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Analytical Framework for Oppression Remedy under the *Business Corporations Act*

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Case Commented On: *Patel v Chief Medical Supplies Ltd*, 2015 ABQB 694

In *Patel v Chief Medical Supplies Ltd.*, 2015 ABQB 694, the Court of Queen's Bench of Alberta was confronted with the issue of oppression of the interest of minority shareholders under the *Business Corporations Act*, RSA 2000, c B-9 [ABCA]. The judgment raises a number of important jurisprudential questions including the analytical framework for the oppression provision in section 242 of the ABCA and the scope of the remedy for oppression under the ABCA. In the ensuing discussion, this writer offers his opinion on these issues and posits that, in determining whether there is oppression in any given instance, Alberta courts ought to adopt the analytical framework enunciated by the Supreme Court of Canada (SCC) in *BCE v 1976 Debentureholders* [2008] 3 SCR 560 [*BCE*]. Doing so would enhance the development of the oppression remedy in Alberta.

Facts

The Applicants (consisting of the Patel and Lasaleta families) and the Respondent, Paul Tulan, are shareholders in two companies, Chief Medical Supplies Ltd. ("CMS") and 1134853 Alberta Ltd. ("113"). CMS specializes in the development and manufacture of pharmaceutical products including high quality dialysis fluids, while 113 owns a building in Calgary.

The Respondent holds sixty per cent of the shares of CMS while the remaining shares are held by the Applicants and other shareholders. Although the Applicants are minority shareholders in CMS, they contributed the majority of the capital in CMS, including the initial start-up capital.

Beginning from their incorporation both CMS and 113 have been managed primarily by the Respondent. There was a close friendship between the Applicant families and the Respondent. Given this close relationship, the Applicants were happy to have the Respondent manage the business and affairs of CMS and 113. The Applicants trusted the Respondent to carry on the business in the best interests of the companies and the shareholders.

The Applicants alleged that, in the course of managing the business and affairs of CMS and 113, the Respondent engaged in conduct that oppressed or unfairly prejudiced or unfairly disregarded the interests of the Applicants. In particular, the Applicants alleged that the Respondent encumbered the assets of CMS and 113 (including the building owned by 113 in Calgary) to obtain an $11 million loan from the Bank of Montreal to further his (Respondent's) personal interest and to the detriment of the shareholders of CMS and 113.

Regarding the loan, the Respondent had incorporated 2427419 Ontario Ltd. ("242") in July of 2014 in order to buy a warehouse in Mississauga, Ontario. The Respondent owns sixty percent

interest in 242, while the remaining shares in 242 are owned by shareholders not specifically identified in the judgment. The Applicants do not own shares in 242. The loan was obtained by the Respondent for, and on behalf of, 242 but the assets of CMS and 113 were used to secure the loan, apparently without the knowledge or approval of the Applicants. With the aid of the loan '242' acquired a building and purchased certain pharmaceutical equipment.

The Applicants alleged further that the Respondent misappropriated a number of business opportunities belonging to CMS and 113 for his personal benefit. These business opportunities include:

(1) The incorporation by the Respondent of Alberta Veterinary Laboratories Ltd. ("AVL") and the use by 'AVL' of CMS' resources, personnel and office space without payment of rent. AVL's address is the 113 building and 'AVL' operates out of that building and CMS' space.

(2) The Respondent's acquisition of Get-Away Dialysis Ltd. ("Get-Away"), a company engaged in the provision of a high standard of dialysis treatment.

Finally, the Applicants alleged that the Respondent paid himself an unusually high and unwarranted management fees in contravention of an agreement reached by the parties that no management fees were to be paid to the Respondent until the shareholder loans were repaid.

To remedy these alleged oppressive conduct the Applicants prayed the court to appoint a Receiver or an Inspector pursuant to s. 242(3) of the ABCA.

The Respondent did not dispute the substance of the allegations but argued that he acted within the scope of his management power. More specifically, the Respondent argued that the loan was obtained with the tacit approval of the Applicants and that the business opportunities in which he participated are different from the usual business of either CMS or 113. These business opportunities, the Respondent argued further, are matters in which CMS and 113 would not normally be interested.

The Decision

The Honourable Mr. Justice G.C. Hawco of the Court of Queen's Bench found that the Respondent managed both CMS and 113 "as if he were the only shareholder" [at para 21]. The court concluded that "the Applicants' interests have been unfairly disregarded" by the Respondent [at para 28]. In particular, the court found that the following actions of the Respondent unfairly disregarded the interests of the Applicants:

(1) Securing the loan by encumbering 113's primary asset, which is the 113 building [at para 21].

