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THE EXERCISE OF DIRECTORS' POWERS: — THE BATTLE OF AFTON MINES

By Frank Iacobucci*

A. Introduction

Under Canadian company law directors of a corporation are generally given the responsibility for the management of the affairs of the corporation; this authority to manage derives either from the relevant corporation statute or from the particular corporation's constitution. The position of the directors with regard to the shareholders of the corporation and the corporation itself is somewhat curious: directors are elected by the shareholders and in effect act on behalf of the shareholders; but generally they owe duties only to the

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In the jurisdictions in Canada which followed the English system of incorporation, the articles of association would normally contain a provision conferring on the directors the power to manage the affairs of the corporation; these jurisdictions are Alberta, British Columbia, Newfoundland, Nova Scotia and Saskatchewan. In the other Canadian jurisdictions, director responsibility is generally provided for in the corporation statute; for example, section 132 of the Ontario statute provides that the directors shall manage or supervise the management of the affairs and business of the corporation. The Business Corporations Act, S.O. 1970, c.25, as amended by S.O. 1971, c.26, 1972, c.1 (hereinafter referred to as the Ontario BCA). Compare the proposed new federal corporation legislation contained in Proposals For a New Business Corporations Law for Canada, Commentary (vol. 1) and Draft Canada Business Corporations Act (vol. 2) (1971) (hereinafter referred to as Commentary and Draft Canada Act, respectively). Section 9.01 of the Draft Canada Act provides that the business and affairs of the corporation shall be managed by one or more directors, subject to the articles, by-laws and any unanimous shareholder agreement. See generally Neuman, “Letters Patent and Memorandum of Association Companies,” in Studies in Canadian Company Law, ed. Ziegel, (Toronto: Butterworths, 1967) at 61, 80-82 (hereinafter cited as Studies).
"corporation" and must act in the best interests of the "corporation," which has in turn usually been interpreted to mean the interests of all the shareholders taken as one group. Directors' duties fall into two categories: those of a fiduciary nature, to reflect the fact that directors occupy positions of trust and confidence; and those relating to care, skill and diligence, to reflect their role as persons making entrepreneurial decisions.

Recently there has been much legislative reform in Canada aimed at upgrading the duties of directors. Moreover, there have been increased efforts to make the directors of a corporation more accountable to the shareholders and, to a lesser extent, the creditors of the corporation, through legislative provisions giving these groups more effective remedies. There has also been much discussion and criticism of the traditional role of the board of directors as representative mainly of shareholders and not other interested groups, such as employees; however, most of this attack has taken place abroad. In Canada, concerns of nationalism have been manifested through legislative provisions requiring a majority of directors to be "resident Canadians".

These statutory changes concerning directors are only part of a vast proliferation of corporate law reform, which in turn is only a part of a more general review of laws which affect corporations, such as the recent overhaul of tax legislation and proposed federal legislation on competition and foreign investments, not to mention provincial reforms involving securities regulation and personal property security. In the midst of this legislative log-jam, one tends to forget the impact of the judiciary on the legal process. Obviously, with the legislatures so active the proportion of "law" coming from judicial pronouncements is minute by comparison. But that does not mean judicial decisions are less important than previously, especially when a decision is rendered in the wake of legislative change.

Such a decision was handed down recently by Mr. Justice Berger of the

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2 See Percival v. Wright, [1902] 2 Ch. 421. Arguably this result may be qualified by the facts of a particular case, however: Allen v. Hyatt (1914), 30 T.L.R. 444 (P.C.). Rules relating to improper insider trading now qualify the common law to impose liability on directors who sell or buy shares using confidential information. See, e.g., Ontario BCA section 150; see also The Report of the Company Law Committee para. 89 (1962), cmnd. no. 1749 (the Jenkins Report).

3 Alexander v. Automatic Telephone Co., [1900] 2 Ch. 56 (C.A.). Arguably future shareholders' interests should also be considered: Re Lee, Behrens & Co. Ltd., [1932] 2 Ch. 46. For an excellent discussion of directors and control and management of the corporation generally, see Eisenberg, The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking (1969), 57 Calif. L. Rev. 1.

4 E.g., Ontario BCA section 144; Draft Canada Act, section 9.19.

5 Notable in this respect are the enforcement provisions of the Draft Canada Act, especially sections 19.01 to 19.05, which give shareholders and creditors relatively easy access to the courts and confer upon the courts a wide assortment of remedial powers. See generally Iacobucci, Shareholders Under the Draft Canada Business Corporations Act, to be published in the McGill Law Journal.

6 Section 122(3) of the Ontario BCA requires that a majority of the directors of any corporation must be "resident Canadians" as defined. At the time of writing it has been announced that the British Columbia and federal governments will be enacting similar provisions.
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British Columbia Supreme Court in *Teck Corporation Limited v. Millar et al.*

The case involved a review and exposition of the law concerning the powers of directors generally and, more particularly, the power of directors to issue shares. This article will be devoted to a discussion of some points raised by the decision, primarily because of their importance, and secondarily because of the distinctly refreshing judgment which the learned trial judge has given.

B. *The Teck Case*

1. *The Facts: A Mining Promotion Short Story*

   Afton Mines Ltd. (N.P.L.) was incorporated in B.C. in 1965 by a group led by defendant Chester Millar, a geological engineer and one-time drilling contractor, who in 1964 became interested in some mining claims near Kamloops, B.C. The claims were acquired by a syndicate formed by Millar, the defendant Douglas Price, and four other investors, and subsequently were transferred to Afton. The claims relate to a copper property the development of which became the focal point in the case.

   Since it was a junior mining company, Afton was financially unable to carry on an extensive drilling programme. Thus Millar, who was a director, the president, and the principal spokesman of Afton, sought to interest a major mining company in providing capital for the drilling and eventual development of a mine; apparently the "major," as the larger companies are called, will also provide personnel, technical assistance, and managerial and marketing experience. In return, the major will obtain possession of the property and will generally extract a bonus involving some equity interest either by way of shares in the company or by an interest in the mining property itself. If such a contract with a major is known as the "ultimate deal."

   After a couple of contracts with majors which did not lead to any significant results, Afton raised money through an underwriting of shares which enabled it to carry on the drilling itself in September and October, 1971. The results of this drilling were for the first time encouraging. Drilling continued after a further underwriting of shares, and the assays aroused considerable interest in Afton such that the major companies were now serenading Millar rather than vice-versa.

