



Business judgment rule does not trump unanimous shareholders' agreement

By Michael Osborne, *Affleck Greene McMurtry LLP*

Directors of a corporation cannot invoke the business judgment rule to justify decisions that violate a unanimous shareholders' agreement, the Ontario Divisional Court held recently.¹

Facts

In 2005, Bruno Barbieri and Peter, John, and David Herwynen bought Platinum Wood Finishing Inc., a company that pre-finishes hardwood floors and plywood. The Herwynen brothers acquired a 70% interest through their holding company, and Mr. Barbieri acquired a 30% interest, also through a holding company. The Herwynen brothers insisted that Mr. Barbieri pay a premium for his 30% interest, which they justified on the basis that their sawmill, Herwynen Sawmill, would continue to be Platinum's biggest customer. Mr. Barbieri agreed, but on condition that a unanimous shareholders' agreement would specify, among other things, that he would be President of Platinum at an annual salary of \$100,000, and that certain decisions, including changes to his pay, would require unanimous agreement of the shareholders.

These terms were included in a letter agreement summarizing the terms of a planned unanimous shareholders' agreement, which the parties contemplated would supersede the letter agreement.

The transaction closed and Mr. Barbieri began running Platinum. He achieved "exceptional"² financial results, paying down debt and recording significant profits from which dividends were paid to the shareholders.

However, in March 2008, Mr. Barbieri took ill. He was ultimately diagnosed with leukemia and spent two and a half months in hospital. While he was in hospital, Peter Herwynen visited him to tell him that he should not be drawing his salary, and his pay was in fact cut off. When he got out of hospital, the Herwynen brothers purported to hold a directors' meeting at which Mr. Barbieri was fired and effectively removed as a director.

Mr. Barbieri applied under the *Ontario Business Corporations Act's* oppression remedy³ for an order requiring the Herwynen brothers to buy his shares in Platinum, and directing a trial on the issue of damages for his wrongful dismissal from employment with Platinum. In September 2008, Mr. Justice Newbould of the Ontario Superior Court of Justice ordered the Herwynen brothers to buy Mr. Barbieri's shares and directed a trial on the issue of damages. The Herwynen brothers appealed to the Ontario Divisional Court. On March 30, 2009, the Divisional Court dismissed the appeal.

Business judgment rule does not trump USA

One of the main issues on appeal was whether the business judgment rule applied. This rule exempts from scrutiny decisions of corporate directors who are acting in good faith. The Herwynen brothers argued that this rule trumps any specific terms contained in a unanimous shareholders' agreement and any reasonable expectations of shareholders. Writing for the panel, Madam Justice Wilson held that the business judgment rule does not apply where the shareholders have agreed upon a particular issue in a unanimous shareholders'

agreement. She noted that the shareholders had expressly provided that Mr. Barbieri was to manage the company and be paid \$100,000, and that this agreement was central to Mr. Barbieri agreeing to take a vulnerable, minority shareholder position. Wilson J. added:

If the business judgment rule were held to override the express terms of a unanimous shareholder agreement, such agreements would be of negligible value to a minority shareholder who becomes an equity owner in reliance on the protection contained in terms of a unanimous shareholder agreement. Instead of providing protection, such agreements could easily become the instruments of a "bait and switch" if controlling shareholders were permitted to shelter under the business judgment rule when violating the terms of a unanimous shareholder agreement to the prejudice of a minority.⁴

Thus she concluded:

While the business judgment rule applies to confer deference upon business decisions made in good faith in the interests of the company, there is no rationale for conferring the same deference where the parties have at the outset made express agreements as to particular business matters.⁵

Herwynen brothers' conduct was oppressive and not in the best interests of the company

Wilson J. also rejected the Herwynen brothers' assertions that they had acted in the best interests of Platinum in removing Mr. Barbieri. It is also noteworthy that in his decision, Newbould J. rejected all of the reasons the Herwynen brothers advanced as justifying Mr. Barbieri's removal⁶ and criticized the Herwynen brothers for preferring the interests of their sawmill over the interests of Platinum.⁷

The Divisional Court also upheld Newbould J.'s finding that the Herwynen brothers had engaged in oppressive conduct. Newbould J. found that the Herwynen brothers had engaged in a number of

oppressive acts. The principal oppressive conduct was stopping Mr. Barbieri's pay, firing him, and removing him as a director and co-signer of cheques, all of which was contrary to the unanimous shareholders' agreement.⁸ They also engaged in oppressive conduct by allowing the accounts receivable owed by their sawmill to build up to an inordinate degree, effectively using Platinum as a banker for the sawmill.⁹ Some of what the Herwynen brothers did was not oppressive. They refused to declare dividends, for instance, but the unanimous shareholders' agreement required unanimous agreement to declare dividends. Newbould J. also considered that he could not determine whether the low pricing the Herwynen Sawmill benefited from, as well as the move of the business to a plant owned by the sawmill, were oppressive.¹⁰

Wrongful dismissal claim

Another issue was whether Mr. Barbieri could properly claim for his wrongful dismissal from his position as President of Platinum with his oppression application. The normal rule is that a claim for wrongful dismissal cannot be intermingled with a claim for oppression. There is an exception for cases that are "at heart an oppression claim with a wrongful dismissal component".¹¹ Wilson J. held that Mr. Barbieri's was such a case, as his agreement to buy into the company in the first place was directly tied to his position as president and manager, his \$100,000 salary, and the requirement that a unanimous shareholders' resolution would be required to change it. She concluded, "The vulnerability of Barbieri's Company minority shareholding would be balanced by Barbieri's role in management and his secure salary."¹²

