INSTITUTIONAL ACTIVISM: CURRENT TRENDS AND EMERGING LEGAL ISSUES

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> Ford U.S. treated Ford Canada as if it were a wholly owned subsidiary with the acquiescence of the management of Ford Canada and maintained a transfer pricing system that was unfairly prejudicial to the interests of the minority shareholders. Ford U.S. was the beneficiary of a transfer pricing system which yielded non-arm's length results . . .[1]
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> . . . . .
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> Mr. Berg did not conduct himself in an upright manner, as he was required to do. He requested types and amounts of compensation that he knew or ought to have known were not in the best interests of Repap . . . Mr. Berg failed utterly in his duties to Repap. His own self-interest prevailed. His conduct was exactly opposite to the conduct that the law required of him as a fiduciary — disclosure, honesty, loyalty, candour and the duty to favour Repap's interest over his own.[2]
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> . . . . .
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> CCRC has taken its interest in a valuable asset . . . and is substituting therefore an asset of more dubious value (unsecured promissory notes) . . . CCRC is acquiescing in the upstreaming of the funds . . . out of its control despite the fact that the result will be that it will lose control of its most meaningful asset with no direct benefit to CCRC . . . CCRC . . . is unfairly disregarding the

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* Miller Thomson LLP. This article is based on a paper originally delivered as part of a Law Society of Upper Canada seminar on April 28, 2006. This paper is confined to civil litigation. Institutions may engage in a wide variety of other activism including informal persuasion and voting on corporate governance issues. Most noticeably, of late institutions have banded together and held out for higher prices on takeovers — particularly related party takeovers — and have often been able to secure an increase in price. A useful website dealing with voting and related issues is <www.issproxy.com> (Fairvest is now part of Institutional Investor Services).

1. *Ford Motor Co. of Canada, Ltd. v. Ontario Municipal Employees Retirement Board,* [2004] O.J. No. 191 (QL) at para. 349, 41 B.L.R. (3d) 74, 2004 D.T.C. 6224 (S.C.J. (Comm. List)), affd on this point [2006] O.J. No. 27 (QL), 263 D.L.R. (4th) 450, 79 O.R. (3d) 81 (C.A.), leave to appeal dismissed [2006] S.C.C.A. No. 77.
2. *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.*, [2002] O.J. No. 2412 (QL), 214 D.L.R. (4th) 496, 27 B.L.R. (3d) 53 (S.C.J. (Comm. List)), affd [2004] O.J. No. 636 (QL), 250 D.L.R. (4th) 526, 183 O.A.C. 310 *sub nom. UPM-Kymmene Corp. v. Repap Enterprises Inc.* (C.A.) (hereafter *Repap*).

bondholders' interests in failing to preserve and protect its assets . . . Calpine is unfairly disregarding the interests of the bondholders through its involvement in the conduct complained of . . .[3]

I. INTRODUCTION — THE NEED FOR INSTITUTIONAL ACTIVISM

The divergence between control and ownership that lies at the heart of our corporate structure creates opportunities for officers and directors of public corporations to favour their personal interests or those of controlling shareholders over those of minority shareholders and other more vulnerable stakeholders. This is a fundamental and unavoidable fact that drives almost all litigation in the corporate arena. Our laws (both corporate and securities) provide a set of checks and balances that aim to minimise the potential for managerial opportunism. The market — through mechanisms such as the hostile takeover — also may provide a disciplinary role.[4] Despite these barriers, to one reading through the business section or the law reports it may sometimes seem that a not insignificant cross-section of the Canadian business community can resist everything but temptation.

We are told that in recent years the incentive of managers to cheat has been amplified by the growth of stock options as a primary method of management (and occasionally director) compensation. It is unclear today whether the checks and balances internal to a public corporation are vigorous enough to withstand the forces that massive amounts of money inevitably create. In the view of some, directors are an ineffective check on corporate misbehaviour. In the entirely pessimistic — but unfortunately perhaps too well-informed — view of a senior corporate partner at one of Canada's largest law firms, "directors, in law and in fact, are ineffective representatives of the interest of investors. They are the champions of management . . .".[5] Other commentators despair of auditors,

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3. *Harbert Distressed Investment Master Fund, Ltd. v. Calpine Canada Energy Finance II ULC,* [2005] N.S.J. No. 317 (QL) at paras. 135-39, 235 N.S.R. (2d) 297, 7 B.L.R. (4th) 276 (S.C.) and following (hereafter *Calpine*).
4. But where there is a dual share class structure this discipline may be absent due to the ability of insiders to control despite having a limited economic stake.
5. W. Grover Q.C., "Corporate Governance of Greed", Falconbridge 2004 Lecture available at the York University (Osgoode Hall) website: <www.osgoode.yorku.ca/media2.nsf/>.

lawyers or financial advisors doing anything to curb managerial opportunism,[6] given their self-interest in pleasing clients.

Governmental oversight is not strong enough alone to provide meaningful deterrence. Although the funding of the Ontario Securities Commission (OSC) has been very significantly enhanced, its track record viewed most favourably is at best mixed. Even then, the sanctions that it imposes have a questionable deterrent impact when weighed against the millions or tens of millions that can be gained by misconduct. For practical purposes our criminal law does not exist to deter wrongdoers in the public markets.

The combination of greed with opportunity, internal corporate controls whose robustness buckles under the economic realities of the day, and a lack of meaningful punishment from our regulatory/criminal system have inevitably resulted in scandal. There are first the notorious frauds — the fake gold deposits in the Busang, the fake magnet factories in Romania and the fake accounting. Although these frauds are deeply troubling in their length and scope, to some degree we may rationalise to ourselves that frauds will from time to time occur no matter how strong the deterrents contained in our legal system. There will always be a few who cannot be deterred by any legal system and, sadly, it seems that there will always be lawyers, accountants, directors and financial advisors who will be fooled by them, either as a result of the shrewdness of the fraudster or their inability to add 2 plus 2 and to get 4.

Perhaps more troubling than the outright frauds are cases where the actors are able to rationalise their actions and where the advisors — perhaps having fallen prey to the risk of identifying too strongly with the individuals who give them their instructions — are able to clothe the actions of the clients in a patina of respectability. Although we can never eliminate the fraudster, one would hope that we have a system that would result in honest corporations, receiving expert advice, always placing the interests of stakeholders first. But that also does not seem to be the case, or at least there are enough instances in the recent law reports and business pages where it is not the case to cause concern.

The three quotations at the beginning of this article show a pattern that is not comforting. These cases all involved respected

6. J. Coffee Jr., "Understanding Enron: It's About the Gatekeepers Stupid" (2002), 57 Bus. Law. 1403. For a sobering Canadian case, see *Orsini (Re)* (1991), 2 B.L.R. (2d) 271 (Ont. Sec. Com.).

corporations with blue chip advisors and blue chip boards. Yet, for some reason the legitimate interests of stakeholders were subordinated to the interests of those in control. One is left with an uneasy concern that part of the calculus of some of the actors was a conclusion that, even if the conduct involved was questionable, there was no effective mechanism available at law or in the market to curb the behaviour. One does not have to be a cynic to recognise that normally good people, if led to believe that they can "get away with it", are apt to approach or even cross boundaries.

In *Ford Canada*[7] it has been held by our courts that one of Canada's largest and most respected corporations followed a pattern of conduct in pricing inter-company sales that caused a staggering amount of damage (something in the range of $500 million) to minority shareholders. This $500 million was effectively transferred to its American parent. Management of Ford Canada knew that the pricing mechanism was unfair to the minority but said nothing until its ex-president, who had retired and was thus out of the contest for further advancement within Ford, pressed the issue. Even then, rather than disclosing the problem to minority shareholders and seeking to make amends, the corporation pursued a course of conduct, a going-private transaction, that, if successful, would have buried the issue for all time. It was only the intervention of a group of institutional shareholders who were willing to spend millions of dollars in litigation that brought the matter to light.

In the *Repap*[8] case, the corporation was a highly leveraged pulp and paper company. It was efficiently run by management but a turnaround in its fortunes was almost entirely dependent on something — commodity prices — that was beyond the control of management. The court held that the new chairman of the board was able to control and channel the information that went to the board in a manner that allowed him to secure a grossly unfair employment contract. Without a change in control (and an activist institutional shareholder who had finally had enough with executive overcompensation) it seems entirely likely that the transaction would never have been attacked and that the recipient of the corporate largesse instead would one day have been featured on the front page of the *Report on Business* as one of Canada's highest paid executives.