   At this point additional financing was needed. Millar did not want further underwritings since they had not been satisfactory; but he also did not think Afton should make an "ultimate deal" as yet. Consequently, he felt it best for Afton to sell some shares to a major to raise the money needed for drilling, without giving up control of the company while at the same time obtaining the advantage of being associated with a major, which Millar thought would enhance the value of Afton's shares. Millar first approached Bethlehem Copper Ltd., which did not show interest in buying 100,000 shares of Afton;

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7 [1973] 2 W.W.R. 385, 33 D.L.R. (3d) 288. According to a newspaper report, the main feature of the dispute has been settled and an appeal which was announced earlier will probably be abandoned. *The Globe and Mail*, May 11, 1973, at B-12.
and then he approached representatives of Placer Development Ltd., which has mining operations throughout the world and whose exploration and development arm in Canada is Canadian Exploration Ltd., or Canex.8

Placer's representatives met with Millar on March 17, 1972, and said they did not want to buy shares but they would take an ultimate deal involving 60% of the equity for them and 40% for Afton. Millar thought a better deal would be available to Afton after further drilling, so he offered Placer only the 100,000 shares at that time, but indicated that he was also willing to grant a first right of refusal on any future financing. On March 22, 1972, agreement was reached between Millar and Placer, and then a formal contract between Afton and Canex was drawn providing for the sale of shares to Canex and giving it a first right of refusal on any future financing, which included any ultimate deal submitted to Afton.

In the meantime the plaintiff, Teck Corporation Limited, had shown an interest in Afton and as early as January, 1971, had notified Millar of Teck's desire to develop the Afton property. Dr. N.B. Keevil, Jr., Teck's executive vice-president, went to Vancouver for meetings with Millar, aimed primarily at obtaining the ultimate deal on the Afton property; as an alternative, Teck offered to buy the shares of Millar and his group. Teck was also willing to buy a bloc of 100,000 Afton shares at $4.00 per share if it got a first right of refusal on future financing. However, Millar preferred to deal with Placer, even though it was willing to pay only $3.00 per share: Millar, Price, and another Afton director (and defendant), John Haramboure, were impressed by Placer's excellent reputation in the mining industry and its enviable record of successful ventures, several of which were in B.C.; on the other hand, Teck apparently had not brought a mine into production in B.C. and Millar did not think Teck had the experience or personnel that Placer had. Millar accepted Placer's offer to buy shares at a lower price than that offered by Teck because he specifically wanted Placer involved in the property: Berger, J., found it of great importance that from the beginning — long before Teck started to acquire Afton shares — Millar believed that dealing with Placer instead of Teck was better for Afton.

In the late spring of 1972, negotiations among the various parties intensified and the plot thickened. The most significant developments concerned Afton's shares. The company's authorized capital consisted of 5,000,000 shares, with 2,600,000 issued; Millar, Price, and Haramboure had 400,000 shares and another member of the Millar group, Alex Berglund (the prospector who originally staked the claims), owned 200,000 shares. In April Teck offered to buy one-half of the Millar group's shares, but its offer was refused. Thereafter it went into the market to buy Afton shares; and by the end of May, Teck, in conjunction with a company it controlled called Iso

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8 Canex is apparently a wholly-owned subsidiary of Placer, and Berger J. found that the officers and directors of Placer acted throughout for Canex.

9 In the end, Canex paid $3.50 a share: because the market price increased between the date the agreement for the sale was made and the date on which the formal agreement was executed, the Vancouver Stock Exchange insisted that Canex pay the higher amount.
Mines Ltd., eventually had obtained a majority of Afton's shares, for which they had paid more than $16,000,000 at an average price of $13.00 per share.  

Throughout this period many discussions were held between Millar and representatives of Teck with respect to an ultimate deal on the Afton property, and renewed discussions were held regarding selling the Millar group's Afton shares to Teck. During April and May, meetings were also frequently held between Placer representatives and Millar and Price, at which terms for an ultimate deal were discussed, with several negotiating ploys and tactics being used by the parties. On May 19, Placer put two proposals for an ultimate deal in writing, one of which indicated Placer would accept a bonus of 40% of the equity — considerably down from its previous proposal of 60%. But Millar was not prepared to accept the proposal, and Price and Haramboure stood with him.

Toward the end of May, Millar — and Placer knew that Teck was buying more Afton shares and was coming close to having control. Millar had been talking to other majors and more meetings were held all around. Millar, Price, and Haramboure realized they would not be in control of Afton much longer; and since they knew Placer realized this, they contacted Placer to see if it would accept a bonus of 30%. This Placer accepted on May 30, 1972. Thereafter, a contract was prepared and was finally signed on June 1 by Afton and Canex. It was signed on behalf of Afton by Millar, Price, and Haramboure, who men held a directors' meeting at which they approved the execution of the agreement.

Under the agreement, Canex was responsible for the exploration and development of the property; and if Canex chose to put the property into production, it would receive 30% of the then issued and outstanding shares of Afton. Canex was to proceed with geological studies, engineering and related work in order to carry out a feasibility study; upon completion of such study, Canex was to notify Afton whether or not it intended to place the property into production. If it so intended, Canex had to arrange all necessary funds, including working capital, on a project-financing basis. In addition, Canex

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10 By May 31, 1972, Teck and Iso had acquired a total of 1,318,603 shares, with 65% of those held by Teck and 35% by Iso.

11 Although Berger, J., said Millar was not a "polished negotiator" the judge noted that the defendant was "astute throughout".

12 The other proposal was even more advantageous to Afton in that Placer would require only a 25% equity interest, but under that proposal Placer would not have been responsible for arranging the necessary financing for the development of the property.

13 Dr. Keevil, Sr., the president of Teck, visited Mr. McClelland, the president of Placer, on May 26; McClelland asked him if Teck intended to acquire control of Afton and he replied affirmatively. Keevil then asked if Placer would sell its 100,000 shares of Afton to Teck; and after consulting his colleagues, McClelland said no because Placer still had two proposals before Afton.

14 Teck held about 52% of the 2,600,000 outstanding Afton shares. After the issue of 1,167,437 shares to Canex, which was the figure agreed to by the parties to the action, Teck's percentage would be reduced to approximately 35% of the outstanding shares.
had other obligations relating to marketing, providing the necessary personnel, and technical assistance of various kinds.

Teck had meanwhile become concerned that Millar and Price would place the ultimate deal with another major.\textsuperscript{15} Having previously informed Millar of its shareholding position and having told him that it could make an ultimate deal twice as good as any other (although no specific terms had been outlined by Teck), Teck sent a letter to the Afton directors on May 29 saying no ultimate deal should be made yet and restating that Teck could arrange better terms than anyone else. On May 30, Teck requisitioned a shareholders' meeting of Afton. On May 31, Teck wrote and delivered a letter to Millar, Price, and Haramboure requesting that no ultimate deal be made without consultation, and indicating legal action would be taken if any deal were made involving the issuance of shares. Also on May 31, a letter was delivered from Teck's solicitors to Afton's solicitors informing the latter of Teck's control position and stating that nothing outside the ordinary course of business, especially specifically relating to the Kamloops property, be done pending the outcome of the shareholders' meeting requisitioned by Teck; otherwise legal action would be commenced. Despite the letter, Afton's solicitor advised the three directors that they could still enter into the deal with Canex, provided they genuinely thought such action to be in the best interests of Afton, although he also warned them that legal action might be brought and that they would very likely be removed from the board of directors.

