder;

(f) an order winding up the corporation; and

(g) an order requiring the trial of any issue.[47]

In addition, the Court may order the corporation or its affiliates to "pay to the complainant interim costs, including reasonable legal fees and disbursements".[48] In order to obtain such an order, the applicant must establish that there is a case of sufficient merit to warrant pursuit and that the applicant is genuinely in financial circumstances which, but for an order, would preclude the claim from being pursued.[49]

However, where a complainant, a minority shareholder, is unable to persuade the Court that he does not have the resources to pursue the action or fails to disclose his financial circumstances, the Court will refuse to make an order for interim disbursements.[50]

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[47] OBCA s.248(3). Not all available remedies are listed here. The entire section may be viewed online at http://www.e-laws.gov.on.ca/DBLaws/Statutes/English/90b16_e.htm#BK269

[48] OBCA s.249(4)

[49] *Alles v. Maurice* (1992) 9 C.P.C.(3d) 42 (Ont. Gen. Div.) (QL)

[50] *Molinaro v. U-Buy Discount Foods Limited* [2000] O.J. No. 4642 (Ont. Superior Court of Justice)

The management by the Court of shareholder expectations is an important aspect of the oppression remedy. Even at the interim stage of the proceedings, the Court's objective is to main a semblance of the status quo ante even if allegations of oppression have not been fully proved. In *Alizadeh et al. v. Akhavan et al.*[51], a judge of the Ontario Superior Court restored historic payments of management fees to an equal shareholder pending trial without drawing any conclusions about the merit of the oppression allegations.

Use of the Oppression Remedy by Non-Shareholders

As set out above, the definition of "complainant" under the derivative action and oppression remedy is extremely broad, including current and former shareholders, current or former directors and officers, and "any other person who, in the discretion of the court, is a proper person" to bring the application.[52]

In *First Edmonton Place Ltd. v. 315888 Alberta Ltd.*,[53] an Alberta case examining the scope of an identical oppression remedy provision in the Alberta statute, the Court identified two circumstances under which a creditor could be considered a "proper person" to bring an application:

(a) where the directors or management of the corporation have used the corporation as a vehicle for committing fraud upon the applicant; and

[51] *Alizadeh v. Akhavan* [2004] O.J. No. 2147 (Jarvis J.) (Ont. Superior Court)

[52] OBCA s.245

[53] [1988] A.J. No. 511 (Alta. Q.B.) (QL)

(b) where the directors or management of the corporation have breached the underlying expectations of the applicant arising from the circumstances in which the applicant's relationship with the company arose.

On the basis of these principles, the oppression remedy has been available to a trade creditor where the corporation had taken actions to conceal its insolvency,[54] and to a wrongfully dismissed employee against former directors where a corporate reorganization resulted in the corporation which paid the employee's salary ceasing to exist.[55]

Oppression and Arbitration

In *Deluce Holdings Inc. v. Air Canada*[56], the court was asked to examine in what circumstances, if any, oppressive conduct could operate to postpone arbitration proceedings, which were mandatory under the terms of a shareholders' agreement. In that that case, a shareholders' agreement provided for arbitration for disputes as to value of the shares held by each of the parties in Air Ontario, a regional carrier for Air Canada. The valuation provision was triggered by the termination of Deluce from his employment as CEO, which was effected by Air Canada (the majority shareholder) in an effort to obtain 100% control of Air Ontario and to reorganize its corporate operations.

[54] *C.C. Petroleum v. Allen et al.* [2002] O.J. No. 2203 (S.C.J.) (QL)

[55] *Downtown Eatery (1993) Ltd. v. Ontario* [2001] O.J. No. 1879 (C.A.) (QL)

[56] (1992) 98 D.L.R. (4th) 509 (Ont. Gen. Div.) (QL)

Senior Regional Justice Blair (as he then was) of the Ontario Superior Court held that the actions of Air Canada in removing Deluce could be found to be "oppressive" and that Deluce's holding corporation (the minority shareholder) had a reasonable expectation that Mr. Deluce would only be terminated where such a move was in the best interests of Air Ontario.

In terminating Deluce, the representatives of Air Canada on Air Ontario board of directors had been fulfilling an Air Canada agenda and had paid little attention to the best interests of Air Ontario itself. Under the circumstances, the court held that the entire underpinning of the arbitration structure had been destroyed, taking the subject of the dispute out of the purview of the matters to be dealt with under the agreement. The arbitration was therefore stayed and the oppression remedy action proceeded.

Investigations

The effective exercise of shareholder remedies will frequently depend on possessing the relevant information. An important statutory aid to shareholders in this respect is the court-ordered investigation of the corporation's affairs where the shareholder can satisfy the court that there are circumstances that warrant the court order. In particular, section 161(2) of the OBCA provides that an investigation may be ordered by the court where it appears to the court that:

(a) the business of the corporation or any of its affiliates is or has been carried on with intent to defraud any person;

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised, in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards, the interests of a security holder;

(c) the corporation or any of its affiliates was formed for a fraudulent or unlawful purpose or is to be dissolved for a fraudulent or unlawful purpose; or

(d) persons concerned with the formation, business or affairs of the corporation or any of its affiliates have in connection therewith acted fraudulently or dishonestly.

An application for an investigation may be brought by a shareholder without notice to the corporation.[57] To balance the needs of the shareholders with the ability of management of the corporation to effectively conduct the business, the hearing of an application under section 161(2) is closed to the public[58] and is subject to a publication ban.[59]

It is worth noting that unlike many other provisions of the statute, which require the court to be "satisfied", the court may make the order granting the investigation where it "appears" that the impugned conduct fits into the listed categories. This may result in a lower burden of proof being placed on the shareholder and could be an appropriate remedy where an aggrieved shareholder does not have access to the information required to meet a higher burden.

The investigation provisions provide that the court may make any order it thinks fit and proceed to enumerate twelve specific orders that may be made by the court.[60] The most

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[57] OBCA s.161(1)

[58] OBCA s.161(5)

[59] OBCA s.161(6)

[60] OBCA s.162(1)

important of these is obviously the order to investigate.[61] The other listed orders are ancillary to this general order, generally focusing on the appointment of the investigator and the powers of the inspector once appointed. For example, the investigator may, if so ordered:

- enter any premises in which the court is satisfied there might be relevant information, and examine any thing and make copies of any document or record found on the premises;
- compel any person to produce documents or records; and
- conduct a hearing, administer oaths and examine any person on oath.

Although the investigation remedy could be of great assistance to shareholders, the courts have traditionally been reluctant to order an investigation unless a shareholder can demonstrate that the information was not available through other means.[62]

Appraisal Remedy

An appraisal right is the right of a shareholder to require the company to purchase his shares at an appraised "fair value" under certain circumstances. There are three circumstances under which the appraisal remedy is triggered under the OBCA:

(a) where shareholders are granted rights of dissent upon certain fundamental changes. These changes include amendments to articles, amalgamations, and sales of all or substantially all of the assets of the corporation;[63]

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[61] OBCA s.162(1)(a). s.162(1) is online at www.e-laws.gov.on.ca/DBLaws/Statutes/English/90b16_e.htm#BK178

[62] *Re Royal Trustco Ltd. (No.3)* (1981) 14 B.L.R. 307 (Ont. S.C.) (QL)

[63] OBCA s.185(1)

(b) compulsory acquisitions, which arise where a person making a take-over bid purchases 90% or more of the shares of a particular class;[64] and

(c) shareholder's right to request acquisition where he holds 10% or less of the outstanding shares of a particular class.[65]

The OBCA sets out the procedural steps and timelines under which each appraisal remedy may be exercised, which are beyond the scope of this paper to discuss. In *Re Domglas Inc.,*[66] the Quebec Superior Court held that "fair value" is the just and equitable value of the shares. The Court identified four methods to assess value:

- market value: this method uses quotes from the stock exchange;
- net asset value: this method takes into account the current value of the company's assets and not just the book value;
- investment value: this method relates to the earning capacity of the company;
- a combination of the preceding three methods.

Winding-up

The dissolution order is "the most drastic form of shareholder relief".[67] The OBCA, like other corporate statutes, sets out a number of circumstances under which a court may order a winding-up of the corporation.[68] These include where an oppression remedy

[64] OBCA s.188(1)

[65] OBCA s.189(1)

[66] (1980) 13 B.L.R. 135 (Que. S.C.); aff'd138 D.L.R.(3d) 521

[67] (1980) 13 B.L.R. 135 (Que. S.C.); aff'd138 D.L.R.(3d) 521

[68] Ziegel, supra f.n. 3 at 1290

claim has been met, where unanimous shareholder agreements provide the shareholder with rights to make an application and, perhaps most importantly, where it is "just and equitable for some reason, other than the bankruptcy or insolvency of the corporation, that it should be wound up."[69] The court may make any order it thinks fit in connection with an application for winding-up.[70]

The courts have, in the exercise of their powers under the "just and equitable" doctrine, made it abundantly clear that each case must be determined on its own facts. There emerge from the cases four situations in which the "just and equitable" rule will be applied:[71]

- disappearance of substratum: this involves a failure of the fundamental objectives of the corporation. The cases fall into three categories:
  - the subject matter of the company is gone,
  - the object for which it was incorporated has substantially failed, or
  - it is impossible to carry on the business of the corporation except for at a loss;[72]
- justifiable lack of confidence in the management of the corporation;
- deadlock; and
- the partnership analogy.[73]

[69] OBCA s.207(1)

[70] OBCA s.207(b)(iv)

[71] OBCA s.207(2)

[72] Peterson, supra note 4 at 20.36. See also *Giannotti v. Wellington Enterprises Ltd.* [1997] O.J. No. 574 (Ont. Gen. Div.) (QL), where the corporation was wound up because the company had no reason to exist once its assets were distributed.

[73] *Ebrahimi v. Westbourne Galleries Ltd.* [1972] 2 All E.R. 492 (H.L.)

Conclusion

As noted in the introduction, a fundamental point in corporate law is the struggle to balance the protection of corporate stakeholders and the ability of management to conduct the affairs of the company in an efficient manner without undue interference. Shareholders and other interested or affected parties are therefore provided with certain rights and remedies under corporate law, all of which attempt to foster this balance.

Toronto, March, 2005.

Igor Ellyn, QC, FCIArb.

Digitally signed by Igor Ellyn, QC, FCIArb.
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TAB 3

Indexed as:

Hercules Managements Ltd. v. Ernst & Young

Hercules Managements Ltd., Guardian Finance of Canada Ltd. and Max Freed, appellants (plaintiffs/respondents), and Friendly Family Farms Ltd., Woodvale Enterprises Ltd., Arlington Management Consultants Ltd., Emarjay Holdings Ltd. and David Korn, (plaintiffs);

v.

Ernst & Young and Alexander Cox, respondents (defendants/applicants), and Max Freed, David Korn and Marshall Freed, (third parties), and The Canadian Institute of Chartered Accountants, intervener.

[1997] 2 S.C.R. 165

[1997] S.C.J. No. 51

File No.: 24882.

Supreme Court of Canada

1996: December 6 / 1997: May 22.

Present: La Forest, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR MANITOBA

Negligence -- Negligent misrepresentation -- Auditors' report prepared for company -- Report required by statute -- Individual investors alleging investment losses and losses in value of existing shareholdings incurred because of reliance on audit reports -- Whether auditors owed individual investors a duty of care with respect to the investment losses and the losses in the value of existing shareholdings -- Whether the rule in Foss v. Harbottle affects the appellants' action.

Northguard Acceptance Ltd. ("NGA") and Northguard Holdings Ltd. ("NGH") carried on business lending and investing money on the security of real property mortgages. The appellant Guardian

Finance of Canada Ltd. ("Guardian") was the sole shareholder of NGH and it held non-voting class B shares in NGA. The appellants Hercules Managements Ltd. ("Hercules") and Max Freed were also shareholders in NGA. At all relevant times, ownership in the corporations was separated from management. The respondent Ernst & Young was originally hired by NGA and NGH in 1971 to perform annual audits of their financial statements and to provide audit reports to the companies' shareholders. The partner in charge of the audits for the years 1980 and 1981, Cox, held personal investments in some of the syndicated mortgages administered by NGA and NGH.

In 1984, both NGA and NGH went into receivership. The appellants, and a number of other shareholders or investors in NGA, brought an action against the respondents in 1988 alleging that the audit reports for the years 1980, 1981 and 1982 were negligently prepared and that in reliance on these reports, they suffered various financial losses. They also alleged that a contract existed between themselves and the respondents in which the respondents explicitly undertook to protect the shareholders' individual interests in the audits as distinct from the interests of the corporations themselves.

The respondents brought a motion for summary judgment in the Manitoba Court of Queen's Bench seeking to have the plaintiffs' claims dismissed. The grounds for the motion were (a) that there was no contract between the plaintiffs and the respondents; (b) that the respondents did not owe the individual plaintiffs any duty of care in tort; and (c) that the claims asserted by the plaintiffs could only properly be brought by the corporations themselves and not by the shareholders individually. The motions judge granted the motion with respect to four plaintiffs, including the appellants, and dismissed their actions on the basis that they raised no genuine issues for trial. By agreement, the claims of the remaining plaintiffs were adjourned sine die. An appeal to the Manitoba Court of Appeal was unanimously dismissed with costs.

At issue here are: (1) whether the respondents owe the appellants a duty of care with respect to (a) the investment losses they incurred allegedly as a result of reliance on the 1980-82 audit reports, and (b) the losses in the value of their existing shareholdings they incurred allegedly as a result of reliance on the 1980-82 audit reports; and (2) whether the rule in Foss v. Harbottle (which provides that individual shareholders have no cause of action in law for any wrongs done to the corporation) affects the appellants' action.

Held: The appeal should be dismissed.

Four preliminary matters were addressed before the principal issue. Firstly, the question to be decided on a motion for summary judgment under rule 20 of the Manitoba Court of Queen's Bench Rules is whether there is a genuine issue for trial. Although a defendant who seeks dismissal of an action has an initial burden of showing that the case is one in which the existence of a genuine issue is a proper question for consideration, it is the plaintiff who must then, according to the rule, establish his claim as being one with a real chance of success. Thus, the appellants (who were the plaintiffs-respondents on the motion) bore the burden of establishing that their claim had "a real chance of success". Secondly, no contract existed between the appellant shareholders and the respondents and, in any event, the contract claim was not properly before this Court. Consequently, the appellants' submissions in this regard must fail. Thirdly, the independence requirements set out in s. 155 of the Manitoba Corporations Act do not themselves give rise to a cause of action in negligence. Similarly, breach of those independence requirements could not establish a duty of care in tort. Finally, it was not necessary to inquire into whether the appellants actually relied on the audited reports prepared by the respondents because the finding of an absence of a duty of care rendered the question of actual reliance inconsequential.

The existence of a duty of care in tort is to be determined through an application of the two-part Anns/Kamloops test (Anns v. Merton London Borough Council; Kamloops (City of) v. Nielsen). That approach should be taken here. To create a "pocket" of negligent misrepresentation cases in which the existence of a duty of care is determined differently from other negligence cases would be incorrect. Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of the audit reports, therefore, depends on (a) whether a prima facie duty of care is owed, and (b) whether that duty, if it exists, is negated or limited by policy considerations.

The existence of a relationship of "neighbourhood" or "proximity" distinguishes those circumstances in which the defendant owes a prima facie duty of care to the plaintiff from those where no such duty exists. In the context of a negligent misrepresentation action, deciding whether a prima facie duty of care exists necessitates an investigation into whether the defendant-representor and the plaintiff-representee can be said to be in a relationship of proximity or neighbourhood. The term "proximity" itself is nothing more than a label expressing a result, judgment or conclusion and does not, in and of itself, provide a principled basis on which to make a legal determination.

"Proximity" in negligent misrepresentation cases pertains to some aspect of the relationship of reliance. It inheres when (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation, and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable.

Looking to whether reliance by the plaintiff would be reasonable in determining whether a prima facie duty of care exists (as opposed to looking at reasonable foreseeability alone) is not to abandon the basic tenets underlying the first branch of the Anns/Kamloops test. While specific inquiries into the reasonableness of the plaintiff's expectations are not normally required in the context of physical damage cases (since the law has come to recognize implicitly that plaintiffs are reasonable in expecting that defendants will take reasonable care of their persons and property), such an inquiry is necessary in the negligent misrepresentation context. This is because reliance by a plaintiff on a defendant's representation will not always be reasonable. Only by inquiring into the reasonableness of the plaintiff's reliance will the Anns/Kamloops test be applied consistently in both contexts.

The reasonable foreseeability/reasonable reliance test for determining a prima facie duty of care is somewhat broader than the tests used both in the cases decided before Anns and in those that have rejected the Anns approach. Those cases typically require (a) that the defendant know the identity of either the plaintiff or the class of plaintiffs who will rely on the statement, and (b) that the reliance losses claimed by the plaintiff stem from the particular transaction in respect of which the statement at issue was made. In reality, inquiring into such matters is nothing more than a means by which to circumscribe -- for reasons of policy -- the scope of a representor's potentially infinite liability. In other words, adding further requirements to the duty of care test provides a means by which concerns that are extrinsic to simple justice -- but that are, nevertheless, fundamentally important -- may be taken into account in assessing whether the defendant should be compelled to compensate the plaintiff for losses suffered.

In light of this Court's endorsement of the Anns/Kamloops test, enquiries concerning (a) the defendant's knowledge of the identity of the plaintiff (or of the class of plaintiffs) and (b) the use to which the statements at issue are put may now quite properly be conducted in the second branch of that test when deciding whether policy considerations ought to negate or limit a prima facie duty that has already been found to exist. Criteria that in other cases have been used to define the legal test for the duty of care can now be recognized as policy-based ways by which to curtail liability and they can appropriately be considered under the policy branch of the Anns/Kamloops test.

The fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that the defendant might be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class". While the criteria of reasonable foreseeability and reasonable reliance serve to distinguish cases where a prima facie duty is owed from those where it is not, these criteria can, in certain types of situations, quite easily be satisfied and, absent some means by which to circumscribe the ambit of the duty, the prospect of limitless liability will loom. The general area of auditors' liability is a case in point. Here, the problem of indeterminate liability will often arise because the reasonable foreseeability/reasonable reliance test for ascertaining a prima facie duty of care may be satisfied in many, even if not all, such cases.

While policy concerns surrounding indeterminate liability will serve to negate a prima facie duty of care in many auditors' negligence cases, there may be particular situations where such concerns do not inhere. The specific factual matrix of a given case may render it an "exception" to the general class of cases, in that while considerations of proximity might militate in favour of finding that a duty of care inheres, the typical policy considerations stemming from indeterminate liability do not arise.

