

**NATIONAL CIVIL LITIGATION
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**DUTIES OF DIRECTORS PURSUANT TO SECTION 122 CBCA
A CASE STUDY OF PEOPLES DEPARTMENT STORES INC.
(TRUSTEE OF) V. WISE**

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1. INTRODUCTION

In today's corporate environment, directors face numerous challenges and pitfalls. Directors must oversee their company's destiny and generate profits. Yet, they constantly have to remind themselves of the array of statutory liabilities which await in cases of failure: personal responsibilities for unpaid wages, taxes, deductions at source and environmental issues to name a few. In the last 25 years or so, the focus on these statutory provisions eclipsed a director's most fundamental duties: the fiduciary duty and the duty of care.

The fiduciary duty imposes upon the director the obligation to act in good faith and honestly with a view to the best interest of the corporation. The duty of care requires that a director, in making a decision, exercise a certain degree of care, diligence and skill.

The origin of these duties date back to the British Common Law. Their very existence is now enshrined in every corporate law which governs this country and yet seldom were they ever reviewed by our courts. That is until a 1998 Quebec Superior Court judgment rendered in the bankruptcy of *Peoples Department Stores Inc.* ("Peoples") literally shook the Canadian corporate world¹.

The trial judge found that directors of Peoples had shown a reckless disregard vis-à-vis their duties owed to the corporation and condemned the directors to pay an aggregate amount of \$4,400,000.00 to the bankruptcy trustee. The trial judge also concluded that the Canadian law should impose upon directors the duty to protect the interests of the corporation's creditors.

Law professors and insolvency lawyers across the country were quick to embrace the trial judge's novel interpretation of a director's duties. Certain decisions in Ontario made favourable reference to the Peoples decision but no other director suffered the same

¹ *Peoples Department Stores Ltd. (Bankruptcy of): Caron Bélanger Ernst & Young Inc., trustee v. Lionel Wise et als*, J.E. 99-318, 23 CBR (4th) 200.

faith as the directors of Peoples. In 2002, the Quebec Court of Appeal overturned the trial judge's conclusions and clearly stated that the directors had not been responsible for Peoples' bankruptcy².

The Supreme Court of Canada reviewed the matter and its highly anticipated judgment was rendered on October 29, 2004. It sided with the directors and agreed that there had been no wrongdoing on their part³.

1. THE FACTS

In the early 1990s, Wise Stores ("Wise") was a publicly traded company operating some 50 junior department stores with annual sales of \$100,000,000.00. The founder's three sons, Lionel, Ralph and Harold Wise were majority shareholders and directors of the company.

Peoples, with its 75 stores, was a division and then became a subsidiary of Marks & Spencer Canada Inc. ("M & S"). Peoples generated sales of \$150,000,000.00 but operated at a loss of some \$10,000,000.00 annually.

In 1992, Wise purchased Peoples for \$27,000,000.00. An important balance of sale was to be paid to M & S over a seven year period. To secure its position, M & S negotiated strict financial restrictions concerning the operations of Peoples. The corporation could not be merged with Wise until the purchase price was fully paid and Peoples was not to provide any financial assistance to Wise. The Wise brothers were appointed sole directors of Peoples.

After the acquisition, management consolidated the administrative, accounting and purchasing departments of both companies and essentially operated them as a single entity. The same individuals dealt simultaneously with suppliers and managed the

² *Peoples Department Stores Inc. (trustee of) v. Wise* [2003] R.J.Q. 796.

³ *Peoples Department Stores Inc. (trustee of) v. Wise* [2004] 3 RCS 461.

inventory on behalf of both Peoples and Wise. Parallel bookkeeping and shared warehousing arrangements led to disastrous administrative problems which drained \$10,000,000.00 of equity from the corporations.

Under pressure to resolve the situation, Lionel Wise consulted David Clément, the companies' vice-president of Administration and Finance. Clément recommended that the corporations make better use of the computer systems already in place. Only this required that one of the corporations take on the role of purchasing agent for the group, deal exclusively with the suppliers, manage the inventory and then resell the requisite merchandise to the other corporation's stores. All this would be managed by a single software which would instantaneously control purchases, deliveries and inventory status for all stores. Peoples was designated as purchasing agent for the group under this new procurement policy. In effect, some \$45,000,000 of Wise orders, annually, were transferred to and managed by Peoples. Certain suppliers questioned Wise's management as to the reason for this change, some requested corporate guarantees from Wise. Overall, suppliers continued to deal with the Peoples-Wise group notwithstanding the effects of the new procurement policy.

Implemented in February 1994, the new policy eliminated the administrative problems. Unfortunately, it was not well received by M&S. The policy could be used to cause Peoples to finance Wise, a situation which was prohibited under the sale agreement. M&S and Wise agreed to limit to \$3,000,000.00 the sums of money owed by Wise to Peoples and to rescind the new policy at the beginning of the next fiscal year.

In October 1994, as merchandises were massively shipped to the stores to prepare for the Christmas season, Wise's indebtedness to Peoples shattered the \$3,000,000.00 barrier and rose to \$15,000,000.00. To make matters worst, Peoples was performing poorly with lagging sales and the re-emergence of deficits in the millions. M&S could bear no more and sought the appointment of a receiver to control Peoples' assets. To counter act, Wise and Peoples sought refuge behind the *Bankruptcy and Insolvency Act* with a view to present a proposal to their creditors. In January 1995, Wise and Peoples

instead filed for bankruptcy. The liquidation of Wise and Peoples' assets was sufficient to repay the debts owed to M& S and to the Toronto-Dominion Bank, the only secured creditors. Trade creditors claims went unsatisfied.

The trial judge concluded that in implementing new procurement policy, Peoples' directors breached their duties to the company. In his opinion, a reasonable person would have realized "that the new process would strip hand assets (inventory) away from Peoples and it would receive in return an account receivable from Wise which likely would not be collected and would be uncollectible." The trial judge later on added that in his opinion the burgeoning inter-corporate indebtedness owed by Wise to Peoples caused Peoples' slide into bankruptcy.