On the morning of June 1, Millar and Afton's solicitor attended a meeting at Teck's offices but did not disclose that an agreement had been reached with Canex; later that day, the Afton-Canex contract was signed. The next day the Vancouver Stock Exchange authorized the parties to announce the existence of the agreement to the public. On the same day, Teck launched its action.

2. The Action

Procedurally, Teck brought an action as a shareholder of Afton, on its own behalf and on behalf of all other shareholders, against Afton, its directors and Canex, alleging that the contract of June 1, having been made for an improper purpose with Canex's knowledge, was null and void. Teck obtained an interim injunction restraining the directors of Afton from issuing any shares to Canex, and restraining Canex from proceeding with its feasibility study.

Besides asking for the contract to be set aside, Teck also asked for damages on behalf of Afton on the ground that, if the June 1 agreement had not been made, Afton could have otherwise proceeded with the development of the property. Teck alleged that Afton lost some $200,000 a month by reason of the delay, and that damages should run from June 1 to the date of judgment. Teck also argued that, even if it were held that Canex did not

\textsuperscript{15} Apparently Teck posted a lookout at the Vancouver offices of one of the suspected majors to check whether Millar and Price went there.
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have knowledge of the improper purpose of the Afton directors so that the contract would stand, Afton would nevertheless be entitled to damages against the defendant directors on the ground that the Canex contract was improvident from Afton's point of view; the directors authorizing the contract would thus be responsible for damages suffered by Afton, which Teck alleged to be many millions of dollars.

3. The Decision

Relying on the rule in *Foss v. Harbottle*,¹⁸ the defendants argued that the action should have been brought in the name of Afton since the alleged wrong was to Afton. Berger, J., disposed of this argument by simply stating that the rule in *Foss v. Harbottle* did not apply: the plaintiffs did not have to come within one of the "exceptions" to the rule because, at a shareholders' meeting of Afton held in August, a resolution was passed approving of the bringing of the action and disapproving of the signing of the June 1 agreement;¹⁷ because the shareholders had passed such a resolution, in the learned judge's view the court ought to hear the action.¹⁸

On the substantive issues Berger, J., found for the defendants and dismissed the action with costs. Briefly stated, he found that the directors were entrusted to manage the affairs of Afton, and that in authorizing the execution of the Canex agreement they were acting in the best interests of Afton. They had reasonable grounds for believing that a takeover by Teck would cause substantial damage to the interests of Afton and its shareholders because Teck would then be in a position to force Afton into an ultimate deal which the directors believed would mean that the copper property would not be developed as efficiently and profitably for the benefit of Afton's share-

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¹⁸ (1843), 2 Hare 461; 67 B.R. 189. See generally Beck, "An Analysis of Foss v. Harbottle", in Studies, supra, note, 1 at 545.

¹⁷ As to the "exceptions" to the rule, see *Edwards v. Halliwell*, [1950] 2 All E.R. 1064, [1950] W.N. 537 (C.A.). It is very interesting to note that, on the motion for an interim injunction in the *Teck* case, Mr. Justice Anderson of the B.C. Supreme Court, relying on an analysis by Professor Gower, held that there was a further exception to the rule in *Foss v. Harbottle* allowing a minority shareholder to sue on behalf of the company where the interests of justice would be served thereby. This is the so-called "fifth" exception to the rule: Gower, *The Principles of Modern Company Law* (3rd ed. London: Stevens, 1969) at 584 et seq.

¹⁸ Mr. Justice Berger's disposition of the *Foss v. Harbottle* rule in this way has interesting applications beyond the situation in this case. For example, normally in order for a shareholder to bring an action under the "fraud on the minority" exception, the minority shareholder must show either that he has taken all reasonable steps (or made every effort) to cause the corporation to sue, or that taking such steps would be futile because the alleged wrongdoers control the corporation: *Ferguson v. Wallbridge*, [1935] 3 D.L.R. 66 (P.C.); *Wheller v. Annesley* (1957), 11 D.L.R. (2d) 573 (B.C.S.C.); for a recent case discussing the "fraud on the minority" exception in Ontario before the coming into force of section 99 of the Ontario BCA, see *D'Amore v. McDonald*, [1973] 1 O.R. 845 (Ont. High Ct.); (1973), 32 D.L.R. (3d) 543. Under Berger, J.'s ruling, a shareholder can bring an action if he gets it approved by a shareholders' meeting. Of course this could not occur when, as is often the case, the directors are, or represent, the majority or controlling shareholders, since they would vote against the approval.
holders. In other words, the directors of Afton in authorizing the execution of the Canex agreement were not acting with an improper motive.

C. Discussion

1. General Powers and Obligations of Directors

a. The Power of Directors To Manage the Corporation

As mentioned earlier, directors generally have the authority to manage the affairs of the corporation, which authority is traceable in Canada either to the statute governing the corporation or to the constitutional documents of the corporation (usually the articles of association) in jurisdictions modelled after the English registration system. British Columbia is one of the latter jurisdictions. Mr. Justice Berger found that the directors of Afton were authorized to manage the affairs of the corporation because the articles of association of Afton conferred such authority on the directors.

Once the articles of association confer authority on the directors to manage the corporation, the shareholders cannot intervene to reverse decisions made by the directors or otherwise dictate to them; at that point, their only choices are to remove the directors from office (if authority for such removal is provided), amend the articles of association to deny directors the power, or vote for new directors at the next annual meeting. Then the relevant and more difficult question is to determine and interpret the restrictions imposed upon the directors in their management of the corporation's affairs.

The courts have stated that in carrying out their functions directors must act and exercise their powers "in good faith in the best interests of the corporation, and for a proper purpose" — the so-called collateral purpose rule. This standard has been borrowed from trust and agency law to reflect the "fiduciary" nature of directors' obligations. But as with most statements

19 See note 1, supra. See generally Palmer, "Directors' Powers and Duties" in Studies, supra, note 1 at 365.

20 See Neuman, supra, note 1 at 80, citing Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cuninghame, [1906] 2 Ch. 34 (C.A.). In this respect, it is interesting to note section 101 of the Ontario BCA which, if the conditions of that section are fulfilled, gives power to the shareholders to pass any resolution or by-law that directors could pass.

21 Lord Greene stated the rule as follows:

"... they [the directors] must exercise their discretion bona fide in what they consider — not what a court may consider — is in the interests of the company, and not for any collateral purpose."

Re Smith and Fawcett Ltd., [1942] Ch. 304 at 306. As discussed below, the collateral purpose test involves ascertaining what is a proper purpose for the exercise of a particular directors' power and whether that purpose was present in the particular case in some degree (i.e. whether it was a purpose, a primary purpose, or the sole purpose of the transaction). Proof concerning these questions is naturally difficult, since the intentions of the directors have to be examined along with the other circumstances of the case.

