RECONCILING DERIVATIVE CLAIMS AND THE OPPRESSION REMEDY

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We both had the honour of serving as law clerks to Mr. Justice Sopinka at the Supreme Court of Canada. There we discovered that although the breadth of his interests and his mental agility were singular, Mr. Justice Sopinka was exceptionally interested in questions of legal procedure. He would often ask his clerks to pay particular attention to procedural issues in the course of their research. As academics, it is easy for us to overlook the practical importance of legal procedure, but our exposure to it while clerking has proven to be a valuable check on this tendency. This aspect of our experiences with Mr. Justice Sopinka left a strong impression upon us and so we are pleased to be able to dedicate to his memory an essay that examines an important procedural issue in the business law context.

I. INTRODUCTION

One of the most distinctive features of Canadian corporate law is the prominent role that jurisprudence under the oppression remedy plays in determining the rights and duties of corporate stakeholders.

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1 Along with his physical agility — it was not uncommon for him to trounce his clerks, including the authors, in squash, even when they were less than half his age!


3 Beck referred to the Canadian version of the oppression remedy as “beyond question, the broadest most comprehensive and most open-ended shareholder remedy..."
Although much of the litigation under the oppression remedy concerns disputes between majority and minority shareholders in closely held corporations, in Canada the oppression remedy has been used to do much more than simply protect the rights of minority shareholders. First, the oppression remedy has been used to provide redress for wrongs that are derivative in nature, that is, claims seeking redress for harms done to the corporation as a whole rather than just a subset of its shareholders. Second, the oppression remedy has been used to grant relief to creditors as well as shareholders.


6 They have not attracted unanimous criticism either. F. Iacobucci, Pilkington and Prichard, Canadian Business Corporations (1977) at 208–09 described the oppression remedy as encompassing redress for at least a subset of harms to the corporation as a whole. See also Waldron, “Corporate Theory and the Oppression Remedy” (1981-2), Can. Bus. L. J. 129 at 141.

7 See, e.g., Re Goldstream Resources (1986), 2 B.C.L.R. (2d) 244 (S.C.); Goldhar v. Quebec Manitou Mines Ltd. (1975), 9 O.R. (2d) 740 (Div. Ct.).

derivative action, but not the oppression remedy, should be imposed whenever a derivative wrong is the focus of litigation, and therefore that the oppression remedy should not apply to derivative claims. The most important of those requirements is considered to be the requirement to obtain leave of the court to bring the action.\(^9\) With respect to allowing creditors to obtain relief under the oppression remedy, both judges and commentators have objected that this unduly expands creditors’ rights to participate in corporate governance beyond the explicit terms of their agreements with the company.

In this essay we suggest that there are justifications for the conclusions reached by Canadian courts that the oppression remedy embraces litigation involving derivative wrongs ("derivative claims")\(^10\) and claims brought by creditors. We also show that these justifications are closely related to one another.

This essay is organized as follows. In Section II below we examine the question of whether the oppression remedy is suitable for derivative claims. We first outline the procedural requirements accompanying the derivative action and oppression remedy. The common arguments for excluding derivative claims from the oppression remedy rely on the contention that the procedural characteristics of a derivative action, but not of the oppression remedy, prevent a multiplicity of suits, allow courts to award remedies in favour of the corporation and put a quick stop to “strike” suits and frivolous claims. We address each of these arguments in turn and explain why we do not find them compelling.

In Section III we turn to the question of whether and under what circumstances creditors should have standing to bring derivative claims under the oppression remedy. We show that the arguments against granting creditors standing to bring derivative claims do not necessarily apply to the creditors of an insolvent corporation. Then,

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\(^9\) Macintosh (1991), supra, note 8, concludes at 52 that “the balance of authority appears to favour the proposition that all types of derivative actions are permitted under the oppression remedy,” but suggests that a leave procedure, not a requirement under the present oppression remedy, should be required in all cases involving wrongs of a derivative nature.

\(^10\) In this essay we will refer to all proceedings seeking relief for derivative harms as “derivative claims,” regardless of the statutory provision under which those proceedings are initiated. The term “derivative action” will be reserved for proceedings initiated under statutory provisions such as s. 239 of the CBCA, s. 246 of the OBCA and s. 232 of the ABCA.
drawing upon the conclusions established in Section II, we conclude that if it is appropriate to grant a creditor standing to bring a derivative claim then that creditor should not be restricted to the procedure associated with a derivative action. Section IV concludes the essay.

II. IS THE OPPRESSION REMEDY SUITABLE FOR DERIVATIVE CLAIMS?

1. Procedural Differences Between the Derivative Action and the Oppression Remedy

Under the common law rule in Foss v. Harbottle, a majority of shareholders were required to approve any suit by the corporation to seek redress for a wrong done to it. Canadian corporate law statutes of more recent vintage have overturned this requirement. Under the Canada Business Corporations Act and provincial statutes such as the Ontario Business Corporations Act, a court may grant a complainant leave to bring a derivative action in the name of the corporation if the following conditions are met: the complainant must give notice to the directors of an intention to apply for leave to bring the action; and the court must be satisfied that the directors will not pursue the action, that the complainant is acting in good faith, and that bringing the action appears to be in the interests of the corporation.

The procedure under the oppression remedy is quite different. For instance, an individual complainant may apply for an order under the oppression remedy without giving notice to the directors. There is also no need to obtain leave of the court prior to bringing a claim under the oppression remedy.

Another relevant difference between the derivative action and the oppression remedy pertains to costs. We will discuss this in more detail below, but the derivative action explicitly provides that the court may order the corporation to pay reasonable legal fees and any other costs reasonably incurred by the complainant in connection

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11 (1843), 2 Hare 461, 67 E.R. 189 (V.C.).
13 CBCA, s. 239.
14 OBCA, s. 246.
15 The definitions of "complainant" for the purposes of both the derivative action and the oppression remedy are found in CBCA, s. 238, OBCA s. 245.
with the action. While under both the derivative action and the oppression remedy the court has the power to make any order it sees fit, the statutory provisions dealing with the oppression remedy do not explicitly refer to the power of the court to order the corporation to pay the reasonable legal costs of the complainant. Instead, the statutes refer only to the power of the court to order interim costs.

A final procedural feature that we will highlight is remedies. Under the derivative action, the action is brought in the name of the corporation and thus it is the corporation that would typically benefit from any remedial order. For example, a court may order a defendant to pay damages to the corporation. Under the oppression remedy, however, the statute contemplates a wide range of remedial orders. While the court may make any order it sees fit, the statute sets out a non-exhaustive list of possible orders. Many of these remedies are designed to provide redress for an idiosyncratic harm to a particular shareholder or subset of shareholders. For example, the court may order the corporation to purchase securities from a security holder in order to redress a particular harm to that security holder. On the other hand, the list of remedies is non-exhaustive and, as pointed out in Sparling, at least two of the remedies seem to contemplate a remedial order on behalf of the corporation. The statute explicitly sets out that the court may make an order varying or setting aside a contract to which a corporation is a party and compensating the corporation or any other party to the contract. The statute also states that the court may make an order compensating an aggrieved person, which, as the court in Sparling mentioned, may include the corporation itself.

In summary then, the main procedural differences between the derivative action and the oppression remedy are that under the derivative action:

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16 See CBCA, s. 240; OBCA, s. 247.
17 See CBCA, s. 242; OBCA, s. 249.
18 CBCA s. 241; OBCA s. 248.
20 Supra, note 4 at 1125.
21 Id.
• a single action is brought in the name of the corporation;
• any remedy granted is awarded to the corporation;\(^{22}\)
• leave is required to proceed; and
• indemnification for costs is contemplated.\(^{23}\)

Various commentators have suggested that it is inappropriate to allow derivative claims to proceed under the oppression remedy where they are not subject to these procedural requirements. These procedural rules are allegedly necessary to prevent a multiplicity of suits, ease calculation problems in ordering remedies and permit courts to dismiss frivolous or meritless claims quickly. We will assess each of these claims in turn.

