Management Responsibilities in Insolvency Situations: United States and Canada

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I. INTRODUCTION

This article provides an overview of the responsibilities of a company's directors in the United States and Canada with respect to (i) solvent companies, (ii) companies approaching insolvency, and (iii) insolvent companies. This article also addresses the directors' fiduciary duties and the stakeholders to which such fiduciary duties are owed in each of these three stages.

II. UNITED STATES

A. Directors' Fiduciary Duties: Solvent Companies

In Delaware,[1] directors generally owe two fiduciary duties: (i) the duty of care, and (ii) the duty of loyalty.[2]

The duty of care requires that directors use the amount of care that an ordinarily careful and prudent person would use under similar circumstances and consider all material information reasonably available in making business decisions. *Miller v. Am. Capital, Ltd. (In re NewStarcom Holdings, Inc.)*, Adv. No. 15-50063 (CSS), 2016 Bankr. LEXIS 724, 17-18 (Bankr. D. Del. Mar. 8, 2016).

The duty of loyalty requires that "the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and

[1] Generally, the actions of a board of directors are governed by the laws of the state in which the particular entity is organized or formed. This article will focus on fiduciary duties under Delaware law, which is representative of the law in many U.S. jurisdictions. In addition, Delaware is the favored state of incorporation for U.S. businesses.

[2] In addition, officers of Delaware corporations have the same fiduciary duties as directors. *See e.g., Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009) ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold."); *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752 (Del. Ch. 2016) ("Officers are corporate fiduciaries who owe the same fiduciary duties to the corporation and its stockholders as directors.").

not shared by the stockholders generally." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). The duty of loyalty also includes the requirement for directors to act in good faith. *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

In some instances, these fiduciary duties may be limited. For example, a corporation may include language in its charter documents exculpating directors from liability for breach of the duty of care. *See* Del. Code Ann. Tit. 8, §§ 102(b)(7). However, a corporation cannot eliminate fiduciary duties and cannot exculpate directors for breach of the duty of loyalty. *Id*. Delaware law governing limited liability companies (LLCs) and limited partnerships (LPs) provides members and partners with greater flexibility,[3] allowing them to expand, restrict, or eliminate fiduciary duties generally in LLC and LP agreements. *See* Del. Code Ann. Tit. 6, §§ 17-1101(d), 18-1101(c). However, Delaware law does not allow the waiver of the implied covenant of good faith and fair dealing from LLC or LP agreements. *See* Del. Code Ann. Tit. 6, §§ 17-1101(d), (f), 18-1101(c), (e).

Directors' business decisions generally are protected by the "business judgment rule." Under Delaware law, the business judgment rule is a "presumption that directors making a business decision, not involving self-interest, act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest." *Stanziale v. Nachtomi (In re Tower Air, Inc.)*, 416 F.3d 229, 235 (3d Cir. 2005) (citation omitted). *See also Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). In applying this rule, courts "will not disturb the business decisions of loyal and informed directors 'if they can be attributed to any rational

[3] Indeed, the Delaware statute highlights its policy "to give the maximum effect to the principle of freedom of contract and to the enforceability of" LLC and LP agreements. *See* Del. Code Ann. Tit. 6, §§ 17-1101(c), 18-1101(b).

business purpose.'" *In re ALH Holdings LLC*, 675 F. Supp. 2d 462, 477 (D. Del. 2009) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).[4]

As a general matter, directors owe these fiduciary duties to the company. Under Delaware law, when a company is solvent, the directors also owe fiduciary duties to equity holders and must manage the company in the best interests of its equity holders. Equity holders have standing to bring both direct and derivative claims (i.e., claims on the company's behalf) against directors for breach of fiduciary duty.

In evaluating whether a direct or derivative claim is appropriate, Delaware courts evaluate "[w]ho suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?" *Tooley v. Donaldson, Lufkin & Jenrette*, 845 A.2d 1031, 1035 (Del. 2004). In evaluating who suffered the alleged harm, courts consider whether the plaintiff has demonstrated that it can prevail without showing an injury to the company. *Id*. at 1036. Where an equity holder is directly injured, it retains the right to bring a direct cause of action, and any recovery from such lawsuit will flow directly to the equity holder. *Id*. A derivative claim, on the other hand, lies "if it affects all stockholders equally." *Id*. at 1039. Because derivative claims are brought on behalf of the company, the proceeds of any recovery on such claims inure to the benefit of the company (not the individual equity holder that initiated the litigation). *Id*. at 1036.