22 Technically the director is not a "trustee" since he owns or holds no legal interest in any property; and strictly speaking he is not an "agent" of the shareholders under our law. See Eisenberg, supra, note 3, at 4-6.
about duties and responsibilities in the law, this fiduciary obligation is expressed in very general language, an approach which emphasizes two fundamental aspects of the judicial process: first, the importance of the facts of a particular case; and second, the analysis and characterization of those facts by the trial judge. The Teck case excellently demonstrates those aspects.

b. Transactions Involving “Control” of the Corporation

One of the most essential powers that directors have entrusted to them is the power to issue shares, a power which concerns both money-raising for the corporation and, where voting shares are involved, “control” of the corporation. Obviously, if directors were under no restrictions governing how they should issue shares, abuses would inevitably result; for example, the directors could issue shares to themselves or to persons “friendly” to themselves in order to obtain or keep control of the corporation.

But the ability of directors to affect control of the corporation through transactions involving its voting shares goes beyond their power to issue. For example, if the corporation is empowered to purchase its common shares, as it could be under Ontario law, the directors could manipulate control by authorizing such a purchase and, if desired, the re-issue of the shares to themselves or affiliates. Such a purchase could affect control since the purchased shares would carry no voting rights while in the hands of the corporation; this suspension of voting rights could increase the voting power of the incumbent directors in certain situations. Consequently, there seems little

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23 For example, section 44 of the Ontario BCA permits the directors to issue shares as they determine, but the shares must be fully paid. Compare Draft Canada Act section 5.02. The general duty of directors is found in section 144 of the Ontario BCA, viz. that the directors in exercising their powers must do so honestly, in good faith and in the best interests of the corporation.

24 “Control” is a very elusive term to define. In the United States one commentator referred to a rule of the Securities and Exchange Commission to illustrate what is meant by control:

“... no less than the possession of the power to direct or cause the direction of a corporation’s operations and policies, whether through ownership of securities, occupancy of office, or directorship, with no practical chance of reversal.”


25 Section 39 of the Ontario BCA allows such a power if the corporation’s articles of incorporation expressly authorize it. Formerly the purchase had to be made out of “surplus,” which was not defined; but by recent amendments, common shares may now be purchased if the corporation is not insolvent or rendered insolvent thereby, with “insolvency” defined in section 1(7) in terms of an asset test and a current test of paying debts as they become due.

26 Ontario BCA section 98(2). Under the Draft Canada Act, when a corporation purchases its own shares the shares are cancelled and cannot be resold; and, where the corporation has a certain number of authorized shares, the purchased shares are restored to the status of authorized but unissued shares. Section 5.11(6).

27 For example, suppose 100,000 common shares of a company are outstanding with 45,001 held by the “control” group. If 10,000 shares were purchased by the corporation, this would give the control group a majority of the shares. Moreover, if desired, the control group could then re-issue the acquired shares to themselves, thereby ensuring more definite legal control of the corporation.
doubt that the directors would be subject to a fiduciary obligation to act in
good faith in the best interests of the corporation when authorizing the pur-
chase of its common shares.\textsuperscript{28}

Instead of having the corporation affect control by issuing or buying its
common shares, the directors themselves could buy outstanding shares to
obtain or preserve a control position. Although, arguably, directors are in
breach of their strict fiduciary obligation if they so act,\textsuperscript{29} under Canadian law
probably the only applicable sanctions would be those flowing from improper
insider trading.\textsuperscript{30}

Once directors have gained control of a corporation through stock own-
ership, an interesting question is raised — the answer to which is very unsure
in Canadian law — when this control is sold by the directors (or other control
group) for a premium. The basic issue is whether the premium is exclusively
attached to, and an incident of, the ownership of control and therefore not
subject to any interest of the other shareholders of the corporation, or whether
part of the premium inures to the benefit of the non-selling minority share-
holders.\textsuperscript{31} Hopefully we shall see judicial reaction to this question before
long.\textsuperscript{32}

Finally, apart from stock transactions, several other tactics should be
mentioned by which directors may preserve effective control of a corporation.
These relate directly to their power to manage the affairs of the corporation.
For example, directors have control over the proxy apparatus of the cor-
poration and, more importantly, the funds with which to wage a proxy con-
test. In these situations, access to the corporate treasury is of course most
significant; also the directors hold the strategic weapon of timing, in that they
decide when a meeting will be held and hence can prepare for a contest well
in advance of their opponents.\textsuperscript{33} Directors can also decide when to declare
dividends and in what amounts, and whether cash or stock.\textsuperscript{34} Obviously, a
record of dividends, or specially timed dividends, could be an influencing
factor where control of the corporation was at issue.

Arguably, in all the above transactions involving control of the corpora-
tion, the directors' conduct should meet fiduciary standards, since abuse or
unfairness toward other shareholders could result from their conduct. Of
course, the abuse of power and potential lack of fairness and thus the ap-
plication of the fiduciary standards may differ according to the transaction.

\textsuperscript{28} Section 144 of the Ontario BCA would apply to the directors when authorizing
a section 39 purchase just as it applies to an issuance of shares under section 44.
But there may be subtle differences in the allowable "purposes" in buying a corpora-
tion's own shares as opposed to issuing new shares. In the United States it has been
suggested that in the case of the purchase of a corporation's own stock there is less basis
for arguing a valid business purpose, as opposed to affecting control, than there is in
the case of issuing shares, where legitimate non-control purposes appear to be more
likely (such as the obtaining of cash). Brudney, \textit{supra}, note 24 at 269-70.

\textsuperscript{29} In this context a distinction should perhaps be made between closely- and widely-
held corporations. It has been argued that in the closely-held corporation, with a non-
public market for shares and the greater opportunity for a controlling group to extract
emoluments from the corporation, a change in the prevailing control arrangement may
be injurious to the remaining shareholders; hence fiduciary obligations should be ex-
tended to transactions where purchases of shares are made by director-insiders. In public corporations, on the other hand, there is greater competition from outsiders in vying for control, so that insiders should be free to use their own funds to acquire shares (of course subject to the insider trading rules), even though some abuse could flow from such freedom. Brudney, supra, note 24, at 289-94. See also note 43 infra.

30 E.g., Ontario BCA section 150; The Ontario Securities Act section 113, R.S.O. 1970, c.426, as amended. The recent decision of Grant J. of the Ontario High Court in Green v. The Charterhouse Group (E.R. 220 O.R.) is the first case involving the Ontario insider trade legislation.