2. Multiplicity of Suits

MacIntosh explains the multiplicity point in the following way:

[Allowing each claimant to commence a personal action would expose the corporation to a large number of essentially duplicative lawsuits, each based on the same cause of action but seeking separately calculated damages. Forcing the plaintiff to sue in the name of the corporation creates an effective joinder of all potential actions, avoiding the costs associated with multiple lawsuits.\(^{24}\)]

In our view, this argument, while clearly valid to a point, should not be given great weight. We suggest that it is unlikely that multiple suits will be a problem in practice; indeed, it is the opposite (i.e., no suits) that is a more relevant danger.

To explain, it is useful to introduce a well-recognized observation about derivative claims: they are inherently subject to free-rider problems among stakeholders in the corporation.\(^{25}\) Consider the

\(^{22}\) As noted, a remedy may, but need not, be granted to the corporation under the oppression remedy.

\(^{23}\) It is also worth noting that the oppression remedy proceeds by way of application. The implications of this fact are briefly noted in Section IV.

\(^{24}\) MacIntosh (1991), supra, note 8 at 59.

\(^{25}\) See, e.g., MacIntosh (1991), supra, note 8 (MacIntosh recognizes the problem we discuss. Indeed, our disagreement with MacIntosh on this and many points is really one over the degree of importance to assign various factors. We put great emphasis on the free-rider concern; MacIntosh puts less emphasis on it); Scott, “Corporation Law and the American Law Institute Corporate Governance Project” (1983), 35 Stan. L. Rev. 927.
following example. A corporate director misappropriates $10,000. A remedy ordered on behalf of the corporation against the director would result in $10,000 being paid into the corporate treasury. Suppose there is one class of shares in a widely held corporation and each shareholder owns 5% of the shares. What shareholder would bring a suit against the director?

Consider the case (Case A) where the expected legal costs of bringing the suit exceed $10,000: the shareholders individually and collectively would not wish to bring the suit. Now suppose the legal costs are below $10,000 but above $500 (Case B). Each shareholder would stand to benefit by only $500 through the suit, but would have to spend more than that sum in legal costs. While it is in the collective interest of the shareholders to bring the suit, it is not in any single shareholder's private interest to do so; there is a collective action problem. Finally, consider the case where the expected legal costs would be below $500 (Case C). Even in this case, it is unlikely to be in the interest of any shareholder to bring the suit. Suppose the privately borne costs are $400. Each shareholder faces a positive gain from bringing the suit: the gain of $500 exceeds the $400 cost. However, the shareholders who do not bring the suit are still better off than the one who does — they reap a $500 net gain, not a $100 gain. Consequently, each shareholder has an incentive to wait until a different shareholder brings the suit; each attempts to free-ride on the efforts of others. There is

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26 In Canada, costs follow the event. The expected legal costs therefore comprise two components: if the suit fails, the unsuccessful litigant must pay her own costs in their entirety and a significant fraction of the other side’s costs. MacIntosh (1991), supra, note 8 at 63 note 163 notes that party and party costs typically cover 60%-70% of the successful litigant’s costs. Thus, if the suit is successful, the successful litigant under the common order of party and party costs must bear about 30%-40% of the costs. In what follows, we will assume a 100% probability of success, and that with party and party costs, there remains a significant portion of the costs borne by the shareholder-litigant.


28 If one shareholder, the “expert” shareholder, faces a significantly greater chance of success in litigation than all other shareholders, then the free-rider problem may be overcome. In particular, if the difference between the shareholder’s probability of success and other shareholders’ probability of success times the pro rata benefit to that shareholder from a successful suit exceeds the private cost of the suit, the shareholder may have an incentive to bring the action. That is, the expert shareholder (denoted by the subscript “ex”; “non-ex” denotes the non-expert shareholders) will
again a collective action problem and no shareholder is likely to bring the suit. 29

For all of the reasons given above, rather than a multiplicity of derivative suits, we would expect the absence of suits. However, this assertion must be qualified in two respects. First, our description of this hypothetical derivative suit does not account for the possibility of the court ordering the corporation to indemnify the litigant’s legal costs. We note this here and return to this very important point in discussing the leave provision. Second, we assumed above that any damages are paid into the corporation. However, in the absence of the statutory derivative action one would expect the ordinary rules of

bring the suit if \((P_h - P_{max}) \times b > C_h\), where \(P\) is the probability of success, \(b\) is the pro rata share of the remedy, and \(C\) is the private costs of bringing the action. Given that all shareholders have access to legal advice, we are sceptical that there are vastly heterogeneous probabilities of success across shareholders. Even if some investors, such as institutional investors, are more expert in bringing litigation, or have access to more expertise, free-riding is only overcome in the implausible case where one of these shareholders has a much greater chance of success than other institutional shareholders in the same corporation; if not, there will be free-riding among the “experts”: see Macintosh, “Institutional Shareholders and Corporate Governance in Canada” (1995), 26 Can. Bus. L. J. 145 at 158-59 [hereinafter “Macintosh (1995)”] (institutional investors are not “uncontaminated by free rider problems”). Moreover, to have an incentive to bring the suit, the expert would need to know that it has a significantly greater likelihood of success than other potential plaintiffs.

Another reason why the free-rider problem may be overcome is that the private benefits of the litigation (\(b\)) may be greater for one shareholder than for others. This may arise where there are private benefits from litigation outside the pro rata share of damages. For example, if an institutional shareholder seeks a reputation for active monitoring, it may realize benefits from pursuing a derivative claim; its reputation for activism may improve corporate governance at other firms in which the shareholder has an interest: see E. Iacobucci, “The Effects of Disclosure on Executive Compensation” (1998), 48 U.T.L.J. 489 at 499. Undermining this possibility is the recognition that institutional shareholders may not wish to antagonize management of firms in which they hold shares: see Macintosh (1995) at 160-61.

For these reasons, we acknowledge that the importance of free-riding is an empirical question, but our prediction is that it would be important in practice. Indeed, as we will explain, the cost indemnification rules for plaintiffs in derivative actions suggest to us that the law in this area is predicated on a concern about free-riding. To be consistent with the statutory scheme, any contention that free-riding is not important must be accompanied by a rival (i.e. a non-free-riding) justification of the cost indemnity provision.

29 The free-rider problem that arises in this final case (Case C) is mitigated by the fact that ultimately the imminent expiry of the relevant limitation period may force potential plaintiffs to file suit. However, even if a limitation period forces a number of plaintiffs to file suits, the free-rider problem described in the text will still provide them all with an incentive to delay proceeding to trial.
damages to apply: the defendant must pay the plaintiff her damages. Thus, in the above example, if she were allowed to bring a personal action, the shareholder-plaintiff would expect to reap damages of $500. This appears to avoid the problem presented by Case C where each shareholder attempts to free-ride on the efforts of others to have damages of $10,000 paid into the corporation: since other shareholders do not benefit from the litigating shareholder’s efforts they may have an incentive to bring a suit.

If damages are payable only to the shareholder who brings the suit, as opposed to the corporation, does this overcome the free-rider problem and invite instead a multiplicity of suits? We remain sceptical. Case B remains problematic: if the shareholders could act collectively, the suit would take place, but individually it is not rational for the shareholders to act since the private costs of the suit exceed the private benefits. Moreover, there may remain a collective action problem even where the private benefits exceed the private costs of a suit (Case C): To show this, it is necessary briefly to outline the doctrines of issue estoppel and its close relation, abuse of process.

In Canada, a party is precluded by the doctrine of issue estoppel from re-litigating a particular question where three requirements are met: (1) the same question has been decided; (2) the judicial decision which is said to create the estoppel was final; and (3) the parties to the judicial decision or their privies were the same persons as the parties to the proceedings in which the estoppel is raised or their privies.\(^{20}\) Courts have tended to relax the third requirement in substance, if not in form, by allowing non-mutual issue estoppel on the basis of an “abuse of process,” not “issue estoppel per se. In Bomac Construction Ltd. v. Stevenson,\(^{31}\) for example, two people were injured in an airplane accident. One person sued the pilot and the airplane owner for negligence and was successful. The second person later sued and sought to have the defendants’ defence struck out. The Saskatchewan Court of Appeal allowed the application, stating that to allow the defence to proceed would be an abuse of process.\(^{32}\)


It is clear how such a doctrine may affect the likelihood of a multiplicity of suits in the corporate context. In our hypothetical example of a manager misappropriating funds, each shareholder has an incentive to let other shareholders bring the action and bear the extra costs entailed in trying the issues in full, while she waits and relies on abuse of process in the event of the first plaintiff's success. The result is the familiar free-rider problem: each shareholder relies on the others to bring the action and hence no shareholder brings the action; rather than a multiplicity of actions, there is no action. Even if the private benefits of initially bringing the suit exceed the private costs, it is rational not to bring the suit initially, but rather to wait and rely on the doctrine of abuse of process to free-ride on the initial plaintiff's efforts.

