University of Alberta

Director and Officer Indemnification

by

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Abstract

This thesis explores director and officer indemnification under the *Canada Business Corporations Act,* R.S.C. 1985, c. C-44, as am. by S.C. 2001, c. 14, s. 124. as well as at common law and in equity. It will show that, beyond statutory protections, rights to indemnification subsist by virtue of agency and fiduciary law. The presence of these extra-statutory protections is of particular importance given the apparently decreased rights to indemnification reflected in the current *CBCA*, as amended in 2001. A related purpose of this thesis is to advocate for two *CBCA* amendments. First, Parliament is encouraged to replace the current "act or omission" test in the CBCA with the wording used in its predecessor test, namely the "substantially successful" test. Second, the CBCA should be amended to expressly acknowledge what this thesis contends is already the case, namely that director and officer indemnification rights at common law and equity survive the statute.

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Part I Introduction

Under the *Canada Business Corporations Act*[1] a corporation may indemnify directors and officers against litigation costs, charges and expenses because of the individual's association with a corporation. Director and officer indemnification serves multiple purposes, including, discouraging shareholder strike suits, reimbursing good faith behaviour by directors and officers, and attracting and encouraging persons to accept positions as directors and officers. Director and officer indemnification is a contentious area of law, however, because it reflects an inevitable tension. That is, a director or officer will want assurances that the corporation he or she manages will pay legal defence costs if sued in that capacity. However, shareholders will not want corporate funds to be used for the purposes of defending a director or officer if he or she is guilty of wrongdoing.

In 2001 the *CBCA* underwent a variety of changes intended to modernize the law of corporate governance, including the provision relating to director and officer indemnification, s. 124. These amendments to s. 124 reduced the rights of directors and officers to indemnification as compared to its predecessor section. The current *CBCA* provides directors and officers with a right to indemnification if he or she:

a. acted honestly and in good faith with a view to the best interests of the corporation, or, as the case may be, to the best interests of the other entity

[1] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as am. by S.C. 2001, c. 14 [*CBCA*], s. 124 [*CBCA*].

for which the individual acted as director or officer or in a similar capacity at the corporation's request;[2]

b. in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, the individual had reasonable grounds for believing that the individual's conduct was lawful;[3] and,

c. was not adjudged by the court or other competent authority to have committed any fault or omitted to do anything that the individual ought to have done.[4]

Prior to 2001, the *CBCA* entitled a director or officer to indemnification if he or she:

a. satisfied the fiduciary duty test;[5]

b. satisfied the lawful conduct test;[6] and,

c. was substantially successful on the merits in the defence of any civil, criminal or administrative action or proceeding.[7]

There is a significant difference between the substantially successful test of the predecessor *CBCA* and the act or omission test under the current *CBCA*. As this paper will argue, directors and officers who are substantially successful in

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[2] [fiduciary duty test]
[3] [lawful conduct test]
[4] [act or omission test]
[5] *CBCA*, pre-2001, s.124(1)(a).
[6] *CBCA*, pre-2001, s. 124(1)(b).
[7] *CBCA*, pre-2001, s. 124 (3)(a) [substantially successful test].

their defence may no longer be entitled to indemnification under the *CBCA* as currently formulated.

The purpose of this thesis is to explore director and officer indemnification under the *CBCA*, at common law and in equity. More specifically, this thesis will show that beyond statutory protections, rights to indemnification continue to subsist by virtue of agency and fiduciary law. The presence of these extra-statutory protections is of particular importance given the apparently decreased rights to indemnification reflected in the *CBCA*, as amended. A related purpose of this thesis is to advocate for two amendments to the *CBCA*. First, the act or omission test must be replaced with its predecessor test, namely the substantially successful test. As will be argued later in this paper, such an amendment would ensure that the director or officer who is largely, but not entirely successful, in defending multiple torts or charges would nonetheless be entitled to indemnification. Second, the *CBCA* should be amended to expressly recognize that director and officer indemnification rights at common law and in equity survive and are not supplanted by statute. Such an amendment would, as I will argue, merely reflect present case law and thereby lend increased clarity and certainty to this area of law.

This thesis is divided into several parts. Part II discusses director and officer indemnification in order to provide necessary background and context to the *CBCA* statutory indemnification provision. It will show how amendments to

the *CBCA* in 2001 created a gap in indemnification law such that directors and officers are exposed to greater litigation expense risk by virtue the increased number of requirements that must be satisfied before they can claim a right to indemnification. Part III discusses trustee and agency indemnification law at common law and in equity in an effort to draw an analogy between the rights in this area and the rights of directors and officers. It will show that the indemnification rights of trustees and agents are logically applicable to directors and officers, although have yet to achieve stable recognition by courts in Canada or the United States. I will also offer an indemnification test for directors and officers, based on the case law, that courts should apply at common law or in equity to establish indemnification rights. In Part IV, I will argue that this test is not displaced by the statutory rights and limitations under the *CBCA* and therefore would have application notwithstanding the current statutory regime. In Part V, I will compare the enforcement potential of this common law and equitable right with enforcement of indemnification rights under statute, by contract or by constating instruments. I will argue that this right to indemnification using the test I offer, justifiably and in a manner consistent with the case law, enhances indemnification rights by providing directors and officers with a broad range of remedies. In short, it provides a complimentary source of protection when the indemnification provisions of the *CBCA* fail.

Part II Director and Officer Indemnification

In this Part, I will review how director and officer indemnification is a means by which capable persons are encouraged to accept the roles of directors and officers and such persons are reimbursed for their good faith behaviour, while at the same time holding them liable for their culpable actions. Indeed, one of the principal purposes of director and officer indemnification is to strike a balance between these interests. I will also address how, despite the usefulness of the purposes served by indemnification provisions, there is an unjustified reduction of those who were protected by statute before and after the 2001 amendments to the *CBCA* by virtue of an increase in the number of requirements to be satisfied in establishing a right to indemnification. As will be seen, this gap leaves directors and officers vulnerable to being excluded from indemnification for no clear policy reason. Finally, I will review the inclusion of an indemnification prohibition in the *CBCA* and its effects on ss. 124(1) and (4) of the *CBCA*, being the permissive and derivative action indemnification provisions respectively.

It is well known that directors are responsible for the management, or the supervision of the management, of the business and affairs of a corporation, subject to a unanimous shareholder agreement and applicable legislation.[8] Understanding that managing a corporation is not an exact science[9] is to

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[8] *CBCA*, s. 102.

[9] *Walton* v. *Houlihan, Howard & Zukin* (in *re UA Theatre Co.*), 315 F. 3d 217 (3rd Cir. 2003) [*Walton* cited to F.3d] ("The art of governing (it is emphatically not a science) is replete with judgment calls and "bet the company" decisions that in retrospect may seem visionary or deranged, depending on the outcome. Corporate directors do not choose between reasonable

understand the context in which the purposes of indemnification, namely balancing the above noted interests, are realized. In business, directors and officers may be personally and financially rewarded for taking business risks that, on any given day, may yield high profits. These same directors and officers may be personally and financially destroyed for undertaking the same business risks that, again, on any given day, may yield disastrous results. One businessperson's act of brilliance may be another businessperson's act of recklessness.[10] When directors and officers take business risks on behalf of the corporations they manage, directors and officers expose themselves to personal liability if they have acted culpably.

According to Margaret Smith, the theory behind making directors personally liable under law is:

> ...[T]he risk of being found liable will make directors more attentive to their legal obligations in managing the corporation...Moreover, where a corporation has violated a statutory requirement, the liability of directors provides a means of punishing that violation."[11]

Excessive liability for directors and officers, however, "may cause corporate boards to spend significant amounts of time on averting liability,

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(non-negligent) and unreasonable (negligent) alternatives, but rather face a range of options, each with its attendant mix of risk and reward" at 231).

[10] See *New York Dock Company* v. *McCollom,* 173 Misc. 106; 16 N.Y.S. 2d 844; 1939 N.Y.Misc. LEXIS 2614 [*McCollom* cited to Misc]. See also *Solomine* v. *Hollander,* 129 N.J. Eq. 264; 19 A.2d 344 [*Solomine* cited to N.J.Eq.] ("I do not consider that liability to charges of misconduct in office is one of thte hazards inhering in the office of director of a company and that such hazard is impliedly assumed in the acceptance of that office" at 269-70).

[11] Canada, Law and Government Division of the Parliamentary Research Branch, *Director's Liability* (Parliamentary Discussion Paper PRB 99-44E) (Ottawa: Library of Parliament, 2000) at 2 (Margaret Smith) [*Director's Liability*].

thereby reducing innovation and adversely affecting competitiveness."[12] Indemnification is intended to create a balance between accountability when directors act improperly, and encouraging the growth of commercial innovation when directors act reasonably. This view is reflected in the Supreme Court of Canada's assessment of director and officer indemnification in *Blair* v. *Consolidated Enfield Corp.*:[13]

> Permitting [an individual] to be indemnified is consonant with the broad policy goals underlying indemnity provisions; these allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection. Indemnification is geared to encourage responsible behaviour yet still permit enough leeway to attract strong candidates to directorships and consequently foster entrepreneurism...A balance must be maintained.[14]

In the same year as the *Blair* decision, a 1995 Industry Canada Discussion Paper, outlining proposed amendments to the *CBCA*,[15] described the purpose of statutory indemnification provisions thus:

> The fundamental issue that must be addressed by [statutory] indemnification provisions is the establishment of policies consistent with broad principles to ensure that: (1) indemnification is permitted where it will be consistent with corporate policies, and (2) indemnification is prohibited where it might protect or encourage wrongful or improper conduct.[16]

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[12] *Director's Liability, supra* note 11 at 1.

[13] (1995), 128 D.L.R. (4th) 73 (S.C.C.) [*Blair*].

[14] *Ibid.* at 96. See also *Mooney* v. *Willys-Overland Motors, Inc.* 204 F.2d 888 (3rd Cir. 1953); 1953 U.S. App. LEXIS 2534; 39 A.L.R.2d 566 [*Mooney* cited to F.2d] ("It seems clear that the purpose of [director and officer indemnification] statutes such as Delaware's is to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve" at 898).

[15] Canada, Industry Canada, *Canada Business Corporations Act, Discussion Paper, Directors' Liability* (Ontario: Corporate Law Policy Directorate, 1995) (Lyne Tassé) [*CBCA Discussion Paper*].

[16] *Ibid.* at 27.

On a related front, an important purpose of indemnification provisions is to discourage strike suits, that is unfounded litigation brought against directors and/or officers who seek settlement on the basis of nuisance value.[17]

Indemnification rights and limitations in the *CBCA* seek to serve the foregoing purposes, namely balancing indemnification interests and discouraging strike suits. More specifically, the *CBCA* seeks to establish a standard for corporate statutory law in Canada,[18] which each province and territory in Canada echo in their own statutory indemnification rights and limitations.[19] Across the country, these provisions are relatively similar.[20] Most Canadian indemnification provisions, for example, including the *CBCA*, continue to distinguish between

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[17] See *Solomine, supra* note 10 (A strike suite is litigation "brought in the expectation that the accused directors and officers will pay something to escape not so much the risk of surcharge or removal as the substantial costs involved in adequate defense, particularly if the litigation is likely to be a prolonged one" at 272). See also: *Beneficial Industrial Loan Corporation* v. *Smith,* 337 U.S. 541; 69 S.Ct. 1221 (1949) at 1226; William Douglas, "Directors Who Do Not Direct" (1934) 47 Harv. L.Rev. 1305: ("[T]here are the managers and the board who need effective protection against the blackmailer or striker, lest the risks attendant to those business positions prove to be too onerous" at 1327 cited in *McCollom, supra* note 10 at 112).

[18] In the United States, see Delaware *General Corporation Law,* Del. Code Ann. Tit. 8 (1993) §145 [*DGCL*] and the *Model Business Corporation Act,* Chapter 8, Subchapter E § 8.51-8.59 [*MBCA*].

[19] Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 124; British Columbia *Business Corporations Act,* S.B.C. 2002, c. 57 [*BCBCA*]; Manitoba *Corporations Act*, R.S.M. 1987, c. C225, s. 119; New Brunswick *Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 81; Nunavut *Business Corporations Act* S.N.W.T. 1996, c. 19, s. 125; Newfoundland *Corporations Act*, R.S.N. 1990, c. C-36, s. 205; Northwest Territories *Business Corporations Act* S.N.W.T. 1996, c. 19, s. 125; Ontario *Business Corporations Act*, R.S.O. 1990 c. B-16,s. 136; Saskatchewan *Business Corporations Act*, R.S.S. 1978, c. B-10, s. 119; Yukon *Business Corporations Act*, R.S.Y. 2002, c.20, s. 126.

[20] See Canada, Information Canada, *Proposals for a New Business Corporations Law for Canada* vol. I and vol. II (Ottawa, Ont.: Information Canada, 1971) (Robert W.V. Dickerson, John L. Howard and Leon Getz) [*Dickerson Report*]. (While statutory indemnification rights have developed over the past few decades, consistency among legislation in the various Canadian jurisdictions has not necessarily been achieved. The *Dickerson Report* only referenced statutory indemnification rights for the purpose of explaining why and how proposals for the *Canada Business Corporations Act*, S.C. 1974-1975, c. 33, s. 119 were to be drafted. The *Dickerson Report* did not state that its recommendations were based on case law, but rather, drafted its proposed indemnification legislation in reference to New York statute law and the "bewildering number of models in current statutes..." vol. I, s. 243 at 83).

indemnification *rights*;[21] and, indemnification *limitations*, such as a permissive indemnification provision;[22] and, indemnification in derivative actions.[23] The *CBCA*, however, includes an additional indemnification limitation, namely an explicit indemnification *prohibition*,[24] as will be discussed in this Part.

Addressing first the parameters of a right to indemnification under the *CBCA*, there has been relatively little guidance as to how statutory indemnification provisions should be interpreted. The 1971 *Dickerson Report*, for example, only briefly discussed a director's or officer's entitlement to indemnification as follows: "[A] director or officer may claim indemnity from a corporation as a matter of right where he has been wholly successful in his defence..."[25]

While the right to indemnification provision under the *CBCA* in 1975 allowed for an entitlement to indemnification when a director or officer was substantially successful in defending a proceeding, this entitlement was restricted in 1978 by the additional requirement that a director or officer satisfy the fiduciary duty test and, if applicable, the lawful conduct test.[26]

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[21] *CBCA*, s. 124(5).
[22] *CBCA*, s. 124(1).
[23] *CBCA*, s. 124(4).
[24] *CBCA*, s. 124(3).
[25] *Dickerson Report, supra* note 20 vol. I, s. 248 at 85.
[26] S.C. 1978, c. 9, s. 32.

The 1995 *CBCA Discussion Paper*, leading to the 2001 amendment, did not discuss modifications to the statutory right to indemnification. While judicial commentary on the predecessor provision is meager, there are no indications that the application of the right to indemnification threshold under the pre-2001 *CBCA* was problematic.[27] Nevertheless, the 2001 amendments to the *CBCA* changed the indemnification rights of directors and officers with the addition of the act or omission test. In short, a director or officer must now satisfy the act or omission test,[28] the fiduciary duty test[29] and, in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, the lawful conduct test.[30]

There are several implications of this new *CBCA* right to indemnification provision, both to the corporation and to its directors and officers. First, once a director or officer satisfies the legislative tests, the director or officer has a cause of action against the corporation to enforce indemnification. Second, a corporation cannot opt out of indemnification rights using the corporation's articles, its by-laws or by a resolution.[31] Third, the *CBCA* does not require a

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[27] *Chromex Nickel Mines Ltd.* v. *British Columbia (Securities Commission)* (1991), 4 B.L.R. (2d) 189 (B.C.S.C.) [*Chromex*]; *Fuhr* v. *Battleford's Urban Native Housing Corp.* (1994),119 Sask.R. 188 (Sask. Q.B.) [*Fuhr*].

[28] *CBCA*, s. 124(5). (There is no counterpart to the *CBCA*'s act or omission test under the *DGCL* or the *MBCA*).

[29] *CBCA*, s. 124(3)(a).

[30] *CBCA*, s. 124(3)(b).

[31] *CBCA*, s. 122(3) (Subject to a unanimous shareholders agreement, "no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act or the regulations or relieves them from liability for a breach thereof." As such, none of these extra-statutory sources of law can relieve directors and officers from the duties that are imposed upon them by virtue of the fiduciary duty test and lawful conduct test in s. 124).

court to find that a director or officer is without fault or that the individual did everything that he or she was required to do. But, indemnification entitlement is eliminated if a court finds that the person committed any fault or omitted to do anything that ought to have been done. For example, in litigation involving multiple counts or charges, a finding of fault with respect to one count or charge may be interpreted as removing a director's or officer's right to indemnification for the whole of the litigation.

