CORPORATE DIRECTORS' DISQUALIFICATION: THE NEW CANADIAN REGIME?

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An insolvent time in a corporation's life may compel directors to engage in reckless behaviour and wrongful conduct to hide the state of financial distress from creditors as the directors attempt to trade out of insolvency. Currently, Canadian legislation does little to protect from this type of situation. In this article, the author examines the different schemes in the United Kingdom, specifically directors' personal liability and the director disqualification scheme, and argues that the disqualification scheme has been successful for protecting creditors. The author then considers the Canadian provisions currently in place that allow for the removal of directors and concludes that the adoption of a disqualification scheme, especially under the federal insolvency power, should be seriously considered.

Une période d'insolvabilité dans la vie d'une entreprise peut obliger les administrateurs à faire preuve d'insouciance et à transgresser la loi pour cacher l'état du désastre financier des créanciers tout en tentant de sortir de l'insolvabilité. De nos jours, la loi canadienne n'offre que peu de protection contre ce genre de situation. Dans cet article, l'auteur examine les divers stratagèmes frauduleux qui existent au Royaume-Uni, tout particulièrement la responsabilité personnelle des administrateurs et la déchéance d'un administrateur, et fait valoir que la déchéance d'un administrateur a réussi à protéger les créanciers. L'auteur examine ensuite les dispositions canadiennes en vigueur maintenant qui permettent de retirer des administrateurs. Il conclut que l'adoption du stratagème de la déchéance d'un administrateur, surtout en vertu des pouvoirs fédéraux en matière d'insolvabilité, doivent être sérieusement envisagés.

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I. INTRODUCTION

An insolvent time in a corporation's life may compel directors to engage in reckless behaviour and wrongful conduct to hide the state of financial distress from the creditors as

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the directors attempt to trade out of insolvency. If the eventual outcome is bankruptcy, the pool of corporate assets that would be have been available for the general body of creditors can be considerably smaller if the directors dissipated it in an effort to trade out of insolvency. Canadian legislation is currently without much to protect from this type of situation, either at the outset of incorporation or towards the end of a corporation's life. At the outset, minimum capital requirements do not exist for a corporation before it can commence business in Canada and the Supreme Court of Canada recently limited directors' obligations to creditors in *Peoples Department Stores Inc. (Trustee of) v. Wise*[1] on the eve of a corporation's bankruptcy. The pre-*Peoples* position had slowly been moving toward a recognition that directors' fiduciary duties should take creditors' interests into account as the corporation approaches insolvency, a position similar to the statutory duty imposed in the United Kingdom under its "wrongful trading" provisions. However, that move was sharply halted with the *Peoples* decision, which determined that although directors' duties of care could encompass various constituents, their fiduciary duty is owed only to the corporation, and does not change in the period preceding bankruptcy.[2] In addition, Canadian legislation is currently without a personal liability scheme for insolvent trading by directors and suggestions to adopt one in the past have failed to materialize.[3]

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1 2004 SCC 68, [2004] 3 S.C.R 461[*Peoples*]. The Supreme Court of Canada recently released *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, 301 D.L.R. (4th) 303 [*BCE*], dealing with directors' duties, but in a different context. *BCE* dealt with directors' duties and the rights of creditors in a change of control transaction at a time when the corporation was solvent. The Court, confirming *Peoples*, restated that, in discharging their fiduciary duty, which is to the corporation, directors must consider the best interests of the corporation and may consider, *inter alia*, the interests of shareholders, creditors, employees, consumers, government, and the environment (at para. 40). Since the beneficiary of the directors' duty of care is the corporation, it is difficult to enforce, since "[t]he directors who control the corporation are unlikely to bring an action against themselves for breach of their own fiduciary duty" (at para. 41). Accordingly, there are special remedies available, including the oppression remedy, which "focuses on harm to the legal and equitable interests of stakeholders affected by oppressive acts of a corporation or its directors" (at para. 45). The oppression remedy is available to security holders, creditors, directors, and officers. In order to prove oppression, a claimant must establish a reasonable expectation that was violated by conduct qualifying as oppressive, unfairly prejudicial, or unfairly disregarding of the relevant interest (at para. 89). Finally, the Court confirmed that the Delaware Revlon standard, an American doctrine maintaining that during a change of control directors have a primary duty to enhance shareholder value, is not the law in Canada (at paras. 86-87). The Supreme Court did not depart from its prior position in *Peoples*, namely that directors' fiduciary duty to the corporation often includes consideration of shareholders' and other stakeholders' interests, but if they conflict, the duty is to the corporation (at para. 37), and that the fiduciary duty to the corporation did not change in the time prior to bankruptcy (at para. 88).

2 In discharging their fiduciary duties, directors may consider the interests of creditors: *Peoples*, *ibid.* at paras. 42-43; *BCE*, *ibid.* at para. 88. See also "Symposium on the Supreme Court's Judgment in the *Peoples Department Stores* Case" (2005) 41 Can. Bus. L.J. 167 at 167-246, which includes Catherine Francis, "*Peoples Department Stores Inc. v. Wise*: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care" (2005) 41 Can. Bus. L.J. 175; Wayne D. Gray, "A Solicitor's Perspective on *Peoples v. Wise*" (2005) 41 Can. Bus. L.J. 184; Warren Grover, "The Tangled Web of the *Wise* Case" (2005) 41 Can. Bus. L.J. 200; Ian B. Lee, "*Peoples Department Stores v. Wise* and the 'Best Interests of the Corporation'" (2005) 41 Can. Bus. L.J. 212; Stéphane Rousseau, "Directors' Duty of Care after *Peoples*: Would It Be Wise to Start Worrying about Liability?" (2005) 41 Can. Bus. L.J. 223; Jacob S. Ziegel, "The *Peoples* Judgment and the Supreme Court's Role in Private Law Cases" (2005) 41 Can. Bus. L.J. 236.

3 See Canada, Study Committee on Bankruptcy and Insolvency Legislation, *Report of the Study Committee on Bankruptcy and Insolvency Legislation* (Ottawa: Information Canada, 1970) (Chair: Roger Tassé) [Tassé Report]; and Canada, Advisory Committee on Bankruptcy and Insolvency, *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (Ottawa:

In the last several years, questions have arisen in several countries as to whether personal liability should be imposed on directors; holding them personally liable for debts incurred by the corporation when it should not have been trading.[4] Those arguing against director liability have cited concern that its imposition will cause talented individuals to pass up board positions, resulting in a shrinking market for directors and consequential corporate suffering as a result of being unable to retain the most experienced individuals to fill the directors' positions. Although these concerns cannot translate into a refusal to implement any penalty, it may be necessary to shift our focus away from personal liability to another scheme, a scheme that has as its goal the protection of creditors and the public, but one under which the financial penalty may not be as severe. If Canadians are reluctant to hold directors personally liable for the debts of the corporation, or to impose directors' fiduciary duties to creditors, they may nonetheless consider the adoption of a scheme that seeks to protect the public from unfit directors through disqualification.

The idea of adopting a director disqualification scheme in Canada is not a novel one. Indeed, the idea has been deliberated for approximately 40 years.[5] Currently, there are provisions in Canada that deal with the removal of directors.[6] However, there is no scheme devoted to disqualifying directors who have been found to be unfit to manage a corporation from continuing involvement in corporate management. A look at the U.K., a jurisdiction with both a personal liability and a disqualification scheme in place since the mid 1980s, indicates that the latter may be a more effective choice.[7]

This article will examine the different schemes in the U.K., their underlying objectives, and the success that each has enjoyed. It will maintain that the disqualification scheme in the U.K. has been more successful than the personal liability scheme, and it may be a path Canada should consider adopting. In doing so, this article will consider the Canadian

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Supply and Services Canada, 1986) (Chair: Gary F. Colter) [Colter Report].

4 The literature on this topic is extensive. For a short list, see Ronald J. Daniels, "Must Boards Go Overboard? An Economic Analysis of the Effects of Burgeoning Statutory Liability on the Role of Directors in Corporate Governance" in Jacob S. Ziegel & Susan I. Cantlie, eds., *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford: Clarendon Press, 1994) 547; Christopher C. Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001) 35 Can. Bus. L.J. 1; Dale A. Oesterle, "Corporate Directors' Personal Liability for 'Insolvent Trading in Australia, 'Reckless Trading' in New Zealand and 'Wrongful Trading' in England: A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders" in Ian M. Ramsay, ed., *Company Directors' Liability for Insolvent Trading* (Melbourne: Centre for Corporate Law and Securities Regulation, 2000) 19; Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass.: Harvard University Press, 1991).

5 The concept was first mentioned in the Tassé Report, *supra* note 3, and has been subsequently debated several times, as will be discussed below.

6 This article will discuss two legislative schemes under which a court can remove a director from office. First, the securities legislation in most provinces provide the Securities Commissions with the ability to order a director or officer to resign his or her position held with the issuer and to prohibit a person from becoming or acting as a director or officer of any issuer. Second, the powers granted under the oppression remedy are significant and the court is able to make any interim or final order it thinks fit, including an order that the conduct complained of be restrained and that directors be appointed in place of, or in addition to, all, or any, of the directors then in office. See Part III.A.2, below.

7 The personal liability scheme is found in the *Insolvency Act 1986* (U.K.), 1986, c. 45, s. 214 and the disqualification scheme is found in the *Company Directors Disqualification Act 1986* (U.K.), 1986, c. 46 [*CDDA*].

provisions already in place that allow for the removal of directors and conclude that the provisions are unable to provide the type of protection the *CDDA* provides in the U.K. Specifically, it will consider securities legislation, the oppression remedy, and the 2005 and 2007 amendments[8] to the *Bankruptcy and Insolvency Act*[9] and the *Companies' Creditors Arrangement Act*.[10] It will also discuss the potential effect of a disqualification scheme on the business judgment rule. This article does not aim to add to the immense body of literature that debates the finer points of limited liability or the advantages and disadvantages of imposing additional liability on directors, as these issues have been debated extensively for some time.[11] The article will conclude that the provisions pursuant to which Canadian courts can currently remove directors cannot act as an equivalent to a disqualification scheme and that such a scheme should be seriously considered in Canada.

While the article discusses directors' duties in general, the focus will be on directors' duties and conduct towards creditors as the corporation approaches insolvency. The *CDDA* applies to all director misconduct, at any time within the corporation's life. However, the provision for disqualification for unfitness under s. 6 of the *CDDA*, the most litigated provision in the statute, deals with director misconduct when the corporation has become insolvent and much of this misconduct has affected the corporations' creditors.

First, the article will consider the law dealing with directors' duties in the U.K. and will include discussions on the wrongful trading provisions, directors' duties at common law, as well as the *CDDA*. The discussion on the *CDDA* will examine its purposes, consequences of a disqualification order, how the disqualification scheme works, its effectiveness, as well as problems with the scheme. Second, the article turns to look at Canadian law. In this Part, the new provisions, introduced pursuant to c. 47, will be examined to determine whether they can fill the same role as the *CDDA* in the U.K. Provisions in provincial securities legislation

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8 *The Wage Earner Protection Program Act*, S.C. 2005, c. 47. Chapter 47 was derived from Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2005 (assented to 25 November 2005). Bill C-62, *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, 1st Sess., 39th Parl., 2007 (as passed by the House of Commons 14 June 2007), setting out proposed amendments to c. 47, was introduced on 13 June 2007 but died on the order paper when Parliament was dissolved. The new session of Parliament adopted Bill C-62 on 29 October 2007 and reintroduced it as Bill C-12, *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, 1st Sess., 39th Parl., 2007 (assented to 14 December 2007) [Bill C-12]. Bill C-12 adopted all previous readings and was subsequently approved by the Canadian Senate in December 2007 and enacted as S.C. 2007, c. 36. At the time of writing, these amendments were not in force.

9 R.S.C. 1985, c. B-3 [*BIA*].

10 R.S.C. 1985, c. C-36 [*CCAA*].

11 For some of the discussions see Brian R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997) at 541; Oesterle, *supra* note 4; Canada, Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: Standing Senate Committee on Banking, Trade and Commerce, 2003) at 118 (Chair: Richard H. Kroft) [*Senate Report*]; see Jacob S. Ziegel, "Corporate Governance and Directors' Duties to Creditors: Two Contrasting Philosophies" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2003* (Toronto: Thomson Carswell, 2004) [Ziegel, "Corporate Governance"]; see generally Daniels, *supra* note 4.

and the *Canada Business Corporations Act*[12] will also be examined to determine whether they can provide alternate ways for courts to disqualify directors. Finally, problems in the U.K. scheme will be examined and an exploration will be undertaken of how, constitutionally, a disqualification scheme could best be implemented in Canada.

II. UNITED KINGDOM LAW

The U.K., a state that has taken a more active role during corporate insolvencies, has long imposed significant creditor protections to ensure directors exercise restraint and refrain from acting recklessly when a company is insolvent.[13] The methods adopted by the U.K. include the statutory imposition of personal liability on directors when they continue operating the company without due regard for its perilous financial situation and a director disqualification regime to prevent unfit individuals from participating in the management of companies. Each scheme has different underlying objectives, and while there is some overlap, they each seek to address a different situation and potential problems that arise when a corporation approaches insolvency. Below, an overview of the wrongful trading provisions is provided, as well as of the directors' disqualification regime. This Part will take a detailed look at the legislation, the problems, and the success of the schemes in the U.K.

A. WRONGFUL TRADING[14]

The wrongful trading provisions were introduced to provide an incentive to directors of insolvent companies to cease trading and wind up the company if there is no reasonable prospect of avoiding liquidation.[15] They arose as a response to the fraudulent trading provisions, which required a finding of "intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose."[16] Due to the subjective nature of the imposition of liability under the fraudulent trading provisions and the difficulty of proving fraud, that law was perceived to be inadequate.[17] The Cork Committee therefore sought to establish a lower threshold for a finding of liability by imposing civil liability on directors for wrongful trading, such that an honest but unreasonable action would leave directors open to personal liability.[18] More accountability on the part of directors would thus be encouraged, requiring them to ensure the presence of adequate funds prior to making decisions to continue trading, and to take immediate steps to put the company into liquidation, receivership, or administration when the company has no reasonable prospect of being able to meet new obligations. The Cork Report recommended the imposition of an

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12 R.S.C. 1985, c. C-44 [*CBCA*].

