The Derivative Action under the *Ontario Business Corporations Act*: A Review of Section 97

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Synopsis

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Introduction

Prior to 1971, it was encumbent upon a shareholder seeking to sue in Ontario to enforce a right or duty owed to the corporation to bring himself within the exceptions to the rule in *Foss* v. *Harbottle*.[1] Since the corporation was considered to be an entity distinct from its shareholders, only the corporation could maintain an action against a wrongdoer to remedy the

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[1] (1843) 2 Hare 461, 67 E.R. 189 (V.C.). See, generally, Wedderburn, *Shareholders' Rights and the Rule in Foss v. Harbottle* (1957) 15 Cambridge L.J. 194 [Part I], (1958) 16 Cambridge L.J. 93 [Part II]; Beck, "An Analysis of *Foss* v. *Harbottle*" in J. Zeigel, *Studies in Canadian Company Law* (1967), vol. 1, 545.

injury sustained. Where the wrongdoer was in control of the corporation, and unless the minority shareholders could maintain a derivative action, the wrong to the company would probably go unredressed.

A body of law developed from the decision in *Foss* v. *Harbottle* which would for the next century frustrate and bedevil minority shareholders seeking to right a wrong done to the corporation. The route to redress was not an easy one and did not often allow the shareholder his day in court.

In an attempt to clear the procedural stumbling blocks that impeded the way to a shareholder's derivative action, the Select Committee on Company Law[2] recommended that a statutory derivative action[3] be entrenched in *The Ontario Business Corporations Act*.[4] The Committee, while concluding that the derivative action was the most effective remedy to enforce the duties and responsibilities imposed upon directors and officers, was concerned with a related, American problem. In the United States, shareholder derivative actions are frequently commenced with the hope of obtaining large counsel fees or private settlements without any intention of benefitting the corporation on whose behalf the lawsuit was theoretically brought. In order to avoid the problems of these "strike suits", the Lawrence Committee recommended various procedural provisions designed to maintain the integrity of the derivative action.[5]

Section 97 of the *Act* sets out a procedural code for commencing a derivative action. It is now clear that it embraces all forms of shareholder actions purporting to be brought on behalf of and for the benefit of the corporation.[6] Since s. 97 subsumes all causes of action in law or in equity that a shareholder may sue for on behalf of a corporation, compliance with the procedural requirements is mandatory where a derivative action is sought to be commenced. The right of the shareholder to bring a personal action to redress a wrong done to him remains unaffected by s. 97. Accordingly, a shareholder is free to sue to enforce a right or duty owed him without regard to s. 97.

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[2] Hereinafter "the Lawrence Committee".

[3] While the *Act* does not speak of "derivative actions" as such, the American terminology is, in practice, almost exclusively used and has received wide judicial recognition. This is, perhaps, because the name "derivative action" is indicative of the true nature of the action, that being a suit on behalf of a corporation to enforce rights derived from it.

[4] R.S.O. 1970, c. 53, s. 99 proclaimed in force on 1 January 1971; now R.S.O. 1980, c. 54, s. 97. [Hereinafter the *Act* will be cited as the *Ont. B.C.A.*]. See Appendix.

[5] *1967 Interim Report of the Select Committee on Company Law*, 27th Legis. Ontario, 5th Sess. [hereinafter the *Lawrence Report*].

[6] See, *e.g.*, *Farnham* v. *Fingold* [1973] 2 O.R. 132 (C.A.). But see also the criticism of this decision in Zacks, *Comment* (1973) 8 U.B.C. L. Rev. 191.

It is less certain whether the statutory derivative action in Bill 6 is, like s. 97, exhaustive of the common law.[7] Its language is clearly not as expansive as that of s. 97. Section 244 of the proposed Act deals with leave to bring, defend or intervene in any action under that Act. It does not purport to subsume all causes of action under any other statute or in law or equity that could be enforced by the corporation. Since s. 244 is virtually identical to s. 232 of the *Canada Business Corporations Act*,[7a] the interpretation given to the latter would be of assistance. Unfortunately, there does not appear to be any reported case law in this area. It is therefore uncertain whether it is necessary to comply with s. 244 if the cause of action arises outside of the proposed Act.

Since compliance with s. 97 of the *Act* is a condition precedent to commencing a derivative action, the critical threshold question in shareholder litigation is whether the action is personal or derivative. This question is a difficult one in itself and has been the subject of discussion.[8] For the purposes of this article, it is assumed that the action has been determined to be derivative. The objective of this article is to examine the procedural requirements for commencing a derivative action in Ontario. Reference will also be made to Bill 6 and the changes it proposes. While a discussion of whether the shareholder action is personal or derivative is outside the intended scope of this article, the issue is so fundamental to shareholder litigation that any examination of derivative actions would be incomplete without reference being made to it.

I. The Personal Action vs The Derivative Action

As Professor Beck points out,[9] the real distinction for company law purposes is between the personal action and the derivative action. The Ontario Court of Appeal in *Goldex Mines Ltd* v. *Revill* dealt with this distinction:

> Where a legal wrong is done to shareholders by directors or other shareholders, the injured shareholders suffer a personal wrong, and may seek redress for it in a personal action. That personal aetion may be by one shareholder alone, or (as will usually be the case) by a class action in which he sues on behalf of himself and all other shareholders in the same interest (usually, all other shareholders save the wrongdoers). Such a class action is nevertheless a *personal* action.
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> A derivative action, on the other hand, is one in which the wrong is done to the company. It is always a class action, brought in representative form, thereby binding all the shareholders.[10]

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[7] *An Act to Revise the Business Corporations Act*, 32d Legis. Ontario, 2d Sess., 20 October 1981, 2d reading [hereinafter "Bill 6" or "the proposed Act"]. See Appendix for relevant sections.

[7a] S.C. 1974-5-6, c. 33.

[8] See Beck, *The Shareholders' Derivative Action* (1974) 52 Can. Bar Rev. 159.

[9] *Ibid.*, 185.

[10] (1975) 7 O.R. (2d) 216, 221 (C.A.) *per* Brooke, Arnup and Estey JJ.A.

At a theoretical level, the distinction between the personal action and the derivative action is quite clear. In practice, however, it can often be difficult to distinguish one from the other, cspecially when personal and derivative actions are interrelated.[11] The Court of Appeal in *Goldex Mines Ltd* v. *Revill* recognized the difficulty of this interrelationship. The Court realized that the same wrongful act can be both a wrong to the company and to each shareholder. An attempt was made by the Court to provide some guidance in the determination of whether the wrong gave rise to a personal or derivative action. The Court quoted with approval from the judgment of Traynor C.J. in the California case of *Jones* v. *H.F. Ahmanson & Co.*[12] wherein Traynor C.J. refers to *Shaw* v. *Empire Savings & Loan Assoc.*:[13]

> the court [in *Shaw*] noted the "well established general rule that a stockholder of a corporation has no personal or individual right of action against third persons, including the corporation's officers and directors, for a wrong or injury to the corporation which results in the destruction or depreciation of the value of his stock, since the wrong suffered by the stockholder is merely incidental to the wrong suffered by the corporation and affects all stockholders alike." From this the court reasoned that a minority shareholder could not maintain an individual action unless he could demonstrate the injury was somehow different from that suffered by other *minority* shareholders. In so concluding the court erred. The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If the injury is not incidental to an injury to the corporation, an individual cause of action exists.[14]

The Court of Appeal interpreted Traynor C.J. to mean that a personal action would not arise "simply because the corporation itself has been damaged and as a consequence of the damage to it, its shareholders have been injured".[15] This distinction has been criticized as lacking clarity and cogency in that it is impossible to determine with any confidence what constitutes an incidental injury, and the absence of any good reason for not treating an incidental injury as a wrong to the shareholders personally.[16] Notwithstanding the limitations of the distinction, it is the only judicial assistance presently available. Regardless of the test employed, there will always remain grey areas of wrongs that do not lend themselves to easy categorization. All shareholder suits cannot be arbitrarily placed in one

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[11] See Prentice, *Comment* (1976) 15 U.W.O. L. Rev. 225, 231-2 wherein Professor Prentice discusses, as an example, the payment of excessive remuneration to directors. While this is traditionally characterized as a wrong to the corporation, he argues that it could just as easily be characterized as a wrong to shareholders individually as it depreciates the value of their investment. However, the fact remains that it is almost inevitable that a wrong to a corporation will adversely affect the value of each shareholder's interest in the corporation.