It is in this last regard that there is an unjustified reduction of those who were protected before the 2001 amendments to the *CBCA* compared to those protected under the current regime. Furthermore, it is not clear from the statutory language whether this act or omission must adversely or materially affect a corporation. Any finding of fault by the court arguably removes the protection. Nor is it clear from the statutory language whether such act or omission relates to legally actionable fault or omissions, such as a tortious act, breach of contract or breach of a regulatory statute, as opposed to mere criticism of the individual's decision which gave rise to the litigation. The reasonable conclusion is that the statute refers to a legal actionable act or omission. To conclude otherwise would enable courts to second guess business, and not legal, decisions of directors and officers.

That said, it is interesting to compare the lawful conduct test against the act or omission test. In particular, the lawful conduct test contemplates a right to

indemnification in circumstances where the director or officer committed an illegal act but had reasonable grounds for believing that such act was legal. The lawful conduct test narrows this requirement to proceedings enforced by monetary penalty. Nevertheless, if we are to read into the act or omission test that a right to indemnification is only available in absence of committing a legal actionable act or omission, then the lawful conduct test is rendered redundant. In the result, if we are to interpret the act or omission test as referring to a legal actionable act or omission, then the lawful conduct test serves no purpose. If the lawful conduct test serves no purpose then there is no explanation for why the legislature retained it for the purposes of the indemnification provision. On the other hand, if we are to interpret the act or omission test as referring to *any* act or omission, whether legally actionable or not, then the courts are open to criticize business decisions of directors and officers in their management of corporations.[32] This is unlikely to happen because it is not reasonable to

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[32] See *Aronson* v. *Lewis* 473 A. 2d 805 (Del. 1984) at 812 cited in *re Abbott Laboratories Derivative Shareholders Litigation* 325 F. 3d 795 (7th Cir. 2003) (In the United States, courts have formally shown deference to the business decisions of managers through the business judgment rule. In particular, 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 was taken in the best interests of the company" at 807). See also *Walton, supra* note 9 (This presumption under the business judgment rule was recognized on the following premises: "A creature of common law...[the business judgment rule] acknowledges a judicial syllogism derived from fundamental tenets:

> (1) the management of corporation's affairs is placed by law in the hands of its board of directors;
> (2) performance of the directors' management function consists of (a) decision-making – i.e., the making of economic choices and weighing of the potential risk against the potential of reward, and (b) supervision of officers and employees – i.e., attentiveness to corporate affairs;
> (3) corporate directors are not guarantors of the financial success of their management efforts;
> (4) although not guarantors, directors as fiduciaries should be held legally accountable to the corporation and its stockholders when their performance falls short of meeting appropriate standards; and,

conclude that the legislation intended to interfere with business decisions in this way. This is not the role of the judiciary. Nevertheless, the lack of clarity in the law is unnecessary and should be rectified.

The implication of the new provision is that a director or officer must achieve perfect results in litigation before a right to indemnification is realized. This is inconsistent with judicial acknowledgement that management is not an exact science and hindsight application of perfection is to be discouraged. Further, it ignores the potential for a litigation action involving multiple claims in which a defendant director or officer has been successful with respect to the vast majority of the claims, but unsuccessful in just one claim.

As the foregoing discussion demonstrates, the act or omission test restricts a director's or officer's right to indemnification and creates uncertainty in the law. Furthermore, other amendments to the *CBCA* provisions continue to restrict a corporation's ability to indemnify in other contexts, namely, the *CBCA* provision which *permits* (as opposed to requires) indemnification,[33] the provision relating to derivative actions[34] and the provision which *prohibits* indemnification.[35]

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(5) such culpability occurs when directors breach their fiduciary duty – that is, when they profit improperly from their positions (i.e., breach the "duty of loyalty") or fail to supervise corporate affairs with the appropriate level of skill (i.e., breach the "duty of care")" at 233).

[33] *CBCA*, s. 124(1).
[34] *CBCA*, s. 124(4).
[35] *CBCA*, s. 124(3).

The *CBCA* permits a corporation to indemnify a director or officer provided the director or officer satisfies the fiduciary duty test and, where applicable, the lawful conduct test in relation to the allegations forming part of the litigation.[36] Fortunately for directors and officers, permissive indemnification is not conditional on fulfilling the statutory duty of care.[37]

With respect to actions against a director or officer by the corporation, either directly or derivatively, s. 124(4) of the *CBCA* provides that the defendant director or officer may only be indemnified for litigation costs and expenses with court approval.[38] The reasoning behind requiring court approval stems from the nature of derivative action litigation, as explained by Kingston and Grover as follows:

> The policy in restricting indemnification in derivative (not direct) actions is based on the fact that the ultimate plaintiff in such actions is the corporation for whose benefit the action was brought. Therefore, the corporation would not receive the benefit of a judgment in its favour if it had to reimburse the defendant.[39]

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[36] *CBCA*, s. 124(1) and (3). (A corporation "may" indemnify under the permissive indemnification provision. The significance of the words "a corporation may provide indemnification" is that the directors may resolve to indemnify a director or officer without shareholder approval. Directors, however, under s. 118(2)(d) will be jointly and severally liable if they vote to indemnify another director or officer contrary to the statutory indemnification requirements. Pursuant to s. 118(7) of the *CBCA*, directors who vote for indemnification remain exposed to liability for two years from the date of the resolution authorizing indemnification of a director or officer. Ultimately, according to Wayne Gray, "Corporations as Winners under the CBCA" (2004) 39 C.B.L.J. 4 at 12, "[t]he decision as to who should be indemnified has been left to the business judgment of the directors of the indemnifying corporation, limited of course to their general fiduciary duties and standard of care").

[37] *CBCA*, s. 122(1)(b) (Directors and officers are required to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances). See Carol Hansell, *Directors and Officers in Canada: Law and Practice*, vol. 2 (Scarborough, Ontario: Carswell, 1999) ("The good faith prerequisite in the indemnification provisions in effect permits a corporation to indemnify a director or officer for negligence (failure to satisfy the duty of care) but *not* for breach of fiduciary duty" at 14-12).

[38] *CBCA*, s. 124(4).

[39] Kingston & Grover, *Canada Corporation Manual* (Toronto: Carswell, 1996) at 7-34.1.

Regardless of the nature of an action, the *CBCA* continues to outline circumstances under which corporations are expressly prohibited from indemnifying directors and officers. Although the *CBCA* prior to 2001 neither explicitly prohibited indemnification, nor required court approval for the permissive indemnification provision, the 1971 *Dickerson Report* recommended that no indemnification whatsoever be paid without court approval.[40] This recommendation was intended to avoid abuse of indemnification powers.[41] The *Dickerson Report*'s reasoning was that there would have been no need for a prohibition if court approval was required in every case as the judicial system would ensure that indemnification was provided only in the proper circumstances.

While the 1995 *CBCA Discussion Paper* did not mention an explicit indemnification prohibition, a prohibition was included in the 2001 amendments to the *CBCA*. The *CBCA* now prohibits indemnification unless the individual satisfies the fiduciary duty test and, if applicable, the lawful conduct test.[42] Perhaps the inclusion of a prohibition was an attempt to be consistent with the Delaware *General Corporation Law*[43] and the *Model Business Corporation Act*,[44]

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[40] *Dickerson Report*, *supra* note 20 vol. I, s. 246 at 84.
[41] *Ibid.* vol. I, s. 246 at 84 .
[42] *CBCA*, s. 124(3).
[43] *DGCL*, *supra* note 18 §145 (Indemnification shall "be made by the corporation only ...upon a determination that ... the person has met the applicable standard of conduct set forth in [the legislation]..." The *DGCL* prohibits indemnification unless the person seeking indemnification has satisfied Delaware's version of the fiduciary duty test and lawful conduct test).
[44] *MBCA*, *supra* note 18 § 8.51-8.59 (A corporation may not indemnify a director under the permissive indemnification provision unless a majority of all disinterested directors, legal counsel, or disinterested shareholders determine that the director has satisfied the *MBCA*'s version of the fiduciary duty test and lawful conduct test).

or simply a response to judicial hints, as will be seen next, that indemnification should be prohibitory in certain circumstances.

Two pre-*CBCA* amendment cases, *R.* v. *Bata Industries Ltd,*[45] and *Saratoga Utilities Ltd.* v. *Long,*[46] are illuminating for how they handle indemnification prohibitions. In *Bata,* Bata Industries Ltd., governed by the *OBCA,*[47] and two of its directors were charged with provincial environmental regulatory offences.[48] The directors were each convicted of certain offences while others were stayed. The court of first instance in *Bata*, being the Ontario Court (Provincial Division), issued an order prohibiting the corporation from indemnifying the directors for the fines imposed by the Court.[49] The Court of Appeal put its reasoning for overturning the prohibition order as follows:

> According to s. 136(1) [of the Ontario *Business Corporations Act*], indemnification is permitted if the directors acted honestly, in good faith, and in the reasonable belief that their conduct was lawful. If [the directors] failed to meet these requirements, the prohibition order is superfluous because Bata is prohibited from indemnifying them under s. 136(1). If they did act honestly, in good faith, and in the reasonable belief that their conduct was lawful, the prohibition order contradicts the legislative scheme of the Ontario *Business Corporations Act.*[50]

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[45] (1995), 127 D.L.R. (4th) 438 (Ont. C.A.) [*Bata*].
[46] [1998] B.C.J. No. 772 (B.C.S.C.) (QL) [*Saratoga Utilities*].
[47] Ontario *Business Corporations* Act, S.O. 1982, c. 4 – now R.S.O. 1990, c. B16.
[48] *Environmental Protection Act,* R.S.O. 1990, c. E.19 and *Ontario Water Resources Act,* R.S.O. 1990, c. O. 40.
[49] *Bata, supra* note 45 at 440.
[50] *Ibid.* at 447. (In addition to overturning the prohibition, the fines imposed by the court of first instance in *Bata* were reduced on appeal to the Court of Appeal on the basis of credit for the directors' clean records and their remorse. A reason for overturning the prohibition order lay in the fact that the trial judge seemed intent on punishing the defendant directors whereas the order itself should have been directed at the corporate defendant, Bata. As such, punishing the directors by way of an indemnification prohibition did little to secure the good conduct of Bata or of preventing repetition of the same offence).

In *Bata*, then, the Ontario Court of Appeal was of the view that the permissive indemnification provision of the *OBCA*, identical to the permissive indemnification provision of the pre-2001 *CBCA*, was impliedly prohibitory in nature.

Another attempt to prohibit indemnification in a court order can be found in the 1998 case of *Saratoga Utilities*. In that case, the British Columbia Supreme Court strongly suggested that a corporation not indemnify its directors for damages awarded in favour of a plaintiff customer against the defendant directors for breach of contract and breach of statutory duties. According to the Court, the directors "acted in a vindictive and malicious manner toward [a customer] in disconnecting and refusing to reconnect his water service which he requested upon reasonable notice and after tendering payment."[51] The Court, in ordering damages, made the following remarks as to how the award against the directors was to be paid:

> Saratoga is a closely held corporation that has a regulated cash flow in common with other corporations licensed under the *Utilities Commission Act*. Such corporations often have indemnity arrangements to protect directors from findings of personal liability. One consequence of that type of arrangement could be, the burden of this award is passed onto its customers. That result would be unjust.
>
> Accordingly, I recommend to the Deputy Comptroller that this award not be passed on to Saratoga's customers by way of an increase in the rate structure, but shall be paid by the utility through an injection of capital or other resources into the company, as the directors intended to do when they planned improvements to the pump house, or shall be paid by the directors personally.[52]

[51] *Saratoga Utilities, supra* note 46 at para. 62.
[52] *Ibid.* at para. 64-5.

The courts' opinion in *Bata* and *Saratoga Utilities* illustrate a judicial determination that directors and officers not be indemnified by corporations when such persons have, in the opinion of the court, acted wrongly. As such, there is at least some inclination to expressly prohibit indemnification in certain circumstances by court order or very strong suggestion. The Court of Appeal in *Bata* determined that such a prohibition would be in effect by operation of statute alone and did not require its express intervention.

The 2001 *CBCA*'s explicit indemnification prohibition was the first legislative provision of its kind in Canada. British Columbia became the second jurisdiction to implement an indemnification prohibition with the British Columbia *Business Corporations Act,*[53] proclaimed in force in 2004. The *BCBCA*, like the *CBCA*, prohibits indemnification if the director or officer fails to satisfy the fiduciary duty test and, if applicable, the lawful conduct test.[54] The *CBCA*'s and *BCBCA*'s similar prohibitions are consistent with the Court of Appeal's opinion in *Bata* that a director or officer would be prohibited from indemnification under the permissive indemnification provision.

This Part has attempted to show the origin and current scope of the indemnification provisions under the *CBCA*. It has also highlighted aspects of the legislation that merit criticism, such as the inclusion of an act or omission test

[53] *BCBCA*, *supra* note 19.
[54] *Ibid.*, s. 154.

that apparently requires directors and officers to achieve litigation perfection before they are protected. No other jurisdiction in Canada included such a test, not even the newly enacted *BCBCA*.

As this Part has shown, there is a spectrum of indemnification law in which indemnification rights exist at one end and statutory limitations exist at the other. As will be argued in Part III, filling in the gap between these two ends of the spectrum are indemnifications rights and liabilities at common law and in equity. To the extent that such rights exist, it is also relevant to determine whether those rights exist under the 2001 *CBCA* or whether, instead, the legislation is an exhaustive code in that regard. Part IV will explore this very question.

Part III Indemnification at Common Law and in Equity

In this Part III, I will draw an analogy between the common law and equitable indemnification rights of trustees and agents on the one hand, to directors and officers, on the other. My purpose is to assess the potential for non-statutory indemnification rights of directors and officers. To do this, I will review why trustees and agents have acquired such rights, the test for when trustees and agents may assert indemnification rights, and how they may enforce their claims. The rationales for these rights and the cases that consider them will be applied to directors and officers.

Indemnification principles applicable to trustees and agents shall be reviewed together in this Part because of the large extent to which such principles overlap. As will be shown next, the extent to which these indemnification principles apply to directors and officers is problematic. Canadian courts have concluded that directors and officers are at times trustees of and agents for the corporations they manage. However, courts have not been requested to decide the question of whether directors and officers have common law and equitable indemnification rights when they act as agent or trustee. That said, nor do these cases forbid such a finding and, as will be seen, there is no policy analysis that would support or bolster the conclusion that indemnification rights do not exist. On the contrary, based on the reasoning of these decisions, I will argue that directors and officers have indemnification rights at common law

and in equity which may be proven using the same tests and the same enforcement mechanisms as those applicable to trustees and agents in general.

A. Indemnification Rights of Trustees and Agents

There are several reasons why trustees and agents are entitled to indemnification in equity and at common law, including the reasoning that a person who is not entitled to benefit from his actions, should not be required to bear the corresponding financial burdens. A related reason is to encourage capable persons to take on the tasks of trusteeship and agency.

With respect to the former, according to the King's Bench decision of *Jennings* v. *Mather*,[55] because a trustee is prohibited by law from profiting from a trust estate, "it is only just that, on the other hand, he should be legally protected against all liabilities properly incurred by him in the administration of the trust estate."[56] The beneficiary, therefore, as opposed to the trustee, must bear the burdens incidental to ownership.[57] As the court in *Hardoon* v. *Belilios*[58] stated:

> The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself. The obligation is equitable and not legal, and the legal decisions negativing it, unless there is some contract or custom imposing the obligation, are wholly irrelevant and beside the mark.

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[55] [1902] 1 K.B. 1 (C.A.) [*Jennings*]. See also *X* v. *A.*, [2000] 1 All E.R. 490.
[56] *Jennings, ibid.* at 7.
[57] Philip Pettit, *Equity and the Law of Trusts*, 7th ed. (London: Butterworths, 1993) at 462.
[58] [1901] A.C. 118 (H.L.) [*Hardoon*]. See also *Kimwood Enterprises Ltd.* v. *Roynat Inc.*, [1985] 3 W.W.R. 67 (Man. C.A.).

....