1. DIRECTORS' LIABILITY PURSUANT TO THE SECTION 122 OF THE CANADIAN BUSINESS CORPORATION ACT

The trustee argued that the Wise Brothers, in implementing the new procurement policy, had favoured the interests of Wise over the interests of Peoples. The trustee further advanced that the directors had been guilty of reckless disregard as to the negative financial consequences of this decision and that having failed to properly analyse or review the potential consequences of their decision, they had failed to readily anticipate Wise's financial downfall. Agreeing with the trustee's submissions, the trial judge concluded that the Wise Brothers had breached their fiduciary duty and duty of care owed to the corporation as these duties were imposed unto them by section 122 *Canadian Business Corporation Act* ("CBCA"):

- Section 122(1):
 1. Every director and officer of a corporation in exercising his powers and discharging his duties shall
 - a) act honestly and in good faith with a view to the best interest of the corporation; and

- b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.⁴

1.0 HISTORICAL REVIEW

At the end of the nineteenth century, British courts ruled that in managing and supervising the operation of their companies, directors had to satisfy two principal duties: the fiduciary duty and the duty of care.

) **Fiduciary duty**

The British courts drew certain parallels between the responsibilities conferred unto directors and those conferred unto trustees. In each of these situations, agents manage assets belonging to third parties.

A trustee must oversee the preservation of another person's property. To achieve this goal, the trustee must resort to conservative investments. Such limitations are contrary to the business world where risk taking frequently forms part of the winning formula. In dealing with corporate cases, British courts adapted the traditional duties imposed unto trustees in light of directors' responsibilities in the pursuit of the corporation's commercial objectives.⁵

It is the shareholders who convey to the directors the responsibility to manage the affairs of the corporation. Fending off competition, the directors are asked to make decisions which ultimately must bring together the proper conditions allowing increases in profit and constant growth of shareholders' equity. Sometimes, this requires risk taking. If all works out well, the company has met its objectives, if not, deficits abound and may force the company to close down its operations:

⁴ R.S.C. 1985, c. C-44.

⁵ *In re: City Equitable Fire Insurance Company Ltd.*, [1925] Ch. 407, page 426.; *In re : Faure Electric Accumulator Company*, (1888) 40 Ch. 141, page 151.

"It was a mercantile adventure involving risk, and not a mere trustee investment."⁶

British courts thus determined that directors were subject to the same standard of honesty as trustees and that they were to act in good faith with a view to the best interests of the corporation. This fiduciary duty, as they called it, make directors accountable for their personal conduct. Integrity and good faith were analyzed in light of the directors' motivation and were not to be contingent upon the actual results of their decisions.

In any given situation, how do you define the best interests of the corporation? Better yet, are the courts and their judges sufficiently experienced or knowledgeable to answer this question? British courts decided to defer to the directors' judgment provided that the directors' motivations were beyond reproach:

"They [the directors] must exercise their discretion bona fide en what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose."⁷

Before the CBCA, Canadian courts agreed with these British precedents and adopted their definition of the fiduciary duty:

"The test is whether the directors honestly believed that they were acting in the best interests of the company, and whether there were reasonable grounds for their belief... Their actions must be viewed in the context of the circumstances that then existed or were thought by them to exist."⁸

⁶ *In re : New Mashonaland Explorator Co.*, (1892) 3 Ch 577, page 582.

⁷ *Re Smith & Fawcett, Ltd*, [1942] Ch. 304, page 306; see also *Shuttleworth v. Cox Brothers & Co.*, [1927] 2 K.B. 9, page 23.

⁸ *Olson v. Phoenix Industrial Supply Ltd* (1984) 9 D.L.R. (4th), 451, page 455; see also *Teck Corporation Ltd. v Millar*, (1972) 33 D.L.R. (3d) 288, pages 315 and 316.

) **Duty of care**

It is one thing to be honest, but what about bad decisions? British courts ruled that directors had to answer to a duty of care. When referring to this second duty, British courts were principally concerned about the directors' decision making process. But despite its name, the duty of care hardly had any teeth.

British courts recognized that, when asked to review a board of directors' decision, they were better informed than the directors themselves at the time of their decisions. Courts could hardly recreate all of the circumstances as they existed when the directors were called upon to resolve a particular problem or chose between business objectives. It is always easier to identify all of the problems and errors associated with a particular course of action after everything has played itself out as opposed to predicting same in the heat of the moment. Furthermore, judges are assisted by experts who have had ample time to deconstruct the chain of events while directors may have had to react rapidly or with a limited quantity of information readily available.

British courts thus recognized that directors would sometimes make mistakes and that such mistakes should not automatically trigger their liability. Directors were thus allowed to err:

"Anything like corruption or dishonesty on the part of the directors being out of the question, I am unable to treat them as responsible for the consequences of permitting this transfer. Even if the act was, with the knowledge which they had at the time, a grave error of judgment, that is not a ground upon which the Court could properly hold them liable."⁹

⁹ *Re Faure Electric Accumulator Company*, (1888) 40 Ch. 141, pages 152 and 153.

"It is perhaps only another way of stating the same proposition to say that directors are not liable for mere errors of judgment."¹⁰

British courts ruled against directors only in case of gross negligence. To distinguish between negligence and gross negligence, British courts introduced a subjective standard of review. Directors were liable if and when they made a decision which, to their knowledge, would be detrimental to the company's operations:

"An act, or an omission to do an act, is wilful where the person of whom we are speaking knows what he is doing and intends to do what he is doing. But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing, and intends to commit, a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty."¹¹

Again, Canadian courts, before the CBCA, followed the example of these British precedents:

"(translation) It is useful to recall the restrictive liability that the courts have held directors to. They are not personally liable for the acts of the company unless they commit gross negligence. It is accepted that directors must bring a fair and reasonable duty of care to the management of the company and act honestly and no more, and it was decided that they need not have any special knowledge."¹²

1.0 A NEW ACT: THE CBCA

The Canadian Federal Government created a commission, chaired by Mr. Robert Dickerson. Its mandate was to review and update Canadian corporate laws. In 1970, the commission recommended the tightening of a director's duties. The

¹⁰ *In re City Equitable Fire Insurance Company Limited*, [1925] Ch. 407, page 429.