7. *Supra*, footnote 1.
8. *Supra*, footnote 2.

In *Calpine*,[9] the parent corporation was one of America's largest electricity generators. In buoyant times it had raised $22 billion in debt by way of bank debt and bonds. The debt had been raised though various finance subsidiaries to fund operating entities, and was backed by the guarantee of the parent. The parent's credit-worthiness came into doubt. The value of its bonds fell to roughly 65-70 cents on the dollar. Its banks began to pressure it. The parent began causing its subsidiaries to sell off assets. In one transaction, the parent took a number of complex steps the net effect of which would have been on completion to strip cash out of one subsidiary without regard to the fact that one class of bondholders should have had a first call on the proceeds of the sale of its assets. The convoluted corporate structure made it impossible for any but the most sophisticated of investors to understand what was occurring. One sophisticated investor waded through the dense corporate disclosure and recognised that if the stripping of funds was stopped the bonds of the subsidiary in question would go to 100 cents on the dollar. It bought up approximately $125 million (U.S.) of bonds on margin and moved to stop the funds from being channelled up to the parent. The financing had occurred through a Nova Scotia unlimited liability corporation. This brought the oppression remedy into play. The court held that the proposed transaction was oppressive. Without an aggressive hedge fund that had the sophistication to ferret out the problem — and was willing to back its analysis with the purchase of tens of millions of bonds and to litigate to protect the value of these bonds — this corporate transgression too would have been allowed to pass unnoticed.

The three decisions above all suggest that the use by institutional investors of the civil litigation system may provide an important additional check that will have to be considered by market participants in Canada before engaging in conduct that may be oppressive. In each case, institutions were able to prove that oppressive conduct had occurred. At the same time, two of the decisions — *Ford Canada* and *Calpine* — raise troubling issues as to whether the remedies available in the civil system will truly act as a deterrent for corporate misbehaviour.

In *Ford Canada*, the complaining institutional shareholders had apparently bought their shares toward the end of Ford's 10-year pattern of oppressive conduct. As a result of a technical legal point —

9. *Supra*, footnote 3.

the court held that the loss for the earlier oppressive conduct had been suffered by the shareholders who had sold to the institutions and not by the institutions themselves — the monetary award actually received by the litigating minority shareholders was only about 1% to 3% of the actual gain secured by Ford by its misconduct.[10] Viewed globally, the result of the litigation is that Ford got away with roughly 98% of the results of its oppressive conduct. Although some lawyers may be comfortable with the legal gymnastics that led to this result, one can doubt whether non-lawyers would be as likely to think that the end result was entirely just.

In *Calpine* the result was, if possible, even worse. There, despite oppression being shown, it was held the plaintiff was entitled to no remedy as it had known about the proposed oppressive conduct when it bought its bonds (*i.e.* it had "bought into the oppression") and thus had not had its reasonable expectations thwarted.[11] The hedge fund thus received no remedy in its favour despite spending very significant resources and betting millions on the litigation through its purchase of bonds. (The court did order, however, relief in favour of other long-term bondholders who had not bought into the oppression. It ordered sufficient funds be frozen to protect their interests. Some positive relief to the benefit of other stakeholders was thus secured).[12]

To put it mildly, unless the approach in *Ford Canada* and *Calpine* is reversed in future cases, or unless other approaches to civil recovery can be fashioned, these decisions will act as a significant disincentive to institutional activism in the civil litigation sphere. Strictly speaking, the refusal by the Supreme Court of Canada to grant leave to appeal in the *Ford Canada* case does not amount to an endorsement of the reasoning of the Ontario Court of

10. A back of the envelope calculation (based on the trial decision) is found at J. Chapman, "Limitations Act Implications: Ford Motor Co. of Canada v. Ontario Municipal Employees Retirement Board" (2004), 29 Adv. Q. 340 at p. 345. The trial decision had awarded between 2% and 6% of the losses. It did this by awarding a small part of the historic loss plus increasing the fair value as at going private. As the Court of Appeal eliminated any damage award to the minority shareholders for historic oppression (save for one day or about $18,000 in total) the percentage of recovery dropped by a bit more than half from the possible recovery at trial.
11. *Supra*, footnote 3, at para. 169.
12. Calpine later filed for Chapter 11 and Companies Creditors' Arrangement Act, R.S.C. 1985, c. C-36 protection after a U.S. court stopped further asset stripping: *Calpine Corp v. Bank of New York,* 2005 WL 311956 (Del. Ch. Ct.). It is possible that under insolvency law the frozen funds may have to be shared by all bondholders and so it may be that the institution would ultimately derive benefit from the litigation.

Appeal. Indeed, it does not even amount at law to an endorsement of the result in the Court of Appeal. Nevertheless, as a practical matter the refusal leaves the decision in *Ford Canada* as a potential roadblock to any institutional investor contemplating a civil action. It may well be that in the future counsel, rather than hitting that roadblock head on, will attempt to work around the decision by turning to the derivative action procedure.

II. A BRIEF HISTORY OF INSTITUTIONAL ACTIVISM IN CANADA

For many years the accepted wisdom was that institutional investors in the Canadian capital markets were averse to litigation. As late as 1995 the Allen Committee in its Interim Report[13] summarized the information that it had received from institutional investors (in the context of secondary market claims) as follows:

> Institutional investors admitted that they would be loath to sue a company for misleading disclosure. Several reasons were cited for this stance. Institutions are reluctant to draw attention to investment "mistakes". Institutions do not wish to pour extensive resources (management time, money and expertise) into a lengthy litigation process when resources can be more fruitfully employed targeting new investment opportunities. Finally, institutions prefer to deal with sensitive issues such as disclosure practices in a far less confrontational and more private manner. Often discussions with management on such issues are productive.[14]

This observation by the Allen Committee was no doubt accurate when it was made in 1995.[15]

There is equally no doubt that a similar committee struck today would not make the same observation. The fact is that over the last ten years institutions have increasingly come forward in Canadian courts to advance the rights of equity and bond holders. A variety of economic and legal factors have contributed to this phenomenon. These include:

- The increased integration of the Canadian and American capital markets that has resulted in the increased presence of U.S.

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13. TSE Committee on Corporate Disclosure (Thomas I.A. Allen, Chair), "Toward Improved Disclosure: A Search for Balance in Corporate Disclosure" (Interim Report) (Toronto, Toronto Stock Exchange, 1995).
14 *Ibid.*, at p. 45.
15. A detailed discussion of the reasons that led to Canadian institutions formerly being averse to litigation is beyond the scope of this article. Readers with greater interest in this topic are referred to S. Erlichman, "Canadian Institutional Investor Activism in the 21st Century", available at <www.faskens.com>.

institutional investors in the Canadian market. This, in turn, has tended to reduce the clubby atmosphere that formerly existed in Canadian capital markets.

- There has been an increase in the United States of institutional involvement in litigation since the lead plaintiff provisions of the Private Securities Litigation Reform Act of 1995[16] were introduced. Canadian institutions have increased their exposure to the United States market and have learned lessons. A Canadian pension plan was the co-lead plaintiff in the recent Nortel settlement.
- The emergence of entrepreneurial institutional investors such as hedge and vulture funds. These funds have a tendency to take pro-active steps (including litigation) to enhance shareholder or bondholder value as opposed to following the old "Wall Street Rule" of simply selling and walking away from a bad investment. Indeed, these investors sometimes consciously seek out securities whose values have been distressed by questionable corporate conduct with a view to overturning that conduct and restoring lost value. These funds have become a major player in Canadian restructurings and it was inevitable that their interest would eventually stray into other value maximisation opportunities.
- An increasing recognition by Canadian institutional investors that their collective interest in the integrity of the market may require them to band together despite whatever procedural and cost difficulties may be posed by individual cases. Given the weaknesses elsewhere in the system, it may be that it is only through litigating over possible individual governance failures that a deterrent signal can be sent to participants in the market as a whole.
- The number of high profile corporate governance failures in Canada.
- The increasing value of investments held by institutional investors.[17]
- A greater sensitivity by institutions (especially long-term investors such as pension funds) that they have a fiduciary

16. Pub L. No. 104-67, 109 Stat. 737 (1995) (hereafter PSLRA).
17. G. Yaron, "Acting Like Owners: Proxy Voting, Corporate Engagement and the Fiduciary Responsibility of Pension Trustees" (available at <www.share.ca>) states that in 2004 pension plans owned approximately 21.7% of the domestic market capitalisation of the TSE. Their total equity holdings were $181.2 billion. The Investment Funds Institute of Canada's website, online at <http://www.IFIC.ca>, states that as of December 31, 2005 the assets held by mutual funds were $570 billion.

responsibility to protect the value of the investments in their portfolios and that this may, on occasion, extend to litigating.