> [A]bsolute beneficial owners of property must in equity bear the burdens incidental to its ownership and not throw such burdens on their trustees.[59]

Indemnification rights are also, according to *re Grimthorpe*,[60] premised on the understanding that persons "who take the onerous and sometime dangerous duty of being trustees are not expected to do any of the work at their own expense...".[61]

Analogous to trustees, agents acting for the benefit of another are entitled to indemnification. In *Wallersteiner* v. *Moir (No. 2)*,[62] the Court held that a court is open to award indemnification of legal expenses incurred by a complainant, acting as an agent for a corporation in a derivative action, as follows:

> [T]he minority shareholder, being an agent acting on behalf of the company, is entitled to be indemnified by the company against all costs and expenses reasonably incurred by him in the course of the agency. The indemnity does not arise out of contract express or implied, but it arises on the plainest principles of equity. It is analogous to the indemnity to which a trustee is entitled from his *cestui que trust* who is *sui juris*... Seeing that, if the action succeeds, the whole benefit will go to the company, it is only just that the minority shareholder should be indemnified against the costs he incurs on its behalf.[63]

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[59] *Hardoon, supra* note 58 at 123-4.
[60] [1958] 1 All E.R. 765 (Ch.) [*Grimthorpe*]; *Frymer* v. *Brettschneider* (1992), 9 C.P.C. (3d) 294 (Ont. Gen. Div.).
[61] *Grimthorpe, ibid.* at 769. (In *Grimthorpe* the trustees of a trust sought court directions enabling the trustees to invest funds beyond the scope of the trust. The trustees then sought indemnification of the costs and expenses incurred in retaining counsel for the purposes of the court appearances and legal opinion. The Chancery Division awarded the trustees all of the legal costs and expenses incurred on the basis that, at 769, "they are entitled to be paid back all that they have had to pay out").
[62] [1975] 1 All E.R. 849 (C.A.) [*Wallersteiner*].
[63] *Ibid.* at 858-9.

Trustees and agents are entitled to indemnification on the basis that they should not bear the financial burdens of their roles. Furthermore, responsible people ought not to be dissuaded from taking on such roles. In this regard, as argued by Pettit, a purpose behind indemnifying a trustee when he defends himself against allegations is because he does so for the "safety of trustees, and the need to encourage persons to act as such by protecting them."[64] Resonant of the purposes behind indemnification of directors and officers, the Court in *Re Spurling's Will Trusts*[65] articulated the purposes behind a trustee's right to indemnification as follows:

> It is not the course of the court in modern times to discourage persons from becoming trustees by inflicting costs upon them if they have done their duty, or even if they have committed an innocent breach of trust. The earlier cases had the effect of frightening wise and honest people from undertaking trusts, and there was a danger of trusts falling into the hands of unscrupulous persons who might undertake them for the sake of getting something by them.[66]

The principles of equity and fairness which form the indemnification rights enjoyed by agents and trustees determine *when* they can successfully ask a court to order indemnification. As early as the 1728 case of *Balsh* v. *Hyham*[67] it has been a rule that a *cestui que trust* is to indemnify a trustee when the trustee has acted honestly and fairly, without profit. According to e*x parte Chippendale,*

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[64] Pettit, *supra* note 58 at 463.
[65] [1966] 1 All E.R. 745 (Ch.) [*Spurling's Will*]. (The request for indemnification in this case was by a trustee for legal costs and expenses incurred in the successful defence of an action by the *cestuis que trust*). See also *Walters* v. *Woodbridge* (1878), Ch. D. 504 (C.A.); *Re Whitley*, [1962] 3 All E.R. 45 (Ch.).
[66] *Turner* v. *Hancock* (1882), 20 Cg. D. 303 at 305 cited in *Spurling's Will, ibid.* at 755.
[67] (1728) 2 P.Wms. 453 [*Balsh*]. See also *Phené* v. *Gillan* 5 Hare 1 [*Phené*].

Re German Mining Co.,[68] "[t]rustees are entitled to be indemnified against expenses bona fide incurred by them in the due execution of their trust."[69] As a matter of principle, as put forth in *Downing* v. *Marshall*,[70] "persons acting in *autre droit*, as executors, administrators, trustees, guardians, receivers, etc..., are, upon a faithful execution of their trusts, to be indemnified out of the trust property, for all expenses necessarily incurred in the faithful performance of their duties."[71] Finally, the Court in *Hardoon* v. *Belilios*[72] held that indemnification rights arise when the trustee has "incurred liability within the scope of his trust, and for the benefit of his *cestui que trust*...nothing more is required."[73]

As stated by Zeigel, agency law also provides an agent with a right to indemnification from his principal for "liabilities properly incurred by the agent in carrying out his mandate."[74] As put forth by the court in *Toplis* v. *Grane*,[75] "...where an act has been done by the plaintiff under the express directions of the defendant which occasions an injury to the rights of third parties, yet, if such act is not apparently illegal in itself, but is done honestly and *bona fide* in compliance with the defendant's directions, he shall be bound to indemnify the

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[68] (1854), 4 De GM & G 19 [*Re German Mining*].
[69] *Ibid.* at 52. See also *Re Exhall Coal Co. Beaulah Park Estate* (1866), 35 Beav. 449.
[70] (1867), 37 N.Y. 380 (C.A.) [*Downing*].
[71] *Ibid.* at 388.
[72] *Hardoon*, *supra* note 58.
[73] *Ibid.* at 125.
[74] Jacob Zeigel "The Sealed Contract Rule and the Agent's Right of Indemnification", (2001) 36 Canadian Business Law Journal 139 at 139.
[75] [1835-42] All E.R. Rep. 592 (C.P.D.) [*Toplis*]. See also G.H.L. Fridman, *Law of Agency*, 6th ed. (Toronto: Butterworths, 1990) at 180.

plaintiff against the consequences thereof."[76] The reasoning in *Topolis* was reiterated in *Thacker* v. *Hardy*[77] as follows:

> Upon general principles an agent is entitled to indemnity from his principal against liabilities incurred by the agent in executing the orders of this principal, unless those orders are illegal, or unless the liabilities are incurred in respect to some illegal conduct of the agent himself, or by reason of his default.[78]

The Court of Exchequer in *Duncan* v. *Hill*[79] similarly recognized that at common law agents are entitled to be indemnified by their principals,[80] unless, of course, losses are incurred due to the agent's own default:

> ...[W]here [an] agent...is subject to loss, not by reason of his having entered into the contracts into which he was authorized to enter by his principal, but by reason of a default of his own...it cannot be said that he has suffered loss by reason of his having entered into the contracts made by him on behalf of his principal, and consequently there is no promise which can be implied on the part of his principal to indemnify him...[81]

The reference to illegal conduct in *Thacker* was a question of whether a gambling contract was illegal. When addressing the issue of an act of default in *Duncan*, the Court considered whether the agent in that case violated the rules of the London Stock Exchange. The Court in *Jennings*[82] also premised a trustee's right to indemnification on an absence of an act of default. In *Jennings* the Court used the example of misappropriating funds as an act of default. As such,

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[76] *Topolis*, *supra* note 75 at 596.
[77] (1878), 4 Q.B.D. 685 (C.A.) [*Thacker*].
[78] *Ibid.* at 687.
[79] (1873), LR 8 Exch. 242 [*Duncan*].
[80] *Ibid.* at 248.
[81] *Ibid.* at 248.
[82] *Jennings*, *supra* note 55.

judicial accounts of acts of default that would negate an indemnification claim appear to be the same as illegal acts on the part of the fiduciary.

With respect to indemnification of officers as agents, in *Re Famatina Development Corporation,*[83] the Court of Appeal of the Chancery Division found that an employee acting with responsibilities analogous to those of an officer, is entitled to indemnification under agency law as follows:

> ...[The employee] was much more than a servant of the company and the duties imposed upon him were far wider than those of a consulting engineer. He was undoubtedly appointed to be the agent of the company for many purposes and all he had done was done in pursuance of his duties as agent. *Therefore he came within the well settled rule that an agent had a right against his principal, founded upon an implied contract, to be indemnified against all losses and liabilities, and to be reimbursed all expenses incurred by him in execution of his authority.* [84]

The Court of Appeal did not review whether officers are entitled to indemnification outside of the role of agent.

These cases demonstrate that the test for asserting trustee and agent indemnification rights includes an analysis of whether the trustee or agent acted honestly and fairly, without profit, within the scope of duties and without doing anything apparently illegal.

As to whom carries the burden of proof with respect to this test as it applies to trustees, the Court in *Jennings* placed the burden on the beneficiary:

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[83] [1914] 2 Ch.D. 271 [*Re Famatina*].
[84] *Ibid.* at 282 [Emphasis added].

> It is clear that [the trustee]... incurred personal liabilities to the execution creditor and others, in respect of which *prima facie* his right to indemnity out of the trust estate exists. It seems to me that, if that *prima facie* right is to be rebutted, as it may be, by shewing that he was in default to the trust estate to an extent which wiped out his claim to indemnity, the onus of proving that to be so must, in the circumstances of a case like this, rest upon those who assert the existence of such a default.[85]

A trustee is therefore entitled to indemnification subject to proof that the trustee did something apparently illegal. Unfortunately, there is no comparable case which discusses the burden in relation to the agent's claim to indemnification.

Applying this test of entitlement and burden of proof in favour of directors and officers is consistent with the purposes of indemnification. In particular, a person who is not entitled to profit from his actions should not be required to bear the corresponding financial burdens. It would seem appropriate and defensible for a court to recognize and attach legal significance to the analogous positions held by trustees and agents on the one hand and directors and officers on the other. Both incur liabilities and are exposed to legal risk not because they are acting in their own right but because they are acting on behalf of and for the benefit of another.

Flowing from the agent and trustee vulnerability to loss, and the policy why they should be protected, courts have accorded indemnification rights a priority

[85] *Jennings, supra* note 55 at 7.

over other claims. The Court in *Jennings*, for example, held that the trustee's right to indemnification constitutes a first charge and a lien against the trust property:

> A trustee has for his protection a right to have costs and expenses properly incurred by him in the administration of the trust paid out of the trust property, and the amount of such costs and expenses constitutes a first charge upon that property. A Court of Equity will never take trust property out of the hands of the trustee without seeing that such costs and expenses are reimbursed to him, and that he is relieved from personal liability in respect of them; and, when the legal title to trust property is vested in the trustee, he has a right to resort to that property, without the assistance of the Court, for the purpose of indemnity against liabilities properly incurred by him in the administration of the trust. [86]

Similarly, in *Governors of St. Thomas's Hospital* v. *Richardson*[87] the King's Bench reiterated the rule that a trustee's indemnification rights constitute a first charge against trust property.[88] And, in case there was any doubt, in *Re Griffith*[89] the Court of Chancery affirmed a trustee's indemnification lien by stating that "[i]t is a well-settled rule of the Court that administrators [of an estate] have priority for payment of their costs out of their intestate's estate."[90]

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[86] *Jennings, supra* note 55 at 6. See also *Stott* v. *Milne* (1884), 25 Ch.D. 710 (C.A.) ("The right of trustees to indemnity against costs and expenses properly incurred by them in the execution of the trust is a first charge on the trust property, both income and *corpus*" at 715).
[87] [1910] 1 K.B. 271 (C.A.) [*St. Thomas's Hospital*].
[88] *Ibid.* ("Now it is necessary to consider carefully what is the position of a trustee, A., in whom a leasehold term is vested as assignee, his sole cestui que trust being B.... In respect of this right of indemnity A. has a first charge or lien upon the trust property, and he cannot be compelled to assign to B. until this charge or lien is satisfied... Moreover, A. can maintain an action to enforce his charge or lien. As Kay J. said in *In re Pumfrey* [(1882), 22 Ch. D. 255 at 262], "His right of indemnity gives him a right of charge or lien upon the trust estates. He has a right to come and say, I claim to have my right of indemnity. I am now called upon to pay a sum of money for which I have a right of indemnity out of the trust estate, and that gives me the right in equity to have a charge against the estate, and to have the charge enforced by the Court of Equity" at 275-76).
[89] [1904] 1 Ch. 807 [*Re Griffith*]; *re Burden* (1974), 3 O.R. (2d) 626 (Ont. H.C.).
[90] *Re Griffith, supra* note 89 at 809.

Agents are in a much less stable position. According to Reynolds, "[c]lear authority for the general proposition as to the lien right of an agent is difficult to find,"[91] and examples of an agent's right to exercise a lien are sparse.[92] Nevertheless, some examples of an agent's lien right can be found, including costs associated with cargo shipments[93] and expenses incurred by an agent in relation to consigned goods.[94]

Even though courts have been considerate of the vulnerabilities shared by both agents and trustees, the agent's lien right is possessory, not equitable.[95] That is, the agent only has a right to retain *possession* of property until fees, charges and expenses relating to the property have been paid.[96] As Reynolds summarizes the matter:

> An agent has a general or particular possessory lien on the goods and chattels of his principal, for remuneration earned, or advances made, or losses or liabilities incurred, in the course of the agency, or otherwise arising in the course of the agency, provided –
> (a) that the possession of the goods or chattels was lawfully obtained by him in the course of the agency, and in the same capacity as that in which he claims the lien;
> (b) that there is no agreement inconsistent with the right of the lien; and

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[91] F.M.B. Reynolds, *Bowstead and Reynolds on Agency* 16th ed. (London: Sweet & Maxwell, 1996) at 337.
[92] Cameron Harvey, *Agency Law Primer* 3rd ed. (Toronto: Carswell, 2003) ("Curiously, there appear to be no Canadian cases dealing with the agent's possessory lien, other than cases having to do with lawyers" at 145). See also: Reynolds, *supra* note 92 ("Clear authority for the general proposition as to the lien of an agent is difficult to find. This is not surprising, for the word agent can be applied in many situations, and no doubt some persons to whom the word could be applied would have no lien" at 337).
[93] *Bryans* v. *Nix* (1839), 4 M.& W. 775.
[94] *Evans & Evans* v. *Nichol & Nichol* (1841), 3 M. & G. 614.
[95] Harvey, *supra* note 92 at 145.
[96] *Dixon* v. *Standsfield* (1850), 10 C.B. 398 at 418 cited in Fridman, *supra* note 75 at 185.

(c) that the goods or chattels were not delivered to him with express directions, or for a special purpose, inconsistent with the right of lien.[97]

In short, the mere existence of an agency relationship is insufficient to create a lien. Unlike a trustee who takes title to trust assets and can assert a lien right accordingly, an agent must take lawful possession of the goods over which he claims a lien right. While the agent's lien rights differ from those of a trustee, these rights nevertheless provide agents with an enforcement mechanism in terms of indemnification rights and involve parallel policy rationales.

Based on the foregoing, there are clear and compelling policy reasons for the existence of indemnification rights enjoyed by agents and trustees. Furthermore, the circumstances when and how such rights may be exercised are not contentious. Provided the agent or trustee acts fairly and honestly, within the scope of duties, without profit and without doing anything apparently illegal, the right to indemnification subsists. The next section considers in more detail the extent to which similar reasoning and analysis applies to directors and officers.

[97] Reynolds, *supra* note 91 at 337.