13 Jacob S. Ziegel, "Creditors as Corporate Stakeholders: The Quiet Revolution — An Anglo-Canadian Perspective" (1993) 43 U.T.L.J. 511 at 517-24 [Ziegel, "Creditors as Corporate Stakeholders"].

14 Some parts of this section were originally published in Jassmine Girgis, "Deepening Insolvency in Canada?" (2008) 53 McGill L.J. 167 at 173-75.

15 Rizwaan J. Mokal, "An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors' Bargain" (2000) 59 Cambridge L.J. 335 at 340.

16 *Companies Act, 1948* (U.K.), 11 & 12 Geo. VI, c. 38, s. 332(1); now s. 213(1) of the *Insolvency Act 1986*, *supra* note 7.

17 See U.K., H.C., "Insolvency Law and Practice: Report of the Review Committee", Cmnd 8558 in *Sessional Papers* (1981-82) 1 at para. 1782 (Chairman: Sir Kenneth Cork)[Cork Report].

18 *Ibid.*

objective test, that of the "ordinary, reasonable man" and what he would have done in the circumstances.[19]

The Department of Trade and Industry, in accepting the Cork Report's recommendation for the imposition of liability for wrongful trading,[20] determined that during a winding up, if it was found that directors had continued to trade and the existing creditors of the company were, as a result, in a worse financial position or that new, unpaid liabilities had been incurred by the company during that time, then the directors who knew, or ought to have known, that the company could not reasonably have avoided that situation would be personally liable for the loss suffered by creditors.[21] Under s. 214 of the *Insolvency Act 1986*,[22] a court, upon an application by a liquidator, can declare directors liable to make a personal contribution to the company's assets during the winding up if the directors failed to have the company cease trading as it approached insolvent liquidation. A determination of whether the company was liquidated at the proper time is made by looking at whether the company was in a worse position at the date of liquidation than it would have been had it ceased trading when it was appropriate to do so.[23] In order to make this determination, the court must decide whether the directors acted properly when the company was in financial distress, before it was liquidated.[24] The quantum of recovery under the wrongful trading provisions is compensatory, not penal.[25]

A director has a defence to a wrongful trading action if, once he or she realized the company would be unable to avoid insolvent liquidation, the director took "every step"[26] to minimize the potential loss to the company's creditors.[27] The standard to which a director is held for the purposes of the wrongful trading provisions is both objective and subjective. Objectively, the director must have the knowledge, skill, and experience of a reasonably

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19 *Ibid.* at paras. 1783, 1790.

20 U.K., H.C., "A Revised Framework for Insolvency Law," Cmnd 9175 in *Sessional Papers* (1983–84) 1 at 28.

21 *Ibid.* Due to the legislative reforms in 1985–86, the criminal provision became s. 458 of the *Companies Act 1985* (U.K.), 1985, c. 6 and the civil sanctions became ss. 213-15 of the *Insolvency Act 1986*, *supra* note 7, for fraudulent and wrongful trading: Paul L. Davies, *Gower and Davies' Principles of Modern Company Law*, 8th ed. (London: Sweet & Maxwell, 2008) at paras. 9-5–9-7.

22 *Supra* note 7, s. 214.

23 *Marini Ltd. (Liquidator of) v. Dickenson*, [2003] EWHC 334 (Ch.), [2004] B.C.C. 172 [*Marini*]. The Judge in *Marini* (at para. 68), relied on *Re Continental Assurance Co. of London Plc (In Liquidation) (No. 4)* (2001), [2007] 2 B.C.L.C. 287 (Ch.D.) [*Re Continental Assurance*].

24 To make this determination, the Court compared the "net deficiency" in the company's assets at the date the Court decided the company should have ceased trading to the date the company did cease trading (*Marini*, *ibid.* at para. 68). "Net deficiency" is defined in *Re Continental Assurance*, *ibid.* at para. 297, as "the loss to [the company] as a result of liquidation being delayed." In *Re Continental Assurance* the liquidators were unable to show any increase in net deficiency, and in *Marini* the Court found that the company was not worse off as a result of continuing to trade (*ibid.* at para. 69).

25 Marion Simmons, "Wrongful Trading" (2001) 14 Insolvency Intelligence 12 at 14; *Re Produce Marketing Consortium Ltd. (No. 2)*, [1989] B.C.L.C. 520 at 533 [*Re Produce Marketing*].

26 *Insolvency Act 1986*, *supra* note 7, s. 214(3). "Every step" is not defined in the legislation but has been characterized as including "calling a creditors' meeting in order to advise them of the state of the company; liquidating the company; suggesting a chargeholder might appoint an administrative receiver; appointing an administrator; [and] convening regular board meetings to review the position of the company": Andrew R. Keay & Peter Walton, *Insolvency Law: Corporate and Personal* (Harlow, U.K.: Pearson Education, 2003) at 527-28.

27 *Insolvency Act 1986*, *ibid.*

diligent person carrying out the same functions as those which have been entrusted to the director.[28] Subjectively, a director must take the same steps as a person with the same knowledge, skills, and experience would have taken.[29] Under s. 214, a director is required to meet the standard expected of someone with his or her own experience and must also meet the standard expected of a reasonable director. While there is a minimum standard that will be imposed,[30] these standards will vary depending on the size of the company, the kind of company, and the type of business it carries out.[31] If the director does not meet either standard, or meets one but not the other, the director could be held liable under s. 214. Accordingly, an honest, but incompetent, director who failed to foresee an unavoidable insolvency that a diligent director carrying out the same functions would have foreseen will be held liable under these provisions.

While there was much confidence with regard to the success of the wrongful trading provisions at the outset, the provisions have proven problematic and difficult to implement, due to the difficulty of establishing the requirements in the legislation, along with a difficulty of getting funding to pursue the proceedings.[32] As a result, there have been few reported cases under the provisions.[33]

B. *COMPANY DIRECTORS DISQUALIFICATION ACT*

The courts can resort to another method of director disqualification, as they not only have the power to disqualify directors who misbehave during a company's insolvency, but also to disqualify directors at any time during the company's life. The courts have had some ability to disqualify directors for years, but in 1981-82 the Cork Report recommended strengthening the courts' discretionary disqualification powers and instituting mandatory disqualification for directors in certain circumstances.[34] In 1986, the disqualification

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28 *Ibid.*, s. 214(4)(a).

29 *Ibid.*, s. 214(4)(b).

30 *Re Produce Marketing, supra* note 25 at 550.

31 Keay & Walton, *supra* note 26 at 526; *cf.* in *Re Produce Marketing, ibid.*, Knox J. noted
> that the requirement to have regard to the functions to be carried out by the director in question, in relation to the company in question, involves having regard to the particular company and its business. It follows that the general knowledge, skill and experience postulated will be much less extensive in a small company in a modest way of business, with simple accounting procedures and equipment, than it will be in a large company with sophisticated procedures.

32 See Andrew Keay, "Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective" (2005) 25 L.S. 431 at 434. See also Ziegel, "Corporate Governance," *supra* note 11 at 155, citing Mokal, *supra* note 15 at 354-56, on the number of proceedings arising under the wrongful trading provisions.

33 See e.g. Andrew Campbell, "Wrongful Trading and Company Rescue" (1994) 25 Cambrian L. Rev. 69; Vanessa Finch, "Company Directors: Who Cares About Skill and Care?" (1992) 55 Mod. L. Rev. 179; Keay, *ibid.*

34 Cork Report, *supra* note 17 at paras. 1766, 1816-37. In fact, the court has had the power to disqualify certain individuals from managing a company since 1928: see *Companies Act, 1928* (U.K.), 18 & 19 Geo. V, c. 45, s. 75, subsequently consolidated as s. 275 of the *Companies Act, 1929* (U.K.), 19 & 20 Geo. V, c. 23; see generally U.K., H.C. "Company Law Amendment Committee 1925-26: Report Presented to Parliament by Command of His Majesty," Cmd 2657 in *Sessional Papers*, vol. 4 (1925-26) 477 (Chairman: Wilfred Greene, K.C.). The provision came about as a result of the recommendation of the Company Law Amendment Committee under the chairmanship of Mr. Greene, K.C., but as time went by, the court's power became more extensive. When the provisions were re-enacted in the *Companies Act, 1948* (U.K.), 11 & 123 Geo. VI, c. 38, undischarged bankrupts were prohibited from

provisions in various statutes were consolidated in the *CDDA*[35] and further reforms to the *Insolvency Act 2000* introduced the "disqualification undertaking" to supplement a "disqualification order."[36] Now, the most commonly reported conduct under the *CDDA* includes allowing the company to continue to trade when it was unable to pay its debts, failing to keep proper accounting records, failing to prepare and file accounts or make returns to Companies House, and failing to submit returns or pay the Crown any tax due.[37]

1. PURPOSE OF *COMPANY DIRECTORS DISQUALIFICATION ACT*

As a scheme aimed at the removal of unfit directors from the market, the *CDDA* was enacted primarily to protect the public interest[38] against "the future conduct of companies by persons whose past records as directors of insolvent companies showed them to be a danger to creditors and others."[39] In contrast to the wrongful trading provisions, which exist to impose personal liability on directors for the debts of the company, the disqualification scheme aims to "maintain the integrity of the business environment,"[40] and does not exist to punish unfit directors. While there is some overlap between the two schemes, as it is possible for directors to be disqualified if they have been found liable under the wrongful trading provisions,[41] the wrongful trading provisions are much more limited in scope and exist to provide incentives for directors to liquidate an insolvent company at the optimal time. The disqualification provisions are broader both in terms of purpose and with regard to the type of behaviour caught.

Prior to the enactment of the disqualification provisions, the court could do little to protect the public from directors who had engaged in misconduct, other than finding them personally liable for the debts of the company. While the wrongful trading provisions were designed to impose personal liability on directors who are found to have abused "the privilege of limited liability,"[42] the Cork Report determined that the wrongful trading provisions are only useful when the statutory requirements for liability, which are difficult to prove, are met.[43] Most

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being directors without leave of the court, and courts could prevent those who had been convicted of fraudulent trading from being involved in managing companies. In 1976, the maximum possible period for disqualification was increased to 15 years and an individual could be disqualified for having behaved improperly during a company's insolvency. These provisions were re-enacted in the *Companies Act 1985*, (U.K.), 1985, c. 6 and in the *Insolvency Act 1986*, *supra* note 7. For an overview of the history of the disqualification provisions, see Fiona Tolmie, *Corporate and Personal Insolvency Law*, 2d ed. (London: Cavendish Publishing, 2003) at 246; see Davies, *supra* note 21 at para. 10-2; see Ziegel, "Creditors as Corporate Stakeholders," *supra* note 13 at 523.

35 *CDDA*, *supra* note 7, ss. 1, 1A.

36 *Insolvency Act 2000* (U.K.), 2000, c. 39, s. 1A.

37 The Insolvency Service, *What is Disqualification?*, online: The Insolvency Service <http://www.insolvency.gov.uk/directordisqualificationandrestrictions/whatisdisqualification.htm> [The Insolvency Service, *Disqualification*].

38 *CDDA*, *supra* note 7, s. 7: "If it appears to the Secretary of State that it is expedient in the public interest that a disqualification order under section 6 should be made against any person, an application … against that person may be made."

39 *Re Lo-Line Electric Motors Ltd.*, [1988] 1 Ch. 477 at 477 [*Electric Motors*].

40 The Insolvency Service, *Disqualification*, *supra* note 37.

41 *CDDA*, *supra* note 7, s. 10.

42 The Insolvency Service, *Disqualification*, *supra* note 37. The Insolvency Service maintains that the *CDDA* itself is "a powerful tool against those who abuse the privilege of limited liability."

43 Cork Report, *supra* note 17 at para. 1808.

importantly, the provisions imposing liability could not prevent directors from committing similar misconduct in the future. The Cork Report determined that proper protection for the public could only be achieved by restraining directors or officers of insolvent companies from being involved in the management of other companies.[44] In particular, the Cork Report wanted to address the "widespread dissatisfaction" with the way in which directors could allow their companies to become insolvent and then go on to form new companies, while leaving their unpaid creditors behind.[45] Accordingly, the *CDDA* sought to address this type of problem through the issuance of prohibition orders against unfit directors, a remedy that is more effectively aimed at protecting the public than the wrongful trading provisions.

2. CONSEQUENCES OF A DISQUALIFICATION ORDER

The *CDDA* is a concise statute consisting of 26 provisions and four schedules. Directors can be disqualified on the basis of several grounds, the most litigated being unfitness. If the circumstances within the *CDDA* are met, the court may, and under the unfitness ground shall, make a disqualification order.[46] A person subject to a disqualification order is prohibited from being a director, liquidator or administrator, receiver, or "in any way, whether directly or indirectly, [being] concerned or [taking] part in the promotion, formation or management of a company" throughout the period specified in the order.[47] The prohibition in a disqualification order extends beyond disallowing a person to be a director of a company and seeks to prevent a person from being involved with a company's affairs in any way. The court has interpreted the prohibition widely, finding that "[the language] is cast in the widest of terms — '... in any way whether directly or indirectly, be concerned or take part in the management....' It would be difficult to imagine a more comprehensive phraseology. It is designed to make it impossible for persons to be part of the management and central direction of company affairs."[48]

Disqualification proceedings are civil, however, once a disqualification order is made, it is guaranteed by criminal sanctions as well as financial liability. If a person breaches a disqualification order, he or she can be liable to conviction for a summary or indictable offence, as well as for payment of a fine.[49] In addition, a person will be personally liable for company debts incurred while the person was contravening the disqualification order by being involved in the management of the company.[50] This personal liability will extend to any person who has acted on instructions given by the person subject to a disqualification order.[51] Although the disqualification provisions are not aimed at punishing directors, an application for disqualification nonetheless has the potential to substantially interfere with the freedom of a director. Courts have therefore indicated that the rights of the individual

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44 *Ibid.* at paras. 1807-809.