- The growth of an entrepreneurial class of plaintiffs' lawyers and recognition of contingency fees.
- The teaming of legal resources between American and Canadian law firms.
- Class action legislation across Canada and a greater appreciation of the benefits that can flow from such legislation.
- The increasing use of the oppression remedy in the public corporation context.[18]

Significant civil cases having institutions as their lead litigant (or instigator) since 1995[19] include

- *Fidelity Management & Research Co. v. Gulf Canada Resources*.[20] Here an institutional investor bought up preference shares and argued that the corporation under the share conditions was obliged to declare dividends in arrears of $57 million. The corporation had suspended those dividends due to financial constraints but, by the time of the action, had capacity to pay the dividends. The action was dismissed based on the wording of the share conditions.
- *Deutsche Bank Canada v. Oxford Properties Group Ltd.*[21] The plaintiff owned $60 million of convertible debentures. An issue arose as to whether a dividend by the issuer triggered an adjustment to the conversion price. This in turn raised a question as to whether the terms of the indenture under which the debentures had been issued accurately reflected what the purchasers had been told in the prospectus. The institution's oppression remedy suit succeeded.

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18. See generally, J.S. Leon and S. Armstrong, "The Relevance of the Oppression Remedy as a Control on Corporate Governance in Canada" (2003), 27 Adv. Q. 402.
19. Of course, some cases did exist prior to 1995. Notable cases included the institutional response before the OSC to oppose the Canadian Tire takeover *C.T.C. Dealer Holdings Ltd. (Re)* (1987), 10 O.S.C.B. 857, affd 59 O.R. (2d) 79 (Div. Ct.); the Public Trustee's litigation over the Maple Leaf Garden takeover, *Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493, 13 B.L.R. (2d) 265 (Gen. Div.) and *Palmer v. Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161, 56 D.L.R. (4th) 128, 32 O.A.C. 113 (Div. Ct.). Also of note was the civil insider trading action brought by the CBC Pension Fund in the Doman/Bennett case.
20. [1996] O.J. No. 2508 (QL), 27 B.L.R. (2d) 135 (Gen. Div.).
21. [1998] O.J. No. 4375 (QL), 40 B.L.R. (2d) 302 (Gen. Div.) (*Oxford Properties*).

- *Casurina Limited Partnership v. Rio Algom Ltd.*[22] In this proceeding the plaintiffs were owners of $35 million of convertible debentures with a right to convert at a price of $40 at any time up to 2007.[23] This amounted to about 10% of all debentures.[24] When a takeover of Rio Algom in 2000 at a price of $27 occurred, the debentureholders effectively lost their right to convert their debentures into stock in the 2000-2007 time period (*i.e.*, they lost a potential upside if the share price rose.) The new owners of Rio Algom said that the debentureholders' only right under the terms of the debenture was to be bought out at the face value of the debentures. The owners sued for damages resulting from the loss of opportunity to convert into equity. They led evidence that in the market even "out of the money" conversion options had real value. However, the court held that the contractual remedy of buyout at par was the only remedy available to the debentureholders and dismissed their claims.[25]
- *CC&L Dedicated Enterprise Fund v. Fisherman*[26] (*YBM Magnex*). This was the prospectus (class) proceeding arising out of the YBM Magnex fraud. When the fraud came to light, institutional shareholders banded together to have a receiver appointed over YBM. The receiver was able to secure information about "who did what" in connection with YBM's operations and financing. It would turn out that the receivership application was a crucial tactical step. The shareholder litigation raised a number of significant and complicated legal issues, most particularly the ability of investors to claim against lawyers who had acted in connection with a prospectus and, on the secondary market side, the issue of inferred reliance. The prospectus action and the parallel secondary market claim secured a total recovery to investors of about $100 million. The settlement value of the claim was also assisted by a parallel OSC action which allowed additional information to publicly come to light.
- *Repap* (trial decision 2002) discussed above[27] — 100% institutional success.

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22. (2002), 28 B.L.R. (3d) 44 (S.C.J. (Comm. List)), affd [2004] O.J. No. 177 (QL), 181 O.A.C. 19, 40 B.L.R. (3d) 112 (C.A.), leave to appeal to S.C.C. refused 203 O.A.C. 399*n*.
23. The trial decision indicates that some of the plaintiffs were long-term owners while others may have bought after the takeover was announced.
24. The trial decision (*supra*, footnote 22, para. 20) indicates the total debenture offering was $353 million.
25. The case is also notable for its upholding of a "no action clause" that required any action on the debentures to be brought by the trustee in a collective fashion.
26. The settlement approval decision is reported at [2002] O.J. No. 1855 (QL).
27. See text accompanying footnote 8, *supra*.

- *Ford Canada* (trial decision 2003) discussed above[28] — 100% success on the facts but 98% of relief denied on a technical point.
- *AT&T Canada Inc. (Re)*.[29] In this proceeding institutions that owned warrants complained that their warrants had been rendered worthless as they had not received adequate notification of the need to convert them prior to the AT&T Canada going-private transaction. The matter got tangled up in a technical issue. It ended up settling on the basis that approximately 50% of the claim by the institutions was allowed in the AT&T Canada CCAA restructuring.
- *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*[30] The affairs of Hollinger were extremely complicated and intertwined with the even more complex affairs of Hollinger International.[31] In early 2005, the OSC blocked a proposed going-private transaction by its parent.[32] In parallel civil litigation, an institutional shareholder successfully moved for the appointment of an inspector. No one knows yet what the practical result of this will be. It is of interest to note that as of February 2006 the inspection had cost $19.2 million, or about $1 million per month.[33]
- *Metro Toronto Police Widows and Orphan Funds v. Telus*.[34] The plaintiffs owned $150 million worth of debentures carrying an 11.35% interest rate. Interest rates declined. Telus had the right in certain circumstances to repay the debentures but a provision in the debenture prevented Telus from directly or indirectly borrowing money at a lower cost in order to repay the debentures. Telus entered into a securitization transaction and sought to use the proceeds secured from the sale to the securitization special purpose vehicle to pay out the debentures. The holders objected, saying the transaction was more akin to a borrowing. The deben-

28. See text accompanying footnote 10, *supra*.
29. [2003] O.J. No. 5086 (QL), 127 A.C.W.S. (3d) 607 (S.C.J.).
30. [2004] O.J. No. 3886 (QL), 48 B.L.R. (3d) 194 (S.C.J.). At writing there are also 18 other reported decisions in this litigation.
31. The *Wall Street Journal* reported in March 2006 that Hollinger International had paid $102 million in litigation costs as at the end of 2005. See E. Cherney, "When Investors Help Find Fraud What Is It Worth?", *Wall Street Journal*, March 16, 2006, at p. C4.
32. Online at <http://www.osc.gov.on.ca/enforcement/proceedings/2005/rad_20050327_hollingerinc.pdf>.
33. See <www.hollinger.com>. The thwarted takeover bid was at a minimum of $7.65 per share. Although the stock price roughly doubled from $3.25 to $6.50 immediately after the court ordered inspection, it has since (August 2006) fallen to around $2.25.
34. [2005] O.J. 2309 (QL), 75 O.R. (3d) 784, 198 O.A.C. 287 (C.A.), leave to appeal to S.C.C. refused 350 N.R. 398*n*.

tureholders won, based on the Court of Appeal's holding that the securitization transaction constituted an indirect borrowing.