[4] However, directors are not always protected by the business judgment rule. For example, courts may apply an "enhanced scrutiny" standard where the directors "faced potential conflicts of interest because of the decisional dynamics present in particular recurring and recognizable situations. . . ." *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013). In addition, courts may apply an "entire fairness" standard where the directors "confronted actual conflicts of interest such that the directors making the decision did not comprise a disinterested and independent board majority. . . ." *Id*.

B. Directors' Fiduciary Duties: Companies Approaching Insolvency

Over the past decade, Delaware courts have issued several opinions clarifying a director's fiduciary duties during the period leading up to a company's insolvency.

Prior to this clarification, courts grappled with identifying the parties that may benefit from a director's fiduciary duties during a time called the "zone of insolvency" which refers to an indeterminate time when a company is in financial distress but not yet insolvent. Courts, academics, and practitioners generally interpreted Delaware law (and in particular, a so-called "famous" footnote in the *Credit Lyonnais* case) to mean that a director's fiduciary duties shifted from equity holders to creditors during the zone of insolvency. *See Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns. Corp.*, Civ. A. No. 12150, 1991 Del. Ch. LEXIS 215, at 108 n.55 (Del. Ch. Dec. 30, 1991) (noting that "directors will recognize that in managing the business affairs of a solvent corporation in the ***vicinity of insolvency***, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.") (emphasis added); *Quadrant Structured Prods. Co., v. Vertin*, 102 A.3d 155, 185-86 (Del. Ch. 2014) (noting that, after the *Credit Lyonnais* court used the phrase "solvent corporation in the vicinity of insolvency" in footnote 55, the "debate raged over this concept" until the *Gheewalla* case was published) . In so finding, parties recognized that, while the interests of the company's stakeholders generally may be aligned, there will be times where the interests of creditors and equity holders diverge—where creditors would like the directors to act conservatively to preserve value, but equity holders would like the directors to pursue higher-risk strategies that ultimately may afford them greater value.

In 2007, the Supreme Court of Delaware set forth a bright line test indicating that a director's fiduciary duties do not shift in the zone of insolvency.

> When a solvent corporation is navigating in the zone of insolvency, ***the focus for Delaware directors does not change***: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.

N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (emphasis added). *See also Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 174 (Del. Ch. 2006) ("The incantation of the word insolvency, or even more amorphously, the words zone of insolvency should not declare open season on corporate fiduciaries. Directors are expected to seek profit for stockholders, even at risk of failure. With the prospect of profit often comes the potential for defeat."), *aff'd sub nom. Trenwick Am. Litig. v. Billett*, 931 A.2d 438 (Del. 2007).

Other U.S. jurisdictions generally follow the bright line test set forth in *Gheewalla*, holding that fiduciary duties remain unchanged while a company is in the zone of insolvency. *See e.g., RSL Commc'ns. PLC v. Bildirici*, 649 F. Supp. 2d 184 (S.D.N.Y. 2009) ("the Court concludes that adopting Plaintiff's 'zone of insolvency' theory would provide redundant legal protections to creditors, while impeding corporations' ability to recruit qualified directors, generate capital, and serve their general wealth-maximizing function."), *aff'd sub nom. RSL Commc'ns PLC v. Fisher*, 412 Fed. Appx. 337 (2d Cir. 2011); *Berg & Berg Enters., LLC v. Boyle*, 178 Cal. App. 4th 1020, 1041 (Cal. Ct. App. 2009) (holding that "there is no fiduciary duty prescribed under California law that is owed to creditors by directors of a corporation solely by virtue of its operating in the 'zone' or 'vicinity' of insolvency.'").

C. Directors' Fiduciary Duties: Insolvent Companies

Upon the commencement of a bankruptcy case under Chapter 11 of the Bankruptcy Code, the debtor's management and board of directors retain control of the debtor's assets and operations and continue normal business activities, subject to the limitations imposed by the Bankruptcy Code.[5] The debtor becomes a "debtor-in-possession," and the debtor's management and the board continue to have the fiduciary duties to act in the best interests of company, as described above.

