A Trustee for the Oppressed

by Albert S. Frank, LL.B.

Suppose the directors, officers, and shareholders of a corporation see that it has problems. Can they "take the money and run" by selling the corporation to a buyer of dubious substance, perhaps even a shell corporation, leaving the creditors to suffer in the resulting bankruptcy?

Anybody tempted by this approach should read the case of ***Dylex Ltd. (Trustee of) v. Anderson*** (2003), 63 O.R. (3d) 659. Richter & Partners Inc. (R&P Inc.), as trustee in bankruptcy of Dylex Ltd., sued various persons including the former directors, officers and shareholders of Dylex. Dylex had been put into bankruptcy just four months after the completion of an agreement between Dylex and the Harof Wolf Group Inc. (HWGI) under which HWGI bought all of the shares of Dylex.

R&P Inc. claimed that the HWGI sale was harmful to Dylex and its creditors because it resulted in making Dylex insolvent, and because HWGI wrongfully took Dylex's assets. R&P Inc. claimed that the share sale was oppressive to the interests of Dylex's creditors, a breach of common law and statutory duties of care owed by the directors and senior officers to Dylex, and a breach of fiduciary obligations to protect the interests of creditors.

The former directors and senior officers of Dylex brought a Motion under Rule 21 of

Ontario's Rules of Civil Procedure, asking that the statement of claim be struck out (in other words, that it should be eliminated at a preliminary stage long before trial).

Specifically, they asked the Court to rule that:

- the trustee in bankruptcy did not have the legal capacity to assert the oppression remedy claim against the defendants;

- the trustee in bankruptcy did not have the legal capacity to sue for a breach of fiduciary duty allegedly owed by the former directors and officers of Dylex towards creditors; and

- the former directors and senior officers had no legal duty to conduct investigations into the moral character and background of HWGI for potential dishonesty before HWGI acquired the shares of Dylex.

Rule 21

The principles that apply to motions to strike out claims as disclosing no reasonable cause of action or for the determination of points of law under Rule 21 have been well settled, for example by the Supreme Court of Canada in ***Hunt v. Carey Canada Inc.***, [1990] 2 S.C.R. 959. The principles are:

1. The statement of claim should not be struck out unless it is “plain and obvious” that the claim discloses no reasonable cause of action;

2. The allegations in the statement of claim are to be taken as true or capable of being proven unless they are patently ridiculous or incapable of proof;

3. The statement of claim is to be read generously with due allowance for drafting deficiencies;

4. The court should not at this stage of the proceedings dispose of matters of law that are not fully settled in the jurisprudence.

Oppression Remedy

According to the ***Canada Business Corporations Act***, R.S.C. 1985, c. C 44 (*CBCA*) and the similar provisions found in the legislation of Canada’s provinces generally, a corporation and its officers and directors may be liable under the Oppression Remedy if there is conduct that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of a complainant. Although the Oppression Remedy is not to be used for regular debt collection, under certain circumstances the courts have recognized that creditors can be complainants.

What about a trustee in bankruptcy? The moving parties argued that the trustee stands in the shoes of the corporation and that the corporation could not sue the directors, officers and shareholders for what had been done because once the decisions were made the acts done were the acts of the corporation itself. Therefore the trustee could not sue.

The successful answer to this was that the trustee "as the creditors' appointed representative" could be "a proper person to seek oppression remedy relief," and:

> *In any event, it cannot be readily concluded at this stage of the proceedings that this issue of law is fully settled in the jurisprudence and that it is plain and obvious that the trustee in bankruptcy does not have such capacity.*

Fiduciary Duty

Do directors owe a fiduciary duty to creditors? The traditional answer would be, "obviously not." A fiduciary duty is a duty to put the interests of another ahead of one's own interests. Why should directors owe such a duty to a corporation's creditors any more than they (or the corporation) owe such a duty to the corporation's competitors?

There seems to be a trend in Canada and certain other Commonwealth countries, however, towards recognizing that there could be a fiduciary duty to creditors, particularly where the corporation was insolvent when it made the challenged transaction or where the transaction made the company insolvent. The trustee in bankruptcy argued, and the other side acknowledged, that under some circumstances directors may owe a fiduciary duty to creditors.

The Motion Judge could not conclude that it was plain and obvious that a trustee cannot assert a claim of breach of fiduciary duty on behalf of creditors, so he ruled against the Motion.

Result

The result was that the Motions were dismissed. The claims have enough potential to proceed to trial. The Motions Judge did not, of course, make any findings as to whether the factual allegations are true or whether the claims would ultimately succeed.

# # #

The above article first appeared in the August, 2003 issue of ***The Bottom Line.***

# # #

Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

# # #

Albert S. Frank is a business and trial lawyer with over 30 years of experience.

Phone: 416 929 7202
Email: afrank@FrankLaw.ca
Web: www.FrankLaw.ca