[12] 460 P. 2d 464 (Cal. 1969).

[13] 186 Cal. App. 2d 401 (Dist. Ct App. 1960).

[14] *Supra*, note 12, 470-1 [references omitted].

[15] *Supra*, note 10, 222.

[16] *Supra*, note 11, 232.

category to the exclusion of others. The concept of incidental injury serves a useful purpose in the resolution of the threshold question of whether the action is personal or derivative. The answer involves two considerations. First, is the individual's injury distinct from the corporation's injury in that it does not occur simply because the corporate injury exists? Second, is the individual's injury in an area where the shareholders by their own representative actions are exercising a power in bad faith, or the directors are abusing a duty owed to minority shareholders different from that owed to the corporation?[17] If the answer to either consideration is affirmative, then a personal cause of action will exist. Admittedly, there may, in some circumstances, still be uncertainty as to the nature of the cause of action. In those cases, leave should be obtained as a matter of precaution.

II. Conditions Precedent to a Derivative Action

A. *Leave to Commence a Derivative Action*

Section 97 of the *Act*, as already discussed, sets out a procedural code for bringing a derivative action. It was designed to prevent the commencement of derivative actions solely for the purpose of provoking secret settlements with companies. To this end, s. 97(2) requires, as a condition precedent to commencing the action, that the plaintiff obtain a court order permitting him to commence it. The application must be made to a judge of the Supreme Court on seven days' notice to the corporation.[18] Bill 6 requires the applicant to give 14 days' notice to the directors of the corporation or its subsidiaries of his intention to apply for leave.[19] Pursuant to s. 244(3) of the proposed Act, where it is not expedient to give notice, the applicant may make an *ex parte* application to the court for an interim order pending the giving of notice. This is an attempt to restore the time-honoured right of a shareholder to seek *ex parte* interim relief in exigent circumstances. Under s. 97, there could be no *ex parte* applications.[19a]

Since an application under s. 97 is made only for the purpose of obtaining authority to commence a derivative action, it is not necessary that a draft writ and statement of claim be filed with the court in addition to the supporting affidavit material. It is sufficient if an originating notice of motion and a supporting affidavit are filed.[20] While it may be sufficient to file an originating notice of motion and supporting affidavit to commence s. 97 proceedings, it would appear that an application under s. 97 is in the

[17] *MacCallum* v. *MacCallum* (Ont. H.C.) 12 November 1975, 7120/74 *per* Pennell J.

[18] *Ont. B.C.A.*, R.S.O. 1980, c. 54, s. 97(3). See also *Saarimaki* v. *Unsworth* (Ont. C.A.) 30 March 1978, 692/76 *per* Dubin, Lacourcière and Zuber JJ.A.

[19] Bill 6, s. 244(2).

[19a] See *Re Goldhar and Québec Manitou Mines Ltd* (1976) 9 O.R. (2d) 740-6 (Div. Ct) *per* Reid J.

[20] *Re Loeb and Provigo Inc.* (1978) 20 O.R. (2d) 497 (H.C.).

nature of an interlocutory proceeding rather than an originating application. Accordingly, it is not necessary that the affidavit be based on personal knowledge as is generally required in originating applications.[21] In *Armstrong* v. *Gardner*[22] an application for leave to commence a derivative action was made by a minority shareholder. The affidavit material of the applicant was based upon information and belief. Counsel for the respondents contended that the application was in the nature of an originating motion and that the Court should therefore not act upon an affidavit based upon information and belief. Cory J. (as he then was) realized the restricted access that minority shareholders have to corporate information. His Lordship stated:

> An application to bring an action such as this must in a great many situations be dependent on information and belief of others that has been related to the deponent. Almost invariably minority shareholders will be in such a disadvantageous position that they will not be able to obtain firsthand evidence and information upon which to found their motion. To deny an application on that ground would, in my opinion, fly in the face of both the provisions and intent of the *Business Corporations Act.*
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> It may be that this application ought not to be considered an originating motion. By analogy it most closely resembles an application under the former Rules of Practice for leave to commence an action out of the jurisdiction. The affidavits used on such applications were also of necessity often based on information and belief but were accepted, for such applications were not considered to be originating motions. In my opinion, this is not an originating motion. It is in nature an interlocutory application brought pursuant to the provisions of the *Business Corporations Act* and ought not to be refused solely because the affidavit in support is based in part upon information and belief.[23]

Where the plaintiff does not have leave to commence a derivative action, the facts set out in the statement of claim must only give rise to a personal cause of action. If the cause of action is derivative or if derivative claims are intermingled with personal claims then leave must be obtained under s. 97.

Where personal claims are interwoven with derivative claims and leave was not obtained before the commencement of the action, the court may either strike out the writ of summons or merely strike out the endorsement on the writ with leave to amend. It appears that the court will not do the former if a limitation period has expired since to do so would be to deny the action. In *Goldex Mines Ltd* v. *Revill* the Court of Appeal, faced with an endorsement that contained inextricably interwoven derivative and personal claims, stated:

> We considered whether it would be appropriate merely to strike out the endorsement on the writ, with leave to amend, rather than strike out the writ itself, as the Divisional Court did. We have decided against doing so, for two reasons. No limitation period is

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[21] *Rules of Practice and Procedure,* R.R.O. 1970, Reg. 545, Rule 292.
[22] (1978) 20 O.R. (2d) 648 (H.C.).
[23] *Ibid.*, 651-2.

> involved, and a new writ can be issued. In addition, the plaintiff may decide to apply for leave under s. 99 [now s. 97], and if it obtains leave, it can add to the derivative claims as it sees fit (subject, of course, to the Rules).[24]

The Court makes it clear that a derivative action may be joined with a personal action once leave is obtained if the rules respecting joinder have been complied with.[25] It would therefore seem that if there is any uncertainty about the cause of action being derivative in nature, leave of the court should be obtained.