While the directors' fiduciary duties do not change upon the company's insolvency, when the company is solvent, equity holders have the ability to enforce those fiduciary duties but, when a company becomes insolvent, creditors have the ability to enforce those fiduciary duties. *Gheewalla*, 930 A.2d at 101 ("When a corporation is *insolvent* . . . its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.") (emphasis in original); *Quadrant Structured Prods. Co.*, 102 A.3d at 172 (same). Even when a company is insolvent, "directors are free to pursue value maximizing strategies, while recognizing that the firm's creditors have become its residual claimants and the advancement of their best interests has become the firm's principal objective." *Trenwick Am. Litig. Trust*, 906 A.2d at 175.

The Delaware Chancery Court has repeatedly held that directors may engage in business activities that they believe, in their business judgment, are in the best interests of the company,

[5] In contrast, the appointment of a trustee is required in cases under chapter 7, 12, and 13 of the Bankruptcy Code. In some chapter 11 cases, the bankruptcy court may limit the authority of management and the board, and may order the appointment of a chapter 11 trustee "for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor" or "if such appointment is in the interests of creditors, any equity security-holders and other interests of the estate...." *See* 11 U.S.C. §1104(a). The appointment of a trustee in a chapter 11 case is an extraordinary remedy as there is a strong presumption that the debtor will retain control over its business and affairs. As an alternative to ordering the appointment of a trustee in chapter 11 cases where parties question the prepetition activity of the debtor, a court may order the appointment of an examiner to conduct an investigation into the company's prepetition activities. *See* 11 U.S.C. §1104(c).

even if those activities increase risk for some or all of the company's stakeholders.[6] In fact, the Delaware Chancery Court recently held that the business judgment rule applies, not only to independent directors making risky business decisions in an effort to maximize the company's value, but to non-independent directors as well. In *Quadrant Structured Prods. Co.*, the Delaware Chancery Court applied the business judgment rule to the board's decision to pursue a relatively more risky business strategy to benefit its sole stockholder, where the company was insolvent, the directors were dual-fiduciaries to creditors and equity holders, and two of the five directors held positions in the stockholder's company. *Id*. at 192 ("If a creditor-plaintiff could sue derivatively and establish a lack of director independence and disinterestedness by alleging that the director who owned equity or who owed duties to a large stockholder adopted a risky business strategy to benefit the common stock, the directors of an insolvent corporation would face precisely the same type of fiduciary conflict that *Gheewalla* sought to avoid.") The Court distinguished between (i) actions designed to confer "direct and specific benefits" to the directors themselves or to particular constituency, and (ii) actions designed to increase the value of the firm as a whole. *Id*. at 187-188. In a case involving "direct and specific benefits", the entire fairness test would apply. However, "when directors make decisions that appear rationally designed to increase the value of the firm as a whole, Delaware courts do not speculate about whether those decisions might benefit some residual claimants more than others" and the business judgment rule applies. *Id*.

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[6] *See e.g.*, *Quadrant Structured Prods. Co.*, 102 A.3d at 185-86 (noting that "Delaware law does not require the Board to shut down [the company's] business and manage towards a near-term dissolution for the benefit of creditors" and "[n]otwithstanding a company's insolvency, the directors continue to have the task of attempting to maximize the economic value of the firm.") (citation omitted); *Shandler v. DLJ Merch. Banking, Inc.*, C.A. No. 4797-VCS, 2010 Del. Ch. LEXIS 154, at *55 (Del. Ch. July 26, 2010) ("Even when [the company] was insolvent, the board was entitled to exercise a good faith business judgment to continue to operate the business if it believed that was what would maximize [the company's] value."); *Trenwick Am. Litig. Trust*, 906 A.2d at 174-75.

Notwithstanding the shift in the residual beneficiaries, Delaware courts recently limited creditors' rights to bring lawsuits against directors of insolvent companies, holding that "individual *creditors* of an *insolvent* corporation have *no right to assert direct* claims for breach of fiduciary duty against corporate directors[]" and may only bring "derivative claims on behalf of the insolvent corporation or any *other* direct nonfiduciary claim . . . that may be available for individual creditors." *Gheewalla*, 930 A.2d at 103. See also *Quadrant Structured Prods. Co.*, 102 A.3d at 172 ("Because the creditors of an insolvent corporation join the class of residual claimants, 'equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation.'") (quoting *Gheewalla* at 102). Thus, while equity holders may bring direct or derivative claims for breach of fiduciary duty, a creditor may only bring derivative claims for breach of fiduciary duty once the company is insolvent.

The shift from fiduciary duties benefiting equity holders to benefiting creditors may have little practical effect in a director's day-to-day activities because directors often are unable to determine when exactly insolvency occurs.