¹¹ *Ibid.*, page 434, see also page 468.

¹² *Crevier c. Paquin*, [1975] C.S. 260, page 265 (l'honorable juge Charles Gonthier)

commission was particularly concerned about the application of the purely subjective criteria set out in the British decision of *In re City Equitable Fire Insurance Company Limited*. The commission proposed the adoption of a text which imposed upon the directors the duty to exercise the care diligence and skill of a reasonably prudent person.

John Howard, one of the commissioners, in a presentation following the adoption of the CBCA, summarized the commission's objectives:

"Subsection 117(1), on the other hand, is a recent innovation in federal corporation law that was adapted from several U.S. state and provincial statutes. In contrast to the other duty provisions it is a formidably difficult concept, partly because it embodies several protean standards, partly because, contrary to expectations — or fears, as the case may be — it probably adds little to existing law. (...)

Paragraph (a), the fiduciary standard, is a succinct declaration of the common law standard: a director or officer must act honestly and in good faith, that is, must not accept a bribe or otherwise have any conflict of duty or interest; and he must not act in his own interests but objectively in the best interests of the corporation. (...)

Although not equally clear from an examination of the bare text, viewed in the light of the defences available to directors and officers who allegedly have committed a breach of their duty of care, paragraph 117(1)(b) also is essentially declaratory of the common law standard. More specifically, paragraph 117(1)(b) aims at the following objectives. Although it could have declared generally the duty of care — since that duty clearly subsumes skill and diligence, which are only aspects of the duty of care — the provision focuses specifically on diligence and skill because these particular criteria were felt to be sub-standard in Anglo-Canadian law. In general, it is unlikely that a court will hold directors and officers liable for their breach of duty of care except where they have turned their backs to the corporation or have transferred control to dishonest or irresponsible persons. The term diligence was expressly used to abrogate the low standard of English law and to substitute the higher standard of U.S. law, which requires that a director turn his attention to the affairs of the corporation. The term skill was expressly used to legitimate distinctions between inside and outside directors and between business generalists and professionals. Finally the phrase "reasonably

prudent person would exercise in comparable circumstances" was employed to distinguish this standard from the general fiduciary standard that requires the same attention the fiduciary would give to his personal affairs. The standard in paragraph 117(1)(b) thus underlines the distinction between a fiduciary who is employed to preserve assets and a director or officer who is employed to select amongst alternative business risks. »¹³

The government did not follow the recommendation of the Dickerson report and acted in a somewhat more timid fashion by adopting a text which imposed upon the director the duty to exercise the care diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Again, John Howard, one of the commissioners, made the following comments on the text as adopted by the legislator:

"The courts have therefore been understandably reluctant to adjudge in retrospect that a policy error, even if it turned out to be an egregious blunder, entitled the affected corporation or its shareholders to seek compensation for the resulting financial loss. By indirection the CBCA continues this policy, expressly declaring duty of care standards but at the same time preserving the common law defences and setting out a number of provisions that go far to relieve directors and officers of the intolerable burden of being accountable for honest errors of business judgment."¹⁴

1.0 SECTION 122 CBCA, BEFORE PEOPLES

) Fiduciary duty

Before Peoples, section 122 CBCA, despite its 25 years of existence, rarely attracted the attention of our Canadian courts. Other sections of the CBCA and sections found in other statutes use text which is similar to that of section 122 CBCA. The court's interpretation of these other provisions, even if these interventions are just as rare, were still the only guidelines to which practitioners could revert to.

¹³ John L. HOWARD, « Directors and officers in the context of the Canada Business Corporations Act », (1975), Meredith Memorial Lectures 282, pages 288, 293, 297 and 298.

¹⁴ *Ibid.*, pages 302 and 303.

In *Blair*¹⁵, the Supreme Court indirectly addressed the concept of fiduciary duty. Legal proceedings were directed at Blair, the company's president and a shareholder, by another shareholder attacking Blair's decisions as president of the annual meeting of shareholders. The shareholder's proceedings were well founded and the courts overturned Blair's decisions. Despite losing in court, Blair asked the company to indemnify him for his legal expenses. To qualify, Blair, even though his decision were proven wrong, had to demonstrate that he had acted in good faith with a view to the best interests of the corporation:

"Permitting Blair to be indemnified is consonant with the broad policy goals underlying indemnity provisions (*which require that the director acted honestly and in good faith with a view to the best interests of the corporation*); these allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection. Indemnification is geared to encourage responsible behaviour yet still permit enough leeway to attract strong candidates to directorship and consequently foster entrepreneurship. It is for this reason that indemnification should only be denied in cases of *mala fides*. A balance must be maintained."¹⁶

More recently, the Quebec Court of Appeal, without making specific reference to the provisions of the CBCA as it was dealing with a matter pursuant to the *Quebec Companies Act*, confirmed that courts should not interfere except in cases where the directors acted improperly:

"(translation) Courts must not involve themselves in the internal affairs of a corporation nor must they substitute their judgments to that of the directors. It is not sufficient to establish simple errors of judgment or poor business decisions but rather acts that the directors knew or should

¹⁵ *Blair c. Consolidated Enfield Corporation*, [1995] 4 R.C.S. 5.

¹⁶ *Ibid*, p. 64.

have known improper and likely to cause an advantage to some to the detriment of others."¹⁷

) **Duty of care**

In *Re Soper*, the Federal Court of Appeal, while addressing problems relating to the interpretation of section 227.1 of the *Income Tax Act* compared the text of the later with the dispositions of section 122 CBCA. The Honourable Justice Robertson acknowledged that the text of section 122 CBCA had introduced an objective element in a court's review of a director's duty of care but added at the same time that this new element did not entirely replace the subjective element found in the British court precedents:

"Put differently, a reasonably prudent person in comparable circumstances may be, for example, an unskilled person. In my view, it is correct to distinguish in this way between a reasonably prudent person and a reasonably skilled person so as to conclude that the subjective element of the common law standard of skill has not been altered by federal statute. (...)"¹⁸

The legislative history of the Ontario *Business Corporations Act*, whose standard of care provisions are virtually identical to those found in the *CBCA*, supports my conclusion that the common law standard of care, while altered slightly, has not been significantly upgraded by statute."¹⁹

The Federal Court of Appeal also expressed following opinion concerning the duty of care and section 122(1)b) CBCA:

"A director who manages a business is expected to take risks to increase the profitability of the business and the

¹⁷ *Alcar Holdings Inc. c. Naimer*, R.E.J.B. 2000-20406 (C.A.Q.), page 10.