A shareholder, who is attempting to sue on behalf of a corporation, must bring the action in a representative capacity for himself and all the other shareholders of the corporation. This was required at common law and is adopted by s. 97(1) of the *Act*. Shareholders who are alleged wrongdoers will be named as the defendants.[26] The purpose of this requirement is to ensure that all the other shareholders will be bound by a judgment in the action, thus avoiding a multiplicity of suits. Notwithstanding that the plaintiff shareholder purports to bring the derivative action in a representative capacity on behalf of himself and all the other shareholders, save the alleged wrongdoers, the corporation remains at all times both the injured party and the true plaintiff. Where the plaintiff shareholder is the only shareholder apart from the alleged wrongdoer, he is not precluded from maintaining a derivative action even though he cannot purport to sue on behalf of the other shareholder.[27]

The corporation must be added as a nominal defendant to the derivative action. This allows judgment to be given in the corporation's favour and renders any decision in the case *res judicata* as concerns it.[28]

The proposed Act borrows the concept of "complainant" from the *Canada Business Corporations Act*.[29] This concept is a more expansive genus than "shareholder" and potentially encompasses anyone with an interest in the affairs of the corporation. It includes past and present registered holders or beneficial owners of shares or debt obligation of the corporation or any of its affiliates and present and former directors and officers of the corporation or its affiliates. The concept goes even further to include any other person who, in the discretion of the court, is a proper person to make on application for leave. Unfortunately, the proposed Act does not indicate the circumstances in which such a person will be considered

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[24] *Supra*, note 10, 226. See also *Winchell* v. *Del Zotto* (1976) 1 C.P.C. 338 (Ont. H.C.).

[25] *Rules of Practice and Procedure*, R.R.O. 1970, Reg. 545, Rules 69 and 73.

[26] *Goldex Mines*, *supra*, note 10, 221; see also *Feld* v. *Glick* (1975) 8 O.R. (2d) 7 (H.C.).

[27] *Feld* v. *Glick*, *ibid.*, 13.

[28] L. Gower, *The Principles of Modern Company Law*, 4th ed. (1979), 651; see also Beck, *supra*, note 1, 562.

[29] S.C. 1974-5-6, c. 33, s. 231.

a proper person to apply for leave and there does not appear to be any case law under the federal provision that can assist in this regard.

The availability of the derivative action to "complainants" makes it possible for virtually any person to initiate a derivative suit. It is, however, difficult to understand why security holders, other than shareholders, were included in the definition of "complainant" when such creditors would, presumably, be adequately protected by their own private security agreements. The extension of status to directors and officers would serve to better protect the rights of the corporation and the interests of minority shareholders since directors and officers are generally, because of their access to corporate information, better able to identify improprieties involving the corporation.[30]

Unlike s. 97, the proposed Act treats the corporation and its affiliates as one unit for the purposes of the derivative action. This is a positive step in the recognition of the realities of modern corporate organization. With the increasing emphasis in the business world on takeovers and conglomerate acquisitions, a shareholder who finds himself in a corporate hierarchy immediately acquires a vested interest in the well-being of the other subsidiary companies. Bill 6 recognizes this and permits a "double derivative" action. By treating the immediate corporation and all subsidiary corporations as one, it confers upon the complainant the right to initiate a derivative action in the name of the subsidiary notwithstanding that he does not own securities of the subsidiary. The proposed Act provides that a corporation is a subsidiary of another corporation only if

> (a) it is controlled by,
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> (i) that other corporation, or
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> (ii) that other corporation and one or more corporations, each of which is controlled by that corporation, or
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> (iii) two or more corporations, each of which is controlled by that other corporation; or
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> (b) it is a subsidiary of a corporation that is that other's subsidiary.[30a]

However, the control required is essentially *de jure* control. Voting securities of the controlled corporation carrying more than 50 per cent of the votes for the election of the directors must be held by or for the benefit of the controlling corporation. In addition, the votes carried by such securities must be sufficient to elect a majority of the board of directors. This restriction ignores the prevalence of *de facto* control in many widely held corporations by holding companies. Corporations that find themselves

[30] See F. Iacobucci, M. Pilkington & J. Prichard, *Canadian Business Corporations: An Analysis of Recent Legislative Developments* (1977), 188-91.

[30a] Bill 6, s. 1(2).

controlled by a minority shareholder may escape the definition of "subsidiary" in Bill 6. However, it would seem that a shareholder of such a corporation could be held by the court to be "a proper person", within the definition of "complainant", to make an application for leave under s. 244.

If leave is granted under s. 244 of the proposed Act, the complainant is entitled to sue in the name of the corporation rather than naming himself as the nominal plaintiff and joining the corporation as a nominal defendant. The proposed Act permits the corporation to be the nominal plaintiff notwithstanding that the directors will not authorize the suit. This obviates the necessity of requiring the applicant to bring the derivative action in a representative form since if judgment is given, the matter will be *res judicata.*

The proposed Act not only permits the commencement of a derivative action but it also allows the complainant to intervene in an action to which the corporation or its subsidiaries are a party for the purpose of prosecuting, defending or discontinuing the action on behalf of such corporation. This is a further step in the direction of the protection of the interests of minority shareholders. It is in the nature of a prophylactic remedy in that it may ultimately prevent the occurrence of a wrong to the corporation. The situation may arise where it is not in the personal interests of the directors of a corporation to diligently defend an action against the corporation.[31] In such circumstances, a shareholder could not, under s. 97, apply to intervene and defend the action on behalf of the corporation. The shareholder would have to wait until the directors had breached their duty to the corporation by failing to act in good faith and in the best interest of the corporation and then apply for leave under s. 97 to commence a derivative action to redress the injury sustained by the corporation. Under the proposed Act, the complainant is permitted to apply for leave to intervene in the action for the purposes of defending the action on behalf of the corporation provided that he complies with the statutory procedural requirements. These are the same requirements that must be complied with in order to obtain leave to commence a derivative action under Bill 6.

1. Probability of Success

Both s. 97 of the *Act* and s. 244 of Bill 6 do not *prima facie* require that the intended action have any probability of success. However, the courts appear to have adopted the view that leave will not be granted if the proposed action is frivolous or vexatious or is bound to be unsuccessful. It is

[31] For example, in an action against a corporation on a debt where the loan was personally guaranteed by the directors, if the corporation had a valid defence against the enforcement of the loan agreement, the directors may prefer to spread the liability through the corporation by not advancing the available corporate defence, thereby protecting themselves from liability under their guarantee.

important to note that since an application under s. 97 is in the nature of an interlocutory proceeding, the court will not, at that time, try the case on its merits in order to determine the probability of success of the action. The court will weigh the affidavit material filed on the application to determine whether it shows that the intended action is without merit or is frivolous or vexatious.

In *Re Marc-Jay Investments Inc. and Levy* application was made under s. 99 [now s. 97] for leave to commence a derivative action. O'Leary J. stated that with respect to the application:

> It is not my function to decide whether such contemplated action will succeed at trial, but simply to decide whether there is *prima facie* merit to it.
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> ...
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> It is obvious that a Judge hearing an application for leave to commence an action, cannot try the action. I believe it is my function to deny the application if it appears that the intended action is frivolous or vexatious or is bound to be unsuccessful. Where the applicant is acting in good faith and otherwise has the status to commence the action, and where the intended action does not appear frivolous or vexatious and could reasonably succeed; and where such action is in the interest of the shareholders, then leave to bring the action should be given.
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> ...
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> I agree that I have to weigh [the affidavit material filed in support of the application] to determine whether it shows that the intended action is without merit or is frivolous or vexatious.... I believe, however, that is the extent to which I am entitled to weigh the evidence. I am not to deny leave to bring an action simply because on a weighing of the evidence I should decide it is unlikely that the action will be successful.[32]

It may be argued that the applicant will be required to show that the intended action could "reasonably" succeed in order to be granted leave. This requirement may be extracted from the words of O'Leary J.[33] But such a requirement would appear to contradict the main thrust of His Lordship's reasons for judgment which suggests that *prima facie* merit is sufficient. It seems apparent that O'Leary J. did not intend to require the applicant to show a reasonable chance of success in the contemplated action in order to obtain leave. Such a requirement may be particularly onerous and would ultimately result in an assessment of the merits of the action at an interlocutory stage of the proceedings. Reid J. in *Geist* v. *Nazaret Construction Company Ltd* [34] seemed to be of the view that once the intended action is determined not to be frivolous or vexatious, it becomes unnecessary for the court to decide whether that action will be or even may be successful. If the intended action cannot be properly described as frivolous or vexatious, in which category His Lordship includes those actions that are apparently bound to be unsuccessful, it is not up to the court, at that time, to weigh the question of whether the action may succeed if the prescribed conditions of

[32] (1974) 5 O.R. (2d) 235, 236-7 (H.C.).