There are two traditional tests for evaluating whether a company is insolvent: (i) the balance sheet test, and (ii) the equitable insolvency test. Under the balance sheet test, the debtor is insolvent if the sum of its liabilities is greater than the sum of its assets. *Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 648, 636 (3d Cir. 1991) (citing 11 U.S.C. §101(32)); *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 789 (Del. Ch. 1992). Under the equitable insolvency test, a company is insolvent if it is unable to pay its debts as they come due in the ordinary course of business. *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. Del. 2007) (equitable insolvency is "the general inability of the corporate debtor to meet its pecuniary liabilities as they mature, by means of either available assets or an honest use of credit.") (citation omitted); *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d at 789.[7]

While a director may know that the company is in financial distress, it may not be able to pinpoint the exact moment when the company turns from solvent to insolvent. For this reason, a prudent director should consider the interests of creditors as soon as the company starts showing signs of financial distress. Moreover, as discussed above, directors generally can avoid or limit liability by making decisions at all times with the goal of maximizing the value for the entire corporate enterprise.

Once the company files a chapter 11 petition, breach of fiduciary duty actions against directors will not automatically be stayed due to the company's bankruptcy. To extend the stay to non-debtor parties, including directors and officers of the debtor, a party must show, in the Fourth Circuit, that unusual circumstances exist (*i.e.*, "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will effect be a judgment or finding against the debtor[]"), or in the Second Circuit, that a claim against the non-debtor would have an immediate adverse economic consequence for the debtor's estate. *See A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986); Summary Order, *Residential Capital, LLC v. Fed. Hous. Fin. Agency (In re Residential Capital, LLC)*, No. 12-3342, (2d Cir. July 15, 2013) [ECF No. 94] (citing *Queenie Ltd. v. Nygard Int'l.*, 321 F.3d 282, 287 (2d Cir. 2003)).

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[7] The Delaware Chancery Court recently rejected the "irretrievable insolvency" test for determining whether a creditor is eligible to bring a derivative lawsuit. The irretrievable insolvency test, which generally is used by Delaware courts when determining whether to appoint a receiver, requires "a deficiency of assets below liabilities with no reasonable prospect that the business can be successfully continued in the face thereof." *Quadrant Structured Prods. Co., v. Vertin*, 115 A.3d 535, 557 (Del. Ch. 2015) (citation omitted).

D. Deepening Insolvency

"Deepening insolvency" is a term used to describe a situation where directors make decisions that ultimately result in the company becoming more deeply insolvent. Courts, including those in Delaware and most other U.S. jurisdictions, do not recognize deepening insolvency as a cause of action. *See Trenwick Am. Litig. Trust*, 906 A.2d at 174.

> Even when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are creditors does not mean that the directors cannot choose to continue the firm's operations in the hope that they can expand the inadequate pie such that the firm's creditors get a greater recovery. By doing so, the directors do not become a guarantor of success. Put simply, under Delaware law, "deepening insolvency" is no more of a cause of action when a firm is insolvent than a cause of action for "shallowing profitability" would be when a firm is solvent. Existing equitable causes of action for breach of fiduciary duty, and existing legal causes of action for fraud, fraudulent conveyance, and breach of contract are the appropriate means by which to challenge the actions of boards of insolvent corporations.

Id.

While deepening insolvency may not be recognized as a valid cause of action, some courts have held that deepening insolvency is a valid theory of damages for breach of duty of loyalty claims. *See Miller v. McCown De Leeuw & Co. (In re The Brown Schs.)*, 386 B.R. 37, 46 (Bankr. D. Del. 2008). Where this theory applies, damages for breach of the duty of loyalty may increase dramatically.

III. CANADA

A. Directors' Fiduciary Duties Generally

In Canada, a company may incorporate federally using the Canada Business Corporations Act (CBCA) or provincially in the appropriate jurisdiction using one of the numerous business corporation laws set forth by the Canadian provinces and territories. The decision for a company to incorporate federally or provincially will be based on a variety of factors, including, without limitation, the scope of the business, the residence of existing or potential investors, and various regulatory and tax matters.[8]

Under the CBCA, a director has (i) the fiduciary duty of loyalty and good faith, and (ii) the duty of care, diligence, and skill. Specifically, CBCA Section 122(1) requires directors and officers to "act honestly and in good faith with a view to the best interests of the corporation" and "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." *See* CBCA § 122(1)(a)-(b). CBCA Section 122(2) further provides that a director is required to comply with the CBCA, the regulations, articles, bylaws, and any unanimous shareholder agreement.[9]

A director has complied with its fiduciary duties if it has exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on: (i) financial statements of the company represented by an officer or in a written auditor's report fairly to reflect the financial condition of the company, or (ii) the report of a person whose profession lends credibility to the statements made by such person. *See* CBCA Sections 123(4)-(5).