Exacerbating the free-rider problem is the fact that even if the first shareholder is unsuccessful in her suit, this may not preclude later shareholders from seeking damages from the director. Abuse of process has only been invoked where the party against whom the adverse finding has been made has had the opportunity to litigate the question in a prior action. This means that later plaintiff-shareholders have a strong incentive to free-ride on others' efforts: if others succeed, they may rely on abuse of process; if others fail, the later plaintiffs are no worse off than had they initiated the action in the first place. The dominant strategy is clearly to let others litigate first.

In Bomac, however, the Court in obiter dicta stated that a second plaintiff would be bound by the first decision by the abuse of process doctrine, even if the decision were adverse to the second plaintiff. As Watson states, this "draconian" rule "is certainly an extreme position," although one with the merit of perhaps discouraging "wait and see" (or "free-rider") plaintiffs. Yet even if this position were adopted, it is not clear that it would discourage free-riding. If all shareholders predict for themselves an equal probability of success in litigation as that facing other shareholders, there is little incentive to be the first shareholder to bring an action. If the first

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33 Watson, supra, note 32 at 664.
34 As noted above, given that all shareholders have access to legal advice, we would not expect the probability of success to vary significantly across shareholders. As also noted above, however, if a particular shareholder does face a much higher probability of success in the litigation than others, this may eliminate the free-rider problem. In the present context, where damages are payable only to an individual, but
plaintiff succeeds, others may free-ride on its efforts; if it fails, others may simply conclude that they would not have fared any better in the litigation and thus are no worse off (and in fact saved legal costs) by allowing a different shareholder to test the waters. There remains an incentive to let others bring the suit first.

Even absent the doctrine of abuse of process, there may be an advantage in not being the first plaintiff to bring the action. Later plaintiffs may have learned a great deal from earlier litigation that will assist them in their cause, perhaps increasing their chances of success while incurring lower legal costs than the first plaintiff. This too may give rise to a free-rider problem and the absence of any suit.

In summary, free-rider problems undermine considerably the concern that in the absence of requiring shareholder-plaintiffs to bring derivative suits in the name of the corporation, there will be a multiplicity of suits. Self-interest and free-riding suggest that there will be a scarcity of suits whether the damages are paid into the corporation or to individual plaintiff-shareholders. If damages are paid into the corporation, each shareholder benefits from the remedy and thus each has an incentive to let others bring the suit. If damages are paid to shareholders on an individual basis according to the loss of each shareholder, each shareholder has an incentive to let others bring the action and later rely on the doctrine of abuse of process to lower its litigation costs. Even if abuse of process were unavailable, there would be advantages to being subsequent

other plaintiffs or the defendant may rely on abuse of process to enforce the result in future cases, free-riding may be overcome where the incremental gain in the expected damages from the suit (probability of success times the damages) from having the "expert" litigate first exceeds the savings in costs to the expert from litigating later. That is,

\[(P_\text{ex} - P_{\text{non-ex}}) b_2 > C_1 - C_2\]

where "ex" and "non-ex" denote expert and non-expert respectively, \(P\) is the probability of success, \(b\) is the damages to the plaintiff, \(C\) is the cost to the plaintiff, where the superscript 1 indicates the cost of litigating first and 2 indicates the cost of litigating later. Reputational effects may also overcome free-riding, as noted above, by changing the private benefits of litigation, \(b\). Of course, where the private benefits of litigation are similar across plaintiffs, and there is more than one shareholder with expertise, free-riding can arise among the experts. Moreover, even if there were one particularly expert plaintiff, it would have to know of its relative expertise in order to have an incentive to bring a suit. Thus, if the \textit{obiter dicta} in \textit{Bomac} were followed, the likelihood of free-riding would again raise an empirical question, but we predict that it would be significant.

\[36\] See Watson, \textit{supra}, note 32 at 663.
plaintiffs such that there may not be a shareholder willing to be the first plaintiff.

It should be noted that some of the free-rider problems discussed above (and in particular those that arise because of the doctrines of issue estoppel and abuse of process) might not be salient in jurisdictions that allow applications under the oppression remedy to be brought by way of class proceedings in which lawyers are permitted to recover contingency fees.\footnote{See, e.g., *Class Proceedings Act, 1992*, S.O. 1992, c. 6 [as am.]; *Stern v. Imasco Ltd.*, [1999] O.J. No. 4235 (QL) (S.C.J.).} This is because the prospect of earning fees may give entrepreneurial lawyers an incentive to initiate proceedings on behalf of classes of corporate stakeholders who would otherwise be discouraged from litigating by free-rider problems.

Although this possibility diminishes the relevance of some of the arguments made above, it does not lead us to conclude that we should be concerned about a multiplicity of proceedings under the oppression remedy. This is because we presume that typically only one class proceeding will be certified in respect of any given derivative claim. It is true that shareholders would be free to opt out of that class and initiate individual proceedings.\footnote{Id., s. 9.} However, unless they believe that they have a greater likelihood of prevailing by proceeding individually and/or expect to be able to do so at a relatively low cost, shareholders will have little incentive to opt out of a class proceeding. Therefore, the existence of class action legislation makes it plausible that one claim will be brought under the oppression remedy in respect of any given allegation of harm to the corporation, but no more. This hardly seems objectionable since permitting a derivative action to be brought in respect of such an allegation gives rise to the same number of potential proceedings. In our view, the critical point is that, whether or not class actions are permitted, we are not likely to see more than one derivative claim being brought under the oppression remedy in respect of any given wrong done to the corporation.

The situation would be different if shareholders who opted out of a class proceeding under the oppression remedy were free to initiate additional class proceedings. Then there might be reason to fear that self-interested lawyers would use the oppression remedy to initiate multiple class proceedings in respect of each wrong done to a
However, there is a fairly straightforward reason why this fear need not materialize: courts can prevent a multiplicity of class proceedings from arising by simply refusing to certify more than one class proceeding.\textsuperscript{39} It is well accepted that decisions at the certification stage should be consistent with the policies that underlie class proceedings legislation, one of which is to promote judicial economy by avoiding a multiplicity of proceedings.\textsuperscript{40}

Finally, notwithstanding the above, even if multiple individual or class suits do materialize, the court will retain the discretion to order that the suits be consolidated or heard at the same time.\textsuperscript{41} That is, requiring joinder in all cases through the derivative action is

\textsuperscript{38} It is not entirely clear, however, that multiple suits would result in this case. Multiple suits are particularly unlikely to arise if the remedy sought will be granted to the corporation. In that case, since all potential plaintiffs expect to share automatically and \textit{pro rata} in the benefits of any existing proceedings, they have little incentive to incur the additional legal costs that would be associated with additional proceedings. The situation is admittedly different if the remedy will be granted to the individual plaintiffs (or classes of plaintiffs). Plaintiffs who have opted out of class proceedings are statutorily barred from receiving the benefit (or the burden) of issue estoppel in subsequent proceedings: \textit{Class Proceedings Act}, s. 27(2). Consequently, plaintiffs in class proceedings have less incentive to let others litigate first than do individual plaintiffs. This means that the free-rider problem associated with the doctrine of issue estoppel is less likely to prevent a class proceeding from being brought than it is to prevent an individual's suit from being brought. On the other hand, there is still one form of free-rider problem that serves to limit the probability of observing multiple class proceedings: even in the context of class proceedings, plaintiffs might still find it advantageous to delay litigation in order to profit from information generated by earlier proceedings.

\textsuperscript{39} Some might argue that the possibility of bringing class proceedings under the oppression remedy gives rise to two independent concerns: concern about generating a multiplicity of suits and concern that frivolous suits or strike suits will be brought. We believe that the last two problems can also be addressed at the certification stage if courts refuse to certify class proceedings involving unreasonable claims. We should also note that this latter problem is an example of a more general problem that arises whenever litigants do not bear the full costs of litigation, a problem that is typically solved by permitting the courts to screen plaintiffs and dismiss unreasonable claims. Thus, later in this essay we claim that a similar problem arises in the context of a derivative action where plaintiffs expect to be indemnified for their legal costs by the corporation. We go on to argue that there is no particular reason to fear frivolous suits or strike suits — and thus no need to require the courts to screen plaintiffs — in cases where applicants under the oppression remedy expect to bear their own legal costs.