45 *Ibid.* at para. 1813.

46 *CDDA*, *supra* note 7, s. 1(1).

47 *Ibid.*, s. 1(1)(a).

48 *R. v. Campbell* (1983), [1984] 78 Cr. App. R. 95 at 100. The Court was discussing the meaning of "take part in the management of a company" pursuant to the *Companies Act, 1948*, *supra* note 16, s. 188(1). See also *supra* note 34 regarding the consolidation of the legislation into the *CDDA*.

49 *CDDA*, *supra* note 7, s. 13. On conviction, the period of imprisonment cannot be more than two years for an indictable offence and six months for a summary offence.

50 *Ibid.*, s. 15.

51 *Ibid.*, s. 15(5).

director must be protected,[52] and even though unfitness must be proven on a balance of probabilities, in reality, more conclusive evidence is required in the proceedings.[53]

3. HOW IT WORKS

The court can, and in some cases must, make a disqualification order depending on the misconduct in which the director engages. While an application for disqualification can be made at any time, once a company has failed it is necessary for the official receiver,[54] or in the case of a voluntary liquidation, administrative receivership, or administration, the Insolvency Practitioner, to send a report to the Secretary of State on the conduct of all directors who were in office in the last three years of the company's trading. Based on the contents of that report, the Secretary of State must determine whether it is in the public interest to seek a disqualification order. Any application made is heard and determined by a court.[55] The provision also allows for an official receiver, liquidator, administrator, or receiver to report any potentially unfit conduct to the Secretary of State.[56] Any application for a disqualification order for unfitness must be made within two years from the day on which the company has become insolvent.[57]

Once an application for disqualification for unfitness is submitted to the court, a director can make submissions in the form of a statement of truth, consisting of explanations or reasons for his conduct. Others, such as bankers, accountants, and creditors can also submit statements of truth as evidence for or against the director. The court will then determine whether the individual's conduct as a director in the company makes him or her unfit to be concerned in the management of the company.[58]

4. GROUNDS FOR DISQUALIFICATION

The grounds for automatic or discretionary disqualifications are largely uncontroversial and do not generate excessive litigation. Mandatory disqualification orders, however, which must be made upon having proof that the person is unfit, have generated plenty of case law as well as numerous disqualification orders against directors. The discussion below will

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52 *Electric Motors*, *supra* note 39 at 479. This application for disqualification was brought under s. 295 of the *Companies Act 1985*, *supra* note 34, under which courts had the power to disqualify a person from being a director for a maximum of 15 years in the specified circumstances.

53 Tolmie, *supra* note 34 at 256.

54 Official receivers are civil servants in the Insolvency Service, which is part of the Department of Business, Enterprise, and Regulatory Reform, and officers of the court. In the event of a bankruptcy or compulsory winding up, an official receiver will be appointed to the case.

55 The Insolvency Service, *Disqualification*, *supra* note 37.

56 *CDDA*, *supra* note 7, s. 7(2A).

57 *Ibid.*, s. 7(2).

58 The Insolvency Service, *Disqualification*, *supra* note 37. Other than by court order, a disqualification order by means of undertaking is also available, but only on the grounds of unfitness. The Secretary of State and the director can reach an out of court agreement, a disqualification undertaking, which provides that the person will not act as a director or be concerned with taking part in forming or managing a company except with leave of the court (*CDDA*, *ibid.*, s. 1A). The director can trigger a court hearing by refusing to agree to the terms of the undertaking (Davies, *supra* note 21 at para. 10-4), and can also, after having accepted the undertaking, apply to the court to have the disqualification period reduced or the order cease to be in force (*CDDA*, *ibid.*, s. 8A).

briefly describe the grounds upon which automatic and discretionary disqualification orders are made and will focus on the unfitness ground.

Undischarged bankrupts[59] and persons whose orders are revoked by the court due to a default in payment under a county court administration order[60] are automatically disqualified. The court has discretionary power to make disqualification orders in several circumstances. The second highest number of disqualifications, second only to the unfitness ground, occur under s. 2 of the *CDDA*.[61] Under this section, a director can be disqualified upon conviction for an indictable offence in connection with the promotion, formation, management, or liquidation of a company, or in connection with the receivership or management of a company's property, including the conducting of business without legal authorization.[62] A director can also be disqualified for persistently failing to comply with the provisions of companies' legislation requiring document filing with the registrar of companies.[63] A disqualification order can be issued if it appears that, in the course of the winding up of the company, a person has engaged in fraudulent trading, whether or not convicted,[64] or has otherwise been guilty of other fraud in relation to the company or of any breach of duty as officer, liquidator, receiver, or manager.[65] A disqualification order can also be issued against a person who has been summarily convicted for failing to file returns, etc. where, during the previous five years, the person has three or more default orders or convictions.[66] The court can disqualify a person if a finding of unfitness is made in the management of a company after a statutory investigation is conducted.[67] Finally, a disqualification order can be made against a person who has been found liable for wrongful trading.[68]

5. DISQUALIFICATION FOR UNFITNESS

A disqualification order for unfitness can be made pursuant to two provisions of the *CDDA*: ss. 6 or 8. The Secretary of State takes the initiative to apply for the disqualification order under both sections, but there are two significant differences between them. First, under s. 6, the court is required to make a disqualification order against a person if satisfied that he or she is, or was, the director of a company that has become insolvent and that the person's behaviour as director makes that person unfit to be concerned in the management of a company. Under s. 8, a finding of unfitness does not oblige the court to make a disqualification order and a company need not have become insolvent before a disqualification order is made. Second, a disqualification order made under s. 6 carries with it a two year minimum mandatory disqualification period, and a maximum period of 15

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59 *CDDA*, *ibid.*, s. 11.
60 *Ibid.*, s. 12.
61 Andrew Hicks, *Disqualification of Directors: No Hiding Place for the Unfit?*, Association of Chartered Certified Accountants Research Report 59 (London: Certified Accountants Educational Trust, 1998) at 35.
62 *CDDA*, *supra* note 7, s. 2(1).
63 *Ibid.*, s. 3(1).
64 *Ibid.*, s. 4(1)(a).
65 *Ibid.*, s. 4(1)(b).
66 *Ibid.*, s. 5.
67 *Ibid.*, s. 8.
68 *Ibid.*, s. 10.

years.[69] For the purposes of s. 6, a company becomes insolvent if it goes into liquidation when its assets are insufficient to pay off its debts and other liabilities.[70] The provision has been the focus of much litigation, mostly involving the definition of "unfitness." Even though both provisions deal with unfitness, the increased litigation under s. 6 is likely due to the fact that the provision is brought to the forefront and forced into issue every time a company becomes insolvent.

The most litigated part of the *CDDA* has involved actions brought under s. 6, with regard to the definition of "unfitness." As indicated above, under s. 6 a court can make a disqualification order against a person who has been, or is, a director of a company that has become insolvent where that that person's conduct as director makes him or her unfit to be concerned in the management of a company. For the purposes of determining the unfitness of a director, the court can consider not only the person's conduct as director of the company that has become insolvent, but also his conduct as a director of any other company or companies. In order to help determine the unfitness of directors, Schedule I of the *CDDA* contains Part I that applies to all cases of unfitness and Part II that applies to situations where the company has become insolvent.

Broadly, unfitness can be found in breach of commercial probity, incompetence, or both.[71] In *Re Bath Glass Ltd.*,[72] the court said:

> To reach a finding of unfitness the court had to be satisfied that the director has been guilty of a serious failure or failures, whether deliberately or through incompetence, to perform those duties of directors which were attendant on the privilege of trading through limited liability companies.[73]

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69 *Ibid.*, s. 6(4). Prior to 1995, one subject of litigation under s. 6 was whether the length of the disqualification order should be dependent on the director's past conduct or on the likelihood of relapse in the future. Clarification was provided in *Re Grayan Building Services Ltd. (In Liquidation)* (1994), [1995] 3 W.L.R. 1 at 11[*Re Grayan*], when the Court of Appeal determined that in order for the court to be satisfied about the future protection of the public it was not to look at evidence "which showed that despite the defendant's shortcomings in the past, he was unlikely to offend again." Rather, the analysis was a backward-looking one, and the court needed to decide "whether that conduct, viewed cumulatively and taking into account any extenuating circumstances, has fallen below the standards of probity and competence appropriate for persons fit to be directors of companies." Evidence pertaining to whether a director is likely to reoffend will be relevant to leave proceedings but not to the original period in the disqualification order: *Secretary of State for Trade and Industry v. Griffiths* (1997), [1998] 2 All E.R. 124, adopting *Re Grayan*; *Re Grayan* was also adopted in subsequent and more recent cases, including *Re Bunting Electric Manufacturing Co. Ltd.*, [2005] EWHC 3345 (Ch.), [2006] 1 B.C.L.C. 550 at para. 57; *Secretary of State for Trade and Industry v. Thornbury*, [2007] EWHC 3202 (Ch.), [2008] B.C.C. 768 at para. 33.

70 *CDDA*, *ibid.*, s. 6(2).

71 *Re Sevenoaks Stationers (Retail) Ltd.* (1990), [1991] Ch. 164 (C.A.) [*Re Sevenoaks*]. It is important to remember that this should only be taken as guidance and that each case will turn on its own facts. The Court of Appeal has warned about the tendency to treat the statements as "judicial paraphrases of the words of the statute," which has the effect of construing them "as a matter of law in lieu of the words of the statute" (*Re Sevenoaks*, at 176). In *Re Sevenoaks*, the first decision on s. 6 to reach the Court of Appeal, the Court maintained that the question of unfitness is one of fact and in each case the test must go back to the ordinary words of the statute to decide whether the person's conduct as a director of the company or companies in question "makes him unfit to be concerned in the management of a company" (at 176).

72 (1987), 4 B.C.C. 130 [*Re Bath Glass*].

73 *Ibid.* at 131.

In general, breach of commercial probity tends to involve dishonest behaviour, that is, behaviour containing an element of intention to misbehave, while incompetence tends to encompass reckless behaviour, although the threshold has recently been lowered to include negligent behaviour. Directors' treatment of the company's creditors is a significant consideration when courts are looking into the unfitness of directors. Matters for determining the unfitness of a director include a consideration of the extent of the director's responsibility for the causes of the company becoming insolvent and failure by the company to supply any goods or services for which it has been paid.

Breach of commercial probity can take many forms. In *Re Keypak Homecare Ltd. (No. 2)*,[74] when the company, Keypak Homecare Ltd., experienced serious financial difficulties, its two directors set up a new company, acquired Keypak's stock at a forced-sale price, and took other assets belonging to Keypak.[75] The Court found that even though it did not have any clear evidence that the directors had any real understanding of what they did, their actions were so misconceived that they amounted to a failing to follow proper standards. The actions rendered the directors unfit and the Court ordered them disqualified for a period of three years. In *Re Linvale*,[76] while the Court did not find that the directors had deliberately sought to defraud the creditors and the company, the Court nonetheless found that they recklessly incurred debts that they were unable to repay. The directors had become involved in the management of three companies, all of which had become insolvent and the commencement of each new company left a trail of unpaid creditors in its wake. The Court found the directors to be unfit and disqualified them for five years. Similarly, in *Re Ipcon Fashions Ltd*.,[77] the director carried on business in a succession of companies over 15 years. When each company went into insolvent liquidation, the director went on to commence trading through another company. He also incurred debt at a time he knew, or ought to have known, that the company would be unable to repay the debt. The Court found that he had acted contrary to commercial morality and issued a disqualification order for a period of five years. More recently, in *Secretary of State for Trade and Industry v. Aviss*,[78] the directors were found to have wilfully failed to respect corporate principles by applying creditors' money to companies in which the creditors had no interest. The directors' actions were found to be detrimental to creditors and their period of disqualification was seven years.[79]

A finding of "unfit to be concerned in the management of a company" can also be made against a director who has been incompetent in company dealings. The level of incompetence required has been the subject of debate over the years and has fluctuated from the higher

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74 (1989), [1990] B.C.C. 117 (Ch.D.).

75 *Ibid.* at 119. The directors also committed various other actions, including receiving excessive remuneration at a time they knew of Keypak's financial situation and one of them accepted repayment of a loan from Keypak which, at the time it was made, constituted a fraudulent preference. The Court found that the fraudulent preference and the remuneration package did not involve a lack of commercial probity (*ibid.* at 120).

76 [1993] B.C.L.C. 654 (Ch.D.).

77 (1989), 5 B.C.C. 773 (Ch.D.).

78 [2006] EWHC 1846 (Ch.), [2007] B.C.C. 288.

79 *Ibid.* at para. 115. One of the directors had been acting as a director contrary to a disqualification order that had already been issued against him. He was therefore disqualified for a period of 11 years (at para. 116).

threshold of recklessness to the lower threshold of negligence. In *Re Stanford Services*,[80] the director was found to have recklessly acquired or commenced the business that he ought to have realized was insolvent. The standard articulated was at the lower threshold of "total incompetence" in *Electric Motors*,[81] where Sir Nicolas Browne-Wilkinson V.-C. stated "[o]rdinary commercial misjudgment is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate."[82] In *Re Sevenoaks*, a case in which a director had been very negligent, but not dishonest, in running the business, Dillon L.J., speaking for the court, lowered the threshold and found that incompetence need not be total, but rather that "incompetence or negligence in a very marked degree … is enough to render him unfit."[83] In *Secretary of State for Trade and Industry v. Goldberg (No. 2)*,[84] the court quoted Lindley M.R. in *Lagunas Nitrate Co. v. Lagunas Syndicate*,[85] an 1899 decision that stated, "[t]heir negligence must be not the omission to take all possible care; it must be much more blameable than that: it must be in a business sense culpable or gross."[86] In short, the standard of incompetence required under this provision has been modified over the years and it is clear that while recklessness may not be required, the standard will require something more than simple negligence.