This concept can be articulated within the framework of the Anns/Kamloops test. Under this test, factors such as (1) whether the defendant knew the identity of the plaintiff (or the class of plaintiff) and (2) whether the defendant's statements were used for the specific purpose or transaction for which they were made ought properly to be considered in the "policy" branch of the test once the first branch concerning "proximity" has been found to be satisfied. The absence of these factors will normally mean that concerns over indeterminate liability inhere and, therefore, that the prima facie duty of care will be negated. Their presence, however, will mean that worries stemming from indeterminacy should not arise since the scope of liability is sufficiently delimited. In such cases, policy considerations will not override a positive finding on the first branch of the Anns/Kamloops test and a duty of care will quite properly be found to exist.

On the facts of this case, the respondents clearly owed a prima facie duty of care to the appellants. Firstly, the possibility that the appellants would rely on the audited financial statements in conducting their affairs and that they might suffer harm if the reports were negligently prepared must have been reasonably foreseeable to the respondents. Secondly, reliance on the audited statements by the appellant shareholders would, on the facts, be reasonable given both the relationship between the parties and the nature of the statements themselves. The first branch of the Anns/Kamloops test is therefore satisfied.

As regards the second branch of this test, it is clear that the respondents knew the identity of the appellants when they provided the audit reports. In determining whether this case is an "exception" to the generally prevailing policy concerns regarding auditors, the central question is therefore whether the appellants can be said to have used the audit reports for the specific purpose for which they were prepared. The answer will determine whether policy considerations surrounding indeterminate liability ought to negate the prima facie duty of care owed by the respondents.

The respondent auditors' purpose in preparing the reports was to assist the collectivity of shareholders of the audited companies in their task of overseeing management. The respondents did not prepare the audit reports in order to assist the appellants in making personal investment decisions or, indeed, for any purpose other than the standard statutory one. The only purpose for which the reports could have been used so as to give rise to a duty of care on the part of the respondents, therefore, is as a guide for the shareholders, as a group, in supervising or overseeing management.

In light of this finding, the specific claims of the appellants could each be assessed. Those claims were in respect of: (1) moneys injected into NGA and NGH by Hercules and Freed, and (2) the devaluation of existing equity caused by the appellants' alleged inability (a) to oversee personal investments properly, and (b) to supervise the management of the corporations with a view to protecting their personal holdings.

As regards the first claim, the appellants alleged that they relied on the respondents' audit reports for the purpose of making individual investments. Since this was not a purpose for which the reports were prepared, policy concerns surrounding indeterminate liability are not obviated and these claims must fail. Similarly, the first branch of the appellants' second claim must fail since monitoring existing personal investments is likewise not a purpose for which the audited statements were prepared.

With respect to the second branch relating to the devaluation of appellants' equity, the appellants' position may at first seem consistent with the purpose for which the reports were prepared. In reality, however, their claim did not involve the purpose of overseeing management per se. Rather, it ultimately depended on being able to use the auditors' reports for the individual purpose of overseeing their own investments. Thus, the purpose for which the reports were used was not, in fact, consistent with the purpose for which they were prepared. The policy concerns surrounding indeterminate liability accordingly inhered and the prima facie duty of care was negated in respect of this claim as well.

The absence of a duty of care with respect to the appellant's alleged inability to supervise management in order to monitor their individual investments is consistent with the rule in Foss v. Harbottle which provides that individual shareholders have no cause of action for wrongs done to the corporation. When, as a collectivity, shareholders oversee the activities of a corporation through resolutions adopted at shareholder meetings, they assume what may be seen to be a "managerial" role. In this capacity, they cannot properly be understood to be acting simply as individual holders of equity. Rather, their collective decisions are made in respect of the corporation itself. Any duty owed by auditors in respect of this aspect of the shareholders' functions is owed not to shareholders qua individuals, but rather to all shareholders as a group, acting in the interests of the corporation. Since the decisions taken by the collectivity of shareholders are in respect of the corporation's affairs, the shareholders' reliance on negligently prepared audit reports in taking such decisions will result in a wrong to the corporation for which the shareholders cannot, as individuals, recover. A derivative action would have been the proper method of proceeding with respect to this claim.

Cases Cited

Considered: Fidkalo v. Levin (1992), 76 Man. R. (2d) 267; Caparo Industries plc. v. Dickman, [1990] 1 All E.R. 568; Anns v. Merton London Borough Council, [1978] A.C. 728; Kamloops (City of) v. Nielsen, [1984] 2 S.C.R. 2; Canadian National Railway Co. v. Norsk Pacific Steamship Co., [1992] 1 S.C.R. 1021; Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465; Haig v. Bamford, [1977] 1 S.C.R. 466; Ultramares Corp. v. Touche, 174 N.E. 441 (1931); Glanzer v. Shepard, 135 N.E. 275 (1922); referred to: Foss v. Harbottle (1843), 2 Hare 460, 67 E.R. 189; Hercules Management Ltd. v. Clarkson Gordon (1994), 91 Man. R. (2d) 216; R. in right of Canada v. Saskatchewan Wheat Pool, [1983] 1 S.C.R. 205; Queen v. Cognos Inc., [1993] 1 S.C.R. 87; Murphy v. Brentwood District Council, [1991] 1 A.C. 398; Sutherland Shire Council v. Heyman (1985), 60 A.L.R. 1; B.D.C. Ltd. v. Hofstrand Farms Ltd., [1986] 1 S.C.R. 228; London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299; Winnipeg Condominium Corporation No. 36 v. Bird Construction Co., [1995] 1 S.C.R. 85; Edgeworth Construction Ltd. v. N. D. Lea & Associates Ltd., [1993] 3 S.C.R. 206; Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553; Donoghue v. Stevenson, [1932] A.C. 562; Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164; H. Rosenblum (1983), Inc. v. Adler, 461 A.2d 138 (1983); Roman Corp. Ltd. v. Peat Marwick Thorne (1992), 11 O.R. (3d) 248; Roman Corp. v. Peat Marwick Thorne (1993), 12 B.L.R. (2d) 10; Prudential Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354; Goldex Mines Ltd. v. Revill (1974), 7 O.R. (2d) 216.

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Corporations Act, R.S.M. 1987, c. C225, ss. 149(1), 155(1), (2), (6), 163(1), 232.
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APPEAL from a judgment of the Manitoba Court of Appeal (1995), 102 Man. R. (2d) 241, 93 W.A.C. 241, 125 D.L.R. (4th) 353, 19 B.L.R. (2d) 137, 24 C.C.L.T. (2d) 284, dismissing an appeal from judgment by Dureault J. Appeal dismissed.

Mark M. Schulman, Q.C., and Brian A. Crane, Q.C., for the appellants.
Robert P. Armstrong, Q.C., and Thor J. Hansell, for the respondents.
W. Ian C. Binnie, Q.C., and Geoff R. Hall, for the intervener.

Solicitors for the appellants: Schulman & Schulman, Winnipeg.
Solicitors for the respondents: Aikins, MacAulay, Thorvaldson, Winnipeg.
Solicitors for the intervener: McCarthy, Tétrault, Toronto.

The judgment of the Court was delivered by

1 **LA FOREST J.**:-- This appeal arises by way of motion for summary judgment. It concerns the issue of whether and when accountants who perform an audit of a corporation's financial statements owe a duty of care in tort to shareholders of the corporation who claim to have suffered losses in reliance on the audited statements. It also raises the question of whether certain types of claims against auditors may properly be brought by shareholders as individuals or whether they must be brought by the corporation in the form of a derivative action.

Facts

2 Northguard Acceptance Ltd. ("NGA") and Northguard Holdings Ltd. ("NGH") carried on business lending and investing money on the security of real property mortgages. The appellant Guardian Finance of Canada Ltd. ("Guardian") was the sole shareholder of NGH and it held non-voting class B shares in NGA. The appellants Hercules Managements Ltd. ("Hercules") and Max Freed were also shareholders in NGA. At all relevant times, ownership in the corporations was separated from management. The respondent Ernst & Young (formerly known as Clarkson Gordon) is a firm of chartered accountants that was originally hired by NGA and NGH in 1971 to perform annual audits of their financial statements and to provide audit reports to the companies' shareholders. The partner in charge of the audits for the years 1980 and 1981 is the respondent William Alexander Cox. Mr. Cox held personal investments in some of the syndicated mortgages administered by NGA and NGH.

3 In 1984, both NGA and NGH went into receivership. The appellants, as well as Friendly Family Farms Ltd. ("F.F. Farms"), Woodvale Enterprises Ltd. ("Woodvale"), Arlington Management Consultants Ltd. ("Arlington"), Emarjay Holdings Ltd. ("Emarjay") and David Korn (all of whom were shareholders or investors in NGA) brought an action against the respondents in 1988 alleging that the audit reports for the years 1980, 1981 and 1982 were negligently prepared and that in reliance on these reports, they suffered various financial losses. More specifically, the appellant Hercules sought damages for advances totalling $600,000 which it made to NGA in January and February of 1983, and the appellant Freed sought damages for monies he added to an investment account in NGH in 1982. All the plaintiffs claimed damages in tort for the losses they suffered in the value of their existing shareholdings. In addition to their tort claims, the plaintiffs also alleged that a contract existed between themselves and the respondents in which the respondents explicitly undertook, as of 1978, to protect the shareholders' individual interests in the audits as distinct from the interests of the corporations themselves.

4 After a series of amendments to the initial statement of claim, over 40 days of discovery, and numerous pre-trial conferences and case management sessions, the respondents brought a motion for summary judgment in the Manitoba Court of Queen's Bench seeking to have the plaintiffs' claims dismissed. The grounds for the motion were (a) that there was no contract between the plaintiffs and the respondents; (b) that the respondents did not owe the individual plaintiffs any duty

of care in tort; and (c) that the claims asserted by the plaintiffs could only properly be brought by the corporations themselves and not by the shareholders individually. The motions judge granted the motion with respect to the plaintiffs Hercules, F.F. Farms, Woodvale, Guardian and Freed and dismissed their actions on the basis that they raised no genuine issues for trial. By agreement, the claims of the remaining plaintiffs were adjourned sine die. An appeal to the Manitoba Court of Appeal by Hercules, Guardian and Freed was unanimously dismissed with costs. Leave to appeal to this Court was granted on March 7, 1996 and the appeal was heard on December 6, 1996.

Judicial History

Manitoba Court of Queen's Bench

5 Dureault J. began his reasons by noting that only the claims of Hercules, F.F. Farms, Woodvale, Guardian and Freed had to be addressed since, by agreement, the claims of the other plaintiffs had been adjourned. He then proceeded to set out the appropriate test to be applied in summary judgment motions. Referring to Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules, Reg. 553/88, (which governs summary judgment motions) and citing Fidkalo v. Levin (1992), 76 Man. R. (2d) 267 (C.A.), he explained that while the defendant bears the initial burden of proving that the case is one where the question whether there exists a genuine issue for trial can properly be raised, the plaintiff bears the subsequent burden of establishing that his claim has a real chance of success.

6 After rejecting the claim of the plaintiff F.F. Farms on the ground that it failed from the outset to establish any cause of action, Dureault J. turned to the more substantive issues in the motion. He began by addressing the question whether the plaintiffs qua shareholders may properly bring an action for the devaluation in their shareholdings in NGA and NGH, and held that

> . . . shareholders have no cause of action in law for any wrongs which may have been inflicted upon a corporation. This principle of law is often referred to as "the rule in Foss v. Harbottle". The plaintiff shareholders are trying to get around this principle. At best, if any wrong was done in the conduct of the defendants' audits, it was done to [NGA] and [NGH] and cannot be considered an injury sustained by the shareholders.

Dureault J. found on this basis that the claims of Hercules, Guardian, Woodvale and Freed did not disclose any genuine issue for trial since they ought to have been brought by the corporations and not by the plaintiffs as individual shareholders.

7 The motions judge next addressed the question whether any duty of care in tort was owed by the defendants to the plaintiffs in their capacities as either shareholders or investors in the audited corporations. He noted that

> [g]enerally speaking, the law requires more than foreseeability and reliance.

> Actual knowledge on the part of the accountant/auditor of the limited class that will use and rely on the statements, referred to as the "proximity test", is also required.

Adopting the defendants' submissions on this issue, Dureault J. found that no duty of care was owed the plaintiffs because the audited statements were not prepared specifically for the purpose of assisting them in making investment decisions.

8 Finally, Dureault J. addressed the plaintiffs' claim that their losses stemmed from a breach of contract by the defendants. He recognized that the engagement of the auditors by the corporations is a contractual relationship, but rejected the contention that this relationship can be extended to include the shareholders so as to permit them to bring personal actions against the auditors in the event of breach. Finding that none of the plaintiffs' claims raised a genuine issue for trial, Dureault J. granted the motion with costs.

Manitoba Court of Appeal (1995), 102 Man. R. (2d) 241 (Philp, Lyon and Helper JJ.A.)

9 An appeal was brought to the Manitoba Court of Appeal by Hercules, Guardian and Freed. Helper J.A., writing for the court, began her reasons by finding that the learned motions judge had correctly applied the Fidkalo test for summary judgment motion under Rule 20.03(1) She also distinguished that test from that applicable on a motion to strike pleadings on the ground that, unlike the situation on a motion to strike, a Rule 20 motion requires an examination of the evidence in support of the plaintiff's claim.

10 Turning to the question whether the respondents owed a duty of care in tort to the appellants, Helper J.A. noted the latter's two alternative submissions. The first (at p. 244) was that

> . . . a common law duty of care arose . . . because the respondents knew or ought to have known: i) that the appellants were relying on the audited statements and the services and advice provided by the respondents; ii) the purpose for which the appellants would rely upon the respondents' services and statements; iii) that the appellants did so rely upon those audited statements for investment and other purposes; and iv) that the respondents breached their duties to the appellants thereby causing them a financial loss.

In response to this claim, Helper J.A. explained, the respondents contended that the appellants were simply trying to avoid the rule in Foss v. Harbottle (1843), 2 Hare 460, 67 E.R. 189 (H.L.), by asserting their claims as individual shareholders rather than by way of derivative action. The respondents also argued that they had no knowledge that investments would be made on the basis of the audited statements and that there was no evidence to support the contention that they ought to have known that their reports would be relied upon in this manner. Finally, Helper J.A. noted, the respondents asserted that there was no evidence demonstrating that the appellants had, in fact, relied on the audited statements at issue.

11 In analysing this first main submission, Helper J.A. undertook a thorough review of Caparo Industries plc. v. Dickman, [1990] 1 All E.R. 568, where the House of Lords considered the question of the scope of the duty of care owed by auditors to shareholders and investors. After reviewing the Canadian case law on the matter, she concluded, at p. 248, that

> [t]he appellants were unable to direct this court to any evidence in support of their position which was ignored by the motions judge. Nor am I persuaded that the order dismissing the appellants' claims is contrary to the existing jurisprudence.
>
> The evidence showed that the auditors had prepared the annual reports to comply with their statutory obligations. There was a total absence of evidence to indicate the respondents knew the appellants would rely upon the reports for any specific purpose or that the appellants did rely upon the reports before infusing more capital into their companies. The appellants were content to allow management to continue running the companies despite a drop in profitability reflected in the 1982 audited report and invested more capital in the face of that report. The evidence filed in opposition to the motion did not support the appellants' claim on this issue.

In the view of the Manitoba Court of Appeal, then, the first of the appellants' submissions regarding the existence of a duty of care could not succeed.

12 The appellants' second main submission concerning the existence of a duty of care consisted in an allegation that the respondent auditors contravened the statutory independence requirements set out in s. 155 of the Manitoba Corporations Act, R.S.M. 1987, c. C225, and that this in itself gave rise to a cause of action in the individual shareholders. The relevant portions of s. 155 are as follows:

> 155(1) Subject to subsection (5), a person is disqualified from being an auditor of a corporation if he is not independent of the corporation, all of its affiliates, and the directors or officers of the corporation and its affiliates.

155(2)For the purposes of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if he or his business partner

(i) is a business partner, a director, an officer or an employee of the corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates, or

(ii) beneficially owns or controls, directly or indirectly, a material interest in the securities of the corporation or any of its affiliates, or

(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

. . .

155(6) The shareholders of a corporation may resolve to appoint as auditor, a person otherwise disqualified under subsections (1) and (2) if the resolution is consented to by all the shareholders including shareholders not otherwise entitled to vote.

Specifically, the appellants alleged that because s. 155(6) of the Act allows a single shareholder to exercise a veto power over the appointment of the auditors, each shareholder also has a right of action against the auditors where damage has been occasioned by a breach of the independence requirement in s. 155(2). Helper J.A. rejected this submission both on the ground that it was unsupported by authority and on the basis that the wording of s. 155 as a whole does not suggest the interpretation urged by the appellants.

13 Finally, Helper J.A. addressed the appellants' contractual claim and held that the respondents' engagement to audit the financial statements of NGA and NGH in accordance with the Act did not give rise to a contractual relationship between them and the appellants. Similarly, she found the appellants could not sue on the contract between the corporations and the respondent Ernst & Young because of the lack of privity. Finding no evidence to support the existence of the requisite contractual relationship, Helper J.A. rejected the appellants' claim in this regard. For all these reasons, the Court of Appeal unanimously dismissed the appeal with costs.

Issues

14 The issues in this case may be stated as follows:

(1) Do the respondents owe the appellants a duty of care with respect to

(a) the investment losses they incurred allegedly as a result of reliance on the 1980-82 audit reports; and

(b) the losses in the value of their existing shareholdings they incurred allegedly as a result of reliance on the 1980-82 audit reports?

(2) Does the rule in Foss v. Harbottle affect the appellants' action?

Analysis

Preliminary Matters

15 Four preliminary matters should be addressed before turning to the principal issues in this appeal. The first concerns the procedure to be followed in a motion for summary judgment brought under Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules. That rule provides as follows:

> 20.03(1) Where the court is satisfied that there is no genuine issue for trial with respect to a claim or defence, the court shall grant summary judgment accordingly.

I would agree with both the Court of Appeal and the motions judge in their endorsement of the procedure set out in Fidkalo, supra, at p. 267, namely:

> The question to be decided on a rule 20 motion is whether there is a genuine issue for trial. Although a defendant who seeks dismissal of an action has an initial burden of showing that the case is one in which the existence of a genuine issue is a proper question for consideration, it is the plaintiff who must then, according to the rule, establish his claim as being one with a real chance of success.

In the instant case, then, the appellants (who were the plaintiffs-respondents on the motion) bore the burden of establishing that their claim had "a real chance of success". They bear the same burden in this Court.