[33] See *Armstrong* v. *Gardner*, *supra*, note 22, 653 *per* Cory J.

[34] (Ont. Div. Ct) 9 July 1980, 717/79 *per* Reid, Cory and J. Holland JJ.

s. 97 have been fulfilled. This is a sensible approach. The judge should not be entitled to weigh the evidence to determine whether the action could reasonably succeed. Such a requirement would unduly restrict the development of the derivative suit. Only established causes of action which had a proven chance of success would be granted leave. It may be argued that the absence of a requirement of a probability of success in the intended action will encourage strike suits and harassing shareholder litigation. While this may have been a problem in the United States, the absence of a contingency fee system in Ontario and the prospect of the losing plaintiff being liable for costs are both effective disincentives to frivolous litigation. In addition, the procedural requirements for leave to be granted assist in maintaining the integrity of the statutory derivative action.

2. Novelty of Cause of Action

The fact that a given cause of action is unknown in Ontario should not *per se* be sufficient ground for a refusal to grant leave to commence a derivative action. In *Farnham* v. *Fingold*[35] the claims made by the plaintiff were completely novel in Ontario. Their success depended on the trial Court applying or extending the principle followed in the American cases of *Perlman* v. *Feldmann*[36] and *Brown* v. *Halbert*[37] or on the Court holding that a breach of the provisions of Part IX of *The Securities Act*[38] constitutes an actionable civil wrong. Jessup J.A., speaking for the Court, adopted the decision of Morand J. in the High Court[39] wherein Morand J. expressed the view that difficult questions of law raised by the novelty of the plaintiff's claims should not be determined in interlocutory proceedings: "Where the matters involved turn on an interpretation and application of a statute and where there are important questions of fact to be determined as well, a Court should not strike the pleadings at such an early stage. The fact of novelty does not alter this ...." Cory J., in *Armstrong* v. *Gardner*,[40] was also of the opinion that the fact that a cause of action is unknown in the Province of Ontario ought not in itself constitute a ground for a refusal to grant leave.

3. Onus of Proof

The onus is on the applicant under s. 97 to bring before the court more than mere suspicions to warrant the granting of leave. In *Re Loeb and Provigo Inc.*[41] a shareholder applied for leave to commence and maintain a derivative action to seek an injunction restraining the corporation from

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[35] *Supra*, note 6.
[36] 219 F. 2d 173 (Conn. C.A. 1955), *cert. denied* 349 U.S. 952 (1954).
[37] 76 Cal. Rptr 781 (1st Dist. Ct App. 1969).
[38] R.S.O. 1970, c. 426.
[39] [1972] 3 O.R. 688, 698.
[40] *Supra*, note 22, 653.
[41] *Supra*, note 20.

using its controlling interest to consolidate its operation with another corporation and divert present or future business to the detriment of the first corporation. Steele J. refused to grant leave on the basis that there was insufficient material before the Court to justify granting leave and that the applicant had failed to satisfy the Court that the intended action was in the interests of the company or its shareholders. His Lordship did not indicate the materials that the applicant had relied on in support of his application. However, His Lordship was of the opinion that there was no evidence or material before the Court to indicate any impropriety on the part of the directors. Steele J. referred to the burden on the applicant: "There is an onus on an applicant to bring before the court more than mere suspicion to warrant the granting of leave."[42]

It is not clear how much evidence is required to support an application for leave. The supporting affidavit should at least indicate that there has been some improper conduct on the part of the directors. The applicant is not required to prove his case on the application. He must, however, show that the intended action is not completely without merit.

B. *Other Requirements*

A shareholder cannot obtain leave to commence a derivative action unless he has satisfied the court of the following:

(i) he was a shareholder of the corporation at the time of the transaction or other event giving rise to the cause of action;[43]

(ii) he has made reasonable efforts to cause the corporation to commence or prosecute diligently the action on its own behalf;[44]

(iii) he is acting in good faith and it is *prima facie* in the interests of the corporation or its shareholders that the action be commenced.[45]

Notwithstanding that the shareholder is able to satisfy the court as to all the above, there appears to be a discretion in the court whether to grant leave.

1. Contemporaneous Ownership

Section 97(3)(a) of the *Act* requires the applicant to have been a shareholder of the corporation at the time that the wrong occurred to the corporation. It is a contemporaneous ownership requirement in that the applicant must at the time of the application for leave still be a shareholder. Thus, a person is unable to buy litigation. This requirement has been

[42] *Ibid.*, 500.
[43] *Ont. B.C.A.*, R.S.O. 1980, c. 54, s. 97(3)(a).
[44] Section 97(3)(b).
[45] Section 97(3)(c).

criticized as not being appropriate in Canadian company law.[46] There is no apparent need for the applicant to have held shares in the company continuously since the wrong was committed. It appears to be sufficient that he owned shares at two crucial moments — at the time the wrong complained of occurred and at the time he applies under s. 97 for leave to commence a derivative action.

The proposed Act eliminates the contemporaneous ownership requirement. The complainant concept, as discussed previously, has discarded the requirements that the applicant even be a shareholder. Former holders of shares and debt obligations of the corporation have standing under s. 244 to apply for leave to commence a derivative action. There is, in fact, no requirement that the complainant, if he is a "security" holder,[47] have held securities in the corporation at the time that the wrong occurred. It is sufficient if he presently holds shares or debt of the corporation or did at any time in the past hold such securities. It may seem that a former security holder should have some connection with the wrong done to the corporation as, for example, where he held shares at the time that the injury occurred and subsequently sold the shares at a lower price than could be obtained in the absence of the injury. However, the issue of ownership of securities of the corporation is irrelevant to the derivative suit. The questions for determination should be: first, whether the corporation has been wrongly injured and second, who is the most appropriate person to enforce the corporation's right of action. Whether the complainant is or was a security holder does not alter the fact that the corporation has sustained an injury for which, unless otherwise remedied, redress must be obtained through a derivative action.

The applicant need not be the registered owner of the shares of the corporation provided that he is the beneficial owner of such shares. The beneficial owner of a share has the status to bring an action under s. 97 even though he is not the registered owner of the share.[48] This is adopted by the proposed Act which defines "complainant" to include the beneficial owner of a security of the corporation.

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[46] See Beck, *supra*, note 8, 205-6. Professor Beck contends that the requirement was taken from American legislation where it served the valid purpose of preventing the collusive practice of the resident of one state transferring his shares to the resident of another state to manufacture diversity of federal jurisdiction in order that the matter may be litigated in a federal court. The requirement also served to prevent strike suits and purchased litigation. Beck argues that the first reason has no application in Canada. The second reason has little, if any, application in the absence of the contingency fee in Canada and the presence of the potential liability for costs of a litigant and the procedural requirements under s. 97 of the *Ont. B.C.A.*

[47] Bill 6, s. 1(1)(38) defines "security" as a share or debt obligation of the corporation.