The courts have determined that a director will not escape a finding of incompetence or unfitness merely because he or she did not know the obligations associated with the position. In *Re Continental Assurance Co. of London plc*,[87] the Court found that competence included knowing what "any competent director in his position would have known" and that the director's failure to know, itself, displayed a serious incompetence or neglect.[88] In *Secretary of State for Trade and Industry v. Arif*,[89] the Court determined that the category of those whose conduct makes them unfit includes those who assume the obligations of directors while knowing that they cannot fulfill them. Specifically, "[i]t is no answer to that charge to say, 'I did what I could'. If a director finds that he is unable to do what he knows ought to be done then the only proper course is for him to resign."[90]

Some courts, when articulating the proper standard to which a director must be held under s. 6 of the *CDDA*, have relied on and adopted the standards to which directors are held under other provisions, such as the wrongful trading provisions or their fiduciary duty towards the company. The courts have not required, however, that standards under other legislation be met in order for the definition of "unfitness" to be met under the *CDDA*. In *Re Bath Glass*, Gibson J. determined:

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80 3 B.C.C. 326 (Ch.D.).
81 *Supra* note 39 at 486.
82 *Ibid.*
83 *Supra* note 71 at 184.
84 [2003] EWHC 2843 (Ch.), [2004] 1 B.C.L.C. 597 [*Goldberg*].
85 [1899] 2 Ch. 392 [*Lagunas*].
86 *Ibid.* at 435.
87 [1996] B.C.C. 888 (Ch.D.).
88 *Ibid.* at 895.
89 [1996] B.C.C. 586 (Ch.D.).
90 *Ibid.* at 596.

> To reach a finding of unfitness the court must be satisfied that the director has been guilty of a serious failure or serious failures, whether deliberately or through incompetence, to perform those duties of directors which are attendant on the privilege of trading through companies with limited liability. Any misconduct of [a director] may be relevant, even if it does not fall within a specific section of the Companies Acts or the Insolvency Act.[91]

In *Re Bath Glass*, it was determined that even though the director's conduct did not amount to wrongful trading under the *Insolvency Act*, it was still found to amount to misconduct under s. 6 and was therefore relevant to the Court's unfitness analysis.[92] Similarly, in *Secretary of State for Trade and Industry v. Baker (No. 5)*,[93] the Secretary of State's case was being made out on incompetence alone and any allegations were so directed. Parker J. determined:

> Although in considering the question of unfitness the court must have regard (among other things) to 'any misfeasance or breach of any fiduciary or other duty' by the respondent in relation to the company it is not in my judgment a prerequisite of a finding of unfitness that the respondent should have been guilty of misfeasance or breach of duty in relation to the company. *Unfitness may, in my judgment, be demonstrated by conduct which does not involve a breach of any statutory or common law duty*.[94]

The Court of Appeal upheld the statements by Parker J., maintaining, "a finding of breach of duty is neither necessary nor of itself sufficient for a finding of unfitness. As the judge observed, a person may be unfit even though no breach of duty is proved against him or may remain fit notwithstanding the proof of various breaches of duty."[95]

In conclusion, while judicial statements about the law surrounding findings of unfitness can be used as guidance, it is important to remember that this is a factual determination and the facts of each case must be examined. Unfitness can be found when there has been dishonest, intentional conduct, or simply conduct that constitutes gross or severe negligence. A finding of unfitness is not conditional upon finding that a director has breached a duty arising under other legislation or common law, but a court can look to those findings in making its determination.

6. EFFECTIVENESS OF THE *COMPANY DIRECTORS DISQUALIFICATION ACT*

Determining how to measure the success of the *CDDA* in the U.K. has proven to be a difficult task. It stands to reason that the most evident method of determination would be a consideration of the number of disqualification orders imposed since the establishment of the *CDDA*, as well as whether there has been an increase or decrease in the number or frequency of disqualification orders over the years. However, the means of determining success may not be as simple as it first appears. The question that must be asked is whether an increasing

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91 *Supra* note 72 at 133.

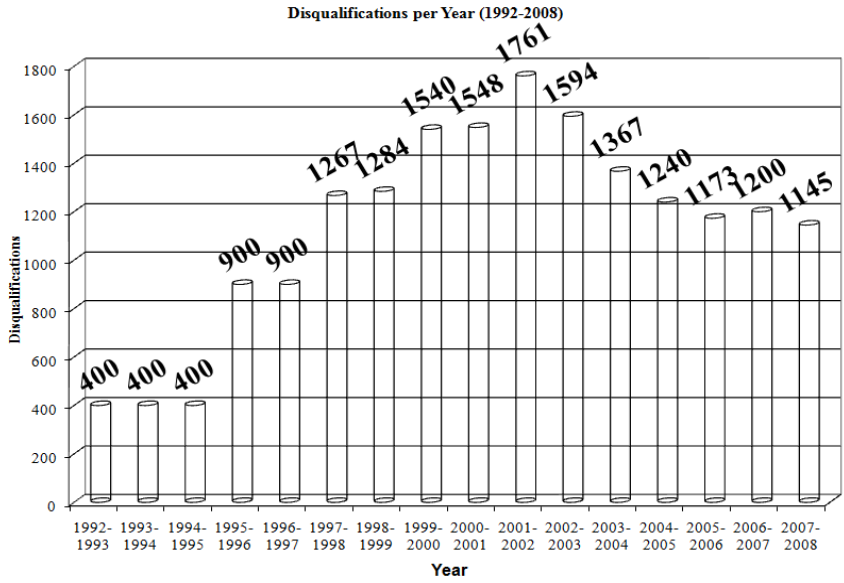
92 See also *Secretary of State for Trade and Industry v. Creegan*, [2001] EWCA Civ 1742, [2004] B.C.C. 835.

93 [1999] 1 B.C.L.C. 433 (Ch.D.).

94 *Ibid.* at para. A12 [citations omitted, emphasis added].

95 *Baker v. Secretary of State for Trade and Industry* (2000), [2001] B.C.C. 273 at para. 35.

number of disqualification orders means the *CDDA* has actually been successful, or whether another method of determination must be considered. This section will discuss the commonly employed objectives and the figures released by the government regarding the numbers and types of disqualifications made annually. Below, there will be a consideration of common critiques of the system and the types of recommendations that have been made to improve the efficiency and effectiveness of the directors' disqualification system.



With respect to the number of disqualifications and undertakings, the Insolvency Service statistics indicate a continuing increase since the *CDDA* was adopted in 1986, with "more than 9,600 disqualification orders [made] because of unfit conduct in failed insolvent companies."[96] Towards the beginning, in 1989, the Department of Trade and Industry received 3,234 disqualification referrals and authorized 440 of them to proceed to court actions. That year, the courts disqualified 303 directors[97] and the numbers continued to increase in subsequent years. The above graph summarizes the number of disqualification orders that have been implemented between the years of 1992 to 2008.[98]

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96 *Supra* note 37.

97 "Receivers Act" *Daily Telegraph [London]* (15 October 1990) 27.

98 Graph created by Sébastien Raymond. Data taken from the following sources: Business Credit Management U.K., "Insolvency News" *Business Credit News U.K.* (26 July 1998), online: Business Credit Management U.K. <http://www.creditman.co.uk/news/2607.html#insolv>; U.K., The Insolvency Service, *Annual Report and Accounts 2001-02* (London: The Stationery Office, 2002) at 31, online: The Insolvency Service <http://www.insolvency.gov.uk/pdfs/annual2001-02web.pdf>; U.K., The Insolvency Service, *Annual Report and Accounts 2003-04* (London: The Stationery Office, 2004) at 15, 64, online: The Insolvency Service <http://www.insolvency.gov.uk/pdfs/annual2003-04web.pdf>; U.K., The Insolvency Service, *Annual Report and Accounts 2004-05* (London: The Stationery Office, 2005) at 22, online: The Insolvency Service <http://www.insolvency.gov.uk/pdfs/annual2004-05web.pdf>; U.K., The Insolvency Service, *Annual Report and Accounts 2005-06* (London: The Stationery Office, 2006) at 21,

In total, the average annual number of disqualifications continued to increase between 1989 and 2001-02, even though the number of insolvencies in the U.K. dropped by 40 percent between the years of 1995 and 2000.[99] In that light, it would seem that the *CDDA* has been incredibly successful. However, putting those numbers into a different context and looking at a broader picture may reveal that the success of the *CDDA* may be overstated. Even though the number of insolvencies dropped during those years, there were still a total of 70,000 insolvent liquidations between the years 1995-2000, and they only resulted in 5,808 recorded disqualifications under s. 6.[100] In 2002-2003, the number of disqualifications started to drop, and each year, including the last set of statistics published by the Insolvency Service in 2006-2007, has seen continued decreases.[101]

In carrying out the mandate to protect the public interest, several aspects of the disqualification regime encourage public involvement. In 1998, the Insolvency Service set up what has been informally dubbed the "Name and Shame Hotline," formerly the Enforcement Hotline, a telephone line available 24 hours. The hotline is "designed to catch defiant directors and undischarged bankrupts who blatantly disregard disqualification orders made against them."[102] The website indicates that the information provided is used to protect the public from continuing director misconduct.[103] Public figures have praised the concept of public shaming of directors, maintaining that

> [t]here must be no hiding place for those who flout the law. The public response to the hotline is making a major contribution to tracking down rogue directors. Directors who step over the line must be in no doubt of our determination to track them down. Both the public and other businesses must know that unfit directors will be brought to book. I want to protect the public from the abuse of privilege of limited liability and irresponsible conduct. I will continue to name and shame such persons.[104]

The Insolvency Service claims to follow up on every call made to the hotline and the hotline has instated itself as a popular method for tracking down directors engaged in misconduct.[105] In keeping with the public shame motif, the Companies House has also posted a Disqualified Directors Register, through which the details of disqualified directors are made public. The courts are required to provide the Registrar of Companies with information on every disqualification order and that information is available to the public on the website.

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online: The Insolvency Service <http://www.insolvency.gov.uk/pdfs/annual2005-06web.pdf>; U.K., The Insolvency Service, *Annual Report and Accounts 2006-07* (London: The Stationery Office, 2007) at 22, online: The Insolvency Service <http://www.insolvency.gov.uk/pdfs/annual2006-07web. pdf>.

99 Stephen Griffin, "The Disqualification of Unfit Directors and the Protection of the Public Interest" (2002) 53 N. Ir. Legal Q. 207 at 218.

100 *Ibid.*

101 *Annual Report and Accounts 2006-07*, *supra* note 98.

102 Companies House, *Disqualified Directors Register*, online: Companies House <http://www.companieshouse.gov.uk/ddir/> [Companies House, *Disqualified*].

103 *Ibid.*

104 Business Credit Management U.K., *supra* note 98.

105 Department of Trade and Industry (National), "'Fast Track' Disqualification Results in Record Bans" *News Distribution Service for Government and the Public Sector* (2 January 2002), online: News Distribution Service <http://nds.coi.gov.uk/Content/Detail.asp?ReleaseID=37853&NewsAreaID=2> [Department of Trade and Industry (National)].

The Register provides the director's name, address, date of birth, period of disqualification, and the legislation pursuant to which the order was made.[106]

Another successful aspect of the disqualification regime has been the "fast track" disqualification undertaking procedure, used only on questions of unfitness, under which the Secretary of State may reach an agreement with the director that he or she will not be involved in the management of a company for a specified period of time. The undertaking procedure takes place outside the courtroom, thereby allowing for a more cost-effective and faster disqualification process. Since its establishment, the disqualification undertaking procedure has proved to be popular. When the procedure was introduced by the *Insolvency Act 2000*, there was a substantial increase in disqualification orders[107] and the figures above indicate that disqualifications via undertaking make up a substantial number of the total number of disqualifications each year.

C. CONCLUSION

The protections imposed in the U.K. to ensure the safeguarding of creditors and other stakeholders from delinquent directors are extensive. They include common law duties, statutory duties that have the potential to hold directors personally liable, and a statutory disqualification scheme that is designed to deprive unfit directors of their livelihood. The duties imposed in the U.K. are considerable and hold the potential for significant consequences if unmet. In particular, the *CDDA* is designed to protect society from misbehaving directors by removing them from the market for directors and thereby preventing them from inflicting further harm on society through their continued involvement in the management of companies. While there have been some criticisms regarding the disqualification scheme, and while some changes may be necessary for a more effective regime, it can be said that the scheme works; thousands of unfit directors have been disqualified since 1986. The next section of this article looks at the regimes in Canada that allow for the removal of directors from their positions and whether a gap exists in Canadian law that could be eliminated with the adoption of a scheme like the *CDDA*.

III. CANADIAN LAW

The law in Canada dealing with creditor protections has, in several respects, taken a different direction than in other Commonwealth countries. *Peoples* confirmed that directors must always act in the best interests of the corporation when discharging their fiduciary duty and that interest does not shift when the corporation is insolvent. In carrying out that duty, directors may consider creditors' interests, and creditors can also be beneficiaries of the directors' duty of care.[108] Ever since the *Peoples* decision determined there is no direct duty owing to creditors,[109] the legislature has not moved to enact legislation similar to the

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106 Companies House, *Disqualified*, *supra* note 102.

107 Department of Trade and Industry (National), *supra* note 105.

108 See *Peoples*, *supra* note 1 at paras. 42, 57.

109 Specifically, in *Peoples*, *ibid.*, the Court determined that creditors cannot sue directors for failing to consider their interests but they do have other means at their disposal, namely the statutory oppression remedy (at paras. 47-48).

wrongful trading provisions and equivalent provisions in other commonwealth countries. Even the United States has developed the common law doctrine of deepening insolvency, which has the effect of protecting creditors if directors wrongfully prolong the life of the corporation.[110] The question is whether Canada's reluctance to expose directors to this type of liability is constrained to exposing them to financial liability, or whether that reluctance would also preclude Canada from adopting measures aimed at protecting the public, such as a disqualification scheme?

