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Removal of a Director: When Will the Court Intervene?

A fundamental principle of corporate law is that the directors are appointed and, if necessary, removed by the shareholders. Indeed, at common law, directors could not be removed from office during their term. Under statute, shareholders elect directors and have the power to remove them, while the directors may fill vacancies that occur between shareholder meetings. However, pursuant to the oppression remedy, the court is granted the power to make "an order appointing directors in place of or in addition to all or any of the directors then in office". Two recent cases in the Ontario Court of Appeal have considered the scope of a Court's power to remove a director.

In *Re: Stelco*, the court overturned a decision made pursuant to s.11 of the Companies Creditors Arrangement Act ("CCAA") to nullify the appointment of two new directors of Stelco. The new directors were representatives of two investment funds which had collectively acquired a significant position in Stelco stock during the course of its restructuring. They had the support of other shareholders but were opposed by other stakeholders, especially the employees. While the court below found no conduct evidencing a lack of neutrality on the part of the nominees, it held that the possibility of this, as well as the effect the appointments might have on the restructuring process, was a sufficient risk to nullify their appointments.

The court found that there may be situations in which the power to remove directors under the oppression remedy could be imported into a CCAA proceeding, but there was no justification for it in this case. The Court held that the duties of directors do not change with insolvency and that the interests of the corporation must not be confused with those of creditors or other stakeholders. Further, the Court emphasized that removal of

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directors is an exceptional remedy which is rarely exercised due to a well-established deference to business judgment. It requires more than some risk of anticipated misconduct. The court refused to apply the concept of reasonable apprehension of bias to the appointment of directors. Directors are not removed from boards for conflict of interest. They are simply obliged to declare the conflict and abstain from voting.

In Catalyst Fund General Partner Inc. v. Hollinger Inc. et al., the Court of Appeal upheld an order removing White, a director of Hollinger Inc. The underlying oppression application related to certain related party transactions, including a loan which White had helped Hollinger to arrange to benefit Hollinger's majority owner. The applications judge first removed all directors associated with the majority, except White, whom he left in place at the pleasure of Hollinger's five independent directors, since he found that they did not wish to lose his experience in running Hollinger day-to-day. Thus Hollinger would be less affected by his remaining than by his removal. He granted leave to the independent directors to seek further direction on the issue. Matters deteriorated further and a further application was brought, this time to remove White. This was granted and White appealed.

The Court of Appeal, applying Re: Stelco, found that there was jurisdiction under the oppression remedy to grant the order. It held that the Court below had initially found White's actions to be oppressive but had not ordered his immediate removal because his continued service as a director was in the company's best interests. No "fresh" finding of oppression was therefore required to remove him. The initial order made White's continued role an interim one and reflected the court's continued jurisdiction (based on the original finding of oppression) to determine whether and when he should be removed.

The decision re-emphasizes the flexibility of oppression remedy. The court commented on the unusual nature of the original order and noted that it made further contested litigation virtually inevitable. As a result, such orders should only be made in exceptional circumstances. As in Re Stelco, the court emphasized that the power to remove directors should be exercised rarely and only where compelling justification exists.

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Internal Control Audit Opinion Not Required In Canada

In a move that will be widely welcomed by Canadian public companies, the Canadian Securities Administrators (CSA), the umbrella organization for the various Canadian securities regulatory authorities, recently announced that they will not proceed with a proposed rule that would have required issuers to obtain annual "internal control" opinions from their auditors. These opinions involve auditors attesting to management's assessment of the effectiveness of the issuer's internal controls over financial reporting and have been required in the United States under section 404 of the Sarbanes-Oxley Act (SOX) since late 2004.

The U.S. experience has shown that obtaining an internal control audit opinion is a costly and time consuming process; much more so than originally expected, and disproportionately so for smaller issuers. Many questions have been raised as to whether the costs of implementing section 404 exceed its benefits. As a result, the U.S. Securities and Exchange Commission is revisiting the application of section 404 to "smaller" public companies (which, in the U.S., means companies with a market capitalization of less than approximately US\$700 – 750 million). In particular, the SEC is considering an advisory committee recommendation to exempt smaller companies from the internal control audit opinion requirement.

The CSA's decision, which comes shortly after the announcement of the SEC advisory committee recommendation, is important for two reasons. First, from a practical perspective, Canadian public companies no longer face the prospect of incurring the significant costs associated with the auditor attestation process. Second, from a policy perspective, in deciding not to adopt the proposed rule, the CSA appear to have concluded that at least some aspects of SOX are inappropriate for Canada's smaller capital markets and smaller public companies. This contrasts with the CSA's general response to SOX until now, which has generally been focused on harmonizing Canadian rules with the U.S., and is consistent with the "made in Canada" approach to corporate governance reform that many Canadian capital market participants have been advocating for some time.

Despite the withdrawal of the proposed rule, maintaining effective internal controls over financial reporting remains vitally

important for Canadian issuers. Starting this year, CEOs and CFOs will be required to certify, annually, that they have designed internal controls over financial reporting and that any material changes in internal controls over financial reporting have been publicly disclosed. In lieu of obtaining auditor attestations, the CSA are also proposing new rules that would, starting no earlier than 2008, require CEOs and CFOs to certify that they have evaluated the effectiveness of the issuer's internal controls and publicly disclosed their conclusions based on this evaluation. These certification requirements will apply to all issuers, regardless of size.

All in all, the CSA's new approach to internal controls is a thoughtful way of balancing in the context of the Canadian market, the costs and benefits associated with seeking to enhance investors confidence through the increased regulation.