B. Directors and Officers as Trustees, Agents and Fiduciaries

As will be seen in this section, there is clear case law that directors and officers are fiduciaries of the corporations they manage, although courts in both Canada[98] and the United States[99] sometimes stumble in trying to articulate the precise and overall nature of that relationship. Courts, however, have had no

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[98] *re Crédit Canadien Inc.*, [1937] 3 D.L.R. 81 (S.C.C.) (*sub nom. Sun Trust Company Limited* v. *Bégin*) [*Sun Trust*] ("Directors have been said to be 'agents of the company' and, again, they have been said to be 'in the position of a managing partner,' and, still again, it has been often said that they are 'trustees of their powers'" at 82).; Nathaniel Lindley, *Companies*, 6th ed. (London: Sweet & Maxwell); *Regal (Hastings), Ltd.* v. *Gulliver,* [1942] 1 All E.R. 378 (H.L) [*Regal (Hastings)*] ("Directors of a limited company are the creatures of statute and occupy a peculiar position to themselves. In some respect they resemble trustees, in others they do not. In some respects they resemble agents, in others they do not. In some respects they resemble managing partners, in others they do not" at 387).; *Hodgkinson* v. *Simms* (1994), 117 D.L.R. (4th) 161 (S.C.C.) ("...[T]he existence of a contract does not necessarily preclude the existence of fiduciary obligations between the parties. On the contrary, the legal incidents of many contractual agreements are such as to give rise to a fiduciary duty. The paradigm example of this class of contract is the agency agreement, in which the allocation of rights and responsibilities in the contract itself give rise to fiduciary expectations" at 174).; *Aberdeen Railway Co.* v. *Blaikie Bros.*, [1843-60] All E.R. Rep. 2491 (H.L.) [*Aberdeen*] (Delegating to directors the discretionary duties to manage the general affairs of a corporation and to promote the interests of the corporation are duties of a fiduciary nature).; *LAC Minerals Ltd.* v. *International Corona Resources Ltd.* (1989), 61 D.L.R. (4th) 14 (S.C.C.) ("...[W]here by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another, and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary. Equity will then supervise the relationship by holding him to the fiduciary's strict standard of conduct" at 27).; *Canadian Aero Service Ltd.* v. *O'Malley* (1973), 40 D.L.R. (3d) 371 (S.C.C.) [*Canaero*] (held that officers stand in a fiduciary relationship with respect to the corporation as a result of their responsibilities and level of discretion).; *W.J. Christie & Co. Ltd.* v. *Greer* (1981), 121 D.L.R. (3d) 472 (Man. C.A.) (held that directors, officers and senior management employees can maintain fiduciary relationships with respect to a corporation).; *re City Equitable Fire Assurance Co.,* [1925] 1 Ch. 407; *Selangor United Rubber Estates, Ltd.* v. *Cradock (No 3)*, [1968] 2 All E.R. 1073 (Ch.) [*Selangor*] ("...[E]ven though the scope and operation of such obligation differs in the case of directors and strict settlement trustees, the nature of the obligation with regard to property in their hands or under their control is identical, namely, to apply it to specified purposes for other beneficiaries" at 1092).

[99] *McCollom, supra* note 10 ("In spite of casual language in many opinions, a director of a corporation is not an agent either of the corporation or of its shareholders, except in a convenient rhetorical sense, though he may sometimes act in the nature of an agent in dealing with third parties. He derives his powers and authority neither from the stockholders nor from the corporation. His status is *sui generis*. His office is a creature of law" at 109).; *Bailey* v. *Bush Terminal Co. Title Guarantee & Trust Co.,* 46 N.Y.S. 2d 877 (Spec. Term 1943); 1943 N.Y. Misc. LEXIS 2813; [*Bailey* cited to N.Y.S. 2d.] ("The net and unadulterated conclusion is, I think, that a director must be regarded as occupying the status of a fiduciary and trustee, and in this respect I am disinclined to view his status as *sui generis*" at 879) aff'd 293 N.Y. 735; 56 N.E. 2d 739; 1944 N.Y. LEXIS 2150; *re Dissolution of E.C. Warner Company,* 232 Minn. 207 (Sup.Ct. 1950); 45 N.W. 2d 388 [*Warner* cited to Minn.] ("Confusion [with respect to a common law right of directors to indemnification] has resulted from a failure to recognize that the position of a director of a corporation, though fiduciary in many respects, is *sui generis* and is not to be confused with the position of that of a trustee, quasi trustee, or agent" at 212).

difficulty in deciding that directors and officers can be characterized as agents and trustees of the corporation. What Canadian law lacks is an authoritative line of case law whereby directors and officers actually seek indemnification based on their status of agent, trustee or other fiduciary in general.

Drawing analogies between common law and equitable principles application to trustees and agents to directors and officers is not a new concept. For instance, the Court in *Imperial Hydropathic Hotel Co.* v. *Hampson*[100] offered the following with respect to the applicability of such principles to directors and officers:

> ...[W]hen persons who are directors of a company are from time to time spoken of by judges as agents, trustees, or managing partners of the company, it is essential to recollect that such expressions are not used as exhaustive of the powers and responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered – points of view at which for the moment they seem to be cutting the circle, or falling within the category of the suggested kind. *It is not meant that they belong to the category, but that it is useful for the purpose of the moment to observe that they fall pro tanto within the principles which govern that particular class.*[101]

Case law formally acknowledging director and officer indemnification rights at common law or in equity is difficult to find. One must reach back to the 1854 case of *ex parte Chippendale, Re German Mining Co.*,[102] in which the Chancery Court stated its views on the subject matter as follows:

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[100] *Imperial Hydropathic Hotel Co., Blackpool* v. *Hampson* (1882), 23 Ch.D 1; 9 Digest 668, 4454; 49 L.T. 150 [*Imperial* cited to Ch.D.].
[101] *Ibid.* at 12.
[102] *Re German Mining, supra* note 68.

> ...[A]lthough Directors undoubtedly stand in the position of agents, and cannot bind their Companies beyond the limits of their authority, they also stand, in some degree, in the position of trustees; and all trustees are entitled to be indemnified against expenses *bona fide* incurred by them in the due execution of their trust. There is no inconsistency in this double view of the position of Directors. They are agents, and cannot bind their Companies beyond their powers. *They are trustees, and are entitled to be indemnified for expenses incurred by them within the limits of their trust.*[103]

Unfortunately, Canadian courts have not specifically applied the *Re German Mining* case as it relates to indemnification rights of directors and officers. While not addressing common law or equitable indemnification rights specifically, more recent cases in which courts have held that directors and officers are fiduciaries who will be held to be agents of a corporation can be more easily discovered, including cases in which directors and officers are held to be agents by virtue of:

- managing the mercantile and trading affairs of a corporation; [104]
- being appointed for a certain purpose and individual acted in pursuance of that purpose; [105]
- dealing with third parties and acting within apparent scope of authority;[106]
- acting as a commercial business person managing a trading concern for the benefit of a corporation; [107] and,

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[103] *Re German Mining, supra* note 68 at 52 [Emphasis added].
[104] *Aberdeen, supra* note 98 at 253. See also *Transvaal Lands Co. Ltd.* v. *New Belgium (Transvaal Land and Development Co., Ltd.)*, [1914-15] All E.R. Rep. 987 (C.A.).
[105] *re Famatina, supra* note 83 at 282.
[106] *Sun Trust, supra* note 98 at 82-3.

- being charged with initiatives and responsibilities above and beyond those afforded employees. [108]

While none of these cases involved an indemnification claim at common law or equity outside of the specific scope of agency law, one can only extrapolate, albeit on the basis of logic and sound policy analysis already provided, that directors and officers as agents are entitled to indemnification had the indemnification test for agency and trusteeship articulated in this paper been applied. That is to say that if the directors and officers acted honestly, within the scope of duties, without profit and without doing anything apparently illegal, they would fall within the category of those entitled to indemnification.

It would appear that the Alberta case of *Canada Deposit Insurance Corp.* v. *Canadian Commercial Bank,*[109] is one of the only cases in Canada where there was an opportunity to systematically address the existence of a common law or equitable right to indemnification. Such an analysis, however, was not necessary to determine the question at bar and, as such, the court did not explore this issue in great depth. That said, no where in the decision does the Court conclude that such rights are non-existent.

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[107] *re Forest of Deal Coal Mining Co.* (1878), 10 Ch. D. 450 at 452 cited in *Regal (Hastings), supra* note 98 at 393.
[108] *Canaero, supra* note 98 at 381.
[109] [1989] 6 W.W.R. 154 (Alta. C.A.) [*CDIC*].

The Alberta Court of Appeal in *CDIC* held, in reference to corporate by-laws, that the right of directors and officers to indemnification "is contractual though with a statutory sanction."[110] The Court's finding was that the bylaws were, in this case, determinative of the reach of the director's right to indemnification demonstrates that extra-statutory rights to indemnification can, and do, exist. In this way, the Court actually recognized the existence of indemnification rights at common law by virtue of contract.

A second Alberta case, *Northland Bank* v. *Willson,*[111] also decided in the context of the *Bank Act,* the Court of Appeal premised its decision with respect to indemnification strictly on the basis of articles and statute, thereby passing on an opportunity to discuss the virtues of common law or equitable rights.

The third case involving an opportunity to discuss common law and equitable indemnification rights also originates in Alberta. In *Magellan Aerospace Ltd.* v. *First Energy Capital Corp.*[112] the directors and officers raised the issue of extra-statutory indemnification rights. Underwriters, directors and officers all claimed equitable liens against company property. The Court addressed the request of the underwriters first, dismissing the application of

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[110] *CDIC, supra* note 109 at 163.

[111] (1991), 83 D.L.R. (4th) 362 (Alta. C.A.) [*Willson*]. (In *Willson,* two actions were filed against the appellant directors, one by the liquidator for $480 million in damages and one by the Canadian Deposit Insurance Corporation for $650 million. The appellant directors filed a motion in both actions for security for costs to protect their indemnification rights under the Alberta *Business Corporations Act*, S.A. 1981, c.B-15. The Court of Appeal heard the motion covering both actions in this appeal).

[112] [2000] A.J. No. 1176 (Alta. Q.B.); aff'd *National Bank of Canada* v. *Merit Energy Ltd.*, [2001] A.J. No. 918 (C.A.) [*Merit*].

cases such as *Re German Mining*. Then, the Court dismissed the application of the directors and officers on the premise that their arguments failed on the same bases as the underwriters' argument. The problem with this case is that the Court did not explain why cases such as *Re German Mining,* which is clearly not applicable to underwriters, would not be applicable to directors and officers. In this regard, the decision is under-reasoned.

Both *CDIC* and *Willson* were decided under the *Bank Act*, however, the indemnification provisions under the *Act* used the exact same wording as the pre-2001 *CBCA* indemnification provisions. The *Merit* case did not make reference to any governing corporate statute or constating instruments.

Canadian courts have had little opportunity to discuss extra-statutory indemnification rights of directors and officers, although their US counterparts have encountered no such shortgage. A review of American jurisprudence on this subject is important because our Supreme Court of Canada will refer to its case law when relevant and consistent with Canadian policies and principles.

C. Director and Officer Indemnification According to American Case Law

Courts in the United States have considered the possibility of a common law director and officer indemnification right, however, decisions have not been consistent. In the 1907 Wisconsin decision of *Figge* v. *Bergenthal,*[113] for example, the Supreme Court of Wisconsin did not object to director and officer indemnification:

> Respecting the payment of attorney's fees out of the corporate funds in the defense of this action little need be said. Clearly, if no case is made against the defendants it is not improper or unjust that the corporation should pay for the defense of the action.[114]

While the Court in *Figge* accepted the possibility of director and officer indemnification out of corporate funds, it did not describe the existence and extent of a right of directors and officers to indemnification.

An attempt to establish a common law test for a right of directors and officers to indemnification occurred in the 1931 Ohio decision of *Griesse* v. *Lang.*[115] The Court of Appeals of Ohio, Eighth Appellate District, held that the defendant directors were not entitled to indemnification of legal expenses unless:

a. there was a unanimous shareholder vote approving indemnification;[116] or,

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[113] 130 Wis. 594 (Sup.Ct. 1907); 109 N.W. 581; 1907 Wisc. LEXIS 252 [*Figge* cited to Wis.].
[114] *Ibid.* at 625.
[115] 37 Ohio App. 553 (8th Dist. 1931); 175 N.E. 222; 1931 Ohio App. LEXIS 592 [*Griesse* cited to Ohio App.].
[116] *Ibid* at 556-57.

b. the directors could demonstrate to the court that "the corporation received some benefit from the expenditure of attorney fees, or that some interest of the corporation was conserved...."[117]

The Court stated that "[t]he burden of showing there was some benefit to the corporation, or that some interest of the corporation was threatened, is upon the directors."[118] As will be seen next, the *Griesse* case has not been consistently applied in the United States.

The "benefit test" articulated in *Griesse* was referenced in the 1939 *McCollom* case, involving a stockholder's derivative action against the directors of New York Dock Company, Inc. The Supreme Court of New York held that in order to have a court direct or approve indemnification, a director must (a) be successful in his or her defence, and (b) demonstrate that the director "has conserved some substantial interest of the corporation which otherwise might not have been conserved, or has brought some definite benefit to the corporation which otherwise might have been missed...".[119] Interestingly, the Court found that analogies between a director/corporation, agent/principal, trustee/beneficiary or receiver/debtor are "a rule of guidance rather than a rule of law."[120] The Court did not elaborate on what it meant by this comment, thereby missing an opportunity to clarify indemnification law for directors and officers.

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[117] *Griesse, supra* note 115 at 558.
[118] *Ibid.* at 558.
[119] *McCollom, supra* note 10 at 111.
[120] *Ibid.* at 109.

The *McCollom* case prompted the State of New York to enact indemnification legislation, under the *General Corporation Law*,[121] permitting corporations to indemnify directors and officers for legal expenses incurred in litigation brought against them by virtue of their positions. The New York *General Corporation Law* provided that if a director or officer was wholly successful in his or her defence the corporation was responsible for reasonable defence expenses, including attorney's fees. If a defendant director or officer was only partially successful the corporation would still be responsible for reasonable expenses if a court so ordered. A corporation was permitted to indemnify if:

a. a quorum of directors not a party to the litigation;

b. the shareholders; or,

c. the board on the opinion in writing of independent legal counsel,

resolved that the director or officer seeking indemnification satisfied the statutory requirement that the director or officer acted in good faith.[122]

The enactment of indemnification legislation in the United States did not stop the debate over the existence and extent of a right to indemnification at common law. In the 1941 case of *Solomine* v. *Hollander*,[123] the Court of Chancery of New Jersey attempted to outline a common law test under which

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[121] *General Corporation Law,* N.Y. Gen Corp. Law §61-a (L. 1941, c. 350). (The validity of the statute was upheld in *Hayman* v. *Morris*, 37 N.Y.S.2d 884 (Sup. Ct. 1942)).

[122] *Herbert J. Schmidt, Jr.* v. *Magnetic Head Corporation,* 97 A.D. 2d 151 (N.Y. Sup.Ct. 1983); 468 N.Y.S. 2d 649; 1983 N.Y. App. Div. LEXIS 20344 [*Schmidt* cited to A.D. 2d] at 161 (referring to New York *Business Corporation Law* § 724).

[123] *Solomine, supra* note 10.

directors and officers would be afforded a right to indemnification. In holding that the defendants did not need to prove that their defence of the allegations provided a direct or indirect benefit to the corporation, the Court of Chancery of New Jersey commented that there will invariably be a benefit to the corporation in a successful defence by the directors:

> The directors and officers here not only had a right but were under a duty to stand their ground against all unjust attack and to resist the attempt to wrest the corporate trust estate from those hands to which the stockholders had previously committed it. In defending themselves they demonstrated to the investing public the honesty of the corporate management and thus they not alone served their own interests but also performed a duty to which they owed to the beneficiaries of the trust – the stockholders.[124]

Despite the attempt to outline a test for a common law right to indemnification in *Solomine*, the very existence of common law indemnification rights was rejected in the 1943 New York case of *Bailey* v. *Bush Terminal Co. Title Guarantee & Trust Co.*[125] The defendant directors in *Bailey* successfully defended a lawsuit alleging misfeasance and sought indemnification under the recently enacted New York indemnification legislation. When the directors were denied indemnification because the judgment was entered after the legislation took effect, they sought indemnification on the basis of a common law right.

The Court in *Bailey* held that "in the absence of contract or statute, a director who successfully defends an action brought against him by a corporation or on its behalf cannot require the corporation to reimburse him for the costs of

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[124] *Solomine, supra* note 10 at 271.
[125] *Bailey, supra* note 99.

his expense...".[126] The Court rejected the notion of a director being *sui generis* and held that directors were fiduciaries and trustees.[127] Despite concluding that directors were trustees, the Court did not extend the indemnification rights of trustees to directors.

Like the *Griesse* case, the *Bailey* case has not been consistently applied in the United States. This is just as well since the Court in *Bailey* did not see its own findings through to their logical conclusion. In other words, if directors were fiduciaries, why were they not entitled to indemnification like any other trustee? Why would a director, if he is held to be a trustee, not be entitled to the same rights of another person who is a trustee but is not a director? The court's offering of a bare conclusion to the contrary is, in a word, imperious. Because the case is devoid of analysis, a Canadian court is unlikely to find it helpful.

The arguably restrictive concept of a benefit to the corporation test regarding indemnification has been problematic for the American courts. In the 1950 case of *re Dissolution of E.C. Warner Company*, [128] the Supreme Court of Minnesota rejected the benefit test enunciated in *Griesse* and concluded that such a test was contrary to public policy considering the relationship between a corporation and its directors and officers:

> If in keeping with the "benefit theory", applied by some jurisdictions to the trustee of an express trust, we hold that liability to charges of misconduct is one of the inherent hazards impliedly assumed in

[126] *Bailey, supra* note 99 at 880.
[127] *Ibid.* at 879.
[128] *Warner, supra* note 99.