The adoption of a directors' disqualification regime in Canada is not a novel idea. The idea has been deliberated for decades, and at least since 1970 when the Tassé Report[111] recommended both the disqualification of directors of bankrupt companies and the imposition of personal liability by the court for deficiencies in company assets. That report led to insolvency legislation proposals in the late 1970s and early 1980s that died on the Order Paper.[112] In 1986, the recommendation for a disqualification regime was made again in Colter's report entitled *Report of the Advisory Committee on Bankruptcy and Insolvency*.[113] The Colter Report recommended that where there is wrongful conduct by a "responsible person," then any one of "the trustee, the official receiver or any interested person, including any creditor, should be entitled to apply to the court to have the responsible person disqualified from acting as a director of any corporation" for a time deemed sufficient by the court.[114] The Colter Report also recommended that if the wrongful conduct brings about a loss to the estate, the court should be able to order the person to pay damages.[115] Interestingly, the Colter Report indicated that the objective of the disqualification regime should be to penalize the wrongful conduct of those who manage a business,[116] unlike the purpose of the U.K. *CDDA*, which exists to protect the public. Director disqualification was again on topic in the *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*. In this report, Industry Canada determined that "[d]irector disqualification provisions might be effective in weeding out incompetent directors and curbing abuse," but also warned that the drawbacks in the regime would potentially be the cost of enforcement and the deterrence of qualified persons from acting as directors.[117]

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110 Girgis, *supra* note 14 at 175-81. As discussed in the article, however, this doctrine is currently in a state of flux in the U.S.

111 *Supra* note 3. The committee reviewed and reported on Canada's bankruptcy and insolvency legislation. The Tassé Report, released in 1970, formed the basis for a series of insolvency bills introduced in Parliament between 1975 and 1984, none of which were passed; see also Canada, Corporate Law Policy Directorate, *Insolvency Law in the Global Knowledge-Based Economy* (Ottawa: Industry Canada, 2001) at 7-9, online: Industry Canada <http://strategis.gc.ca/pics/cl/dp1e.pdf>.

112 See Canada, Parliamentary Information and Research Service, *Bankruptcy Law Update* by Margaret Smith (Ottawa: Library of Parliament, 1999), online: Parliament of Canada <http://www.parl.gc.ca/information/library/PRBpubs/8816-e.htm>. This document provides background information and progress of the legislation.

113 Colter Report, *supra* note 3.

114 *Ibid.* at 114.

115 *Ibid.* at 115.

116 *Ibid.*

117 Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: Industry Canada, 2002) at 45-46, online: Industry Canada <http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/3040-Bankruptcies.pdf/$FILE/3040-Bankruptcies.pdf> .

Even though the concept has been contemplated for the last 40 years, the Canadian government has refrained from legislating a director disqualification regime. That said, however, the government has allowed various provisions to filter through to allow for the removal of directors in specific circumstances. This part of the article will briefly discuss the current law dealing with director duties in Canada, as well as the proposed amendments put forward by c. 47 to determine whether the provisions allowing for the removal of directors can serve the same purpose as the *CDDA*. The article will also consider provisions in the provincial securities legislation and the oppression remedy to determine whether they can serve as the equivalent of the *CDDA*. The co-existence of a disqualification scheme and the business judgment rule will be considered, as any authority wielded by the court for the purpose of disciplining directors automatically gives rise to concerns about the deference afforded to directors' business decisions. Furthermore, the issues raised with regard to the U.K. disqualification scheme will be revisited to determine whether the problems are as significant as maintained. Finally, this article will consider the question of constitutionality in order to address the issue of the enactment and regulation of the regime in Canada.

A. CURRENT CANADIAN LAW[118]

1. DIRECTORS' DUTIES

Under s. 122(1)(a) of the *CBCA*, each director owes a fiduciary duty to the corporation, sometimes known as a duty of loyalty, to act honestly and in good faith with a view to the corporation's best interests.[119] Separate from this fiduciary duty, each director and officer also has a duty to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances" pursuant to s. 122(1)(b) of the *CBCA*, a requirement generally referred to as the "duty of care."[120]

Originally, directors had no duties to creditors and could ignore creditors' interests, subject only to tort and contract rules.[121] This continued to be the predominant view in Canada until *Re Trizec Corp.*,[122] which dealt with an application for approval of a proposed plan of arrangement. *Trizec* was pivotal because it signalled a significant shift in the traditional concept of directors' duties. Rather than directors owing duties only to the corporation, Forsyth J. determined that "a specific duty to shareholders becomes intermingled with a duty to creditors when the ability of a company to pay its debts becomes questionable."[123] The shift toward the perception that directors' duties extend to creditors as

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118 Parts of this section first appeared in Girgis, *supra* note 14; see also *ibid.* It is important to note that the *Civil Code of Québec*, arts. 329-30 C.C.Q., permit the court to prohibit a person from being a director "if the person has been found guilty of an indictable offence involving fraud or dishonesty" in relation to the corporation, or if the person has "failed to fulfil his [or her] obligations as a director." The prohibition may not extend "beyond five years from the latest act charged." These provisions are outside the scope of discussion for this article and further investigation would be necessary before commentary is possible.

119 *CBCA*, *supra* note 12, s. 122(1)(a).

120 *Ibid.*, s. 122(1)(b). Corporate statutes in each province also impose similar duties.

121 Ziegel, "Creditors as Corporate Stakeholders," *supra* note 13 at 517; *Royal Bank of Canada v. First Pioneer Investments Ltd.* (1979), 106 D.L.R. (3d) 330 (Ont. H.C.J.).

122 (1994), 158 A.R. 33 (Q.B.) [*Trizec*].

123 *Ibid.* at para. 42.

a corporation approaches insolvency gained support with the trial court decision in *Peoples Department Stores Inc. (Trustee of) v. Wise*,[124] in which Greenberg J. found the corporation's directors personally liable for having breached their duties to creditors. He relied on U.K., Australian, and New Zealand jurisprudence to determine that Canadian directors' duties in s. 122(1) of the *CBCA* should extend to the corporation's creditors when the corporation is insolvent or close to insolvency. However, the Quebec Court of Appeal overturned the trial judge's decision and noted that expanding the scope of directors' duties was a legislative issue, not one for the courts.[125]

The dismissal of the subsequent appeal by the Supreme Court of Canada in *Peoples*[126] sharply halted the expansion of directors' duties. The Court held that, in carrying out their fiduciary duty, the board of directors may consider, "*inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment"[127] while realizing that directors owe the fiduciary duty to the corporation and "[t]he interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders."[128] Rather, as directors attempt to alleviate a corporation's financial difficulties, they must act honestly and in good faith in the best interests of the corporation. In so doing, directors will not breach their statutory fiduciary duty, regardless of whether or not they manage to save the corporation.[129] Directors' duties of care, however, could encompass various constituents.

2. CURRENT LEGISLATIVE PROVISIONS DEALING WITH DIRECTOR DISQUALIFICATION — ALTERNATIVE WAYS OF REMOVING DIRECTORS?

Certain provisions in Canadian legislation allow for the removal of directors, but only the provisions found in securities legislation may permit for director disqualification. However, as will be discussed below, the provisions are unlikely to be used as the equivalent of the U.K. *CDDA*.

The most recent amendments to the *BIA* and *CCAA*,[130] once proclaimed, will also have the effect of allowing the court to remove directors, but not disqualify them. The provisions were being contemplated by the legislature at the time Farley J. removed two directors from their posts during the company's restructuring in *Re Stelco Inc.*[131] and based his decision on his inherent jurisdiction and the discretion granted to the court under the *CCAA*.[132] Justice Farley

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124 (1998), 23 C.B.R. (4th) 200 (Qc. Sup. Ct.).

125 *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2003] R.J.Q. 796 (C.A.) at paras. 95-96.

126 *Peoples*, *supra* note 1.

127 *Ibid.* at para. 42; also see *BCE*, *supra* note 1.

128 *Peoples*, *ibid.* at para. 43.

129 *Ibid.* at para. 67.

130 *Wage Earner Protection Program Act*, *supra* note 8.

131 (2005), 75 O.R. (3d) 5 (C.A.) at paras. 2-10 [*Stelco*], rev'g (2005), 7 C.B.R. (5th) 307 (Sup. Ct.) and (2005), 7 C.B.R. (5th) 310 (Sup. Ct.).

132 See *Senate Report*, *supra* note 11 at xxiii, recommendation 35. The idea for a director removal scheme had been proposed in 2003 by the Senate Committee when it recommended that the *BIA* and the *CCAA* be "amended to permit the Court to replace some or all of the debtor's directors during proposals or reorganizations," respectively, if they are impairing the development and implementation of a going concern solution.

was overturned on appeal when the Ontario Court of Appeal determined that the supervisory judge's discretion under s. 11 of the *CCAA*, while broad and flexible, does not extend to the discretion to remove directors.[133] However, the idea of being able to remove directors during a restructuring without having to invoke the oppression remedy was not forgotten. When c. 47 was announced, it contained two proposed provisions that would have the effect of amending both the *BIA* and the *CCAA* in a way to allow for the removal of directors as Farley J. had attempted to accomplish in *Stelco*.[134] The addition of s. 11.5 in the *CCAA*, and s. 64 in the *BIA* will empower the court to order the removal of a director of a debtor company from office if the director is impairing, or likely to impair the arrangement in the case of the *CCAA*, or the proposal, in the case of the *BIA*. The amendments also provide courts with the ability to fill the vacancies created by the removal of directors.[135] Also, it could be argued that the test used to remove directors pursuant to s. 11.5 is comparable to that used to determine the unfitness of a director under the *CDDA*.[136] However, the new provisions cannot be used as an equivalent to the *CDDA*. The amendments allow the court to remove directors in narrow situations involving restructuring, whereas the situations in which a director can be disqualified under the *CDDA* are broader, allowing for a disqualification at any time during the corporation's life. Also, the amendments simply address the removal of directors from a debtor company; they do not provide for the power to disqualify a director from being involved in the management of any company for a defined period of time. Therefore, while directors can be removed pursuant to these amendments, the amendments cannot act as an equivalent to the powers that would be provided to courts pursuant to legislation similar to the *CDDA*.

The remainder of this section deals with the provisions currently in place in Canada which allow for the removal of directors and inquires into whether they could provide an alternative way to go about disqualifying directors to provide an outcome similar to the *CDDA*.

a. Securities Legislation

Provincial securities legislation provides the securities commissions with the ability to order a director or officer to resign his or her position held with the issuer and to prohibit a person from becoming or acting as a director or officer of any issuer.[137] These "public

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133 *Stelco, supra* note 131 at paras. 34-54. Specifically, the Court determined that a supervisory judge could only remove directors in a restructuring pursuant to s. 20 of the *CCAA*, which provides the ability to use the *CCAA* with other acts of Parliament. In this case, s. 20 could provide a gateway for the use of the oppression remedy, pursuant to which a court can order directors to be removed.

134 Industry Canada, *Bill C-55: Clause by Clause Analysis*, online: Industry Canada <http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00785.html>. See especially cl. 42, s. 64; cl. 128, s. 11.5.

135 This addresses the problem of needing to hold potentially lengthy shareholder meetings to elect new directors in the middle of restructuring processes.

136 Marie Bruchet, "Director Removal under the CCAA" (2008) 24 B.F.L.R. 269.

137 This section of the article will focus primarily on Ontario securities legislation but the other provinces have equivalents provisions. In Ontario, *Securities Act*, R.S.O. 1990, c. S-5, s. 127 [Ontario *Securities Act*]; in Alberta, *Securities Act*, R.S.A. 2000, c. S-4, s. 198; in British Columbia, *Securities Act*, R.S.B.C. 1996, c. 418, s. 161; in Manitoba, *The Securities Act*, R.S.M. 1988, c. S50, s. 148; in New Brunswick, *Securities Act*, S.N.B. 2004, c. S-5.5, s. 184; in Newfoundland, *Securities Act*, R.S.N. 1990, c. S-13, s. 127; in the Northwest Territories, *Securities Act*, S.N.W.T. 2008, c. 10, ss. 58-63; in Nunavut, *Securities Act*, S.Nu. 2008, c. 12, ss. 58-63; in Nova Scotia, *Securities Act*, R.S.N.S. 1989, c. 418, ss. 134, 135A, 136A, 145; in Prince Edward Island, *Securities Act*, R.S.P.E.I. 2007, c. 17, ss. 58-63; in Quebec,

interest" orders fall under the commissions' public interest jurisdiction and confer on the commissions very broad powers under which they can also make several orders, including: that a person or company cease trading, be reprimanded, or disgorge to the commission that which was obtained as a result of the non-compliance, or that a person or company failing to comply with the province's securities law pay an administrative penalty.[138] The commission can make any of the above orders only after it has conducted a hearing[139] and it can make an order pursuant to s. 127 even where there has been no breach of securities law.[140]

Section 127 is regulatory and contains administrative sanctions, meaning the commission's public interest jurisdiction is preventative and protective rather than punitive. The provision aims to prevent future conduct that could be prejudicial to the public interest, as opposed to punishing wrongdoers' past conduct.[141] Investors, as well as "[t]he effect of an intervention in the public interest on capital market efficiencies and public confidence in the capital markets"[142] need to be considered when an order in the public interest is made.

As indicated above, the securities commission's public interest powers include the ability to order a director or officer to resign his or her position held with the issuer and to prohibit a person from becoming or acting as a director or officer of any issuer. However, it is unlikely that the power could be used as the equivalent to the *CDDA* since the securities commissions may not be willing to order a director to resign for the same type of misconduct that would give rise to a disqualification order for unfitness under the *CDDA*. An examination of decisions in Ontario and Alberta lead to the conclusion that the types of actions that compel the securities commissions to exercise their public interest jurisdiction involve securities violations, like insider trading, misrepresentation, and the failure to follow registration and prospectus filing requirements.[143] There has been one instance in which the

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Securities Act, R.S.Q. v-1.1, S-42.2, s. 262.1; in Saskatchewan, *Securities Act*, S.S. 1988-99, c. S-42.2, ss. 134, 134.1, 135.1, 135.2; in Yukon, *Securities Act*, S.Y. 2002, c. 16, ss. 58-63.

138 Ontario *Securities Act*, *ibid.*, s. 127(1).

139 *Ibid.*, s. 127(4).

