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PAPER 2.1

Distinguishing Oppression Claims and Derivative Actions

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DISTINGUISHING OPPRESSION CLAIMS AND DERIVATIVE ACTIONS

I. Introduction

In this paper we explore the similarities and differences between "oppression claims" and "derivative actions" under the *Business Corporations Act* SBC 2000 c. 57 (the "BCBCA"). We also address the practical considerations involved when assessing a claim which may give rise to both an oppression claim and a derivative action including:

a) What distinguishes oppression claims and derivative actions;

b) What circumstances can give rise to both and how to determine which remedy to pursue;

c) Procedural issues arising with claims that may give rise to both; and

d) Thoughts on the potential future development in the law with respect to the interaction of oppression claims and derivative actions.

II. Background to Oppression Claims and Derivative Actions

A. Oppression Claims

Pursuant to s. 227 of the BCBCA shareholders (and other appropriate persons) may apply to court for an 'oppression remedy' if the operations of the company, or conduct of its directors, have been conducted in a manner that is a) oppressive or b) unfairly prejudicial to one or more shareholders.

The oppression remedy is an equitable remedy, which gives a court a broad, equitable jurisdiction to enforce not just legal rights, but what is fair amongst the parties. What is just and equitable will be determined based upon the reasonable expectations of the stakeholders in the given circumstances.

Not every unmet expectation, however, will give rise to a remedy. The conduct at issue must also be oppressive or unfairly prejudicial.

Oppressive conduct has been defined as "burdensome, harsh, and wrongful" conduct which "lacks probity in fair dealings in the affairs of a company to the prejudice of some portions of its members".[1]

The Supreme Court of Canada in *BCE Inc., et al v. 1976 Debentureholders* [2008] S.C.J. No. 37 stated that "'unfair prejudice'" may admit of a less culpable state of mind, that nevertheless has unfair consequences".

The remedies available under s. 227 are broad and flexible and include: i) directing or prohibiting any act of the company; ii) regulating the conduct of the company's affairs; iii) appointing a receiver; iv) appointing or removing directors; v) directing that a shareholder's shares be purchased; or vi) directing that the company be liquidated and dissolved . The remedies listed in s. 227 are not exhaustive, however, and the court can issue any final or interim order it considers appropriate.[2]

B. Derivative Claims

An alternate recourse for a claimant seeking to address concerns with the operations of a company or actions of its directors is to seek leave to bring a derivative action. This application for leave is brought pursuant to section 232 of the BCBCA. Unlike an oppression claim, a derivative action is not an end in itself, but merely a procedural step necessary to initiate a 'legal proceeding' in the name of the company. These legal proceedings are broadly defined in subsection 1(1) of the BCBCA, as including (and therefore not limited to) "a civil, criminal, quasi-criminal, administrative or regulatory action or proceeding." Further, subsection 232(3) indicates that the right to pursue a legal proceeding "applies whether the right, duty or obligation arises under this Act or otherwise."

A derivative action's requirement for leave creates a number of hurdles not present in an oppression proceeding. These hurdles are laid out in subsection 233(1) as follows: 1) the complainant must have made reasonable efforts to cause the company's directors to pursue the contemplated prosecution; 2) notice of the application must be given to the company; 3) the complainant must be acting in good faith; and 4) the derivative action must appear to the court to be in the best interests of the company.

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1 *Nystad v. Harcrest Apartments Ltd.* (1986) 3 B.C.L.R. (2d) 39, para. 13, relying on *Scottish Co-op. Wholesale Soc. Ltd. v. Meyer*, [1959] A.C. 324.

2 This is evident in the language of subsection 227(3); it was also found in *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2006] O.J. No. 944 (C.A.) when discussing a similar provision of the Ontario Act.

C. What Distinguishes oppression claims and derivative actions

There are a number of distinctions between oppression claims and derivative actions including:

a) An oppression claim is a personal claim on behalf of a shareholder, while a derivative claim addresses harm done to the company;

b) The substantive standard for a finding of liability;

c) The remedies available;

d) The significance of the timing of the conduct complained of;

e) Who bares the costs of the proceeding;

f) Whether leave is required to commence the proceeding; and

g) An oppression claim is typically commenced by way of Petition proceeding, whereas a derivative claim is brought by Notice of Civil Claim.

Each of these will be addressed in turn below.