Where a director's ability to manage, or supervise the management of, the business and affairs of the company are limited by a unanimous shareholder agreement, the director's fiduciary duties and liabilities are limited to the same extent. *See* CBCA 146(5). Indeed, the only instance where a director may be relieved of liability for breach of fiduciary duty is

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[8] This article will focus on fiduciary duties under the federal Canada Business Corporations Act, not provincial law.

[9] A "unanimous shareholder agreement" is a written agreement among all of the shareholders of the company (or among all shareholders plus one or more non-shareholders) that restricts the power of directors to manage, or supervise the management of, the business and affairs of the company. *See* CBCA Section 146(1).

Directors also are subject to certain statutory liabilities, such as personal liability for employment-related claims, including wages and vacation pay. *See* CBCA § 119.

pursuant to the terms of a unanimous shareholder agreement. *See* CBCA Sections 122(3)[10] and 146(5).[11]

As a general matter, the statutory fiduciary duty of loyalty requires that directors seek to maximize value for the benefit of the corporation as a whole. *See Peoples Dep't Stores Inc. (Trustee of) v. Wise*, 3 S.C.R. 461, 2004 SCC 68 (Can. Oct 9, 2004) (noting that CBCA Section 122(1)(a) refers to the "best interests *of the corporation*" and does not identify any specific individual beneficiary, such as shareholders or creditors) (emphasis added).[12] Thus, under Canadian law, creditors do not have the ability to bring direct claims against directors for breach of the fiduciary duty of loyalty set forth in CBCA Section 122(1)(a). *Id*. ("There is no need to read the interests of creditors into the duty set out in s. 122(1)(a) of the CBCA.").

In contrast, the duty of care set forth in CBCA Section 122(1)(b) requires directors to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances"—this language is much more open-ended and does not specifically refer to the corporation as the beneficiary of the duty. Thus, Canadian courts have held that creditors may have a direct remedy for breach of the duty of care. *See Peoples Dep't Stores Inc. (Trustee of)*, 2004 SCC 68 (holding that it is "obvious" that the duty of care prescribed in CBCA Section 122(1)(b) includes creditors as the beneficiaries).

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[10] CBCA Section 122(3) provides that "[s]ubject to subsection 146(5), no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act or the regulations or relieves them from liability for a breach thereof."

[11] CBCA Section 146(5) provides, in pertinent part, that "[t]o the extent that a unanimous shareholder agreement restricts the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation, parties to the unanimous shareholder agreement who are given that power to manage or supervise the management of the business and affairs of the corporation have all the rights, powers, duties and liabilities of a director of the corporation, . . . and the directors are relieved of their rights, powers, duties and liabilities, including their liabilities under section 119, to the same extent."

[12] In acting for the benefit of the corporation as a whole, "it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment." *Peoples Dep't Stores Inc. (Trustee of)*, 2004 SCC 68.

In evaluating whether a director has satisfied its duty of care, Canadian courts have recognized, similar to U.S. courts, that directors and officers often have business expertise that courts do not have, and as a result, "Canadian courts have developed a rule of deference to business decisions called the 'business judgment rule', adopting the American name for the rule." *Peoples Dep't Stores Inc. (Trustee of)*, 2004 SCC 68. In applying the business judgment rule, Canadian courts evaluate whether the decision falls within a "range of reasonableness". If so, the court should not substitute its opinion for that of the board. *Maple Leaf Foods Inc. v. Schneider Corp.*, 42 O.R. (3d) 177 (Ont. Can. Oct. 20, 1998) ("If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest, and that committee has acted independently, in good faith, and made an informed recommendation as to the best available transaction for the shareholders in the circumstances, the business judgment rule applies."). To challenge a business judgment decision, a plaintiff would need to establish that the directors breached their duty of care in a way that caused injury to the plaintiff. *Id*.

In addition to having direct claims against directors for breach of the duty of care, a creditor may bring a lawsuit against a director for an "oppression remedy" or as a "derivative action."