\textsuperscript{40} \textit{Abdool v. Anaheim Management Ltd.} (1995), 21 O.R. (3d) 453 (Div. Ct.).

unnecessary because where multiplicity is a problem, courts may deal with it through consolidation orders.

3. Remedial Complexity

The second reason MacIntosh provides for maintaining a distinction between the procedures for derivative and personal actions is the difficulty confronting a court contemplating remedies when faced with an individual shareholder-plaintiff and a derivative wrong. In the example discussed above, the damages to the corporation were $10,000 and it was assumed that the damages an individual 5% shareholder would recover would be $500. It was also assumed that this would achieve the same result for the plaintiff as ordering $10,000 to be paid into the corporation. As MacIntosh points out, however, the analysis may be considerably more complicated than that in practice. For example, where there are creditors, damages paid directly to the plaintiffs may overcompensate the plaintiffs. To see this, suppose the corporation from which $10,000 was misappropriated owed a creditor $5,000, but only had assets worth $10,000 (which were misappropriated). Having the defendant pay damages to the shareholders of $500 each for the misappropriation would allow shareholders to avoid the debt to the creditors. MacIntosh suggests that compelling derivative claims to proceed by way of a derivative action in the name of the corporation avoids these problems. Not only does paying damages to the corporation better ensure the appropriate level of compensation for shareholders, it may also avoid subsequent litigation by creditors.

There clearly is a valid concern about remedial efficacy where a derivative wrong has occurred but a personal action is brought. This consideration does not, however, suggest that the oppression remedy ought not to embrace derivative claims. As noted above, the oppression remedy not only grants the court unfettered discretion to make any remedial order it sees fit, it also explicitly contemplates remedies being awarded in favour of the corporation. It is thus within the court's jurisdiction under the oppression remedy to order

42 MacIntosh, supra, note 8 (1991) at 59-63.
43 As noted, the oppression remedy explicitly sets out that a court may make an order compensating the corporation as the result of a contract or transaction and also states that the court may make an order compensating any aggrieved person, which includes the corporation.
a remedy on behalf of the corporation, rather than the shareholder who brought the application. Remedial complications are not, therefore, a valid reason to require derivative claims to proceed by a derivative action rather than the oppression remedy.

4. The Leave Requirement

In determining whether the oppression remedy should address derivative wrongs, much turns on the justification for the leave requirement found in the statutory derivative action. If there is something intrinsic about the nature of a derivative claim that calls for a leave requirement, then allowing parties to bypass the leave requirement through the oppression remedy may not be appropriate. On the other hand, if there is nothing intrinsic about a derivative claim that invites a leave requirement, then it is not necessarily inappropriate for the oppression remedy to embrace derivative claims. We reject the former position. We do not believe that the leave requirement in the derivative action can be justified as a response to the inherent characteristics of a derivative claim. It is our contention that the best justification for the leave requirement is that it is required to complement the cost indemnity provisions peculiar to the statutory derivative action. The fact that those indemnity provisions do not appear under the oppression remedy provides a complete justification for the absence of a leave requirement under the oppression remedy. In our view, there is no reason to presume that the absence of a leave requirement from the oppression provisions justifies the exclusion of derivative claims.

(a) Unsatisfactory Justifications for the Leave Requirement

Three reasons are commonly offered for requiring leave to proceed with derivative actions: the prevention of “strike” suits, the prevention of meritless, but good faith, suits and the prevention of a

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45 MacIntosh (1991), supra, note 8 at 63.
multiplicity of actions. In our view, none of these is a compelling justification for the leave requirement.

The first concern cited is "strike" suits. A strike suit is a meritless suit launched in bad faith in order to exact a settlement from the corporation. Litigation is costly for the corporation, given the legal costs and, perhaps more importantly, the opportunity cost of management's time it entails. Thus, a corporation may settle even meritless litigation where the cost of the settlement is less than the cost of litigating the meritless claim. The leave requirement for a derivative action is said to limit the scope for strike suits. As MacIntosh puts it, "Where leave of the court is required to commence a derivative action and is conditioned on a showing that the plaintiff is acting in good faith and the best interests of the corporation, such warrantless claims are likely to be weeded out at an early stage."

While we do not dispute that strike suits are a possibility, we nevertheless dispute that this possibility explains the leave requirement in this particular context. If the threat of strike suits justified a leave requirement in this context, why would not similar threats justify leave requirements in a wide variety of legal settings? That is, the strike suit justification for the leave requirement proves too much — if it holds, we should see leave requirements in many other contexts. We agree with Scott, who states:

One can conceive of an attorney (or a client) behaving opportunistically to try to extort payment in excess of the merits of his cause of action. Such behavior can occur in any area of litigation and is not limited to the domain of the derivative suit. The legal system has evolved relatively simple, inexpensive ways for defendants to attack groundless suits and obtain their dismissal at early stages in litigation (e.g., a

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46 Dickerson Report, supra note 44 at 161.

47 While these were the reasons given in the Dickerson Report, supra note 44, which was clearly very influential in the evolution of the various Canadian Business Corporations Acts, we do not find them convincing justifications. Our analysis is not intended to provide a political explanation of the features of the derivative action and the oppression remedy. Rather, it is an attempt to set out why those features make sense as a matter of theory, i.e., to provide a justification for the inclusion of the leave requirement in the derivative action and its exclusion from a version of the oppression remedy that encompasses derivative claims.

48 Macintosh (1991), supra, note 8 at 63.

49 Recall that party and party costs fail to cover all the costs of a successful litigant.

50 MacIntosh (1991), supra, note 8 at 63.
demurrer or motion for summary judgment) and to impose penalties on plaintiffs for abusing the legal process. Beyond the threshold of this protection, any defendant with substantial assets and visibility is, in effect, forced to adopt a policy of calling strike suit bluffs, since susceptibility to litigation is not a one-time game. The defendant who chooses to pay off on suits without merit will soon find that their number is infinite.

Consequently, derivative "strike suits" should not be more of a problem than frivolous litigation in general.51

In other words, as a justification for the leave procedure with respect to derivative actions in particular, the fear of strike suits is not compelling.

Moreover, even if there were something peculiar about the corporate context that invites strike suits and thus a leave requirement, this does not explain why derivative actions but not claims under the oppression remedy require leave. If shareholders are particularly likely to bring meritless claims in order to extort settlements, why does the oppression remedy, which also involves shareholders as potential plaintiffs and corporate managers as

51 Scott, "Corporation Law and the American Law Institute Corporate Governance Project" (1983), 35 Stan. L. Rev. 927 at 942–43. There is some debate in the United States over the incidence of strike suits in the corporate context. Some commentators suggest that strike suits are a problem in the U.S.: see, e.g., Alexander, "Do The Merits Matter? A Study of Settlements in Securities Class Actions" (1991), 43 Stan. L. Rev. 497. Indeed, some suggest that frivolous litigation is a particular problem in corporate settings, as opposed to other contexts: see, e.g., Brandi, "The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action" (1994), 98 Dick. L. Rev. 355 at 357 ("Practical experience and empirical studies have led courts and commentators to conclude that in the United States, shareholder litigation appears to be more open to abuse by strike suits brought for their mere nuisance and settlement value than other fields of civil litigation"). On the other hand, another commentator suggests that while shareholder litigation does little to contribute to corporate governance, such litigation is a relatively infrequent occurrence: see Romano, "The Shareholder Suit: Litigation Without Foundation?" (1991), 7 J. L. Econ. & Org. 55. Still another commentator suggests that there is an absence of compelling data on frivolous suits in the securities litigation context that would support restricting private rights of action: Seligman, "The Merits Do Matter: A Comment on Professor Grundfest's 'Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority'" (1994), 108 Harv. L. Rev. 438. Even if the evidence on the high incidence of strike suits in the corporate context in the United States were unambiguous, it is not clear what the implications would be for Canada given important differences between the jurisdictions, such as American cost rules (according to which legal costs are not generally indemnified by the losing party).
potential defendants, not have such a requirement? While different substantive causes of action are likely to arise depending on whether the action is derivative or personal, it is not clear why this should matter given that the strike suit is premised on a meritless claim. The probability of an extorted settlement should not depend on whether it is a meritless derivative action or a meritless personal action. The leave requirement should exist for both procedures if shareholder strike suits were the justification for the leave requirement in derivative actions. Given that it does not, we are sceptical that it provides a suitable justification for the leave requirement in the derivative context.