1. Personal vs. Corporate Harm

The central distinction between derivative actions and oppression claims, as described in the leading decision of *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216 (C.A.), is that an oppression claim is a personal claim made by the shareholder, while a derivative claim is not a personal claim, but rather a claim brought in the name of the company. Accordingly, to determine which proceeding is appropriate, one must ask against whom the alleged harm has been caused. If the harm has been caused to the company alone, then a derivative action is appropriate. If the harm is to one or more shareholders, in their capacity as such, then an oppression claim may be appropriate.

Of course, harms to the company will generally also cause harm to its shareholders. For example, the inappropriate diversion of funds from a company will harm the company, but will also harm its shareholders, by reducing the value of the company. This type of harm to the shareholder, however, is said to be "indirect," as it is only suffered by the shareholder by virtue of the harm suffered by the company.

Attempts by shareholders to make claims for oppression for such indirect harm has lead to an acknowledgment in the case law that oppression claims require something more. To successfully advance a personal claim, a shareholder must demonstrate a unique personal harm, which is not suffered equally by all shareholders.

In "The Oppression Remedy: Personal or Derivative" (1991) 70 Can. Bar Rev. 29, Jeffrey MacIntosh notes the difference between a personal or derivative action (at 30 – 31):

> "A derivative action is commonly said to arise where it is the corporation that is injured by the alleged wrongdoing. The "corporation" will be injured when all shareholders are affected equally, with none experiencing any special harm. By contrast, in a personal (or "direct") action, the harm has a differential impact on shareholders, whether the difference arises amongst members of different classes of shareholders or as between members of a single class. It has also been said that in a derivative action, the injury to shareholders is only indirect; that is, it arises only because the corporation is injured, and not otherwise. [citations omitted]

In *Pasnak v. Chura*, 2004 BCCA 221 Mr. Justice Donald J.A. made this point at paragraph 27 of as follows:

> ". . ., unless [the shareholder] can show that he was affected in a peculiar way, that is, in a manner distinct from the other shareholders by the allegedly oppressive behaviour of [a director], he must seek leave to commence a derivative action against [the director] in [the company's] name."

2. Standard of Liability

Another significant difference between oppression claims and derivative actions is the substantive standard of liability. As set out above, in an oppression proceeding, the court's primary consideration is whether a reasonable expectation of the complainant has been violated in an oppressive or unfairly prejudicial manner. As an equitable remedy, this analysis goes beyond the mere legal rights of the parties and considers the equities. Conversely, a derivative action requires proof of a legal wrong.

3. Remedies Available

The remedies available for the two different proceedings is also a substantial difference between the two. The potential remedies available in an oppression proceeding are broad and flexible and limited only by the creativity of the adjudicator and counsel. The remedies available in a derivative action are limited by the standard remedies available for the cause of action plead.

4. Timing of the Conduct Complained Of

The significance of the timing of the conduct complained is another difference between the two proceedings. Section 227(4) requires the shareholder in an oppression proceeding to bring an application in a timely manner. An oppression proceeding commenced after the allegedly oppressive acts have come to an end, may still be considered timely, particularly in circumstances where it evidences a "course of conduct." [3] Timeliness is not a specified consideration for a derivative action.

In addition, in an oppression proceeding, the court must have a "view to remedying or bringing to an end the matters complained of" as required by subsection 227(3). Many of the enumerated remedies are directed at correcting ongoing acts of oppression, as opposed to remedying past wrongs. As such, where the conduct complained of gives rise to both a potential oppression proceeding and a derivative action, a derivative action may be more appropriate in circumstances where the company is no longer a going concern and the conduct complained of is no longer ongoing.[4]

Further, the oppression remedy does not allow a claimant to seek a remedy for past wrongs. Past oppressive conduct could have only violated the legitimate expectations of the shareholder who held the shares at the time the oppressive conduct took place. If oppressive conduct has taken place and a share is later sold, courts have concluded that the sale price of the share has taken into account the oppression.[5] Accordingly, "[t]o award a shareholder for past oppression would not be compensation but a windfall."[6] No such concern exists in a derivative action, because it is the company not the shareholder who is seeking the remedy.

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3 *Orr v. Sojitz Tungsten Resources Inc.* 2010 BCSC 66.

4 *Bassett-Smith v. Protech Consultants (1989) Ltd et al.*, 2006 BCSC 803 at paras. 45 and 46.

5 *Royal Trust Corp. of Canada v. Hordo*, (1993), 10 B.L.R. (2d) 86 (Ont. Ct. (Gen. Div.)), para. 17.