- *Calpine* (2005) discussed above.[35] The case was 100% successful on the merits but relief to the institution was denied as it had bought into the oppression.
- *Paulson & Co v. Algoma Steel Inc.*[36] Paulson & Co., a hedge fund, bought a significant stake in Algoma and wanted to force a change of the board and a recapitalisation (involving a very large dividend) of the company. After skirmishing over when a shareholder meeting should occur the matter was settled with Paulson securing some board representation and an agreement that a substantial dividend (but one smaller than that initially proposed) would be declared. It is unclear whether the net result differed materially from what would have occurred had a less aggressive approach been taken by the minority shareholder.
- *Greenlight Capital Inc. v. Stronach.*[37] MI Developments owns industrial real estate (which is primarily leased to Magna International, the auto parts manufacturer) and also owns a controlling interest in MEC (which owns racetracks and related enterprises). Greenlight sought relief designed to eventually cause MI Developments to spin off its interest in MEC and to turn itself into a real estate investment trust. It complained that the controlling shareholder of MI Developments, who also was the controlling shareholder of MEC, had exercised undue influence over its affairs and that a special committee of the board had not been truly independent in dealing with certain related party transactions. The application failed. The court held that the special committee had acted properly with the benefit of independent advice and that there was nothing wrong with the controlling shareholder advocating a policy that focused on the long-term growth of investments. The actions were consistent with the public statements of MI Developments in its prospectus and other disclosure documents.

From time to time institutional shareholders have also intervened in actions brought by others, particularly "bitter bidder" cases.[38]

35. See text accompanying footnote 11, *supra*.
36. [2006] O.J. No. 36 (QL), 79 O.R. (3d) 191, 14 B.L.R. (4th) 104 (S.C.J.).
37. [2006] O.J. No. 4353 (QL), 22 B.L.R. (4th) 11 (S.C.J.). The writer occasionally acts for related parties to MI Developments.
38. See, *e.g.*, *Maple Leaf Foods v. Schneider* (1998), 40 B.L.R. (2d) 244 (Gen. Div.), affd 42 O.R. (3d) 177 *sub nom. Maple Leaf Foods Inc. v. Schneider Corp.*, 113 O.A.C. 253,

Although it is outside the scope of this article, we have also seen activist intervention before securities commissions in cases such as *Sears Canada (Re)*.[39]

III. LESSONS OF INSTITUTIONAL ACTIVISM TO DATE

Looked at globally, it is worthy to note that at least seven[40] of the institutional actions discussed above have been successful on the real merits[41] or, through settlement, have resulted in significant investor recovery. Three have been failures (*Gulf Canada, Rio Algom, MI Developments*) and the impact of two others (*Hollinger, Algoma*) is debateable. If one eliminates these latter cases for the purposes of this discussion, the success rate on the merits, at greater than 50%, is relatively good. The high success rate of institutions may be contrasted with proceedings brought by smaller investors (usually on a class proceeding basis) which, as far as one can tell from the law reports, have had a dismal record of success. Indeed, a high proportion of these proceedings have been dismissed at a very early stage, often as a result of Rule 21 motions or failed class proceedings.[42] Although some actions of real merit have come forward from groups of smaller investors or in class proceedings not

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44 B.L.R. (2d) 115 (C.A.) where the institutions intervened at trial but did not pursue the appeal. It is also noted one large union pension fund (the Canadian Commercial Workers Industry Pension Plan) has teamed up with Siskinds in two secondary market continuous disclosure cases (*Royal Group* and *Biovail*) although it does not appear that these cases have progressed appreciably in the court process.

39. August 8, 2006. Reasons available online at <http://www.osc.gov.on.ca>.

40. *Oxford Properties, supra,* footnote 21; *Ford Canada, supra,* footnote 1; *Repap, supra,* footnote 2; *YBM Magnex, supra,* footnote 26; *Telus, supra,* footnote 34; *Calpine, supra,* footnote 3; and *AT&T Canada, supra,* footnote 29.

41. *Ford Canada* and *Calpine* were lost on what some might believe to be technicalities.

42. See, *e.g., Shaw v. BCE Inc.*, [2004] O.J. No. 3109 (QL), 189 O.A.C. 9, 49 B.L.R. (3d) 1 (C.A.), leave to appeal to S.C.C. refused 206 O.A.C. 396*n*; *Menegon v. Philip Services,* [2003] O.J. No. 8 (QL), 167 O.A.C. 277, 31 B.L.R. (3d) 29 (C.A.), leave to appeal to S.C.C. refused [2003] 2 S.C.R. ix; *Epstein v. First Marathon Inc.*, [2000] O.J. No. 452 (QL), 2 B.L.R. (3d) 30, 41 C.P.C. (4th) 159 (S.C.J.); *Stern v. Imasco,* [1999] O.J. 4235 (QL), 2 B.L.R. (3d) 30, 41 C.P.C. (4th) 159 (S.C.J.); *Samos Investments Inc. v. Pattison,* [2003] B.C.J. No. 348 (QL), [2003] 4 W.W.R. 39, 292 W.A.C. 298 (C.A.), *Budd v. Gentra,* [1998] O.J. No. 3109 (QL), 111 O.A.C. 288, 43 B.L.R. (2d) 27 (C.A.). In the loser category one could also add: the *Millgate Financial* saga (*Millgate Financial Corp. v. BCED Holdings Ltd.*, [2003] O.J. No. 5555 (QL), 47 C.B.R. (4th) 278 (S.C.J.), affd [2005] O.J. No. 428 (QL), 137 A.C.W.S. (3d) 303 (C.A.), leave to appeal to S.C.C. refused [2005] S.C.C.A. No. 186), although I note that at least one institution ended up joining in in the latter rounds of that litigation; and *K. Field Resources Ltd. v. Bell Canada International,* [2005] O.J. No. 3935 (QL), 140 A.C.W.S. (3d) 40 (S.C.J.), which may also have had some institutional involvement.

led by institutions, the only cases to date in which such actions have recovered significant sums have had parallel institutional actions.[43]

To the practitioner, the evidence strongly suggests that institutional investors are more likely — and perhaps much more likely — to bring actions of merit. *All* of the actions listed above brought by institutions involved issues of real monetary or business significance. Save possibly for *MI Developments*, where the court castigated the applicant for intimidation tactics, there is essentially no track record in Canada of institutions bringing "strike" type litigation.

This result is hardly a surprising one. It is only to be expected that institutional investors with their sophistication and pragmatic cost/benefit analysis would tend to engage in litigation that would generate practical benefits to them. We would expect that they would have a fair track record of being able to pick winners. As they have to make million dollar decisions to buy or hold securities — and as they typically do not get their lawyers to work on a contingency basis and hence have to pay these bills every 60 days — a business discipline is built into their decision-making process. This may be contrasted with the quixotic flavour that often accompanies actions brought by smaller investors.[44] If one subscribes to the notion that civil liability can be one useful tool to deter corporate misbehaviour it would follow, on a policy basis, that litigation by institutional investors is likely to be the sort of litigation most beneficial to the capital markets. In broad terms, it may be that it is litigation by this category of litigants that should most be encouraged.[45]

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43. *Mondor v. Fisherman; CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman*, [2002] O.J. No. 1855 (QL), 26 B.L.R. (3d) 281 (S.C.J.) and the MLG takeover litigation where the retail class action settled largely as a result of the efforts in the parallel Public Trustee action: *Maxwell v. MLG Ventures Ltd.* (1996), 30 O.R. (3d) 304, 3 C.P.C. (4th) 360 (Gen. Div.). There may be two exceptions to this statement although the settlement amounts were modest in face value: the $1.75 million (16.4%) settlement in the book4golf class proceeding (see <www.koskieminsky.com>). and a $2.15 million settlement in the Canadian Superior Energy proceeding (see <www.siskinds.ca>).

44. Although I do not subscribe to this view, arguably "there is a lack of corporate and securities sophistication of the plaintiff's bar": J.C. Tory, "Strike Suits Come to Ontario" (2000), 3 Corp. Lit. 190. It may be that institutions tend to draw from a different pool of lawyers than smaller investors.

45. This may also have been the conclusion reached in the United States in the "lead plaintiff" provisions of the PSLRA, although it may be more accurate to say that there the proponents of that legislation thought that litigation by small shareholders should be discouraged as it put plaintiff attorneys in too much unsupervised control of the litigation.

A second item of note is that many of the institutional actions — particularly the bondholder proceedings — involve litigation that focuses on the proper interpretation of agreements, prospectuses and other deal documentation. Litigation of this type will tend to have a narrow focus as compared with litigation that deals with the possibility of internal corporate misconduct where unravelling the "who did what when and why" may take millions of dollars and years of litigation. It is, again, not surprising that institutions have tended to bring claims with a narrow focus. As the merits depend largely (if not solely) on the content of public documents that are available to all, these sorts of claims are most amenable to an up-front analysis that can reasonably be relied upon in making the decision to invest and litigate.