A similar argument is available to cast doubt on the claim that the leave requirement is necessary to deter meritless, but good faith, actions. The prospect of meritless, but good faith, claims exists throughout the legal world — why does the derivative action require special treatment? The rule in Canada that costs follow the event and early motions for summary judgment are two procedures designed to deter meritless actions, or at least limit their cost. There is no apparent reason to treat the corporate context distinctively. The risk of meritless suits seems just as compelling in many other legal contexts where leave is not required.

The alternative argument set out above addressing strike suits also applies here: even if there were something distinctive about the corporate context, it is unclear why a distinction between the derivative action and the oppression remedy should exist. Meritless claims seem to be at least equally likely with respect to the oppression remedy, yet no leave requirement exists for it. The possibility of meritless good faith claims is not a compelling justification for the derivative action’s leave requirement.

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52 For example, a claim that a corporate manager violated the duty of care would likely be derivative, not personal.
53 We recognize that indemnity for costs in derivative actions even for losing plaintiffs limits the deterrence nature of costs following the event; indeed, we rely on this point below to explain the leave requirement with respect to the derivative action. Our task here is to show that prevention of meritless claims is not a good explanation of the leave requirement and thus leave aside cost indemnity for the moment.
54 Indeed, with the oppression remedy’s incorporation of consideration of “equitable rights” (see Ebrahimi v. Westbourne Galleries, [1973] A.C. 360, [1972] 2 All E.R. 492 (H.L.)), it may be that uncertainty, and thus the risk of warrantless but good faith claims, is greater under the oppression remedy than in the derivative action context.
The third suggested justification for the leave requirement is that it exists to prevent a multiplicity of actions. We have evaluated the likelihood of a multiplicity of actions already. In our view, free-rider problems inherent in intra-corporate litigation act to suggest that rather than a multiplicity of actions, a scarcity of actions is to be expected. Justifying the leave requirement as responding to a problem that is unlikely to exist (indeed, the opposite problem is likely) is not convincing. In any event, it is not, strictly speaking, the leave requirement under the derivative action that prevents a multiplicity of actions, but the requirement that a derivative action be brought in the name of the corporation. As set out above, the threat of a multiplicity of actions is not a compelling reason to require derivative and personal suits to proceed on the basis of different procedures.

(b) A Justification for Combining the Leave Requirement and Indemnification for Costs

Our view is that the most plausible justification for the leave requirement in the derivative action is that it solves the problems that are associated with the cost indemnity provision that is exclusive to the derivative action.

In a derivative action, all shareholders will generally have suffered similar harm. Consequently, as already discussed, free-rider problems significantly reduce the likelihood that any single shareholder will pursue the action, even if it has a positive expected value from either a collective (that is, pooling the legal costs among all the shareholders) or an individual standpoint. The CECA, OBCA and similar statutes address this concern by establishing that the court may order the corporation to provide the complainant launching the derivative action with full indemnity for "reasonable legal fees and any other costs reasonably incurred by the complainant in connection with the action."56 Such a cost indemnity provision, however, potentially raises at least three problems with respect to the non-plaintiff shareholders. First, if the plaintiff-shareholder could be indemnified by the corporation for all legal costs, a plaintiff-shareholder could impose costs on all other shareholders when bringing a frivolous suit.

56 The quotation in the text is taken from s. 247(d) of the OBCA. The wording of the corresponding provision of the CBCA (s. 240(d)) is slightly different.
Shareholders may fear that owning equity exposes them to bearing the costs of frivolous suits brought by shareholders with a poor understanding of the law or who are motivated by emotional rather than economic concerns. Second, if the corporation indemnifies the legal fees incurred in derivative actions, there would be a strong temptation for lawyers either to own shares themselves and launch actions for the main purpose of recovering fees (win or lose), or to bribe shareholders to bring suits with the intention of sharing the recovered fees with the plaintiff-shareholders in some fashion. Third, the threat by a shareholder-plaintiff to bring a meritless action is made more credible by the subsidization of the action by other shareholders. Consequently, the threat of a strike suit is more credible, making settlement with strategic shareholders an attractive option for management. All these problems present costs to the corporation.

The leave procedure responds to these concerns. The leave procedure serves as a screening mechanism; costs are available if and only if leave has been obtained. Conversely, the leave procedure is only required because of the cost indemnity provision.\(^{56}\)

Support for this conclusion can be found by reviewing the case law on point. The important case establishing the possibility of indemnity for minority shareholders in derivative actions is *Wallersteiner v. Moir (No. 2)*.\(^{67}\) In that case, a small shareholder in two public companies sued management on behalf of the companies. He applied to the court for an order that the companies indemnify him for his legal costs associated with the action, as well as any costs he would be ordered to pay if he were ultimately unsuccessful. In one of three opinions agreeing in the result at the Court of Appeal, Lord Denning M.R. recognized the dilemma facing Moir:

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56. The concern about shareholders assured of recovering fees bringing a suit that harms other shareholders is similar to a concern about the plaintiff-shareholder, once she has carriage of the litigation (either a derivative action or an oppression remedy application), settling the suit in a fashion that benefits the plaintiff-shareholder at the expense of the other shareholders. Just as there is a control *ex ante* on the indemnified plaintiff-shareholder through the leave procedure, there is an *ex post* control as well: the court must approve any settlement reached by the parties in relation to a derivative action or an application for an oppression remedy. See *CBCA*, s. 242 and *OBCA*, s. 249.

Mr. Moir tells us — and I have no doubt it is true — that he has no money left with which to pay the costs in further matters. He is fearful, too, that, if he should lose on them or any of them, he may be ordered to pay personally the costs of Dr. Wallersteiner on them. Even if he wins all the way through, no part of it will redound to his own benefit. It will all go to the benefit of [the companies,] Hartley Baird and Baldwins. His few shares might appreciate a little in value, but that is all. In this situation he appeals to this court for help in respect of the future costs of this litigation.66

It is clear that Lord Denning M.R. appreciated the free-rider problem established by the derivative action: while the individual shareholder would bear the costs of litigation, the benefit would redound to the company.67 As a consequence, the Court of Appeal ordered the companies to indemnify Moir.

Wallersteiner thus established that an indemnity order can be used to mitigate the free-rider problem that faces shareholder-plaintiffs. The majority in that case also established the connection between the leave requirement and indemnification. Both Buckley L.J. and Scarman L.J. agreed that companies should indemnify minority shareholders for their legal costs in bringing derivative actions, but predicated this conclusion on the plaintiff obtaining leave of the court to bring the action. Buckley L.J. stated that the minority shareholder should apply to the court for indemnification and,

[U]pon the effective hearing of the summons the court would determine whether the plaintiff should be authorised to proceed with the action and, if so, to what stage he should be authorised to do so without further directions from the court. The plaintiff, acting under the authority of such a direction, would be secure in the knowledge that, when the costs of the action should come to be dealt with, this would be upon the basis, as between himself and the company, that he has acted reasonably and ought prima facie to be treated by the trial judge as entitled to an order that the company should pay his costs, which should, I think, normally be taxed on a basis not less favourable than the common fund basis, and should indemnify him against any costs he may be ordered to pay to the

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66 Wallersteiner, supra, note 57 at 389 (Q.B.) (emphasis added). For a similar observation, see Buckley L.J. at 404–05.

