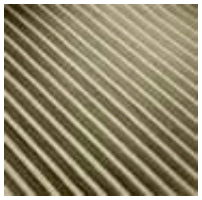

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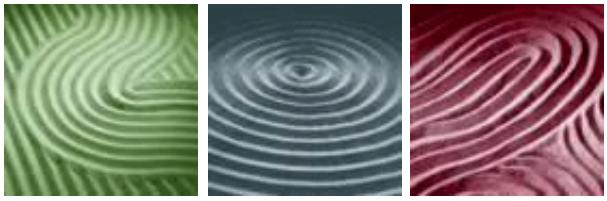

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Dylex: Can a Trustee in Bankruptcy Assert a Claim under the Oppression Remedy?

by John J. Chapman
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Dylex: Can a Trustee in Bankruptcy assert a Claim under the Oppression Remedy?

A recent decision of the Ontario Superior Court of Justice, *Dylex Ltd. (Trustee of) v. Anderson* [2003] O.J. No. 833, has provided disgruntled creditors with another weapon against the misconduct of directors and officers.

One of the principle benefits and purposes of incorporation lies in the insulation of directors, officers and shareholders from personal liability for the debts of the corporation. Upon insolvency, however, the creditors of a corporation may have concerns that the corporation has been operated in a manner that has prejudiced their interests. An individual creditor may lack the economic clout to pursue a claim against officers and directors for corporate mismanagment. However, if the creditors can work collectively through a trustee in bankruptcy, this will increase the practical risk that directors and officers may be held personally liable for their management of the corporation.

The "oppression remedy" provisions of Ontario's *Business Corporations Act* and its federal equivalent provide a powerful vehicle for such collective action. Under these provisions, the courts are given jurisdiction to redress acts of a company that are oppressive or unfairly prejudicial to or that unfairly disregard the interests of a shareholder, director, creditor or any other person who, in the discretion of the court, is a "proper person" to make a claim under these provisions. While the oppression provisions provide a flexible cause of action for those who have either invested in or lent funds to a company, whether a trustee in bankruptcy is a "proper person" to bring an oppression action has been the subject of considerable judicial debate and indecision. How a court decides the issue turns largely on whether it views the trustee as a representative of the bankrupt company or of its creditors.

Originally, the courts held that a trustee is not a "proper person" to bring an oppression action, a position established in *Canada (Attorney General) v. Standard Trust Co* (1991), 5 O.R. (3d) 660 (Ont. Gen. Div.). In that decision, Houlden J.A. ruled that a trustee took the property of the bankrupt company as it found it, and so stood in the shoes of the bankrupt company. Consequently, the trustee had no higher rights than that of the company itself. Thus, where a transaction was unanimously approved by the board of directors of a company, the trustee could not later challenge that transaction, since the company itself could not have attacked the same transaction as oppressive at the time it was made.

The decision in *Dylex*, however, suggests that *Standard Trust* is no longer the law in Ontario. In *Dylex*, the trustee claimed that a pre-bankruptcy transaction under which the shares of Dylex were sold to a shell company, Hardof Wolf Group Inc., was oppressive and unfairly prejudicial to the interests of Dylex's creditors. Four months after the

impugned transaction, Dylex was put into bankruptcy, largely because Hardof Wolf had converted Dylex funds to its own use and had otherwise misapplied Dylex's assets. On behalf of the creditors, the trustee argued that the share acquisition itself was oppressive because the directors of Dylex ignored certain warning signs that the transaction would lead to its bankruptcy, including an illusory financing arrangement that concealed the fact that the transaction was being funded from Dylex's own cash and inventory liquidation proceeds.

In response to the trustee's argument, the directors of the bankrupt contended that the trustee did not have legal capacity to bring an oppression claim and that, consequently, the claim should be struck from the trustee's statement of claim. Lederman J. declined to accept this argument and allowed the oppression claim to proceed.

In doing so, Lederman J. relied on another decision, *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* [2001] O.J. No. 3394, which held that the trustee's primary role is to maximize the value of the bankrupt company on behalf of its creditors. Since a creditor could itself bring an oppression action, so too could the trustee in a representative capacity. Accordingly, Lederman J. found that a trustee could indeed be a "proper person" to a bring an oppression action where the interests of the creditors, which it represents, have been oppressed or unfairly prejudiced.

While Lederman J.'s reliance on *Olympia & York* has further undermined the bald proposition that a trustee cannot avail itself of the oppression remedy, recourse to the oppression remedy will not be allowed in ordinary debt collections. The disgruntled creditors must have suffered conduct that meets the statutory standards of "oppression", "unfair prejudice" or "unfair disregard", which Ontario courts have rolled into "unfairness" as a general, substantive standard. Nonetheless, the *Dylex* decision reflects a broader trend towards allowing creditors and investors to collectively challenge the management of a company under the elastic provisions of the oppression remedy.