NOMINEE DIRECTORS - NEED TO EXERCISE CAUTION

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Introduction

Corporate directors should be aware that over the past decade much attention has been focused on the expected standard of care of directors. The Supreme Court of Canada in Peoples v Wise**[1]** and the Ontario Court of Appeal in Pente Investment Management Ltd. v. Schneider Corp**[2]** both place heavy emphasis on the fact that a director owes a fiduciary duty to the corporation. A director is not an agent of the shareholders or other stakeholders. The director is expected at all times to act in the best interests of the corporation as a complete entity, and not in the best interests of any of its individual parts.

This principle of corporate altruism becomes questionable where a director is a nominee of a specific shareholder. The nominee director must balance his overarching duty to the corporation and his subtler yet underlying obligation to his appointing shareholder. Whether this balance can be achieved depends, realistically, on the degree of involvement of the appointing shareholder. As noted by Farley J. in Ballard**[3]**, 'the life of a nominee director who votes against the interests of his appointing shareholder is neither happy nor long'.

Despite this seemingly obvious conflict of interest, corporation nominee directors still seem to need to appease important shareholders. A nominee director can act as a liaison between the shareholder and the corporation, by ensuring that the shareholder is kept apprised of the corporate decision-making, while simultaneously ensuring that the corporation is aware of the issues which the shareholder deems important. The duty of the nominee director is to cast his vote towards the course of action best suited for the corporation, regardless of how such course may impact the interests of his appointing shareholder.

As Farley J. implies, this can have the effect of biting the hand that feeds you. From a legal standpoint, issues with nominee directors generally only arise where the interests of the corporation are subordinated to that of the appointing shareholder.**[4]** If a nominee director, or the shareholder behind him or her, conducts or attempts to sway the affairs of the corporation in a manner oppressive to other shareholders, the courts will intervene.**[5]**

In this context, it is vital to understand that concerns about exposure to director's liability should not be confined only to those persons who are properly appointed directors. The courts have demonstrated that where there is wrongful conduct which is oppressive to the shareholders of a corporation, the court will look for additional and alternative defendants. In the case of a nominee director, the search will likely begin with an evaluation and assessment of the conduct of the appointing shareholder, and its relationship with the nominee director.

With this in mind, it is important for corporations which have existing nominee directors or have an obligation to appoint such directors to be aware of the likely consequences of a breach of fiduciary duties, and the potential risks to which the corporation is being exposed.

Personal Liability and the Oppression Remedy

A successful claim against a director impacts the capital of a corporation. Yet should a nominee director who breaches his fiduciary duty to the corporation as a result of his commercial obligations to the appointing body, by default be held fully liable for such breach? As noted by Thomas J. of the Court of Appeal of New Zealand**[6]**:

> In commercial practice, the relationship of the appointers and the nominee directors whom they have appointed is almost invariably that of principal and agent or employer and employee. Yet, acting as an agent or employee results in the nominee director being, to a greater or lesser extent, in breach of the recognized fiduciary duties of a director.

This idea that one can act in his or her capacity as agent and be automatically liable for such actions does not correspond with commercial reality. The legislation should take certain steps towards acknowledging the unique qualities which characterize the role of a nominee director.

In Canada, Alberta has made an attempt at acknowledging that nominee directors will give special consideration to the interests of their appointing shareholders. When discussing duties of care of directors and officers, section 122(4) of the Alberta Business Corporations Act**[7]** states:

> In determining whether a particular transaction or course of action is in the best interests of the corporation, a director, if the director is elected or appointed by the holders of a class or series of shares or by employees or creditors or a class of employees or creditors, may give special, but not exclusive, consideration to the interests of those who elected or appointed the director. (emphasis added)

The use of the words 'special, but not exclusive, consideration' was adopted so that the purpose of a nominee director would not be stultified by virtue of their obligations to advance the corporation's interest. Despite its admitted vagueness, the provision was adopted to give a degree of guidance in evaluating the conduct of a nominee director in situations where it was alleged the director was acting as agent to the appointing shareholder, and therefore in breach of his fiduciary duties.**[8]** The task of determining the boundaries between 'special' and 'exclusive' consideration falls ultimately to the judiciary.

The danger, of course, in adopting such a provision in the Canada Business Corporations Act ("CBCA"), or the Ontario Business Corporations Act ("OBCA"), or other provincial legislation is to dilute the established fiduciary duties owed to a corporation by a director, namely to act in the best interests of the corporation.

Taking the Alberta provision a step further to state that special, but not exclusive, consideration could be given to the interests of the appointing shareholder, so long as such consideration was not against the best interests of the corporation at large would also not remedy the situation in its entirety. Unfortunately, such provisions would hardly be groundbreaking, as it is generally accepted commercial practice for current nominee directors to give special consideration to their appointing shareholders, so long as it is done with a view to 'bettering' the corporation.**[9]**

Perhaps the best solution would be to ensure that every director has sufficient directors' and officers' liability insurance coverage, in the event a cause of action is brought, or in the alternative, that the appointing shareholder agree to indemnify the nominee director against any action relating to a breach of fiduciary duties.