[48] *Supra*, note 32, 236 *per* O'Leary J.

2. Demand

Before seeking leave under s. 97, the shareholder must first make reasonable efforts to cause the corporation to commence or prosecute diligently the action on its own behalf.[49] This requirement gives the corporation, or for all intents and purposes the board of directors, the first opportunity to right any wrongs that the corporation may have suffered. However, where the wrongdoers are in control of the company, any attempt by a minority shareholder to cause the wrongdoers to take action against themselves must necessarily be an exercise in futility.

The courts appear to be adopting a liberal approach to the interpretation of s. 97(3)(b) of the *Act*. In *Armstrong* v. *Gardner*[50] the applicant shareholder had sent two letters to the president of the company, who was also a solicitor, suggesting that action be taken. It was argued by counsel for the respondent in an application under s. 99 [s. 97], that the applicant had not complied with the requirements of s. 99(3)(b) [s. 97(3)(b)] in that no reasonable efforts were made to cause the corporation to commence or prosecute diligently the proposed action. Cory J. refused to apply a restrictive construction to s. 99(3)(b). His Lordship stated:

> It must be remembered that although the letters requesting action were not framed with great particularity as to the cause of action to be brought, they were directed to a solicitor. I think that there was a sufficient demand made to bring an appropriate action by the two letters sent on behalf of the minority shareholders to satisfy the provisions of s. 99(3)(b) [s. 97(3)(b)]. I do not think that this section of the *Business Corporations Act* ought to be construed in an unduly technical or restricted manner.[51]

Unfortunately, this case may prove to be of limited value because the letters suggesting action were directed to an officer of the corporation who was also a lawyer. Cory J. was sufficiently impressed with this fact to direct specific attention to it in his judgment. It may well be argued that if that person were not a lawyer, the judge would have ruled that the applicant had not complied with s. 97(3)(b) and accordingly, would have dismissed the application. Notwithstanding this possible argument, some solace can be taken by the clear statement of His Lordship that s. 97(3)(b) is not to be construed in an unduly technical or restricted manner.

Southey J. in *Solmon* v. *Elkind*[52] recognized the futility of a perfunctory demand where the wrongdoers are in control of the corporation. Unfortunately, while His Lordship in that case realized that any efforts to cause the corporation to commence an action against the alleged wrongdoers was doomed to failure, he did not indicate whether a failure to make such reasonable effort would be fatal to the application under s. 97. It

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[49] *Ont. B.C.A.*, R.S.O. 1980, c. 54, s. 97(3)(b).
[50] *Supra*, note 22.
[51] *Ibid.*, 652.
[52] (1976) 3 C.P.C. 31 (Ont. H.C.).

became unnecessary to determine this point since His Lordship was of the opinion that reasonable efforts had been made by the shareholder. Where the wrongdoers are in control of the corporation, it should only be necessary for the applicant to show such control and that any attempt to cause the corporation to commence the action would be futile. There would seem to be no valid purpose served by the reasonable efforts requirement in such circumstances. Rather, s. 97(3)(b) may enable the wrongdoers to put the applicant shareholder to additional unnecessary expense and delay the ultimate commencement of the action. The proposed Act has eliminated the demand requirement. Instead, the complainant need only satisfy the court that the directors of the corporation or its subsidiaries will not bring, diligently prosecute or defend or discontinue the action.

Section 97 is silent on the question of ratification. The possibility of a ratification of the wrong by the majority shareholders has caused some concern.[53] While it is possible that a strict reading of s. 97 could result in the denial of leave on the basis that the wrong was capable of being ratified by the majority, it was clearly the intention of the Lawrence Committee to avoid the strictures of the rule in *Foss* v. *Harbottle* and provide an effective procedure whereby corporate wrongs could be put right.[54] Section 247(1) of the proposed Act states, in no uncertain terms, that the fact that an alleged breach of a right or duty owed to the corporation has been or may be approved by the shareholders cannot by itself determine either an application for leave or a statutory derivative action. However, evidence of the approval by the shareholders is a factor to be considered by the court when hearing the application or the action.

3. Bona Fides

The Lawrence Committee recommended that the shareholder be required to establish to the court, before leave will be granted to commence a derivative action, that he is acting *bona fide* and that it is *prima facie* in the interests of the corporation or its shareholders that the action be brought.[55] This was, undoubtedly, intended to prevent the bringing of shareholder derivative actions which are commenced with no intention of benefitting the corporation on whose behalf the suit is brought but are instead commenced for the sole purpose of provoking secret settlements or causing harassing litigation. In addition, there may be circumstances where, notwithstanding that a wrong has been done to the company, the prosecution of the action may be disadvantageous to the company and its shareholders because, for instance, of the potential damage to the company's reputation or because the

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[53] See Beck, *supra*, note 8, 196-202, and Buckley, *Ratification and the Derivative Action under the Ontario Business Corporations Act* (1976) 22 McGill L.J. 167.

[54] See the *Lawrence Report*, *supra*, note 5, 62-3.

[55] *Ibid.*, 63.

prospect of recovery would not justify the expense of litigation.[56] In an effort to avoid these undesirable results, s. 97(3)(c) of the *Act* requires the shareholder applicant to satisfy the court that he is acting in good faith and that it is *prima facie* in the interests of the corporation or its shareholders that the action be commenced.

There is little guidance as to what will be required to satisfy the court of the *bona fides* of the applicant. The motive of the applicant would, of course, be relevant. However, it is uncertain whether a purely selfish motivation would be sufficient to deny leave. Each shareholder should be able, and indeed expected, to move in his best interests. In a derivative action, the suit is brought on behalf of the corporation in a representative capacity. Therefore, regardless of the motivation of the applicant, the action should, in theory, be in the interests of the corporation or its shareholders. Section 97(3)(e) does not, or at least should not, require the applicant to be an altruist. It is unreasonable not to expect the applicant to be motivated in his own interest. In any event, even though the applicant may be actuated by self-interest, since the cause of action is derivative in nature, any suit to redress the wrong would generally be in the interest of all the other shareholders. The *bona fides* requirement should be construed with regard to its purpose: it was designed to prevent strike suits. Accordingly, the applicant should be required to satisfy the court that the action is not intended to be brought solely for the purpose of provoking secret settlement without any intention of benefitting the corporation or the other shareholders.

The good faith requirement in s. 97(3)(c) is linked with the requirement that the action be *prima facie* in the interest of the corporation or its shareholders. While they appear to be two separate requirements, it is submitted that they appear in the same subparagraph for more than aesthetic reasons; they support each other. If the action is determined to be in the interests of the corporation or its shareholders, then it will buttress the applicant's contention that he is acting in good faith. Conversely, if the action is not in the interest of the corporation or its shareholders, then the applicant's good faith may be suspect. Some support for this proposition may be gleaned from the judgment of Southey J. in *Solmon* v. *Elkind*.[57] In that case, the applicant, his father and three individual defendants were shareholders in a closely-held private corporation. A dispute arose between

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[56] See Buckley, *supra*, note 53, 170: "A trifling breach [by the director] of the duty of care, which causes only nominal loss, should not be the subject of the elaborate machinery of section 99 [now s. 97]". See also Leavell, *The Shareholders as Judges of Alleged Wrongs by Directors* (1961) 35 Tul. L. Rev. 331, 348: "A suit against a corporations's director ... even if successful, can sometimes ... do the corporation more harm than good: his services may be lost; the standing of the corporation in financial circles may be adversely affected; public relations may suffer; the value of the shares may be adversely affected in the market; prosecution of the action may be expensive to the corporation".

