

## Shareholder Control Over Management: The Removal of Directors

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In both the Ontario *Business Corporations Act* and the Draft Canada Business Corporations Act, provision has been made both for an optional cumulative voting method of electing directors<sup>1</sup> and for the removal of directors at any time by ordinary resolution of the shareholders in special<sup>2</sup> or general<sup>3</sup> meeting.

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<sup>1</sup> R.S.O. 1970, c.53, s.127, hereinafter referred to as the *B.C.A.*; s.9.06 of the Draft Canada Business Corporations Act, 1971, hereinafter referred to as the *DCBCA*.

<sup>2</sup> *DCBCA*, s.9.08. The new proposed Federal Corporations Act (Bill C-213) which had its first reading on 18 July, 1973, contains proposals with respect to cumulative voting and director removal by shareholders. S.101 replaces s.9.06 of the *DCBCA* and states:

Where the articles provide for cumulative voting,

(a) the articles shall require a fixed number and not a minimum and maximum number of directors;

(b) each shareholder entitled to vote at an election of directors has the right to cast a number of votes equal to the number of votes attached to the shares held by him multiplied by the number of directors to be elected, and he may cast all such votes in favour of one candidate or distribute them among the candidates in any manner;

(c) a separate vote of shareholders shall be taken with respect to each candidate nominated for director unless a resolution is passed unanimously permitting two or more persons to be elected by a single resolution;

(d) if a shareholder has voted for more than one candidate without specifying the distribution of his votes among the candidates, he is deemed to have distributed his votes equally among the candidates for whom he voted;

(e) if the number of candidates nominated for director exceeds the number of positions to be filled, the candidates who receive the least number of votes shall be eliminated until the number of candidates remaining equals the number of positions to be filled;

(f) each director ceases to hold office at the close of the first annual meeting of shareholders following his election;

(g) a director may not be removed from office if the votes cast against his removal would be sufficient to elect him and such votes could be voted cumulatively at an election at which the same total number

Considered independently, each type of provision can be hailed as tending to advance the cause of the shareholder in his uphill struggle to effectively control the management of the company in which he has invested his capital. The cumulative voting system greatly increases the chance that a group of minority shareholders will be able to achieve proportional representation in the management of the company, *i.e.* to elect a representative to the Board against the wishes of the majority group.<sup>4</sup> The provisions enabling shareholders to remove directors before the expiration of their term by passage of an ordinary resolution can be viewed as greatly facilitating director removal and thus as enhancing the ability of shareholders to control the disposition of their invested capital.

It is when these provisions are considered in detail and their inter-relationship precisely examined that it begins to become apparent that the shareholder may not yet be much better off than has traditionally been the case. On the other hand, just as it is unrealistic to consider such provisions independently of each other, so it is to consider them together but *in vacuo*, particularly when it seems clear that the shareholder's ability to control management in Ontario has been enhanced by the virtual abrogation of the rule in *Automatic Self-Cleansing Filter Syndicate Company Limited v. Cuninghame*.<sup>5</sup>

of votes were cast and the number of directors required by the articles were then being elected; and

(h) the number of directors required by the articles may not be decreased if the votes cast against the motion to decrease would be sufficient to elect a director and such votes could be voted cumulatively at an election at which the same total number of votes were cast and the number of directors required by the articles were then being elected.

S.103 replaces s.9.08 of the *DCBCA* and states:

(1) The shareholders of a corporation may by ordinary resolution at a special meeting remove any director or directors from office.

(2) Where the holders of any class or series of shares have an exclusive right to elect one or more directors, a director so elected may only be removed by an ordinary resolution at a meeting of the shareholders of that class or series.

(3) Subject to paragraphs 101(b) to (e), a vacancy created by the removal of a director may be filled at the meeting at which the director is removed or, if not so filled, may be filled under section 105.

Under Bill C-213, as under the *B.C.A.* in Ontario, cumulative voting will require adoption in the articles of incorporation.

<sup>3</sup> R.S.O. 1970, c.53, s.140 as amended S.O. 1972, c.138, s.37(2).

<sup>4</sup> See Campbell, *The Origin and Growth of Cumulative Voting For Directors*, (1955) 10 *The Business Lawyer*, No.3, 3.

<sup>5</sup> *Automatic Self-Cleansing Filter Syndicate Company Limited v. Cuninghame*, [1906] 2 Ch. 34; 94 L.T. 651 (C.A.). See R.S.O. 1970, c.53, s.101.

