MINDEN GROSS LLP BARRISTERS AND SOLICITORS
145 King Street West, Suite 2200, Toronto, ON M5H 4G2
P. 416.362.3711 ▪ F. 416.864.9223 ▪ www.mindengross.com

Removal of Directors of Business Corporations[1]

Hartley R. Nathan, Q.C.
Partner, Minden Gross LLP
T. 416.369.4109
hnathan@mindengross.com

Ira Stuchberry
Associate, Minden Gross LLP
T. 416.369.4331
istuchberry@mindengross.com

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Introduction[2]

Occasionally, the shareholders of a corporation may wish to remove a director from office. Some of the reasons for removal may be that the director has breached his or her fiduciary duties to the corporation or may have otherwise acted inappropriately in the course of performing his or her duties. The two primary mechanisms through which shareholders can remove a director are shareholder meetings and court orders. This paper provides an overview of both of these possible avenues for the removal of a director.

1. Removal of Directors by Shareholders Meetings

For a business corporation, the power of shareholders to remove directors exists under the *Canada Business Corporations Act*[3] (*CBCA*) and the Ontario *Business Corporations Act*[4] (*OBCA*) regardless of anything in the corporation's articles or any agreement between the director and the corporation. Section 109(1) of the *CBCA* and section 122(1) of the *OBCA* provide that a director of a corporation may be removed by an ordinary resolution of the shareholders passed at a special meeting of shareholders called for that purpose.

1 Mr. Nathan is a senior partner of Minden Gross LLP and Editor-in-Chief of the *Directors Manual*.

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3 RSC, 1985, c C-44.

4 RSO 1990, c B16.

For not for profit corporations, the provisions of the Ontario *Corporations Act*[5] (*OCA*) in sections 66 and 67 and the *Canada Not-for-profit Corporations Act*[6] (*CNCA*) in section 130 apply with regard to the removal of directors. While the provisions of the *CNCA* are essentially identical to the provisions of the business corporations acts identified above, the *OCA* is significantly different in the manner in which it addresses this issue. According to the provisions of the *OCA,* the corporation's letters patent or by-laws *may* provide for the removal of directors by a resolution passed by two thirds of the members.

It is important to note that under Canadian corporate legislation, unlike some American legislature, this power can only be exercised at a meeting of shareholders. In other words, a director cannot be removed by a resolution in writing. For example, even if a single shareholder owns 100% of the shares, he or she must still call a meeting of shareholders to remove a director. Section 139(4) of the *CBCA* and section 101(4) of the *OBCA* read as follows:

If a corporation has only one shareholder, or only one holder of any class or series of shares, the shareholder present in person or by proxy constitutes a meeting.

It is important to remember that *only* the shareholders of a corporation can remove a director. The board of directors *does not* have the authority to remove a director. This concept has been discussed and upheld by the courts in several cases.[7].

While the shareholders have ultimate decision making power in this regard, the directors have several rights related to opposing their removal from office. A director of a corporation is entitled to receive notice of, attend and be heard at every meeting of shareholders, including a meeting at which his or her removal is sought. In fact, failure to give the director such notice has been found to amount to oppression[8]. A director is also entitled to submit to the corporation a written statement outlining his or her reasons for opposing any proposed action or resolution. The corporation is then obligated to send a copy of such statement to every shareholder entitled to receive notice of any meeting of shareholders. If proper corporate procedure is not followed, the attempted removal will fail.

There are a number of cases in which courts have dealt with this issue. For example, in *Kaiser v Borillia Holdings*[9]*,* the sole shareholder purported to remove the sole director without giving the director notice of the shareholder meeting or an opportunity to give reasons opposing his removal. The shareholder admitted that he had failed to follow the requirements of the *OBCA*, but argued

5 SC 2009, c 23.

6 RSO 1990, c C38.

7 *Re Lajoie Holdings Ltd*, (1991), 24 ACWS (3d) 1332 (BCSC), where the British Columbia Supreme Court held that a board of directors did not have the authority to remove a director under the British Columbia Company Act whose provisions are similar to the CBCA and the OBCA.

8 *Castillo v Xela Enterprises Ltd, et al* 2015 ONSC 6671.

9 (2007), 157 ACWS (3d) 537, ON SCJ.

that the breach was merely technical and that he would remove the director in any event. The Ontario Superior Court of Justice held that the applicant was still a director, even though it was clear that the shareholder would remove the director as soon as possible thereafter.

2. Removal of Directors by Court Orders

In exceptional circumstances, courts have exercised the right to remove directors. However, it should be emphasized that court-ordered removal of directors is an extreme remedy and one that is only exercised when corrective sanctions are absolutely necessary. This reluctance is rooted in the court's historical unwillingness to interfere with the internal management of corporate affairs as well as the court's well-established deference to the decisions made by directors and officers in the exercise of their business judgment.

In *Albrecht v Kuhn*[10], the Ontario Superior Court of Justice refused to remove the board of directors and stressed how rarely the remedy is invoked with the following comment:

The removal and replacement of directors is the most extreme form of judicial intervention in the business affairs of a corporation and is a remedy which should be ordered only in the most extraordinary circumstances.

The removal of directors through a court order has also been described as a "measure of last resort" because tinkering with the board directly influences the management of the corporation.

The threshold of misconduct required to remove a director through a court order is relatively high. In *Walker v Betts*[11], the British Columbia Supreme Court explained that where the director's misconduct triggers the oppression remedy, judicial intervention by removing and replacing the director may be warranted in order to rectify or alleviate the oppression. A number of cases suggest that directors may be removed where they favour their own interests or a majority shareholder's interest over that of a minority shareholder.

In *Aquino v First Choice Capital Fund*[12], immigrant investors purchased non-voting shares in investment funds that were incorporated and operated by two individuals. These two individuals held all of the voting shares and also served as directors. Evidently, the investment funds made investments in other corporations affiliated with the two individuals as well as the corporation through which those individuals held their shares. The Saskatchewan Court of Queen's Bench found that this use of the investment funds' monies constituted oppressive conduct and the individuals were removed as directors in order to alleviate the oppression.

10 (2006), 146 ACWS (3d) 265, ON SCJ.

11 2006 BCSC 1096.

12 (1997), 73 ACWS (3d) 395, SKQB.

Conclusion

If shareholders elect to remove a director through a meeting of shareholders, they must ensure that they follow the appropriate procedural requirements. Although shareholders may also have a director removed through a court order, these orders will only be granted where the director's misconduct is sufficient to trigger the oppression remedy.