(2) The acquisition of Get-Away Dialysis Ltd. This is because, as is clear from CMS records and as admitted by the Respondent, CMS had earlier planned to expand their business to include the provision of dialysis treatment. Moreover, "[t]he acquisition of this company without bringing something or anything to CMS has resulted in a loss to CMS while Mr. Tulan or his company has made a profit in excess of $300,000" [at para 25].

(3) The unilateral payment of management fees (in excess of $1.8 million) to the Respondent [at paras 26 & 28]. In the words of the court,

> "Notwithstanding the fact that it was agreed that no management fees were to be paid to Mr. Tulan until the shareholder loans were repaid, those loans have not been repaid and yet Mr. Tulan has awarded himself management fees in excess of $1,800,000" [at para 26].

The court appointed an Inspector to investigate the affairs of CMS, 113 and 242 with a view to determining whether the Respondent misappropriated the assets of the companies or usurped for his personal benefit any corporate opportunities belonging to CMS and 113 [at paras 28 & 29].

Analysis of the Decision

This writer agrees with the court that the actions of the Respondent unfairly disregarded and unfairly prejudiced the interests of the Applicants. The problem, however, is that in arriving at its decision the court failed to engage in a rigorous analysis of the oppression remedy provision under the ABCA. In fact, despite a plethora of decided cases on the issue the court failed to cite any case(s) in support of its decision. A more worrisome observation is that the analytical framework enjoined by the SCC in the seminal case of *BCE* was completely ignored by the court.

The oppression remedy provision under section 242(2) of the ABCA is to the effect that:

> If, on an application under subsection (1), the Court is satisfied that in respect of a corporation or any of its affiliates
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> (a) any act or omission of the corporation or any of its affiliates effects a result,
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> (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
>
> (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
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> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the Court may make an order to rectify the matters complained of.

In *BCE*, the SCC enunciated a two prong approach to the oppression remedy. The SCC held that:

> In our view, the best approach to the interpretation of s. 241(2) [of the *Canada Business Corporations Act*] is one that combines the two approaches developed in the cases. One should look first to the principles underlying the oppression remedy, and in particular the concept of reasonable expectations. If a breach of a reasonable expectation is established, one must go on to consider whether the conduct complained of amounts to "oppression", "unfair prejudice" or "unfair disregard" as set out in s. 241(2) of the *CBCA* [at para 56].

Thus, in determining whether or not there is oppression in any given case, Canadian courts are

required to conduct "two related inquiries" viz: "(1) Does the evidence support the reasonable expectation asserted by the claimant? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms 'oppression', 'unfair prejudice' or 'unfair disregard'" [*BCE*, at para 68].

In the instance case, the trial judge failed to conduct these two related inquiries. The trial judge ought to ascertain, first and foremost, the Applicants' reasonable expectation(s) and whether the evidence supports the reasonable expectation(s) asserted by the Applicants. Reasonable expectation could arise from a numbers of factors including "general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and agreements; and the fair resolution of conflicting interests between corporate stakeholders" [*BCE*, at para 72].

The reasonable expectation of the Applicants in this case is that the Respondent, as director and manager of both CMS and 113, would act honestly and in good faith with a view to the best interest of CMS and 113. As the SCC held in *BCE*, shareholders and other stakeholders have a reasonable expectation that directors would act in the best interest of the corporation [*BCE*, at para 66]. Moreover, shareholders "have a reasonable expectation of fair treatment" [*BCE*, at paras 64 & 70].

While in this case the court ignored the *BCE* analytical framework, it is worth noting that many cases in Alberta have adopted and followed the *BCE* framework. See, for example, *Shefsky v California Gold Mining Inc*., 2014 ABQB 730 (CanLII); *Krulc v Krulc*, 2015 ABQB 213 (CanLII); *1408418 Alberta Ltd. v Oslund*, 2015 ABQB 560 (CanLII); and *R. Floden Services Ltd. v Solomon*, 2015 ABQB 450 (CanLII).

Is the Appointment of an Inspector Justified?

As indicated previously, the court appointed an Inspector to investigate the affairs of CMS, 113 and 242 [at paras 17, 28 & 29]. The court acknowledged that the appointment of an Inspector is not specifically provided for by the ABCA, but held that because section 242(3) of the ABCA empowers the court to "make any interim or final order it thinks fit", the court had the power to appoint an Inspector [at para 20]. The court justified the appointment of an Inspector partly as follows:

> I am also concerned that obtaining information and documents from Mr. Tulan has been fraught with difficulties. I am concerned that the Court is not in possession of sufficient information which would warrant granting the appointment of a Receiver or many of the other remedies set forth in s 242(3) of the ABCA [at para 28].