16 The second preliminary matter concerns the appellants' claim that as a result of a meeting in the summer of 1978 between David Korn, Max Freed and the respondent Cox and in light of an engagement letter sent by the respondents to NGA and NGH in 1981, a contract was formed between the shareholders of the audited corporations, on the one hand, and the respondents, on the other. This purported contract ostensibly required the respondents to conduct their audits for the benefit of the shareholders themselves and not merely for the benefit of the corporations. I have reviewed the portions of the record upon which the appellants base this submission and I am unable to find that the requisite elements of contract formation inhere on the facts. In any event, as the respondents pointed out, the appellants' request to amend their pleadings before trial to include a claim for breach of contract was denied by Kennedy J. and no appeal was brought from that decision. (See: Hercules Management Ltd. v. Clarkson Gordon (1994), 91 Man. R. (2d) 216 (Q.B.).) I would find, therefore, that the claim in breach of contract is not properly before this Court and that the appellants' submissions in this regard must fail.

17 Thirdly, the appellants allege that the respondent Cox's investments in certain syndicated mortgages administered by NGA and NGH constituted a breach of the statutory independence requirements set out in s. 155 of the Manitoba Corporations Act and that such a breach either gives rise to a private law cause of action or, alternatively, that it provides an independent basis for finding a duty of care in a tort action. Assuming without deciding that the respondent Cox was in breach of the independence requirements set out in that section, I would agree with Helper J.A. in finding that the section does not, in and of itself, give rise to a cause of action in negligence; see: R. in right of Canada v. Saskatchewan Wheat Pool, [1983] 1 S.C.R. 205. Similarly, I cannot see how breach of the independence requirements could establish a duty of care in tort. This does not mean, of course, that the statutory audit requirements set out in the Manitoba Corporations Act are entirely irrelevant to the appellants' claim. Rather, it simply means that a breach of the independence provisions does not, by itself, give rise either to an independent right of action or to a duty of care.

18 The final preliminary matter concerns whether or not the appellants actually relied on the 1980-82 audited reports prepared by the respondents. More specifically, the appellants allege that the Court of Appeal erred in finding, at p. 248, that

> [t]here was a total absence of evidence to indicate the respondents knew the appellants would rely upon the reports for any specific purpose or that the appellants did rely upon the [1980-82] reports before infusing more capital into their companies. The appellants were content to allow management to continue running the companies despite a drop in profitability reflected in the 1982 audited report and invested capital in the face of that report. The evidence filed in opposition to the motion did not support the appellants' claim on this issue. [Emphasis added.]

Needless to say, actual reliance is a necessary element of an action in negligent misrepresentation and its absence will mean that the plaintiff cannot succeed in holding the defendant liable for his or her losses; see: Queen v. Cognos Inc., [1993] 1 S.C.R. 87, at p. 110. In light of my disposition on the duty of care issue, however, it is unnecessary to inquire into this matter here -- the absence of a duty of care renders inconsequential the question of actual reliance. Having dealt with all four preliminary matters, then, I can now turn to a discussion of the principal issues in this appeal.

Issue 1: Whether the Respondents owe the Appellants a Duty of Care

(i) Introduction

19 It is now well established in Canadian law that the existence of a duty of care in tort is to be determined through an application of the two-part test first enunciated by Lord Wilberforce in Anns v. Merton London Borough Council, [1978] A.C. 728 (H.L.), at pp. 751-52:

> First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or

> neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter -- in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise. . . .

While the House of Lords rejected the Anns test in Murphy v. Brentwood District Council, [1991] 1 A.C. 398, and in Caparo, supra, at p. 574, per Lord Bridge and at pp. 585-86, per Lord Oliver (citing Brennan J. in Sutherland Shire Council v. Heyman (1985), 60 A.L.R. 1 (H.C.), at pp. 43-44), the basic approach that test embodies has repeatedly been accepted and endorsed by this Court. (See, e.g.: Kamloops (City of) v. Nielsen, [1984] 2 S.C.R. 2; B.D.C. Ltd. v. Hofstrand Farms Ltd., [1986] 1 S.C.R. 228; Canadian National Railway Co. v. Norsk Pacific Steamship Co., [1992] 1 S.C.R. 1021; London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299; Winnipeg Condominium Corporation No. 36 v. Bird Construction Co., [1995] 1 S.C.R. 85.)

20 In Kamloops, supra, at pp. 10-11, Wilson J. restated Lord Wilberforce's test in the following terms:

> (1) is there a sufficiently close relationship between the parties (the [defendant] and the person who has suffered the damage) so that, in the reasonable contemplation of the [defendant], carelessness on its part might cause damage to that person? If so,
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

As will be clear from the cases earlier cited, this two-stage approach has been applied by this Court in the context of various types of negligence actions, including actions involving claims for different forms of economic loss. Indeed, it was implicitly endorsed in the context of an action in negligent misrepresentation in Edgeworth Construction Ltd. v. N. D. Lea & Associates Ltd., [1993] 3 S.C.R. 206, at pp. 218-19. The same approach to defining duties of care in negligent misrepresentation cases has also been taken in other Commonwealth courts. In Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, for example, a case that dealt specifically with auditors' liability for negligently prepared audit reports, the Anns test was adopted and applied by a majority of the New Zealand Court of Appeal.

21 I see no reason in principle why the same approach should not be taken in the present case. Indeed, to create a "pocket" of negligent misrepresentation cases (to use Professor Stapleton's term) in which the existence of a duty of care is determined differently from other negligence cases would, in my view, be incorrect; see: Jane Stapleton, "Duty of Care and Economic Loss: a Wider

Agenda" (1991), 107 L.Q. Rev. 249. This is not to say, of course, that negligent misrepresentation cases do not involve special considerations stemming from the fact that recovery is allowed for pure economic loss as opposed to physical damage. Rather, it is simply to posit that the same general framework ought to be used in approaching the duty of care question in both types of case. Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of the 1980-82 audit reports, then, will depend on (a) whether a prima facie duty of care is owed, and (b) whether that duty, if it exists, is negatived or limited by policy considerations. Before analysing the merits of this case, it will be useful to set out in greater detail the principles governing this appeal.

(ii) The Prima Facie Duty of Care

22 The first branch of the Anns/Kamloops test demands an inquiry into whether there is a sufficiently close relationship between the plaintiff and the defendant that in the reasonable contemplation of the latter, carelessness on its part may cause damage to the former. The existence of such a relationship -- which has come to be known as a relationship of "neighbourhood" or "proximity" -- distinguishes those circumstances in which the defendant owes a prima facie duty of care to the plaintiff from those where no such duty exists. In the context of a negligent misrepresentation action, then, deciding whether or not a prima facie duty of care exists necessitates an investigation into whether the defendant-representor and the plaintiff-representee can be said to be in a relationship of proximity or neighbourhood.

23 What constitutes a "relationship of proximity" in the context of negligent misrepresentation actions? In approaching this question, I would begin by reiterating the position I took in Norsk, supra, at pp. 1114-15, that the term "proximity" itself is nothing more than a label expressing a result, judgment or conclusion; it does not, in and of itself, provide a principled basis on which to make a legal determination. This view was also explicitly adopted by Stevenson J. in Norsk, supra, at p. 1178, and McLachlin J. also appears to have accepted it when she wrote, at p. 1151, of that case that "[p]roximity may usefully be viewed, not so much as a test in itself, but as a broad concept which is capable of subsuming different categories of cases involving different factors"; see also: M. H. McHugh, "Neighbourhood, Proximity and Reliance", in P. D. Finn, ed., Essays on Torts (1989), 5, at pp. 36-37; and John G. Fleming, "The Negligent Auditor and Shareholders" (1990), 106 L.Q. Rev. 349, at p. 351, where the author refers to proximity as a "vacuous test". While Norsk, supra, was concerned specifically with whether or not a defendant could be held liable for "contractual relational economic loss" (as I called it, at p. 1037), I am of the view that the same observations with respect to the term "proximity" are applicable in the context of negligent misrepresentation. In order to render "proximity" a useful tool in defining when a duty of care exists in negligent misrepresentation cases, therefore, it is necessary to infuse that term with some meaning. In other words, it is necessary to set out the basis upon which one may properly reach the conclusion that proximity inheres between a representor and a representee.

24 This can be done most clearly as follows. The label "proximity", as it was used by Lord Wilberforce in Anns, supra, was clearly intended to connote that the circumstances of the relationship inhering between the plaintiff and the defendant are of such a nature that the defendant may be said to be under an obligation to be mindful of the plaintiff's legitimate interests in conducting his or her affairs. Indeed, this idea lies at the very heart of the concept of a "duty of care", as articulated most memorably by Lord Atkin in Donoghue v. Stevenson, [1932] A.C. 562, at pp. 580-81. In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable. To use the term employed by my colleague, Iacobucci J., in Cognos, supra, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.

25 I should pause here to explain that, in my view, to look to whether or not reliance by the plaintiff on the defendant's representation would be reasonable in determining whether or not a prima facie duty of care exists in negligent misrepresentation cases as opposed to looking at reasonable foreseeability alone is not, as might first appear, to abandon the basic tenets underlying the first branch of the Anns/Kamloops formula. The purpose behind the Anns/Kamloops test is simply to ensure that enquiries into the existence of a duty of care in negligence cases is conducted in two parts: The first involves discerning whether, in a given situation, a duty of care would be imposed by law; the second demands an investigation into whether the legal duty, if found, ought to be negatived or ousted by policy considerations. In the context of actions based on negligence causing physical damage, determining whether harm to the plaintiff was reasonably foreseeable to the defendant is alone a sufficient criterion for deciding proximity or neighbourhood under the first branch of the Anns/Kamloops test because the law has come to recognize (even if only implicitly) that, absent a voluntary assumption of risk by him or her, it is always reasonable for a plaintiff to expect that a defendant will take reasonable care of the plaintiff's person and property. The duty of care inquiry in such cases, therefore, will always be conducted under the assumption that the plaintiff's expectations of the defendant are reasonable.

26 In negligent misrepresentation actions, however, the plaintiff's claim stems from his or her detrimental reliance on the defendant's (negligent) statement, and it is abundantly clear that reliance on the statement or representation of another will not, in all circumstances, be reasonable. The assumption that always inheres in physical damage cases concerning the reasonableness of the plaintiff's expectations cannot, therefore, be said to inhere in reliance cases. In order to ensure that the same factors are taken into account in determining the existence of a duty of care in both instances, then, the reasonableness of the plaintiff's reliance must be considered in negligent misrepresentation actions. Only by doing so will the first branch of the Kamloops test be applied consistently in both contexts.

27 As should be evident from its very terms, the reasonable foreseeability/reasonable reliance test for determining a prima facie duty of care is somewhat broader than the tests used both in the cases decided before Anns, supra, and in those that have rejected the Anns approach. Rather than stipulating simply that a duty of care will be found in any case where reasonable foreseeability and reasonable reliance inhere, those cases typically require (a) that the defendant know the identity of either the plaintiff or the class of plaintiffs who will rely on the statement, and (b) that the reliance losses claimed by the plaintiff stem from the particular transaction in respect of which the statement at issue was made. This narrower approach to defining the duty can be seen in a number of the more prominent English decisions dealing either with auditors' liability specifically or with liability for negligent misstatements generally. (See, e.g.: Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164 (C.A.), at pp. 181-82 and p. 184, per Denning L.J. (dissenting); Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465; Caparo, supra, per Lord Bridge, at p. 576, and per Lord Oliver, at pp. 589.) It is also evident in the approach taken by this Court in Haig v. Bamford, [1977] 1 S.C.R. 466.

28 While I would not question the conclusions reached in any of these judgments, I am of the view that inquiring into such matters as whether the defendant had knowledge of the plaintiff (or class of plaintiffs) and whether the plaintiff used the statements at issue for the particular transaction for which they were provided is, in reality, nothing more than a means by which to circumscribe -- for reasons of policy -- the scope of a representor's potentially infinite liability. As I have already tried to explain, determining whether "proximity" exists on a given set of facts consists in an attempt to discern whether, as a matter of simple justice, the defendant may be said to have had an obligation to be mindful of the plaintiff's interests in going about his or her business. Requiring, in addition to proximity, that the defendant know the identity of the plaintiff (or class of plaintiffs) and that the plaintiff use the statements in question for the specific purpose for which they were prepared amounts, in my opinion, to a tacit recognition that considerations of basic fairness may sometimes give way to other pressing concerns. Plainly stated, adding further requirements to the duty of care test provides a means by which policy concerns that are extrinsic to simple justice -- but that are, nevertheless, fundamentally important -- may be taken into account in assessing whether the defendant should be compelled to compensate the plaintiff for losses suffered. In other words, these further requirements serve a policy-based limiting function with respect to the ambit of the duty of care in negligent misrepresentation actions.

29 This view is confirmed by the judgments themselves. In Caparo, supra, at p. 576, for example, Lord Bridge refers to the criteria of knowledge of the plaintiff (or class of plaintiffs) and use of the statements for the intended transaction as a " 'limit or control mechanism . . . imposed on the liability of the wrongdoer towards those who have suffered some economic damage in consequence of his negligence'" (emphasis added). Similarly, in Haig, supra, at p. 476, Dickson J. (as he then was) explicitly discusses the policy concern arising from unlimited liability before finding that the statements at issue in Haig were used for the very purpose for which they were prepared and that the appropriate test for a duty of care in the case before him was "actual knowledge of the limited class that will use and rely on the statement". (See also Candler, supra, at p. 183, per Denning L.J.

(dissenting).) Certain scholars have adopted this view of the case law as well. (See, e.g.: Bruce Feldthusen, Economic Negligence (3rd ed. 1994), at pp. 93-100, where the author explains that the approach taken in both Haig, supra, and Caparo, supra, toward defining the duty of care was motivated by underlying policy concerns; see also: Earl A. Cherniak and Kirk F. Stevens, "Two Steps Forward or One Step Back? Anns at the Crossroads in Canada" (1992), 20 C.B.L.J. 164, and Ivan F. Ivankovich, "Accountants and Third-Party Liability -- Back to the Future" (1991), 23 Ottawa L. Rev. 505, at p. 518.)

30 In light of this Court's endorsement of the Anns/Kamloops test, however, enquiries concerning (a) the defendant's knowledge of the identity of the plaintiff (or of the class of plaintiffs) and (b) the use to which the statements at issue are put may now quite properly be conducted in the second branch of that test when deciding whether or not policy considerations ought to negate or limit a prima facie duty that has already been found to exist. In other words, criteria that in other cases have been used to define the legal test for the duty of care can now be recognized for what they really are -- policy-based means by which to curtail liability -- and they can appropriately be considered under the policy branch of the Anns/Kamloops test. To understand exactly how this may be done and how these criteria are pertinent to the case at bar, it will first be useful to set out the prevailing policy concerns in some detail.

(iii) Policy Considerations

31 As Cardozo C.J. explained in Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y.C.A. 1931), at p. 444, the fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that the defendant might be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class". This potential problem can be seen quite vividly within the framework of the Anns/Kamloops test. Indeed, while the criteria of reasonable foreseeability and reasonable reliance serve to distinguish cases where a prima facie duty is owed from those where it is not, it is nevertheless true that in certain types of situations these criteria can, quite easily, be satisfied and absent some means by which to circumscribe the ambit of the duty, the prospect of limitless liability will loom.

32 The general area of auditors' liability is a case in point. In modern commercial society, the fact that audit reports will be relied on by many different people (e.g., shareholders, creditors, potential takeover bidders, investors, etc.) for a wide variety of purposes will almost always be reasonably foreseeable to auditors themselves. Similarly, the very nature of audited financial statements -- produced, as they are, by professionals whose reputations (and, thereby, whose livelihoods) are at stake -- will very often mean that any of those people would act wholly reasonably in placing their reliance on such statements in conducting their affairs. These observations are consistent with the following remarks of Dickson J. in Haig, supra, at pp. 475-76, with respect to the accounting profession generally:

> The increasing growth and changing role of corporations in modern society

> has been attended by a new perception of the societal role of the profession of accounting. The day when the accountant served only the owner-manager of a company and was answerable to him alone has passed. The complexities of modern industry combined with the effects of specialization, the impact of taxation, urbanization, the separation of ownership from management, the rise of professional corporate managers, and a host of other factors, have led to marked changes in the role and responsibilities of the accountant, and in the reliance which the public must place upon his work. The financial statements of the corporations upon which he reports can affect the economic interests of the general public as well as of shareholders and potential shareholders.

(See also: Cherniak and Stevens, supra, at pp. 169-70.) In light of these considerations, the reasonable foreseeability/reasonable reliance test for ascertaining a prima facie duty of care may well be satisfied in many (even if not all) negligent misstatement suits against auditors and, consequently, the problem of indeterminate liability will often arise.

33 Certain authors have argued that imposing broad duties of care on auditors would give rise to significant economic and social benefits in so far as the spectre of tort liability would act as an incentive to auditors to produce accurate (i.e., non-negligent) reports. (See, e.g.: Howard B. Wiener, "Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation" (1983), 20 San Diego L. Rev. 233.) I would agree that deterrence of negligent conduct is an important policy consideration with respect to auditors' liability. Nevertheless, I am of the view that, in the final analysis, it is outweighed by the socially undesirable consequences to which the imposition of indeterminate liability on auditors might lead. Indeed, while indeterminate liability is problematic in and of itself inasmuch as it would mean that successful negligence actions against auditors could, at least potentially, be limitless, it is also problematic in light of certain related problems to which it might give rise.

34 Some of the more significant of these problems are thus set out in Brian R. Cheffins, "Auditors' Liability in the House of Lords: A Signal Canadian Courts Should Follow" (1991), 18 C.B.L.J. 118, at pp. 125-27:

> In addition to providing only limited benefits, imposing widely drawn duties of care on auditors would probably generate substantial costs. . . .
>
> One reason [for this] is that auditors would expend more resources trying to protect themselves from liability. For example, insurance premiums would probably rise since insurers would anticipate more frequent claims. Also, auditors would probably incur higher costs since they would try to rely more heavily on exclusion clauses. Hiring lawyers to draft such clauses might be expensive because only the most carefully constructed provisions would be likely

> to pass judicial scrutiny. . . .
>
> Finally, auditors' opportunity costs would increase. Whenever members of an accounting firm have to spend time and effort preparing for litigation, they forego revenue generating accounting activity. More trials would mean that this would occur with greater frequency.
>
> . . .
>
> The higher costs auditors would face as a result of broad duties of care could have a widespread impact. For example, the supply of accounting services would probably be reduced since some marginal firms would be driven to the wall. Also, because the market for accounting services is protected by barriers to entry imposed by the profession, the surviving firms would pass [sic] at least some of the increased costs to their clients.