140 *Re Cablecasting Ltd.*, [1978] O.S.C. Bull. 37 at 41 [*Re Cablecasting*]. *Re Cablecasting* was a controversial decision by the Ontario Securities Commission, and one held as aiming to maintain the spirit of the legislation and not only carrying out its black letter law. Accord *Re Canadian Tire Corp.* (1987), 10 O.S.C. Bull. 857 [*Canadian Tire*], aff'g (1987), 10 O.S.C. Bull. 1771, restating the principle enunciated in *Re Cablecasting*; see Anita Anand, "Carving the Public Interest Jurisdiction in Securities Regulation: Contributions of Justice Iacobucci" (2007) 57 U.T.L.J. 293 at 298-99.

141 *Re Mithras Management Ltd.* (1990), 13 O.S.C. Bull. 1600 at 1610-11 [*Mithras*]; *Re Albino* (1991), 14 O.S.C. Bull. 365; *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at para. 43 [*Asbestos Minority Shareholders*], aff'g (1999), 43 O.R. (3d) 257 (C.A.)). Justice Iacobucci, speaking for the Court and relying on *Mithras* indicated that "[t]he role of the OSC [Ontario Securities Commission] under s. 127 is to protect the public interest by removing from the capital markets those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets" (at para. 43); *Re Maitland Capital Ltd.*, 2007 ABASC 818 at paras. 12-13.

142 *Asbestos Minority Shareholders*, *ibid.* at para. 41.

143 See e.g. *Re Harper* (2004), 27 O.S.C. Bull. 3937 (Harper was prohibited from becoming or acting as a director or officer of any reporting issuer for 15 years, after he was prosecuted for insider trading); see also *Re Cartaway Resources Corp.*, 2004 SCC 26, [2004] 1 S.C.R. 672 (the British Columbia Securities Commission found two securities brokers had relied on a prospectus exemption to which they were not entitled and barred them from acting as brokers or directors of controlling companies for one year and penalized them $100,000 each. The penalty was upheld by the Supreme Court of Canada); *Ochnik v.*

provision was used to order a director to resign as a result of having breached his fiduciary duty and duties of care,[144] but the decision is isolated and the situation seems to be more of an exception than a rule. It is the case that even though the securities commissions have the power to order directors and officers to resign and prohibit them from becoming involved in the management of a corporation, their focus is on securities legislation contraventions, rather than the broader scope of infringements that would be caught by the definition of "unfitness" in the *CDDA*. Attempting to bring situations involving questions of fitness before the securities commissions necessarily means their focus must be expanded to encompass misconduct that may not necessarily involve a violation of securities legislation. While it may be possible to expand their jurisdiction, it is neither desirable nor realistic. As experts in securities legislation, broader misconduct constituting unfitness, namely misdeeds involving breach of directors' duties, misfeasance, incompetence, gross negligence, trading at the risk of creditors, alleged wrongs done to stakeholders, and breach of commercial morality, will fall outside the focus of the commissions. If a director disqualification scheme is created, it would necessarily be the case that the jurisdictions of the securities commissions and those entrusted with managing the *CDDA*, be it a commission or the courts, would overlap in certain respects. However, that does not mean that a separate system should not be set up to deal with disqualification issues that are separate and apart from violations of securities legislation.

b. Oppression Remedy

Another provision pursuant to which courts could remove directors for the types of wrongs caught by the *CDDA* is the oppression remedy.[145] The oppression remedy can be granted when the court is satisfied that the corporation or its directors acted in a way "that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer."[146] "Oppressive" conduct has been defined "as

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Ontario (Securities Commission) (2007), 224 O.A.C. 99 (Sup. Ct. J.) (the Superior Court upheld the Ontario Securities Commission's order that a trader engaged in an RRSP loan scheme who was trading while unregistered be permanently prohibited from becoming or acting as a director); see also *Turkawski v. 738675 Alberta Ltd*., 2006 ABQB 360, 402 A.R. 150.

144 *Re Keywest Resources Ltd.*, [1995] 14 B.C.S.C.W., Summ. 9, aff'd (1995), 8 C.C.L.S. 201 (C.A.); see also *Canadian Tire*, *supra* note 140 (it was determined that an allegation of breach of fiduciary duty, and evidence of the allegation, would support a cease trading order).

145 See generally Robert Yalden *et al.*, *Business Organizations: Principles, Policies and Practice* (Toronto: Emond Montgomery, 2008) at 841. The U.K. also has an oppression remedy but the one found in the *CBCA* is broader. The Canadian oppression remedy broadens the class of potential applicants for the remedy, expands the types of interests protected, and expands the range of conduct that may form the basis of a successful application.

146 *CBCA*, *supra* note 12, s. 241(2); see also Alberta's, *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 242(2) [*ABCA*]; in Manitoba, *The Corporations Act*, R.S.M. 1987, c. C255, s. 234(2); in New Brunswick, *The Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 166(2); in Newfoundland, *Corporations Act*, R.S.N. 1990, c. C-36, s. 371(2); in Nova Scotia, *Companies Act*, R.S.N.S. 1989, c. 81, Sch. III, s. 5(2); in Ontario, *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 248(2) [*OBCA*]; in Saskatchewan, *The Business Corporations Act*, R.S.S. 1978, c. B-10, s. 234(2); in Yukon, *Business Corporations Act*, R.S.Y. 2002, c. 20, s. 243(2); in the Northwest Territories and Nunavut, *Business Corporations Act*, S.N.W.T. 1996, c. 19, s. 216(1); in British Columbia, *Business Corporations Act*, S.B.C. 2002, c. 57, ss. 227(2), 228(1) (British Columbia only protects shareholders "or any other person whom the court considers to be [appropriate]"); there is no such provision under the Prince Edward Island or Quebec statutes.

'burdensome, harsh and wrongful'; 'unfairly prejudicial' as 'inequitable or unjust' and 'unfairly disregarding' as 'unjustly or without cause … paying no attention to the interests of creditors.'"[147]

Section 241 of the *CBCA* allows for a complainant to make an application under the following circumstances:

> (1) A complainant may apply to a court for an order under this section.
>
> (2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates
>
> > (a) any act or omission of the corporation or any of its affiliates effects a result,
> >
> > (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
> >
> > (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.[148]

The powers granted under the oppression remedy are significant and the court is able to make "any interim or final order it thinks fit,"[149] including an order that the conduct complained of be restrained[150] and that directors be appointed "in place of or in addition to all or any of the directors then in office."[151] The oppression remedy provides "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world"[152] and is worded broadly enough such that virtually anyone can be granted status as a "proper person"[153] to pursue the remedy at the court's discretion.[154]

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147 *Heap Noseworthy Ltd. v. Didham* (1996), 137 Nfld. & P.E.I.R. 240 (S.C.) at para. 15; *Westfair Foods Ltd. v. Watt* (1990), 106 A.R. 40 (Q.B.) at paras. 46-61; *Stech v. Davies* (1987), 80 A.R. 298 (Q.B.) at paras. 14-20.

148 *Supra* note 12, ss. 241(1), 241(2).

149 *Ibid.*, s. 241(3).

150 *Ibid.*, s. 241(3)(a).

151 *Ibid.*, s. 241(3)(e).

152 Stanley M. Beck, "Minority Shareholders' Rights in the 1980s" in Law Society of Upper Canada, ed., *Special Lectures of the Law Society of Upper Canada: Corporate Law in the 80s* (Don Mills: Richard De Boo, 1982) 311 at 312.

153 *CBCA*, *supra* note 12, s. 238(d).

154 *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 60 Alta. L.R. (2d) 122 (Q.B.), at 152, (complainant status can be granted to an applicant "if the act or conduct of the directors or management of the corporation which is complained of constituted a breach of the underlying expectation of the applicant arising from the circumstances in which the applicant's relationship with the corporation arose"); Janis P. Sarra & Ronald B. Davis, *Director and Officer Liability in Corporate Insolvency: A Comprehensive Guide to Rights and Obligations* (Markham: Butterworths, 2002) at 35 (the definition of "proper person" has been broadly interpreted to include creditors); Ontario is jurisdiction to which this applies. In Alberta, however, legislation has specified that a creditor cannot be a complainant, subject to the court's discretion; see *ABCA*, *supra* note 146, s. 239; see *Peoples*, *supra* note 1 at paras. 47-51 (the Supreme Court of Canada claimed that directors' duties toward creditors are not necessary given that creditors already have the oppression remedy and Canadian creditors have been allowed to bring applications for the remedy on numerous occasions); *Olympia & York Developments Ltd. (Trustee*

Courts have repeatedly asserted that they have tremendous powers under the oppression remedy to fashion any remedy they think fit,[155] and it has been held that this power is "among the broadest and most flexible of the powers vested in the courts in the corporate law domain."[156] The conduct complained of need not be deliberate; courts are able to intervene even if bad faith has not been established.[157] The remedy, however, is not without its limitations. Courts are not able to freely participate in the management of the corporation, but must limit their involvement to making orders "to rectify the matters complained of."[158] Accordingly, the jurisdiction of the courts ceases to exist once the matter complained of has been rectified.[159]

It is undisputed that courts can exercise their powers under the oppression remedy to remove directors,[160] and they have been doing it for years. Dennis Peterson, in *Shareholder Remedies in Canada*, determined that the "order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager."[161] The leading Canadian case is *Sparling*, in which the court removed company directors when it was found that they considered only the interests of majority shareholders and neglected those of the minority. In *Ballard*, the directors were removed for neglecting the interests of the corporation for those of the controlling shareholder. In *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*,[162] directors were removed under the oppression remedy after it was found that their continued involvement would "significantly impede" public shareholders' interests and that they were putting their interests ahead of the company's.[163] Courts have also removed directors for self-dealing or misappropriation of corporate assets,[164] causing harm

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of) v. Olympia & York Realty Corp. (2001), 16 B.L.R. (3d) 74 (Ont. Sup. Ct. J.), aff'd (2003) 68 O.R. (3d) 544 (C.A.) (finding the trustee in bankruptcy to be a proper complainant and allowing him to pursue the oppression remedy in the interests of the creditors because his primary obligation was to protect the creditors); *Levy-Russell Ltd. v. Shieldings Inc.* (1998), 41 O.R. (3d) 54 (Ct. J. (Gen. Div.)); *Danylchuk v. Wolinsky*, 2007 MBQB 65, [2007] 6 W.W.R. 453 at para. 20; *Dylex Ltd. (Trustee of) v. Anderson* (2003), 63 O.R. (3d) 659 (Sup. Ct. J.) (courts have granted the necessary standing to Canadian creditors, and to the trustees representing them, in cases in which directors failed to consider their interests).

155 *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 at para. 120 (Ont. Ct. J. (Gen. Div.)) (quoting Beck, *supra* note 152 at 312) [*Ballard*], aff'd (1991), 3 B.L.R. (2d) 113 (Ont. Ct. J. (Gen. Div.)).

156 *Catalyst Fund General Partner I Inc. v. Hollinger Inc.* (2006), 79 O.R. (3d) 288 (C.A.) at para. 49 [*Catalyst*].

157 *Sparling v. Javelin International Ltd.*, [1986] R.J.Q. 1073 at 1077 (Sup. Ct.) [*Sparling*, Sup. Ct.], aff'd (1991), [1992] R.J.Q. 11 (C.A.), leave to appeal to S.C.C. refused, [1992] 3 S.C.R. vi [*Sparling*].

158 *Sparling*, Sup. Ct., *ibid.* at 1077.

159 *Ibid.*

160 *Ibid.* at 1078; accord *Stelco*, *supra* note 131 at paras. 47, 55; accord *Catalyst*, *supra* note 156 at paras. 51-52.

161 Dennis H. Peterson, *Shareholder Remedies in Canada*, looseleaf (Toronto: Butterworths, 1989) at para. 18.172.

162 *Catalyst Fund General Partner I Inc. v. Hollinger Inc.* (2004), 1 B.L.R. (4th) 186 (Ont. Sup. Ct. J.) [*Catalyst* (S.C.J.)].

163 *Ibid.* at paras. 82-83, aff'd *Catalyst*, *supra* note 156.

164 *Brokx v. Tattoo Technology Inc.*, 2004 BCSC 1723, 50 B.L.R. (3d) 221; *Tsui v. International Capital Corp.*, [1993] 4 W.W.R. 613 (Sask. Q.B.), aff'd [1993] 4 W.W.R. lxvii (Sask. C.A.); *Chicago Blower Corp. v. 141209 Canada Ltd.* (1988), 40 B.L.R. 201 (Man Q.B.); *Ambeau v. Buck A Day Co.* (2003), 123 A.C.W.S. (3d) 586 (Ont. Supt. Ct. J.); *Walker v. Betts*, 2006 BCSC 1096, 58 B.C.L.R. (4th) 180,

to the corporation as a result of their incompetence,[165] and failing to remit taxes.[166] However, that said, removing directors under the oppression remedy, "one of the most interventionist orders under the oppression remedy,"[167] is an exceptional remedy to be used in moderation.[168] Courts will refrain from exercising that power, as they generally seek to refrain from interfering in the management of companies unless such interference is warranted in the circumstances. The starting point used by all courts is set out by Peterson:

> Removing and appointing directors to the board is an extreme form of judicial intervention.... It is clear that the board of directors has control over policy-making and management of the corporation. By tampering with a board, a court directly affects the management of the corporation. If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of directors should be a measure of last resort. The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager.[169]

So can the oppression remedy be used in place of the *CDDA*? First and foremost, it is important to realize that the oppression remedy can only be used to remove directors from the immediate oppressive situation, not to disqualify them from becoming involved in the management of companies in the future. While the court does have the power to render "any interim or final order," the order must be limited to deal with the particular oppressive situation. A court would be hard pressed to justify an order disqualifying a director from becoming involved in the management of corporations not involved in the particular situation before the court. Even if it would be possible for courts to disqualify directors using the oppression remedy, the issue, as shown above, is not whether courts are able to remove directors for oppressive conduct. Rather, the issue is whether the courts would be willing to expand the scope of their jurisdiction under the oppression remedy and overcome their unwillingness to use it for the removal of directors for the types of conduct for which directors are disqualified under the *CDDA*. It would certainly be possible to bring the broader misconduct constituting unfitness into the oppression remedy; misconduct involving directors' duties, misfeasance, incompetence, gross negligence, trading at the risk of creditors, alleged wrongs done to stakeholders, and breach of commercial morality can constitute oppressive conduct in appropriate circumstances. Any one of the instances cited above, in which directors were removed under the oppression remedy, is capable of being construed as conduct harmful to the interests of the corporation and the stakeholders. However, since the removal of directors is seen as an exceptional remedy, the likelihood of instituting a successful system for the removal of directors under the oppression remedy is

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(the director was removed for breaching fiduciary duty to the shareholders by misappropriating corporate funds for her personal benefit).