67 While the action was brought in Moir's name, Moir was held to be acting as an agent for the companies: Wallersteiner, supra, note 57 at 391 (Q.B.).
defendants. Should the court not think fit to authorise the plaintiff to proceed, he would do so at his own risk as to the costs.\textsuperscript{60}

Buckley L.J. treated the leave of the court as the screen to ensure the plaintiff is acting reasonably — if so, he is \textit{prima facie} entitled to costs. The cost indemnity order exists to overcome free-riding, and the leave procedure protects the company from plaintiffs acting unreasonably (from the corporation’s standpoint) because of the prospect of indemnity. Note that Buckley L.J. did not require absolutely the plaintiff to obtain leave, but rather stated that the plaintiff would risk losing indemnity for costs in the absence of such leave. Presumably, Buckley L.J. was confident that in the absence of leave, the threat of paying costs would discipline unreasonable plaintiffs; only where there is indemnity is there a need for the court to screen plaintiffs.\textsuperscript{61}

While the approach in \textit{Wallersteiner} was based upon the inherent jurisdiction of the court to make cost orders, as noted, Canadian corporate statutes now explicitly give the court discretion to order that the corporation indemnify a plaintiff’s reasonable costs associated with a derivative action. The leading case interpreting these provisions is \textit{Turner v. Maillhot}.\textsuperscript{62} \textit{Turner} relied heavily on \textit{Wallersteiner}. The Court stated:

If the reasoning [in \textit{Wallersteiner}] were applied here it would suggest strongly that Turner, having obtained leave of this court to bring the action, had established a \textit{prima facie} claim to indemnity. There is nothing in the [Ontario] \textit{Business Corporations Act} which would indicate to me that the views expressed in \textit{Wallersteiner} would not form a reasonable basis for the interpretation of the sections of the Act governing the application before me. The section of our Act that governs applications for leave to bring a derivative action simply states in statutory language the gist of what the judges of the Court of Appeal said in \textit{Wallersteiner}.

\begin{itemize}
  \item \textsuperscript{60} \textit{Wallersteiner}, supra, note 57 at 405 (Q.B.).
  \item \textsuperscript{61} A similar approach is found in the reasons of Scarman L.J. in \textit{Wallersteiner}, supra, note 57 at 407 (Q.B.).
  \item \textsuperscript{62} (1985), 50 O.R. (2d) 561 (H.C.).
\end{itemize}
Since an applicant, in order to obtain leave under s. 245 . . . must, in effect, fulfil the conditions laid down in Wallersteiner, he or she could reasonably be taken to have established a prima facie right to indemnity. 63

Turner thus established that the terms for obtaining leave are precisely those required for prima facie entitlement to indemnity. 64 The relationship between costs and leave that emerges from the case law is clear: an indemnity is available to overcome the tendency to seek to free-ride, but the concern about meritless actions by plaintiffs seeking to shift the costs of the action to other shareholders implies that leave must be obtained in order to create a presumption that the plaintiff is entitled to indemnification. 65

The justification for the leave requirement developed in the case law and set out here explains, in a way that other theories cannot, why such a requirement exists for the derivative action but not other legal procedures generally, and not the oppression remedy specifically. In most legal actions, indemnity for costs from third parties is unavailable. There is no need for the court to screen plaintiffs because the threat of paying their own and a significant portion of the successful defendant’s costs deters meritless actions.

63 Id. at 566-67.
64 In the result, the court in Turner, supra, note 62, did not order a full indemnity notwithstanding the prior obtaining of leave. Because the corporation was closely held and the plaintiff stood to gain a great deal from the success of the action, and had the resources to prosecute the action, the court ordered the corporation to indemnify half the plaintiff’s costs. This result is open to challenge: such an order could discourage a plaintiff from bringing an action because the private costs outweigh the private benefits from doing so, even though the costs to the corporation are lower than the benefits. Notwithstanding this flaw, the result in a certain respect supports the thesis herein that the leave and costs provisions are together designed to overcome free-riding without encouraging meritless claims. It was clear on the facts that if Turner did not bring the action, no other plaintiff would have, hence free-riding was not a concern. In the circumstances, then, not ordering the corporation to pay the costs in full did not encourage free-riding.
65 A more recent case stressed the importance of leave as a condition precedent to any cost order: see Silverman v. Goldman (1995), 20 B.L.R. (2d) 134 at 136 (Ont. Gen. Div.) where the Court rejected a request to order indemnity on behalf of creditors launching a derivative action, stating: “Counsel for Silverman has urged me to follow the order of Reid J. in Turner . . . and make an order which is within the spirit if not within the letter of the relevant sections of the OBCA. [W]ith great respect, I do not think the situation is analogous. In that case, the plaintiff had earlier obtained leave from the court to commence the derivative action and there was in existence an action in connection with which a funding order could be made.”
The statutory oppression remedy in the CBCA and the OBCA, for example, does not set out that the court may order indemnity of costs.\textsuperscript{66} Moreover, courts have noted that the principles that apply to the derivative action with respect to indemnity do not apply to oppression remedy applications.\textsuperscript{67} The derivative action, however, has the indemnity provision and this gives rise to a need for the check of a leave procedure to ensure that any claims brought are in the best interests of the corporation. On this view, the absence of a leave requirement under the oppression remedy simply means that complainants under that provision should not enjoy the benefit of a presumption of entitlement to indemnification. However, the absence of a leave requirement does not support the inference that the oppression remedy should not embrace derivative claims.

5. Summary

In summary, none of the alleged drawbacks of allowing the oppression remedy to embrace derivative claims is compelling. The danger of a multiplicity of suits is unlikely to materialize in practice, and if it does, the courts may consolidate the suits. The oppression remedy contemplates remedies on behalf of the corporation, so remedial complexity is not an obstacle to allowing this remedy to embrace derivative claims. Finally, the leave requirement exists in conjunction with cost indemnity under the derivative action, indemnity which does not arise under the oppression remedy. There is no reason not to allow the oppression remedy to embrace derivative claims.

III. Is the Oppression Remedy Suitable for Derivative Claims Brought by Creditors?

Our conclusion that the oppression remedy is suitable for claims that are derivative in nature has important implications for a second issue that has occupied Canadian courts in recent years, namely,
when should creditors be permitted to bring claims of any sort under the oppression remedy? At first glance this issue seems wholly unrelated to the question of whether the oppression remedy encompasses derivative claims. However, as at least one commentator has noted, many, if not most, of the cases in which creditors seek standing under the oppression remedy involve complaints that are in substance derivative claims.68 If we had come to the conclusion that the oppression remedy is unsuitable for derivative claims, then we would conclude that the oppression remedy is also unsuitable for derivative claims brought by creditors. However, we came to the opposite conclusion. Consequently, we need to explore whether derivative claims brought by creditors under the oppression remedy merit different treatment from other types of derivative claims.

There is certainly a great deal of textual support for the proposition that creditors have standing to bring complaints under the oppression remedy. Canadian corporate statutes typically state that relief is available under the oppression remedy for conduct that is oppressive or unfairly prejudicial to or unfairly disregards the interests of any “security holder, creditor, director or officer of the corporation.”69 Interestingly though, none of the Business Corporations Acts explicitly grants creditors standing to seek relief from oppression. Instead the statutes provide that “complainants” have standing to initiate both derivative actions and proceedings under the oppression remedy. The definition of the term complainant does not explicitly include creditors, but does include both present and former holders of securities (which can include debt obligations) of the corporation or its affiliates as well as “any other person who, in the discretion of the court, is a proper person to make an application.”70 Creditors are usually recognized as complainants on the second of these two grounds.71 Curiously, it has been held that the trustee in bankruptcy of a corporation, who is commonly

69 CBCA, s. 241(2); OBCA, s. 248(2) (emphasis added).
70 CBCA, s. 238; OBCA, s. 245.

Although it is clear in principle that creditors can obtain standing to bring complaints under the oppression remedy, in practice legislators, judges and commentators seem uncomfortable with the notion that creditors should automatically be granted standing under the oppression remedy. The fact that legislators were unwilling to grant creditors standing under the oppression remedy as a matter of course is evidenced by the fact that creditors who are not security holders are not explicitly identified in the definition of a complainant. A number of judges have also expressed reservations about granting creditors standing.\footnote{See, e.g., Re Daon Development Corp. (1984), 54 B.C.L.R. 235, 10 D.L.R. (4th) 216, 26 B.L.R. 38 (S.C.); Royal Trust Corp. of Canada v. Hordo (1993), 10 B.L.R (2d) 86 (Ont. Gen. Div.).}