[57] *Supra*, note 52.

the father and the three defendants as to the management of the company. The father commenced a personal action against the three defendants alleging wrongful conduct. The father then became concerned that certain of the claims advanced in that action were derivative in nature. Instead of the father applying for leave to commence a derivative action, his son, the applicant, did so. The affidavit of the applicant in support of the application was largely limited to information that was derived from an examination of the corporate records. Counsel for the respondent argued that leave should be refused since the applicant was really bringing the action as a nominee of the father. Counsel contended that if the father had applied for leave, he would have been subject to a searching cross-examination on his affidavit in respect of the matters alleged in both statements of claim. Counsel's position was that an application under s. 97 should be refused unless the material supporting it complied with the best evidence rule and the best evidence in this case was an affidavit from the father.

While it may be said that counsel for the respondent was merely taking a tactical position based on non-compliance with the technicalities, it is submitted that what counsel was essentially asserting was that the applicant was not acting in good faith. Assuming that the claims were derivative, the action was intended to be brought in a manner which would avoid a searching cross-examination of the most knowledgeable shareholder. This motivation, it is suggested, does not affect the applicant's good faith. It should be sufficient to satisfy the court that the action is not intended to be brought for extortionate purposes. If the action would benefit the corporation or its shareholders then this may be accepted as evidence of the applicant's good faith.

Southey J. stated:

> The third requirement is that the proposed plaintiff be acting in good faith and that it is *prima facie* in the interest of the corporation or its shareholders that the action be commenced. I am satisfied from the material that there is very real and genuine dispute between these parties, which, unless settled, must be determined eventually in the courts and that the claims that are advanced in the proposed statement of claim are properly the subject of a derivative action .... [I]f the proposed action is successful it will have turned out to be in the interest of the corporation.
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> Accordingly, I am satisfied that Melvyn Solmon [the applicant] is acting in good faith even though he may have brought the action instead of his father in order that the defendants would not have the opportunity to cross-examine the father before the action was commenced. In my judgment, the Solmons were under no obligation to bring the action in such a way that permitted such cross-examination when it was possible for it to be brought by a shareholder who would be a less fruitful subject of cross-examination.[58]

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[58] *Ibid.*, 34.

In *Anderson* v. *Anderson*,[59] O'Driscoll J. considered the issues of *bona fides* and interest of the corporation or shareholders. In that case, an application for leave to commence a derivative action was brought by the daughter of the proposed defendant. The evidence revealed that the respondent father owned 25 per cent of the corporation. He had given the remaining 75 per cent to the applicant, his son and his daughter-in-law. The respondent was president of the corporation and retained a casting vote pursuant to the by-laws of the company. The applicant alleged essentially that the respondent had mismanaged the company. O'Driscoll J., in a very terse judgment, dismissed the application on the basis that the application was not in good faith nor was it in the best interest of the corporation or the shareholders that the action be commenced. His Lordship also held that in any case, he would refuse the order under the residual discretion conferred upon him by the closing words of s. 97(3).

O'Driscoll J. appears to base his decision that s. 97(3)(c) was not complied with on a number of facts. First, two large independent corporations — RoyNat (which held a five per cent beneficial interest in the company) and the Royal Bank (which held the balance of the shares by way of pledge) — both had sufficient confidence in the respondent to give him all their proxies and the Royal Bank had during the last year loaned the company in excess of one million dollars. Second, the applicant was never involved in the daily operation of the company. Finally, whatever material assets the applicant possessed was a result of gifting by the respondent.

His Lordship did not specifically indicate why he was of the view that the application was not in good faith. It would seem that His Lordship was influenced by the evidence that the company, under the respondent's management, had enjoyed a dramatic increase in net worth in the last few years. This was evidence of anything but mismanagement. In addition, the respondent had given the applicant all her shares and had for some time supported her financially.[60] It must have seemed that the applicant was actuated by ill will to the respondent notwithstanding the respondent's apparent munificence. The fact that the corporation had prospered under the control of the respondent was an indication that it was not in the best interest of the company or its shareholders that an action be commenced. While it may not have been expressed by O'Driscoll J. in his reasons for judgment, this was likely viewed as a case where a derivative action was sought not to benefit the corporation but to coerce the respondent into a settlement.

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[59] (Ont. H.C.) 15 May 1978, 6529/77.

[60] Counsel for the respondent in *Anderson* v. *Anderson*, *ibid.*, described the 32 year-old applicant as a "spoiled brat" who had conducted herself as a "professional student" for several years until the respondent refused to continue to pay the expenses.

The touchstone of *bona fides* should be whether the interests of the shareholders or the corporation are being served. Notwithstanding that the applicant may be actuated by malice, ill will or other personal motives towards the person in control of the company, if the action can be said to be in the interest of the corporation or its shareholders, then the fact that the persons on whose behalf the action will be brought will benefit should be evidence of the applicant's good faith under s. 97(3)(c).[61] Where the beneficiaries of the derivative suit will be the corporation or its shareholders, as is intended by the derivative action, then the objective of the legislation has been fulfilled.

The proposed Act maintains the requirement of good faith.[62] However, this requirement is no longer linked with the requirement that the action be in the best interest of the corporation or its shareholders. It is uncertain whether this suggests that the issue of *bona fides* is to be determined solely by an examination of the motives of the applicant or whether it is in recognition of the fact that a derivative action by definition must necessarily benefit the corporation on whose behalf it is brought. I would submit that it is more likely the latter than the former and that the preceding analysis should still be followed. It will no longer be necessary that the applicant satisfy the court that it is *prima facie* in the interest of the corporation *or* its shareholders that the action be commenced. Section 244(2)(c) of the proposed Act provides: "It *appears to be* in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued."[63] The deletion of the words "*prima facie*" in favour of the words "appears to be" seem to suggest that some lesser amount of evidence is required to satisfy the court that the action is in the interests of the corporation. The deletion of the interests of the shareholders in that paragraph does not effect any substantive change since anything in the interests of the corporation should invariably be in the interests of the shareholders.

4. Residual Discretion

Section 97(3) of the *Act* appears to confer a residual discretion upon the judge in an application for leave to commence a derivative action. Notwithstanding that the applicant has satisfied the court as to paragraphs (a), (b) and (c) of s. 97(3), the court may refuse to grant leave. The closing words of s. 97(3) are permissive: "the court *may* make the order".[64] O'Driscoll J. in *Anderson* v. *Anderson* expressly acknowledged the existence of such residual discretion:

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[61] See also *Rainey* v. *Norman* (Ont. H.C.) 6 May 1976, 33/76 *per* Cory J., where good faith appears to be determined by the validity of the dispute and the benefit to the corporation or its shareholders.

[62] Bill 6, s. 244(2)(b).

[63] [Emphasis added.]

[64] [Emphasis added.]