IV. BUYING INTO OPPRESSION — DAMAGES FOR PAST OPPRESSION

In looking at the cases above the litigation brought by institutions may be broadly divided into two categories. The first involves opportunistic acquisition of shares by institutions in the belief that they have spotted something that the market as a whole has missed, such as a possible right to past dividends (*Gulf*) or that an announced corporate transaction in fact violates rights or is contrary to the oppression remedy (*Calpine*).[46] In these cases, litigation is used to enforce a right that others in the market may not have fully appreciated existed or may not have wanted to expend the resources to establish in court. The second set involves actions by longer term holders who feel that a corporation's affairs have been unfairly conducted. Cases such as *Oxford Properties*, *Rio Algoma*, *Repap*, *YBM* and *Telus* fit in here.[47] In very rough terms the first group of actions are brought by traders, the second by investors.

The proceedings brought by recent purchasers of securities raise an interesting issue. If a corporation's internal affairs have been conducted oppressively, often the public share price of the corporation's securities will have suffered. A buyer of securities will buy at a lower price than would have been the case absent the oppression.

46. *Palmer v. Carling O'Keefe*, *supra*, footnote 19, is another example of this.

47. Although in some of these cases additional securities were bought near the time litigation was commenced. *Ford Canada* is someplace in the middle. The plaintiffs did not knowingly buy into possible oppression but were not owners throughout the period of oppressive conduct.

If the buyer then sues for damages for oppression an issue arises as to whether it is the buyer or the previous shareholders that has truly suffered the damages as a result of the oppression. Arguably, to award the buyer damages would be to give it a "windfall"; the buyer has itself already benefited from the oppression (as it has purchased at a depressed price). In these cases the question becomes: who is entitled to collect the damages? Is it the former or present owner of the shares? Further, do the shareholders have a direct right of recovery or does a derivative action have to be brought on behalf of the corporation?

Ford Canada and *Calpine* effectively hold that a buyer who has (knowingly or unknowingly) bought into the oppression cannot recover for past oppression (oppression prior to the acquisition of shares by a plaintiff). Conversely, *Repap* and *obiter* comments in *Ford Canada* indicate that if the action is brought on behalf of the corporation itself (using the derivative action provision), rather than the shareholder commencing an oppression remedy action to recover damages directly, the corporation can recover damages. This will normally result in the benefit indirectly flowing through to the later owners of the shares.[48] The result is that the procedural form that an action takes may be highly significant.

1. The Pragmatic Approach

A pragmatist might approach the past oppression question raised in *Ford Canada* by asking: what is the practical effect of choosing one rule over another? Will one rule lead to more litigation by stakeholders designed to remedy corporate oppression? If so, is more litigation by stakeholders a good thing for our capital markets?

For the purposes of this article I will assume the answer to the second question. I will assume that (within limits) more litigation is good. The assumption will be that more civil litigation (within limits) will tend to have a deterrent effect on corporate misbehaviour and that this benefit is not disproportionate to the costs associated with the litigation. This is the assumption that underlay the recent Bill 198 amendments to the Securities Act[49] and I will, for now, proceed on the basis

48. But note, there is the power under the derivative action provision to make directly an award in favour of former shareholders rather than the corporation. See, *e.g.*, CBCA, s. 240(c).

49. Although it is to be noted that that assumption itself was derived from the Allen Committee, which had engaged in an exhaustive study of one particular issue — continuous disclosure — before arriving at that conclusion.

that it enjoys general support. I appreciate, however, that whether this assumption is correct is very much open to debate.[50]

If we assume that a moderate amount of litigation is good, there are pragmatic arguments that we should allow recovery by the purchasing shareholders where the actions complained of in the litigation have caused damage to the corporation and hence reduced the value of shares.[51] The argument can be briefly put as follows. This rule would encourage investors who believe there has been a failure of corporate governance to come forward and buy up securities and prosecute such claims. Such shareholders will be more likely to prosecute actions than more passive shareholders. This increases the chance that oppressive conduct will be sanctioned and will tend to result in less managerial opportunism. Such a rule may also be consistent with the normal result in the capital markets that those who take the risk of investing are entitled to receive the benefits from taking risk. It thus does not strongly offend our sense of fairness. Further, as a practical matter in many cases the corporate actions complained of could also be the subject of a derivative action. The end result of a successful derivative action is normally to benefit present shareholders. Allowing purchasing shareholders to directly recover damages has the same effect.

As with any argument based on pragmatism, there is room for a healthy diversity of views. The discussion below is from a non-

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It may be that one cannot automatically translate a finding in one area (continuous disclosure) into other areas of corporate behaviour. Given that many investors in the marketplace are highly diversified, litigation tends to result in money "going around in circles" in the market. A significant additional cost may also be imposed on the market: the costs of all those lawyers who are litigating. This may effectively depress overall investor returns. For that reason, the key issue in any analysis of the desirability of civil remedies is the issue of whether those remedies will have an overall deterrent effect in the marketplace. For an interesting discussion in an American context see John C. Coffee Jr., "Reforming the Securities Class Action: An Essay on Deterrence and Implementation" available at <ssrn.com>.

For an example where a court, based on empirical data, held that one class of litigation was not of benefit to the capital markets or shareholders, see *In Re Cox Communications Litigation,* 879 A. 2d 604 (Del. Ct. Chancery June 6, 2005).

50. For a contrary approach see K. Thomson, S. Campbell and D. Ricci, "The Oppression Remedy and the Duty to Maximise Shareholder Value" (LSUC seminar April 28, 2006), taking the view that certain litigation is coercive in nature and designed to favour short-term investors over long-term investors with an overall detrimental effect on corporation decision-making.

51. This is to be contrasted to cases involving breach of continuous disclosure obligations where the impact would have been to artificially elevate the share price. In those cases it obviously makes no sense to allow a purchaser who will have purchased after the misleading disclosure has come to light to recover damages.

expert and is designed to encourage debate rather than to suggest any firm conclusion.[52] There are also counter-arguments. Two are raised below.

2. The Pragmatic Arguments for Recovery for Past Oppression

Our public markets have a broad spectrum of institutional investors. These range all the way from passive index funds[53] to mutual funds[54] that try to beat the market, to those who purchase distressed securities, right on up to those who buy and break up public entities in order to unlock shareholder value. Each has their place in the world of finance. Each contributes to the overall market. On one view of the market, institutions who invest in distressed or special situations (including investors who are willing to invest in corporations with questionable corporate governance with a view to correcting that behaviour) give liquidity to less aggressive investors wishing to exit such situations.[55]

The public price of a security reflects the perception of the market based on available information. If the market perceives that there is the possibility of a future change in corporate governance or recovery by the corporation of losses occasioned by oppressive transactions, this possibility will be factored into the share price (although no doubt discounted due to risk). Even if a purchaser sees a possibility of corporate change but the market does not, this purchaser's demand for securities will, in theory, increase the price vendors are able to receive for them.[56] On either scenario the purchaser may, if things turn out well for it, get a bargain in the

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52. I also confess I have changed my mind two or three times on this issue.
53. Who presumably would have no interest in engaging in litigation as their focus is on minimizing costs.
54. Litigation may not be attractive to mutual funds for two reasons. First, litigation expenses will be current. Any benefit from litigation will be somewhere down a (long) road. As the institution will have to fund the expenses on a current basis it will likely need to charge these expenses against the funds under administration — hence depressing the return on a current basis and the ability to sell to the market.

    Many mutual funds may also be managed by corporations that provide pension fund management, investment banking or other services to issuers. Although mutual fund managers are under a fiduciary obligation to their investors, they may tend to avoid litigation as it might involve suing a client or potential client.
55. J. Levitz, "Mutual Funds Back Executive Pay", *Globe and Mail*, March 28, 2006 at p. B8 quotes one huge institutional investor (Fidelity) as saying "it prefers to sell shares if it is unhappy with a company".
56. A factor recognised in *Palmer v. Carling O'Keefe, supra,* footnote 19.

same way as it may secure a bargain in any other situation where its assessment of an issuer is more perceptive than the market's as a whole. But that is the way our markets work.