> accepting a corporate directorship, and that therefore a director is not entitled, after a *successful defense upon the merits*, to reimbursement for reasonable expenses *unless he can show a specific benefit to the corporation*, we shall have then, in contravention of sound public policy, placed a premium upon faithless and irresponsible corporate leadership and action. In the first place, directors and officers have not only a right but a fiduciary duty to stand their ground against any unjust attack which, if permitted to go unchallenged, will ultimately remove the guidance of the corporate activity from the hands of those to whom the stockholders had previously committed it. In the light of this obligation of faithful stewardship, the policy of the law should be to encourage directors to resist unjust charges, in the confidence that ultimately, if their innocence be judicially established, they will be reimbursed for their necessary expenses of defense...Unless this is the rule, we have the further result that it is not likely that men of substance will be willing to assume the responsibility of corporate directors.[129]

Notwithstanding this disagreement as to *when* directors and officers are entitled to extra-statutory indemnification, both the courts in *Griesse* and *re Dissolution of E.C. Warner Company* concurred that such a right exists. Support for a common law right can also be found in the 1953 United States Court of Appeals - Third Circuit case of *Mooney*,[130] wherein the Court mentioned in *obiter* that, while cases have been divided as to whether a common law right to indemnity exists, case law points to the development of a common law right.[131] By way of contrast, in 1970, the Superior Court of Delaware in *Merrit-Chapman & Scott Corporation* v. *Wolfson*[132] held that "[n]o common law right existed" and that indemnification rights are to be found in statute.[133] Then, in the 1979 case of

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[129] *Warner, supra* note 99 at 213-14 [Emphasis in original].
[130] *Mooney, supra* note 14.
[131] *Ibid.* at 899. (The Court was referencing the case of *Warner, supra* note 99).
[132] *Merrit-Chapman & Scott Corporation* v. *Wolfson*, 264 A.2d. 358 (Del. Sup.Ct. 1970); 1970 Del. Super. LEXIS 361 [*Wolfson No. 1* cited to A.2d].
[133] *Ibid.* at 360.

Texas Society, Daughters of the American Revolution, Inc. v. *Fort Bend Chapter, The National Society, Daughters of the American Revolution*[134] the Court of Civil Appeals of Texas held that "[t]here is no common law right of indemnification of corporate officers and directors in Texas. Their right to indemnification is purely statutory."[135] Finally, in 1983, the Supreme Court of New York, Appellate Division in *Herbert J. Schmidt, Jr.* v. *Magnetic Head Corporation*[136] equivocally held that at common law there is no right indemnification if a director or officer is unsuccessful, although a possibility would exist if the company was substantially benefited from the director's or officer's defence.[137]

These case law references highlight the inconsistent, back and forth positions of the courts in the United States with respect to indemnification. Just when the courts appear to close the door on a common law indemnification right, they leave open a crack by referencing the possibility of such a right if there exists a benefit to the corporation if the officer or director was substantially successful. In summary, the courts in *Griesse*, *McCollum, Solomine* and *re Dissolution of E.C. Warner Company* and *Mooney* found in favour of a extra-statutory right to indemnification. The courts in *Bailey*, and *Merrit-Chapman, Texas Society* and *Herbert J. Schmidt* held to the contrary.

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[134] *Texas Society, Daughters of the American Revolution, Inc.* v. *Fort Bend Chapter, The National Society, Daughters of the American Revolution*, 590 S.W. 2d 156 (Tex. C.A. 6th.Dist. 1979); 1979 Tex. App. LEXIS 4148 [*Texas Society* cited to S.W.2d].
[135] *Ibid.* at 164.
[136] *Schmidt, supra* note 122 at 160.
[137] *Ibid.* at 160.

Even if successfully claimed, indemnification rights at common law do not necessarily extend to recovery of expenses incurred in enforcing indemnification rights. There is statute law in some United States jurisdictions that govern directors' and officers' entitlement to indemnification of fees, costs and expenses incurred in enforcing statutory indemnification rights and, in such jurisdictions, directors and officers are protected. For example, under section 14-2-854(b) of the *Georgia Business Corporations Code*, a director may apply to a court for an order that the corporation pay the director's expenses in obtaining court ordered indemnification or advance of expenses. Attempts to seek "fees for fees" in jurisdictions without a statutory right to fees for fees have failed. For instance, in *Mayer* v. *Executive Telecard, Ltd.*[138] the Court of Chancery of Delaware held that unlike corporate statutes in other jurisdictions, the *DGCL* did not explicitly provide that a director, officer or agent would be entitled to "fees for fees".[139] The Court argued that "fees for fees" is a legislative prerogative and not one for court interpretation.[140]

Based on the case law discussion in this section, the *Warner* and *Solomine* cases are to be preferred over cases such as *Bailey, Merritt-Chapman* or *Texas Society* because they follow their own findings to the logical conclusion. Specifically, if directors and officers are trustees or agents, then they are entitled to indemnification consistent with the purposes and policies supporting indemnification of trustees and agents in general. Cases that hold otherwise

[138] 705 A.2d 220 (Ch. Del. 1997); 1997 Del.Ch. LEXIS 60 [*Mayer* cited to A.2d].
[139] *Ibid.* at 222.
[140] *Ibid.* at 223.

appear to shut down the possibility of a common law indemnification right without explaining why such a right could not, or should not, exist. On that basis alone, they fail to be persuasive.

D. Contextual Indemnification

Thus far, it has been said that directors and officers have extra-statutory indemnification rights, at least according to some decisions such as *CDIC, re German Mining* and *re Famatina*. In order to provide additional foundation and support to these lines of authority, the following section will review situations where, outside the realm of agency and trust, indemnification rights also exist. These cases also provide additional rationales for recognizing director and officer non-statutory rights to indemnity. For instance, the Court of Common Pleas in *Dugdale* v. *Lovering*[141] acknowledged indemnification rights in the context of one person acting at the request of another:

> It is a general principle of law when an act is done by one person at the request of another, which act is not in itself manifestly tortious to the knowledge of the person doing it, and such act turns out to be injurious to the rights of a third party, the person doing it is entitled to an indemnity from him who requested that it should be done.[142]

The Court in *Dugdale* found that "[t]he right to an indemnity does not depend in such a case on any special relationship between the parties such as

[141] (1875), L.R. 10 C.P. 196 [*Dugdale*].
[142] *Ibid.* at 197.

that of principal and agent."[143] After reviewing *Topolis*, the Court rebuffed arguments that indemnification was dependant on an agency relationship:

> It is urged by on the part of the defendant that there is no authority for such an indemnity except in the case of agents. But in none of these cases, as I have observed, was the fact of agency relied on.[144]

In *Goldstein* v. *Canadian Pacific R.W. Co.*[145] the Ontario Court of Appeal elaborated on the requirement for an implied or express request to act to establish a right to indemnity at common law:

> The general rule as to the right of indemnity is, that the claim, unless expressly contracted for, must be based upon a previous request of some kind, either express or implied, to do the act in respect of which the indemnity is claimed.[146]

While the courts in *Dugdale*, *Toplis* and *Goldstein* addressed circumstances in which a person acted pursuant to the specific direction of another, the House of Lords in *Sheffield Corporation* v. *Barclay*[147] addressed circumstances in which a person acts pursuant to a general request to perform a statutory duty:

> ...[W]here a person invested with a statutory or common law duty of a ministerial character is called upon to exercise that duty on the request, direction, or demand of another..., and without any default on his own part acts in a manner which is apparently legal, but is in fact illegal and a breach of the duty, and thereby incurs liability to third parties, there is implied by law a contract by the person making

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[143] *Dugdale, supra* note 141 at 197-98.
[144] *Ibid.* at 200.
[145] (1911), 23 O.L.R. 536 (C.A.) [*Goldstein*].
[146] *Ibid.* at 540.
[147] [1904-7] All E.R. Rep. 747 (H.L.) [*Barclay*].

> the request to keep indemnified the person having the duty against any liability which may result from such exercise of the supposed duty.[148]

The Privy Council, referencing *Dugdale*, in the 1938 case of *Secretary of State* v. *Bank of India*[149] also found that a right to indemnity will arise when an individual acts at the request of another and such action "is not in itself manifestly tortious to the knowledge of the person doing it, and such act turns out to be injurious to the rights of a third party."[150]

The Ontario Appellate Division in *McFee* v. *Joss*[151] held that indemnification rights could exist independent of contract or statute "where a person who, without fault on his part, is exposed to liability and compelled to pay damages...":[152]

> A right to indemnity generally arises from contract express or implied, but it is not confined to cases of contract. A right to indemnity exists where the relation between the parties is such that either in law or equity there is an obligation upon one party to indemnify the other. There are, for instance, cases in which the state of circumstances is such that the law attaches a legal or equitable duty to indemnify arising from an assumed promise by a person to do that which, under the circumstances he ought to do. The right to indemnity need not arise by contract; it may (to give other circumstances) arise by statute; it may arise upon the notion of a request made under circumstances from which the law implies that the common intention is that the party requested shall be indemnified by the party requesting him; it may...arise in cases in

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[148] *Barclay, supra* note 147 at 751.
[149] [1938] 2 All E.R. 797 (P.C.) [*Bank of India*].
[150] *Dugdale, supra* note 141 at 197 cited in *Bank of India, ibid.* at 800.
[151] (1925), 56 O.L.R. 578 (C.A.) [*McFee*].
[152] *Ibid.* at 584.

> which the Court will 'independent of contract raise upon his ... conscience an obligation to indemnify...[153]

In *Proctor* v. *Seagram*[154] the Ontario Appellate Division acknowledged:

> [A] right to indemnity may arise from contract, express or implied, but it is not confined to cases of contract. It will exist wherever the relation between the parties is such that either in law or equity there is an obligation upon one party to indemnify the other with respect to liability falling upon or assumed by that other.[155]

However, there is no right to indemnification if an individual incurs liability as a result of his or her own misconduct unless the person is specifically directed to do the precise thing that constitutes the act of misconduct:

> If the precise thing done constituting the alleged misconduct had been authorised and instructed by the master, then there would be an implied obligation on the part of the master to indemnify the servant against the consequences of his obedience to the master's orders.[156]

The Court of Appeal – Chancery Division in *Birmingham and District Land Company* v. *London and North Western Railway Company*[157] held that such indemnification rights may arise by virtue of an implied contract as follows:

> [I]f A. requests B. to do a thing for him, and B. in consequence of his doing that act is subject to some liability or loss, then in consequence of the request to do the act the law implies a contract by A. to indemnify B. from the consequence of his doing. In that

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[153] *Eastern Shipping Co. Ltd.* v. *Quah Beng Kee*, [1924] A.C. 177 at 182 cited in *McFee*, *supra* note 151 at 584-5.
[154] (1925), 56 O.L.R. 632 (C.A.) [*Proctor*].
[155] *Ibid.* at 634.
[156] *Ibid.* at 634.
[157] (1886), 34 Ch. D. 261 [*Birmingham*].

> case there is not an express but an implied contract to indemnify the party for doing what he does at the request of the other.[158]

In the 1994 case of *Fuhr* v. *Battleford's Urban Native Housing Corp.*[159] the Saskatchewan Court of Queen's Bench noted, "it is an implied term of both employment and agency contracts that employees and agents are entitled, within limits, to indemnification from their employers or principals for losses incurred in the execution of their duties. To that extent the law is the same."[160]

Indemnification rights are therefore not confined to strictly contexts of trustees or agents because to do so would be a hard and unjustifiable limitation. Where one person acts at the request of another, acts pursuant to a specific direction, exercises a statutory duty, is an employee or there is a conscionable obligation to indemnify, such person may be entitled to indemnification. Of course, a person cannot claim indemnification rights for liabilities arising from his own illegal conduct or actions that were manifestly tortious.[161] The test for non-trustee and non-agency indemnification rights are therefore dramatically similar to the test for trustee and agency indemnification rights at common law and in equity. As such, the door remains open for courts to consider common law and equitable indemnification rights in the context of directors and officers. Furthermore, while these rights are merely a reflection of the current law, courts are not precluded from expanding on equitable principles. Equity is not confined

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[158] *Birmingham, supra* note 157 at 272.
[159] *Fuhr, supra* note 27.
[160] *Ibid. at* 192.
[161] *Dugdale, supra* note 141; *Bank of India, supra* note 149.

to existing doctrines and is capable of growth, as articulated by the Supreme Court of Canada in *Cadbury Schwepps Inc.* v. *FBI Foods Ltd.*,[162] "[e]quity, like the common law, is capable of ongoing growth and development."[163]

Based on the case law reviewed in this Part, I propose that Canadian courts recognize directors' and officers' right to indemnification at common law and in equity when a director or officer: (a) acted honestly and fairly;[164] (b) without profit;[165] (c) within the scope of responsibilities;[166] and (d) without doing anything apparently illegal[167] (hereinafter the "proposed test"). This test is consistent with the purposes of indemnification, namely, encouraging responsible persons to accept the roles of director or officer and holding persons liable for their culpable actions. Also, this test is consistent with indemnification rights available based on a contextual analysis of a particular relationship. That is to say, a director or officer acts at the request of and under the direction of the shareholders and board of directors, respectively. Directors and officers are mandated to fulfill their statutory duties under the *CBCA*. The proposed test is also defensible because it is entirely consistent with the objectives of statutory

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[162] (1999), 167 D.L.R. (4th) 577 (S.C.C.) [*Cadbury Schwepps*].
[163] *Ibid.* at 604.
[164] *Balsh, supra* note 67; *Phené, supra* note 67; *Re German Mining, supra* note 68; *Downing, supra* note 70.
[165] *Balsh, supra* note 67; *Phené, supra* note 67.
[166] *Re German Mining, supra* note 68; *Downing, supra* note 70; *Hardoon, supra* note 58; *Re Famatina, supra* note 83.
[167] *Toplis, supra* note 75; *Thacker, supra* note 77; *Jennings, supra* note 55; *Duncan, supra* note 79 (An assessment as to whether a direcor or officer did anything apparently illegal would, by virtue of logic and reason, have to contemplate whether the director or officer had, at the time of the act, objective, and not subjective, reason to believe the conduct was legal).

indemnification, albeit with wider application, and case law regarding fiduciaries.[168]

[168] *Jennings, supra* note 55; *Hardoon, supra* note 58; *Balsh, supra* note 67; *Phené, supra* note 67; *Re German Mining, surpa* note 68; *Toplis, supra* note 75; *Thacker, supra* note 77; *Duncan, supra* note 79; *Re Famatina, supra* note 83.

Part IV Survival of Common Law and Equitable Indemnification Rights

In Part II I articulated the statutory indemnification test under the *CBCA* to include satisfaction of the fiduciary duty test, lawful conduct test (if applicable) and the act or omission test. As noted, this test will leave certain directors and officers without a statutory remedy when, for example, they are not wholly successful in their defence of an action. In Part III, I outlined the proposed test for a common law or equitable indemnification right, namely that directors and officers act (a) honestly and fairly; (b) without profit; (c) within the scope of responsibilities; and (d) without doing anything apparently illegal.

In this Part IV, I will argue that the common law and equitable rights of directors and officers to the remedy of indemnification have not been displaced by the 2001 *CBCA*. Put another way, the proposed test is not moot because indemnification rights at common law and equity survive the *CBCA* and the proposed test is not ousted by legislative implication either. In this Part, I will review the decisions and commentary that argue statutory rights do not automatically remove common law or equitable rights nor the remedies that accompany them. Then, I will compare the proposed test for when a director or officer entitled to indemnification at common law and in equity with the 2001 *CBCA* indemnification test. The purpose will be to apply judicially articulated indicia of when common law and equitable rights and remedies have been

ousted by legislation in order to demonstrate that the proposed test subsists under the *CBCA*.