Remedies

The remedies awarded to Mr. Barbieri present a number of interesting aspects. First, Newbould J. held that the appropriate remedy was an order that the respondents buy out Mr. Barbieri's shares in Platinum. He determined that a judicially-imposed shot-gun buy-out process would not be appropriate in light of the relative financial position of the parties, and because it would be contrary to the unanimous shareholders' agreement.¹³

Second, Newbold J. held that there was to be no minority discount for Mr. Barbieri's shares, reasoning that because he paid a premium to acquire his 30% interest in the first place, it would be unjust to subject his interest to a discount. Wilson J. agreed.¹⁴

Third, Newbold J. ordered that *all* of the respondents, that is, the Herwynen brothers, their holding company, and Herwynen Sawmill, would be jointly and severally responsible to buy Mr. Barbieri's shares. This is of interest because among the respondents, only the Herwynen brothers' holding company was a shareholder of Platinum. Only Peter and John Herwynen were directors of Platinum. David Herwynen was a vice president of the holding company, but his precise role in the various companies was unclear.

Wilson J. upheld Newbold J.'s decision, citing precedent for the proposition that directors or officers can be found liable for oppression if they have benefited personally.¹⁵ Wilson J. held Herwynen Sawmill was also properly made liable for oppression because it was "directly linked to the oppressive conduct by benefiting from the non-payment" of money it owed to Platinum.¹⁶

Newbold J.'s extension of liability to Herwynen Sawmill is of interest. Neither his decision nor Wilson J.'s articulates fully the basis for extending liability to a separate corporation, Herwynen Sawmill. Herwynen Sawmill may have been an affiliate of Platinum as that term is defined in the statute, based on Herwynen brothers owning it as well as 70% of Platinum, but the decision does not indicate this clearly.¹⁷ Newbold J. held that David and John Herwynen breached their fiduciary duties

to act in Platinum's best interest by favouring Herwynen Sawmill, a company they owned.¹⁸ They allowed Herwynen Sawmill to use Platinum as its banker. Herwynen Sawmill thus benefited from this breach, as Wilson J. observed.¹⁹ Thus it would appear that Herwynen Sawmill knowingly received property that was transferred in breach of fiduciary duty, and is thus liable under the doctrine of "knowing receipt".²⁰ Liability for knowing receipt is restricted to disgorgement of the amount received, and not for the whole loss, however. Extending liability for the whole amount of the breach would only be justifiable if Herwynen Sawmill were liable for "knowing assistance", that is, if it assisted in the breach of fiduciary duties.²¹ Herwynen Sawmill was likely complicit in the breach, as no doubt it was its need for funds that motivated the breach of fiduciary duty. It is at least questionable, however, whether Herwynen Sawmill could be considered to have assisted in the breach on this ground.



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¹ 2082825 *Ontario Inc. v. Platinum Wood Finishing Inc.*, (2009), [cite] (Div. Ct.)

² 2082825 *Ontario Inc. v. Platinum Wood Finishing Inc.*, (2009), [cite] (S.C.J.)

³ Sections 207 and 248. Similar provisions exist in the federal *Canada Business Corporations Act*, and most provincial corporate statutes.

⁴ Div. Ct. decision, ¶23

⁵ Div. Ct. decision, ¶24

⁶ SCJ decision, ¶53-56

⁷ SCJ decision, ¶46.

⁸ SCJ decision, ¶31-37.

⁹ SCJ decision, ¶41-47.

¹⁰ SCJ decision, ¶48-50.

¹¹ *Walters v. Harris Partners Ltd.*, 2001 CarswellOnt 1424 (S.C.J.); *Nanef v. Con-Crete Holdings Ltd.* (1993), 11 B.L.R. (2d) 218 (Ont. Gen. Div.); cited by Div. Ct. decision at ¶44-46.

¹² Div. Ct. decision at ¶48.

¹³ SCJ decision at ¶70.

¹⁴ SCJ decision, ¶72. Div. Ct. decision, ¶62-63.

¹⁵ *Budd v. Gentra Inc.* (1998), 111 O.A.C. 288 (C.A.), cited by Div. Ct. decision at ¶54.

¹⁶ Div. Ct. decision ¶56.

¹⁷ The Ontario *Business Corporations Act* defines “affiliate” as follows:

Affiliated body corporate

(4) For the purposes of this Act, one body corporate shall be deemed to be affiliated with another body corporate if, but only if, one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person. [Emphasis added]

¹⁸ SCJ decision at ¶46-47.

¹⁹ Div. Ct. decision at ¶56.

²⁰ *Waxman v. Waxman*, [2004] O.J. No. 1765 (C.A.), *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] S.C.J. No. 92, Paul Perell, “Intermeddlers or Strangers to the Breach of Trust or Fiduciary Duty”, (1999), 21 *Advocates Q.* 94.

²¹ *Waxman v. Waxman*, at ¶553, *Citadel General Assurance Co. v. Lloyds Bank Canada*, at ¶48-51, Perell at 115-116.