Professor Ivankovich describes similar sources of concern. While he acknowledges certain social benefits to which expansive auditors' liability might conduce, he also recognizes the potential difficulties associated therewith (at pp. 520-21):

> . . . [expansive auditors' liability] is also likely to increase the time expended in the performance of accounting services. This will trigger a predictable negative impact on the timeliness of the financial information generated. It is equally likely to increase the cost of professional liability insurance and reduce its availability, and to increase the cost of accounting services which, as a result, may become less generally available. Additionally, it promotes "free ridership" on the part of reliant third parties and decreases their incentive to exercise greater vigilance and care and, as well, presents an increased risk of fraudulent claims.

Even though I do not share the discomfort apparently felt by Professors Cheffins and Ivankovich with respect to using an Anns-type test in the context of negligent misrepresentation actions (See: Cheffins, supra, at pp. 129-31, and Ivankovich, supra, at p. 530), I nevertheless agree with their assessment of the possible consequences to both auditors and the public generally if liability for negligently prepared audit reports were to go unchecked.

35 I should, at this point, explain that I am aware of the arguments put forth by certain scholars and judges to the effect that concerns over indeterminate liability have sometimes been overstated. (See, e.g.: J. Edgar Sexton and John W. Stevens, "Accountants' Legal Responsibilities and Liabilities", in Professional Responsibility in Civil Law and Common Law (Meredith Memorial Lectures, McGill University, 1983-84) (1985), 88, at pp. 101-2; and H. Rosenblum (1983), Inc. v. Adler, 461 A.2d 138 (N.J. 1983), at p. 152, per Schreiber J.) Arguments to this effect rest essentially on the premise that actual liability will be limited in so far as a plaintiff will not be successful unless both negligence and reliance are established in addition to a duty of care. While it is true that damages will not be owing by the defendant unless these other elements of the cause of action are proved, neither the difficulty of proving negligence nor that of proving reliance will preclude a disgruntled plaintiff from bringing an action against an auditor and such actions would, we may assume, be all the more common were the establishment of a duty of care in any given case to amount to nothing more than a mere matter of course. This eventuality could pose serious problems both for auditors, whose legal costs would inevitably swell, and for courts, which, no doubt, would feel the pressure of increased litigation. Thus, the prospect of burgeoning negligence suits raises serious concerns, even if we assume that the arguments positing proof of negligence and reliance as a barrier to liability are correct. In my view, therefore, it makes more sense to circumscribe the ambit of the duty of care than to assume that difficulties in proving negligence and reliance will afford sufficient protection to auditors, since this approach avoids both "indeterminate liability" and "indeterminate litigation".

36 As I have thus far attempted to demonstrate, the possible repercussions of exposing auditors to indeterminate liability are significant. In applying the two-stage Anns/Kamloops test to negligent misrepresentation actions against auditors, therefore, policy considerations reflecting those repercussions should be taken into account. In the general run of auditors' cases, concerns over indeterminate liability will serve to negate a prima facie duty of care. But while such concerns may exist in most such cases, there may be particular situations where they do not. In other words, the specific factual matrix of a given case may render it an "exception" to the general class of cases in that while (as in most auditors' liability cases) considerations of proximity under the first branch of the Anns/Kamloops test might militate in favour of finding that a duty of care inheres, the typical concerns surrounding indeterminate liability do not arise. This needs to be explained.

37 As discussed earlier, looking to factors such as "knowledge of the plaintiff (or an identifiable class of plaintiffs) on the part of the defendant" and "use of the statements at issue for the precise purpose or transaction for which they were prepared" really amounts to an attempt to limit or constrain the scope of the duty of care owed by the defendants. If the purpose of the Anns/Kamloops test is to determine (a) whether or not a prima facie duty of care exists and then (b) whether or not that duty ought to be negated or limited, then factors such as these ought properly to be considered in the second branch of the test once the first branch concerning "proximity" has been found to be satisfied. To my mind, the presence of such factors in a given situation will mean that worries stemming from indeterminacy should not arise, since the scope of potential liability is sufficiently delimited. In other words, in cases where the defendant knows the identity of the plaintiff (or of a class of plaintiffs) and where the defendant's statements are used for the specific purpose or transaction for which they were made, policy considerations surrounding indeterminate liability will not be of any concern since the scope of liability can readily be circumscribed. Consequently, such considerations will not override a positive finding on the first branch of the Anns/Kamloops test and a duty of care may quite properly be found to exist.

38 As I see it, this line of reasoning serves to explain the holding of Cardozo J. (as he then was) in Glanzer v. Shepard, 135 N.E. 275 (N.Y.C.A. 1922) . There, the New York Court of Appeals held that the defendant weigher was liable in damages for having negligently prepared a weight certificate he knew would be given to the plaintiff, who relied upon it for the specific purpose for which it was issued. In reaching his decision, Cardozo J. explicitly noted that the weight certificate was used for the very "end and aim of the transaction" and not for any collateral or unintended purpose (Glanzer, supra, at p. 275). On the facts of Glanzer, supra, then, the scope of the defendant's liability could readily be delimited and indeterminacy, therefore, was not a concern.

39 The same idea serves to explain the rationale underlying the seminal judgment of the House of Lords in Hedley Byrne, supra. While that case did not involve an action against auditors, similar concerns about indeterminate liability were, nonetheless, clearly relevant. On the facts of Hedley Byrne, supra, the defendant bank provided a negligently prepared credit reference in respect of one of its customers to another bank which, to the knowledge of the defendants, passed on the information to the plaintiff for a stipulated purpose. The plaintiff relied on the credit reference for the specific purpose for which it was prepared. The House of Lords found that but for the presence of a disclaimer, the defendants would have been liable to the plaintiff in negligence. While indeterminate liability would have raised some concern to the Lords had the plaintiff not been known to the defendants or had the credit reference been used for a purpose or transaction other than that for which it was actually prepared, no such difficulties about indeterminacy arose on the particular facts of the case.

40 This Court's decision in Haig, supra, can be seen to rest on precisely the same basis. There, the defendant accountants were retained by a Saskatchewan businessman, one Scholler, to prepare audited financial statements of Mr. Scholler's corporation. At the time they were engaged, the accountants were informed by Mr. Scholler that the audited statements would be used for the purpose of attracting a $20,000 investment in the corporation from a limited number of potential investors. The audit was conducted negligently and the plaintiff investor, who was found to have relied on the audited statements in making his investment, suffered a loss. While Dickson J. was clearly cognizant of the potential problem of indeterminacy arising in the context of auditors' liability (at p. 476), he nevertheless found that the defendants owed the plaintiff a duty of care. In my view, his conclusion was eminently sound given that the defendants were informed by Mr. Scholler of the class of persons who would rely on the report and the report was used by the plaintiff for the specific purpose for which it was prepared. Dickson J. himself expressed this idea as follows, at p. 482:

> The case before us is closer to Glanzer than to Ultramares. The very end and aim of the financial statements prepared by the accountants in the present case was to secure additional financing for the company from [a Saskatchewan government agency] and an equity investor; the statements were required primarily for these third parties and only incidentally for use by the company.

On the facts of Haig, then, the auditors were properly found to owe a duty of care because concerns over indeterminate liability did not arise. I would note that this view of the rationale behind Haig, supra, is shared by Professor Feldthusen. (See Feldthusen, supra, at pp. 98-100.)

41 The foregoing analysis should render the following points clear. A prima facie duty of care will arise on the part of a defendant in a negligent misrepresentation action when it can be said (a) that the defendant ought reasonably to have foreseen that the plaintiff would rely on his representation and (b) that reliance by the plaintiff, in the circumstances, would be reasonable. Even though, in the context of auditors' liability cases, such a duty will often (even if not always) be found to exist, the problem of indeterminate liability will frequently result in the duty being negated by the kinds of policy considerations already discussed. Where, however, indeterminate liability can be shown not to be a concern on the facts of a particular case, a duty of care will be found to exist. Having set out the law governing the appellants' claims, I now propose to apply it to the facts of the appeal.

(iv) Application to the Facts

42 In my view, there can be no question that a prima facie duty of care was owed to the appellants by the respondents on the facts of this case. As regards the criterion of reasonable foreseeability, the possibility that the appellants would rely on the audited financial statements in conducting their affairs and that they may suffer harm if the reports were negligently prepared must have been reasonably foreseeable to the respondents. This is confirmed simply by the fact that shareholders generally will often choose to rely on audited financial statements for a wide variety of purposes. It is further confirmed by the fact that under ss. 149(1) and 163(1) of the Manitoba Corporations Act, it is patently clear that audited financial statements are to be placed before the shareholders at the annual general meeting. The relevant portions of those sections read as follows:

> 149(1) The directors of a corporation shall place before the shareholders at every annual meeting
>
> . . .
>
> (b) the report of the auditor, if any; and
>
> . . .
>
> 163(1) An auditor of a corporation shall make the examination that is in his opinion necessary to enable him to report in the prescribed manner on the financial statements required by this Act to be placed before the shareholders, except such financial statements or part thereof as relate to the period referred to in sub-clause 149(1)(a)(ii).

In my view, it would be untenable to argue in the face of these provisions that some form of reliance by shareholders on the audited reports would be unforeseeable.

43 Similarly, I would find that reliance on the audited statements by the appellant shareholders would, on the facts of this case, be reasonable. Professor Feldthusen (at pp. 62-63) sets out five general indicia of reasonable reliance; namely:

> (1) The defendant had a direct or indirect financial interest in the transaction in respect of which the representation was made.
> (2) The defendant was a professional or someone who possessed special skill, judgment, or knowledge.
> (3) The advice or information was provided in the course of the defendant's business.
> (4) The information or advice was given deliberately, and not on a social occasion.
> (5) The information or advice was given in response to a specific enquiry or request.

While these indicia should not be understood to be a strict "test" of reasonableness, they do help to distinguish those situations where reliance on a statement is reasonable from those where it is not. On the facts here, the first four of these indicia clearly inhere. To my mind, then, this aspect of the prima facie duty is unquestionably satisfied on the facts.

44 Having found a prima facie duty to exist, then, the second branch of the Anns/Kamloops test remains to be considered. It should be clear from my comments above that were auditors such as the respondents held to owe a duty of care to plaintiffs in all cases where the first branch of the Anns/Kamloops test was satisfied, the problem of indeterminate liability would normally arise. It should be equally clear, however, that in certain cases, this problem does not arise because the scope of potential liability can adequately be circumscribed on the facts. An investigation of whether or not indeterminate liability is truly a concern in the present case is, therefore, required.

45 At first blush, it may seem that no problems of indeterminate liability are implicated here and that this case can easily be likened to Glanzer, supra, Hedley Byrne, supra, and Haig, supra. After all, the respondents knew the very identity of all the appellant shareholders who claim to have relied on the audited financial statements through having acted as NGA's and NGH's auditors for nearly 10 years by the time the first of the audit reports at issue in this appeal was prepared. It would seem plausible to argue on this basis that because the identity of the plaintiffs was known to the respondents at the time of preparing the 1980-82 reports, no concerns over indeterminate liability arise.

46 To arrive at this conclusion without further analysis, however, would be to move too quickly. While knowledge of the plaintiff (or of a limited class of plaintiffs) is undoubtedly a significant factor serving to obviate concerns over indeterminate liability, it is not, alone, sufficient to do so. In my discussion of Glanzer, supra, Hedley Byrne, supra, and Haig, supra, I explained that indeterminate liability did not inhere on the specific facts of those cases not only because the defendant knew the identity of the plaintiff (or the class of plaintiffs) who would rely on the statement at issue, but also because the statement itself was used by the plaintiff for precisely the purpose or transaction for which it was prepared. The crucial importance of this additional criterion can clearly be seen when one considers that even if the specific identity or class of potential plaintiffs is known to a defendant, use of the defendant's statement for a purpose or transaction other than that for which it was prepared could still lead to indeterminate liability.

47 For example, if an audit report which was prepared for a corporate client for the express purpose of attracting a $10,000 investment in the corporation from a known class of third parties was instead used as the basis for attracting a $1,000,000 investment or as the basis for inducing one of the members of the class to become a director or officer of the corporation or, again, as the basis for encouraging him or her to enter into some business venture with the corporation itself, it would appear that the auditors would be exposed to a form of indeterminate liability, even if they knew precisely the identity or class of potential plaintiffs to whom their report would be given. With respect to the present case, then, the central question is whether or not the appellants can be said to have used the 1980-82 audit reports for the specific purpose for which they were prepared. The answer to this question will determine whether or not policy considerations surrounding indeterminate liability ought to negate the prima facie duty of care owed by the respondents.

48 What, then, is the purpose for which the respondents' audit statements were prepared? This issue was eloquently discussed by Lord Oliver in Caparo, supra, at p. 583:

> My Lords, the primary purpose of the statutory requirement that a company's accounts shall be audited annually is almost self-evident. . . . The management is confided to a board of directors which operates in a fiduciary capacity and is answerable to and removable by the shareholders who can act, if they act at all, only collectively and only through the medium of a general meeting. Hence the legislative provisions requiring the board annually to give an account of its stewardship to a general meeting of the shareholders. This is the only occasion in each year on which the general body of shareholders is given the opportunity to consider, to criticise and to comment on the conduct by the board of the company's affairs, to vote the directors' recommendation as to dividends, to approve or disapprove the directors' remuneration and, if thought desirable, to remove and replace all or any of the directors. It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing . . . and, second, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided. [Emphasis added.]

Similarly, Farley J. held in Roman Corp. Ltd. v. Peat Marwick Thorne (1992), 11 O.R. (3d) 248 (Gen. Div.), at p. 260 (hereinafter Roman I) that

> as a matter of law the only purpose for which shareholders receive an auditor's report is to provide the shareholders with information for the purpose of overseeing the management and affairs of the corporation and not for the purpose of guiding personal investment decisions or personal speculation with a view to profit.

(See also: Roman Corp. v. Peat Marwick Thorne (1993), 12 B.L.R. (2d) 10 (Ont. Gen. Div.).) Lord Oliver was referring to the relevant provisions of the U.K. Companies Act 1985 (U.K.), 1985, c. 6, in making his pronouncements, and Farley J. rendered his judgment against the backdrop of the statutory audit requirements set out in the Ontario Business Corporations Act, R.S.O. 1990, c. B.16.

49 To my mind, the standard purpose of providing audit reports to the shareholders of a corporation should be regarded no differently under the analogous provisions of the Manitoba Corporations Act. Thus, the directors of a corporation are required to place the auditors' report before the shareholders at the annual meeting in order to permit the shareholders, as a body, to make decisions as to the manner in which they want the corporation to be managed, to assess the performance of the directors and officers, and to decide whether or not they wish to retain the existing management or to have them replaced. On this basis, it may be said that the respondent auditors' purpose in preparing the reports at issue in this case was, precisely, to assist the collectivity of shareholders of the audited companies in their task of overseeing management.

50 The appellants, however, submit that, in addition to this statutorily mandated purpose, the respondents further agreed to perform their audits for the purpose of providing the appellants with information on the basis of which they could make personal investment decisions. They base this claim largely on a conversation that allegedly took place at the 1978 meeting between Mr. Cox, Mr. Freed and Mr. Korn, as well as on certain passages of the engagement letter sent to them by the respondents. I have read the relevant portions of the record on this question and I am unable to accept the appellants' submission. Indeed, on examination for discovery, Mr. Freed discussed the engagement letter of the respondents and stated as follows:

Q It is this that you say is the document that says, it will speak for itself, but you interpret it to mean that they [the respondents] will look after your interests specifically [sic]? . . .

A I am saying that I took for granted that that was their duty.

Q I see. All right. Was there ever anything in writing specifically that says that is your duty, is to look after my interests, I am away all the time?

A I am not aware.

Q Either, from you, or to you in that respect?

A I am not aware of any.

Q This letter happens to say, "We are always prepared upon instruction to extend our services beyond these required procedures." Did you ever give them any additional instructions?

A No. I never saw them.

Q Nor did you communicate with them in writing, or otherwise? Is that right?

A Not that I recall.

Similarly, the transcript of Mr. Korn's examination for discovery reveals the following exchange:

Q You emphasized [at the 1978 meeting] you say to Mr. Cox that because you were no longer in the management stream or chain, you would be relying more on the audited statements?

A Yes, and that -- well, I wanted a sort of commitment that he understood that he was the shareholders' auditor and I did refer to the fact that he had [a] close personal association with Mr. Morris and he said no, he fully understood, have no fear.

Q Did you consider that to be a change from the normal kind of audit engagement, or were you just emphasizing something that was part of the normal audit engagement?

A I just pointed out the change. As a matter of fact, he already knew about the change.

. . .

Q But my question was whether you considered that to be any kind of alteration from the usual audit engagement process.

A Well, that's what happened. That's the fact that I said it to him and those are the words I said, and however he took it, that's however he took it.

Q But I'm asking you if you considered that to be a change from a normal audit engagement.

A Well, I'm not -- whether that was -- whether those words were some sort of special instructions, those were the words and I guess there will be experts to say what consequences should have flown [sic] from them, and I'm not here as an expert on audit --

Q I'm entitled to know what you consider to be the case.

A Well, I made it clear that he should remember that he's the shareholders' auditor, that Clarkson was the shareholders' auditor, notwithstanding his personal relationship with Murray Morris.

Q Auditors are always the shareholders' auditors, are they not?

A And that's what I -- if they are, they are.

Q And that's in fact what they are always?

A Well, that's good, I'm glad to hear that, glad to hear you say it.

Q Do you agree?

A That the auditors are the shareholders' auditors?

Q Yes.

A I agree precisely.

To my mind, these passages serve to demonstrate that despite the appellants' submissions, the respondents did not, in fact, prepare the audit reports in order to assist the appellants in making personal investment decisions or, indeed, for any purpose other than the standard statutory one. This finding accords with that of Helper J.A. in the Court of Appeal, and nothing in the record before this Court suggests the contrary.

51 It follows from the foregoing discussion that the only purpose for which the 1980-82 reports could have been used in such a manner as to give rise to a duty of care on the part of the respondents is as a guide for the shareholders, as a group, in supervising or overseeing management. In assessing whether this was, in fact, the purpose to which the appellants purport to have put the audited reports, it will be useful to take each of the appellants' claims in turn. First, the appellant Hercules seeks compensation for its $600,000 injection of capital into NGA over January and February of 1983 and the appellant Freed seeks damages commensurate with the amount of money he contributed in 1982 to his investment account in NGH. Secondly, all the appellants seek damages for the losses they suffered in the value of their existing shareholdings.