The 1995 *CBCA Discussion Paper* acknowledged that the rights of directors and officers to indemnification under corporate legislation are not intended to be exhaustive:

> Although the issue does not appear to have been judicially considered, most commentators have argued that the intention of the legislator in spite of the silence of the law is that the CBCA indemnification provision is not exclusive. This would mean that a corporation may provide for indemnification of its directors and others through contracts, articles, by-laws, directors resolutions, etc. in situations which are not covered in s. 124, but are not contrary to public policy nor prohibited by statute.[169]

Although the Discussion Paper confines its observation to the notion that the common law, as a source of indemnification rights, survives the statute, there is no reason to think that equity as an additional source somehow does not. It would appear that the absence of an express mention of equity in the quote above is merely an oversight. It is also worth noting that the 1971 *Dickerson Report* stipulated that its proposed amendments to the 1975 *CBCA* were not intended to be exhaustive of indemnification rights or limitations. Indemnification legislation offers only one form of indemnification rights as "[a] corporation may, however, impose a stricter regime by its articles, by-laws or through a shareholder agreement."[170]

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[169] *CBCA Discussion Paper*, *supra* note 15 at 36. See also *CDIC*, *supra* note 109.
[170] *Dickerson Report*, *supra* note 20, vol. I, s. 244 at 83.

The view that equitable and common law rights to the remedy of indemnification subsist is consistent with both textbook and judicial authority. As put forth by Sullivan, for example, statutes are presumed to not have changed the common law.[171] This is consistent with Côté's assertion that courts will recognize common law and equitable rights and freedoms, and restrictively construe statutes that encroach on such rights.[172] To enforce such rights, parties to an action, therefore, have a choice of remedies under statute and at common law or in equity unless deliberately excluded by the legislature.[173]

With respect to judicial authority, according to the Supreme Court of Canada in *Goodyear Tire & Rubber Co. of Canada* v. *T. Eaton Co.*, it is presumed that legislation will not displace common law or equitable rights unless the legislative intention is explicit:

> [A] Legislature is not presumed to depart from the general system of the law without expressing its intentions to do so with irresistible clearness, failing which the law remains undisturbed.[174]

The existence of a statutory right, therefore, does not automatically annul common law or equitable rights and remedies. Specifically, the Privy Council, in the 1938 case of *Secretary of State* v. *Bank of India, Inc.*,[175] ruled that statutory

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[171] Ruth Sullivan, *Sullivan and Dreidger on the Contrstruction of Statutes*, 4th ed. (Vancouver: Butterworths, 2002) at 349.
[172] Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3rd ed. (Scarborough: Carswell, 2000) at 470.
[173] Sullivan, *supra* note 171 at 350.
[174] *Goodyear Tire & Rubber Co. of Canada* v. *T. Eaton Co.*, [1956] S.C.R. 610; (1956), 4 D.L.R. (2d) 1 (S.C.C.) at para. 13 [*Goodyear* cited to D.L.R.].
[175] *Bank of India*, *supra* note 149. (In *Bank of India*, Ms. Gangabai owned a promissory note with the Government Securities Department. A broker forged her signature and presented the

indemnification provisions do not debar a person from relying on indemnity under the common law.[176] Even when a statute provides a remedy, optional remedies at common law or in equity will not be automatically displaced. For example, in *Stewart* v. *Park Manor Motors Ltd.*[177] the Ontario Court of Appeal held that the creation of a new remedy under statute does not automatically exclude or replace remedies enforceable in civil courts:

> ...[T]hat summary remedy was provided as a matter of convenience or, perhaps, policy, but in my view it was at most an optional remedy which was never intended to replace the ancient remedy available in the Superior, District or County Courts.[178]

Sometimes, however, it is the intention of the legislator to oust common law and equitable rights and remedies. Indicia of that intention to oust include: if a common law (i.e., a right) is not in any sense additive of the statutory right, but merely duplicative,[179] or if the statute is a comprehensive, exclusive code such that it "supplies both the duty and provides the necessary adjudicative machinery

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promissory note to the Bank of India. The Bank of India accepted the note and applied to the Government Securities Department to have a renewed note payable to it issued. Ms. Gangabai found out about the forgery and successfully sued the Secretary of State for conversion. The Secretary of State then sued the Bank of India for indemnification on the principle that the Securities Department had issued the renewed note at the request of the Bank of India.

Section 21 of the *Indian Securities Act* provided that the prescribed officer may in any case arising (i) issue a renewed security upon the applicant giving the prescribed indemnity against the claims of all persons claiming under the security so renewed, or (ii) refuse to issue a renewed security unless such indemnity is given. In this case, the government officer, when issuing the renewed note to the Bank of India, did not exact a security. The court held, at 803, that a common law right to indemnity will arise when an individual acts at the request of another and such action turns "out to be injurious to the rights of a third party." Based on the common law principle enunciated in *Dugdale*, the Privy Council held that the Secretary of State was entitled to recover from the Bank of India the amount of the claim).

[176] *Bank of India*, *supra* note 149 at 800.

[177] (1967), 66 D.L.R. (2d) 143 (Ont.C.A.) [*Park Manor*]. (In *Park Manor* an automobile salesman was entitled to annual paid vacation, or paid in lieu of, under the Ontario *Hours of Work and Vacations With Pay Act*. An employer's failure to comply with the Act was a punishable offence. The employer argued that the employee's civil lawsuit for vacation pay was ousted by the Act which would have provided the employee with a remedy).

[178] *Ibid.* at 150-51.

[179] *Bank of India*, *supra* note 149.

such that resort to the common law is duplicative in any situation where the statute applies,"[180] or, the remedy is explicitly abolished by statute.[181] Indicia that common law and equitable remedies have not been ousted by legislation include: differences in the onus of proof between common law and equitable rights on the one hand, and statutory rights on the other;[182] the common law and equity are not displaced with irresistible clearness;[183] or, the common law or equitable right does not rely on a breach of a statute to give rise to the cause of action.[184] The presence or absence of any one of these factors may not be determinative of the question whether a common law or equitable right or remedies continues to exist. Rather, courts will regard the legislation as a whole and assess whether it was the legislature's intent to remove common law and equitable rights to remedies.

Gathering these indicia together, I will first examine whether the proposed test is different from or duplicative of the statutory test. Then, I will review the 2001 *CBCA* to assess whether the adjudicative machinery under it is comprehensive. Finally, I will assess whether common law and equitable rights have been abolished by statute with irresistible clearness.

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[180] *Gendron* v. *Supply & Services Union of the Public Service Alliance of Canada, Loc 50057*, [1990] 1 S.C.R. 1298 at para. 42 [*Gendron*]. See also *Rawluk* v. *Rawluk* (1990), 65 D.L.R. (4th) 161 (S.C.C.) [*Rawluk*].
[181] *Rawluk, ibid.*
[182] *Westfair Foods Ltd.* v. *Lippens Ltd.* (1989), 64 D.L.R. (4th) 335 (Man.C.A.); [1990] 2 W.W.R. 42 (Man. C.A.) [*Westfair* cited to D.L.R.].
[183] *Goodyear, surpa* note 174. See also *Rawluk, supra* note 180.
[184] *Westfair, supra* note 182.

A. Is the Proposed Test Duplicative of or Different from the *CBCA*?

To determine whether the proposed test is duplicative of or different from the 2001 *CBCA*, I will compare under each test the types of proceedings in relation to which indemnification can be sought; the existence of a prohibition against indemnification; the persons covered by the right to indemnification, whether there is opportunity for an advancement of funds to the applicant prior to a final determination of the legal liability at issue; the indemnification test itself; the onus of proof as to whether the conditions for indemnification have been met; and, enforcement of the indemnification remedy.

As will be seen next, the statutory indemnification test shares similarities with the proposed test in terms of types of proceedings in relation to which indemnification can be sought and with respect to the indemnification prohibition. The statutory indemnification test, however, differs from the proposed test with respect persons covered, right to an advancement of funds, the indemnification test itself, onus of proof and enforcement. This means that the proposed test is largely distinct from its statutory counterpart thereby pointing to the conclusion that it has not been ousted.

With respect to types of proceedings in relation to which indemnification can be sought, costs under the 2001 *CBCA* are limited to costs, charges, and expenses reasonably incurred in connection with the defence of any civil, criminal, administrative, investigative, or other proceeding to which the individual

is subject because of the individual's association with the corporation. Equitable indemnification rights include all costs and expenses properly incurred and are not limited to any particular form of proceeding. It would seem therefore that both tests are co-extensive to at least this degree.[185]

With respect to indemnification prohibitions, the explicit prohibition under the 2001 *CBCA* appears at first blush to already exist implicitly in equity. Specifically, the test, as outlined in this paper, is a right of directors and officers that can only be exercised when a director or officer: (a) acted honestly and fairly; (b) without profit; (c) within the scope of responsibilities; and (d) without doing anything apparently illegal. Nevertheless, this proposed test concerns a right for the benefit of directors and officers and not a prohibition against a corporation in the event this test is not satisfied. In short, a corporation is not bound by the test unless the right is exercised by a director or officer. But, a corporation is not explicitly prohibited from indemnifying directors and officers in circumstances lying outside the common law and equitable test.

While an explicit prohibition does not exist with respect to the indemnification test outlined herein, it is implicitly present. This is because the principles behind the test, namely equity and fairness, should ensure that a

[185] For example, prior to the 2001 *CBCA*, the Court in *Denton* v. *Equus Petroleum Corp.*, [1986] B.C.J. No. 3130 (B.C.S.C.) (QL) opined that it could not consider investigative proceedings costs claimed by a director because the 1975 *CBCA* did not explicitly include investigative proceedings as one of the enumerated head of indemnification recovering.

corporation does not improperly indemnify a director or officer. In short, if equity is to protect directors and officers to ensure proper indemnification, then equity should also protect a corporation from improper indemnification. As was argued in this paper, directors owe a fiduciary duty to the corporation, that is, a duty to act in the best interests of the corporation. It is that duty that will be upheld by courts in equity to ensure that directors are not improperly indemnified and a complaint is made by a corporate stakeholder. The proposed test is therefore similar to the statutory test by virtue of equity's implicit prohibition against improper indemnification.

In other ways, however, the proposed test is clearly distinct. For example, with respect to persons covered, the 2001 *CBCA* applies to a specific list of individuals. If an individual is a director or officer of an entity specified under the legislation, the individual acquires the benefits of the indemnification provisions.[186] Conversely, in equity, an individual is entitled to indemnification by virtue of *relationship* characteristics in a particular context, e.g., trustee, agent or fiduciary.[187] This means that the number of persons covered at common law and in equity is broader than those under statute because common law and equity are not confined to the specific language of the legislation. Hence, while the tests are duplicative in the sense that directors and officers are covered under both, the proposed test is inherently broader because it covers more than just directors, officers or persons acting in a similar capacity.

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[186] *CBCA*, s. 124(1).
[187] *Re German Mining, surpa* note 68. See also *Frame* v. *Smith* (1987), 42 D.L.R. (4th) 81 (S.C.C.).

With respect to an opportunity for advancement of funds, legislative permission to advance funds is a new development under the *CBCA*.[188] That is, s.124(2) of the *CBCA* permits a corporation to advance moneys to directors or officers provided they repay the moneys if they did not fulfill the fiduciary duty test and, if applicable, the lawful conduct test. Section 124(7) of the *CBCA* provides that an application may be made to the court for an order approving indemnity under s. 124. It would appear that there is an opportunity for a director or officer to apply to a court for an order forcing a corporation to advance monies but, the legislation is unclear. Specifically, the legislation does not clearly provide a director or officer with a right to an advancement of funds. It is that lack of precision that creates uncertainty in the rights and obligations of directors and officers and the corporations they manage. The proposed test does not suffer from this uncertainty. All costs properly incurred, whether there is a final determination or not, would be subject to indemnification.[189]

Continuing with this review of the advancement of funds, case law suggests that complainants may not be able to pursue their statutory remedies under s.

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[188] The *DGCL*, *supra* note 18, §145(e) and *MBCA*, *supra* note 18, §8.53 both permit the advancement of funds upon receipt by the corporation of a written undertaking to repay the advancement in the event it is concluded that the director or officer was not entitled to indemnification. It would appear on its face that a corporation is not required to advance monies to a director or officer because the language provides that a corporation *may* advance monies. Looking to the DGCL, it appears that a requirement to advance monies does not exist in Delaware. But, §8.54 of the MBCA expressly provides that a director or officer may apply to the court for an order to advance monies if in view of all of the relevant circumstances, it is "fair and reasonable" to do so.

[189] *Jennings*, *supra* note 55; *Hardoon*, *supra* note 58; *Downing*, *supra* note 70; *Thacker*, *supra* note 77; *Dugdale*, *supra* note 141; *Barclay*, *supra* note 147.

124(7) prior to a final determination of the proceeding for which indemnification is sought. For example, in cases such as the Québec Court of Appeal case of *Balestreri v. Robert*[190] and the Alberta Court of Appeal *CDIC*[191] case, indemnification was deferred until a final determination. At least one court in Canada was willing to grant an order enforcing indemnification rights prior to a final determination. In *Chromex Nickel Mines Ltd.* v. *British Columbia (Securities Commission),*[192] the British Columbia Supreme Court was petitioned by the corporation and one of its directors for a determination as to whether the permissive indemnification provision of the *CBCA* required that an action or proceeding be concluded or decided before a director may be indemnified.

In *Chromex* the board of directors of the corporation in *Chromex* passed a resolution concluding that the director had satisfied the fiduciary duty test pursuant to the 1975 *CBCA*. As well, the resolution approving indemnification included expenses to be incurred by the director in the future. The Court in *Chromex* made the following declaration in permitting the advancement of funds, but only for "those amounts that have actually been incurred."[193] According to the Court:

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[190] *Balestreri v. Robert*, [1992] A.Q. No. 495 (Que.C.A.); (1986) 30 B.L.R. 283 (Ont. S.C.).
[191] *CDIC, supra* note 109 (In *CDIC* the court found the statutory indemnification provision to be permissive and the by-laws mandatory The extent to which the by-laws were mandatory were limited, according to the court, to a requirement of the corporation to indemnify upon a final determination.) For United States cases in which indemnification rights have been deferred until a final determination, see *Galdi* v. *Berg* 359 F.Supp. 698 (Del. 1973); *Haenel* v. *Epstein*, 88 A.D.2d 652 (N.Y. 2nd Dept. 1982); 450 N.Y.S.2d 536; leave to appeal to Court of Appeals of New York denied 61 N.Y. 2d 604; *Lussier* v. *Mau-Van Development, Inc.*, 4 Haw.App. 421 (1993); *Merritt -Chapman & Scott Corp.* v. *Wolfson*, 321 A.2d 138 (Del. Super. 1974) [*Wolfson No. 2*].
[192] *Chromex, supra* note 27.
[193] *Ibid.* at 195.

> In summary, then, I find that s. 124(1) of the [1975 *CBCA*], authorizes the companies to indemnify Michael Hretchka as an officer and director of the companies against legal expenses reasonably incurred by him in respect of any civil or administrative action or proceeding to which he has been made a party by the respondent by reason of being or having been a director or officer of such companies without the necessity of such action or proceeding being concluded or decided.[194]

So, while the *Chromex* case suggests that directors and officers can seek indemnification prior to a final determination, the court was permissive and did not mandate the corporation to indemnify.

In *Manitoba (Securities Commission)* v. *Crocus Investment Fund*[195] the Manitoba Court of Queen's Bench ordered the advancement of funds prior to a final determination on the following premises: indemnities are founded on legal and equitable principles;[196] the court has a discretion to decide "whether those with a right to potential indemnification are entitled to payment of ongoing costs rather than awaiting completion, or substantial completion, of all proceedings";[197] the costs of litigation create the potential for real financial hardship;[198] and, the obiter in *Blair*[199] is persuasive, namely that in the absence of *mala fides* indemnification should not be denied.[200] As such, while the court did not find that

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[194] *Chromex, supra* note 27 at 195-6.
[195] [2006] M.J. 30 (QL) [*Crocus*].
[196] *Ibid.* at para. 38.
[197] *Ibid.* at para. 40.
[198] *Ibid.* at para. 41.
[199] *Blair, supra* note 13.
[200] *Crocus, supra* note 195 at para. 44. (The *Crocus* decision was decided in the context of the *Corporations Act*, C.C.S.M. c. C225, s. 119 with indemnification provisions identical to the pre-2001 *CBCA*, and corporate by-laws that rendered indemnification mandatory if the fiduciary duty and lawful conduct tests are satisfied).

it was mandated to provide for indemnification notwithstanding a by-law to this effect, it determined that there were convincing reasons to do so.

Similarly, the current *CBCA* permits advancement of funds but does not mandate such advancement. One could take a lead from the *Crocus* case and apply to the court for indemnification under the indemnification provisions of the statute or, possibly, under the oppression remedy.[201] The statutory test, therefore, is different from the proposed test in that the statutory test is permissive and can only be mandated with court assistance. In contrast, a common law and equitable indemnification right, however, would entitle a director or officer to indemnification upon the proper incurring of expense. Furthermore, the proposed test would not require court assistance as a pre-requisite to the entitlement, although functionally a court application may be necessary for enforcement.