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Standing In The Shoes Of An Estate Trustee And Getting Paid

While lawyers have always provided legal advice to estate trustees during the administration of an estate, more and more lawyers are being retained to perform many of the duties normally reserved to estate trustees. The issue of the fee charged by a lawyer for performing such services was recently considered in *Bott Estate (Trustee of) v. Macaulay*.

By way of background, Alma Bott died in June 2003. Her son, Gerald Bott ("Bott"), was appointed estate trustee with a will in August 2003 pursuant to his mother's last Will and Testament. The Will left the entire estate, \$650,000, to Bott and his sister in equal shares. Bott decided to retain a solicitor recommended by the funeral home to help him with the administration of the estate, as he had little or no experience in such matters. The solicitor ultimately rendered two accounts: the first on October 21, 2003, in the amount of \$7,204.49 for services as a solicitor on behalf of the estate. A second account, for \$34,828.50 dated, October 28, 2003 was addressed to Bott for services on Bott's behalf as estate trustee, represented five per cent of the value of the estate, plus GST. The solicitor paid ("pre-took") the accounts out of the proceeds of the estate at the same time as he delivered them to Bott.

The trustee brought an application for the review of the Solicitor's accounts as well as an order for an assessment of the solicitor's accounts. In responding to the application to challenge the second account (the first was not in issue), the solicitor took the position that the court had no jurisdiction to order an assessment under the Solicitors Act, in that his fees could only be challenged on a passing of accounts. Nevertheless Cullity J. ordered an assessment of the account. He expressed his surprise and displeasure both that the solicitor pre-took his 5% compensation and that the solicitor characterized conveyancing work as executor's work and not solicitor's work.

Cullity J. noted that an estate is not a juridical person and cannot retain anyone or incur liabilities. As such, an "estate solicitor" is one who performs services for an estate trustee and not an estate. The estate trustee, not the estate, is therefore personally liable to the solicitor. In the normal course, an estate trustee is entitled to be reimbursed/indemnified from the assets of the estate for the estate solicitor's fee. However, whether or not an indemnity exists does not affect the liability of the estate trustee to the solicitor. In this context, Cullity J. stated:

If the estate trustee wishes to challenge the fees or disbursements charged by the estate solicitor, the appropriate procedure is by an assessment pursuant to the Solicitors Act unless, on a passing of accounts, the beneficiaries have challenged the reasonableness of the fees as an expense incurred by the estate trustee in administering the estate, or unless the estate trustee wishes to have an order approving the right to an indemnity or reimbursement.

In his decision, Cullity J. noted that nothing prevents a solicitor from performing services that are ordinarily part of the estate trustee's work and for which the estate trustee is personally liable. However, the estate trustee cannot claim compensation for such work and his or her compensation would be otherwise reduced.

Absent any special agreement between the estate trustee and a solicitor, a solicitor will generally be entitled to charge only on the normal quantum meruit basis and the reasonableness of the fees can be questioned on an assessment. While remuneration paid to the solicitor for services reserved to the estate trustee may be calculated at a special rate or as a percentage of the value of the estate, the beneficiaries are entitled to challenge the reasonableness of the amount paid on a passing of accounts.

Moreover, even in the face of any such arrangement or agreement, the estate trustee is not prevented from assessing his/her solicitor's account, though such an arrangement would factor into the assessment officer's consideration.

Finally, in addressing the specific account in issue, Cullity J. held that there was no agreement between Bott and the solicitor that entitled the solicitor to a percentage of the value of the estate. The solicitor's fees were to be determined on a quantum meruit basis and without reference to any amount that might be awarded to Bott as estate trustee. As a final rebuke, the solicitor was ordered to deposit the \$34,828.50, plus interest, he pre-took into an interest bearing account pending the completion of the assessment.

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Da Vinci Code Case Affirms No Copyright Protection For Ideas

Dan Brown, author of the best-selling novel *The Da Vinci Code*, recently became the subject of a copyright infringement claim brought in London's High Court. The Court has now vindicated Brown, in a decision that re-affirmed a long standing principle of copyright law.

Historians Michael Baigent and Richard Leigh brought a copyright infringement suit against Brown's publisher, Random House, claiming that the central theme of *The Da Vinci Code* was stolen from their 1982 non-fiction best-seller, *The Holy Blood and The Holy Grail*. The theme at issue, and the premise of Brown's novel, was the controversial idea that Jesus Christ married Mary Magdalene and conceived a family, the descendants of which are living today.

In court in London, the lawyer for Random House reportedly took the position that Baigent and Leigh were seeking to monopolize broad ideas about Jesus Christ's life and lineage which were too general to be protected by copyright law. The Court ultimately agreed.

The case raised an issue that has long troubled artists and authors, namely the fact that copyright law protects only the actual expression of an idea and not the idea itself. Novel ideas regarding plots for plays, movies, books and television shows are

not protected by copyright law unless they are sufficiently developed into a plot and/or character outline or script to constitute a literary or dramatic work. Even then, only substantial copying of that work is actionable as copyright infringement.

To protect ideas, authors and artists must find means other than copyright law. One option, which is effective prior to mass publication of a work, is for authors to have potential collaborators and financiers enter into non-disclosure agreements, in which they agree not to divulge or to use in any way the ideas of the author. However, once a work has been published or performed in public others are entitled to use the ideas embodied in it as a basis for their own works, as long as they express the idea differently, such as in different words or pictures.

The High Court has now re-affirmed that mere ideas are public domain. While the decision has allayed fears of a floodgate of litigation against successful authors and artists, it leaves all authors with the age-old challenge of preventing unauthorized exploitation of ingenuous ideas.

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