An oppression remedy is a personal remedy available to creditors where the board acts in a manner that is "oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer . . ." CBCA Section 241(2)(c). Oppression is an equitable remedy that seeks to ensure fairness—courts granting an oppressive remedy have jurisdiction to enforce "not just what is legal but what is fair." *BCE Inc., Re*, 3 S.C.R. 560, 564 (Can. Dec. 19, 2008). Like many equitable remedies, oppression is fact-specific and will be judged by the reasonable expectations of the stakeholders in context, taking into account the relationships at play. "Conduct that may be oppressive in one situation may not be in another." *Id*. at 591.

In contrast, a derivative action is an action brought on behalf of the company to remedy an injury against the company itself. In order to bring a derivative action, the complainant must apply for leave of the court, give notice to the directors of its intent to apply for leave of the court, and act in good faith. In addition, the derivative action must "appear[] to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued." *See* CBCA Section 239(1)-(2).

Recently, the Ontario Court of Appeal held that the oppression remedy and derivative action are distinct remedies but they are not mutually exclusive. *Rea v. Wildeboer*, 2015 ONCA 373 (2015). While, generally speaking, the oppression remedy is available to address wrongs done to an individual stakeholder and derivative actions are available to address wrongs done to the corporation, there may be circumstances giving rise to both types of actions. For example, wrongful acts involving closely-held private companies may involve a wrong committed against the corporation that also directly affected the plaintiff in a manner that is different from the indirect effect of the wrong on similarly placed parties. *Id*.

B. Directors' Fiduciary Duties: Company is Approaching Insolvency

The Supreme Court of Canada has held that a director's "fiduciary duty does not change when a corporation is in the nebulous 'vicinity of insolvency'." *Peoples Dep't Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68. Thus, similar to U.S. law, directors and officers under Canadian law "at all times . . . owe their fiduciary obligation to the corporation." *Id*.

The Supreme Court of Canada acknowledged that when a company is operating in the vicinity of insolvency, "shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, [while] creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation." *Id*. However, in holding that the director's fiduciary duties to the company remain unchanged, the Supreme Court of Canada recognized, similar to U.S. courts, that, "any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors." *Id*. Thus, if a director is unsuccessful in its efforts to address the company's financial issues, it will not qualify as a breach of the duty of loyalty.[13] *Id*.

C. Directors' Fiduciary Duties: Company is Insolvent

Canadian insolvency law is under the jurisdiction of the federal government. However, provincial law governs property and civil rights (including the rights of secured creditors and landlords) and therefore can impact insolvency matters as well.

Under Canadian law, an insolvent company may choose to liquidate or reorganize. In liquidation proceedings, referred to as "bankruptcy" proceedings, the company's assets statutorily vest with the trustee who will administer the estate for the benefit of the company's unsecured creditors—the pre-filing directors and officers will no longer be responsible for managing the company's affairs. In contrast, in reorganization proceedings, the company's existing directors and officers will remain in place to manage the company's day-to-day operations, and those parties will continue to have the same fiduciary duties as they had to the company prepetition.[14]

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[13] In certain limited instances, however, a director may seek to take action that maximizes value for some constituents while negatively impacting the value available for others, particularly in the area of pension law. Where the company has a defined benefit pension plan and enters the so-called vicinity of insolvency, directors must be careful not to serve contemporaneously as a director and pension plan administrator. The interests of the majority of the company's stakeholders likely are divergent from the interests of the pension plan participants, and a director serving in both roles will suffer a conflict of interest, potentially leading to personal liability.

[14] A company seeking to commence reorganization proceedings may choose between two paths: (i) a proposal process, which is governed by the Bankruptcy and Insolvency Act (BIA) and is a highly codified process commonly used for less complicated or small business restructurings, or (ii) a process under the Companies' Creditors

While the company is in reorganization proceedings, directors continue to have fiduciary duties but they may benefit from the stay, which prevents parties from commencing or continuing a lawsuit against any former, current, or future directors during the reorganization process. The stay is not automatic but is typically imposed by court order immediately upon the commencement of the reorganization process. Any party seeking to bring a lawsuit against a director during the reorganization proceeding would need permission from the Court to lift the stay.

Arrangement Act (CCAA), which is designed to assist larger companies in the reorganization process and provides companies with much greater flexibility and creativity in restructuring. In each type of reorganization proceeding, the company's directors will remain in place but will be subject to court oversight. In addition, in the proposal process, a "proposal trustee" will be appointed to oversee the directors, and in the CCAA process, a "monitor" will be appointed to oversee the directors.