52 The claims of Hercules and Mr. Freed with respect to their 1982-83 investments can be addressed quickly. The essence of these claims must be that these two appellants relied on the respondents' reports in deciding whether or not to make further investments in the audited corporations. In other words, Hercules and Mr. Freed are claiming to have relied on the audited reports for the purpose of making personal investment decisions. As I have already discussed, this is not a purpose for which the respondents in this case can be said to have prepared their reports. In light of the dissonance between the purpose for which the reports were actually prepared and the purpose for which the appellants assert they were used, then, the claims of Hercules and Mr. Freed with respect to their investment losses are not such that the concerns over indeterminate liability discussed above are obviated; viz., if a duty of care were owed with respect to these investment transactions, there would seem to be no logical reason to preclude a duty of care from arising in circumstances where the statements were used for any other purpose of which the auditors were equally unaware when they prepared and submitted their report. On this basis, therefore, I would find that the prima facie duty that arises respecting this claim is negated by policy considerations and, therefore, that no duty of care is owed by the respondents in this regard.

53 With respect to the claim concerning the loss in value of their existing shareholdings, the appellants make two submissions. First, they claim that they relied on the 1980-82 reports in monitoring the value of their equity and that, owing to the (allegedly) negligent preparation of those reports, they failed to extract it before the financial demise of NGA and NGH. Secondly, and somewhat more subtly, the appellants submit that they each relied on the auditors' reports in overseeing the management of NGA and NGH and that had those reports been accurate, the collapse of the corporations and the consequential loss in the value of their shareholdings could have been avoided.

54 To my mind, the first of these submissions suffers from the same difficulties as those regarding the injection of fresh capital by Hercules and Mr. Freed. Whether the reports were relied upon in assessing the prospect of further investments or in evaluating existing investments, the fact remains that the purpose to which the respondents' reports were put, on this claim, concerned individual or personal investment decisions. Given that the reports were not prepared for that purpose, I find for the same reasons as those earlier set out that policy considerations regarding indeterminate liability inhere here and, consequently, that no duty of care is owed in respect of this claim.

55 As regards the second aspect of the appellants' claim concerning the losses they suffered in the diminution in value of their equity, the analysis becomes somewhat more intricate. The essence of the appellants' submission here is that the shareholders would have supervised management differently had they known of the (alleged) inaccuracies in the 1980-82 reports, and that this difference in management would have averted the demise of the audited corporations and the consequent losses in existing equity suffered by the shareholders. At first glance, it might appear that the appellants' claim implicates a use of the audit reports which is commensurate with the purpose for which the reports were prepared, i.e., overseeing or supervising management. One might argue on this basis that a duty of care should be found to inhere because, in view of this compatibility between actual use and intended purpose, no indeterminacy arises. In my view, however, this line of reasoning suffers from a subtle but fundamental flaw.

56 As I have already explained, the purpose for which the audit reports were prepared in this case was the standard statutory one of allowing shareholders, as a group, to supervise management and to take decisions with respect to matters concerning the proper overall administration of the corporations. In other words, it was, as Lord Oliver and Farley J. found in the cases cited above, to permit the shareholders to exercise their role, as a class, of overseeing the corporations' affairs at their annual general meetings. The purpose of providing the auditors' reports to the appellants, then, may ultimately be said to have been a "collective" one; that is, it was aimed not at protecting the interests of individual shareholders but rather at enabling the shareholders, acting as a group, to safeguard the interests of the corporations themselves. On the appellants' argument, however, the purpose to which the 1980-82 reports were ostensibly put was not that of allowing the shareholders as a class to take decisions in respect of the overall running of the corporation, but rather to allow them, as individuals, to monitor management so as to oversee and protect their own personal investments. Indeed, the nature of the appellants' claims (i.e. personal tort claims) requires that they assert reliance on the auditors' reports qua individual shareholders if they are to recover any personal damages. In so far as it must concern the interests of each individual shareholder, then, the appellants' claim in this regard can really be no different from the other "investment purposes" discussed above, in respect of which the respondents owe no duty of care.

57 This argument is no different as regards the specific case of the appellant Guardian, which is the sole shareholder of NGH. The respondents' purpose in providing the audited reports in respect of NGH was, we must assume, to allow Guardian to oversee management for the better administration of the corporation itself. If Guardian in fact chose to rely on the reports for the ultimate purpose of monitoring its own investment it must, for the policy reasons earlier set out, be found to have done so at its own peril in the same manner as shareholders in NGA. Indeed, to treat Guardian any differently simply because it was a sole shareholder would do violence to the fundamental principle of corporate personality. I would find in respect of both Guardian and the other appellants, therefore, that the prima facie duty of care owed to them by the respondents is negated by policy considerations in that the claims are not such as to bring them within the "exceptional" cases discussed above.

Issue 2:

The Effect of the Rule in Foss v. Harbottle

58 All the participants in this appeal -- the appellants, the respondents, and the intervener -- raised the issue of whether the appellants' claims in respect of the losses they suffered in their existing shareholdings through their alleged inability to oversee management of the corporations ought to have been brought as a derivative action in conformity with the rule in Foss v. Harbottle rather than as a series of individual actions. The issue was also raised and discussed in the courts below. In my opinion, a derivative action -- commenced, as required, by an application under s. 232 of the Manitoba Corporations Act -- would have been the proper method of proceeding with respect to this claim. Indeed, I would regard this simply as a corollary of the idea that the audited reports are provided to the shareholders as a group in order to allow them to take collective (as opposed to individual) decisions. Let me explain.

59 The rule in Foss v. Harbottle provides that individual shareholders have no cause of action in law for any wrongs done to the corporation and that if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action. The legal rationale behind the rule was eloquently set out by the English Court of Appeal in Prudential Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354, at p. 367, as follows:

> The rule [in Foss v. Harbottle] is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder. When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting. The law confers on him the right to ensure that the company observes the limitations of its memorandum of association and the right to ensure that other shareholders observe the rule, imposed on them by the articles of association. If it is right that the law has conferred or should in certain restricted circumstances confer further rights on a shareholder the scope and consequences of such further rights require careful consideration.

To these lucid comments, I would respectfully add that the rule is also sound from a policy perspective, inasmuch as it avoids the procedural hassle of a multiplicity of actions.

60 The manner in which the rule in Foss v. Harbottle, supra, operates with respect to the appellants' claims can thus be demonstrated. As I have already explained, the appellants allege that they were prevented from properly overseeing the management of the audited corporations because the respondents' audit reports painted a misleading picture of their financial state. They allege further that had they known the true situation, they would have intervened to avoid the eventuality of the corporations' going into receivership and the consequent loss of their equity. The difficulty with this submission, I have suggested, is that it fails to recognize that in supervising management, the shareholders must be seen to be acting as a body in respect of the corporation's interests rather than as individuals in respect of their own ends. In a manner of speaking, the shareholders assume what may be seen to be a "managerial role" when, as a collectivity, they oversee the activities of the directors and officers through resolutions adopted at shareholder meetings. In this capacity, they cannot properly be understood to be acting simply as individual holders of equity. Rather, their collective decisions are made in respect of the corporation itself. Any duty owed by auditors in respect of this aspect of the shareholders' functions, then, would be owed not to shareholders qua individuals, but rather to all shareholders as a group, acting in the interests of the corporation. And if the decisions taken by the collectivity of shareholders are in respect of the corporation's affairs, then the shareholders' reliance on negligently prepared audit reports in taking such decisions will result in a wrong to the corporation for which the shareholders cannot, as individuals, recover.

61 This line of reasoning finds support in Lord Bridge's comments in Caparo, supra, at p. 580:

> The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy. But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders . . . will be recouped by a claim against the auditor in the name of the company, not by individual shareholders. [Emphasis added.]

It is also reflected in the decision of Farley J. in Roman I, supra, the facts of which were similar to those of the case at bar. In that case, the plaintiff shareholders brought an action against the defendant auditors alleging, inter alia, that the defendant's audit reports were negligently prepared. That negligence, the shareholders contended, prevented them from properly overseeing management which, in turn, led to the winding up of the corporation and a loss to the shareholders of their equity therein. Farley J. discussed the rule in Foss v. Harbottle and concluded that it operated so as to preclude the shareholders from bringing personal actions based on an alleged inability to supervise the conduct of management.

62 One final point should be made here. Referring to the case of Goldex Mines Ltd. v. Revill (1974), 7 O.R. (2d) 216 (C.A.), the appellants submit that where a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action. Nothing in the foregoing paragraphs should be understood to detract from this principle. In finding that claims in respect of losses stemming from an alleged inability to oversee or supervise management are really derivative and not personal in nature, I have found only that shareholders cannot raise individual claims in respect of a wrong done to the corporation. Indeed, this is the limit of the rule in Foss v. Harbottle. Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder qua individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out.

63 The facts of Haig, supra, provide the basis for an example of where such a claim might arise. Had the investors in that case been shareholders of the corporation, and had a similarly negligent report knowingly been provided to them by the auditors for a specified purpose, a duty of care separate and distinct from any duty owed to the audited corporation would have arisen in their favour, just as one arose in favour of Mr. Haig. While the corporation would have been entitled to claim damages in respect of any losses it might have suffered through reliance on the report (assuming, of course, that the report was also provided for the corporation's use), the shareholders in question would also have been able to seek personal compensation for the losses they suffered qua individuals through their personal reliance and investment. On the facts of this case, however, no claims of this sort can be established.

Conclusion

64 In light of the foregoing, I would find that even though the respondents owed the appellants (qua individual claimants) a prima facie duty of care both with respect to the 1982-83 investments made in NGA and NGH by Hercules and Mr. Freed and with respect to the losses they incurred through the devaluation of their existing shareholdings, such prima facie duties are negated by policy considerations which are not obviated by the facts of the case. Indeed, to come to the opposite conclusion on these facts would be to expose auditors to the possibility of indeterminate liability, since such a finding would imply that auditors owe a duty of care to any known class of potential plaintiffs regardless of the purpose to which they put the auditors' reports. This would amount to an unacceptably broad expansion of the bounds of liability drawn by this Court in Haig, supra. With respect to the claim regarding the appellants' inability to oversee management properly, I would agree with the courts below that it ought to have been brought as a derivative action. On the basis of these considerations, I would find under Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules that the appellants have failed to establish that their claims as alleged would have "a real chance of success".

65 I would dismiss the appeal with costs.

cp/d/hbb/DRS/DRS

TAB 4

CANADIAN BUSINESS CORPORATIONS LAW

SECOND EDITION

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misconduct of the liquidator. Generally, if the liquidator has done anything which the liquidator ought not to have done, the remedy is to pursue the matter in the accounting.[246]

E. PROVISIONS OF GENERAL APPLICATION RELATING TO LIQUIDATION

(i) Administration of the Corporate Estate

§15.103 So far we have considered only the special rules that apply to voluntary liquidation (in contrast to liquidation under court order). As a general rule, however, the rules and procedures applicable to both classes of wind-up are the same. More specifically, sections 220 to 236 of the OBCA set out a number of rules of general application which apply to both voluntary and court ordered wind-ups. Before looking at those provisions in detail, it is worth noting that the winding-up provisions of the OBCA (and also those of the CBCA and other corporate law statutes, for that matter) are directed toward a number of consistent objectives. These include:[247]

- the equitable treatment of all creditors and other claimants against the corporation;
- the avoidance of preferences;
- the disposition of the assets of the corporation on the most favourable terms, to the betterment of all persons who are interested in the corporation;
- to provide a single procedure and process for marshalling the assets of the corporation and applying them to the payment of its liabilities;
- the avoidance of the flood of claims that might otherwise arise upon the decision to wind up the corporation, as every person with a claim or potential claim against the corporation seeks to make sure that its claim will be properly paid;[248]
- the minimization of the administrative and professional costs associated with resolving all outstanding issues relating to the business and affairs of the corporation (in particular discouraging any race to the courthouse and the institution of numerous lawsuits both by and against the corporation); and

246 *Commonwealth Investors Syndicate Ltd. v. KPMG Inc.*, [2005] B.C.J. No. 18, 7 C.B.R. (5th) 90 at para. 22.

247 See, generally, *F.D.I.C. as receiver for Buena Vista Bank & Trust Company v. American Casualty Co. of Reading*, 843 P.2d 1285 (S.C. Colo. 1992) — although this decision was with respect to the liquidator of an insolvent bank, much of the discussion is equally applicable in all liquidation contexts.

248 *Stewart v. LePage*, [1916] S.C.J. No. 29, 53 S.C.R. 337 at para. 62, *per* Brodeur J.: "The object of this legislation is to prevent litigation being carried on by anyone prejudicial to the estate, to prevent the assets being dissipated by law suits, and to have all such matters decided promptly by a summary petition."

- where recovery from contributories is necessary, ensuring the equitable apportionment of losses and minimizing litigation.

The basic duty of the liquidator is set out in clause 221(1)(*a*) of the Act. It requires the liquidator to apply the property of the corporation in satisfaction of all its debts, obligations and liabilities and — subject to their prior payment of creditors — to distribute the property ratably among the shareholders according to their rights and interests in the corporation.

§15.104 The above summary of the principles regarding the administration of the corporate estate is deceptively simplified insofar as it suggests that there will be little controversy with respect to how those principles are to be applied. Often, those who have an interest in the amount realized will complain that a better offer could have obtained for corporate assets, using some other method of sale or disposition than that which the liquidator has employed. In a surprisingly large number of cases, a "late offer" will materialize for corporate assets that appears to better the offer for those assets than the offer accepted by the liquidator. In such cases, the court may be asked to overturn the liquidator's decision.

§15.105 There can be little argument with the general proposition that where the liquidation is proceeding under the supervision of the court, it is the responsibility of the court to see that the above objectives are attained to as great an extent as possible.[249] It is self-evident, however, that as a practical matter, the day-to-day discharge of these responsibilities will be entrusted to the liquidator who (while subject to the overall control of the court) will necessarily exercise a great deal of discretion and decision-making authority. Indeed, clause 221(1)(*a*) and section 223 of the OBCA makes clear that this will be the case.[250] There is considerable case law with respect to the oversight that courts are expected to exercise over trustees-in-bankruptcy and court-appointed receiver-managers with respect to the provident administration of corporate estates. Much of this case law would seem to be directly applicable to court-appointed liquidators.

§15.106 Since the decision in *Crown Trust Co. v. Rosenberg*,[251] it has been accepted that the courts may place reasonable reliance upon the decisions made and recommendations given by such court-appointed officers with respect to the

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249 See, for instance, *Re Christian Brothers of Ireland*, [2004] O.J. No. 359, 69 O.R. (3d) 507 at para. 36 (S.C.J.), *per* Blair J.

250 See, however, subsection 217(1), which provides:

> 217.(1) Where the realization and distribution of the property of a corporation being wound up under an order of the court has proceeded so far that in the opinion of the court it is expedient that the liquidator should be discharged and that the property of the corporation remaining in the liquidator's hands can be better realized and distributed by the court, the court may make an order discharging the liquidator and for payment, delivery and transfer into court, or to such person as the court directs, of such property, and it shall be realized and distributed by or under the direction of the court among the persons entitled thereto in the same way as nearly as may be as if the distribution were being made by the liquidator.

251 [1986] O.J. No. 2990, 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.).

sale of assets and other aspects of administration. In many cases, the language suggests a degree of "deference" to the views of the officers concerned, but perhaps a more appropriate description is that of reasonable reliance upon the professional competence and integrity of the officer, in the absence of reason to doubt that such competence and integrity has been exercised.[252] Realistically speaking, any rigorous and ongoing process of micromanagement by the court would essentially defeat the very purpose of appointing an officer such as a liquidator.

§15.107 The liquidator's administration of the corporation's business and affairs, and its dealing with the assets of the corporation should be conducted in a manner that is as transparent as is consistent with the best interests of the corporation and those who are interested in it.[253] Accordingly, the basis for any recommendation should be reasonably clear and capable of explanation. The process followed must be commercially reasonable and fair from the perspective of potential purchasers, creditors and debtors alike. It is equally important from the perspective of preserving public confidence in the liquidation process that the procedure have the appearance of being fair and reasonable.[254] In *Royal Bank of Canada v. Soundair Corp.*[255] the Ontario Court of Appeal approved the summary of the responsibilities of the court with respect to any dispute concerning a proposed sale of corporate assets, as set out in the Crown Trust decision. It stated that the court must:

(a) consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;

(b) consider the interests of all parties;

(c) consider the efficacy and integrity of the process by which offers are obtained; and

(d) consider whether there has been unfairness in the working out of the process.

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[252] *Re Regal Constellation Hotel Ltd.*, [2004] O.J. No. 2744, 71 O.R. (3d) 355 at para. 23 (C.A.), *per* Blair J.A.

> Although the courts will carefully scrutinize the procedure followed by a receiver, they rely upon the expertise of their appointed receivers, and are reluctant to second-guess the considered business decisions made by the receiver in arriving at its recommendations. The court will assume that the receiver is acting properly unless the contrary is clearly shown.

[253] See, generally, *Re Wagman*, [2006] O.J. No. 1579, 21 C.B.R. (5th) 144 at para. 10 (S.C.J.), *per* Registrar Nettie.

[254] *Toronto-Dominion Bank v. Crosswinds Golf & Country Club Ltd.*, [2002] O.J. No. 1398, 59 O.R. (3d) 376 (S.C.J.), *per* Wilson J.

[255] [1991] O.J. No. 1137, 4 O.R. (3d) 1 at 42 (C.A.), *per* Galligan J.A.

In *Skyepharma PLC v. Hyal Pharmaceutical Corp.*,[256] Farley J. described the required effort on the part of a receiver (or liquidator) to obtain the best price in the following terms:

> A receiver's duty is not to obtain the best possible price but to do everything reasonably possible in the circumstances with a view to obtaining the best price ... Other offers are irrelevant unless they demonstrate that the price in the proposed sale was so unreasonably low that it shows the receiver as acting improvidently in accepting it. It is the receiver's sale not the sale by the court... The receiver, after a reasonable analysis of the risks, advantages and disadvantages of each offer (or indication of interest if only advanced that far) may accept an unconditional offer rather than risk delay or jeopardize closing due to conditions which are beyond the receiver's control. Furthermore, the receiver is obviously reasonable in preferring any unconditional offer to a conditional offer ...
>
> .....
>
> Provided a receiver has acted reasonably, prudently and not arbitrarily, a court should not sit as in an appeal from a receiver's decision, reviewed in detail every element of the procedure by which the receiver made the decision (so long as that procedure fits with the authorized process specified by the court if a specific order to that affect has been issued). To do so would be futile and duplicative.