> [I]f I am wrong in that finding and if the evidence before me today does meet that test [under s. 97(3)], I am independently and separately of the view that I should refuse an order under the residual discretion which I appear to have in the closing words of subs. (3) of s. 99 [s. 97(3)].[65]

The rationale for this apparent residual discretion is less than clear given the procedural conditions precedent to the institution of a derivative action. If an applicant is able to convince the court that it has satisfied the procedural requirements of s. 97, there would seem to be no good reason for giving the court the authority to deny leave in those circumstances. Under what circumstances will leave be denied notwithstanding that s. 97 has been complied with? This question is left unresolved by s. 97 and as such, creates an intangible obstacle to lawyers advising minority shareholders in a derivative suit. If this residual discretion of the court does exist, as is suggested by O'Driscoll J., then the court indeed becomes the final arbiter of the issue of the commencement of a derivative action. While it may be viewed as an additional precaution to prevent the abuse of the derivative suit, it would necessarily imply a lack of confidence in the ability of the procedural requirements of s. 97 to maintain the integrity of derivative actions.

The language of s. 244 of the proposed Act is such that there does not appear to be any discretion in the court to deny leave to an applicant where the procedural requirements of the section have been complied with.

C. *Discontinuance and Settlement*

In an effort to avoid secret settlements, the Lawrence Committee recommended that court approval be required in order to discontinue, compromise or settle any derivative action.[66] Section 97(6) of the *Act* provides that a derivative action cannot be discontinued, settled or dismissed for want of prosecution without the approval of the court. It further provides that if the court determines that the interests of the shareholders or any class of shareholders may be substantially affected by such discontinuance, settlement or dismissal, it may direct that notice be given to the shareholders whose interests will be so affected.

A derivative action must be commenced before court approval is required for settlement. The question is, at what point is the action commenced? If the writ of summons marks the commencement of the action, a shareholder who has applied for and has received leave to commence a derivative action, may at any time up to the moment that the writ is issued, settle the matter with the alleged wrongdoer without the need to obtain court approval. It may be that the obtaining of leave rather than the issuance of the writ will be the device used to provoke a secret settlement. However, in light of the procedural requirements to the granting of leave and

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[65] *Supra*, note 59. See also Getz, *Corporation Law* (1971) 5 Ottawa L. Rev. 154, 156.
[66] *Lawrence Report*, *supra*, note 5, 67.

the apparent residual discretion of the court, it is unlikely that a shareholder will be able to obtain leave under s. 97 in order to abuse it. In *Abraham* v. *Prosoccer Ltd*,[67] Reid J. suggests that a derivative action is commenced once leave is granted. Therefore, once a shareholder has received leave, he cannot thereafter discontinue or settle the action without the approval of the court. This would certainly discourage the use of leave applications as a lever to promote secret settlements. However, the requirement of court approval for the settlement of a derivative action, where leave has been obtained but no writ has yet been issued, may prove to be onerous in terms of the time and expense associated with reaching a court-approved settlement. Nonetheless, the view of Reid J. is preferred. Once leave is obtained, the applicant shareholder undertakes to act, not only on his own behalf, but also for the benefit of the other shareholders and the corporation on whose behalf he is suing. Accordingly, the shareholder who obtains leave should not be permitted to disregard his obligation to the other shareholders in attempting to settle the suit. Section 97(6) must protect, to some extent, the interests of the shareholders not before the court.

Similarly, Bill 6 requires that court approval be given for any stay, discontinuance, settlement or dismissal for want of prosecution of an application made or action brought or intervened in. This clarifies the issue that s. 97(6) leaves in doubt, namely, whether court approval is only required once the writ of summons has been issued. Section 247(2) of the proposed Act makes it clear that once an application for leave is made, the approval of the court is required for any settlement. This would seem to indicate that not only can the matter not be settled without court approval once leave is granted, but approval is also required to settle once the notice of motion is filed.

Where a discontinuance, settlement or dismissal of the action for want of prosecution may substantially affect the interest of the shareholders or any class of shareholders, the court has the discretion to require that notice be given to those parties. Section 247(2) of the proposed Act also allows the court to order that notice be given to any complainant whose interest, the court has determined, may be substantially affected by a stay, discontinuance, settlement or dismissal for want of prosecution. This notice provision will offer the other shareholders (on whose behalf the plaintiff is generally suing) some protection where the action is dismissed, since such a dismissal will be binding upon them.[68] In addition, where a settlement is being effected, the notice provision would promote shareholder disclosure and prevent secret profits. However, there is no provision in s. 97 for the

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[67] (1981) 31 O.R. (2d) 475 (H.C.).

[68] If a limitation period has not expired, the shareholder will be able to seek leave to commence his own derivative action. However, since the dismissal was court-approved in the first instance, it may well be unlikely that leave will be granted in the second instance.

distribution of any settlement funds to the other shareholders. Presumably, the court will require that they receive notice of the intended settlement in order that they may look after their own interests. Under Bill 6, the court may, where its approval is sought to stay, discontinue, settle or dismiss for want of prosecution an application made or action brought or intervened in, grant such approval upon such terms as it thinks fit.[69] Accordingly, the court would be able to order a distribution of the settlement funds among the shareholders of the corporation.

It is uncertain whether s. 97(6) of the *Act* would enable a shareholder, who was a stranger to the proceedings, to assume carriage of the derivative action and be substituted for the original plaintiff who has or is about to withdraw from the action. It would seem that one of the reasons for requiring the giving of notice under s. 97(6) is to enable a shareholder who is a stranger to the proceedings to become involved in the derivative suit. Since the purpose of requiring that a derivative action be brought in a representative capacity was to bind all the shareholders by the judgment and prevent a multiplicity of actions, it would seem logical that where the shareholder who has commenced the derivative action decides to discontinue the suit, any other interested shareholder should be able to substitute himself for the original plaintiff. This would obviate the necessity of having to make another application for leave and the duplication of costs in repeating the same procedural steps that the original plaintiff has already completed. In addition, if the second shareholder is required to start a new action, he may be at a disadvantage when he applies for leave in that there would likely be a presumption that since the first settlement was sanctioned by the court, the second action is either multiplicitous, harassing or illegitimate.[70] Under the proposed Act, since the discontinuance would have to be court approved, the court can impose such terms as it thinks fit. Therefore, the court would have the power to substitute one party in the place of another who is about to withdraw from the action.

Section 97(6) does not indicate when approval will be granted to discontinue or settle the action. It would seem obvious that the court should not approve discontinuance or settlement of the suit unless it is in the interest of the corporation or its shareholders to do so. The action should not be dismissed for want of prosecution without notice to the shareholders whose interests may be affected by the dismissal. Unreasonable delay in the prosecution of the derivative action by the original plaintiff ought not to

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[69] Bill 6, s. 247(2).

[70] See *Abraham* v. *Prosoccer Ltd*, *supra*, note 67, where leave to substitute a plaintiff in a class action and an intended derivative action was refused. Note that leave had not yet been obtained to commence the derivative action, therefore there could have been no prejudice to the second shareholder. In addition, the *bona fides* of the party seeking to be substituted was suspect.

prejudice the interests of the corporation or the other shareholders on whose behalf the action was commenced. Notice in such circumstances would enable an interested shareholder to assume carriage of the action.

The proposed Act also does not indicate when approval will be granted to stay, discontinue or settle the derivative action. Accordingly, the above discussion would still be of some relevance.

At common law, where a judgment is recovered in favour of the corporation, the damages recovered belong to the corporation and not to the minority shareholder who instituted the action.[71] While the plaintiff shareholder will see some appreciation in his shares reflecting the amount recovered from the wrongdoers, where the wrongdoers are the majority shareholders in control of the corporation, most of the damages recovered from them will revert to them as shareholders. Section 97 of the *Act* does nothing to change this. However, under s. 245 of Bill 6, the court can direct that any judgment recovered be paid, in whole or in part, directly to former and present security holders of the corporation or its subsidiaries instead of to the corporation or its subsidiaries. Presumably, the court will be able to direct payment to innocent past or present security holders to the exclusion of those who have engaged or acquiesced in misconduct.