While shareholders are still unable to interfere in the management of a company simply by passing a resolution (e.g., that certain company assets be sold), the holders of ten per cent of a company's voting shares may now achieve the same result by requisitioning the passage of such resolution at a meeting of directors. However, this should only be done if the shareholders will be able to muster a majority of the votes cast at the shareholders' meeting which the requisitionists may call to validly pass the resolution in the event of default by the directors.<sup>6</sup>

Accordingly, it cannot be argued that no gains have been made by shareholders in the present context. Even if there is some question about the effectiveness of the Ontario Legislature's purported abolition of the rule of *Foss v. Harbottle*<sup>7</sup> by provision for derivative actions by shareholders,<sup>8</sup> it can be hoped that its provision to shareholders of power to obtain court orders of compliance by directors, officers and employees of a corporation with the provisions of the B.C.A., the articles or by-laws of the corporation<sup>9</sup> will render meaningful the shareholders' power to requisition directors' resolutions and initiate by-laws under s.101. It might even be suggested that shareholder power has been so dramatically increased that there is no need for a provision to shareholders of a statutory power of director removal. Clearly, both the personal interests of the directors and the company's interest in seeing their duties unflinchingly performed must be borne in mind. These factors have even been weighed against provision to shareholders of such statutory power where the shareholders possess no corresponding power to requisition director's resolutions.<sup>10</sup>

As will be shown, the legislature nevertheless has consciously decided upon provision to shareholders of such a statutory power and one should therefore examine its scope in order to identify the difficulties that shareholders may encounter in attempting its exercise.

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<sup>6</sup> See Iacobucci, *The Business Corporations Act, 1970: Management and Control of a Corporation*, (1971) 21 U. of T. L.J. 543, 558. Because the directors can attract personal liability for payment of the requisitionists' expenses in the event of their non-compliance with the requisition (s.101(7)), directors may comply therewith unless they are tolerably certain of defeating the requisitionists at the shareholders' meeting.

<sup>7</sup> *Foss v. Harbottle* (1843), 2 Hare 461; 67 E.R. 189 (H.L.).

<sup>8</sup> R.S.O. 1970, c.53, s.99.

<sup>9</sup> R.S.O. 1970, c.53, s.261.

<sup>10</sup> See Travers, *Removal of the Corporate Director during his Term of Office*, (1967) 53 Iowa L.Rev. 389.

## The Removal of Directors by Shareholders

Until passage of the *Companies Act*, 1948, shareholders in a British company were unable to remove a director before the expiration of his term of office unless provision for such removal was made in the company's Articles of Association.<sup>11</sup> Without such a provision, shareholders wanting to remove directors had to change the articles — something possible only by passage of a special resolution requiring a three-fourths majority of the shares voted<sup>12</sup> — or wait out the director's term of office. At that time, they could refuse to re-elect him. However, if he had been given a life directorship, he did not come up for re-election and was impreguably entrenched.<sup>13</sup>

It is true that, where directors had "neglected the duty of their office, even after notice",<sup>14</sup> they were liable to removal from office by majority vote before the expiration of their terms. It is clear, however, that if it is only where a director has fallen into breach of his duties that he may be so removed, shareholders will be unable to pressure the director whose undesirability falls short of breach of duty, something which itself in many cases could be expected to require identification by the courts before the shareholder could effect removal.

The concept of the entrenched director was imported without reservation by the Ontario High Court in 1896.<sup>15</sup> Shareholders in an Ontario company simply were prohibited from removing directors from office during the term for which they were appointed, in the absence of any provision for recall in the company's by-laws. In England, with the enactment of s.184 of the *Companies Act*, 1948, the shareholders were at last given the statutory power to remove a director at any time simply by passing an ordinary resolution that he be removed.<sup>16</sup> Similar statutory power was conferred shortly thereafter in Ontario, with the significant distinguishing characteristics that the shareholders' ability to remove a director hinged on the passage of a resolution by a majority of at least two-thirds

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<sup>11</sup> *Imperial Hydropathic Hotel Company, Blackpool v. Hampson* (1882), 23 Ch.D. 1; 49 L.T. 150.

<sup>12</sup> *Companies Act*, 1948, 11 & 12 Geo. VI (U.K.), c.38, s.141(2).

<sup>13</sup> See Gower, *Modern Company Law* 3d ed. (1969), 133.

<sup>14</sup> *Rex v. Richardson* (1758), 1 Burr. 517, 531; 97 E.R. 426, 434 per Lord Mansfield.

<sup>15</sup> *Stephenson v. Vokes* (1896), 27 O.R. 691 (H.C.); see also *London Finance Corp. v. Banking Service Corp.*, [1925] 1 D.L.R. 319; 23 O.W.N. 138.