6 *Ford Motor Company of Canada, Ltd. v. Ontario Municipal Employees Retirement Board (2006)*, 79 O.R. (3d) 81 (CA), para.115.

5. Costs

Another distinction between the two proceedings is with respect to the cost of the respective claims. As a personal claim, the claimant will pay the costs associated with prosecuting oppression claim, and will only be entitled to recover costs if awarded costs at the end of the proceeding, typically only if successful and based upon the costs tariff. In derivative claims, however, the person conducting the action will typically be entitled to recover costs on a solicitor-client basis, if the claim is successful.[7]

Further, while generally not ordered, it is possible for the person conducting the action to apply pursuant to s.233 to have the costs of the litigation financed on an interim basis.

6. The Leave Requirement

The leave requirement for derivative actions, also a significant distinction between the two proceedings, was intended, in part, to address the possibility of the company having the pay the cost of the litigation. The leave requirement for derivative actions limits the exposure of the company to being forced into frivolous litigation. This point was made in *Ontario (Securities Commission) v. McLaughlin*, [1987] O.J. No. 1247 (H.C.J.), where it was stated at para 12:

> "leave is required... to protect the corporation from frivolous and unwarranted interference by disaffected claimants who seek to inject the corporation into litigation as a party plaintiff for which the corporation may initially have to provide the financing. The proceeding now created by sec. 247 [for an oppression claim] on the other hand is quite different; it creates a new personal cause of action to which the corporation need not be a party."

7. Petition Proceeding vs. Action

Initially, all applications pursuant to s.227 must be brought by way of petition: *Gittings v. Caneco Audio-Publishers Inc.* (1988), 26 B.C.L.R. (2d) 349 (C.A.). Generally, where the proceeding does not involve substantial issues in dispute it will be heard by summary procedure. A derivative action is typically brought by Notice of Civil Claim. This is another distinction that should be considered in assessing which procedure to invoke, as a summary proceeding will generally be resolved in a much shorter period of time, with significantly less cost.

III. What drives the decision to pursue one proceeding over another when both may be available?

In circumstances where either proceeding appears to be available on the facts, the combination of the broad remedies available and the lower standard for establishing liability would militate in favour of choosing the oppression remedy.

Where the "shareholder" bringing the claim has a strong case, the preferential cost treatment for derivative claims would not likely be sufficient to override the preferential remedies and standard of liability applicable in an oppression proceeding. Further, the requirement to obtain leave and the different procedural requirements will often make a derivative action slower and more expensive.

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7 *Primex Investments Ltd v Northwest Sports Enterprises Ltd* (1995), 13 BCLR (3d) 300 (SC), aff'd 26 BCLR (3d) 357 (CA).

IV. Pursuing both proceedings simultaneously

There may be circumstances in which it is appropriate to pursue an oppression remedy simultaneously with seeking leave to bring a derivative action.

The law is clear that oppression and derivative claims are not mutually exclusive; rather, some scenarios may give rise to both. This point was addressed by Newbury, J. (as she then was) in *Furry Creek Timber Corp. v. Laad Ventures Ltd*. (1992), 75 B.C.L.R. (2d) 246, where she stated (at page 254):

> "Obviously, the duty of a director to act in the best interests of the company is a duty owed to the company and the company may sue in respect of a breach. Can the same breach be the basis of a shareholder's oppression action? Although there appear to be authorities in Canada that suggest the derivative action and oppression action are mutually exclusive, I think the better view is that it can, provided the complaining shareholder has been affected by the breach in a manner different from or in addition to the indirect effect on the value of all shareholders' shares generally."

A similar point was acknowledged in *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, where Mr. Justice LaForest said at para. 62:

> "[w]here a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action." (relying on *Goldex Mines*)

In order for conduct that gives rise to a derivative action to also give rise to an oppression claim, the conduct must directly affect the shareholder in a manner that is different from the indirect effect on all of the shareholders' shares.