¹⁸ (1997) 149 D.L.R. (4th) 297.

¹⁹ *Ibid.*, pages 313, 314 and 315.

duties of care, diligence and skill are measured by this expectation."²⁰

Before Peoples, it seemed pretty well established law in Canada that the duty of care varied from one individual to the other. If a director did not have to defend his or her deeds in light of what a reasonable person would have done, then one had to conclude that the gross negligence standard had survived adoption of the CBCA:

"However, the "gross negligence" standard continues today."²¹

1.0 THE SUPREME COURT JUDGMENT

) **Fiduciary duty**

In his factum, the trustee summarized the directors' breach of their fiduciary duties as determined by the trial judge's conclusions:

"? The New Policy ...would expose Peoples to "*potentially disastrous financial consequences*"... that any reasonable person would have understood and foreseen these consequences;

? "It is clear that, in instituting the new domestic inventory procurement policy the Wise Brothers preferred the interests of Wise over those of Peoples. There was a reckless disregard by them of the negative financial implications to Peoples resulting from that new policy.

? Peoples ... under the New Policy would be used to "*subsidize and support Wise*".²²

It was argued that these conclusions mainly focused on the consequences of the directors' decision but failed to address their motivation. It was undisputed that the new procurement policy was implemented to resolve

²⁰ Canada (PG) c. McKinnon, [2001] 2 CF 203.

²¹ E.M. IACOBUCCI, "A Wise Decision? An analysis of the relationship between corporate ownership structure and directors' and officers' duties", (2002) 36, *Can. Bus. L.J.* 337, pp. 347.

²² Trustee's factum before the Supreme Court of Canada, par. 35 and 36.

an inventory management problem. In discarding, without explanation, his own conclusions concerning this inventory management problem to find that the directors were guilty of a breach of their fiduciary duty, the trial judge appeared to have treated the directors' fiduciary duty and duty of care as one.

Contrary to the trial judge, the Supreme Court concluded that the new policy was a reasonable business decision made with a view to rectifying a serious problem affecting the operations of both companies. It is legitimate for directors to attempt to redress a corporation's financial problems.

The Supreme Court referred to the fiduciary duty as a "duty of loyalty". The duty requires that directors respect the trust and confidence of the shareholders who have appointed them to office. To achieve this goal, the directors must:

- Avoid conflict of interests with the corporation.
- Avoid abusing their position to gain personal benefit.
- Maintain the confidentiality of information disclosed to them in their capacity as directors²³.

The operations of Wise and Peoples were negatively affected by an inventory management problem. With the help of the company's Vice-President of Administration and Finance, the Wise brothers conceived and implemented a solution which ultimately resolved the situation.

It is sometimes difficult to draw the line between the interest of the corporation and the personal interest of the directors. Because they are

²³ Supreme Court judgment, par. 35.

shareholders of the corporation or because their compensation is directly related to the corporation's financial results, directors' financial riches are intertwined with and dependent upon the corporation's operations, something which at first glance could appear to be in contradiction with the Common Law's definition of the fiduciary duty.

The "specific substance" of the fiduciary duty of directors to the corporation under the CBCA favours directors in a sufficient way to allow them to personally benefit from the corporation's success:

"However, it is not required that directors and officers in all cases avoid personal gain as a direct or indirect result of their honest and good faith supervision or management of the corporation. In many cases the interests of directors and officers will innocently and genuinely coincide with those of the corporation. If directors and officers are also shareholders, as is often the case, their lot will automatically improve as the corporation's financial condition improves. Another example is the compensation that directors and officers usually draw from the corporations they serve. This benefit, though paid by the corporation, does not, if reasonable, ordinarily place them in breach of their fiduciary duty."²⁴

Having failed to prove an improper purpose in the directors' decision to adopt the new procurement policy, the trustee argued that the directors had exploited the new policy in a manner as to cause Peoples to subsidize Wise. The latter's survival allowed the directors to maintain and collect generous salaries and expense accounts.

The Supreme Court discards this argument in its conclusion that:

"...the trial judge's determination that there was no fraud or dishonesty in the Wise brothers' attempts to solve the

²⁴ Supreme Court judgment, par. 39.

mounting inventory problems and Wise stands in the way of a finding that they breached their fiduciary duty."²⁵

We believe that the Supreme Court's rather strong statement must also be read in light of its comments in the following paragraph of its decision where it is also mentioned that there was no evidence of a personal interest on the part of the brothers or improper purpose in the new policy.²⁶

The trustee had attacked the directors' decision, on the basis of a breach of fiduciary duty, on the grounds that a reasonable person, as determined by the trial judge, would have foreseen Wise's financial collapse. Consequently, there could not have been any reasonable ground to defend their decision.

Without directly addressing this argument, the Supreme Court appears to have dismissed it when it introduces the concept of the "better corporation":

".. and in light of the evidence of a desire to make both Wise and Peoples "better" corporations, we find that the directors did not breach their fiduciary duty under section 122(1)a) of the CBCA."²⁷

This small section of the Supreme Court judgment may lead to conflicting interpretations. Is this desire to make a better corporation another means of defense available to the directors or does it form part of the fiduciary duty? Is this desire compatible with the desire to maintain the status quo or does it imply changes in the company's methods and operations?

²⁵ Supreme Court judgment, par. 40.

²⁶ Supreme Court judgment, par. 41.

²⁷ Supreme Court judgment, par. 41.