There are several differences between the proposed test and the statutory test. While under both tests directors and officers must as fiduciaries fulfill the duties of loyalty, good faith, and avoidance of conflict and self interest,[202] the director under the proposed test has a broader scope of recovery. Put another way, the *CBCA* indemnification right is more restrictive and requires that the

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[201] *CBCA*, s. 241.

[202] See *Canaero, supra* note 98 (This case illustrates how courts treat the fiduciary duties of directors and officers, particularly with respect to the avoidance of self interest).; See also *Aberdeen, supra* note 98 (This case also outlines the fiduciary duties of directors to act in the best interests of a corporation, without personal conflict).

individual not only satisfy the fiduciary duty test and the lawful conduct test (if applicable). They must also satisfy the act or omission test. The removal of the substantially successful test and the inclusion of this act or omission test strongly suggests that a director or officer must be wholly successful in his or her defence. As noted earlier in this paper, directors and officers who are substantially successful, but not completely successful, in their defence may no longer be entitled to indemnification under the *CBCA* as currently formulated.[203] Specifically, the inclusion of *any* act or omission under the statutory test points to a requirement for a wholly successful defence. If a director or officer has been found liable in any way, it is to be concluded that the director or officer failed to do, or omit to do, something he or she ought to have done. As such, the *CBCA* exposes directors and officers to litigation expense risk in the event they are not completely vindicated. By way of contrast, it could be argued that under the proposed test, directors and officers do not share the same vulnerability. That is, the proposed test does not require the litigation perfection suggested under the *CBCA* act or omission test. This is because it cannot be necessarily concluded that if a director or officer has been found liable, that he or she failed to act honestly, fairly, without profit, within the scope of responsibilities and without doing anything apparently illegal.

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[203] It is interesting to note that the *DGCL* and the *MBCA* both address the extent to which a director or officer must achieve litigation success to be entitled to the remedy of indemnification. Section 8.52 of the *MBCA* reads "A corporation shall indemnify a director who was *wholly successful*, on the merits or otherwise, in the defense of any proceeding to which he was a party because he was a director of the corporation against reasonable expenses incurred by him in connection with the proceeding." Section 145(c) of the *DGCL* reads "To the extent that a present or former director or officer of a corporation has been *successful on the merits* or otherwise in defense of any action, suit or proceeding ... or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith."

To illustrate by way of example, consider a situation where a director receives advice from legal counsel and senior management regarding how to act in relation to an issue that is governed by strict liability laws, e.g., environmental regulatory offences, and the director acts in accordance with this advice. Because the director sought the advice of counsel and senior management he has shown that he acted honestly and fairly, thus satisfying the first component of the proposed test. The action taken by the director does not profit him personally or the company, thus satisfying the second component of the proposed test. The issue with which the director is addressing is ultimately his responsibility, thus satisfying the third component of the proposed test. The director proceeds with a specific course of action, based on legal advice and an objective belief that what he was doing was not apparently legal, thus satisfying the fourth component of the proposed test. A court later finds that a strict liability offence has been committed as a result of the director's action, specifically a court finds that the director's action caused the offence to occur. As such, the director committed a legally actionable fault which resulted in legal liability. Under the proposed test the director would be entitled to the remedy of indemnification. Under the *CBCA* statutory test, however, the director *would not* be entitled to indemnification because he was adjudged by a court of competent authority to have committed a fault.

It is to be admitted that the last component of the proposed test, namely the apparently illegal aspect, and the lawful conduct test are indeed similar. But, these are only components of the respective right to indemnification test and, as illustrated, they are indeed substantively different. The example also illustrates the inherent inconsistency within the statutory test, namely the inconsistency between the lawful conduct test and the act or omission test. The lawful conduct test specifically contemplates a director or officer being entitled to the indemnification remedy in circumstances when he or she did not act legally, but had reasonable grounds for believing he or she acted legally. The act or omission test, which is not mutually exclusive from the lawful conduct test in determining a right to indemnification, contemplates the opposite. That is to say, if someone acted illegally, whether or not there were reasonable grounds for believing the act was legal, that person would have invariably violated the act or omission test.

Of further concern is the ambiguity created by the statutory inclusion of an act or omission test on a settlement. In particular, the best method by which a director or officer can ensure that he is completely vindicated is to see a proceeding through to its final determination. But, most proceedings these days end up in a settlement. A settlement agreement would not necessarily state that a director or officer satisfied the act or omission test. Even if such a settlement agreement did make such a statement, would that be held up in court in the event a director or officer tried to exercise his right to indemnification? To avoid

the risk of no indemnification, a director or officer, if it is believed that no wrong has been committed, would not have an incentive to settle a dispute, but would be keen to see a dispute proceed to its costly finality. By way of contrast, the proposed test would entitle a director or officer to the remedy of indemnification unless a complainant has shown that the individual did not act honestly and fairly, without profit, within the scope of responsibilities, and without doing anything apparently illegal.

With respect to onus of proof, in equity, a fiduciary such as a trustee is presumed to have acted properly.[204] Subject to the displacement of this presumption, the trustee is entitled to indemnification. Under the 2001 *CBCA*, there is no statutory presumption of proper conduct. The effect is that the *CBCA* "stacks the deck" against a director or officer who must, unless advanced monies, bear the cost burden of litigation. A burden of proof at common law and in equity favouring directors and officers is consistent with indemnification policies, namely, encouraging responsible people to take on the roles of directors and officers and discouraging strike suits. The effect is a fair and reasonable burden of proof that gives directors and officers the benefit of the doubt until proven otherwise in a proceeding.

With respect to enforcement, this issue is significant and, as such, will be addressed in greater depth in Part V. Suffice to say at this point that in equity, a

[204] *Jennings, supra* note 55.

fiduciary such as a trustee, provided the right to indemnification is not displaced, is entitled to a lien against the assets being administered by the fiduciary.[205] There is no statutory lien for a director or officer entitled to indemnification under the 2001 *CBCA*. If an indemnification right is enforced under the right to indemnification provision or pursuant to an enhanced indemnification right in constating instruments, the director or officer bears the risk that the corporation has insufficient assets or insufficient insurance.

In summary, the statutory test bears some resemblance to the common law and equitable test in terms of types of proceedings and an indemnification prohibition. The common law and equitable test for indemnification rights is not, however, duplicative, but is indeed different from, the 2001 *CBCA* test in real and substantive aspects, namely, in terms of the persons covered, a right to an advancement of funds, the indemnification test, the onus of proof and enforcement. It can be concluded then, that, at this stage of the analysis, the common law and equitable indemnification test exists independent of the indemnification provisions under the *CBCA*.

B. Does the *CBCA* Provide for Adjudicative Machinery?

The next step in the analysis of determining whether common law and equitable rights have been displaced by statute involves an examination of the

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[205] *Jennings, supra* note 55; *Hardoon, supra* note 58; *St. Thomas's Hospital, supra* note 87; *re Griffith, supra* note 89.

statute to determine whether it is intended to be an exhaustive code by virtue of its adjudicative machinery. For indicia as to when this has happened, *Seneca College of Applied Arts and Technology* v. *Bhadauria*[206] is instructive. In this case the Supreme Court of Canada held that the Ontario human rights legislation was an exhaustive code, in large part because the legislation provided its own comprehensive adjudicative machinery.[207] As the Court stated:

> In the present case, the enforcement scheme under the Ontario *Human Rights Code* ranges from administrative enforcement through complaint and settlement procedures to adjudicative or quasi-adjudicative enforcement by boards of inquiry. The boards are invested with a wide range of remedial authority including the award of compensation (damages in effect), and to full curial enforcement by wide rights of appeal which, potentially, could bring cases under the Code to this Court.
>
> ....
>
> The Code itself has laid out the procedures for vindication of that public policy, procedures which the plaintiff respondent did not see fit to use.[208]

The Court therefore concluded that the legislation sufficiently protected the rights and obligations of those who sought to enforce human rights laws. Unlike the Ontario human rights code, however, the *CBCA* does not contain complaint or settlement procedures and there are no adjudicative or quasi-adjudicative boards of inquiry with curial enforcement. This would suggest that the *CBCA* was not intended to be an exhaustive code for those seeking to enforce corporate laws.

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[206] [1981] 2 S.C.R. 181 [*Seneca College*]. See also *Rawluk*, *supra* note 183.
[207] *Seneca College*, *ibid* (The Court held that resort to creating new common law rights was not required, namely the new tort of "unjustified invasion of his or her interest not to be discriminated against in respect of a prospect of employment on grounds of race or national origin" at 182).
[208] *Ibid.* at 194-195.

Other evidence of such an intention is the absence of privative clauses. Put another way, privative clauses indicate that a statute was intended to be an exhaustive code. For example, a privative clause relating to labour board decisions is an indication that the legislature intends to restrict access to courts and defer to the statute and its consequent tribunal as a comprehensive code.[209] By way of contrast, the *CBCA* does not contain any provisions for resolution of disputes, let alone a privative clause, with respect to indemnification. That is, all questions of law pursuant to the 2001 *CBCA* fall within the jurisdiction of superior courts.[210] Given that the *CBCA* does not supply the necessary adjudicative machinery, such as an administrative tribunal, resort to the common law is not duplicative in any situation where the statute applies. This means the parties to an indemnification dispute must seek judicial assistance to enforce indemnification rights. Virtually by definition then, the *CBCA* provision cannot be seen as an exhaustive code.

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[209] *Gendron, supra* note 180 at 1321. (As also noted in *Gendron,* at 1322, by restricting access to courts, legislature promotes finality and speed. Unfortunately, the legislature is also restricting access to equitable rights available in a court of inherent jurisdiction).

[210] *CBCA*, s. 2: "court" means the trial division of the Supreme Court in Newfoundland and Labrador and Prince Edward Island; the Superior Court of Justice in Ontario; the Supreme Court in Nova Scotia and British Columbia; the Court of Queen's Bench in Manitoba, Saskatchewan, Alberta and New Brunswick; the Superior Court in Quebec; the Supreme Court of the territory in the Yukon Territory and Northwest Territories; and the Nunavut Court of Justice in Nunavut.

C. Has the *CBCA* Abolished Common Law and Equity Rights and Remedies with Irresistible Clearness?

Section 122(3) of the *CBCA* is one example of the legislation making it expressly clear that it is not intended to be exhaustive. Specifically, s. 122(3) of the *CBCA* provides that, subject to a unanimous shareholders agreement, "no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act or the regulations or relieves them from liability for a breach thereof." As such, sources of law such as contract or constating instruments cannot displace the statutory obligations of directors and officers. But, parties can use contracts to create rights in addition to those available under statute, provided they do not run afoul of mandatory provisions. The statute therefore explicitly acknowledges rights and remedies existing outside statute, countering any argument that common law and equity have been ousted with irresistible clearness.

An example of how an explicit acknowledgement of extra-statutory rights and remedies in a constating instrument affected the outcome of a dispute is the case of *Citadel Holding Corp. v. Roven*.[211] In this case, Roven was a director and a shareholder of Citadel, a loan holding company. In 1987 Roven and Citadel entered into an indemnity agreement and "[t]he stated purpose of the Agreement was to provide Roven with protection greater than already provided him by

[211] 603 A.2d 818 (Del. Sup.Ct. 1992) [*Roven*].

Citadel's Certificate of Incorporation, Bylaws and insurance."[212] The Court held that while a contract cannot circumvent legislation, it can expand indemnification rights beyond those provided under statute or in by-laws.[213] This means that the court explicitly acknowledged the availability of extra-statutory rights and obligations in constating instruments.

It can be concluded, then, that the existence of a statutory indemnification right under the *CBCA*, therefore, has not displaced common law or equitable indemnification rights. In fact, numerous factors point in the opposite direction. This is true because at common law and in equity, rights are not automatically displaced by statute; the common law and equitable test differs from statute in real and substantive aspects; there is no evidence to prove that the *CBCA* was intended to be an exhaustive code by virtue of adjudicative machinery. Put another way, the common law and equity have not been ousted with irresistible clearness. As such, there is an overwhelming argument to find that the common law and equitable indemnification rights of directors and officers survive under the *CBCA*.

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[212] *Roven, supra* note 211 at 820.
[213] *Ibid.* at 823. See also *Mooney, supra* note 14; *Bergonzi* v. *Rite Aid Corporation* 2003 Del. Ch. LEXIS 117.

Part V Enforcing Indemnification Rights at Common Law and in Equity

Given my conclusion that common law and equitable indemnification rights survive the *CBCA*, it is particularly relevant to establish how directors and officers can enforce those rights. Under the common law and equitable test, a director or officer is entitled to a lien against the assets being administered by the fiduciary, provided the right to indemnification is not displaced.[214] There is, however, no similar statutory lien for a director or officer entitled to indemnification under the *CBCA*. This fact illustrates yet another advantage regarding common law and equitable indemnification rights and remedies, namely the superior enforcement.

Equity can be enforced in its own right and is not reliant on the existence of a tort, contract or legislation.[215] Numerous examples of enforcing equitable and common law indemnification rights were outlined in Part III,[216] including the use of an equitable lien.[217] In this section I will outline how courts have considered securing corporate assets for the purpose of costs in litigation. Then, I will compare indemnification enforcement at common law and in equity against enforcement of indemnification rights under contract, constating instruments and statute. The purpose of this section is to continue exploring how the law could be

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[214] With respect to equitable liens available to trustees, see *Jennings, supra* note 55; *Hardoon, supra* note 58; *St. Thomas's Hospital, supra* note 87 and *re Griffith, supra* note 89.
[215] *Selangor, supra* note 98 at 1098.
[216] *Jennings, supra* note 55; *Hardoon, supra* note 58; *Balsh, supra* note 67; *Re German Mining, supra* note 68; *Downing, supra* note 70; *Toplis, supra* note 75; *Thacker, supra* note 77; *re Griffith, supra* note 89; *Dugdale, surpa* note 141; *Barclay, supra* note 147; *Bank of India, supra* note 149; *Bayliffe* v. *Butterworth* (1847), 1 Exch. 425.
[217] *St. Thomas's Hospital, supra* note 87 at 276.

improved by formally recognizing common law and equitable indemnification rights of directors and officers.

Canadian courts have not directly addressed equitable liens on corporate assets for the purpose of director and officer indemnification. They have, however, contemplated ranking the indemnification interests of directors and officers in priority to the interests of shareholders and other equity holders. For instance, in the Alberta decision of *Magellan Aerospace Ltd.* v. *First Energy Capital Corp.*[218] the Court of Queen's Bench ranked the indemnification interests of directors and officers in priority to equity holders, such as shareholders, in a receivership context. The Court reasoned that "directors and officers require indemnities and commercial necessity dictates that these indemnities have real value."[219]

Canadian courts have also contemplated securing assets for costs in indemnification cases. This is analogous to an equitable lien because, like a lien, assets are ear-marked for the purpose of fulfilling the indemnification obligations

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[218] *Merit, supra* note 112.

[219] *Ibid.* at para. 61. (The Court dismissed an application for a declaration that directors and officers were entitled to an equitable lien arising out of the indemnity obligations of the corporation. The directors and officers relied on personal properly legislation and contractual agreements in their application submissions. The legislation and the contracts acknowledged the priority of equitable rights, should such rights be shown to exist. As put by the Court of Appeal at para. 22, "...the language in question does not create a right to a lien, it merely indicates that if one were to exist it would have a priority. Put another way, the language simply states the security of the Lenders[,directors and officers are] subject to any equitable remedies which may exist but does not itself create them").

of a corporation. For instance, in *CDIC*,[220] the Court of Appeal upheld an order for a bank to provide security for costs. This is because certain directors, officers and senior management had a right under the corporate by-laws to indemnification if they satisfied the fiduciary duty test and, if applicable, the lawful conduct test in the final result.[221]

Two years later in the *Northland Bank* v. *Willson*[222] case, the Alberta Court of Appeal relied upon *CDIC* and the indemnification provisions of the *Bank Act*[223] in awarding the defendant directors, officers, auditors and other persons who acted for the bank, security for costs in an action by the bank's liquidator seeking $480 million. The Court denied security for costs in an action filed the same day as the liquidator's action by the Canada Deposit Insurance Corporation seeking $650 million for reimbursement of depositors and loans made to save the bank.

The Court decided that security for costs in the liquidator's action was warranted because the insolvency of the bank. Specifically, unless the Court

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[220] *CDIC, supra* note 109.

