Directors' Duties in the 'Vicinity of Insolvency': Why a Fiduciary Duty to Creditors Should not be Triggered

Michael Byers

April 2011

The extent of the duties of directors of corporations that are insolvent, or near-insolvent, has become a timely topic over the past decade. After scandals led to the collapse of Enron and WorldCom, corporate behaviour began to attract greater attention from the public. Towards the end of the decade, the global financial crisis forced former corporate titans like Lehman Brothers in bankruptcy and others such as the once-mighty General Motors into government-sponsored restructuring. While the global financial system has emerged (relatively) intact, the road to recovery is expected to be slow and the years going forward may well continue to be marked by economic volatility.

In *Peoples Department Stores Inc. (Trustee of) v. Wise*, the Supreme Court of Canada held that directors of financially troubled corporations only owe a fiduciary duty to the corporation itself, and not to that corporation's creditors.[1] This paper will defend this approach to director's duties, and argue that creditors should not become beneficiaries of a fiduciary duty when a corporation is on the brink of insolvency. Section A of this paper will provide an overview of the statutory framework governing director's duties in Canada and offer a brief summary of relevant aspects of the *Peoples Department Stores* decision. Section B will posit the argument that the notion of a "vicinity" of insolvency is inherently vague and suggest that imposing a shifting fiduciary duty towards creditors at such a point in time would hinder the ability of directors and officers to exercise their business judgement. Section C will discuss how owing a fiduciary duty to creditors would undesirably limit the degree to which directors may take into account other important stakeholder interests. Section D will explore the idea that creditors do not require the benefit of a fiduciary duty to ensure that their interests are adequately protected.

[1] 2004 SCC 68, [2004] 3 S.C.R. 461. [*Peoples Department Stores*]

A) The Canadian Legal Landscape: Directors Fiduciary Duties and the *Peoples Department Stores* Decision

The *Canada Business Corporations Act*[2] establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, a corporation. The first (and the one with which this paper is primarily concerned) is what Major and Deschamps JJ, writing for the Court in *Peoples Department Stores*, referred to as the statutory fiduciary duty or "duty of loyalty." This consists of the obligation to "act honestly and in good faith with a view to the best interests of the corporation." The second is the "duty of care," which requires directors to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."[3] With regard to their obligations under the former, Major and Deschamps JJ held that directors and officers

> must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit...Directors and officers must serve the corporation selflessly, honestly and loyally.[4]

The trial judge in *Peoples Department Stores*, relying on decisions from the United Kingdom, Australia and New Zealand, held that the fiduciary duty under s. 122(1)(a) of the *CBCA* extended to a company's creditors when a company is insolvent or in the vicinity of insolvency. He found as a fact that the Wise brothers (directors of Peoples Department Stores) had implemented a corporate policy that was detrimental to the interests of Peoples' creditors. Because the policy

---

[2] R.S., 1985, c. C-44. [*CBCA*]
[3] *CBCA*, s. 122(1).
[4] *Peoples Department Stores*, *supra* note 1, at para 36.

was implemented when the corporation was in the vicinity of insolvency, the Wise brothers were liable for breach of the fiduciary duty they owed to creditors of Peoples.[5]

The Supreme Court of Canada, affirming the decision of the Quebec Court of Appeal, overruled the trial judge. The Court reasoned that the Wise brothers were faced with a difficult situation and responded by implementing a policy that they genuinely hoped would resolve Peoples' financial troubles. Since the Wise brothers did not have a personal interest or improper purpose in implementing the policy, and given evidence that their actions were aimed at making Peoples a "better" corporation, the Court found that they did not breach their statutory fiduciary duty.[6] Major and Deschamps JJ were clear that

> [t]he various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the *CBCA*. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[7]

While it noted that creditors' interests increase in relevance to the governance of the corporation as its finances deteriorate, the Court was clear that creditors are never owed a fiduciary duty. The rest of this paper will discuss three principal reasons why this should be the case.

B) The Notion of a Vicinity of Insolvency is Vague and Impractical

If a fiduciary duty towards creditors is found to exist, the precise time at which it is triggered must be established. Demarcating such a point involves the dubious presumption that such a situation can be legally defined. As Major and Deschamps JJ wrote in *Peoples Department Stores*, the "vicinity of insolvency" is a "nebulous" term which is "incapable of

[5] *Peoples Department Stores (Trustee of) v. Wise* (1998), 23 C.B.R. (4th) 200, [1998] Q.J. No. 3571 (Qc. Sup. Ct.).
[6] *Peoples Department Stores, supra* note 1, at para 41.
[7] *Ibid*, at paras 42-43.

definition and has no legal meaning."[8] Further, supposing that such a situation can be properly defined, imposing a legal test for when this ought to be done would involve a judicial usurpation of directorial discretion.