<sup>16</sup> Subject to requirements of proper notice. See Gower, *Modern Company Law* 3d ed. (1969), 133-134.

of the votes cast at the meeting, and that such statutory power was available only where the letters patent, supplementary letters patent or by-laws of the company did not provide for the election of directors by cumulative voting, as was authorized by s.64 of the *Corporations Act*.<sup>17</sup>

While the shareholder might welcome these changes in principle, it was apparent to the Select Committee on Company Law, appointed in 1965 by the Legislative Assembly of Ontario, that his power of removal should be increased. Recognizing that "probably the most important individual right accruing to the shareholder of an Ontario company is his right to elect the board of directors",<sup>18</sup> the Committee felt not only that there was no reason why the corollary right of director removal should not exist, but also that there appeared to be "no persuasive reason why removal should require a vote in excess of the majority of the votes cast at the meeting duly called for the purpose".<sup>19</sup> Considering the problems in widely held corporations of shareholder apathy,<sup>20</sup> directoral control of both proxy machinery and indeed the shareholders' meeting itself, there were persuasive reasons for an early simplification of the director removal procedure.

The Legislature followed the Committee's recommendation and enacted s.140 of the *B.C.A.* which, as amended, provides as follows:

140. (1) Removal of directors. — Subject to subsection (2) the shareholders may, by resolution passed by a majority of the votes cast at a general meeting duly called for that purpose, remove any director before the expiration of his term of office and may, by a majority of the votes cast at the meeting, elect any person in his stead for the remainder of his term, but, where the directors have been elected by the method of voting provided by section 127, no director shall be removed from office

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<sup>17</sup> R.S.O. 1960, c.71, s.66. It is interesting to note by reference to R.S.O. 1970, c.89, s.67 that the statutory power of removal under discussion is now available only where the letters patent, supplementary letters patent or by-laws of a company *do* provide for the election of directors by cumulative voting. While the *Corporations Act* has had no general application to Ontario companies since 1 January, 1971, when the *B.C.A.* came into effect, that statute still regulates certain species of corporations (see R.S.O. 1970, c.53, s.2). In the light of subsequent discussion herein, it may be concluded that the legislature has rendered the shareholders' power of director removal virtually illusory in the context of these types of corporation.

<sup>18</sup> *Interim Report of the Select Committee on Company Law* (1967), 75, 8.3.4.

<sup>19</sup> *Ibid.*

<sup>20</sup> For a provocative response to this problem, see Fuqua, "End Annual Meetings", *New York Times*, April 23 1972. The writer urges discontinuation of the requirement that annual shareholders' meetings be held. His most dramatic example of apathy is the "highly publicized" 1971 General Motors annual meeting, reportedly attended by no more than 0.1% of stockholders.

where the votes cast against the resolution for his removal would, if cumulatively voted at an election of the full board of directors, be sufficient to elect one or more directors.

(2) *Idem.* — Where a class of shares carries the exclusive right to elect a part of the board of directors, no director so elected may be removed from office before the expiration of his term except by resolution passed by a majority of votes cast at a meeting of holders of shares of the class duly called for that purpose.

It will be recalled that when the right of director removal was originally conferred on Ontario shareholders, it was available only where a company had not adopted the cumulative voting method of electing directors.<sup>21</sup> Under s.140, that right is now available whether or not cumulative voting has been adopted. This being so, however, a proviso has been inserted into the section whose intent is apparently to protect from disruption by the majority shareholders the tenure of a director elected to the Board by the minority. However, *any* director elected under the cumulative voting system is going to be very difficult to dislodge because of the operation of this proviso. It may even be suggested that the promoter/director has been provided with an easy means of self-entrenchment. It is true that if he causes the company to adopt the cumulative voting system provided in s.127, he is greatly enhancing the chance that a minority shareholder will secure representation on the Board.<sup>22</sup> The majority of the Board, however, will have been elected pursuant to the same voting method, and will be able first to override the minority representative in Board deliberations and second to resist any proposal calling for their removal. As shall be shown, a director elected by a majority group of shareholders under the cumulative system will be secure from removal under the section even where a large number of those who elected him are now calling for his head.

### The Cumulative Voting System and Director Removal

In recommending the provision of a cumulative voting system for the election of directors, the Ontario Select Committee was laudably concerned by the fact that under the normal voting system, a majority group of shareholders can elect all of a company's directors, notwithstanding that their block represents a mere 51% of the voting shares.<sup>23</sup> As each vacancy comes up for consideration,

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<sup>21</sup> R.S.O. 1960, c.71, s.66.

<sup>22</sup> But then only if he chooses not to emasculate the system. See *infra*, notes to f.n.29.

<sup>23</sup> *Interim Report of the Select Committee on Company Law (1967)*, 71, 8.2.3.

51% of the voting shares cast for candidate A overpowers the remaining 49% cast for candidate B. The Committee therefore recommended inclusion in the *B.C.A.* of a cumulative voting provision,<sup>24</sup> explaining the mechanics of the system by use of an example to which it is instructive to make reference.