In practice, this may only prove to be a partial solution. In those cases where an oppression action is brought against a nominee director, the appointing body will likely be named as a defendant as well, on the basis that the appointing body is a de facto director of the corporation. In the event that either the nominee director, or the appointing body as either a de facto director or indemnitor are found liable, the capital of the corporation may still suffer at either of the management or shareholder levels, even with both insurance and indemnification.

Ensuring that appointing bodies are aware of their potential exposure in the event of an oppression action is crucial in the corporate governance process. Such knowledge may help to alleviate certain pressures exerted on the nominee directors by the appointing body, with the effect of avoiding such actions entirely. At the very least, open communication as to the likelihood of liability may discourage certain persons from accepting nominee director roles, without proper indemnification from their nominator, or insurance.

Statutory Qualifications of the Board of Directors

In addition to liability concerns, there are other considerations of which all boards of directors must be aware. Both the OBCA and the CBCA contain specific requirements relating to residency. Section 118(3) of the OBCA and section 105(3) of the CBCA state that 25 per cent of the directors of a Canadian corporation must be resident Canadians. Where a corporation has less than four directors, at least one director must be a resident Canadian.

Where a corporation is a subsidiary of a US or other foreign parent and cannot find a resident Canadian nominee director willing to act as such, a possible solution to this problem would be to incorporate in a jurisdiction which does not require a minimum resident Canadian requirement, such as New Brunswick or Nova Scotia. The caveat to this approach, however, is to be watchful of the limitations on rights of action within the jurisdiction. In Jaber v. Hughes et al.,**[10]** an action was commenced against a company incorporated in Nova

Scotia but carrying on business in Ontario. The plaintiff sought relief through the oppression remedy under the OBCA in the Ontario Superior Court of Justice. The Court declined to accept jurisdiction.

Concerns

1. Nominee directors are a fact of commercial life and cannot be ignored. However, until the status of nominee directors who are agents and who act as agents of their appointing body are recognized as such, persons who agree to act as nominee directors will continue to be held liable (potentially as will the appointing body) for any damages suffered by other stakeholders of the corporation from any breaches of fiduciary duty owed therein.

2. A nominee director should ensure the appointer has arranged satisfactory insurance and the nominee director has a solid indemnity agreement because he or she may be denied indemnity under the relevant corporate statute. In Balestreri v. Robert[11] the matter came before the court as an oppression remedy application under the CBCA. In 1982 the Court had ordered Javelin International Ltd., put under the curatorship of Mtre. Robert, in response to an oppression remedy application. This issue under appeal was the right of one Mr. Balestreri, a director of Javelin, to an indemnity under the CBCA in respect of litigation taking place since 1982 as well as in respect of general legal advice which Mr. Balestreri felt that he needed. In determining that Mr. Balestreri was not entitled to indemnification, the Court analyzed his behavior and cited with approval the following passage from the trial judgment:

Having heard Petitioner as a witness it is obvious that he does not understand now and has never understood that the duty of a director and officer of a corporation is to act, vote and administer in such a way as to benefit the corporation as a whole. Anything done for the exclusive benefit of one or of a few shareholders, to the detriment of the corporation and the other shareholders is improper and dishonest. Petitioner's first loyalty seems always to have been to Mr. Doyle (principal shareholder) in spite of his fiduciary responsibility to Javelin. His failure to fulfill his primary duty of loyalty to the corporation, as distinct from his obvious desire to protect the person who had caused him to be appointed a director and the president of an important public corporation, is enough in itself to convince the court that he cannot be considered to have been in good faith.

Accordingly, the nominee director needs to exercise caution.

*(*This was originally published in Directors Briefing a CCH Canadian Limited publication)*

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[1] [2004] 3 S.C.R. 461

[2] (1998) 42 O.R. (3d) 177

[3] 820099 Ontario Ltd. v Harold E. Ballard Ltd. (1991). 3 B.L.R. (2d) 113 (ON. S.C.)

[4] Boulding v. Assn. of Cinematograph Television and Allied Technicians [1963], 2 A.C. 606

[5] Scottish Co-operative Wholesale Society Ltd. v. Meyer [1959] A.C. 324

[6] Thomas, Justice E W, The Role of Nominee Directors and the Liability of their Appointers, as published in Chapter Nine of Corporate Governance and the Duties of Companies Directors, [end cite]

[7] S.A. 1981, c. B-15

[8] Alberta Institute of Law Research and Reform, Proposals for a new Alberta Business Corporations Act, Report No. 36, 1980, at 66

[9] Wood v. C.F.N. Precision Inc. [2008], Canlii 19797 (ON S.C.)

[10] Court file No. 07-CL-7184 - decision rendered April 3, 2008 (ON S.C.)

[11] (1992) J.E. 92-533 (Quebec C.A.).