32 A case has been brought in Ontario on this and other matters relating to the sale of controlling shares; but — unfortunately, from the point of view of those interested in the substantive points raised — an interlocutory motion for dismissal has just been granted. Farnham v. Fingold, [1973] 2 O.R. 132 (C.A.), reversing [1972] 3 O.R. 688, 29 D.L.R. (3d) 279. The plaintiff's prayer for relief sought, inter alia, a declaration that the premium for control obtained by the controlling shareholders should be held for the benefit of the corporation "and/or its general shareholders and/or the vendors of such shares to them [the controlling shareholders]." [1973] 2 O.R. 133. For a discussion of this question in the context of business combinations, see Rosenfeld, "Corporate Acquisitions" in [1972] Special Lectures of the Law Society of Upper Canada 367 at 371-81. The Kimber Report suggested that the imposition on a control group or other insiders of a fiduciary duty toward other shareholders in cases of change of control should be left to the judicial process for development. The Report of the Attorney-General's Committee on Securities Legislation in Ontario (1965). In the approximately eight years that have passed, however, not much development has occurred. It is interesting to note briefly the procedural grounds on which the Farnham case was dismissed: the Court of Appeal dismissed the action because the plaintiff shareholders had not obtained leave of the court to bring a representative action pursuant to section 99(2) of the Ontario BCA. The court (per Jessup J.A.) reasoned that section 99 embraced all causes of action that a shareholder might sue for on behalf of the corporation "and/or its general shareholders and/or the vendors of such shares to them [the controlling shareholders]." [1973] 2 O.R. 133. For a discussion of this question in the context of business combinations, see Rosenfeld, "Corporate Acquisitions" in [1972] Special Lectures of the Law Society of Upper Canada 367 at 371-81. The Kimber Report suggested that the imposition on a control group or other insiders of a fiduciary duty toward other shareholders in cases of change of control should be left to the judicial process for development. The Report of the Attorney-General's Committee on Securities Legislation in Ontario (1965). In the approximately eight years that have passed, however, not much development has occurred. It is interesting to note briefly the procedural grounds on which the Farnham case was dismissed: the Court of Appeal dismissed the action because the plaintiff shareholders had not obtained leave of the court to bring a representative action pursuant to section 99(2) of the Ontario BCA. The court (per Jessup J.A.) reasoned that section 99 embraced all causes of action that a shareholder might sue for on behalf of a corporation. Compare the remarks of Haines J., who suggested in Goldex Mines Ltd. v. Revill, [1973] 1 O.R. 659 (High Ct.), that it would be unduly harsh to interpret section 99 as being all-inclusive; in his view it would still be open to commence a derivative action under Foss v. Harbottle exceptions at common law, because of the rule of statutory construction that common law rights are not to be affected by a statute unless the derogation of those rights is clearly expressed or necessarily implied. [1973] 1 O.R. at 680.

33 For a good illustration of this advantage, see Goldex Mines Ltd. v. Revill, supra, note 32, especially at 667-68. Difficult questions arise as to who should be reimbursed for expenses incurred in a proxy contest and under what conditions — the incumbents and/or the insurgents, whether or not successful. See Hall v. Trans-Lux Daylight Picture Screen Corp. (1934), 20 Del. Ch. 78, 171 A. 226; Rosenfeld v. Fairchild Engine & Airplane Corp. (1955), 309 N.Y. 168, 128 N.E.2d 291. See generally Aranow & Einhorn, Proxy Contests For Corporate Control (2nd ed. New York: Columbia University Press, 1968). Many of the U.S. cases have distinguished between expenses incurred for a fight on "policy" issues rather than on "personnel" issues. For a lucid discussion of these tests in the context of control situations, see Brudney, supra, note 24, at 282-85.

34 E.g., Ontario BCA sections 153, 154.
This commentary will not discuss these differences, however, but instead will focus at this point on the situation in the *Teck* case, where the plaintiffs argued that the directors had acted improperly by executing the agreement providing for the issuance of shares to Canex.

2. **The Fiduciary Obligation of Directors Issuing Shares**

   a. **The Collateral Purpose Rule**

   As mentioned above, directors' acts must meet the requirements of the so-called collateral purpose rule, that is, with respect to every power of a director a proper purpose must be found.\(^5\) Then, once the court has prescribed the proper purposes for the power involved, it must sift through the facts of the particular case to ascertain if a proper purpose was in fact the real purpose of the directors' acts or conduct in question.

   Turning to the situation of issuing shares, it has been suggested that the primary proper purpose therefor is the raising of capital;\(^3\) however, there could be other valid purposes for issuing shares,\(^3\) for example, as consideration for property purchased or services performed, or for employee stock options. On the other hand, where directors issue shares to retain control for themselves, the courts of the United States,\(^3\) United Kingdom,\(^9\) Australia\(^4\) and Canada\(^4\) have all assailed the transaction. This is as it should be since, *inter alia*, directors as fiduciaries should not be allowed to place their personal interests in conflict with their obligations to the corporation, or to reap personal benefit from acting as directors to the detriment of the corporation. Hence the issuance of shares to maintain control is generally agreed to be the exercise of a director's power for an improper (or collateral) purpose.

   In the *Teck* case the directors' agreement with Canex involved the issuance of shares, and that issuance was going to affect the control position of Afton by diluting Teck's majority shareholding. Indeed, as will be discussed below, Mr. Justice Berger dealt at length with the law concerning the issuing of shares for control purposes. However, the *Teck* situation was different from the ordinary control case in one notable respect: the evidence clearly supported the conclusion that the primary purpose of the directors in authorizing the execution of the Canex agreement was the development of the copper property in the best interests of Afton (that is, all its shareholders taken as one group). The issuance of shares to Canex under the agreement was truly incidental and subordinate to the main purpose of the agreement and was not itself the main objective of the arrangement; in other words, the issuance of the shares was part and parcel of a quite usual arrangement to develop Afton's principal property and was not motivated by a desire to defeat the control position of Teck or to keep the incumbents in office. Insofar as the shareholding of Teck was in fact diluted (and intentionally so) by the agreement, this was an inevitable result flowing from arrangements of that kind. These conclusions were supported by the prior genuine dealings that the directors had had with Placer and other companies relating to arranging an ultimate deal on the property. The terms of the agreement itself were also fair and reasonable, especially in light of the fact that majors did not usually consent to taking less than 50% of the equity. Another influencing factor
was that Afton had been dealing with Placer well before Teck began acquiring shares in Afton. Lastly, in selling the 100,000 shares to finance its drilling operations, and thus making its first association with a major, Afton, had preferred Canex to Teck, for sound reasons, even though Teck had offered more money.

35 The idea that every director power has certain proper purposes may become much less emphasized once corporation statutes require directors to act in good faith in the best interests of the corporation, as does the Ontario BCA in section 144: since the statutory provision says nothing about proper purposes, courts may be more likely to judge directors' conduct by the standard of "the best interests of the corporation," and thus will look far more to the particular act and the particular circumstances of the case, rather than relying at least in part on preconceived judicial notions of what constitutes a proper exercise of a given power. Compare Commentary, supra, note 1, paras. 237-41.


37 In Punt v. Symons & Co., Limited, supra, note 36, Byrne J. first made the statement that the power to issue shares was given to the directors primarily to enable them to raise capital, but then he went on to say that there might be occasions when the directors might fairly and properly issue shares for other reasons. [1903] 2 Ch. at 516-17.