165 *Such v. RW-LB Holdings Ltd.* (1993), 147 A.R. 241 (Q.B.), (the defendant director failed to remit taxes, pursued frivolous lawsuits, had the company's operating licence revoked as a result of having breached regulatory statutes, and treated corporate assets as his own); *Trnkoczy v. Shooting Chrony Inc.* (1991), 1 B.L.R. (2d) 202 (Ont. Ct. J.(Gen. Div.)) [*Trnkoczy*].

166 *Trnkoczy*, *ibid.*; *Khayraji v. Safaverdi* (1996) 33 B.L.R. (2d) 108 (Ont. Ct. J. (Gen. Div.)).

167 Markus Koehnen, *Oppression and Related Remedies* (Toronto: Thomson Carswell, 2004) at 349.

168 *Catalyst* (S.C.J.), *supra* note 162 at para. 68; *Stelco*, *supra* note 131 at para. 55 (the Court of Appeal indicated that the remedy should be used only once a very high bar has been met).

169 *Supra* note 161 at para. 18.172.

remote. Reserving the oppression remedy for situations in which oppression is involved, and having a separate scheme under which directors can be disqualified, would be the simpler, preferred method.

While directors can be removed pursuant to the power granted under securities legislation and the oppression remedy, they cannot be disqualified as is done in the U.K. pursuant to the *CDDA*. It is therefore important to seriously consider adopting a scheme similar to the *CDDA* in Canada. If Canadians are reluctant to hold directors personally liable for the debts of the corporation or impose fiduciary duties to creditors, a disqualification scheme may be the answer. While disqualification poses a threat to directors' livelihood, it is not as severe as imposing personal liability on them for the debts incurred by a corporation when it should not have been trading. Most importantly, disqualification protects the public and creditors from directors who have been proven to be unfit to manage a corporation.

IV. DIRECTOR DISQUALIFICATION SCHEME AND THE BUSINESS JUDGMENT RULE

The implementation of a director disqualification scheme may give rise to concerns regarding the undermining of the business judgment rule. The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[170] The rule protects directors by ensuring that courts refrain from substituting their own judgment for that of directors so long as the directors were prudent, diligent, and carried out their decision in good faith. The rule is necessary in order to "avoid the risk of stifling innovation and venturesome business activity."[171] Imposing a scheme allowing for courts to disqualify directors based on decisions they have made with regard to the corporation raises concerns that directors, worried about having their decisions second-guessed or subjected to court scrutiny, will refrain from taking risks on behalf of the corporation in order to avoid disqualification.

In the U.K., while there has been no statutory adoption of the business judgment rule,[172] the courts have nonetheless been reluctant to assess directors' business decisions where fraud or bad faith was not a factor.[173] As early as 1974, in *Howard Smith Ltd. v. Ampol Petroleum*

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170 *Aronson v. Lewis*, 473 A.2d 805 at 812 (Del. Sup. Ct. 1984) [*Aronson*]; *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 at 954 (Del. Sup. Ct. 1985) (citing *Aronson*).

171 American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, vol. 1 (St. Paul: American Law Institute, 1994) at para. 4.01.

172 Davies, *supra* note 21 at para. 16-15; U.K., Law Commission & Scottish Law Commission, *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (London: Law Commission, 1999), online: Law Commission <http://www.lawcom.gov.uk/docs/cpl53.pdf>. The Law Commission did not think the statutory adoption of a "business judgment rule" was necessary in the U.K. after considering the state of law in the U.S. and in Australia. The Commission found that in Australia, the statutory provisions were brought in as a result of uncertainty that existed with regard to the monitoring role for company directors, which, unaddressed, would have impeded decision-making by directors (at paras. 15.42-15.49), but determined that unless similar uncertainty existed in the U.K., the present law would be sufficient (at para. 15.50).

173 Caroline Bradley, "Enterprise and Entrepreneurship: The Impact of Director Disqualification" (2001) 1 J.C.L.S. 53 at 64; Davies, *ibid.*

Ltd., Lord Wilberforce stated, "it would be wrong for the court to substitute its opinion for that of the management, or indeed to question the correctness of the management's decision … if bona fide arrived at."[174] Similarly, in *Equitable Life Assurance Society v. Hyman* in 2000, the House of Lords maintained, "[t]he courts will not interfere with the exercise by directors of a discretionary power granted by the articles of a company unless it is shown that the power has not been exercised bona fide in the interests of the company or that it has been exercised for a collateral purpose."[175] Therefore, even though the business judgment rule has not been formally adopted, the courts in the U.K. approach the assessment of directors' business judgments in a way similar to the approach employed by courts in the U.S. and in Canada. Therefore, the *CDDA* and the informally-adopted business judgment rule have co-existed in the U.K. since the adoption of the *CDDA*.

In discussing the adoption of a disqualification scheme in Canada, the Colter Report cited the above concern and recommended that wrongful conduct caught by a disqualification scheme should include "inexcusable disregard of commercial morality" but not "a mistake of judgement,"[176] which was likely an attempt to prevent courts from undermining the business judgment rule. That concern is largely unwarranted, as it is unlikely that Canadian courts would begin second guessing directors' good faith and diligently-made decisions regardless of the statutory scheme adopted. This has not been a problem in the U.K., a jurisdiction that does not formally recognize the business judgment rule. The concern would surface in the courts' development of the definition of "unfitness," which, as indicated above, can be found when there has been a lack of commercial morality or incompetence under the *CDDA*. However, under the *CDDA*, when questions of fraud or bad faith are not in issue, the threshold required for a finding of incompetence has usually been high and has not dipped to one of mere negligence, with U.K. courts using words like "reckless,"[177] "gross negligence,"[178] "total incompetence,"[179] and "negligence in a very marked degree"[180] to define the standard. The statement, "[t]heir negligence must be not the omission to take all possible care; it must be much more blameable than that: it must be in a business sense culpable or gross"[181] seems to encapsulate the general view taken by U.K. courts when defining "unfitness." If a high threshold is maintained for a finding of unfitness, there will be no concern about undermining the business judgment rule.

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174 [1974] A.C. 821 at 832 (P.C.) [*Ampol Petroleum*].

175 (2000), [2002] 1 A.C. 408 at 446. This proposition has been stated numerous times: see *Ludgate Insurance Co. Ltd. v. Citibank NA*, [1998] Lloyd's Rep. I.R. 221 (C.A. (Civ. Div.)); *Re Smith and Fawcett, Ltd.*, [1942] Ch. 304 (C.A.); *Baerlein v. Dickson* (1909), 25 T.L.R. 585; *Ampol Petroleum, ibid.*; *Wayde v. New South Wales Rugby League Ltd.* (1985), 180 C.L.R. 459; *Edge v. Pensions Ombudsman* (1997), [1998] Ch. 512.

176 Colter Report, *supra* note 3 at 115.

177 *Re Stanford Services Ltd.* (1987), 3 B.C.C. 326 at 335 (Ch.D.).

178 *Electric Motors*, *supra* note 39 at 486.

179 *Ibid.*

180 *Re Sevenoaks*, *supra* note 71 at 184.

181 *Goldberg*, *supra* note 84 at para. 18, quoting *Lagunas*, *supra* note 85 at 435; see also Griffin, *supra* note 99 at 214, where he says "conduct which exhibits the hallmarks of gross incompetence as opposed to mere business folly, may, depending on the consequences of such conduct, give rise to a disqualification order."

V. PROBLEMS WITH *COMPANY DIRECTORS DISQUALIFICATION ACT* — INSURMOUNTABLE?

While the numbers cited above may suggest that the *CDDA* has been a successful tool in ridding the market of misbehaving directors in the U.K., commentators have long speculated that the disqualification regime and/or the way it is implemented is problematic and that the numbers reported are misleading. Criticisms about the regime have ranged from the cost of the process to the difficulty courts have in defining "unfitness."[182] One of the most important and ongoing concerns, however, was voiced by Andrew Hicks in his research study, "Disqualification of Directors: No Hiding Place for the Unfit?" in which he maintained that the disqualification system needed to cease focusing on and measuring its success by the quantity of the disqualifications, and instead focus on the quality of the disqualifications attained.[183]

Professor Hicks maintained that the high number of disqualifications orders annually cited by the Insolvency Service should not be taken to mean that the disqualification regime is fulfilling its purpose,[184] namely protecting the public from rogue directors and providing an incentive for directors to behave by creating a "public shaming" system in which directors would be unable to obtain work in the field once his or her reputation is destroyed by virtue of a disqualification order. He found that most of the disqualification orders were against directors who were owner-managers of small businesses,[185] which fails to fulfill both elements of the purpose of the legislation, as disqualification does not have the same consequences for them as it does for directors of larger companies. The directors of smaller businesses tend to go on and find new work or eventually set up another business, whereas the career executives would have difficulty re-establishing themselves after a disqualification order has been made, as they tend to suffer reputational consequences and are unable to obtain jobs in the future. The problem, however, is that by simply focusing on the numbers of disqualifications, one is not accounting for the types of directors who are being disqualified. Ideally, through disqualification, a potential hazard is removed from the market, the director whose misconduct has the potential to affect a significant segment of society, and that goal is met to a lesser degree when directors of small companies are disqualified. As Professor Hicks said:

> Government policy needs to avoid concentrating its resources on increasing the crude number of disqualifications. It should, rather, focus its efforts on investigating and, if necessary disqualifying, directors of larger companies whose unfit conduct has the potential to cause the greatest damage within the commercial world and for whom the consequences of disqualification are likely to have the greater impact. Further, the legislation needs to be reformed so as to allow longer, even indefinite, periods of disqualification

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182 For an excellent discussion of the concerns and the attempts to address them, see Davies, *supra* note 21 at para. 10-4; see also Cork Report, *supra* note 17 at paras. 1813-37 for concerns about the disqualification provisions before they were consolidated in the *CDDA*; Andrew Hicks, "Disqualification of Directors" *Association of Chartered Certified Accountants* (1 June 1999), online: ACCA <http://www.accaglobal.com/archive/sa_oldarticles/36797> [Hicks, ACCA].

183 Hicks, *supra* note 61.

184 Hicks, ACCA, *supra* note 182.

185 *Ibid.*

> in appropriate cases. Overall, the emphasis should be on the quality and not the number of disqualifications achieved.[186]

While Professor Hicks' concerns are certainly notable, they may paint a more dire picture than necessary. Even if disqualification orders are most commonly imposed on directors of closely held corporations, this does not necessarily mean that unfit directors of failed publicly held corporations are allowed to escape consequences. As he notes, the purpose of the disqualification regime is the provision of a public shaming system and consequent reputational damage. While that can be achieved through a disqualification order, it may also be achieved through the public market for directors, at least for executive directors.

The type of conduct flagged by Professor Hicks may be more prevalent in closely-held companies. This conduct includes phoenixism, whereby directors drive a company to liquidation then go on to start a similar company. In this situation, personal guarantees by directors to creditors compel directors to keep trading when the company is in financial difficulty in order to avoid becoming personally liable.[187] In such circumstances, it may be beneficial for the focus of disqualification proceedings to be on the owner-managers of small businesses, since market forces that operate to control the behaviour of directors of publicly held corporations are not as applicable to the directors of small businesses. If executive directors make poor business decisions and become known as being unable to manage distressed companies, they suffer consequences only the market can provide for them, namely a loss of reputation after the company's collapse and the consequent inability to obtain a job as a director in the future due to a tarnished reputation. Directors of smaller companies may not have the reputation to start and so the market for directors may not provide the reputational incentives it does for executive directors. Professor Hicks points out that reputational consequences of a disqualification order are a threat when it comes to career executives, but it may not necessarily be the case that reputational consequences can only come on the heels of a disqualification order.[188] Reputational consequences are likely an inherent part in the failure of any public company. Albeit, the simple failure of a company without a finding of unfitness does not automatically place blame on the directors, but it does raise questions about their ability to manage a distressed company.

The concerns cited above are noteworthy. However, the types of disqualifications may also point to the tendency of the disqualification scheme to focus on the companies with more prevalent issues surrounding phoenixism and personal guarantees, and less on the companies potentially more influenced by the market for directors. Without an examination of the market effects on career executives and a comparison to the disqualification effects, it may be premature to conclude that the types of disqualifications paint a dire picture.

VI. CONSTITUTIONAL QUESTION

The adoption of a directors' disqualification scheme in Canada necessarily gives rise to questions regarding constitutional implications. Before any legislative scheme can be

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186 *Ibid.*
187 *Ibid.*
188 *Ibid.*

implemented it is necessary to determine whether the proper sphere of jurisdiction would be the federal and provincial powers to incorporate or the federal insolvency power. It is possible to implement the scheme under either jurisdiction, but it would likely be more workable if implemented under the latter. This Part of the article considers how the scheme could be adopted under either power, and the potential set-backs inherent under the power to incorporate.

The implementation of the current style of corporate legislation in Canada saw the *CBCA* adopted in 1975,[189] following the Dickerson Committee's 1971 recommendations.[190] Most statutes in Canada then went on to model themselves on the *CBCA*,[191] leading to a high level of harmonization.[192] The jurisdiction to enact legislation dealing with the power to incorporate can be found in the *Constitution Act, 1867*[193] for both the provincial and federal legislatures. The provincial legislatures derive their power to incorporate companies under s. 92(11) "The Incorporation of Companies with Provincial Objects" of the *Constitution Act, 1867*, and while there is no explicit federal power to create corporations, the court has ruled that it is residuary in the federal government's jurisdiction relating to peace, order, and good government (POGG).[194]

Any legislation dealing with aspects of incorporation, including the disqualification of directors, will likely be ancillary to the power to incorporate and would accordingly fall within the jurisdiction under which the corporation was incorporated[195] especially since each corporation is required to have at least one director.[196] The power to enact corporate legislation is broad and "cannot be read in a manner so strict as to limit it to the subject of

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189 The *OBCA*, *supra* note 146, was adopted in 1970 based on the Lawrence Committee Report (Ontario, Select Committee on Company Law, *Interim Report of the Select Committee on Company Law* (Toronto: Queen's Printer, 1967) (Chair: Allan F. Lawrence)).