Company A has 10,000 voting shares. 5,100 are held by Group X, 4,900 by Group Y. 9 directors are to be elected. Group X therefore has 45,900 votes, Group Y, 44,100 votes (each figure produced by multiplying the number of each Group's shares by the number of directors to be elected, pursuant to s.127). The Select Committee pointed out that by distributing its votes equally between four favoured candidates for the nine vacancies, giving each candidate 11,025 votes, Group Y will be assured of electing four candidates to the Board. This is because no matter how Group X distributes its 45,900 votes it will be unable to give 11,025 votes to more than 5 candidates. The magic ingredient is Group Y's right to distribute all of its votes as it likes, on the face of it in a "first nine past the post" election.

Clearly there would be little purpose served if the shareholders at the election meeting could first pass a resolution to conduct individual ballots in which all their votes could be used repeatedly for each of the vacancies to be filled. An election conducted in such manner was held to be illegal and void where a company's constitutional document provided for a cumulative voting system.<sup>25</sup> The right of the shareholder to vote cumulatively:

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<sup>24</sup> The section, as enacted, provides as follows:

127. Cumulative voting for directors. — The articles or a special by-law of a corporation may provide that,

(a) every shareholder entitled to vote at an election of directors has the right to cast thereat a number of votes equal to the number of votes attached to the shares held by him multiplied by the number of directors to be elected, and he may cast all such votes in favour of one candidate or distribute them among the candidates in such manner as he sees fit;

and

(b) where he has voted for more than one candidate without specifying the distribution of his votes among such candidates, he shall be deemed to have divided his votes equally among the candidates for whom he voted.

<sup>25</sup> *Wright v. Central California Water Co.*, 8 P. 70 (Cal. S.C., 1885), cited in Campbell, *The Origin and Growth of Cumulative Voting For Directors*, (1955) 10 *The Business Lawyer*, No.3, 3.

...can only be exercised according to the constitutional provision by allowing him to cast his ballot singly, cumulatively, or distributively at one time for the election of directors.<sup>26</sup>

It appears that whether the election be of the "first nine past the post" category or consist of a series of separate ballots, the essential characteristic is that each shareholder will be allowed to use each of his votes but once. While the *B.C.A.* is silent on which of these methods of election is to be employed, the DCBCA expressly provides for a series of individual ballots, unless a unanimous resolution permits two or more persons to be elected by a single resolution.<sup>27</sup> If a far more interesting tactical conflict is likely to ensue where a series of individual ballots is held, and further, if incumbency often confers a decided advantage the more complicated the battle becomes, it can be suggested that the rebellious minority shareholder is better served by holding one ballot for all of the vacancies.<sup>28</sup>

While it is not intended here to assess more than briefly the merits of cumulative voting, its drawbacks must be alluded to as a background to an assessment of the impact of the proviso to s.140(1) of the *B.C.A.* First, it guarantees nothing to the minority shareholder group, which in some cases may not be able to muster sufficient votes to elect even one director. As the number of its votes is directly dependent on the number of vacancies to be filled, it follows that its voting power is vulnerable to a decrease in the number of directors of the company engineered by the majority group.<sup>29</sup>

In Ontario, a company may by special by-law increase or decrease the number of its directors, save a corporation offering its securities to the public, whose number may not be reduced below three.<sup>30</sup> A special by-law requires confirmation by at least two-thirds of the votes cast at a general meeting of shareholders,<sup>31</sup> leaving a

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<sup>26</sup> *Wright v. Central California Water Co.*, 8 P. 70, 73 per McKee, J. (1885).

<sup>27</sup> DCBCA, s.9.06(c). It should be noted that s.9.06 provides that the cumulative voting system will apply to every company incorporated under the Act unless expressly excluded by its articles. Cf. *B.C.A.*, s.127 and Bill C-213, s.101, *supra*, f.n.2.

<sup>28</sup> Any doubts that cumulative voting elections can be complicated may be dispelled by reference to Mills, *The Mathematics of Cumulative Voting*, (1968) Duke L.J., No.1, 28.

<sup>29</sup> See Campbell, *The Origin and Growth of Cumulative Voting for Directors*, (1955) 10 *The Business Lawyer*, No.3, 3, 11.

<sup>30</sup> R.S.O. 1970, c.53, ss.124(1), 122(2)(b).