38 E.g., Condec Corporation v. The Lunkenheimer Company (1967), 230 A.2d 769 (Del.Ch.) (the issuance of stock as part of a share exchange invalidated on the grounds it was done to defeat a takeover without any reasonable grounds for expecting damage to the corporation); Bennett v. Propp (1962), 187 A.2d 405 (Del.) (a purchase of shares by the chairman on behalf of his corporation invalidated because of his control motive). Compare Kors v. Carey (1960), 158 A.2d 136 (Del. Ch.), and Cheff v. Mathes (1964), 199 A.2d 548 (Del.) (the purchase of shares by the corporation in takeover situation found justified). For a recent decision involving similar issues revolving around an employees' stock trust, see The Herald Company v. Seawell (1972), 472 F.2d 1081 (10th Cir.). Quite illuminating is the view of the court in that case on the profit motive involved in the management of a corporation:

"We are fully cognizant of the well established corporate rule of law which places corporate officers and directors in the position of fiduciaries for the stockholders. Basic in that rule of law is the profit motive of the corporate entity. In this case we have a corporation engaged chiefly in the publication of a large metropolitan newspaper, whose obligation and duty is something more than the making of corporate profits. Its obligation is threefold: to the stockholders, to the employees, and to the public." Id., at 1091.


It is certainly difficult to interpret an agreement made by directors in terms of having to conclude what was the real or primary purpose of the arrangement especially when agreements and conduct leading thereto can be disguised to be something they really are not. However, judicial line-drawing is endemic in the examination of directors' conduct to see if fiduciary standards have been met. In most cases involving an issue of shares where a fight for control is in the background, the court will likely find that the main reason (or a main reason) for the issue was to maintain or obtain control. But on the facts of the Teck case, one could reasonably conclude that the central dispute was over who should get the ultimate deal to develop Afton's copper property and not over who should control Afton.

Another question should be raised briefly at this point: whether an act of directors can pass the collateral purpose test so long as its primary purpose was proper, regardless of whether another major purpose was improper. Mr. Justice Berger indicated that the Canex agreement should be judged on the basis of its primary objective, which he found was not the dilution of Teck's position as controlling shareholder. But this test is perhaps not sufficiently stringent, since it is often easy for directors to concoct evidence sufficient to convince a court that one or another of their motives was the controlling one. It would seem that a more workable test, and one less open to abuse, would be to scrutinize an act to see whether any major purpose for it was improper. Even by this standard, however, the agreement in the Teck case would not be invalid since, as mentioned above, the share issuance under the agreement was ancillary to the normal ultimate deal.

b. Issuance of Shares for Control Purposes

A very interesting question emerges from the foregoing discussion: assuming it were found that the directors had authorized the issue of Afton shares primarily for a control purpose, could that issuance be justified if the directors believed it to be in the best interests of the company? There is considerable authority which would suggest a general rule that directors cannot authorize such an issuance. On the other hand, some cases have held that directors may exercise their power to issue (or, in the United States, to buy) shares to affect control in some way if they can demonstrate to the court

42 In several cases the courts have not accepted the argument that the share issuance was not for control purposes but for other valid business reasons. See Madden v. Dimond, supra, note 41, where it was argued that the issuance of shares was consideration for the purchase of a mine; Smith and Tatchell v. Hanson Tire & Supply Company Limited, supra, note 41, where it was argued that shares were issued in order to pay off a creditor; and the Ashburton Oil case, supra, note 40, where it was argued that the share issuance was made to acquire interest in a mining company and in mineral claims.

43 A similar view was expressed in the Ashburton Oil case, supra, note 40, by Gibbs J., who stated: "... but the question is whether it has been established prima facie that a substantial purpose of any such allotments would be to advance the private interests of the directors." (Emphasis supplied.) 45 A.L.J.R. at 172.

44 See notes 38-41 supra.
that they have reasonable grounds for believing that they were acting in the best interests of the corporation.\textsuperscript{45}

The judgment in the \textit{Teck} case dealt at length with the law involving directors issuing shares for “control purposes.” In particular it discussed \textit{Hogg v. Cramphorn Ltd.},\textsuperscript{46} which involved a sophisticated attempt to thwart the employees and then issued shares to the trust, which purchased the shares with funds loaned by the company. The court struck down the arrangement, finding that the issuance of shares to the trust was made to ensure control and not for the benefit of the company. In \textit{Teck}, however, Mr. Justice Berger chose not to follow \textit{Hogg v. Cramphorn} and instead adopted the following test:\textsuperscript{47}

I think that directors are entitled to consider the reputation, experience and policies\textsuperscript{48} of anyone seeking to take over the company. If they decide, on rea-

\textsuperscript{45}E.g., \textit{Kors v. Carey}, supra, note 38; \textit{Cheff v. Mathes}, supra, note 38; \textit{The Herald Company v. Seawell}, supra, note 38. See also the rather rash statement of Harvey, C.J.A. in \textit{Spooner v. Spooner Oils Limited}, supra, note 41:

“There is nothing in the authorities cited that would stand in the way of upholding an issue of shares for the sole purpose of giving someone control of the company if the directors honestly believed on reasonable grounds that it was for the interest of the company that that should be done.” [1936] 1 W.W.R. at 562.

\textsuperscript{46}Supra, note 39.

\textsuperscript{47}In so doing Mr. Justice Berger referred to several U.S. cases and to a great extent adopted their reasoning.

It should be noted that Mr. Justice Berger need not have gone so far as to make this controversial statement, since \textit{Teck} could have been distinguished from \textit{Hogg v. Cramphorn} and decided solely on the ground that the retention of control was not a major purpose in the directors’ issuance of shares; hence the issuance and the agreement were not made for an invalid purpose. \textit{Hogg} and related cases (such as \textit{Martin v. Gibson}, supra, note 41, and the other U.K. cases, supra, note 39) would have been relevant only if the judge had found that the agreement with Canex was a sham because its real purpose, or one of its main purposes, was to defeat Teck’s majority position. Indeed, \textit{Hogg} itself contained language which could have been used to distinguish the cases: Buckley, J., indicated that the loan by the company to the trust was invalid because “it was not . . . \textit{a conscientious exercise} by the directors of their powers to make loans of the company’s funds for the purposes of the company’s business or purposes reasonably incidental thereto.” [1967] Ch. at 270 (emphasis added). Thus presumably if he had found the facts as falling within the emphasized language, he would have upheld the loan; similarly in the \textit{Teck} case, the issuance of shares could have been found to fall within the emphasized language and therefore to be valid.

Yet another ground of distinction between \textit{Teck} and \textit{Hogg} might perhaps have been found: in \textit{Hogg} the maintenance of control of a closely-held corporation was at issue, whereas in \textit{Teck} a public corporation was involved. This difference can lead to different fiduciary obligations because of the ability of the public corporation shareholder to dispose of his shares if he is displeased with the corporation’s policies. See \textit{Brudney}, supra, note 24, at 265-69.