As the activist investors live in a more rough and tumble world, they bring a different set of skills to the table than passive investors. If they are to survive in the marketplace they have to have a superior ability to ferret out reasons behind corporate under-performance and the ability and perseverance to take proactive steps to allow them to positively influence a corporation's affairs and increase shareholder value or recover shareholder losses. All of this effort comes at a significantly greater cost than a passive investment strategy. In order to make money on a turnaround investment they must have resources sufficient to buy a significant percentage of the debt or equity of an issuer in order to cover their litigation/opportunity costs and secure a benefit from any turn-around/litigation success that occurs. As demonstrated by *Calpine*, where $125 million of bonds were purchased on margin, the bets may be very large ones with potentially very large rewards.

On this view, aggressive institutional investors fill their own market niche. An institutional investor who takes a calculated risk in investing millions in a security whose value has been depressed and who then has the fortitude to proceed and prove in court that a corporation's affairs have been conducted oppressively is providing a valuable service. Such an investor is entitled to retain any damage award referable to oppressive actions prior to its purchase of the security. This allows the investor a return for its risk taking. If an investor is smart enough to see an opportunity that others do not see or that others are not persistent enough to pursue, it is a strain to call the fruits of its risk-taking a windfall. Indeed, some might argue that as their actions will usually redound to the benefit of all security-holders, if any windfall results from their actions, it accrues to others who have had a free ride on the efforts of the activist institution.

The pragmatic argument would further hold that aggressive purchasers who look for and analyse instances of possible corporate mis-behaviour are more likely than investors as a whole (and hence more likely than the typical selling shareholders class) to detect and prosecute cases of abusive behaviour. Vesting in them the right to sue for damages increases the deterrent effect of civil remedies and should act on an overall basis to reduce the extent of corporate misbehaviour. It is true that the relative lack of sophistication/determination by more

passive participants in the market can be partially offset by class proceedings legislation, which effectively transfers to class counsel the role of detecting and prosecuting claims. Still, on this analysis, it is preferable to have proceedings brought forward by those who are significant investors in an issuer rather than to have them entirely driven by lawyers working on a contingency fee.[57]

Allowing the present owners of shares to recover damages for past oppressive acts also has very significant logistical advantages. Under this rule, the present owner of a share would get all damages associated with that share. There is only one present owner of any one share. Conversely, to say that past owners are entitled to recover would mean that one would need to track past ownership. The damages attributable to shares would have to be apportioned among former owners based on the damage suffered while the shares were owned. Although it is possible that the damage formula might be linear (*i.e.*, it might be the case the damage accrued at a constant rate over the period of oppressive conduct) that would just be a happenstance. Other formulae are possible if the particulars or the practical impact of the oppressive conduct changed over time. This scenario would put one sub-class of former owners in conflict with other sub-classes. Each sub-class would want to argue that the damage occurred during their ownership. There could be many sub-classes. Would separate representation for the sub-classes be needed? Would the conflicts created in the class of former owners be sufficient to preclude class certification? The British Columbia Court of Appeal thinks so.[58] Clearly, if certification cannot occur in the vast majority of cases no proceeding could practically be brought on behalf of former owners. To say that the former owners retain the right to sue for past oppression might mean that, as a practical matter, no one could sue at all.

Even if the certification issue were resolved and a formula eventually derived to divide up the damages, it would then have to be applied. It would be applied years later to what would have been the

57. The track record in the United States would also suggest that institutional shareholders are also interested in securing certain remedies — such as personal payment by directors and officers (*e.g.*, the outside directors in Worldcom: see G. Morgenson, "10 Ex- Directors from Worldcom to Pay Millions", *New York Times*, January 6, 2005 at p. A1) or changes in corporate governance — that may have a positive impact on the market going forward. They are not just interested in money.

58. *Samos Investments*, *supra*, footnote 42.

constantly shifting mass of often anonymous shareholders. This may be a logistic impossibility in a case (such as *Ford Canada*) where the conduct occurred over a great many years in a publicly traded entity. The result is that even if a class proceeding were (successfully) brought on behalf of former shareholders it might be impossible to divide up the funds received. What rational representative plaintiff would lend its name to such a suit? What rational counsel would take it on?

3. Some Pragmatic Arguments against Recovery for Past Oppression

There are pragmatic arguments that the present owners be entitled to recover damages for past oppression when the effect of the oppressive conduct has been to depress the share price. But the argument is not without its flaws.

First, the argument assumes that the only way to incentivise aggressive institutional investors to bring actions for corporate misconduct — and hence to impose sanctions on managerial opportunism — is to give them a direct remedy under the oppression remedy for past damages. This is just wrong. Such institutions can seek leave to commence a derivative action after purchasing shares. As the Ontario Court of Appeal has indicated in *Ford Canada*, if this procedure is employed the institution will normally benefit if the action is successful. Any improper benefit received by insiders will be stripped away from them. Deterrence will occur. Although some additional procedural expense and delay is no doubt incurred due to the leave requirement, for the type of lawsuits we are talking about (and if we assume an institutional investor who has invested millions in security purchases) this is only a moderate barrier. Indeed one need only look south of the border to note that institutional investors frequently bring derivative actions there to recoup losses caused to corporations.[59] Just because the institutional investors in *Ford Canada* did not follow the derivative action procedure is no reason for ignoring its existence.

Second, the above argument assumed that the purchaser-shareholder who is incentivised to bring a lawsuit for past oppression

59. For example, in the Hollinger International litigation Cardinal brought a derivative action which settled for $50 million against the outside directors: *Hollinger International Inc. v. American Home Assurance Co.*, [2006] O.J. No. 140 (QL), 34 C.C.L.I. (4th) 17 (S.C.J.).

will be an institution and will bring to the table whatever positive attributes an institutional investor may bring. But under this proposed rule there is nothing that would prevent the contingency lawyer from finding a client to buy up a few shares on an after-the-fact basis in order to get status to commence a class proceeding. Trading in shares may lead to trafficking in litigation. If such a rule potentially leads to strike litigation another mechanism needs to be in place to provide a counterbalance. Many will argue that costs sanctions alone are enough to discourage unmeritorious litigation. However, that was not the determination that was made by the legislature in enacting Bill 198.[60] In dealing with one particular type of claim of corporate misconduct the legislature ended up building in the protection that court leave was necessary: this is similar to the protection against marginal lawsuits that exists under the derivative action provisions.[61] If there are reasons in one corporate context (continuous disclosure) to give public corporations protection against strike suits, it is possible to argue that the courts should not allow for direct recovery for past oppression, but rather insist upon a procedural mechanism for other sorts of claims (the derivative action procedure) that provides similar protection.

A third issue arises if the oppressor has bought the shares. The problem may be illustrated by using *Ford Canada* as an example. At one point the public float of Ford Canada had been about 25% of its total shares. Through ordinary course purchases in the market by Ford from shareholders, the float was significantly reduced. This set the stage for the going-private transaction. About half the then shareholders tendered their shares in the going-private transaction without dissenting. In the result only a small percentage of the shares dissented and were represented in the litigation.

The institutions in *Ford Canada* argued that they had (immediately prior to the going-private) the right to sue for past oppression as they were the then owners of the shares.[62] If so, it would follow that those shareholders who had sold their shares to Ford Canada previously (either in ordinary market sales or by agreeing to the

60. The Allen Committee had not recommended a leave requirement. It was put in as a result of a compromise leading to the legislation.
61. There are some important differences — most notably that Bill 198 requires the court to engage in a more detailed examination of the merits of the proposed lawsuit.
62. They also argued the value of this right (as determined after trial) should be added to their share value under the appraisal remedy.

going-private transaction) would have no right to sue for past oppression. If the plaintiffs are right, on the numbers in *Ford Canada* the vast majority of minority shareholders who sold to Ford Canada at a share price that had been depressed by the corporate oppression would have effectively given up their right to sue for this past oppression. This example demonstrates that a simple, blanket rule that "present owners have the right to recover for past oppression" cannot be the entire answer to the question. If instituted it would need to be supplemented in some fashion to deal with the contingency of the oppressor purchasing.[63]

4. The Reasons in *Ford Canada* and *Calpine*

In *Ford Canada* the Ontario Court of Appeal affirmed the trial judgment that the inter-company pricing policy was oppressive. The net effect of the policy was that Ford Canada paid more to Ford U.S. for auto parts than it would have had the policy been fair. This in turn depressed Ford Canada's profits and the public share price of Ford Canada's shares. It seems clear[64] that, had Ford Canada remained public and had the shareholders commenced a derivative action on Ford Canada's behalf, Ford U.S. would have been required to reimburse Ford Canada for the overcharging. If Ford U.S. actually paid Ford Canada such damages there would have been a positive impact on the balance sheet of Ford Canada and the price of Ford Canada shares. If one leaves out the considerable wrinkle arising from the fact that Ford Canada went private, the result would be that following one procedure (a derivative action) the present shareholders could, indirectly, recover damages for past oppression. The result is the same as any successful corporate litigation: when a lawsuit is won and the money comes in the door it

63. One possibility is that the direct vendors who sold to Ford Canada could argue that they could recover against Ford Canada the difference between their sale price and true value under the insider trading remedy as Ford Canada had knowledge of an undisclosed material fact (the fact that the shares should have been worth more but for the pricing policy) at the time of purchase.

