

## Tools For Shareholders, Stakeholders

# Two sides of same coin: Derivative action and oppression remedy

By **Matthew Stroh**



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(November 28, 2019, 8:51 AM EST) -- One of the most fundamental principles of Canadian corporate law is that a corporation has a legal personality distinct from its shareholders. At common law, shareholders were precluded from bringing their own action in respect of a wrong done to the corporation. Even majority or controlling shareholders had no personal cause of action for a wrong done to the corporation (*Foss v. Harbottle* (1843), 67 E.R. 189, 2 Hare 461 (Eng. V.C.)).

However, such a rule could lead to inequitable results. This is especially so in situations involving minority shareholders with no ability to control the business or affairs of the corporation and no ability to compel the majority shareholders to do so.

As a result, the above general principle of corporate law has been modified by two general statutory procedures/remedies set out in the *Canada Business Corporation Act*, R.S.C., 1985, c. C-44 (CBCA), and in similar provincial statutes based on the same model law: (1) the derivative action (s. 239 of the CBCA); and (2) the oppression remedy (s. 241 of the CBCA).

## Derivative action and oppression remedy

The derivative action was designed to counteract the impact the rule at common law had that a shareholder could not sue for a *wrong committed against a corporation*. It provides minority shareholders, and sometimes others as well, with a statutory right to apply to the court for leave to bring an action "in the name of and on behalf of a corporation ... for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate." It is an action for "corporate" relief in the sense that the goal is to recover for *wrongs done to the company itself* (*Rea v. Wildeboer* 2015 ONCA 373 at para. 18). The derivative action is an extraordinary remedy in its ability to shift control of corporate litigation from the board of directors of the corporation to shareholders, and in some cases creditors, of the corporation. For this reason, leave of the court is required to pursue derivative relief.

The oppression remedy, on the other hand, is designed to give a shareholder, director, or other "complainant" standing to apply to the court, without obtaining leave, in order to recover for *wrongs done to the individual complainant* by the corporation, or as a result of the affairs of the corporation being conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the complainant. The oppression remedy is a *personal claim* (*Rea v. Wildeboer* at para. 19). It is more frequently pursued than the derivative action.

Although these remedies frequently intersect given that a wrongful act may be harmful to both the corporation and the personal interests of a complainant, as a shareholder, director, or creditor, at law they remain distinct remedies with different statutory requirements. These remedies are not mutually exclusive, and there are circumstances where the factual matrix of a case will give rise to both types of remedies (*Rea v. Wildeboer* at para. 26).

However, in general terms, where a claimant seeks to recover solely for wrongs done to a corporation, the thrust of the relief sought is solely for the benefit of that corporation, and there is no allegation that the complainant's individualized personal interests have been affected by the wrongful conduct, a claim must be pursued by way of a derivative action (after obtaining leave of the court). Failure to do so may result in the claim being struck out or dismissed.

The policy behind requiring leave to pursue a derivative action is less compelling in cases involving small closely held corporations than those involving large publicly traded ones, as was the case in *Rea v. Wildeboer*. As explained by Justice Robert Charney in *Paul Shaughnessy Investments Inc. v. Drain* 2018 ONSC 1850, at para. 72:

"... the distinction between derivative actions and oppression claims are the sharpest when the corporation is both a widely-held and public corporation as in *Rea*. There is more room for overlap when the corporation is a closely held private corporation as in *Malata*. Where the corporation is more widely held, the courts insist on more personalized claims, such as a creditor claim, as in *Malata*, or the wrongful termination claim in *Mozas*. Where there are only two or three shareholders, there may be no real distinction between a wrong to all shareholders generally and the loss or damage suffered by a particular shareholder, and a dispute between shareholders can be equated to an individualized personal claim. In addition, there is less reason to be concerned with the risk of frivolous lawsuits against the corporation if there are 'relatively few shareholders.'"

Oppression claims have been permitted to proceed by the courts even though the wrongs asserted were wrongs to the corporation, where those same wrongful acts have also directly affected the complainant in a manner that was different from the indirect effect of the conduct on similarly placed complainants, especially in the context of closely held corporations (*Rea v. Wildeboer* at paras. 27-29). For example, in a closely held corporation, the misappropriation of funds may not only impact a corporation (and the indirect interest of its shareholders), but the direct interests of shareholders. The key point is that the impugned conduct must harm the complainant personally, and not just the body corporate.

The classic case of oppression arises where the complainant has effectively been denied the very benefit he or she sought to obtain when joining the corporation in the capacity of a director, officer, or shareholder or when investing in its securities (Kevin P. McGuinness, *Canadian Business Corporations Law*, 3rd ed.).

The courts have found that both the derivative action and the oppression remedy may be used in the context of closely held corporations where a director engages in self-dealing to the detriment of the corporation and other shareholders or creditors (*Malata Group (HK) Limited v. Jung* 2008 ONCA 111). In some cases, they have even been used concurrently (see for example, *Seymour Resources Ltd. v. Hofer* 2004 ABQB 303).

Although both the derivative action and the oppression remedy remain valuable tools for aggrieved shareholders and other corporate stakeholders, including creditors, their distinction remains important and the pros and cons of pursuing each remedy should be carefully considered.

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