In fact, at the end of his judgment, Mr. Justice Berger does distinguish \textit{Hogg} by saying: “If I am wrong in rejecting \textit{Hogg v. Cramphorn}, it is not applicable here in any even. . . . I find that the primary purpose of the [Afton] directors was to serve the best interests of the company [in making the best contract they could].”\textsuperscript{49}

\textsuperscript{48}Mr. Justice Berger did not in fact discuss any evidence showing that the directors of Afton had considered the “reputation, experience and policies” of Teck with regard to Teck’s being a majority shareholder. Reference is made several times to the defendant directors’ “misgivings” about and “low opinion” of Teck in terms of their never having brought a mine into production in British Columbia, and not having the financial capacity, experience or personnel to equal Placer’s; but these references were made with regard to the making of an ultimate deal with Placer rather than Teck.
sonable grounds, a takeover will cause substantial damage to the company's interests, they are entitled to use their powers and protect the company.

Fundamentally, strict fiduciary doctrine and rules of fairness would hold that the directors should not be able to issue shares for control purposes, notwithstanding a finding that an agreement was entered into in the best interests of the company; but this would seem to be perhaps an unduly narrow view of the directors' fiduciary duty, and a view which might lead to results as unsettling and intrinsically unfair as those that duty is intended to avoid. There would appear to be at least three approaches to this problem.

One way to ensure equality of treatment for the shareholders is for the corporation statute to require a pre-emptive right with regard to the issuance of shares, so that each shareholder would be entitled to his pro rata portion of newly issued shares. This solution to the problem of share issuing for control is in theory ideal, particularly since it is self-enforcing; however, it can run into serious practical difficulties, especially in the widely-held public corporation. Hence it may not be as attractive a solution as it appears at first glance.

A second approach is the one already mentioned: that the issue of shares for control is not allowable under any circumstances whatsoever. This rule has certain positive features. It avoids the potential abuses resulting from directors' self-dealing in share issuances and at the same time it protects the rightful voting power of shareholders to decide who will manage the affairs of the corporation. It also has the advantage that the courts will not be forced to interpret and decide in individual cases whether the incumbents should be allowed to retain control — a question which arguably should not be decided by the courts at all but rather by the shareholders. However, as already suggested, the absolute ban on share issue for control is perhaps too restrictive a rule, in that it is preoccupied with the interests of the shareholders. A situation can readily be imagined — that of corporate raiding or looting — in which the employees and even the creditors of the corporation should arguably be protected, since these non-shareholder groups do not have a readily transferable interest as the shareholders do (and it should be added that in the raiding situation the shareholder who gets out is even apt to gain initially since raiders try to get a short-term increase in the market price of the stock). In this type of situation the strict rule can lead to injustice.

Thus the third approach is a modification of the second: the issue of shares for control is not allowable as a general matter, but it would be open to directors to plead exceptional circumstances to validate their share issue — despite the intrinsic self-dealing involved. Thus in an impending takeover by a looter, the incumbent directors would be entitled to consider the best interests of the company, including its employees and creditors, and issue shares to prevent what they felt would be tantamount to a disaster. Such a share issuance would have to be a last resort; the directors would have to have taken all other reasonable steps to prevent the takeover, such as advising the shareholders not to sell their shares. The directors would also have to demonstrate reasonable grounds for thinking that the persons attempting the takeover would be harmful to the company. The directors should not be able merely to point to different business practices or vague charges of dif-
ferent policies on the part of the would-be acquirors; on the contrary, differences over policies are a legitimate reason for taking over a company so that rules should not be developed to prevent such a transaction. Finally, of course, the directors’ actions in this kind of situation would be subject to court review to determine whether the normal strict fiduciary duty of the directors should be relaxed.

In this connection, in the Teck case Mr. Justice Berger said the burden of proof was on the plaintiffs to show that the directors had no reasonable grounds for believing that a takeover by Teck would cause substantial damage to the interests of Afton and its shareholders. But because the directors

49 It has been argued very forcefully that in allowing the issuance of shares for control purposes, the Delaware courts have mixed the duty of care owed by directors with their fiduciary duty, and, by permitting self-dealing on the part of the directors, have eroded the shareholders' right to choose who will manage the corporation. Brudney, supra, note 24 at 272-77.

50 Under section 3.05 of the Draft Canada Act, this pre-emptive right is automatically given unless expressly taken away by the corporation's articles. The draftsmen felt that the equitable restrictions on directors in issuing shares are “notoriously imprecise, as any attempt to reconcile the authorities on this question shows . . . .” See Commentary, supra, note I, paras. 114-17.

51 This is the approach taken by Brudney, supra, note 24 at 272-77.

52 It must be conceded, of course, that there has not been much judicial or statutory acknowledgment of directors acting in the interests of non-shareholder groups. See Parke v. Daily News Ltd., [1962] Ch. 927, 3 W.L.R. 566 (directors not allowed to prefer employees over shareholders in a winding-up). A commendable statutory start is section 203(3) of the Ghana Companies Code 1963, drafted by Professor Gower, which expressly permits directors to consider the interests of employees and, where representing a special class of shareholders or creditors, the interests of those persons. In the Teck case, Berger J. in a very courageous way rejected the classical view of directors looking only to the shareholders and said modern circumstances have changed the traditional approach. In his view, if directors consider the interests of employees or of the community on a particular question, so long as such consideration is not exclusive or in disregard of shareholders, the directors could be said to be acting bona fide in the interests of shareholders. See also the view of the court in The Herald Company v. Seawell, supra, note 38.

53 Under takeover bid legislation, an offeror may attach a condition allowing it to get out of the offer where the action of the board of directors of the offeree company after the date of the offer materially changes the undertakings, assets or capital of the offeree company. See Ontario Securities Act, section 82(10). Thus the issuing of shares might have the effect of ridding the company of the would-be acquiror altogether if he chose to retract his takeover offer under this type of section.

54 Compare the evidence justifying the directors' issuance of shares in three cases in which the share issuances were upheld: Kors v. Carey, supra, note 38; Cheff v. Mathes, supra, note 38; Harlowe's Nominees Pty. Ltd. v. Woodside (Lakes Entrance) Oil Co. N.L., supra, note 40. If those cases had been decided following the approach suggested (that is, one of exceptional or extraordinary circumstances), it is doubtful that the issuances would have been upheld. Certainly on the evidence referred to in Teck, Berger J. would not have been justified in saying real harm to Afton would have resulted from Teck's majority position thereby warranting the directors to issue shares solely to defend that majority position.