In *Re Selkirk*,[257] the court stated that:

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

Certainty, credibility and predictability in this disposition process are required to ensure that good prices can be obtained where a corporation is in liquidation. Prospective purchasers must have confidence that negotiations with liquidators can be relied upon and will be adhered to without undue interference from the court.[258] In practice, it is difficult to challenge the liquidator's recommendation with respect to sale where it follows reasonable advertisement, the property is put on the market for an apparently reasonable period of time, and the offering price was based upon an apparently reliable appraisal prepared by a qualified appraiser.

§15.108 The courts may also place reasonable reliance upon the recommendations made by a liquidator concerning the settlement of claims against the corporation,

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256 [1999] O.J. No. 4300, 12 C.B.R. (4th) 87 at paras. 4, 5 and 7 (S.C.J. — C.L.), appeal quashed [2000] O.J. No. 467, 47 O.R. (3d) 234 (C.A.).

257 [1987] O.J. No. 2006, 64 C.B.R. (N.S.) 14 at 142 (Gen. Div.) *per* McRae J.

258 *Toronto-Dominion Bank v. Crosswinds Golf & Country Club Ltd.*, [2002] O.J. No. 1398, 59 O.R. (3d) 376 (S.C.J.), *per* Wilson J.

but here the extent of reliance is more qualified and limited in scope than in the case of the sale of the assets of the corporation. The general approach of the courts in this regard was explained in *Re Ravelston Corp.*,[259] in which Farley, J. stated:

> ... it seems to me that there is a subtle distinction to make between reliance on a receiver's commercial expertise concerning a recommended sale and the receiver's expertise in regards to a settlement of a legal dispute (while of course taking into account that such a receiver will have had appropriate legal advice from its own counsel). That distinction is based on the fact that the court is the "expert" in respect of the law and will generally be in a better position to assess the law involved in a situation than it would be as to the commercial aspects of a sale of property. In this regard, one may wish to consider the analogous situation of expert opinions as discussed in *R. v. Mohan*.[260] Thus it seems to me that the court, with the assistance of counsel (both counsel supporting the approval of a settlement and counsel opposing), should conduct an analysis of the strengths and weaknesses of the case, including the general vagaries of litigation plus the benefits of certainty and the avoidance of delay concerning possible appeals, sufficient for the court to conclude that the proposed settlement fell within the range of what was fair and commercially reasonable. The case here involved an all or nothing result if the case went on to a court decision.

However, where the range of claims against a corporation is highly complex, and the liquidator has been specifically entrusted by the court with developing an overall process to treat all claimants who have similar claims reasonably and equally, and the receiver has developed a systematic method for doing so, drawing upon suitable professional expertise and experience, the court may rely upon the liquidator's recommendations.[261]

(ii) Effect of the Liquidation Upon the Directors of the Corporation

§15.109 Clause 221(1)(*c*) of the OBCA provides that upon a winding-up, all the powers of the directors cease upon the appointment of a liquidator, "except in so far as the liquidator may sanction the continuance of such powers". This wording is ambiguous: if the liquidator sanctions the directors to exercise powers, do they exercise those powers as directors or as agents of the liquidator?[262] Whichever view one takes of this question, it is clear that unlike a receivership, in a liquidation (whether voluntary or involuntary) there is no residual power left in the directors as such to commence any proceeding on behalf of the corporation, to petition it into bankruptcy or to seek relief under the *Companies' Creditors Arrangement Act*.[263] However, not all statutes providing for the liquidation of a corporation have such an exhaustive consequence. In particular, the fact that a

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259 [2005] O.J. No. 3802, 14 C.B.R. (5th) 207 at para. 3 (S.C.J. — C.L.).

260 [1994] S.C.J. No. 36, [1994] 2 S.C.R. 9.

261 See, for instance, *Re Christian Brothers of Ireland*, [2004] O.J. No. 359, 69 O.R. (3d) 507 at para. 39 (S.C.J.), *per* Blair J.

262 *Re Country Traders Distributors Ltd.*, [1974] 2 N.S.W.L.R. 135 (S.C.), *per* Mahoney J.

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

corporation is being liquidated under the *Bankruptcy and Insolvency Act* does not destroy the corporate entity or fully restrict its ability to function as a corporation. It continues to exist as a corporation, and to possess certain rights and capacities, such as the power to waive its solicitor-client privilege. The exercise of these residual capacities will usually be complicated by the fact that the corporation will have no officers or directors and so no present means to exercise them, but in such cases a shareholders' meeting may be held for the election of directors.[264]

§15.110 There is an implicit intent in any liquidation proceeding that it be concluded as quickly as the circumstances will allow — ideally with the minimum of expense consistent with prudent administration of the corporation and the closure of its estate. The phrase "as quickly as the circumstances will allow" should not be mistaken to mean that a winding-up should (much less, will) necessarily conclude quickly. Large, complex enterprises can take a very lengthy time to close down, particularly where the business and affairs of the enterprise are in disarray. Since the liquidation of a business is to a very large extent the creditors' last real shot at recovering what is owed to them, in certain cases the final resolution of a corporate estate may need to be deferred until such time as the ultimate damages resulting from a wrong can be estimated with reasonable accuracy.[265] Claims brought by the corporation against others may need to proceed through trial and appeal. The prudent disposition of corporate property may also take time. Each possibility can lead to a lengthy liquidation. In *Commonwealth Investors Syndicate Ltd. v. KPMG Inc.*,[266] counsel for the appellant remarked that the winding-up of that company began when he was in high school. Counsel for the respondent topped that claim by remarking that the proceedings began before he was born.

(iii) Absence of a Liquidator

§15.111 Clause 220(*a*) of the OBCA makes clear that where at any time during the course of either a voluntary or court-ordered winding-up there is no liquidator, the court may appoint a person to act as a liquidator on the application of a shareholder. While this clause makes no reference to an application by anyone other than a shareholder, the power of the court to intervene in a voluntary wind-up under subclause 207(1)(*b*)(ii) and subsections 208(1) and 210(1) would seem to be sufficient authority for the court to appoint a new liquidator on the application of a creditor or contributory. In any event, until such time as a new liquidator is appointed, the estate and effects of the corporation are under the control of the court.[267]

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264 *Bre-X Minerals Ltd. (Trustee of) v. Verchere*, [2001] A.J. No. 1264, 293 A.R. 73 (C.A.); *Ciriello v. The Queen*, [2000] T.C.J. No. 829, 21 C.B.R. (4th) 9 at 17; *National Trust Co. v. Ebro Irrigation & Power Co.*, [1954] O.J. No. 545, [1954] 3 D.L.R. 326 (H.C.J.); *Shepherd (Trustee) v. Shepherd*, [1997] O.J. No. 4675, 50 C.B.R. (3d) 115 (Gen. Div. — C.L.).

265 See, for example, *Re Fund of Funds Ltd.*, [2004] O.J. No. 2580, 2 C.B.R. (5th) 191 (S.C.J.) — claim bar ordered after 30-year liquidation.

266 [2005] B.C.J. No. 18; 7 C.B.R. (5th) 90 (C.A.).

267 OBCA, s. 220(*b*).

liquidator where all of the creditors and bond holders of a corporation appeared to wish it.

(vii) Rights of Shareholders

§15.134 The two basic rights of the shareholders in a liquidation of a corporation are: (1) to insist upon an accounting by the liquidator of his or her conduct of the liquidation and the property of the corporation disposed of;[338] and (2) after the application of the property of the corporation in satisfaction of all its debts, obligations and other liabilities, to receive a ratable distribution among themselves of the remaining property of the corporation, according to the rights and interests of each shareholder concerned in the corporation. The liquidation of a corporation is a matter in which all shareholders have a common interest, and no one shareholder or group of shareholders may be charged with the costs of the liquidation of the corporation, even where other shareholders or groups of shareholders opposed the liquidation.[339]

§15.135 The right of the shareholders to receive a distribution constitutes a return of share capital rather than a dividend. In the absence of a contrary provision in the articles, the shares of a corporation are presumed to be equal and all are entitled to share equally in the surplus assets remaining after payment of the creditors and the return of stated capital held in respect of each class of shares to the shareholders of those classes.[340] Clearly where a shareholder purchased shares from a prior shareholder, the amount paid at the time of purchase from that prior shareholder is irrelevant to determine the current shareholder's entitlement. However, all holders of the shares of the same class are entitled to receive an equal share of the amount payable to them, irrespective of the amount originally paid to the corporation in respect of the issue of the shares concerned.[341] The following example illustrates the application of this rule:

338 OBCA, s. 205(1).

339 *Reader v. Crown Laundry & Dry Cleaning Co.*, [1986] N.J. No. 116, 61 Nfld. & P.E.I.R. 186, 185 A.P.R. 186 (T.D.).

340 *Re Porto Rico Power Co.; International Power Co. v. McMaster University*, [1946] S.C.J. No. 4, [1946] S.C.R. 178.

341 *Superstein v. Albertawest Forest Products Corp. (Liquidators of)* (1966), 58 W.W.R. 147 at 153-54, 59 D.L.R. (2d) 580 (Alta. C.A.), *per* McDermid J.A.

TAB 5

Indexed as:

Hillcrest Housing Ltd. (Re)

IN THE MATTER OF the Winding-up Act, R.S.P.E.I. 1974, Cap. W-7;
AND IN THE MATTER OF Hillcrest Housing Ltd.

[1992] **P.E.I.J. No. 17**

97 Nfld. & P.E.I.R. 124

308 A.P.R. 124

31 A.C.W.S. (3d) 960

Action No. GDC-3960

Prince Edward Island Supreme Court - Trial Division

MacDonald C.J.T.D.

Heard: June 26, 1991
Judgment: January 22, 1992

(21 pp.)

Courts -- Jurisdiction -- Whether Court had jurisdiction to grant interim costs in petition by minority shareholder to wind-up company -- Equity.

This was an application by the petitioner for interim costs in an petition to wind up a company of which the petitioner was a minority shareholder. The petitioner alleged that he lost confidence in the management of the company, that there were violations of company law and bylaws and that he feared loss of his investment. At issue was whether the Court had jurisdiction to order interim costs.

HELD: The Court did have inherent jurisdiction to order interim costs. Nowhere in the Winding-up Act could it be found that indemnity could not be awarded in the circumstances. The defendant was using the company's money to conduct his defence while the petitioner had to fund his costs from his own resources. Such a situation cried for equitable relief. The petitioner had a reasonable case.

STATUTES, REGULATIONS AND RULES CITED:

Business Corporations Act, S.O. 1982, c. 4. Corporations Act, R.S.O. 1960, c. 71, s. 258. Courts of Justice Act, S.O. 1984, c. 11. Supreme Court Act, R.S.P.E.I. 1988, c. S-10, ss. 2(1), 53(1). Winding-Up Act, R.S.C. 1970, c. W-10, s. 13. Winding-Up Act, R.S.P.E.I. 1974, c. W-7, s. 25.

CASES CITED:

Attorney General of Canada v. Cardinal Insurance Company (1983), 20 B.L.R. 9; Re R.J. Jowsey Mining Co. Ltd. (1969), 2 O.R. 549; Hill v. Hill (1988), 63 O.R. (2d) 618; Cook v. Ip (1985), 52 O.R. (2d) 289, 22 D.L.R. (4th) 1; Re Schmarr, [1902] 1 Ch. 326 (C.A.) Foss v. Harbottle (1843), 2 Hare 461, 67 E.R. 189 (Ch. D.); Wallersteiner v. Moir (No. 2), [1975] 1 Q.B. 373, [1975] 1 All E.R. 849 (C.A.); Turner v. Mailhot (1985), 50 O.R. (2d) 561.

TEXTS CITED:

Pennington's Company Law 4th ed. (Butterworths, 1979) p. 585, 588; Palmer's Company Law 24th ed. Vol. 1 (Stevens & Sons, 1987), p. 976; Gower's Principles of Modern Company Law 4th ed. (Stevens & Sons, 1979), p. 647; Corporate Law in Canada (Butterworths, 1984), p. 517, p. 648, p. 518.

David W. Hooledy and James T. Revell, for the Petitioner.
William G. Lea, Q.C. and Kenneth L. Godfrey, for the Respondents.

MACDONALD C.J.T.D.:-- On August 17, 1982, Richard Wedge presented a petition under the Winding-up Act, R.S.P.E.I. 1974, Cap. W-7 to wind up Hillcrest Housing Limited ("Hillcrest"). The petitioner and his family members have approximately a one-third interest in Hillcrest. The remaining two-thirds interest is basically held by Dr. Hubert MacNeill and his family members. There are some other shareholders but their holdings are small. The grounds for making a court ordered winding-up order are stated as being a loss of confidence by Wedge in the management of Hillcrest, violations of company law and by-laws of Hillcrest by the Board (the "MacNeills"), the exclusion of Wedge and his family from participation in the management of Hillcrest and fears of loss of his investment in Hillcrest through the action of the MacNeill group.

The action has dragged on for many years and at the present time the respondent (Hillcrest) is presenting its evidence. Wedge has now made an application to me for interim costs. The question is whether interim costs may be awarded under s. 25 of the Winding-up Act, and, if so, what evidence is relevant to the exercise of the court's discretion in awarding interim costs.

Section 25 of the Winding-up Act:

Section 25 reads as follows:

> 25. The court may make the order applied for or may dismiss the petition with or without costs, may adjourn the hearing conditionally or unconditionally, or may make any interim or other order, and upon the making of the order may, according to its practice and procedure refer the proceedings for the winding up and delegate any powers of the court conferred by this Act to any officer of the court.

The petitioner, Wedge, states that s. 25 confers a broad jurisdiction upon the court which would allow it to award interim costs and, in particular, emphasizes the words "... may adjourn the hearing conditionally or unconditionally or may make an interim order or other order that it deems just ...".

The petitioner cites the case of Attorney General of Canada v. Cardinal Insurance Company (1983), 20 B.L.R. 9, where Justice White of the Ontario Supreme Court was considering conditions that he should attach to a winding-up order which would allow the company to preserve its rights against third parties. In Cardinal, s. 13 of the Winding-Up Act, R.S.C. 1970, c. W-10 is for all intent and purpose similar to s. 25 of the Prince Edward Island Act. Justice White interpreted the section he was dealing with broadly and inserted a condition in the winding-up order in order to do justice.

The respondent, however, refers to an earlier case from the Ontario Court of Appeal, namely, Re R. J. Jowsey Mining Co. Ltd. (1969), 2 O.R. 549. There Laskin, J.A. speaking for himself and MacKay, J.A. dealt with s. 258 of the Corporations Act, R.S.O. 1960, C-71, a section similar to s. 25, except that after the words "or may make any interim or other order" in our Act the Ontario Act stated "as is deemed just". However, I do not see the latter words as playing any part in the Jowsey decision. At p. 550 Laskin, J.A. stated:

> I hold the view that s. 258, implementing s. 256 and being in turn supplemented by s. 259, is concerned with orders directed to a winding-up and not to an alternate remedy. The orders ('interim or other order as is deemed just') which may be made under s. 258 on a winding-up application (short of dismissal of the application) are ancillary orders, referable to a winding-up and which may result ultimately in dismissal or granting of the application according to whether the terms of such ancillary orders are or are not observed. I do not read s. 258 as empowering the Court to stay a winding-up application and introduce an entirely independent remedy that will operate outside of a prospective winding-up.

In both Cardinal and Jowsey conditions upon a winding-up order were under consideration.

Whether or not a wide construction should be placed on s. 25, I do not see the Jowsey decision as being a detriment to the petitioner's position in the present matter. The present matter does not concern a final winding-up order nor does it relate to any type of winding-up order with conditions, nor is it related to any other remedy in substitution for a winding-up order.

In Jowsey, Laskin, J.A. stated that the section under review did provide "considerable scope for interim adjustments". At p. 551 he stated:

> Its reference to 'other orders' must be given substance, and, having regard to the context of the section I would construe those words as pointing to orders in furtherance of or otherwise in connection with a present or prospective winding up order.

The order sought here is for interim costs. It is not an order for winding-up or any other type of independent remedy in substitution for the winding-up order. It can be more properly classified as an order in furtherance of a prospective winding-up order.

The respondent makes the further argument that the matter of interim costs is not provided for in s. 25 or in any other section of the Winding-up Act. Section 25, the respondent states, only refers to the granting of costs when an order of winding-up has been made or dismissed. I am unable to accept such a position. Merely because the Act deals with the award of costs when the application is allowed or dismissed does not mean that the court cannot award costs in any other instance. In fact, provision is made for the award of "any interim or other order".

Section 53(1) of the Supreme Court Act, R.S.P.E.I. 1988, Cap. s-10 reads:

> 53.(1) Subject to the express provision of any statute, the costs of and incidental to all proceedings authorized to be taken in court or before a judge are in the discretion of the court or judge, and the court or judge has full power to determine by whom and by what extent the costs shall be paid. [Emphasis added]

I do not see s. 25 of the Winding-up Act as expressly taking away the inherent authority of the court to award costs.

Section 2(1) of the Supreme court Act sets forth the jurisdiction of the Court:

> 2.(1) The Supreme Court of Prince Edward Island as constituted before this Act shall continue as a superior court of record having criminal and civil jurisdiction, with all the jurisdiction, power and authority historically exercised by courts of common law and equity in England and Prince Edward Island.

A similar provision in the Ontario Courts of Justice Act, S.O. 1984, c. 11, s. 2(1) was considered by Fitzgerald, L.J.S.C. in the case of Hill v. Hill (1988), 63 O.R. (2d) 618 and at p. 620

he stated:

> This general jurisdiction has been broadly interpreted to include all powers necessary to do justice between the parties, and except where provided specifically to the contrary in valid legislation, the court's jurisdiction is unlimited and unrestricted in substantive law.

In Cook v. IP (1985), 52 O.R. (2d) 289, 22 D.L.R. (4th) 1, the Ontario Court of Appeal was dealing with a situation where the Ontario Health Insurance Plan (O.H.I.P.) refused to produce to the defendant in a personal injuries action the medical records of the plaintiff despite the plaintiff's authorization. The court stated that there was an inherent jurisdiction to ensure that all relevant documents were before it. While acknowledging that the Legislature could by statute prohibit the production of medical records, the court stated that such prohibition must be clear and unambiguous. Therefore, except where provided specifically to the contrary, the court's jurisdiction is unlimited and unrestricted in substantive law in civil matters.