64. The Court of Appeal does say this issue is "speculative" but *supra*, footnote 1, at para. 78 and following and paras. 136-37 do demonstrate that Ford U.S. benefited from oppressive conduct in which it played a major role. It is hard to imagine that Ford U.S. would have been allowed to keep these benefits. See also *Richardson Greenshields of Canada Ltd. v. Kalmacoff* (1995), 22 O.R. (3d) 577, 123 D.L.R. (4th) 628 , 80 O.A.C. 98 (C.A.), leave to appeal to S.C.C. refused 126 D.L.R. (4th) vii.

positively affects the share value of the then shareholders. Former shareholders normally do not benefit.[65]

What occurs, however, if a derivative action is not pursued? What happens if the present shareholders sue directly for damages for the (past) oppression? In *Ford Canada* the Court of Appeal noted that the matter was of first impression before it. It reasoned with respect to past oppression that:

> In this case, the OMERS shareholders seek the personal remedy of compensation under s. 242(3)(j) as "an aggrieved person," not an order "compensating the corporation" under s. 242(3)(h), and they must therefore show entitlement to compensation. Compensation excludes any notion of a windfall for wrongs done to others in the past.
>
> As the trial judge said at paras. 252 to 254, the effect of any past oppression would normally be reflected in the market price of the shares at the time the shareholder purchased them. Thus, any purchase was at a market price "that implicitly reflected the publicly reported earnings of Ford Canada under the transfer pricing structure to that point in time . . .
>
> To award a shareholder for past oppression would not be compensation but a windfall . . .[66]

In dealing with the related question as to whether the value of the shares should be adjusted under the appraisal remedy due to the past oppression, the court stated:

> To incorporate an additional amount for past unfair treatment would substantially overcompensate the minority shareholders. These shareholders purchased their shares on the basis of the company's actual value not a notional value that included an allowance for a notional increase in the asset base by reason of prior unfair dealing . . .
>
> . . . The OMERS shareholders led no evidence to show that a notional arm's length buyer of Ford Canada was acquiring some cause of action against Ford U.S. to which a value could be ascribed even assuming that a hypothetical cause of action is properly included in the concept of fair value . . .
>
> . . . The OMERS shareholders' argument with respect to an historical component of fair value is an attempt to receive compensation as if they had commenced and successfully brought a derivative action against Ford U.S. on behalf of Ford Canada. They did not bring such an action and are not entitled to compensation through "fair value" as if they had.[67]

As argued above, it is not clear that the weight that the court gave to the "windfall" issue is above controversy. It depends upon a particular view of the capital markets with which all might not

65. This was the result, for instance, in the much debated law school classic, *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378 (H.L.).
66. *Supra*, footnote 1, at para. 113-16.
67. *Ibid.*, at para. 135-37.

agree and ignores the practical impact that the rule will have. The statement is especially debateable as the court itself recognised the possibility that in ongoing public corporations derivative actions may benefit present and not former shareholders.

In the writer's view, the court is on more firm, although still debatable, ground when it focuses on the form of the proceeding. In theory, the derivative action procedure provides incentives for institutional shareholders to buy up shares and to bring actions and, at the same time, provides safeguards against strike suits. If we proceed from the world-view that litigation (within limits) is to be facilitated in the public corporation context due to the need to curb managerial opportunism, one can argue that the derivative action strikes just about the right balance.[68] The Court of Appeal may be right as a matter of strict legal theory that in most cases a shareholder, if concerned about possibly improper related party transactions in a public corporation, should follow the derivative route.

One concern that could arise with this approach is that by the time of any trial of a derivative action Ford Canada would have been a 100% owned subsidiary of Ford U.S. This raises the possibility that if an award were made in Ford Canada's favour after trial the award would benefit its then shareholder, Ford U.S. A derivative action might result in funds going in a circle. If so, the derivative action is a meaningless procedural alternative.

The CBCA does provide that a court may, in a derivative action, "make any order it sees fit"[69] and, in particular, may order that "an amount payable by a defendant be paid . . . to former or present

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68. There are, of course, counter-arguments. Some say that the procedural roadblocks to derivative actions make this remedy ineffective. See, *e.g.*, E. Iacobucci and K.E. Davis, "Reconciling Derivative Claims and the Oppression Remedy" (2000), 12 S.C.L.R. 87. They point to the almost total recent lack of use of this remedy.

    It is no doubt the case that the remedy has seldom been used since the oppression remedy was enacted. Courts have largely assumed that derivative claims can be brought under the oppression remedy. Given this assumption, it is only to be expected that if litigation lawyers are offered a choice of two procedures — one of which requires court leave to commence an action and one of which does not — they will opt for the more direct procedure. That does not mean, however, that the present derivative action procedure is practically unworkable. It only means another procedure is currently easier. That being said, there may be arguments for amending the derivative action procedure to, for instance, allow large shareholders in public corporations to automatically qualify for leave.

69. The same wording is used under the oppression remedy. See CBCA, s. 241(3). Under the oppression remedy provision there is language explicitly linking the order to "rectifying" the matters complained of.

security holders".[70] Although the relevant section provides no guidance on which remedy should be granted and when, on its plain wording the remedial powers give the court ample powers to fine tune the remedy to achieve justice. Indeed, the power to compensate former shareholders is, on its wording, broad enough to include making orders in favour of those shareholders who had sold to Ford in the open market or who had tendered to the going-private transaction. In the result, a derivative action in *Ford Canada* would have provided the possibility of securing a remedy on behalf of all former shareholders who had been injured by Ford's conduct. A derivative action would have created the possibility that Ford would have been ordered to disgorge all the benefits it had received from the inter-company pricing policy.[71]

It follows that in an ideal world, and with the benefit of perfect hindsight on a very murky procedural issue, a derivative action should have been commenced.[72] This would have maximised Ford's exposure and hence the deterrent effect of the litigation. But the fact is that no derivative action was brought in *Ford Canada*. The former shareholders of Ford Canada who had sold their shares prior to the going-private transaction were not before the Court of Appeal in any manner. The court was faced with the two alternatives: that the litigating institutions might secure a windfall (depending on one's view of what constitutes a windfall) or that Ford would keep the proceeds of its oppressive actions. The court chose Ford.

The result may strike many as intuitively unjust. Yet it may be that in the absence of a derivative action the case law on recovery for past oppression inexorably pointed in that direction. How then can we fashion an analysis that restricts Ford's ability to retain the fruits of its oppressive conduct? One possible solution was to argue, as the institutional shareholders did, that under the appraisal provisions

70. CBCA, s. 240.

71. The derivative action would also have eventually created a conflict among shareholders. Once liability was established, the litigating institutions would have argued that the court should order payment directly to them for the damage done referable to their shares. The court, under the CBCA, would have had the power to make such an order. It also would have had the power to refuse to do this and instead to make an order in favour of those who had sold the shares to the institutions. On this analysis, the derivative action procedure would have eventually led to the same policy issues that arise in connection with the issue, discussed above, of who is entitled to recover for past oppression.