This is more likely to be the case in closely held corporations where certain shareholder/directors or controlling shareholders engage in self dealing. For example, in *Gopal v. Burke*, 2007 BCSC 1930 (CanLII), para. 15, Master Young concluded that diverting corporate opportunities will generally justify a derivative action, but if the opportunity is diverted to a majority shareholder, the minority shareholder may be sufficiently differently affected to also justify an oppression action. This is consistent with Ontario cases which have allowed indirect harms to support oppression claims if a shareholder (often the majority shareholder) has benefitted from the conduct.[8]

There are, however, numerous instances in which the British Columbia courts have rejected attempts to rely on indirect harms to support oppression claims. For example, in *Bruneau v. Irwin Industries (1978) Ltd.*, 2002 BCSC 757, a statement of claim was stuck out for seeking an oppression remedy for the diminution of share value as a result of the fact that it did not establish how the shareholders had been uniquely affected. Further, allegations of directors breaching their fiduciary duties to the company, without something more, was found to be insufficient for an oppression action and was struck as being more appropriately brought as a derivative action. [9]

Similarly, in *Pasnak v. Chura*, 2004 BCCA 221 (CanLII), the Court of Appeal rejected an oppression claim for what amounted to losses to a company for mismanagement. The Court found that the claimant could not demonstrate a unique harm, and, therefore, the appropriate proceeding was a derivative action.

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8 *SCI Systems Inc. v. Gornitzki Thompson & Little Co.* (1997), 36 B.L.R. (2d) 207 (Ont. Ct. (Gen. Div.)), aff'd (1998), 110 O.A.C. 160 (Div. Ct.)); *Neri v. Finch Hardware (1976) Ltd*. (1995), 20 B.L.R. (2d) 216 (Ont. Ct. (Gen. Div.)); *Loveridge Holdings Ltd. v. King-Pin Ltd.* (1991), 5 B.L.R. (2d) 195 (Ont. Ct. (Gen. Div.); *C.I. Covington Fund Inc. v. White*, [2000] O.J. No. 4589 (S.C.J.).

9 *Bruneau*, *supra*, at paras. 17-18.

A review of the case law suggests that the requirement to establish a direct harm, as opposed to the indirect effect on the value of all shareholders' shares generally, is sometimes confused and the results between cases seemingly inconsistent. The courts seem to be more willing to find a direct harm in the circumstances of a closely held corporation, where one of two shareholders derives a benefit as a result of a wrong to the company. (See for example: Hoet, supra., and Gopal, supra.) Further, as will be discussed below, there are signs that this distinction between derivative and oppression claims may be relaxing.

A. Procedural Issues where both proceedings are pursued

There are a number of procedural issues that must be considered when determining whether to bring an oppression remedy and seeking leave to bring a derivative action simultaneously.

Where the decision is taken to advance both an oppression remedy and a derivative action, a party may apply to consolidate the two proceedings or to have them heard at the same time.

In *Discovery Enterprises v. Ebco Industries Ltd*, 2001 BCSC 235, para. 24, Pitfield, J. concluded that consolidation would be inappropriate where the company would be plaintiff in the derivative claim and defendant in the oppression claim, where the remedies sought in either action are unique, or where different people stand to benefit from the remedies in each action. Nonetheless, Pitfield, J. found that it was appropriate for the two matters to be heard at the same time, concluding that (at para 26):

> "evidence pertaining to corporate history, the origin of the dispute... and the nature and course of the arbitration proceeding in which they were involved, will likely be relevant in both actions. Much is to be gained by having the actions heard at the same time. The need for multiple trials will be eliminated. Cost and inconvenience to the parties and the court will be reduced."

There was a similar finding in *Drove v. Mansvelt*, 48 BLR (2d) 72, in which Scarth, J. concluded that it was appropriate to hear the derivative and oppression actions at the same time where the assertions underlying the oppression claim were questions of fact that were to be properly decided in the derivative action. The recent addition of proportionality as a guiding principle in the *Supreme Court Civil Rules,* B.C. Reg. 241/2010 will no doubt support a line of reasoning for hearing the two types of proceedings together, where possible.

Where a claimant pursues derivative and oppression claims, the general requirement that documents obtained through discovery only be used for the action for which they were obtained applies. This means that the discovery process for each should be kept separate. In most cases, however, the information available through discovery in one will be available in the other.[10]

Counsel in a derivative action is required to act in the best interests of the company, while that same counsel in the oppression claim will be required to act in the best interests of the complainant shareholder. This may create a conflict of interest, which courts can resolve by requiring that the claimant obtain separate counsel for each action.[11]

Where an action is in fact a derivative action and is brought without leave (such as in the form of the oppression remedy), the appropriate response is to strike the action as disclosing no reasonable claim.[12]

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10 *Discovery Enterprises Inc v Ebco Industries Ltd*, [1998] 1 WWR 494 (BC SC), ["*Discovery Enterprises*"], para. 39.

11 *Discovery Enterprises*, paras. 38 – 40.