One final reference to this point is found in the case of Re Schmarr, [1902] 1 Ch. 326 (C.A.). In that case an Act excepted certain situations from the power of the court to award costs. In effect the Act made no reference to certain situations while allowing the court to award costs in other situations. Vaughan Williams, L.J. at p. 328 said:

> It is true that s. 80 authorizes the court to give costs only in cases other than those which are excepted. But then comes s. 5 of the Act of 1890, [similar to s. 53(1) of the Supreme Court Act] which in my opinion places these excepted costs in the discretion of the court or judge.

> Stirling, L.J. at p. 329 had this to say:

> It seems to me that s. 80 only abstains from conferring jurisdiction in such a case, but that it does not amount to a legislative prohibition of giving any costs even of proceeding in court in the excepted cases.

Section 25 of the Winding-up Act does not provide any clear statement of legislative intent to disallow the awarding of interim costs. In the circumstances the jurisdiction of the court has not been ousted, leaving the court with its inherent jurisdiction. Section 25 only abstains from conferring jurisdiction in a case where interim costs are asked for under s. 25 of the Winding-up Act. This leaves the court with its discretion to award costs in the present matter. I find that s. 25 allows the awarding of interim costs but, if it does not, it does not expressly exclude making an award leaving the court with its inherent discretion to do so.

In my opinion the matter can be resolved in the above manner. However, because the parties have dealt with the matter in a different manner I will deal with their presentations. The applicant's main submission was that the Winding-up Act permitted the awarding of costs and drew an analogy with the awarding of costs in a derivative action.

The applicant submitted that the principles applicable to derivative actions in the award of costs should be applied in the present matter. The respondent states that the derivative action cases have no application to a winding-up action. It is necessary to review the basis upon which costs have been awarded in a derivative action to determine if the same principles might be applicable here.

For a proper understanding of a derivative action one must start with the rule enunciated in the case of Foss v. Harbottle (1843), 2 Hare 461, 67 E.R. 189 (Ch. D.). In Pennington's Company Law, 4th ed. (Butterworths, 1979) at p. 585 the author states:

> The rule of law known as the rule in Foss v. Harbottle is one which has resulted from the refusal of the court to interfere in the management of a company at the instance of a minority of members who are dissatisfied with the conduct of the company's affairs by the majority or by the board of directors ...
>
> The justification of the rule is the need to preserve the right of the majority to decide how the company's affairs will be conducted, and the ineffectiveness of any attempt by the court to interfere when its decision could be set aside by a resolution of the members.

Therefore, if a complaint is made against the directors of a company alleging that they have, for example, exhibited a lack of care or skill, the company is the proper plaintiff against the directors and in cases involving internal company disputes the company is also the correct plaintiff. Foss v. Harbottle is the type of case resulting from a harm that has been done to the company and the resulting action is being brought to restrain the continuance of that harm.

In addition to the latter type of action, there is an alternative action where the individual shareholder seeks to enforce the company's right by suing in a representative form on behalf of himself and all other shareholders in the company against the wrongdoer. Again, referring to Pennington's Company Law at p. 588 the following appears:

> In certain circumstances an individual member may bring an action to remedy a wrong done to his company or to compel his company to conduct its affairs in accordance with its constitution and the rules of law governing it, even though no wrong has been done to him personally, and even though the majority of his fellow members do not wish the action to be brought. The form of his action in these exceptional cases is peculiar,

> because the plaintiff does not sue in his own right alone, but on behalf of himself and all his fellow members other than those, if any, against whom relief is sought. If the member sues for relief against the company, it must, of course, be made a defendant; if he seeks to enforce a corporate claim against other persons, the company must still be joined as a co-defendant so that it may be bound by the judgment, and so that it may enforce any order giving relief against the substantive defendants.
>
> The individual member's action in these exceptional cases may be described as representative, because it is brought on behalf of per sons other than himself. When relief is sought against third parties for the company's benefit, the action may also be described as derivative, because the individual member sues to enforce a claim which belongs to the company, and his right to sue is derived from it. Representative suits were invented by the Court of Chancery during the eighteenth century and the early years of the last century to enable an action to be brought when the parties wronged by the defendant had the same or similar interests, but were so numerous that they could not conveniently join in the action as co-plaintiffs.

In Palmer's Company Law, 24th ed. Vol. 1 (Stevens & Sons, 1987), the following explanation of the derivative action is given at p. 976:

> The plaintiff is seeking to enforce, not his own right of action, but a right of action vested in or derived from the company. Hence in modern discussions the action is referred to as a derivative action. The alleged wrongdoers are made the defendants in the action, but the company itself is joined as a nominal defendant in order that it can be bound by the judgment. If the action succeeds, any property or damages recovered go, not to the plaintiff, but to the company.

Similarly, in Gower's Principles of Modern Company Law, 4th ed. (Stevens & Sons, 1979), it is stated at p. 647:

> The plaintiff shareholder is not acting as a representative of the other shareholders but as a representative of the company ... this type of action has been given the distinctive name of a 'derivative action', recognizing that its true nature is that the individual member sues on behalf of the company to enforce rights derived from it.

As pointed out by Professor Welling in his book Corporate Law in Canada (Butterworths, 1984), because the cause of action belongs to the corporation, the principle of corporate personality would ordinarily prevent the shareholder form suing. At p. 517 he states:

> However, American judges (where the term derivative action appears to have originated) seem to have cut through the technical difficulty and looked at the economic reality of the situation. They noted that the shareholder is effectively prejudiced, in that any corporate loss is likely to be reflected in lower share prices or lower dividends. Consequently, they were able to identify a second-level right in the shareholder, 'derived' through the corporate entity, to sue the wrongdoer.

Turning to look at the type of wrongs that justify a derivative action, Gower's Principles of Modern Company Law sets forth the conditions that normally must be present. First, the wrong complained of must be such as to involve a fraud on the minority, which could not be validly waived by the company in a general meeting. Such conduct is illustrated in the following actions set forth at p. 648 in Gower:

(a) Expropriation of the property of the company or, in some circumstances, that of the minority,
(b) Breach of the directors' duties of subjective good faith, and
(c) Voting for company resolutions not bona fide in the interest of the company as a whole.

A second condition that must be met to permit a derivative action to proceed is that it must be shown that the alleged wrongdoers control the company. A third condition is that the company must be made a defendant in the action. The reason being that as it is not the plaintiff, the action being in the shareholder's name, it must be a defendant so that the court might award judgment in its favour. Fourthly, the plaintiff shareholder should sue in a representative capacity on behalf of himself and all other members other than the real defendants. Fifthly, the right to bring a derivative action is afforded the individual member as a matter of grace.

These requirements for a derivative action are relevant when looking at the grounds for the successful bringing of a winding-up action, for, in many respects, a derivative action and a winding-up action are similar. While the applicant admits to the distinctiveness of the actions, one being a statutory remedy while the other is not, both actions are available when some wrongdoing has occurred. In such a case the plaintiff selects his action depending on the remedy that is sought.

As earlier stated, the applicant submits that the principles used in awarding costs in a derivative action can be equally applied to a winding-up action. The leading case relating to derivative actions and costs is that of Wallersteiner v. Moir (No. 2), [1975] 1 Q.B. 373, [1975] 1 All E.R. 849 (C.A.). In that case the court held that in a minority shareholder action it could order the company to indemnify the plaintiff against costs incurred in the action. Generally, the basis for that conclusion was because the wrongdoer controlled the company the plaintiff's action was a representative one on behalf of the company for a wrong done to the company and consequently it was a proper exercise of judicial discretion based on the principles of equity (Lord Denning at p. 858). Lord Denning equated an award of costs with the indemnity to which a trustee is entitled from a cestui que trust who is sui juris. At p. 859 Lord Denning stated:

> Seeing that if the action succeeds, the whole benefit will go to the company, it is only just that the minority shareholder should be indemnified against the costs he incurs on its behalf. If the action succeeds, the wrongdoing directors will be ordered to pay the costs; but if they are not recovered from him, they should be paid by the company ...
>
> But what if the action fails? Assuming that the minority shareholder had reasonable grounds for bringing the action - that it was a reasonable and prudent course to take in the interest of the company - he should not himself be liable to pay the costs of the other side, but the company itself should be liable, because he was acting for it and not for himself. In addition, he should himself be indemnified by the company in respect of his own costs even if the action fails.

Lord Buckley also equated the position of a minority shareholder with that of a trustee who sues to protect his trust estate but has no personal interest in the relief sought. Lord Buckley found the minority shareholder's action was a procedural device to get over the difficulty that as a practical matter no authority could be obtained from the company to bring the action in its name. A similar conclusion can be reached in the case of a winding-up action that is not voluntary. The minority shareholder, as stated, is not entitled to the benefits that may come from the action, however, the expenses of making any recovery fall upon the minority shareholder. If the action fails, the minority shareholder is also at risk of paying the defendant's costs.

Lord Buckley came to the same conclusion as Lord Denning, that a minority shareholder should not be inhibited to bring justified actions merely because of the threat of costs. He, along with Lord Denning, stated that the minority shareholder plaintiff should apply to the court at the commencement of the action for an order that the company indemnify the plaintiff against the costs of the action, whether the action succeeds or not. The test they adopted was whether the action was reasonable and prudent in the company's interest.

The present matter has long escalated beyond the stage of the commencement of the action. However, I do not see that as an impediment to the application. In fact, I, at this stage of the action, am in a much better position to determine whether the action is reasonable than I would have been ten years ago. I see the procedure set forth in the Wallersteiner case as being open-ended. The court gave a wide latitude to the plaintiff by allowing the application to be made at the commencement of the action before any evidence was submitted. Further, Lord Denning emphasized that the application should not be allowed to escalate into a minor trial. It is not to be overlooked that in the

Wallersteiner case the action had proceeded to judgment when the application for costs was made. It is also interesting to note that Lord Scarman stated that the plaintiff in the Wallersteiner case should have indemnity for costs already incurred as well as future costs.

In Wallersteiner the court's conclusion was that equity and the court's discretion were in favour of making the requested order. While the present action is based upon s. 25 of the Winding-up Act, equity and the court's discretion are also of prime importance. Nowhere in the Winding-up Act can be found a provision that indemnity cannot be awarded in the present circumstances. Section 25 specifically states that the court may make "any interim or other order".

In equity, the applicant here is in the same position as was the plaintiff in Wallersteiner. In the latter case it was held to be undesirable that a minority shareholder should be inhibited from taking an action, if it was found to be a reasonable one, merely because of the costs involved. The same reasoning should be applied to the present case. The petitioner, J. H. Richard Wedge, who petitions in his own name is in no different position from the minority shareholder who commenced the action in Wallersteiner. It may be that the present petitioner has a greater stake or interest than the minority shareholders in Wallersteiner, but the fact remains that he is a minority shareholder.

The petitioner should be treated as bringing the petition on behalf of the shareholders, of which there are more than those that are included in the Wedge family group. The respondent has strenuously argued that the petitioner's action, if successful, would result in the company's death, and that such a result cannot be said to be a benefit to anyone. I cannot accept such a position. If the respondent company is guilty of violation of company law and the by-laws of the company, or if the company through its directors, who constitute the majority interest, are guilty of misconduct, can it be said that there is a benefit to permit such conduct to continue? It would be an injustice to permit such to continue. The prevention of it would be of benefit to the company.

In considering the equity of the situation, the petitioner's position is that he is attempting to establish misconduct and is faced with a defendant who is using the company's resources to defend the petitioner's action. In doing so the company, through the majority shareholders, is in effect paying for the cost of the defence by using the petitioner's money. For every dollar spent in defence of the petitioner's action, approximately thirty-three cents is coming from what would ordinarily be the petitioner's share of the company's profit. On the other hand, the petitioner must fund his costs from his own resources. Such a situation cries for equitable relief.

A number of Canadian cases were cited where "derivative actions" were before the courts. As pointed out by Professor Welling in Corporate Law in Canada, Canadian courts have used the English and American terminology of derivative action to describe the statutory representative action brought by a complainant under one of the reformed Canadian corporate statutes. At p. 518 he states:

> The Canadian courts are not talking about a shareholder's right derived through the corporation and limited by ordinary principles of corporate

> law; the Canadian courts are using the term 'derivative action' to describe a right derived from the statute, a right limited by extraordinary statutory rules.

I refer to Professor Welling's distinction mainly for the purpose of illustrating that the Canadian cases have dealt with rights that have specifically come from statutes. For example, in the cases of Turner v. Mailhot (1985), 50 O.R. (2d) 561, the Ontario Business Corporations Act, 1982, C-4, provided that in an action brought under the Act the court could make an order requiring the corporation or its subsidiary to pay "reasonable legal fees and any other costs reasonably incurred by the complainant in connection with the action". Because the cases cited dealt with statutory based provisions, they are basically of little benefit to the present action. The common law approach in Wallersteiner is the appropriate authority to follow as guidance in awarding costs if the award were to depend on the analogy of a winding-up action being the same as a derivative action.

Following the latter approach, in considering whether the court has jurisdiction to award costs, either past or future, to the applicant, the factors that I find the applicant would show are first, that the action is one of a minority shareholder seeking redress for wrongs done to the company. Here the action is by a minority shareholder allegedly for wrongs done to the company and himself. The question of the alleged wrongs being justified is to be decided by the second factor, namely, whether the petitioner has a reasonable case. Without, in any way, deciding the issue I find that the applicant at this stage has a reasonable case. A third factor to be established would be to prove that the directors of the company refused to bring the action. There may not be any direct evidence on this point, however, it goes without question that the directors would never have approved of this action and, in fact, have fought it at every stage of the proceedings.

The applicant has suggested additional factors that should be considered, the first being that he has acted in good faith. This is one of the factors enunciated in the Ontario Business Corporations Act and is embodied, in my opinion, within the first factor I listed of the applicant having a reasonable case. A second factor set forth by the applicant, and obviously one that he is willing to prove, is that he is in financial difficulty. In Wallersteiner the financial difficulty of the minority shareholder was not expressed as being a factor in considering whether or not indemnity should be awarded. It was mentioned that the minority shareholder had reached the end of his financial tether, but that was not made a condition of any award. There is no question that in the present case a great deal of money has been expended. So long as the three factors that I have mentioned have been met, the financial status of the applicant should have no bearing.

In conclusion, based on the submission that an action for winding up is closely aligned with a derivative action insofar as the basis for the actions are clearly similar, I find that the court for equitable reasons can award interim costs in this matter. Such costs may be awarded under s. 25 of the Winding-up Act on the general basis that it is equitable in the circumstances to do so. Whether or not all of the factors that must be established in a derivative action have been proven or established in the present instance is not necessarily relevant. I see the principle enunciated in

Wallersteiner as being the relief of an injustice by the granting of equity. Whether or not it is necessary to go through an exercise to equate a derivative action with a winding-up action, may not be necessary so long as the court is willing to recognize that equity must be done.

The respondent wished the court to set forth the factors relevant to the present motion. I have done so and conclude that there is no further evidence necessary on the question of jurisdiction. However, the respondent correctly points out that the question of what costs should be ordered to be paid has not been dealt with. This question relates not only to the present action but to other actions involving the same parties or companies of the principals involved. There is also the question of whether the order should apply to past or future costs or both. It will be necessary to hear from the parties further on this issue.

The respondent states that it would have evidence on the availability of another remedy. I cannot imagine what evidence it would have of an alternative remedy, although it might have a legal submission of such. In any event, I believe it is too late to make such a submission.

MACDONALD C.J.T.D.

Indexed as:

Hillcrest Housing Ltd. v. Wedge (P.E.I.C.A.)

Between
Hillcrest Housing Limited, Appellant, and
J.H. Richard Wedge, Mary Wedge, Paul Wedge, Brian Wedge, Richard H. Wedge, Michelle Strain, and Nicolle Morrison, Respondents

[1992] P.E.I.J. No. 83

94 D.L.R. (4th) 165

100 Nfld. & P.E.I.R. 355

10 C.P.C. (3d) 298

34 A.C.W.S. (3d) 571

Action No. AD-0351

Prince Edward Island Supreme Court - Appeal Division

Carruthers C.J.P.E.I., Mitchell and Mullally JJ.A.

Heard: May 4, 1992
Judgment: June 29, 1992

(21 pp.)

Company law -- Winding-up legislation -- Interim order -- Costs -- Interim costs.

Trial judge awarded interim costs on a winding-up petition under s. 25 of the Winding Up Act. Jurisdiction of the Court to award interim costs questioned. Court of Appeal held that the Court does have jurisdiction to award interim costs. Held that an order for interim costs is in the nature of an order in furtherance of or otherwise in connection with a present or winding-up order.

Cases cited:

Ramawad v. The Minister of Employment and Immigration, [1978] 2 S.C.R. 375; Re R. J. Jowsey Mining Co. Ltd., [1969] 2 O.R. 549; Attorney General of Canada v. Cardinal Insurance Co. (1982), 20 B.L.R. 9; Re Regional Municipality of Hamilton-Wentworth and Hamilton-Wentworth Save the Valley Committee, Inc. et al (1985), 51 O.R. (2d) 23; Re Ontario Energy Board (1985), 51 O.R. (2d) 333; Township of Bruce v. Thornburn et al (1986), 57 O.R. (2d) 77.

Statutes cited:

Winding-up Act, R.S.P.E.I. 1988, Cap. W-5; Immigration Act, R.S.C. 1970, c. I-2; Winding-up Act (Canada); The Consolidated Hearings Act, 1981; Courts of Justice Act, 1984 (Ont.), c. 11.

Kenneth L. Godfrey, for the Appellant.
David W. Hooley, for the Respondents.

CARRUTHERS C.J.P.E.I. (dismissing the appeal):-- This appeal involves the jurisdiction of the Court to award interim costs under s. 25 of the Winding-Up Act, R.S.P.E.I. 1988, Cap. W-5.

BACKGROUND

On August 17, 1982, Richard Wedge presented a petition under the Winding-Up Act, supra, to wind up the appellant, Hillcrest Housing Limited. The hearing of the petition has not been completed as of this date, but it is substantially completed.

On May 17, 1991, the appellant filed a notice of motion seeking, among other things, an order conditionally adjourning the proceeding.

On May 28, 1991, two of the respondents, namely Richard Wedge and Mary Wedge, filed a notice of motion seeking an order for interim costs of the proceedings pursuant to s. 25 of the Winding Up Act. The motion was supported by an affidavit of Brian Wedge, one of the respondents. The affidavit of Brian Wedge was also in response to the appellant's motion for a conditional adjournment. The respondents, therefore, sought an order for interim costs either as a separate order or as a condition of any adjournment that the Court might grant.

