Duties in a Commercial Relationship

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Can a Fiduciary Duty Extend Beyond the Traditionally Accepted Categories?

As a business lawyer, I am frequently asked to advise my clients about the duties they, as a director or shareholder of a company, may owe to other people associated with the company. In this context, the question most frequently asked is whether the relationship between directors and shareholders can ever become one of a fiduciary nature, and if so, what circumstances might give rise to such a duty? Another question I am asked is whether there is a duty of disclosure, either by a director or shareholder, to a minority shareholder when the majority are considering selling their interests in the company. I will consider how the courts have interpreted these issues below.

The relationship between directors and the company is absolute. Subsection 122(1) of the *Canada Business Corporations Act* requires that directors and officers of a corporation, in discharging their duties, shall act honestly and in good faith with a view to the best interests of the corporation, while exercising the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The corporate law statutes of other Canadian jurisdictions, including Manitoba's *The Corporations Act*, contain similar and often identically phrased obligations. The decision of the Supreme Court of Canada (the "SCC") in *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377, is instructive on why this duty exists. As directors are tasked with managing the business decisions and activities of a company, they are entrusted with a great deal of responsibility. Justice La Forest observed in the *Hodgkinson* case that, "From a conceptual standpoint, the fiduciary duty may properly be understood as but one of a species of a more generalized duty by which the law seeks to protect vulnerable people in transactions with others".

Canadian courts distinguish between *per se* and *ad hoc* fiduciary relationships. In the SCC decision of *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, Justice La Forest stated that there are certain relationships which will give rise to the presumption of *per se* fiduciary obligations. Well established examples include relationships between agent and principal, solicitor and client, and trustee and beneficiary. On the other

hand, *ad hoc* fiduciary relationships can arise as a matter of fact. They do not exist at large like *per se* relationships but arise from, and relate to, the legal interests at stake in a particular situation. Consequently, the nature and potential scope of the fiduciary duty must be assessed within this framework. The following are general characteristics of an *ad hoc* fiduciary relationship quoted in the *Lac Minerals* case: (i) the fiduciary has scope for the exercise of some discretion or power, (ii) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests, and (iii) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

While *per se* fiduciary relationships can be easy to identify, in a commercial setting the threshold to establish an *ad hoc* fiduciary relationship is high. As a rule, fiduciary duties will generally not arise from a commercial contract or between arm's length independent parties in commercial transactions because these types of transactions emerge as a result of the pursuit of self-interest. To illustrate this, in *Harris v. Leikin Group Inc*., 2013 ONSC 1525 (CanLII), a group of shareholders wanted the company to redeem their shares. The parties negotiated a share redemption agreement based on a $60 million valuation of the company's key asset. To finance the transaction and avoid going into debt, the company required a new investor. For a 50 per cent interest in the company, the new investor paid $39.3 million, which was based on an increased $78.6 million valuation of the same asset. The selling shareholders sued the company for breach of fiduciary duty, among other things. The court held that the directors and non-selling shareholders did not owe a fiduciary duty and were not under any obligation to disclose to the selling shareholders information related to the financing they secured in order to fund the share redemption transaction.

In the case of *White v. Colliers Macaulay Nicholls Inc.,* 2008 CanLII 4269 (Ont. S.C.), the parameters of disclosure in the context of a takeover transaction were considered. The plaintiff brought an action against his former employer and company of which he held a significant number of shares. The plaintiff's terms of employment were that upon leaving the company, the employer would redeem his shares in accordance with a predetermined formula to calculate share value. The plaintiff involuntarily retired from the company and signed a release. The action centered around the fact that the defendant did not disclose that it was planning to be bought out at a higher share price than the share price received by the plaintiff after he left the company. The court held that the nature of the relationship between the parties was not fiduciary and that there was no duty to disclose details of the company's financial negotiations with respect to a prospective takeover.

The threshold for fiduciary duties in a commercial relationship was again tested in *Simkeslak Investments Ltd. v. Kolter Yonge LP Ltd.,* 2013 ONCA 116, this time in the context of a partnership. In *Simkeslak Investments* the parties formed a property development partnership, with the plaintiffs and the defendant, Kolter Yonge LP Limited ("Kolter") each holding a 50 per cent interest. The relationship soured and the parties proceeded to engage in a series of unilateral attempts to market and sell their interest in the property. From the

resultant sale, Kolter profited substantially more than the plaintiffs and an action was commenced alleging breach of fiduciary duty. The plaintiffs demanded to be compensated, stating that they would have waited to sell their units had they known of the prospect of the better deal. In the motions for summary judgment, the court held that "[t]he fact that fiduciary duties exist in a particular category of relationship, such as a partnership, does not mean that the fiduciary duties inherent in that relationship will necessarily continue unaffected throughout the course of the parties' relationship. It will be 'the facts surrounding the relationship' and the expectation of the parties that will determine the existence and nature of any fiduciary duties." On appeal, the court went even further to say that even in a *per se* fiduciary scenario, not all actions taken by a person will attract a fiduciary obligation.

As described above, a director owes a statutory fiduciary duty to the corporation of which he or she is a director, and is obliged to not act prejudicially or in a conflict of interest to that corporation. It has been expressed by the courts that while there may be some exceptions on a case-by-case basis, a director's duty will usually not extend to a shareholder. There are limited examples where directors have been found to owe a fiduciary duty towards shareholders. For example, in *Dusik v. Newton*, 1985 CanLII 406 (B.C.C.A.) reference was made to the following circumstances that may give rise to a fiduciary relationship: where a director acts as the agent of a minority shareholder, where a director purchases shares from a minority shareholder and where a director has misled a minority shareholder. However, the British Columbia Court of Appeal commented that these exceptions are not closed, the existence of a fiduciary relationship depends on the circumstances of a case. In *Crawfish Investments Inc. v. Atkins*, 2003 B.C.S.C. 165 (CanLII), Master Patterson commented that it is "clear that barring any exceptional circumstances a director owes no fiduciary duty to a shareholder." The underlying theme is that a special relationship of trust and dependency should be present.

In conclusion, it is a well-accepted legal principle that in Canada, a director's relationship to the company is fiduciary in nature. With respect to relationships between shareholders, courts are reluctant to impose fiduciary duties in arm's length commercial settings involving self-interested parties. In the jurisprudence involving the assertion of the existence of a fiduciary duty by an affected party, there is often an event or series of events in the relationship which leads the court to determine that even if an *ad hoc* fiduciary duty could in theory have existed, the event was sufficient to bring the duty to an end. In the *Simkeslak* case it was the covert attempts by each party to sell their interest in the property. In the *Colliers* case it was a release signed by the plaintiff. In the *Leikin Group* case it was simply the fact that the selling shareholders wished to divest themselves of their interest in the company, with both sides negotiating for the best price. In these cases it was found that the actions of the parties constructively ended any on-going duties of a fiduciary nature.

This article was written by Russell Dufault, who is no longer at TDS. Please visit our **Corporate and Commercial Law** page for more information and a list of TDS Corporate and

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