Although the ABCA does not specifically authorize the court to appoint an Inspector, the court can appoint an Inspector if the court believes that such appointment would rectify the matter(s) complained of. Besides, the appointment of an inspector is implicit in the powers vested in the court under sections 231(2) and 242(3) of the ABCA. Section 231(2)(d) provides that the court may order an investigation to be made of a corporation in order to determine whether "persons concerned with the formation, business or affairs of the corporation or any of its affiliates have in that connection acted fraudulently or dishonestly". Investigation may also be ordered by the court in order to determine whether there is oppression, unfair prejudice or unfair disregard of the interest of a security holder [ABCA, s. 231(2)(b)]. Similarly, in an oppression remedy suit

the court may make any interim or final order it thinks fit including an order directing an investigation of the management of a corporation [ABCA, s. 242(3)(o)].

The court did not cite sections 231(2) and 242(3) of the ABCA in support of the order appointing an Inspector, but it is clear that the purpose of the Inspector's appointment coincides with the spirit of these sections. In the words of Justice Hawco:

> This Court further directs the inspector to determine, inasmuch as he or she is able to do so, whether the Respondents or any of them have misappropriated corporate assets or resources and if so to what degree and whether the Respondents or any of them have usurped any corporate opportunities which ought to have been afforded to CMS or 113 [at para 29].

While the court had the power to appoint an Inspector, the question remains whether the appointment of an Inspector in this case rectifies the matters complained of by the Applicants. For the purpose of the oppression remedy, the sole objective of any remedial order is rectification of the matters complained of [ABCA, s. 242(2)]. It is unclear whether the appointment of an Inspector in this case is designed to aid the court in determining whether a more drastic remedy would rectify the complaints of the Applicants. However, the mere appointment of an Inspector in and of itself does not rectify the matters complained of. Notwithstanding the appointment of an Inspector, the Respondent retains the power to manage the business and affairs of CMS and 113 as director of both companies. Thus, the Respondent retains the ability to inflict further damage on the interests of the Applicants. Moreover, because the Respondent retains his managerial power, he could potentially frustrate the Inspector's investigation by being uncooperative. The Respondent has already displayed his uncooperative attitude because, as the court noted at para 28, "obtaining information and documents from Mr. Tulan has been fraught with difficulties."

It should be noted, however, that the court imposed certain restrictions on the management of CMS and 113 including an order restraining both companies "from borrowing any funds or pledging any assets in excess of $10,000.00 or outside the ordinary course of business", as well as an order restraining both companies "from paying, transferring, pledging any funds or assets to any of the individual Respondents or for their benefit, without obtaining the prior consent of the Applicants or the approval of this Court on notice" [at para 30].

Given the magnitude and persistence of the Respondent's oppressive conduct, a more appropriate remedy is an order that puts an end to the Respondent's abuse of his power. In this regard, suspension or removal of the Respondent as director and manager of both CMS and 113 would have been appropriate. In *R. Floden Services Ltd. v Solomon*, 2015 ABQB 450, for example, the Honourable Justice W.N. Renke granted an order permanently removing a director found to be engaged in persistent acts of oppression. In addition, Justice W.N. Renke granted an injunction restraining the director from representing himself as having any ostensible or real authority from the company [*Floden*, at para 139].

A Derivative Action is Desirable

The evidence adduced in this case support the reasonable expectation of the Applicants; hence an oppression remedy suit is appropriate in the circumstances. However, a more appropriate cause of action is a derivative action under section 240 of the ABCA. A derivative action is an action

brought by a "complainant" (that is, a shareholder, director, creditor or 'a proper person') in the name and on behalf of a corporation [ABCA, s. 240(1)]. A derivative action is more appropriate here because most (if not all) of the matters complained of amount to wrongs done by the Respondent to both CMS and 113. For example, the encumbering of 113's building to obtain the loan is breach of the Respondent's fiduciary duty to "act honestly and in good faith with a view to the best interests of the corporation" [ABCA, s. 122(1)(a)]. Likewise, the misappropriation by the Respondent of business opportunities which would normally have accrued to CMS is breach of the Respondent's fiduciary duty owed to CMS [see *Canadian Aero v O'Malley* [1974] S.C.R. 592].

It may well be that the Applicants in this case did not specifically ask for leave to bring a derivative action on behalf of CMS and 113. However, under section 242(3)(q) of the ABCA, the court has power to grant leave to institute a derivative suit even in instances where the applicant applied solely for the oppression remedy. This is exactly what occurred in *Floden* where Justice W.N. Renke granted leave to the claimants (seeking oppression remedy) to sue derivatively [*Floden*, at para 139(5)].