We prefer to read this section of the judgment together with the precedents in the matters of *Olsen and Teck Corporation* wherein the courts had imposed upon the directors the obligation to prove that they had "honestly believed that they were acting in the best interest of the corporation...".²⁸ If so, directors, by proving that they acted with the desire to make their corporation a better corporation, have at their disposals another means to defend proceedings directed against them for failure to respect their fiduciary duty.

The operations of Wise and Peoples were negatively affected by an inventory management problem. With the help of the company's vice-president of administration and finance, the Wise brothers conceived and implemented a solution which ultimately resolved the situation. They were thus motivated by the desire to make Wise and Peoples "better corporations". This motivation, in the absence of fraud, dishonesty and personal benefit on the part of the directors, is perfectly in sink with the duty of loyalty.

) **Fiduciary duty and creditors**

Traditionally, to act in the best interests of a corporation was portrayed as acting in the best interests of its shareholders. This over simplification does not fairly represent the complex modern reality in which corporations operate. Directors' decisions affect the interests of different groups who deal with these corporations: shareholders, employees, creditors, clients, governments and the community (such as in matters concerning environmental issues). It has sometimes been said that these different groups are stakeholders in the affairs of a corporation.

²⁸ See note 8

The Superior Court judgment concluded that Canadian law should afford some degree of protection to one of these stakeholders namely creditors:

"We agree with the thrust of those judgments and find that Canadian Corporate Law should evolve in that direction.

As professor Ziegel wrote in conclusion in his article cited above:²⁹

"...it is not unreasonable, in exchange for the benefit of limited liability, to impose a duty on directors not to sacrifice creditors' interests when the going gets rough.

Chief Justice Street's analogy in *Kinsela* is apt. If the company is insolvent..."

(Or, we are of the view, if the company is embarking on a course of action which will inevitably in the short run render it insolvent, as was the case here when Peoples embarked on the new domestic inventory procurement policy.)

"...only the creditors still have a meaningful stake in its assets. This will be obvious if the company has been formally declared bankrupt. Why should it make a difference that bankruptcy has been delayed for a period of time? If we accept the paramountcy of creditors' interest when the company is insolvent, it must likewise be wrong, and a waste of economic resources, for the directors to continue to buy goods and services on credit knowing there is no reasonable prospect of the creditors ever being paid."

We agree."³⁰

The Quebec Court of Appeal refused to follow the trial judge's lead. It rejected the notion that the directors had a duty to act in the best interests of the creditors when the corporation is insolvent. The Court of Appeal

²⁹ (1988) 4 B.C.C., 30, at page 33.

³⁰ Superior Court judgment, at pages 68-69.

further added that the trustee, as the assignee to the bankrupt company's rights, was barred from claiming damages against the directors, for the creditors' benefit, considering that the directors' decision had been ratified by Peoples' sole shareholder, Wise, the very beneficiary of the new inventory procurement policy.

The trustee attacked the Court of Appeal's reasoning on both grounds and argued before the Supreme Court of Canada that:

"The consideration of Peoples' creditors as its stakeholders is precisely why shareholder approval of the New Policy does not sanction the Wise Brothers' wrongful behaviour or bar Appellant's claim against the Wise Brothers. It is only for this reason that Appellant invites this Honourable Court to recognize that, as the New Policy was adopted, implemented and continued, Peoples' creditors were stakeholders of Peoples, having an interest and how the Wise Brothers governed that corporation. »

(...)

« Appellant submits that it is appropriate for this Honourable Court to recognize the principle that creditors can be stakeholders of a near insolvent or insolvent corporation solely for the purpose for allowing a bankruptcy trustee's claim against directors for wrongful behaviour, despite shareholder approval. There are several sound reasons to support such recognition:

First, as discussed above, when a corporation is on the verge of insolvency, it is unable to meet its liabilities. As such, there is little if any remaining value to be distributed to the shareholders. In this situation, the shareholders have little interest worth protecting and creditors have a greatest stake in how the corporation is governed.

Second, in a closely held corporation, such as Wise and Peoples, the directors themselves may be in a position where they have nothing to lose. In these circumstances, directors may be more likely to engage in risky behaviour, which may benefit them if it succeeds, but may harm creditors if it fails. In this sense, if the corporation is

already troubled, the creditors are required to bear the risk of actions taken to attempt to restore shareholder value.

Third, creditors are often at the disadvantage, lacking any information about the financial stability of the corporation. They then may continue to advance credit to the corporation with little knowledge or expectation that it may never be repaid. Directors, on the other hand, have knowledge of the financial situation of the corporation and are in the best position to remedy the situation. They should be given an incentive to do so.

The consideration of creditors as stakeholders of a near insolvent or solvent corporation is advanced by Appellant for the limited purpose of denying shareholders the right to approve or ratify wrongful directors' behaviour. It is not a radical departure from our law but is really a reformulation of existing legal principles. To recognize creditors' interests would no open the floodgates of litigation against directors. The test will always be whether a reasonable person in a director's position, making an informed and diligent decision, would consider that the rights of creditors are at stake. If so, the directors should avoid decisions harmful the creditors or make decisions in a manner which affords reasonable protection to the creditors."³¹

The trustee's argument relied on a series of British Commonwealth precedents, in which directors were held liable for the consequences of their actions in so far as creditors' interests were concerned.

Re Horsley & Weight Ltd.:

"If, however, there had been evidence and a finding of misfeasance and it appeared that the payment of £10,000 in the event reduced the funds available for creditors, by that sum, or by a substantial proportion of that sum, I am not satisfied that the directors convicted of such misfeasance, albeit with not fraudulent intent or action, could excuse themselves because two of them held all of the issued shares in the company and as shareholders

³¹ Trustee's factum, pages 26, 27, 31 and 32.

ratified their own gross negligence as directors which inflicted loss on the creditors."³²

Kinsella v. Russel Kinsella PTY Ltd.:

"In a solvent company the proprietary interests of the shareholders entitled them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorize or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, or under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration... Secondly, the prejudice to the creditors was the direct and calculated result of the lease; its purpose was to place the company's assets beyond the reach of the creditors; there is thus no occasion to examine on a value basis the commercial wisdom or unwisdom of the decision of the directors."³³

Nicholson v. Permakraft:

"The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider inter alia the interests of creditors. For instance creditors are entitled to consideration, in my opinion, if the company is insolvent, or near insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardize its solvency... But as a matter of business ethics it is appropriate for directors to consider also whether what they do will prejudice their company's practical ability to discharge promptly debts owed to current and likely continuing trade creditors... The recognition of duties to creditors, restricted as already outlined, is justified by the concept that limited liability is a privilege. It is a privilege healthy as tending to the expansion of opportunities in commerce; but it is open to

³² [1982] 3 All E.R. 1045.