55 Citing The Australian Metropolitan Life Assurance Company Ltd. v. Ure (1923), 33 C.L.R. 199, 219 (High Ct. per Isaacs J.), which in turn relied on several U.K. decisions. Berger, J., went on to say, however, that he was satisfied that it had been affirmatively shown that the Afton directors did have reasonable grounds for believing Teck would cause substantial damage.
are attempting to fit their case into an exception to the rule — and also because, as mentioned earlier, directors are too easily able to disguise a given transaction — the onus should be on them to prove the exceptional circumstances once the plaintiff has made a prima facie case: the directors should have to prove to the satisfaction of the court that they had had reasonable grounds for believing that substantial damage to the interests of the corporation would have resulted, and that they had taken all reasonable steps to prevent the takeover by other means. Moreover, as has been stated in some American cases, a conflict of interest exists when directors can use their power to issue (or buy) shares, such that the burden should be on the directors to justify their act as one in the corporation's interest. Naturally it would follow that where the court feels the directors' actions are equivocal, the share issuance should be set aside.

c. Shareholder Ratification of a Share Issuance

Although it is not intended within this note to discuss the subject fully, some mention should be made of shareholder ratification of a share issuance which is found to have been done improperly for control purposes. In Hogg v. Cramphorn and in Bamford v. Bamford such ratification was allowed, while in Martin v. Gibson the court held that the issuance was not ratifiable by the shareholders. There is probably no question in corporation law on which the authorities are more difficult to reconcile than the question of shareholder ratification of directors' breaches of duty. The difficulty arises because the wrongdoing directors can vote qua shareholders at the meeting

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50 See Bennett v. Propp, supra, note 38 at 409; Cheff v. Mathes, supra, note 38 at 554. The Delaware Supreme Court seemed to disapprove of prior Delaware decisions which implied the onus was on the plaintiffs. As has been suggested, placing the burden of proof on the challengers is incompatible both with fiduciary duties involving questions of loyalty and with the defendant directors' superior knowledge of the facts and ability to explain their significance. Brudney, supra, note 24, at 271.

57 "...[I]f he [a director] act in a certain way with the primary object of deriving an improper personal advantage, financial or otherwise, he cannot save himself by shewing that it was also of benefit to the Company. If the circumstances are such that his action is equivocal, and open to two constructions, he must, seeing that he is in a fiduciary capacity, be prepared to shew beyond all reasonable doubt the single-mindedness of his intentions." (Emphasis added.) Madden v. Dimond, supra, note 41 at 87 (per Martin J.). This quotation is interesting also in that the emphasized language indicates a very strict burden of proof on the defendant director. Compare the Hartowe's Nominees case, supra, note 40, at 125 in which the court put forward quite a different standard of proof applicable to the party attacking the directors' action:

"The first task of the trial judge, then, was to decide whether it was established to his satisfaction, even if only on a balance of probabilities, that the directors were actuated by an impermissible purpose." (Emphasis added.)

43 A.L.J.R.

58 Supra, note 39. In both cases, the holders of the newly issued shares did not vote at the shareholders' meetings.

50 (1908), 15 O.L.R. at 632.

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called to consider ratification, provided only that such ratification is not brought about by “unfair or improper means.”

It is certainly very arguable that shareholder ratification of an improper issuance of shares for control should not be allowed. First, the self-dealing aspect of the directors’ conduct is compounded as they end up voting for their own benefit. Moreover, at least in many cases involving an improper issue for control purposes, the directors will have control over the voting of the majority of shares — through actual financial control and through the proxy apparatus — and thus can ensure that their wrongdoing will be wiped away by ratification. Finally, and conceptually most important, in the majority of cases involving improper issue for control, the directors’ conduct would have been found not to be in the best interests of the corporation; it would seem rather peculiar to allow the shareholders to give their blessing to such conduct.

However, there are, perhaps, some types of cases in which justice would be furthered by allowing shareholder ratification of a share issuance for control. For example, in a jurisdiction applying strict fiduciary standards which would invalidate any share issuance which had a control purpose (especially if that were not the primary but only a main purpose), a case could be hypothesized in which the directors in fact acted in the best interests of the corporation in issuing shares for control, notwithstanding that such issuance would be struck down by the courts. In such a case, shareholder ratification should perhaps be allowed; but it seems clear that only disinterested shareholders should be entitled to vote.

D. Summary

In conclusion, the decision of Mr. Justice Berger in the Teck case is correct in validating the agreement between Canex and Afton. The directors of Afton entered into the contract with Canex for a proper purpose — the most advantageous development of Afton’s copper property — and in the best interests of the corporation. The proposed issuance of shares under the agreement was quite ancillary to the primary purpose of the agreement, particularly since it was usual in development agreements of this kind; it was therefore not made for an improper purpose, even though the incidental effect

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62 One problem with extending the right of shareholder ratification in general is that if a breach of duty is ratifiable by a simple majority of shareholders, under the vagaries of the exceptions to the rule in Foss v. Harbottle a minority shareholder cannot bring an action to attack the directors’ wrongdoing. This aspect of the ratification question unfortunately remains uncertain under section 99 of the Ontario BCA. Compare Draft Canada Act section 19.05, which is somewhat clearer on this point. See Commentary para. 487.
63 In the North-West Transportation case, supra, note 61, the Privy Council said that all shareholders could vote for ratification, thus reversing the decision of the Supreme Court of Canada, which had held that ratification had to be effected by a disinterested majority of shareholders.
of the issuance would have been to affect the control of the company by
defeating Tecek's majority position. Hence the agreement was rightfully
upheld.

Insofar as the Teck judgment also concluded that the directors could
issue shares to thwart a takeover, it is perhaps on somewhat less firm ground.
I would suggest that this should be allowed only under very exceptional
circumstances, when it can be demonstrated clearly and unequivocally that
the best interests of the corporation would be served by such issuance. And
in such a case, the directors should have the onus of proving that real harm
would have resulted to the corporation from the takeover.

Notwithstanding these modifications of Mr. Justice Berger's reasoning,
he has perhaps paved the way for further development of the law surrounding
the question of the issuance of shares for control purposes and indeed the
exercise of directors' powers generally. In any event, in my view he has
clearly provided us with one of the most interesting judgments in company
law for some time.

64 The facts of the Teck case are perhaps somewhat unusual, in that the issuance
of shares under the agreement was not to be immediate, but would be effected only
after other parts of the agreement were carried out. Hence the directors had left them-
selves vulnerable for the interim period, and they were, in fact, ousted by Teck. This
willingness to act as they did in the face of the very strong chance that they would
lose their positions arguably adds to the presumption that the directors acted in good
faith and did what they felt was best for the company.

These facts raise another interesting question: should incumbent directors avoid doing
anything of fundamental importance if they know control has been taken over by
interests in opposition to them? Their position is somewhat similar to the lame duck
legislature which suddenly wishes to capture a place in history by passing volumes of
legislation. In both the Teck case and the Ashburton Oil decision (supra, note 40), the
majority shareholders asked that nothing important be undertaken by the directors.
However, in the Ashburton Oil case, Barwick C.J. had this to say on this point:

"Directors who are minded to do something which in their honest view is for
the benefit of the company are not to be restrained because a majority shareholder
or shareholders holding a majority of shares in the company do not want the
directors so to act." 45 A.L.J.R. at 163.