72. Another possibility is that a class proceeding should have been launched on behalf of former shareholders. This would have run into the same problem encountered in *Samos*, *supra*, footnote 42.

fair value might be taken to include a consideration of issues aside from market value. On this approach issues between shareholders (such as the purchaser's past oppressive actions) could be considered. After all, the wording of the appraisal remedy does use the word "fair" in connection with value. The Court of Appeal considered but rejected this argument, holding that as a matter of statutory interpretation the focus of the appraisal remedy was market value.[73] The case law under the appraisal provision also had not previously recognised an adjustment for this factor. Still, the facts of *Ford Canada* are sufficiently unusual that one can see many courts fashioning a remedy unless absolutely precluded from doing so by the wording of the legislation. This is particularly the case as in oppression cases involving private corporations orders have frequently been granted providing that the valuation of a shareholder interest is to be conducted after oppressive related party transactions have been reversed[74] or that adjustments for oppression are "on top" of fair value at buyout. In the end it seems the Court of Appeal chose a narrow interpretation of the scope of the appraisal provision not because it was bound to do so but because it was influenced by the same questionable windfall considerations that led it to reject the past oppression claim.[75]

One might also ask: Can it reasonably be believed that some prejudice was done to Ford by a failure to follow the derivative action

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73. One can see a strong practical desire not to complicate appraisal actions with the dredging up of events throughout a corporation's history. This would make appraisal actions even more time-consuming and expensive than they already are.

74. See, *e.g. Sutherland v. Birks*, [2001] O.J. No 5540 (QL) (S.C.J. (Comm. List)), affd 65 O.R. (3d) 812, 174 O.A.C. 29 (C.A.), albeit that the cases where this has been done all appear to involve long-term shareholders.

75. Another approach may have been to argue that in *Ford Canada* there were two acts of oppression. The first consisted of a ten-year pattern of conduct: the unfair inter-company pricing policy. The second consisted of a discrete act: taking the company private. Had the going-private transaction gone as smoothly as Ford had hoped, it would have had the effect of covering up all past sins. The going-private bid was made without disclosing to the shareholders that it was triggered by Ford Canada receiving a letter from its ex-president indicating that the inter-company pricing policy was preventing Ford Canada from having any reasonable chance of making a profit. Had such disclosure on the background to the bid been made the minority shareholders may have had other remedies available to them, including the ability to seek an order restraining the going-private transaction. One might also note that there is some precedent in other going-private transactions of companies involved in major litigation for shareholders to receive present share value and also to retain a right to participate in any recovery later secured in the litigation: *Cinar (Re)* (2004), 22 O.S.C.B. 1191 referred to in the OSC decision in *Hollinger, supra,* footnote 32.

procedure? The purpose of the derivative action procedure is to make sure that the directors' normal power to make corporate litigation decisions can only be supplanted when stakeholders seek to bring actions on behalf of the corporation in good faith and in the best interests of the corporation.[76] There can be little doubt that the proceeding in *Ford Canada* met these requirements. It seems extremely likely that the discovery and trial evidence would not have differed at all had the derivative action procedure been followed. Indeed, it may be that the only practical impact of a derivative action would have been that Ford's potential liability would have been significantly increased as it would have been exposed to an order that it compensate all former shareholders, not just the institutions that had joined in the litigation. It is very hard to see that Ford suffered any prejudice from the procedure employed.

More globally, one can debate the wisdom of having procedural forms of action continue to rule us. There is something particularly dissatisfying about a claim being established on the merits but then being defeated by a procedural point that in no way impacts on the fairness of the underlying proceeding. At some point our civil litigation system must come back to the bedrock principle that its goal is to secure a just determination on the merits of civil proceedings. To the extent our procedural rules create unexpected landmines for litigants and allow persons to profit from their misconduct they result in a diminution of the respect for the law.

Knowing what we know now, the procedural problem that the Ontario Court of Appeal said existed for the institutional shareholders in *Ford Canada* can be avoided. A derivative action should allow recovery of damages for improper related party transactions. Under the CBCA the defendant can be ordered to pay the funds directly to the former or present shareholders as a class. Deterrence will therefore occur. The entitlement as between various sub-classes of former and present shareholders could then be determined by subsequent court order taking into account whatever policy arguments the court feels appropriate.

In *Calpine*, the issue was different from the issue in *Ford Canada*. In *Calpine*, rather than dealing with past oppression the court was dealing with oppressive conduct which was actually unfolding before it. The crucial step in the chain of oppressive conduct — the actual upstreaming of funds — had not yet occurred. The then owners of bonds tried to stop this from occurring. But the

76. See generally *Richardson Greenshields*, *supra*, footnote 64.

court was also dealing with an investor which it held knew about the proposed oppressive conduct prior to purchasing the debt. The *ratio* in *Calpine* for denying relief is that as the plaintiff knew of the proposed (oppressive) conduct it could not complain about it as its "reasonable expectations" could not have been thwarted; its expectation at the time it purchased in fact would have been that the oppressive transaction would proceed. It thus was not entitled to an order restraining the consummation of the transaction.

In *Calpine* the reasonable expectation doctrine is treated as an all-inclusive test for when the oppression remedy may be invoked. In many ways that is not surprising. The words have been repeated so many times by the courts that, although found nowhere in the statute, they have assumed a quasi-statutory force. But the proposition that the reasonable expectation test is all encompassing may be questioned. The reasonable expectation doctrine originally arose in *Ebrahimi*[77] to deal with circumstances where the actions complained of were otherwise legal but where equitable considerations "made it unjust or inequitable to insist on legal rights or to exercise them in a particular way".[78] It is a doctrine that is used to grant a remedy for conduct that, under the previous law, may technically have been argued to be legal.[79] It has nothing to do with refusing to restrain illegal conduct just because a share or bond holder at the time it purchased believed such conduct was planned. One can also test the proposition by a thought experiment. If a shareholder buys shares in a public company believing the controlling shareholder/CEO is being paid much in excess of a reasonable and fair wage does this mean it cannot take steps to rectify an injustice? That cannot be the law.

It is submitted that, rather than analysing and rejecting the bondholder's application on the "reasonable expectation" basis, the court would have been better advised to recognise that the oppression remedy can be used to enforce obligations among stakeholders in a corporation and, in particular, to restrain a corporation from violating corporation legislation or agreements that form part of the internal compact among stakeholders. If it is necessary to use the reasonable expectation phraseology at all, the analysis is that stakeholders as a matter of law are taken to have a reasonable

77. *Ebrahimi v. Westbourne Galleries*, [1972] 2 All E.R. 492, [1973] A.C. 301 (H.L.).
78. *Ibid.*, at p. 500.
79. See "Corporate Oppression: Structuring Judicial Discretion" (1996), 18 Adv. Q. 170 for my views.

expectation that a corporation will comply with its legal obligations.[80] A violation of the obligations related to the internal affairs of the corporation thus gives rise to relief under the oppression remedy.

It is also noted that *Calpine*, like *Ford Canada*, may have a procedural aspect to it. It is likely that, had the bondholders brought a derivative action on behalf of the corporation of which they were creditors to restrain the conduct, such an action would have succeeded. The bondholders were creditors of a finance corporation which in turn was a creditor of the operating subsidiary. The operating subsidiary's upstreaming of funds was contrary to a debenture it had given to that finance corporation. The finance corporation should have been able to restrain the upstreaming had it brought an action. Like *Ford Canada*, the result in *Calpine* should be able to be reversed by following a different procedure.

Most importantly, the discussion of the procedural technicalities surrounding *Ford Canada* and *Calpine* obscures the more important market considerations that lie embedded in these decisions. Lawyers dwell on small details. We often deal in a self-contained world where no reference is made to anything other than the pronouncements of judges. But sometimes that is not enough. To what extent do we believe that the courts should facilitate civil remedies becoming a meaningful deterrent to misbehaviour by those in control of public corporations? That is the question that lies at the heart of both decisions. The decisions undercut the role of civil remedies but do not seem to fully recognise the practical impact of what they are doing. The value judgments that ought openly to be discussed for all to debate were instead obscured by the lawyerly arguments that occupied the courts' attention. If one ascribes to the belief that civil remedies have a valuable role to play in the capital markets, *Calpine*, and probably *Ford Canada*, reach the wrong result. Those who see institutions who buy up securities and bring lawsuits to rectify corporate misconduct as meddlers will welcome the decisions.

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80. See, *e.g.*, *Bank Leu AG v. Gaming Lottery Corp.* (2003), 37 B.L.R. (3d) 1 at para. 72, 231 D.L.R. (4th) 251, 175 O.A.C. 143 (C.A.), leave to appeal to S.C.C. refused 236 D.L.R. (4th) vii; *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi, supra,* footnote 2, and Morritt, Bjorkquist and Coleman, *The Oppression Remedy* (Aurora, Ont., Canada Law Book, 2004), para 3:20:50.