³³ [1986] 4 N.S.W.L.R. 722.

abuse. Irresponsible structural engineering – involving the creating, dissolving or transforming of incorporated companies to the prejudice of creditors – is a mischief to which the courts should be alive... In a case of an insolvent company, at least in the sense that its liabilities exceed its assets, directors in the management of the company must have regard to the interest of creditors. That it is because according to the order of application of assets on a winding up they are trading with the creditors' money. It has been suggested that when the solvency of a company is doubtful or marginal it will be a misfeasance (probably not capable of being ratified or exonerated by shareholders) to enter into a transaction which directors ought to know is likely to cause a loss to creditors.³⁴

Winkworth v. Edward Barren Development Co. Ltd.:

"But the company owes a duty to its creditors, present and future. The company is not bound to pay off every debt as soon as it is incurred and the company is not obligated to avoid all ventures which involve an element of risk, but the company owes a duty to its creditors to keep its property inviolate and available for the repayment of its debts. The conscious of the company, as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered, that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors."³⁵

These precedents, despite their strong words attacking the conduct of the directors and their recognition of creditors' interest, are truly facts specifics. All but the *Nicholson* case dealt with fraudulent or highly questionable dealings involving corporate assets which ultimately favoured the directors or related parties. As far as the *Nicholson* case is concerned, Justice's Cook's minority opinion did not receive the support of his two colleagues from the New Zealand Court of Appeal.

³⁴ [1985] 1 N.Z.L.R. 242.

³⁵ [1987] 1 All E.R. 114.

From the University of Cambridge, professor Sealy cautioned the legal community against this new approach and predicted that these precedents would ultimately lead courts to recognize a duty in favour of creditors when in reality no such duty ever existed in Common Law:

"If these judicial occurrences are examined in their context, it will be seen that in most cases they are nothing more than extraneous words of censor directed at conduct which anyway comes within some well established rule of law, such as the law imposing liability for misfeasance, the expropriation of corporate assets or fraudulent preference...

Another risk is that, taken out of context, all this talk of "duty" will be regarded as laying down rules which are legal rules in their own right, based independently of company law, and independently sanctioned...

The law as it stands gives the courts ample scope to deal with all potential abuses of trust by company directors, without the need to invent any new cause of action based on phoney jurisprudential antecedents... Against this background, well meant but ill-focused dicta about directors "duties" to creditors can be seen as both unnecessary and potentially pernicious."³⁶

Another British law professor, Andrew Keay, questioned the true nature of these precedents:

"In fact, a perusal of the cases in Australia, New Zealand and the United Kingdom suggests that courts have erred on the side of the magnanimity when confronted with evidence of alleged breaches of directors duties. Arguably, the only occasion on which courts have found directors liable in Australia, New Zealand and the United Kingdom are when the directors have done something either commercially improper or verging on the improper. Where directors have made decisions that have turned out

³⁶ L.S. SEALY, "Directors Duties – an Unnecessary Gloss", 1988, *C.L.J.* 175, pp. 175, 176 and 177.

to be bad ones, but they acted in good faith, the courts have refrained from holding them liable."³⁷

We always believed that the trial judge's error laid in his erroneous understanding that these British Commonwealth precedents fairly depicted an independent duty to creditors as opposed to concerns voiced by certain judges exposed, and outraged, to directors' fraud or to inappropriate conduct on the part of the directors.

In Canada, even before the Supreme Court's decision, Justice Cullity of the Ontario Superior Court, in *Millgate Financial Corporation Limited v. BCED Realty Holdings Limited*, reviewed the British Commonwealth cases addressing the duties of the directors and concluded that no direct duty was owed to creditors:

"Hence the view that it is "extremely doubtful" whether Mason J. "intended to suggest that directors owe an independent duty directly to creditors..."

In *Re New World Alliance Pty Ltd. v. Syotex Pty Ltd v. Aseler*, Gummow J. pointed out:

It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders. This restriction does not, in the absence of any conferral of such a right by statute, confer upon creditors any general right against former directors of the company to recover losses suffered by those creditors... The result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.

In so far as remarks in [a South Australian case] suggest that the directors owe an independent duty to, and

³⁷ Andrew KEAY, "The directors' duty to take into account the interest of companies' creditors: when is it triggered", [2001] *MULR* 11, pp. 14-15.

enforceable by, the creditors by reason of their position as directors they are contrary to principle and later authority and do not correctly state the law...

It would obviously be a mistake to infer from the reasoning at first instance in *Peoples Department Stores*, and in the Canadian cases that have referred to it, that the authorities in Australia and in the United Kingdom unanimously support the view that directors will owe fiduciary duties to creditors directly when the company is in financial difficulties. The comments in *Spies* appear to make it highly unlikely that this view will be accepted in Australia and, as the following statement of Toulson J. in *Youkong Line Ltd v. Rensberg Investments Corporation* (No. 2), [1998] 1 W.L.R. 289 (Q.B.D.), at page 312 illustrates, despite the much discussed and analysed dicta of Lord Templeman in *Winkworth*, the prevailing view in England may be no different to that in Australia:

"Where a director, or person having management, of an insolvent company acts in breach of his duty to the company by causing assets of the company to be transferred in disregard of the interests of its creditor or creditors, under English law he is answerable through the scheme which Parliament has provided. In my judgment he does not owe a direct fiduciary duty towards an individual creditor, nor is an individual creditor entitled to sue for breach of the fiduciary duty owed by the director to the company."³⁸

In other words, and in essence this was at the core of the debate before the Supreme Court of Canada, was there a commonality of interest between the insolvent company and the creditors such that the imperfect obligation owed to creditors was similar to the obligation owed to the insolvent company and that such interest and imperfect obligation are, after all is said and done, one and the same, as opposed to different duties with different objectives. This seemed rather unlikely. Even if it is insolvent, the company's best interests lay with its economic survival. The creditors, on the other hand, may prefer its liquidation to

³⁸ Ontario Superior Court, no. 93 – CQ – 45025, November 12, 2003.

its restructuring efforts and objectives. They may not share the company's optimistic forecasts and the potentially negative impact of any workout plan on the company's present assets available for liquidation.