<sup>31</sup> R.S.O. 1970, c.53, s.1(1).



minority group unable to muster more than one-third of the votes cast entirely defenceless against the reduction.<sup>32</sup>

Alternatively, the minority group may be overborne by the power of the directors to issue shares. In Ontario, their discretion is absolute (subject to their fiduciary duties) unless there is a provision to the contrary in the company's articles or by-laws.<sup>33</sup> In the DCBCA, shareholders are afforded proportionate pre-emptive rights to newly-issued shares, but only in respect of newly-issued shares of the same class as they hold, and only if the articles do not exclude such pre-emptive rights.<sup>34</sup>

It should be added that under both the Ontario and the proposed Federal Act, shareholders holding different classes of shares may have different numbers of votes attached to their shares, subject only to the express provision in Ontario that all shares of a class must have the same voting rights attached thereto.<sup>35</sup> Further, because of differences in the value of the shares, voting rights may not accurately represent the proportion of capital invested by individual shareholders.

Although each shareholder is entitled to a cumulative vote for each share, different par values may distort 'proportional representation'. If a corporation has a capital stock of \$1.1 million consisting of 10,000 shares of \$100 Class A common stock and 100,000 shares of \$1 par Class B common stock (all issued at par), the Class B shareholders have ten times the voting

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<sup>32</sup> DCBCA, s.9.06(h), however protects the minority group by severely impeding the possibility of a reduction in the number of directors. See s.101(h), Bill C-213, *supra*, f.n.2.

<sup>33</sup> R.S.O. 1970, c.53, s.44(1).

<sup>34</sup> DCBCA, ss.5.02(1), 5.05(1). Bill C-213 contains proposals dealing with pre-emptive shareholders' rights. S.25(1) replaces s.5.02(1) and states:

Subject to section 28, shares may be issued at such times and for such consideration as the directors acting in good faith and in the best interests of the corporation may determine.

S.28(1) replaces s.5.05(1) and states:

If the articles so provide, no shares of a class shall be issued unless the shares have first been offered to the shareholders holding shares of that class, and those shareholders have a pre-emptive right to acquire the offered shares in proportion to their holdings of the shares of that class, at such price and on such terms as those shares are to be offered to others.

Thus, for a pre-emptive right to exist, Bill C-213, unlike the DCBCA, requires that it be specifically provided for in the articles of the company.

<sup>35</sup> R.S.O. 1970, c.53, ss.28, 29(2). S.140(2) can be seen as sanctifying the device of attaching to one class of shares the right to elect part of the Board of Directors.

power of the Class A even though their investment in the corporation is only one-tenth that of the Class A.<sup>36</sup>

The shareholders in the Select Committee's hypothetical Group Y, confronted with none of the shortcomings alluded to above, can be forgiven for assuming that they have benefited greatly from the cumulative voting system. While it is true that the proviso to s.140(1) prevents removal of their directors by Group X, it is equally the case that the directors elected by Group X are similarly protected, even if a substantial number of Group X votes join with Group Y to attempt their removal.

Assume that in the original election, Group Y had only 49% (4,900) of Company A's voting shares, and that it now has 87% (8,700) of such shares because a director elected by Group X has proved to be almost universally unpalatable (but has not provided "cause" for removal). Group X has the remaining 13% (1,300). If the full Board consists of nine members, there will be 78,300 votes for removal and only 11,700 votes against. It will be recalled that 11,025 votes were found to be enough to elect a director to the Board. The removal will be thwarted.<sup>37</sup>

It should be noted that the foregoing analysis is based on an interpretation of s.140(1) and s.9.06(g) of the respective Acts to which there are two seemingly absurd alternatives.

Firstly, it may be argued with some cogency that the number of votes that would be sufficient to elect one director to the Board if cumulatively voted at an election of the full Board may be as low as one in the absence of any guarantee regarding how the shareholders might distribute their votes in such an election. Section 9.06(g) of the DCBCA does provide that the hypothetical election is one at which the same total number of votes is cast as at the removal meeting but it is submitted that this does not restrict the distribution of those votes. If this argument were accepted, it would mean that only one vote cast against the removal resolution would be sufficient to defeat it.

Secondly, it could be argued that neither provision authorizes the multiplication of the number of votes available to shareholders at the removal meeting by the number of the full Board of Directors.

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<sup>36</sup> Vierigg, *One Share, Many Votes — Cumulative Voting for Corporate Directors: Constitutional Mandate, Legislative Directive or Neither?*, (1969) 50 Chi.Bar Rec. 415, 417.

<sup>37</sup> See the counterpart to *B.C.A.*, s.140(1), *DCBCA*, s.9.06(g) and Bill C-213, s.101(g), *supra*, fn.2. It has been assumed that 100% of the company's issued shares are voted at the shareholders' meeting.

Reverting to Company A, this would mean that the *total* number of votes available to all shareholders would be only 10,000, an absurd result if the director's supporters are required to muster 11,025 votes against the removal resolution, this being the number of votes "cumulatively voted at an election" of the full Board that is probably intended to be deemed sufficient to elect at least one director. In point of fact, 11,025 *guarantees* the election of one director of Company A. As has been indicated, only one vote may be merely sufficient to elect him.