Finally, a number of commentators have suggested that creditors’ claims are typically better adjudicated under the law of contracts than either under the oppression remedy or in the context of a derivative action for breach of a fiduciary duty.\footnote{See MacIntosh supra, note 8 (1991), at 54 note 124; Baxter, “The Derivative Action Under the Ontario Business Corporations Act” (1982), 27 McGill L. J. 453 at 460 (“It is however, difficult to understand why security holders, other than shareholders, were included in the definition of ‘complainant’ when such creditors, would, presumably, be adequately protected by their private security agreements”).} As we will explain, however, at least in some circumstances, it is appropriate for creditors to have standing to bring an action under the oppression remedy. It is sensible, therefore, for corporate statutes to include both creditors who are security holders and other creditors (such as trade creditors) who are “proper persons,” in the definition of “complainant.”\footnote{We do not attempt to justify the differential treatment of creditors who are security holders and other creditors.}

One of the bases for concern about extending either the derivative action or the oppression remedy to include claims by creditors is the view that creditors do not have a sufficient interest in the management and affairs of a corporation to justify giving them a formal role in its governance.\footnote{See the cases cited supra, note 73.} That is, creditors generally do not have incentives to maximize the value of the corporation, but rather simply seek repayment. In addition, several courts and
commentators have indicated that the oppression remedy should not be used to grant creditors rights in excess of those that are required to protect their reasonable expectations. It is presumed that those expectations are, at least in the case of voluntary creditors, adequately protected by the law of contract. 77 These concerns are both reflected in the following passage from Re Daon Development Corp. 78:

"...I consider the history of derivative actions and the wording of the section requires that the category be composed of those persons who have a direct financial interest in how the company is being managed and are in a position — somewhat analogous to minority shareholders — where they have no legal right to influence or change what they see to be abuses of management or conduct contrary to the company's interest.

...I am of the opinion that if there is merit in the contemplated action and if it is to the benefit of the company that it be prosecuted, there are classes of person which have a more direct interest in the management of the company affairs than that of a debenture holder — with all the contractual rights the trust indenture gives him — whose debenture is not in default. 79"

By contrast, it is widely accepted that shareholders have a significant interest in the management of a corporation's affairs and that it is not appropriate to rely on the law of contract per se to protect shareholders' interests. The reasoning behind this conclusion is that shareholders hold residual claims on the corporation's assets and consequently decisions that maximize the value of shareholders' claims will also maximize the value of the corporation's assets. As a result, it is convenient simply to require managers of solvent corporations to act exclusively in the best interests of shareholders rather than to force shareholders to contract for more specific control rights. To put it another way, so long as the corporation is and expects to remain solvent, it is safe to presume that acting in the

79 Id., at 243 (B.C.L.R.).
best interests of shareholders is equivalent to acting in the best interests of the corporation.80

The logical implication of these arguments seems to be that creditors should not have the right to bring derivative claims. If the interests of a corporation are co-extensive with the interests of its shareholders then it seems reasonable to conclude that only shareholders ought to have the right to initiate proceedings designed to protect the interests of the corporation. In other words, only shareholders should have standing to bring claims that are derivative in nature. Allowing other classes of complainants to launch such complaints would provide little additional benefit and might actually do some harm by allowing parties whose interests are not aligned with the interests of the corporation to bring suits designed to deter actions that are harmful to their interests, but are nonetheless consistent with the best interests of the corporation as a whole.

However, the arguments in favour of limiting creditors' role in corporate governance to their bargained-for rights begin to break down as the corporation in question descends into insolvency. When a corporation is insolvent, some of its creditors rather than its shareholders may hold the residual claim on its assets. Therefore, for much the same reason that it is sensible to give shareholders a role in the governance of a solvent corporation, it may be sensible to give creditors a role in the governance of an insolvent corporation — once a corporation is insolvent its creditors may well be the best guardians of its interests.

The fact that creditors' interests may be closely aligned with the interests of an insolvent corporation has two important implications. First, those creditors should have the right to conduct legal proceedings — including those arising from events that occurred prior to the date of insolvency — on behalf of the corporation. Second, for the purposes of deterrence, creditors ought to be able to obtain relief if an insolvent corporation's affairs are not conducted in accordance with their interests. For both these reasons there will be cases in which the best way of protecting the interests of an insolvent corporation is to ensure that the applicable procedural

80 Here we assume that the interests of the corporation lie in maximizing the value of its assets. For discussion of the justification for this assumption see Smith, "The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty" (1999), 98 Mich. L. Rev. 214.
rules grant creditors standing to bring a complaint that is derivative in nature. In addition, the second point made above suggests that there will be cases in which substantive legal rules ought to reflect the notion that acting in the best interests of the corporation involves acting in the best interests of some or all of its creditors. Generally speaking, the cases of interest will arise whenever a corporation's liabilities exceed its assets by such a great amount that some or all of its creditors have become residual claimants and so have an interest in maximizing the value of the corporation's assets.

These points can be illustrated by varying the facts of the hypothetical example introduced above. That hypothetical concerned litigation against a corporate director who had misappropriated $10,000. We assumed that a judgment against the director would result in $10,000 being paid into the corporate treasury. Here we will assume that the expected legal costs of the action are less than $10,000. It was implicit in our previous discussion that the corporation was solvent at all relevant times. Now we will assume that the corporation is insolvent and, in fact, its liabilities exceed its

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82 Because creditors' claims differ in their priority and the extent to which they are secured, the creditors of a corporation will not have identical interests.

83 It is important to emphasize that we are not asserting that the interests of creditors are always consistent with the interests of an insolvent corporation. If the liabilities of an insolvent corporation do not greatly exceed its assets, then its creditors may only enjoy a limited portion of the benefits associated with making good decisions on behalf of the corporation. In those cases, the creditors should not be characterized as residual claimants for the purposes of determining whether their interests are fully aligned with the interests of a corporation. For instance, unless creditors can capture the full benefit of their decisions, they will have an interest in making less risky decisions than those that would maximize the value of the corporation's assets. See Lin, "Shift of Fiduciary Duty Upon Corporate Insolvency" (1993), 46 Vand. L. Rev. 1485. That is why we emphasize that creditors only become true residual claimants once the liabilities of the corporation exceed its assets by a sufficiently large amount.

84 In other words, either Case B or Case C obtains — for present purposes it does not matter which.
assets by more than $10,000.\textsuperscript{85} Under these circumstances, shareholders will have no interest, either individually or collectively, in initiating proceedings against the director, even if the corporation was solvent when the director misappropriated the funds. This is because even if the litigation is successful, the shareholders will not see any of the benefits — all the benefits will flow to the creditors.\textsuperscript{86} At the same time, it is clearly in the interests of the corporation (i.e., value-maximizing) to sue the director. Under these circumstances only creditors will have an incentive to initiate or continue proceedings designed to obtain redress. If creditors are denied standing to initiate those proceedings, then a meritorious claim will not be brought.\textsuperscript{87}

This hypothetical example provides a concrete illustration of the proposition that if the liabilities of the corporation exceed its assets by a sufficiently great amount, the interests of creditors of an insolvent corporation will be aligned with the interests of the corporation as a whole and so those creditors should have standing to initiate proceedings that are derivative in nature. This assertion implies that creditors of some insolvent corporations should be able to initiate derivative actions.

Some might argue that even if it is appropriate to give the creditors of insolvent corporations the ability to initiate derivative claims, those creditors should be forced to pursue their claims through the vehicle of a suit brought by a trustee in bankruptcy. Alternatively, one might argue that, even if individual creditors are

\textsuperscript{85} The result that we seek to illustrate through this example occurs whenever the difference in value between the corporation's liabilities and its assets is greater than the value that the litigation is expected to bring to the corporation, net of legal costs.

\textsuperscript{86} It is worth noting that if the corporation were solvent when the director misappropriated the funds, then, until insolvency supervened, shareholders would have had an incentive to sue him. But, if the corporation's liabilities exceeded its assets by more than $10,000 at the time that the director misappropriated the funds, then shareholders would never have had an interest in suing him.