Pamela Huff and Russell Silberglied point out two primary rationales for expanding directors' fiduciary duties to include creditors.[9] The first, the "trust fund theory," assumes that directors of an insolvent corporation hold the company's assets in trust for benefit of creditors. When a corporation is insolvent there is, by definition, little or no equity remaining. If a corporation is in the vicinity of insolvency then shareholders claims are on the verge of (likely) being wiped out and creditors become the main claimants to the corporation's residual value.[10] The second rationale is the "at risk" theory. As a corporation teeters on the edge of insolvency, shareholders tend to prefer that directors pursue high-risk strategies to increase the chances of the corporation's survival, or the maximization of the value of their residual claim. Creditors, by contrast, will generally favour a more conservative course that is likely to preserve the value of the corporation's assets. Since it is the creditors who are most likely to suffer harm, they are arguably the more vulnerable stakeholders in need of legal protection.[11]

Fiduciary relationships, although their exact nature will vary depending on the particular relationship in question, tend to arise from relationships marked by discretionary power and

---

[8] *Peoples Department Stores, supra* note 1, at para 46.

[9] Pamela L.J. Huff & Russell C. Silberglied, "From *Production Resources* to *Peoples Department Stores*: A Similar Response by Delaware and Canadian Courts on the Fiduciary Duties of Directors to Creditors of Insolvent Companies" [2006-2007] J. Bus. and Tech. Law 455 at 461-2.

[10] However, as noted by the Delaware Court of Chancery in *Production Resources Group v. NCT Group, Inc.*, 863 A. 2d (Del. Ch. 2004) ("*Production Resources*"), it is not entirely accurate to refer to creditors of insolvent corporations as the company's sole residual risk bearers. Just because a company is insolvent does not mean that it cannot leave some value for equity. One of many problems with shifting a fiduciary duty to creditors is that they have no incentive to push the company to take a course of action leading to this result. At 790, n. 57. Cited *Ibid*, at pg 464

[11] For a more extensive discussion of shifting stakeholder interests in corporate insolvency, see Edward M. Iacobucci, "Directors Duties in Insolvency: Clarifying What is at Stake" (2003) 39 Cdn. Bus. LJ 398.

trust. They tend to involve a duty of loyalty and "the avoidance of a conflict of duty and interest and a duty not to profit at the expense of the beneficiary."[12] However, the nature of fiduciary duties makes imposing a fiduciary duty to creditors at a specific point problematic. Giving creditors the benefit of a fiduciary duty when a corporation is on the verge of insolvency implies that it is possible to identify a point in time where all other stakeholders cease to have a meaningful interest and at which point it could be fairly said that directors ought to owe a "duty of loyalty" solely to creditors. As one commentator has noted, "attempting to find the exact point in a corporation's life where only the creditors have an economic interest in the company amounts to an almost insoluble problem."[13]

Imposing a fiduciary duty on directors to act in the best interests of creditors may also place pressure on directors that may have a negative impact on the corporate enterprise as a whole. Vladimir Jelsavcic has argued that the 'vicinity of insolvency' test

> [e]xposes directors to liability for breach of fiduciary duty to creditors without clearly defining the point at which this new duty springs forth. This poorly defined, potentially large personal liability could chill directors' exercise of their business judgement when confronted with difficult choices. Directors may feel constrained to make overly-conservative decisions when they are unsure whether their corporation is in the 'vicinity of insolvency.'[14]

The *Peoples Department Stores* model has the virtue of consistency and avoids the predicament of an ill-defined moment where the fiduciary duty shifts. On the other hand, as Karen Bily has noted, a corporation is an artificial entity that does not really have a 'best interest;' it cannot

---

[12] *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, at pp. 646-47, 61 D.L.R. (4th) 14 cited in *Peoples Department Stores*, *supra* note 1. See also *K.L.B. v. British Columbia*, 2003 SCC 51, [2003] 2. S.C.R. 403.

[13] Carina Neumueller "A Canadian Solution: Recent Developments in the Law of Directors' Duties in the Context of Financially Distressed Corporations" (2005) 14 Dal. J. L. Stud. 91.

[14] Vladimir Jelisavcic, "A Safe Harbour Proposal to Define the Limits of Directors' Fiduciary Duty to Creditors in the 'Vicinity of Insolvency'" [1992] Journal of Corporation Law 145 at 159, cited in Andrew Keay, "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" (2001) 25 Melbourne University Law Review 315 at 331.

logically experience the benefits derived from managerial decision-making.[15] *Peoples Department Stores* did not clarify how directors should balance the competing claims of stakeholders where those interests are adverse or irreconcilable. On balance, though, this is a positive development. Directors often have business experience and expertise that courts do not and are better placed than courts to resolve tensions between stakeholders. As noted by the Delaware Court of Chancery in *Production Resources*, good reason exists to "doubt the wisdom of a judicial endeavour to second-guess good-faith director conduct in the so-called zone."[16]