12 *Rogers v. Bank of Montreal* (1985), 64 B.C.L.R. 63 (S.C.), aff'd (1986), 9 B.C.L.R. (2d) 190 (C.A.); *McGauley v. B.C.* (1989), 39 B.C.L.R. (2d) 223 (C.A.); *Yue v. Microlink Int. Inc.*, [1991] B.C.W.L.D. 347 (S.C.) *Hoet v. Vogel*, [1995] B.C.J. No. 621 and *Bruneau v. Irwin Industries* (1978) Ltd., [2002] B.C.J. No. 1095.

Courts have rejected the idea that bringing an oppression claim signals bad faith in any subsequent derivative claim. Accordingly, the fact that a claimant in a derivative action already has an ongoing oppression claim will not itself bar the claimant from obtaining leave for bad faith under subparagraph 233(1)(c).[13]

B. The Future of Derivative Actions

There have been *obiter* comments in recent cases that may signal a relaxing of the division between derivative and oppression actions, though this remains an area of ambiguity.

One area in which this ambiguity has been addressed is in relation to claims involving allegations of breach of fiduciary duty of directors. It has long been established that it is to the corporation that directors owe fiduciary duties. Thus, a claim of breach of fiduciary duty by a director would have to be brought by way of derivative action, unless there was also a unique harm to a group of shareholders, qua shareholders, as a result of the conduct. In *Icahn v. Lions Gate,* 2011 BCCA 228 ["*Icahn*"], the court mused about whether an assertion of a reasonable expectation that the directors of a corporation would not breach their fiduciary duty would suffice to circumvent the requirement in an oppression case for a finding of direct harm. Newbury, J.A. referred to an *obiter* comment in the Supreme Court of Canada's reasons *in BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 ["*BCE*"]. In *BCE*, at para.93, the Supreme Court of Canada referred to a situation in which there was a decision to pay directors' fees higher than the industry norm as an example of "unfair prejudice". At para.72 of *Icahn*, Newbury J.A. wrote:

> "At least prior to BCE, I would have thought, for example, that the decision of a board to pay directors' fees "higher than the industry norm" would not be regarded as the basis for an oppression claim, but as a breach of duty owed to the corporation. However, the Supreme Court of Canada cited this as an example of unfairly prejudicial conduct at para.93 of BCE. Whether the Court thereby intended to signal that derivative actions (for breach of fiduciary duty) and oppression claims should in its view be collapsed into one category, despite their different treatment in Canadian corporate legislation, remains to be seen."

While the very general example in the *BCE* case, in the view of these authors, was not intended to signal such a departure, it is possible that complainants may attempt to utilize the two-prong approach for assessing oppression allegations, and the pre-eminence given to the reasonable expectations of the stakeholders, as creating such a possibility. The historical evolution of the remedy suggests against an interpretation of the reasonable expectations of the complainant that would allow a claimant to succeed for a harm that is solely to the company in the absence of any direct personal harm.

Further, signs of a more relaxed approach to the distinctions between derivative and oppression actions are also found in case law emanating from Ontario. In *Malata Group (HK) Limited v. Jung*, 2008 ONCA 111 ["*Malata*"], Armstrong, J.A. stated that "there is not a bright-line distinction between the claims that may be advanced under the derivative action section of the Act and those that may be advanced under the oppression remedy provisions." Armstrong J.A. further questioned "whether there is any meaningful distinction between the oppression remedy... and the derivative action."

In *Malata*, instead of looking for a unique harm, Armstrong, J.A. adopted a purposive interpretation of the leave requirement to justify a liberal view of when an oppression claim can be brought. Armstrong, J.A. found that the leave requirement existed to prevent frivolous litigation, but since

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13 *Walker et al. v. Betts et al.*, 2006 BCSC 128 (CanLII), para. 93, *Enerex Botanicals Ltd. v. Humet - PBC North America Inc.*, 2010 BCSC 1719 (CanLII), para. 18, *Bellman v. Western Approaches Ltd.*, (1981), 33 B.C.L.R. 45 at 53 (C.A.).

closely held corporations have fewer concerns about such litigation, the leave requirement is unnecessary. Accordingly, in closely held corporations actions that would normally be derivative can proceed as oppression claims. Armstrong, J.A. reasoned as follows (at para 39):

> "In disputes involving closely held companies with relatively few shareholders... there is less reason to require the plaintiff to seek leave of the court. The small number of shareholders minimizes the risk of frivolous lawsuits against the corporation, thus weakening the main rationale for requiring a claim to proceed as a derivative action."

It remains to be seen whether this approach will take hold in other jurisdictions.