Both alternatives therefore seem quite implausible. The inescapable conclusion is that the Ontario and proposed Federal provisions render the shareholders' statutory power of director removal almost illusory where a company has adopted or failed to exclude the cumulative voting procedure. While it is true that some protection against the removal of directors elected under the cumulative system is desirable in principle, it can be argued that minority shareholders would be better served by the repeal of the cumulative voting proviso, particularly in view of the fact that a cumulative voting system, if adopted, is susceptible of emasculation. If a minority group has been able to elect a representative to the Board under an undiluted cumulative procedure, he will admittedly then be liable to removal at any time by holders of a bare majority of the votes cast. It may be thought, however, that this is the lesser of two evils, requiring an active and visibly unfair practice on their part. A potential alternative is a covert emasculation of the cumulative voting procedure even as it is adopted in a company's constitution coupled with a reliance on such adoption by promoter/directors who seek immunity from the shareholders' statutory power to remove them.

Failing repeal of the cumulative voting proviso, Ontario shareholders can be thankful that the Legislative Assembly took heed of the warning that in view of "the uncertainties which surround the true value of the cumulative voting system, the Committee does not recommend that cumulative voting be made mandatory for Ontario companies".<sup>38</sup>

### **Contracts of Service**

It is not only the cumulative voting provision that can seriously undermine the shareholders' statutory power to remove directors. Contracts of service between a company and its directors can also be said to interfere with that power, although the extent to which this is the case in Canada is still uncertain.

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<sup>38</sup> *Interim Report of the Select Committee on Company Law* (1967), 73, 8.2.6.

In England, it has become clear that such a contract, while not capable of directly nullifying the statutory power of removal, nevertheless can indirectly subvert it by making its exercise prohibitively expensive.<sup>39</sup> This, it is suggested, is the result of a combination of two factors. First, the effect of the decisions in *Southern Foundries Ltd. v. Shirlaw*<sup>40</sup> and *Shindler v. Northern Raincoat Co. Ltd.*,<sup>41</sup> where directors were removed without cause by the shareholders under a power set out in the Articles of Association, has in effect made it impossible to remove directors in many cases. In each case, the articles provided for the termination of the director's appointment as managing director of the company automatically upon his removal from office as director. The director, while unable to impeach the exercise of the power, was successful in his suit for damages for wrongful dismissal. The second factor is the express provision in a sub-section to s.184 of the *Companies Act, 1948*<sup>42</sup> that conferral on the shareholders of statutory power to remove directors is not to be taken as depriving a person removed thereunder of any right he may have to compensation or damages arising out of the termination of his appointment or of any appointment terminating with that of director. In addition, the sub-section provides that the conferral of the statutory power is not to be taken as a derogation from any power to remove a director which may exist apart from s.184.

In Canada, the uncertainty flows from the absence of an equivalent to this sub-section. The relevant legislation is silent on whether conferral of the statutory power of dismissal precludes either rights to compensation of terminated directors or any other means by which they might be removed.

It is clear, at least, that a director who is removed for cause under the statutory power will be unable to sue on his contract. Provision by a "faithless fiduciary" of cause for his removal amounts to a breach of his contract of service entitling the company to treat it as discharged.<sup>43</sup> While Canadian courts undoubtedly will have to grapple with the question of what may constitute cause, it is submitted that clear guidance can be obtained from the United States, where, in the frequent absence of a statutory power of removal without cause, shareholders have often sought to establish cause

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<sup>39</sup> Gower, *Modern Company Law* 3d ed. (1969), 134.

<sup>40</sup> *Southern Foundries Ltd. v. Shirlaw*, [1940] A.C. 701; [1940] 2 All E.R. 445 (H.L.).

<sup>41</sup> *Shindler v. Northern Raincoat Co. Ltd.*, [1960] 2 All E.R. 239; [1960] 1 W.L.R. 1038.

<sup>42</sup> S.184(6).

<sup>43</sup> *Application of Burkin*, 136 N.E. 2d 862 (C.A. N.Y., 1956).

for director removal. It requires little effort to agree with American courts that a breach of fiduciary duty by a director amounts to cause for removal<sup>44</sup> or that conversely no cause for removal is established unless the director concerned has performed some acts of non-feasance or mis-feasance.<sup>45</sup> The correct principle, it may be suggested, is that whenever a director is in breach of his duties of care and skill and this involves loss to the company, or is in breach of his fiduciary duties, he has provided cause for his removal. While under the statutory power he may be removed without cause, his "breach of implied condition of a contract of service" will prevent his recovery of damages on the contract.