Conclusion

The statutory derivative action has been in effect for just over ten years. Notwithstanding this fact, there is not an abundance of judicial authority on the subject. The focal point of the derivative action is now the courts, who have become the final arbiter of the question of whether a derivative action will be commenced. In view of the liberal approach taken by the courts to applications for leave, one would expect much future judicial development in the area of shareholder derivative actions.

The procedural requirements of s. 97 of the *Act*, while designated to prevent abuses of the system, are not so restrictive nor so strictly interpreted by the courts that they preclude the institution of derivative suits in all appropriate cases. The procedural requirements of s. 97(3) have been criticized as making the derivative action more expensive and time consuming than it was at common law.[72] While these criticisms may be valid, the statutory derivative action unquestionably provides a more effective means to right corporate wrongs than existed at common law. Section 97 has attempted to do away with the strictures spawned by *Foss* v. *Harbottle*. A minority shareholder seeking to assert a corporate right of action need only comply with the statutory conditions precedent to maintain a derivative action. In addition, the ability of the nominal plaintiff to apply

[71] Gower, *supra*, note 28, 651.

[72] See Zacks, *supra*, note 6, 194-6; Buckley, *supra*, note 53, 169.

to the court at any time while a derivative action is pending for an order for the payment by the corporation of reasonable interim legal costs would mitigate the financial burden attendant on derivative actions by providing interim financial assistance without the necessity of having to await the final disposition of the action.[73]

The proposed Act expands and develops the present statutory derivative action. It makes the action available to a wider class of persons rather than just to shareholders. A complainant is now entitled to defend an action as well as bring one in the name of and on behalf of the corporation. In addition, the possibility of the ratification of the wrong by the shareholders will not *per se* determine the application or action. If the procedural requirements work as they are designed to, s. 97 can serve as an effective procedure whereby a shareholder may commence and prosecute a derivative action, on behalf of the corporation and all the other shareholders, to enforce any rights, duties or obligations owed to the company.

Appendix

I. Section 97 of **The Ontario Business Corporations Act** provides:

97.(1) Subject to subsection (2), a shareholder of a corporation may maintain an action in a representative capacity for himself and all other shareholders of the corporation suing for and on behalf of the corporation to enforce any right, duty or obligation owed to the corporation under this Act or under any other statute or rule of law or equity that could be enforced by the corporation itself, or to obtain damages for any breach of any such right, duty or obligation.

(2) An action under subsection (1) shall not be commenced until the shareholder has obtained an order of the court permitting the shareholder to commence the action.

(3) A shareholder may, upon at least seven days notice to the corporation, apply to the court for an order referred to in subsection (2), and, if the court is satisfied that,

(a) the shareholder was a shareholder of the corporation at the time of the transaction or other event giving rise to the cause of action;

(b) the shareholder has made reasonable efforts to cause the corporation to commence or prosecute diligently the action on its own behalf; and

(c) the shareholder is acting in good faith and it is *prima facie* in the interests of the corporation or its shareholders that the action be commenced, the court may make the order upon such terms as the court thinks fit, except that the order shall not require the shareholder to give security for costs.

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[73] *Ont. B.C.A.*, R.S.O. 1980, c. 54, s. 97(4). However, the plaintiff is accountable to the corporation for such costs if the action is dismissed with costs on a final disposition at trial or on appeal. Section 247(4) of Bill 6 allows the applicant to apply for interim costs when he applies for leave.

(4) At any time or from time to time while an action commenced under this section is pending, the plaintiff may apply to the court for an order for the payment to the plaintiff by the corporation of reasonable interim costs, including solicitor's and counsel fees and disbursements, for which interim costs the plaintiff shall be accountable to the corporation if the action is dismissed with costs on final disposition at the trial or on appeal.

(5) An action commenced under this section shall be tried by the court and its judgment or order in the cause, unless the action is dismissed with costs, may include a provision that the reasonable costs of the action are payable to the plaintiff by the corporation or other defendants taxed as between a solicitor and his own client.

(6) An action commenced under this section shall not be discontinued, settled or dismissed for want of prosecution without the approval of the court and, if the court determines that the interests of the shareholders or any class thereof may be substantially affected by such discontinuance, settlement or dismissal, the court, in its discretion, may direct that notice in manner, form and content satisfactory to the court shall be given, at the expense of the corporation or any other party to the action as the court directs, to the shareholders or class thereof whose interests the court determines will be so affected.

II. The Derivative Action Provisions of Bill 6 provide:

243. In this Part,

(a) "action" means an action under this Act;

(b) "complainant" means,

(i) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,

(ii) a director or an officer or a former director or officer of a corporation or of any of its affiliates,

(iii) any other person who, in the discretion of the court, is a proper person to make an application under this Part. *New.*

244.(1) Subject to subsection (2), a complainant may apply to the court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate.

(2) No action may be brought and no intervention in an action may be made under subsection (1) unless the complainant has given fourteen days' notice to the directors of the corporation or its subsidiary of his intention to apply to the court under subsection (1) and the court is satisfied that,

(a) the directors of the corporation or its subsidiary will not bring, diligently prosecute or defend or discontinue the action;

(b) the complainant is acting in good faith; and

(c) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.

(3) Where a complainant on an *ex parte* application can establish to the satisfaction of the court that it is not expedient to give notice as required under subsection (2), the court may make such interim order as it thinks fit pending the complainant giving notice as required.

(4) Where a complainant on an application can establish to the satisfaction of the court that an interim order for relief should be made, the court may make such order as it thinks fit. R.S.O. 1980, c. 54, s. 97, *part, amended.*

245. In connection with an action brought or intervened in under section 244, the court may at any time make any order it thinks fit including, without limiting the generality of the foregoing,

(a) an order authorizing the complainant or any other person to control the conduct of the action;

(b) an order giving directions for the conduct of the action;

(c) an order directing that any amount adjudged payable by a defendant in the action shall be paid, in whole or in part, directly to former and present security holders of the corporation or its subsidiary instead of to the corporation or its subsidiary; and

(d) an order requiring the corporation or its subsidiary to pay reasonable legal fees and any other costs reasonably incurred by the complainant in connection with the action. R.S.O. 1980, c. 54, s. 97, *part, amended.*

... .

247.(1) An application made or an action brought or intervened in under this Part shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or duty owed to the corporation or its affiliate has been or may be approved by the shareholders of such body corporate, but evidence of approval by the shareholders may be taken into account by the court in making an order under section 205, 245 or 246. R.S.O. 1980, c. 54, s. 97, *part, amended.*

(2) An application made or an action brought or intervened in under this Part shall not be stayed, discontinued, settled or dismissed for want of prosecution without the approval of the court given upon such terms as the court thinks fit and, if the court determines that the interests of any complainant may be substantially affected by such stay, discontinuance, settlement or dismissal, the court may order any party to the application or action to give notice to the complainant.

(3) A complainant is not required to give security for costs in any application made or action brought or intervened in under this Part.

(4) In an application made or an action brought or intervened in under this Part, the court may at any time order the corporation or its affiliate to pay to the complainant interim costs, including reasonable legal fees and disbursements, for which interim costs the complainant may be held accountable to the corporation or its affiliate upon final disposition of the application or action. R.S.O. 1980, c. 54, s. 97, *part, amended.*