[221] *Ibid.* ("In this case, the directors and officers and senior managers may at the conclusion of this litigation be entitled to indemnification under either s. 56(2) or (3) of the *Bank Act*. While s. 56(2) gives the bank the option whether it will seek court approval for indemnification, that option would appear to be removed by the terms of the bank's by-law 7.01. Under it, the persons affected have the right to require the application to be made once the criteria specified by the sections have been met. Accordingly, I respectfully agree with the learned chambers judge that security for costs is appropriate in this order for those persons described in s.56(2) and (3) [of the *Bank Act*] and in the by-law" at 164).

[222] (1991), 83 D.L.R. (4th) 362 (Alta. C.A.) [*Willson*]. (In *Willson,* two actions were filed against the appellant directors, one by the liquidator for $480 million in damages and one by the Canadian Deposit Insurance Corporation for $650 million. The appellant directors filed a motion in both actions for security for costs to protect their indemnification rights under the Alberta *Business Corporations Act*, S.A. 1981, c.B-15. Court of Appeal heard the motion covering both actions in this appeal).

[223] *Bank Act*, R.S.C. 1985, c. B-1 [*Bank Act*].

securing assets for potential indemnification claims, the bank would not have sufficient funds to pay these claims after all other secured creditors were satisfied. The Court's reason for denying security for costs in the Canada Deposit Insurance Corporation action was because it was not insolvent and if successful, the defendants would be able to recover costs as they may be awarded.[224]

The Court in *Northland Bank* also discussed the issue of priority and pointed out that when there is security for costs, there is invariably a sense of priority or else the point of acquiring security would be an illusion.[225] This priority, however, was not a guarantee with respect to costs. Rather, in the event the directors were successful in their defence, their costs, if awarded, would be paid.[226]

What is interesting about the foregoing case is that the Alberta Court of Appeal awarded security for "costs" in reference to the rules of court and the s. 56 of the *Bank Act*.[227] Section 56 of the *Bank Act* includes a right to indemnification where the director, officer or other person acting for a bank was substantially successful on the merits of the defence and satisfied the fiduciary duty test and lawful conduct test. This is the same test under the pre-2001 *CBCA*. As such, the defendant, if the test was satisfied, would have been

[224] *Willson, supra* note 222 at 368.
[225] *Ibid.* at 369.
[226] *Ibid.* at 370.
[227] *Bank Act, supra* note 223.

entitled to indemnification and the judge would not have discretion to award, apportion or deny indemnification. This is vastly different from an award of costs in which a judge would have the discretion to award, apportion or deny costs. At the same time, courts tend to exercise their discretion with respect to costs in reasonably predictable ways. It may be concluded, then, that since the courts are willing to use s. 56 as a premise for awarding security for costs, the link between indemnification and the securitization of assets for indemnification purposes is tenable, whether by means of security for costs or a lien.[228]

Though courts have not yet recognized an equitable lien in the context of non-statutory indemnification, the willingness of the court in *Northland Bank* to permit security for costs advances the argument that directors and officers should be entitled to an equitable remedy. Both contemplate the preservation of assets for the purpose of satisfying indemnification claims. The equitable lien, however, is superior to security for costs because the lien is self-executing. By way of contrast, a director or officer would have to seek judicial assistance to acquire security for costs by acquiring a court order. Furthermore, costs can be discretionary whereas a lien that is not discretionary would be consistent with the principle that indemnification is a *right*.

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[228] But see *re Westar Mining Ltd.* (1992), 14 C.B.R. (3d) 95 (B.C.S.C.) [*Westar*] (In *Westar*, the defendant directors attempted to have assets of the corporation secured for indemnification purposes. At the time, in British Columbia, corporations had to seek judicial approval to indemnify directors and officers according to the *Companies Act*, R.S.B.C. 1979, c. 59. The Court did permit the corporation to indemnify directors and officers for liabilities arising out of the *Employment Standards Act*, S.B.C. 1980, c. 10 but would not grant the security as it argued that such a ruling would potentially modify the existing priorities of the corporation's creditors. The corporation was, at the time, under a stay of proceedings pursuant to the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36).

Moving from the realm of enforcement by way of securing assets to enforcement by way of contract, contracts are an excellent means of securing indemnification rights of directors and officers. Unless the parties have turned their minds to the issue of an indemnification contract, however, directors and officers are only protected to the extent of the law. While there are multiple examples of cases where courts have enforced implied contracts giving rise to indemnification rights,[229] an express contract is a more reliable indemnification enforcement tool. That is, if no such express contract exists, then directors and officers are exposed to litigation costs not covered by statute unless a common law or equitable indemnification right, as argued here, is recognized by the courts.

Indemnification rights under contract may be analogous to indemnification rights created in constating instruments. It is, however, not clear that constating instruments are reliable sources of law for enforcing indemnification rights and limitations because of a dearth of case law on point. Judicial consideration of the enforcement of indemnification rights and obligations in constating instruments under an articles of incorporation regime is, as will be demonstrated next, limited to the *CDIC* case.

[229] *Wallersteiner, supra* note 62; *Duncan, supra* note 79; *Barclay, supra* note 147; *McFee, supra* note 152; *Birmingham, supra* note 157.

In *CDIC*, the Alberta Court of Appeal stated in reference to indemnification rights of directors and officers that "[t]heir potential right to indemnification is contractual though with a statutory sanction."[230] As argued earlier in this thesis, it appears that the Court was referring (perhaps somewhat inaccurately) to the by-laws of the bank providing for indemnity if the defendants were able to satisfy the fiduciary duty and lawful conduct test. This demonstrates that constating instruments such as by-laws under an articles of incorporation regime are capable of being enforced by directors and officers.

On a related front, but concerning an older model of incorporation, there is a historical line of cases involving regimes governed by memorandum of association that argue that the memorandum was simply a contract between shareholders, unenforceable by directors or officers.[231] There are, however, a few cases that viewed articles as the terms under which a director or officer accepts such position, and were enforceable as such.[232]

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[230] *CDIC, supra* note 109.

[231] *re Tavarone Mining Company* (the *Pritchard's Case*) (1873), L.R. 8 Ch.App. 956. (The Court of Appeal of the Chancery Division found that "the articles of association are simply a contract as between the shareholders *inter se* in respect of their rights as shareholders" at 960). See also *Browne v. La Trinidad* (1887), 37 Ch. D 1 (C.A.) at 13-4. But see *Boston Deep Sea Fishing and Ice Company* v. *Ansell* (1888), 39 Ch. D. 339 (C.A.). (The Court enforced a contractual agreement between a director and a corporation that was adopted under the seal of the corporation. While the Court argued at 359 that articles of association are "a mere contract between the shareholders and the company," the Court, at 366, enforced the contract adopted by the corporation).

[232] See *Molineaux* v. *The London, Birmingham and Manchester Insurance Company, Limited.* [1902] 2 K.B. 589 (C.A.) ("The articles, though not themselves a contract between the company and the director, must be regarded as shewing the terms upon which on the one hand he agrees to act as a director, and on the other hand the company agree to pay him remuneration for his services" at 596). See also *In re Brazilian Rubber Plantations and Estates, Limited.* [1911] 1 Ch.D. 425 (The Court argued that the articles of the corporation stipulated that the directors could not be held liable for "loss, damage, or misfortune whatever shall happen in the execution of the duties of his office or in relation thereto, unless the same happen through his own dishonesty. I think upon its construction [the] articles is intended to relieve directors who act honestly from

For another example under an articles of incorporation regime, the reference to by-laws as contractual was put forth in *Amirault* v. *Westminer Canada Ltd.*[233] In *Amirault*, the corporate by-laws provided that a director was entitled to indemnification if a director satisfied the legislative fiduciary duty test and the director's defence was substantially successful. The Trial Judge found that the Seabright directors "committed no fraud, nor did they fail to disclose any material information, and acted honestly and in good faith in the best interests of their company."[234] As a result of this finding, the Court concluded that the Seabright directors were entitled to indemnification pursuant to the 1975 *CBCA* and Seabright's by-laws.[235]

The *CDIC* and *Amirault* cases are recent examples of how constating instruments such as by-laws have been found to be enforceable against a corporation. While this is helpful to a director or officer who finds him or herself exposed by gaps left under a statutory regime such as the *CBCA*, it is important to remain cognizant of the fact that in comparison to rights at common law or in equity, by-laws can be unilaterally rescinded by the corporation's shareholders without the knowledge or consent of an officer and without the consent, but with

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liability for damages occasioned even by their negligence, where such negligence is not dishonest. And, having regard to the [*Molineaux*] decision, I do not see how to escape from the conclusion that this immunity was one of the terms upon which the directors held office in this company" at 440). See also *Wolfson No. 2, supra* note 194 (The Court held that indemnification rights under by-laws are independent of statutory rights).

[233] (1994), 127 N.S.R. (2d) 241 (N.S.C.A.) [*Amirault*].

[234] *Ibid.* at 253.

[235] See *B & B Investment Club v. Kleinert's, Inc.*, 472 F. Supp. 787 (Penn. 1979) (For United States case law supporting the argument that articles and by-laws are enforcement contracts).

the knowledge, of a director. This suggests an inferior form of protection compared to the protection offered by a common law or equitable indemnification right which cannot be unilaterally rescinded.

Like constating instruments, a unanimous shareholders agreement is also an inferior form of indemnification protection. A unanimous shareholders agreement is a contract among shareholders and can be rescinded with the unanimous consent of the shareholders.[236] For example, a unanimous shareholders agreement could provide for indemnification of directors or officers who were not wholly successful in their defence of an action. Suppose that a director or officer who was not a shareholder of a corporation was subjected to litigation. Then, before the final determination of the matter the unanimous shareholders agreement was rescinded, or at least the indemnification provision was rescinded. Section 247 of the 2001 *CBCA* gives a complainant[237] the right to apply for a court order directing compliance with the legislation, the regulations, articles, by-laws or a unanimous shareholders agreement. The director or officer in this case would have standing as a complainant under the legislation. But, if the unanimous shareholders agreement is rescinded before the complainant appears in court to make an argument for indemnification, is there

[236] *CBCA*, s. 146.

[237] A "complainant" is defined in s. 238 of the *CBCA* as "(a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates, (b) a director or an officer or a former director or officer of a corporation or any of its affiliates, (c) the Director, or (d) any other person who, in the discretion of a court, is a proper person to make an application under the [*CBCA*]".

anything to enforce compliance?[238] The point is that a director or officer who is not a shareholder cannot rely on a unanimous shareholders agreement for indemnification if he or she cannot control when such rights will be removed. The indemnification test at common law and equity, on the other hand, cannot be taken away by the shareholders of a corporation. It exists independent of them.

The foregoing discussion illustrates that not only does a common law or equitable indemnification right survive the *CBCA*, enforcement mechanisms of indemnification rights at common law and equity are superior to those under statute, by contract, by constating instruments or unanimous shareholders agreement.

The advantages of common law and equitable indemnifications rights relates to their self-executing nature, that such rights do not require judicial or contractual assistance and that benefits are immediate upon incurring expenses and not deferred until a final determination. There is a good argument that beyond this, courts should recognize equitable liens for directors and officers seeking indemnification. Such a new remedy would involve building on the policy rationales for what is currently allowed, namely securing assets for indemnification purposes.

[238] In the event a unanimous shareholders agreement is unilaterally rescinded to the detriment of a director's or officer's indemnification rights, such director or officer might be able to seek recourse under the oppression remedy available in s. 241 of the 2001 *CBCA*.

Part VI Conclusion

As discussed, the purpose of this thesis has been to explore director and officer indemnification under the *CBCA*, at common law and in equity. A related purpose advocates for two amendments to the *CBCA*.

With respect to the indemnification under the *CBCA*, I have not debated the value of the fiduciary duty test or lawful conduct test under statutory indemnification right provisions. I believe these tests are uncontentious and are consistent with indemnification principles. That is, directors and officers are fiduciaries who must discharge their duties faithfully and loyally to the corporations they serve.

I do, however, conclude that the inclusion of an act or omission test under the 2001 amendments to the *CBCA* has needlessly increased litigation expense risk of directors and officers. This is because the act or omission test creates uncertainty in the law and exposes directors and officers to litigation costs in the event they have not executed their duties perfectly. Specifically, it is not clear that the act or omission test will permit indemnification where a director or officer faces multiple allegations in an action and has been successful in his or her defence of one or more of the allegations. Under the predecessor *CBCA* indemnification provision, a director or officer only had to be substantially successful in order to protect indemnification rights. No other jurisdiction in

Canada has included an act or omission test. Nor is there case law to support an argument as to why such a test enhances the policy or other goals of indemnification law.

With respect to common law and equitable indemnification rights, I conclude that there is sufficient case law to support drawing an analogy between the application of indemnification rights of trustees and agents to directors and officers. The reason for this conclusion is because trustees, agents, directors and officers all bear fiduciary duties to the beneficiaries they serve, whether *cesti que trust*, principal or corporation. Furthermore, case law acknowledges that directors and officers are at time trustees of and agents for the corporations they manage. At least one case, *Re German Mining,*[239] expressly acknowledged that directors are entitled to be indemnified in the same fashion as a trustee. While courts in Canadian cases have had the opportunity to explore the question of a common law or equitable right to indemnification, they have failed to do so. Nevertheless, the basic principles of common law and equity support the conclusion that indemnification could be successfully sought. The United States has addressed the issue of a common law to indemnification but the case law is inconsistent and unstable.

Having sustained the argument that directors and officers are entitled to indemnification analogous to trustees and agents, I have offered an

[239] *Re German Mining, supra* note 68.

indemnification test based on a number of cases.[240] This proposed test states that directors and officers are entitled to indemnification if they have acted honestly, within the scope of duties, without profit and without doing anything apparently illegal. This test has the benefit of placing the burden of proving a director or officer has failed to satisfy the test on the complainant. As such, a director or officer is given the benefit of the doubt until a complainant proves that the director or officer is not entitled to indemnification. Placing the burden of proof in this way discourages strike suits.

This proposed test also has the benefit of providing directors and officers with lien rights against corporate assets. While Canadian courts have not considered the possibility of lien rights in the context of director and officer indemnification, they have considered the possibility of securing corporate assets for the purpose of fulfilling indemnification obligations of a corporation in the event a court finds a director or officer is entitled to indemnification. The concept of a lien right is therefore consistent with the trend of courts. That is, courts are willing to set aside corporate assets in the event a director or officer is entitled to indemnification. While not a perfect protection, this lien right protects a litigating director or officer to some extent against asset insufficiency of the corporation.

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[240] *Jennings, supra* note 55; *Hardoon, supra* note 58; *Balsh, supra* note 67; *Phené, supra* note 67; *Re German Mining, supra* note 68; *Topolis, supra* note 75; *Thacker, supra* note 77; *Duncan, supra* note 79; *Re Famatina, supra* note 83; *St. Thomas's Hospital, supra* note 87; *Re Griffith, supra* note 89; *Dugdale, supra* note 141; *Goldstein, supra* note 145; *Barclay, supra* note 147; *Bank of India, supra* note 149.

Finally, this proposed test has the benefit of giving directors and officers *a right* to an advancement of funds by a corporation. The *CBCA* in comparison permits the advancement of funds but does not render such advancement mandatory.

This test therefore satisfies the public policy applicable to director and officer indemnification in that it encourages capable persons to accept these posts knowing that they will be protected in the event they are subject to litigation by virtue of their positions. It discourages unlawful conduct because directors and officers will know that they will not have the benefit of corporate assets to pay for their litigation expenses where they have not discharged their duties honestly and fairly, without profit, within the scope of their duties or without doing anything illegal. Furthermore, as noted above, this test discourages strike suits because a complainant bears the burden of proving a director or officer has failed the indemnification test.

The indemnification test has not been displaced by the *CBCA* indemnification provisions. Discussion papers regarding the *CBCA* acknowledge that the *CBCA* was not intended to be exhaustive and statute is presumed to have left the common law and equity intact. I have argued that the common law and equitable indemnification rights of directors and officers have not been ousted by the *CBCA* because the common law and equitable test is not duplicative of the statutory indemnification test, there is no adjudicative

ten allegations. Furthermore, there is no evidence that the substantially successful test was problematic in its application by the courts and the act or omission test increases litigation expense risk without explanation for such an increase.

The current indemnification rights of directors and officers, therefore, suffer from lack of clarity and certainty under statute, common law and equity. This thesis has attempted to provide guidance on how to reverse that.

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