190 Robert W.V. Dickerson, John L. Howard & Leon Getz, *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971); see J. Anthony VanDuzer, *The Law of Partnerships and Corporations*, 2d ed. (Toronto: Irwin Law, 2003) at 82-83.

191 The *CBCA* was enacted in 1975 and the following provinces adopted similar legislation and/or reformed, or continued to reform, their existing legislation: Manitoba, *The Corporations Act*, S.M. 1976, c. 40; Saskatchewan, *The Business Corporations Act*, *supra* note 146; Alberta, *Business Corporations Act*, S.A. 1981, c. B-15; New Brunswick, *Business Corporations Act*, *supra* note 146; Quebec, *Companies Act*, R.S.Q. c. C-38 (it was heavily influenced by the *CBCA* but it is not quite identical); Ontario, *Business Corporations Act*, S.O. 1982, c. 4 (this was more in tune with the *CBCA*); Newfoundland, *Corporations Act*, S.N. 1986, c. 12; Yukon, *Business Corporations Act*, R.S.Y. 1986, c. 15; British Columbia, *Business Corporations Act*, *supra* note 146 (British Columbia reformed its corporate law in 1973 and its current statute is a mix of the *CBCA* and the English memorandum and articles of association model)); Nova Scotia, *Companies Act*, *supra* note 146 (also has memorandum of association statutes (English model)); to date, Prince Edward Island, *Companies Act*, R.S.P.E.I. 1988, c. C-14, remains a letters patent jurisdiction); to see citations for the current statutes, see *supra* note 146.

192 Patrick Moyer, "The Regulation of Corporate Law by Securities Regulators: A Comparison of Ontario and the United States" (1997) 55 U.T. Fac. L. Rev. 43 at 70.

193 (U.K.), 30 & 31 Vict., c. 3, ss. 91-92, reprinted in R.S.C. 1985, App. II, No. 5.

194 See *Citizens Insurance Co. of Canada v. Parsons* (1881), [1881-85] All E.R. Rep. 1179 at 1183-84.

195 The power to incorporate must be distinguished from the power to regulate commercial activities, the latter of which may have a different sphere of jurisdiction. See Peter W. Hogg, *Constitutional Law of Canada*, 5th ed., vol. 1, looseleaf (Scarborough: Thomson Carswell, 2007) at para. 23.2.

196 *CBCA*, *supra* note 12, s. 102(2); *ABCA*, *supra* note 146, s. 101(2); *OBCA*, *supra* note 146, s. 115(2).

bringing such companies into being."[197] It extends beyond the act of incorporating to "encompass all aspects of the status of the corporation"[198] and the court has determined that corporate legislation "is but necessary incidental … and advantageous for the proper functioning of a company."[199] Therefore, the same type of implementation procedure that took place for the federal and provincial corporate legislation could be followed for a disqualification scheme, whereby the federal government would implement a scheme and leave the provinces the option of opting in to enact their own disqualification legislation. Ideally, in order to avoid vast differences between the various provincial jurisdictions, as with the *CBCA* and equivalent provincial legislation, the provincial disqualification schemes would be modelled on the federal one. There is, however, no guarantee that each province would adopt a similar scheme and, consequently, the issue relating to jurisdiction shopping may arise.

If the provinces have the option of enacting their own disqualification schemes, some may refrain from doing so, or may implement a different, less onerous scheme. Provinces with less onerous consequences for managerial misbehaviour may come to be regarded as "safe havens" and create what could be termed as "competition for incorporations,"[200] a situation akin to Delaware in the U.S. As a result of its advantageous corporate laws,[201] the state of Delaware houses more than 50 percent of all publicly-traded companies in the U.S., including 63 percent of the Fortune 500 companies.[202] The notability of these figures is evident when one considers that the population in Delaware is less than 1 percent of the total population in the U.S.[203] As a result of the incorporation advantages it provides, Delaware reaps significant returns, including indirect revenues of about a half-billion dollars per

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197 *Reference Re s. 110 of the Dominion Companies Act*, [1934] S.C.R. 653 at 655. This case was followed in four cases including *Montel v. Groupe de consultants P.G.L. Inc.* (1982), 142 D.L.R. (3d) 659 (Qc. C.A.) at para. 27 (text of judgment in French, see English summary at the beginning of the judgment); *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161 at 208.

198 Kevin P. McGuiness, *Canadian Business Corporations Law*, 2d ed. (Markham: LexisNexis Canada, 2007) at para. 4.39; see also *Letain v. Conwest Exploration Co. Ltd.*, [1961] S.C.R. 99.

199 *Rathie v. Montreal Trust Co.*, [1952] 3 D.L.R. 61 (B.C.S.C.) at para. 18. This decision was subsequently not followed, but for a different issue.

200 See generally Ehud Kamar, "Beyond Competition for Incorporations" (2007) 48 Corporate Practice Commentator 719 at 721, discussing the situation in the United States and other European countries; but see Marcel Kahan & Ehud Kamar, "The Myth of State Competition in Corporate Law" (2002) 55 Stan. L. Rev. 679.

201 Marcel Kahan & Edward Rock, "Symbiotic Federalism and the Structure of Corporate Law" (2005) 58 Vand. L. Rev. 1573. These include the fact that Delaware's corporate law, for the most part, does not address matters beyond the internal affairs of the corporation, such as the creation and dissolution of a corporation, powers of a corporation, decision-making powers of shareholders, directors, and officers, shareholder voting, and the obligations of corporate fiduciaries (at 1607) as well as exclusive reliance on private enforcement through private lawsuits. Delaware has no regulatory agency that either examines compliance with corporate law or enforces its corporate law through fines, injunctions, or cease-and-desist orders (at 1604).

202 Delaware Department of State: Division of Corporations, *About Agency*, online: Delaware Department of State <http://corp.delaware.gov/aboutagency.shtml>; see generally Omari Scott Simmons, "Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law" (2008) 42 U. Rich. L. Rev. 1129 at 1134.

203 U.S. Census Bureau, *Annual Estimates of the Population for the United States, Regions, States, and Puerto Rico: April 1, 2000 to July 1, 2007*, online: U.S. Census Bureau <http://www.census.gov/popest/states/NST-ann-est2007.html>. In 2007, Delaware's population was 864,764 and the U.S. population was 301,621,157. Hence, Delaware represents 0.29 percent of the total population.

year.[204] It may be possible for a similar situation to develop in Canada if provincial companies acts provide the proper incentives for incorporation.[205] For example, U.S. parent companies have been motivated to incorporate Canadian subsidiaries under the Nova Scotia *Companies Act*[206] due in part to its allowance for the formation of unlimited liability companies.[207]

Rather than attempting to implement the scheme under the federal and provincial powers to incorporate, a better alternative would be to bring the scheme in under the federal insolvency power under s. 91(21) of the *Constitution Act, 1867*, for three reasons. First, by having the federal government adopt a scheme applying to every insolvent corporation in the country, the problems surrounding a provincial opt-in system, cited above, would be avoided. Second, if a scheme similar to that in the U.K. is implemented under the federal insolvency power, there would be an obligation imposed on insolvency professionals to investigate the conduct of all directors who were in office in the last few years of a failed corporation's trading. In the U.K., the contents of that report are sent to the Secretary of State, who must then determine whether it is in the public interest to seek a disqualification order.[208] A corporate disqualification regime would be unable to impose a similar investigatory obligation and require directors of failed corporations to be subject to similar scrutiny, a necessary aspect of a legislative scheme aimed at protecting the public.

Third, implementing the scheme under the insolvency regime accords well with the purposes of bankruptcy law. Bankruptcy law creates a system that facilitates the orderly distribution of the debtor's assets among creditors and provides for the rehabilitation of the debtor in what is known as a "fresh start."[209] Although the disqualification scheme would apply to bankrupt corporations, and not individuals, precluding the concept of "fresh start," analogies can nonetheless be drawn between the application of these bankruptcy law

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204 Jeffrey MacIntosh, "Canada's Passport to Regulatory Competition" *National Post* (18 March 2004), online: University of Toronto Faculty of Law <http://www.law.utoronto.ca/faculty_content.asp?itemPath=1/7/1/0/0&contentId=866>. This is a securities law article discussing the advantages of a passport system, mainly the incentive to innovate, over a national regulator.

205 Given the significant advantages a province seeks to gain if it provides the proper legislative incentives, a "Delaware of the North" has been cited as a possibility by MacIntosh, *ibid.*

206 "Nova Scotia Turns into Tax Haven" *[Victoria] Times Colonist* (8 March 1996) 1; see also Bill Zink, "Canadian Company Formed by U.S. S Corporation Will be Considered a Partnership" *The Tax Adviser* (1 February 1996), online: The Free Library <http://www.thefreelibrary.com/Canadian+company+formed+by+U.S.+S+corporation+will+be +considered+a...-a017993747>.

207 Until 2005, Nova Scotia was the only Canadian jurisdiction to allow unlimited liability companies. It is now also possible in Alberta. See David Feindel, Barry Horne & Deborah Patterson, "NS vs. Alberta ULCs" *CA Magazine* (January-February 2006), online: CA Magazine <http://www.camagazine.com/archives/print+edition/2006/january-february/regulars/camagazine7794.aspx>; see also Charles Reagh, "Introduction to the Nova Scotia Companies Act" *Corporate Brief* (September 1998), online: CCH Online <http://www.cchonline.ca> for the many incentives provided to incorporate in Nova Scotia, including no directors' liability for unpaid wages and similar matters, and no statutory duty of care or fiduciary duty.

208 The Insolvency Service, *Disqualification*, *supra* note 37. There have been problems cited with this system. There is uncertainty surrounding the level of unfitness that must be shown before an insolvency practitioner will feel compelled to report the director's behaviour. There is also variation between the level of investigation of directors of failed companies, which is usually dependant on the level of assets available: see Hicks, ACCA, *supra* note 182.

209 The articulation of this purpose can be traced back to 1876, see *Heather v. Webb* (1876), 2 C.P.D. 1 at 7.

principles to directors of a corporation. In addition to the two purposes outlined above, bankruptcy law also aims to maintain the integrity of the credit system and deter those who seek to undermine it.[210] Accordingly, when the bankruptcy system is dealing with a repeat bankrupt, "the purpose and intent of the Act shifts from its remedial purpose of assisting well-intentioned but unfortunate debtors to one of protecting society, and in particular unsuspecting potential creditors."[211] The courts hesitate to grant discharges when dealing with repeat bankrupt individuals and instead look to "the need to protect others from the bankrupt's demonstrated financial incompetence, negligence, and carelessness."[212] In *Re Mulligan*,[213] the Master suspended the bankrupt's discharge for 15 years for creditors' protection from the bankrupt's incompetent use of credit. It is at this point that the analogy can be drawn. The law seeks to protect society and, in particular, unsuspecting creditors, from a repeat bankrupt. Similarly, the law should also look to protect society and unsuspecting creditors from directors who drive a company to bankruptcy as a result of their unfitness, and then go on to take a directorship at another company. In *Re Willier*, Reg. Baker maintained that prior to discharging a third-time bankrupt, "the court must be satisfied that the bankrupt has gained sufficient insight and made sufficient changes in his or her life that it is not reasonably possible that further bankruptcy will occur."[214] Although the Court in *Re Willier* discharged the bankrupt, it suspended the discharge for three years to recognize the seriousness of the situation and to protect "unsuspecting future creditors,"[215] adopting Anderson J.'s comment in *Re Hardy*[216] that "the system should not permit 'periodic purging' of debts."[217] Similarly, a director who has been shown to have been unfit in the management of a company needs to be prevented from taking a similar position with another company for a defined period of time, and using the bankruptcy system, in effect, to purge the company's debts while he or she goes on to take another directorship and employ the same methods with future creditors. The period of time in which the disqualification is imposed is important, as with repeat bankrupts, to recognize the seriousness of the situation and protect unsuspecting future creditors of the company.

It is possible to implement the scheme under the federal and provincial powers to incorporate, but a better alternative would be to bring the scheme in under the federal insolvency power, as doing so accords with the goals and principles of bankruptcy law and would allow for investigatory obligations to be imposed once a company fails.

VII. CONCLUSION

When directors engage in reckless behaviour and wrongful conduct to hide the state of financial distress from the creditors during an insolvent time in a corporation's life, they are gambling with money owed to creditors. For the protection of the public and of creditors, the

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210 *Re Meynan*, 2001 ABQB 284, 24 C.B.R. (4th) 79 at para. 12.

211 *Re Willier*, 2005 BCSC 1138, 14 C.B.R. (5th) 130 at para. 12.

212 *Ibid.*

213 2007 BCSC 1784, 38 C.B.R. (5th) 89.

214 *Supra* note 211 at para. 13.

215 *Ibid.* at para. 16.

216 (1979) 23 O.R. (2d) 227 (Ont. S.C.).

217 *Re Willier*, *supra* note 211 at para. 8; see also *Re Boiven*, 2008 BCSC 221, 40 C.B.R. (5th) 281; *Re Hiebert*, 2008 SKQB 153, 42 C.B.R. (5th) 75.

U.K. has determined that directors who engage in this conduct should be prohibited from being involved in the management of companies and, pursuant to the *CDDA*, courts are obliged to disqualify these unfit directors. While there have been some questions about the effectiveness of the *CDDA*, the scheme has nonetheless been successful on a number of grounds. Canadian legislation is currently without much in the form of creditor protection, either at the outset of incorporation or towards the end of a corporation's life. It would therefore be prudent to seriously consider the adoption of a disqualification scheme in Canada. Even though provisions for the removal of directors already exist in Canada, it would be in the public interest to consider taking the concept one step further in the form of a disqualification scheme to be able to disqualify them from being involved in the management of a company if they exhibit behaviour that renders them unfit.