The larger and more interesting task remains — to delineate the significance of a provision giving shareholders a power of director removal without mention of the effect thereof either on a dismissed director's right to sue on his contract of service or on the methods by which he might have been removed.

An argument that the courts should be consistent in their respective decisions on whether the enactment of the statutory power excludes rights of action by dismissed directors and other means of removing them is superficially unattractive. It seems open to the criticism that these ancillary matters are different in kind to the statutory power. It can be suggested, however, that in both cases, similar questions may be asked. Does recognition of a right in a director removed pursuant to the statutory power to sue for damages for breach of contract conflict with that statutory power? Is a by-law conferring power on a company's president to immediately remove any director by serving him notice in writing incompatible with the statutory power?

In both cases, it is possible to answer yes. The right of a dismissed director to damages for breach of his contract of service in one sense may not directly conflict with the statutory power but it most certainly does with its exercise. As will be suggested below, a by-law providing for removal of a director by his president, while not appearing to conflict with the shareholders' power of removal, most certainly interferes with its exercise. However, the possibility that Canadian courts will be prepared to find such a conflict and thus strike down a director's claim for damages and by-laws containing other means of removal is remote.

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<sup>44</sup> *Brown v. North Ventura Road Development Co.*, 30 Cal.Rptr. 568 (Dist. C.A., 1963).

<sup>45</sup> *Elevator Operators & Starters Union Local 117 of San Francisco v. Newman*, 186 P. 2d 1 (Dist. C.A., 1963).

It may be added that the consistency of approach that has been suggested can be viewed as undesirable. It could be argued that directors ought to be entitled to the rights that they are able to negotiate with their companies, especially where they have not provided cause for their removal. This may be a determining factor in their decision to become directors. In addition, it may be suggested that there is a very great difference in degree in their conflict with the statutory power between a contractual right merely rendering it more expensive to remove a director and a by-law that renders such removal pointless.

### Director Removal by the Board

Prior to the enactment of the shareholders' statutory power of director removal, a director could be removed before the expiration of his term if provision was made in the company's by-laws.<sup>46</sup> Following the enactment, it is necessary to examine the relationship between the statutory and the "contractual" powers of removal. What, in particular, is the effect of a by-law conferring on the directors the power to remove a director? A by-law conferring power on the shareholders presumably will not be allowed to dilute the statutory power for there might then be a direct and unacceptable conflict between the two powers. Thus a by-law to provide for director removal by shareholders on passage of a resolution by two-thirds of the votes might be incompatible with the statutory power if there are more than three directors.

That a by-law conferring power of removal on the directors would be struck down is, however, far from clear, despite the fact that there is a demonstrable if indirect conflict between such a by-law and the statutory power of the shareholders. In *Bersel Manufacturing Co. Ltd. v. Berry*,<sup>47</sup> the House of Lords was confronted with a husband and wife who were appointed life directors of a company by the articles of association. Such an appointment would be invalid in Ontario, since the *B.C.A.* requires that directors shall be elected by the shareholders in general meeting and that this election shall take place yearly or at such other interval, not exceeding five years, as is provided by the articles of incorporation.<sup>48</sup> A power was conferred on these permanent life directors by a further article to "terminate forthwith the directorship of any of the ordinary directors by notice in writing". The wife having died, the question for the

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<sup>46</sup> At p. 88.

<sup>47</sup> *Bersel Manufacturing Co. Ltd. v. Berry*, [1968] 2 All E.R. 552 (H.L.).

<sup>48</sup> R.S.O. 1970, c.53, s.126.(1) (2). See *DCBCA*, s.9.05; Bill C-213, s.100.

House of Lords to decide was whether this power of director removal could be exercised by the surviving husband alone. The learned Law Lords, in deciding that it could, did not dwell on the propriety of an article that in effect created a "revolving door" situation, under which a privileged director could repeatedly dismiss directors elected to the Board by concerned shareholders, replacing, for example, directors removed under the statutory power. In the concluding words of Lord Wilberforce, "the reality is that the power of appointing (art. 12) and of removing directors (art. 16H) operates as a suspension, while it lasts, of the powers of the shareholders".<sup>49</sup>

There was no question but that the articles of association could confer on a privileged director the power of appointment and removal of ordinary directors. While in Ontario the permanent life director is a species prohibited under s.126 of the *B.C.A.* and a by-law conferring on him the power to appoint directors would be invalid as incompatible with that section, there is nothing to prevent the conferral of such a power of removal on "the president from time to time of the company", unless it is decided that such a by-law conflicts with the statutory power and accordingly is invalid. It may be argued that were it not for s.184(6) of the *Companies Act*, 1948, the House of Lords would have struck down the removal article as conflicting with the statutory power. In fact, the subsection was not discussed by the learned Law Lords and it is a matter of conjecture whether their assumption that the article was valid was made because such articles had always been valid or because of the subsection.