Furthermore, the notion of a fiduciary duty owed to creditors did not necessarily sit well with the classical definition of fiduciary duties. In the past, the Supreme Court of Canada had cautioned lawyers against the overuse of claims for breach of fiduciary duties:

“The word « fiduciary » is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth. But “fiduciary” comes from the Latin “fiducia” meaning “trust”. Thus, the adjective, “fiduciary” means of or pertaining to a trustee or trusteeship...But to say that a simple carelessness in giving advice is such a breach is a perversion of words... I make this point because an allegation of breach of fiduciary duty carries with it the stench of dishonesty – if not of deceit, then of constructive fraud.”³⁹

The presence of a fiduciary duty is usually excluded from normal commercial transactions:

“Even prior to *Lac Minerals* the Court expressed the view that the policy objectives underlying fiduciary relationships did not generally apply to business entities dealing at arm's length...

(This Court) held that where the ingredients giving rise to a fiduciary duty are otherwise present, its existence will not be denied simply because of the commercial context. The vulnerability of clients to their professional advisors invoked traditional fiduciary principles. In this case there is nothing in the relationship between a juice manufacturer and its licensee to suggest that the former surrendered its self-interest or rendered itself “vulnerable” to a discretion conferred on the latter.”⁴⁰

³⁹ *Lac Minerals c. International Corona Resources*, [1989] 2 R.C.S.575, pages 606 and 607.

⁴⁰ *Cadbury Schweppes Inc. c. FBI Foods Ltd.*, [1999] 1 R.C.S. 142, par. 30.

The Supreme Court concluded that directors owe a fiduciary duty to the company and to no one else. The best interests of the company must not be assimilated with the interests of its creditors or any other shareholders.

It is sometimes legitimate for directors to consider the consequences of their decisions on one of these competing interests. But stakeholders' interests should not be confused with those of the corporation. A corporation's best interests are essentially always the same: to make it profitable, thriving and competitive. Groups of stakeholders have competing interests whose relative importance tend to shift according to each situation. It would be impossible for directors to properly manage the affairs of a corporation if their loyalty was to be directed at one group of stakeholders or another depending on the circumstances. Accordingly, the Supreme Court rejected the notion that directors' fiduciary duties were suddenly owed to the corporation's creditors as the corporation approached the vicinity of insolvency. A difficult concept for directors to respond to considering that the phrase "is incapable of definition and as no legal meaning":

"The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty."⁴¹

Yet, even if their duties are owed to the corporation, directors, in their attempts to create or make a better corporation, cannot unfairly favour the interests of one group of stakeholders to the detriment of others:

"In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best

⁴¹ Supreme Court judgment, par. 46.

interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders."⁴²

Even without a fiduciary duty owed to them, these groups of stakeholders are protected by law. A group or individual who have been unfairly prejudiced by the action of the directors can always seek the intervention of the court by bringing an oppression remedy claim⁴³:

"Section 241 of the CBCA provides a possible mechanism for creditors to protect their interests from the prejudicial conduct of directors. In our view, the availability of such a broad oppression remedy undermines any perceived need to extend the fiduciary duty imposed on directors by s. 122(1)(a) of the CBCA to include creditors."⁴⁴

It had always been one of the odd implications of the trial judge's decision. Without ever making any serious reference to the oppression remedy available to the creditors pursuant to section 241 CBCA, the trial judge had unilaterally created a source of added liability for directors. In its application, this new recourse directed against directors was more generous and readily available to creditors than the oppression remedy already included in the act even though the Canadian oppression remedy had been called the most generous remedy of its kind in the world.

Prior to the Supreme Court's decision, D. Thompson had commented on the analogies between the oppression remedy and the trial judge's findings in favour of a duty owed to creditors:

⁴² Supreme Court judgment, par. 47.

⁴³ The Province of Quebec's *Companies Act* does not provide for an oppression remedy similar to those found in other statutes across the country. The debate continues in this Province as to the extent of protection offered to stakeholders under the law.

⁴⁴ Supreme Court judgment, par. 51.

“ The danger of the Peoples' approach is that every subsequent debt action might routinely be converted into a claim of breach of fiduciary duty – an outcome that is surely undesirable.

Although Peoples marks an interesting development in the doctrine of fiduciary duty, the practical effect of this development seems redundant. The Courts already allow creditors to access the oppression remedy in order to protect themselves from conduct by directors that is prejudicial to, or that disregards, their interest.”⁴⁵

Here is a quick review of Canadian precedents concerning creditors and directors in the context of the oppression remedy:

“The Plaintiff's expectation relating to the solvency of the company and its ability to obtain financing (even if they are reasonable ones for a creditor to have) are not sufficient to base a claim for oppression without some evidence that establishes the directors obtaining a personal benefit from their inability to pay Van-Neck. Even if the directors actively misled Van-Neck as to their company's ability to pay, or made personal guarantees to pay, or were less than truthful about their ability to make payments according to a payment schedule, such conduct is not the basis for the application of the oppression remedy in absence of transactions which personally benefited the directors.”⁴⁶

Ontario Courts have repeatedly concluded that insolvent companies' purchases and the subsequent failure to pay, do not automatically lead to the personal liability of the directors:

“The Plaintiff does not allege fraud or misrepresentation. Its complaint is that Beaver ordered services when it was insolvent and knew that it would most likely be unable to pay for them.