\textsuperscript{87} In this particular case the creditors would probably have recourse under provincial fraudulent conveyances legislation. More generally, if the corporation is bankrupt, the trustee may have recourse under the provisions of the \textit{Bankruptcy and Insolvency Act}, R.S.C. 1985, c. B-3 [as am.], concerning settlements and reviewable transactions: ss. 91, 100 and 101. However, these alternative legal avenues are not perfect substitutes for proceedings under the oppression remedy; the latter is somewhat broader in terms of both the conduct that it embraces and the remedies that it provides.
permitted to initiate derivative suits, they should be compelled to do so by way of a derivative action rather than under the oppression remedy. Both approaches have the apparent virtue of avoiding a multiplicity of proceedings.

The difficulty with granting the trustee in bankruptcy an exclusive right to litigate on behalf of creditors is that the trustee will not always have an incentive to pursue suits that creditors have a collective interest in pursuing. This problem arises where the assets of the bankrupt corporation are small relative to the legal costs entailed in pursuing a claim. In such cases, the trustee will be reluctant to initiate litigation because he or she will be personally liable for any legal costs that exceed the value of the assets of the estate, but will not capture any of the benefits of successful litigation. Permitting individual creditors as well as the trustee to bring derivative claims seems like an appropriate method of increasing the likelihood that meritorious claims will be brought. It is also difficult to see any justification for limiting creditors with derivative claims to the procedure associated with a derivative action, that is, one that involves mandatory joinder, a remedy in favour of the corporation as a whole and an obligation to seek leave of the court before proceeding. This follows by extension of the reasoning discussed in Section II above. To recapitulate, there is no justification for what amounts to mandatory joinder since free-rider problems are likely to discourage creditors from bringing multiple claims in much the same way as they discourage shareholders. As far as remedies are concerned, it may be fair to presume that the proper remedy for a creditor is one in favour of the corporation as a

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88 This problem is not particularly significant if the trustee can freely assign the proceeds of derivative claims to third parties. However, it is not clear how much freedom a trustee has to assign a chose in action upon terms other than those permitted by s. 38 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3. It is even less clear that a trustee can be compelled to make such an assignment. See Re Rizzo & Rizzo Shoes Ltd. (1998), 38 O.R. (3d) 280 (C.A.). Section 38 of the Bankruptcy and Insolvency Act provides that the trustee's assignee must be a creditor and can only retain a portion of any proceeds from the litigation that is sufficient to satisfy the amount of its claim and the legal costs. Any surplus must be remitted to the estate. The consequence of this limitation is that assignees under s. 38 will be reluctant to undertake particularly risky litigation — even if the expected benefit from the litigation outweighs the legal costs. See also Prentice, “Corporate Personality, Limited Liability and the Protection of Creditors” in Grantham and Ricketts (eds.), Corporate Personality in the 20th Century (1998) 99 at 123–24 (discussing a similar problem in the U.K. context).
whole; however, the oppression remedy permits such remedies to be granted if necessary. Finally, so long as the creditor is not seeking to be indemnified for its costs, there is no reason to require it to seek leave to proceed. Consequently, we conclude that certain creditors of insolvent corporations should be permitted to bring derivative claims under the oppression remedy.

IV. CONCLUSIONS

The first question we set out to answer is whether critics are right in suggesting that the oppression remedy should not embrace applications seeking redress for derivative wrongs. We considered whether there are good reasons to compel derivative and personal actions to take different procedural tacks. The first claim considered was that if derivative wrongs could be pursued through personal actions, there would be a multiplicity of actions. Our conclusion was that this was not compelling. Because of the tendency to seek to free-ride, there would only rarely be any plaintiff at all willing to bring a suit. Thus, the multiplicity argument fails to imply that derivative claims should not be pursued under the oppression remedy. The second claim was that bringing a suit in the name of the corporation has advantages when it comes to fashioning a remedy. While remedial efficacy may be important, the oppression remedy gives the court wide remedial flexibility, and explicitly contemplates orders on behalf of the corporation rather than the particular applicant. Therefore, remedial considerations also fail to imply that the oppression remedy ought not to embrace derivative wrongs.

We then looked at justifications for the leave provision. For reasons discussed already, the leave provision is not required to prevent a multiplicity of actions. Preventing meritless suits, either bad faith strike suits or good faith misguided suits, is also not a compelling justification for the leave requirement. In most every other legal context, the threat of adverse cost orders and other procedures, such as moving for summary judgment, serve to deter meritless claims. There is no reason to view the corporate context as any different. Even if there were, there would be no reason for the leave requirement to exist for the derivative action, but not the oppression remedy. Thus, explaining the leave procedure as a response to the risk of meritless suits also fails to convince.

It is our conclusion that the leave requirement is best justified as a screen for meritless claims that arise because of the potential
indemnity for costs. Given that this indemnity for costs does not exist under the oppression remedy, the absence of a leave requirement under the oppression remedy does not imply that it should exclude derivative claims.

The second question that we set out to answer is whether it is appropriate to allow creditors to bring applications under the oppression remedy. We conclude that there are grounds for concern about giving creditors of solvent corporations legal rights vis-à-vis corporate managers that might reach beyond the creditors’ bargained-for rights. This is mainly because creditors’ interests are not particularly well aligned with the interests of the corporation as a whole. However, the situation is different when the corporation is insolvent. In that case, creditors’ interests may be well aligned with the interests of the corporation and so they should have the right to conduct litigation seeking redress for harm to the corporation. In other words, creditors who have effectively become residual claimants of an insolvent corporation should have standing to bring derivative claims. We also make the related but distinct point that the substantive legal rules that define whether actionable harm to the corporation has occurred (including the definition of oppressive conduct under the oppression remedy) should reflect the notion that the affairs of some insolvent corporations ought to be conducted with a view to the best interests of creditors.

For the reasons discussed above, we reject contentions that complainants generally should be forced to bring derivative claims under the statutory derivative action as opposed to the oppression remedy. That reasoning also applies to derivative claims brought by creditors. As a result, we believe that creditors of some insolvent corporations should be permitted to bring derivative claims under the oppression remedy as well as the statutory derivative action. We note that most of the cases in which creditors have been granted standing under the oppression remedy seem to have involved derivative claims.

Although we favour allowing complainants to bring derivative claims under the oppression remedy, it should be evident from the foregoing analysis that we do not believe that the oppression remedy provides the ideal procedural vehicle for those suits. This is mainly because, unlike the derivative action, the oppression remedy does not contain any mechanism for mitigating free-rider problems. On the other hand, there is at least one advantage to pursuing claims under the oppression remedy rather than through the vehicle of a
derivative action. Claims under the oppression remedy proceed by way of application. We do not see any reason why it should not also be possible for derivative actions to be pursued by way of an application. Under the CBCA and OBCA, however, this is impossible; derivative actions must proceed by way of a full action. Therefore, for the time being it is useful for complainants to be able to bring derivative claims under the oppression remedy.

While this essay has focused on the OBCA and CBCA, it is interesting to note the oppression remedy provisions in the ABCA explicitly contemplate an order granting leave to an applicant to bring an action on behalf of the corporation. That is, the oppression remedy explicitly encompasses derivative claims, but leave is required. Consistent with our reasoning in this essay, accompanying the leave requirement is a cost indemnity provision. Section 233 provides, *inter alia*, that the court may order indemnity of a complainant’s legal fees in connection with litigation pursued under the derivative action provision, section 232, and under the derivative claim aspect of the oppression remedy provision, section 234(3)(q). We again observe the connection between the leave and cost indemnity provisions. Since there is no cost indemnity provision in the OBCA or CBCA oppression remedy, there is no need for a leave requirement.

In summary then, we see little basis for concern about the current scope of the oppression remedy found in the OBCA and CBCA. We believe that there is a sensible justification for the prevailing view that derivative claims may be pursued under the oppression remedy and that some creditors should have standing to invoke the oppression remedy against insolvent corporations in order to obtain redress for derivative harms. We disagree with those who suggest that the scope of the oppression remedy should be defined more narrowly.

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89 We agree with MacIntosh (1991), *supra*, note 8, when he states at 68: "[I]t is difficult to justify a difference in the procedures applicable depending on whether the suit is personal or derivative. While it might be argued that derivative actions are generally more complex than personal actions, justifying a higher level of procedural complexity, a perusal of personal oppression applications offers only mixed support for this contention. Even if derivative matters are indeed more complex, it is better in my view to offer all complainants the option of proceeding by way of action or application, allowing the court to refer any issue raised in an application to trial."

90 See the ABCA, s. 234(3)(q).