There is, however, no analogue in the Canadian legislation being considered to that section. It is therefore open to a Canadian court to invalidate such a by-law because, unlike the English courts, it is not obliged to overlook the conflict between it and the shareholders' statutory power. However, Canadian courts will likely follow the House of Lords in its seemingly automatic assumption of validity.

Another House of Lords decision, *Bushell v. Faith*,<sup>50</sup> indicates that Canadian courts confront a strong trend of judicial non-interference from which they may find it difficult to depart. By a four to one majority, the Law Lords upheld a by-law conferring on a director three votes for each share held by him for the purposes of voting on a resolution calling for his removal. The House was not prepared to hold that such a by-law was invalid as conflicting with

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<sup>49</sup> *Bersel Manufacturing Co. Ltd. v. Berry*, [1968] 2 All E.R. 552, 558 (H.L.).

<sup>50</sup> *Bushell v. Faith*, [1970] 1 All E.R. 53; [1970] 2 W.L.R. 272 (H.L.). For a learned comment, see Collier, (1970) 28 Camb. L.J. 41.

s.184 of the *Companies Act*, 1948, the source of the equivalent shareholder power in England. Lord Morris of Borth-Y-Gest, the dissenting Law Lord, recognized that some shares may carry greater voting power than others, but said that this did not justify the device in question, which gave to the director's shares greater voting power only where a resolution for his removal was being considered. The difference between this by-law and one flatly making the director irremovable was only one of degree. He agreed with the learned judge "that to sanction this would be to make a mockery of the law".<sup>51</sup>

While the specific by-law in question would not be upheld in Ontario because it contemplates inequality of voting power between shares of the same class,<sup>52</sup> the decision indicates the unlikelihood that the courts will invalidate by-laws that clearly interfere with the shareholders' statutory power, yet are not expressly prohibited.

The United States provides no direct assistance as a source of authority on this question, mainly because few statutes there contain a corresponding statutory power of removal.<sup>53</sup> On the other hand, American decisions have struck down devices that, while not expressly prohibited by a given corporation statute, are found to contravene state constitutional provisions guaranteeing cumulative voting for corporate directors.<sup>54</sup> It is not likely, however, that the Canadian courts will be moved by such analogies and they will probably follow the English cases.

Accordingly, the compelling conclusion is that legislative action will be necessary to forestall emasculation of the statutory power by a by-law conferring on a privileged director the right to remove other directors at will. The cumulative voting proviso to s.140(1) of the *B.C.A.*<sup>55</sup> might be urged as protecting at least those directors who are elected under a cumulative voting system from such arbitrary removal. It is suggested, however, that while the proviso protects such directors from removal by a bare majority of shareholders, its wording does not evidence an intention on the part of the legislature to protect them from removal by other directors. Even if this conclusion be incorrect, it is submitted that legislative action is necessary since the protection inherent in the proviso extends only to directors elected cumulatively.

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<sup>51</sup> *Bushell v. Faith*, [1970] 1 All E.R. 53, 54; [1970] 2 W.L.R. 272, 275 (H.L.).

<sup>52</sup> R.S.O. 1970, c.53, s.28.

<sup>53</sup> Travers, *Removal of the Corporate Director during his Term of Office*, (1967) 53 Iowa L.Rev. 389.

<sup>54</sup> See generally Vieregg, *One Share, Many Votes*, (1969) 50 Chi.Bar Rev. 415.

<sup>55</sup> See *DCBCA*, s.9.06(g) and Bill C-213, s.101(g), *supra*, f.n.2.



### Conclusion

It must be remembered that the company, its directors and shareholders each have interests that require balancing. It is particularly easy to fall into the trap of assuming that all developments that can be said to aid the shareholder in his relationship with the director are welcome, and to forget the plight of the director. This is understandable because the shareholder has for so long been something less than the director's equal.

In the course of the foregoing discussion, it has been suggested that the statutory power conferred on shareholders to remove directors is not as great as it appears *in vacuo* or as it seems the Legislature intended. In Ontario, where the shareholder has been given unprecedented licence to intervene in the affairs of the Board of Directors,<sup>56</sup> these shortcomings may not be worth redressing. Indeed, to redress them might be to upset the balance of interests too far in the shareholder's favour.

It may be suggested, however, that if the DCBCA is to become the new Dominion Companies Act, it will not upset the balance of interests to remedy these shortcomings in that context.

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<sup>56</sup> R.S.O. 1970, c.53, s.101; see *supra*, f.n.2.