The trial judge allowed the appellant's motion and granted a conditional adjournment but he did not make costs a condition of the adjournment.

The trial judge then heard the respondents' motion for interim costs on June 26, 1991. The appellant submitted that the Court does not have any jurisdiction to grant interim costs on a winding up petition. The trial judge took the jurisdictional issue under advisement and gave a decision on January 22, 1992, whereby he held that the Court does have jurisdiction to award such costs.

The appellant now appeals from that decision and submits that the trial judge erred in law in holding that the Court has jurisdiction to award such interim costs.

A question arose at the commencement of the hearing of this appeal as to whether or not the Appeal Division should entertain this appeal before the conclusion of the hearing of the petition. The Court decided has never been dealt with in this jurisdiction before.

ISSUES

The appellant has advanced several grounds of appeal but the crucial issue is whether the provisions of s. 25 of the Winding-Up Act confer jurisdiction on the Court to award interim costs on a winding up petition.

Section 25 of the Winding-Up Act states as follows:

> (25) The court may make the order applied for or may dismiss the petition with or without costs, may adjourn the hearing conditionally or unconditionally, or may make any interim or other order, and upon the making of the order may, according to its practice and procedure refer the proceedings for the winding-up and delegate any powers of the court conferred by this Act to any officer of the Court.

The appellant submits that the provisions of s. 25 of the Winding-Up Act do not give the Court any jurisdiction to award costs prior to a determination of the merits of the case. The respondents, on the other hand, submit that the provisions of s. 25 of the Winding-Up Act give the Court a broad jurisdiction which includes the power to award interim costs.

Counsel have been unable to cite to the Court any authorities where such a provision as s. 25 has been used to grant the relief sought by the respondents. This does not mean, however, that s. 25 of the Winding-Up Act does not contain such jurisdiction.

The language of s. 25 of the Winding-Up Act would appear to confer a broad jurisdiction on the Court. The section may be broken down as follows: The Court may,

(1) make the order applied for (i.e. a winding-up order) with costs;
(2) make the order applied for (i.e. a winding-up order) without costs;
(3) dismiss the petition with costs;
(4) dismiss the petition without costs;
(5) adjourn the hearing conditionally;
(6) adjourn the hearing unconditionally;
(7) make any interim order;

(8) make any other order;

And upon the making of the order, according to the practice and procedure, may

(9) refer the proceedings for the winding-up to any officer of the Court;
(10) delegate any powers of the court conferred by the Act to any officer of the court.

It is clear that the Court does have jurisdiction to award costs in certain instances on a winding-up application. The issue to be resolved is the scope or extent of this jurisdiction. Does it extend to an award of interim costs?

The appellant submits that costs can only be awarded when an order of winding-up has been granted or dismissed. It submits that the Legislature specifically addressed the issue of costs by stating that the petition may be allowed or dismissed with or without costs and, therefore, the court does not have any further jurisdiction in the matter of costs on a winding-up application. It also submits that the maximum "expressio unius est exclusio alterius" applies and relies on the decision of Mr. Justice Pratte of the Supreme Court of Canada in Ramawad v. The Minister of Employment and Immigration, [1978] 2 S.C.R. 375 as authority for its submission.

The trial judge did not accept these submissions. He states on p. 4 of his judgment as follows:

> The respondent (now the appellant) makes the further argument that the matter of interim costs is not provided for in s. 25 or in any other section of the Winding-Up Act. Section 25, the respondent (now the appellant) states, only refers to the granting of costs when an order of winding up has been made or dismissed. I am unable to accept such a position. Merely because the Act deals with the award of costs when the application is allowed or dismissed does not mean that the court cannot award costs in any other instance. In fact, provision is made for the award of 'any interim or other order'.

The wording of s. 258 of the Corporations Act, R.S.O. 1960, c. 71, which is almost identical to the wording of s. 25 of the Winding-Up Act, was considered by the Ontario Court of Appeal in Re R. J. Jowsey Mining Co. Ltd., [1969] 2 O.R. 549. This case deals with an application for a winding-up order. The trial judge concluded that it was just and equitable that Jowsey should be wound up. He held that there was no middle ground and the application for winding up had to be either granted or dismissed. His decision was appealed and the scope of the Court's power on a winding up application was considered. Mr. Justice Laskin (as he then was) states on p. 550:

> During the hearing of the appeal a question was raised as to the scope of the Court's power on a winding-up application, and particularly, whether what I may for convenience call a regulatory or disciplinary order might be made against

> Jowsey and its directors, or whether the power to adjourn the application (conferred by s. 258) conditionally or unconditionally, could be exercised to make the adjournment sine die.

Mr. Justice Laskin was of the view that s. 258 (similar to s. 25 P.E.I. Act) was concerned with orders directed to a winding-up and not to an alternate remedy. He held that s. 258 did not empower the Court to stay a winding-up application and introduce an entirely independent remedy that would operate outside of a prospective winding-up. He continues on pp. 551-552 as follows:

> Reference may aptly be made to s. 278 which permits the Court 'at any time during a winding up' to stay the proceedings altogether or for a limited time upon terms. Although I do not think that an independent remedy can be substituted, s. 258 does provide considerable scope for interim adjustments or directions. Its reference to 'other orders' must be given substance, and, having regard to the context of the section I would construe those words as pointing to orders in furtherance of or otherwise in connection with a present or prospective winding-up order.
>
> Despite the more than century old prototype of our s. 258 in English legislation, we were not referred to any case in which the words 'other order' were construed to permit a remedy outside of the compass of an immediate or prospective winding-up order. Assuming, however, that the words should be read literally and detached from what I think is their context, I am not persuaded that the present case is one where a substitute or alternative remedy should be prescribed. Any possibility of the Court becoming a superior board of directors should be avoided.

The appellant relies on the judgment of Mr. Justice Laskin for a limited scope for s. 25 of the Winding-Up Act. It submits that the words 'interim or other orders' should only be interpreted to mean orders relating to the conduct of the affairs of the company which, if obeyed, could result in the dismissal of the petition and, if disobeyed, could result in it being granted. The appellant further submits that the respondents' application for interim costs is not directed to the conduct of the affairs of the company, but rather to the conduct of the litigation, and, therefore, is outside the scope of s. 25 of the Winding-Up Act.

I do not read the Jowsey case as restricting the Court's jurisdiction to award interim costs. Mr. Justice Laskin was referring to alternate remedies to a winding-up order. He refers to an entirely independent remedy that would operate outside of a prospective winding-up. He expresses the view that such orders are outside the scope of the Court's jurisdiction but he does agree that orders in furtherance of or otherwise in connection with a present or prospective winding-up order are within the Court's jurisdiction. I would find it difficult to classify an order for interim costs as an alternate remedy to a winding-up order or as an entirely independent remedy that would operate outside of a propsective winding-up. I agree with the trial judge that an order for interim costs would be more in the nature of an order in furtherance of or otherwise in connection with a present or winding-up order and, therefore, within the Court's jurisdiction. It is true that the provisions of s. 25 of the Winding-Up Act do not expressly state that the Courts may award interim costs but this, in itself, does not amount to a legislative prohibition which would prevent the Court from awarding interim costs. The Ramawad decision involved the validity of a deportation order and questioned the ability of a Minister of the Crown to delegate powers vested in him to persons not mentioned in the legislation. Mr. Justice Pratte states on p. 381:

> In R. v. Harrison, [1977] 1 S.C.R. 238 my brother Dickson, speaking for the court said, at p. 245, that 'a power to delegate is often implicit in a scheme empowering a Minister to act'. Whether such power exists however or, in other words, whether it may be presumed that the act will be performed not by the Minister but by responsible officers in his Department will depend on the intent of Parliament as it may be derived from amongst other things, the language used in the statute as well as the subject matter of the discretion entrusted to the Minister.

Mr. Justice Pratte then went on to hold that the general framework of the Act and of the regulations was clear evidence of Parliament's intent that the discretionary power entrusted to the Minister was to be exercised by him unless there was any statutory authority to the contrary. He then held that the provisions of s. 67 of the Immigration Act, R.S.C. 1970, c. I-2 denied the Minister the right to delegate the powers vested in him to people not mentioned in s. 67. Section 67 reads:

> (67) The Minister may authorize the Deputy Minister or the Director to perform and exercise any of the duties, powers and functions that may be or are required to be performed or exercised by the Minister under this Act or the regulations, and any such duty, power or function performed or exercised by the Deputy Minister or the Director under the authority of the Minister shall be deemed to have been performed or exercised by the Minister.

I do not agree with the appellant that the foregoing decision of Mr. Justice Pratte now prevents this Court from awarding interim costs to the respondents. Section 67 of the Immigration Act clearly sets forth that the Minister may only authorize the Deputy Minister or the Director to do certain things. There is no indication at all that the Minister may delegate these duties, powers and functions to any one else. On the other hand, the legislature, pursuant to s. 25 of the Winding-up Act, bestowed upon the Court the jurisdiction to make any interim order and to make any other order and I am satisfied that this jurisdiction encompasses the power to make an award of interim costs in the circumstances of this case. I am of the opinion that such an interpretation is well within the scope of the interpretation that Mr. Justice White of the Ontario Supreme Court gave the provisions of s. 13 of the Winding-up Act (Canada), which are similar to s. 25 of the Winding-up

Act (P.E.I.), in Attorney General of Canada v. Cardinal Insurance Co. (1982), 20 B.L.R. 9 where he states on p. 12:

> Now in my respectful opinion, s. 232 of the Business Corporations Act of Ontario is fair and a proviso inspired by that section would cover the failure of justice that I deem exists if I merely make an order winding-up the company. I intend to interpret the words 'or other order that it deems just' as found in s. 13 of the Winding-Up Act broadly enough for me to in effect grant the relief in the way of the condition for the benefit of the shareholders of Cardinal Insurance Company that I could grant if I were dealing with the winding-up of a company to which the Business Corporations Act of Ontario had application. Of course, s. 232 of that Act has no application whatsoever to the proceedings before me. That Act, however, does provide for me a guide of what probably is the justice of the matter.

The appellant also relies on the following three decisions of the Ontario High Court of Justice, Divisional Court, for the proposition that the Court has no jurisdiction to award interim costs.

> Re Regional Municipality of Hamilton-Wentworth and Hamilton-Wentworth Save the Valley Committee, Inc. et al (1985), 51 O.R. (2d) 23.
>
> Re Ontario Energy Board (1985), 51 O.R. (2d) 333.
>
> Township of Bruce v. Thornburn et al (1986), 57 O.R. (2d) 77.

These three cases all deal with costs. The first two deal with the power of boards and tribunals to award interim costs to enable intervenors to appear. The Consolidated Hearings Board held in Save the Valley case that it had jurisdiction to order the applicant to fund, by way of an award of costs in advance, the participation of two citizens groups in the proceedings before it. The appellant submitted that the Board did not have any jurisdiction to award money in advance under the guise of costs. The parties agreed that the jurisdiction to award costs as set out in the statute was the only basis upon which the impugned orders could be made.

Section 7 of The Consolidated Hearings Act, 1981 provided:

> 7(3) Subject to this Act and the regulations, a joint board may determine its own practice and procedure.

(4) A joint board may award the costs of a proceeding before the joint board.
(5) A joint board that awards costs may order by whom and to whom the costs are to be

paid.

(6) A joint board that awards costs may fix the amount of the costs or direct that the amount be taxed, the scale according to which they are to be taxed and by whom they are to be taxed.

Mr. Justice Holland noted that the words used to authorize the Board to award costs were remarkably similar to those in s. 141(1) of the Courts of Justice Act, 1984 (Ont.), c. 11, from which the Courts derive their costs jurisdiction. He states on p. 30:

> As I turn to the issues to be addressed I do so with the acceptance that the language employed by the Legislature is clear and unambiguous. It is of significance that the words there used to authorize the Board to award costs are remarkably similar to those in s. 141(1) of the Courts of Justice Act, 1984 (Ont.), c. 11, from which courts derive their 'costs' jurisdiction. In s. 7 of the Consolidated Hearings Act, 1981, no words appear to lend credence to the suggestion that the Legislature intended to grant to the Board any special powers beyond that traditionally exercised by courts and it would require very clear and cogent language, embodied in the legislation, to do so. Under this Act, the tribunal's power over costs cannot exceed that of the Supreme Court of Ontario. The Legislature may, of course, give such powers to a tribunal, but in my opinion, it has not done so in the Consolidated Hearings Act, 1981, s. 7.

Mr. Justice Holland then deals with the legal meaning of costs and states on pp. 31-32:

> A point of commencement must be that 'costs' as used in the legal sense, is a word having a well-defined meaning. From the earliest times, it has been recognized that the power to award 'costs' must be found in a statute.
>
> The characteristics of costs developed over many years are:
>
> (1) They are an award to be made in favour of a successful or deserving litigant, payable by the loser.
> (2) Of necessity, the award must await the conclusion of the proceeding, as success or entitlement cannot be determined before that time.
> (3) They are payable by way of indemnity for allowable expenses and services incurred relevant to the case or proceeding.
> (4) They are not payable for the purpose of assuring participation in the proceeding.

He then states that there are special cases where an award of costs has been made without regard to one or some of these characteristics. He refers to the following: matrimonial causes, trustee cases, appeals in forma pauperis or by special leave and security for costs.

Mr. Justice Holland then concluded that the Board did not have the jurisdiction to make the impugned orders as its discretion to award costs did not extend that far. He states on p. 43:

> The Board in the application before us clearly attempted to fund intervention in advance of a hearing and before the Board has had an opportunity to determine the value of the contributions to be made by the intervenor to the issue before it. While the Board has a broad discretion in its power to award costs, I am satisfied that this Board has not awarded 'costs' here, but rather has attempted to compel the applicant to provide intervenor funding, something which the Board has no jurisdiction to do.
>
> It is for the Legislature, in clear language, to so empower a board or tribunal, should it be found desirable as a matter of further policy.

Mr. Justice Holland also gave the decision in the Re Ontario Energy Board case and he states on p. 336:

> For reasons given in the Hamilton-Wentworth decision, delivered concurrently this day, which apply equally to the issue in this stated case, the answer is in the negative. The board cannot lawfully order interim costs to be so paid.
>
> What the stated case contemplates, if lawful, is that the Ontario Energy Board would have the power, under the guise of exercising its 'costs' jurisdiction, to provide intervenor funding in advance of a hearing, under certain circumstances, and for the purpose of ensuring contribution to a full and fair hearing of the issue before it.

These two cases can be distinguished from this case in at least two instances: one, is the content of the legislation in question, and, secondly, is the fact that the case now before the Court cannot be classified as a case of intervenor funding. The appellant submits that in reality this appeal is also concerned with intervenor funding or as counsel for the appellant called it "litigation funding". It is my understanding that the intervenor funding was granted to the intervenors regardless of the outcome of the case whereas the interim costs sought by the respondents in this case are not final and will be subject to whatever decision the trial judge makes on costs when he disposes of the winding-up petition. I do not agree that the term "litigation funding" is appropriate terminology when one considers the background of this case and what is really taking place.

The plaintiff in the Township of Bruce case sought a declaration from the Court identifying the subscribers of a municipal telephone system or declaring that the subscribers could not be identified. On application, an order was made adding certain parties as defendants to represent the unascertained subscribers and directing that all reasonable costs incurred by them should be paid by the system, regardless of the outcome. The order was appealed and one of the issues on appeal was whether the local judge was right in ordering that the reasonable incurred and future costs of the Bryce group should be paid by the BMTS upon final judgment in the action, regardless of the outcome. The local judge, in awarding the costs, held that the case was analagous to a trustee situation, which was found by Mr. Justice Holland in the Save the Valley case to be an exception to the general rule. Mr. Justice Southey held for the Divisional Court that the case did not fall within the trustee cases or any of the other exceptions referred to in the decision of the Divisional Court in Save the Valley case and that the local judge had no jurisdiction to make the order he made.

The Township of Bruce case can also be distinguished from this case as well as it did not deal with statutory provisions similar to s. 25 of the Winding-up Act.

I, therefore, am of the opinion that these three decisions of the Ontario Divisional Court do not assist the appellant in this case. I would, therefore, dismiss this ground of appeal.

I do not consider it necessary to deal with the other grounds of appeal concerning jurisdiction to award interim costs since I have found that s. 25 of the Winding-up Act bestows jurisdiction upon the Court to award interim costs on a winding-up proceeding.

The appellant also advances two other grounds of appeal. It submits that:

(1) the trial judge erred in law in holding that the petitioners (respondents) have a reasonable case prior to the respondent (appellant) leading evidence on the motion; and

(2) the trial judge erred in law in holding that it is too late for the appellant to make submissions as to the existence of an alternative remedy.

The trial judge set forth several factors for consideration when deciding whether or not the Court should exercise its jurisdiction to grant interim costs. One of these factors is whether the respondents have a reasonable case. The trial judge, at p. 17 of his decision, dealt with this factor as follows:

> Without, in any way, deciding the issue I find that the applicant at this stage has a reasonable case.

The appellant now submits that the trial judge erred in deciding this factor without giving it an opportunity to call evidence on the factor. While it may have been preferable for the trial judge to have given the appellant an opportunity to call further evidence, I am not satisfied that the appellant has been prejudiced by this failure to do so. This case has been before the Court for a number of years and its history to date clearly illustrates that the trial judge was in a position to determine whether the respondents had a reasonable case or not. The evidence had practically all been presented to the trial judge at the time of the motion and he has been involved in a lengthy non-suit motion as well. One obviously does not have to hear all the evidence in order to determine whether a reasonable case exists or not. I would dismiss this ground of appeal.

The appellant submits that it should have an opportunity to present evidence to show that the respondents do not have a reasonable case in that there were more appropriate remedies than a winding-up action available to the respondents. The trial judge held on pp. 18-19 of his decision as follows:

> The respondent states that it would have evidence on the availability of another remedy. I cannot imagine what evidence it would have of an alternative remedy, although it might have a legal submission of such. In any event, I believe it is too late to make such a submission.

The appellant has not placed anything before the Appeal Division which would lead me to conclude that the trial judge erred in reaching such a conclusion and I would, therefore, dismiss this ground of appeal.

I, therefore, dismiss the appeal. Counsel may speak to the Court on the matter of costs on the appeal if they wish to do so.

CARRUTHERS C.J.P.E.I.
We concur: MITCHELL and MULLALLY JJ.A.

IN THE MATTER OF THE WINDING-UP OF COVENTREE INC.

Court File No: CV-12-9594-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

Proceeding commenced at Toronto

BRIEF OF AUTHORITIES OF THE LIQUIDATOR
(Motion Returnable December 14, 2012)

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