The Ontario Court of Appeal has spoken clearly on this issue in *Montreal Trust Co. of Canada v. Scotia McLeod Inc.* (1995), 26 O.R. (3d) 481 (Ont. C.A.), where Finlayson

⁴⁵ D. Thomson: "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty not to oppress?", (2000) 50 U.T.L.R.I., p. 51.

⁴⁶ *Leon Van Neck and son Ltd. v. McGorman*, (1998) Carswell Ont. 4509, par. 65 (confirmed in appeal: (2000) Carswell Ont. 2401).

J.A., speaking for the court (Filayson, Galligan and Doherty JJA) says at pp 490 & 491:

The decided cases in which employees and officers of companies have been found personally liable for actions ostensibly carried out under a corporate name are fact-specific. In the absence of findings of fraud, deceit, dishonesty or want of authority on the part of employees or officers that are also rare.

Considering that a corporation is an inanimate piece of legal machinery incapable of thought or action, the court can only determine its legal liability by assessing the conduct of those who caused the company to act in the way that it did. This does not mean, however, that if the actions of the directing minds are found wanting, that personal liability will flow through the corporation to those who caused it to act as it did. To hold the directors of Peoples' personally liable, there must be some activity on their part that takes them out of the role of directing minds of the corporation. In this case there are no such allegations."⁴⁷

) **The duty of care**

The Court of Appeal had concluded that the implementation of the new procurement policy was simply "an honest error of business judgment". The trustee argued that this conclusion was wrong as it limited the judicial review of the duty of care to a mere issue of honesty.

As we mentioned before, it appeared universally accepted that the duty of care answered to an objective-subjective standard which to many meant that directors had to be guilty of gross negligence to be in breach of their duty.

The Supreme Court decided to interpret section 122(1)(b) CBCA in a manner consistent with the Dickerson report's objectives. The duty of care

⁴⁷ *USF Red Star Inc. v 12103 Canada Ltd.*, (2001) 13 B.C.R. (3d) 195 (Ont. Sup. Ct.) par. 20 to 23.

is thus subject to an objective standard as it is in our collective interest to impose standards of quality unto directors:

"...We prefer to describe it as an objective standard..."

The contextual approach dictated by s. 122(1)(b) of the CBCA not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders."⁴⁸

As for the legislator's intervention which led to the amendment of the original text proposed by the Dickerson Report (which amendment added the words: "in comparable circumstances"), it is of little consequence:

"To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(b) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(a) of the CBCA.

The contextual approach dictated by s. 122(1)(b) of CBCA not only emphasizes the primary facts but also permits prevailing."⁴⁹

Despite the introduction of an objective standard, courts should stay clear of the temptation of discarding directors' decisions in favour of their own judicial solutions:

"Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand,

⁴⁸ Supreme Court judgment, par. 63 and 64.

⁴⁹ Supreme Court judgment, par. 63 and 64.

have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not."⁵⁰

The Supreme Court recognizes that directors must have some means of defence against the risk of hindsight application of perfection. The defence based on the *Business Judgment Rule* is now recognized, and so is the expression, in Canadian law:

"Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule."⁵¹

The Supreme Court adopts the following definition of the *Business Judgment Rule* as proposed by justice Weiler of the Ontario Court of appeal:

"The court looks to see that the directors made a *reasonable* decision *not a perfect* decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision [reference omitted]. This formulation of deference to the decision of the Board is known as the "business judgment rule". The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular

⁵⁰ Supreme Court judgment, par. 64.

⁵¹ Supreme Court judgment, par. 64.

alternative was definitely available and clearly more beneficial to the company than the chosen transaction."⁵²

Courts will not impose on directors the burden to prove that they have made the best or perfect decision in light of the circumstances. Directors will have to establish the reasonable nature of their decision without having to support the unfair burden associated with the negative impact of such decisions.

The Supreme Court's decision does not entirely render justice to one of the core elements of the *Business Judgment Rule* as defined by American courts. Courts in the USA will dismiss a defence based on the *Business Judgment Rule* if it is shown that the directors' decision was not an informed decision. American courts expect directors to collect and if need be mandate experts to review and analyse all of the relevant information needed to make a proper decision (particularly in complex matters involving aggressive take-over bids where directors may have little experience in answering to such issues which so impact shareholders' equity). This importance associated with fact gathering may better explain the following section of the Supreme Court's decision:

"Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(b) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known."⁵³

The Supreme Court concludes its chapter on the duty of care by setting out guidelines which are greatly needed to properly balance different concepts which at first glance seemingly appear incompatible:

⁵² *Maple Leaf Foods Inc. c. Schneider Corp.* (1998), 42 O.R. (3d) 177, page 192.

⁵³ Supreme Court judgment, par. 67.

“In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.”⁵⁴

In other words, courts must direct their attention not so much on the decision itself or on their *ex post facto* appreciation of this very decision, but focus rather on the decision making process which process ultimately must convince the courts that the directors did indeed exercise the care, diligence and skill that a reasonably prudent person would have used in comparable circumstances.

1. **CONCLUSION**

So in the end, was the Peoples case much ado about nothing ?

At first glance, and a lot of insolvency practitioners certainly feel this way, it may appear a little out of synch with modern business practices to conclude that no duty is owed to the creditors of insolvent corporations. But rest assured, Canadian and Quebec laws do not protect directors from recourses directed against them in cases of fraudulent or ill motivated transactions.

In this regard our legal regimes are no different from those in the other British Commonwealth countries. We just like to call the whole thing differently. And creditors

⁵⁴ Supreme Court judgment, par. 67.

can still resort to the oppression remedy provisions of section 241 CBCA if their rights were abused.

The Peoples decision did matter. In the wake of the different scandals in the USA concerning corporate governance and boards of directors blinded by management, but for all the wrong reasons, directors in this country and the legal profession could no longer continue forward without clear indications as to the exact meaning and extend of the duties provided in section 122 CBCA.