The Delaware Supreme Court held in *North American Catholic Programming Foundation, Inc. v. Gheewalla* that creditors of a corporation that is either insolvent or in the zone of insolvency may not assert direct claims for breach of fiduciary duty against a corporation's directors.[17] The Court in that case affirmed *Production Resources,* where it was noted that creditors receive the benefit of other forms of legal protection, both inside and outside of insolvency.[18] Assuming that a corporate board has complied with other legal obligations owed to creditors, the Court in *North American Catholic* held that a board should "ordinarily be free to take economic risk for the benefit of the firm's equity owners, so long as the directors comply with their fiduciary duties to the firm by selecting and pursuing with fidelity and prudence a plausible strategy to maximize the firm's value."[19] *Peoples Department Stores* contains similar reasoning. The fiduciary duty of the board of directors is, and should be, at all

---

[15] Karen Bily, "Corporate Managers and the Wide Discretion for their Fiduciary Duties: Problematic or Not?" (LLM Thesis, University of Toronto, 2009) [unpublished].
[16] *Supra* note 10, at pg. 790, n.57.
[17] No. 521, (2006), 2006 WL 1453705. ("*North American Catholic*") This was the first decision by the Delaware Supreme Court on this issue; it confirmed some earlier decisions by the Court of Chancery.
[18] *Production Resources*, *supra* note 10, at 788-90. See part D below for further discussion of these other protections.
[19] *Ibid* at 90. It was also noted in *Production Resources* that recognizing a fiduciary duty to creditors in the "zone of insolvency", could lead to litigation problems for companies when the duty to the company to as a whole conflicts with the interests of the creditors. Directors could potentially be exposed to competing suits for failing to act in the best interests of both parties where there are mutually exclusive outcomes. At 789, n 56.

times directed towards creating a "better" corporation and not favouring the interests of any one group of stakeholders. While changing economic circumstances will certainly alter what is in the best interests of the entire corporate enterprise, and may cause the interests of creditors – forming part of the whole – to increase in relevancy, the fiduciary duty should not shift away from the corporation.

C) A Fiduciary Duty to Creditors Would Prejudice Other Stakeholder Interests

In *Peoples Department Stores,* the Court clarified that "the best interests of the corporation" should not be confused with the "best interests of shareholders." While, from an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation, broader considerations may legitimately figure into directorial discretion:

> in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[20]

In *BCE Inc. v. 1976 Debentureholders* ("*BCE*"), the Supreme Court of Canada – in another unanimous decision – further explained the content of the statutory fiduciary duty. The Court held directors' fiduciary duty requires directors to "act in the best interests of the corporation viewed as a good corporate citizen." This means that directors "may be obliged" to consider the impact of their decisions on corporate stakeholders in particular circumstances (such as in the case of the debenture holders in *BCE*). As noted in both *BCE* and *Peoples Department Stores*, this does not usually present a problem, because these interests generally coincide. But these

[20] *Peoples Department Stores, supra* note 1, at para 42. Many scholars have taken issue with the basis this statement. For example, Darcy L. MacPherson has argued that the Court's justification for this statement was not supported by previous case law which it cited in support. See MacPherson, "The Supreme Court Restates Directors' Fiduciary Duty: A Comment on *Peoples Department Stores v. Wise*" (2005-06) 43 Alta LR. 383.

interests may conflict where, for example, a corporation is struggling financially (as in *Peoples Department Stores*) or where a company is entering into a particular transaction (as in *BCE*). Where these interests do conflict, the Court unanimously held in both cases that directors owe their duty to the corporation and not to particular stakeholders.[21]

Some have taken issue with this formulation of the fiduciary duty. Bily has argued that granting wide discretionary power to directors in managing the corporation raises the issue of directors having "too many masters" to which they must be accountable.[22] However, with respect, this criticism mischaracterizes the Supreme Court's formulation of the issue. There is no master/servant relationship between directors and shareholders; creditors; employees; or any of the other stakeholders that the Court in *Peoples* expressly identified as deserving of directorial consideration. The board's only "master" is the corporation itself; directors never have to "obey" any other stakeholder. Similarly, Brian Morgan and Harry Underwood have maintained that where shareholders and creditors interests conflict – such as in the vicinity of insolvency – directors "face the prospect of squaring the circle" where they must "serve" both interests.[23] There is, however, no obligation to square anything. If a corporation finds itself in the vicinity of insolvency, directors may take a particular course of action that may have an adverse effect on its creditors if, in the board's *bona fide* exercise of its business judgement, such an act is in the best interests of the whole company. This satisfies their fiduciary duty. Directors do not have the license to entirely disregard the interests of any particular group of stakeholders but rather should

[21] *BCE Inc. v. 1976 Debentureholders,* 2008 SCC 69 at para 66, [2008] 3 S.C.R. 560. *Peoples Department Stores, supra* note 1, at para 44.
[22] Bily, *supra* note 15, pp. 54-55.
[23] Brian Morgan and Harry Underwood "Directors' Liability to Creditors on a Corporation's Insolvency in light of the *Dylex* and *Peoples Department Stores* Litigation" (2004) 39 Can. Bus. LJ. 336, at 354. It should be pointed out, in fairness, that Morgan and Underwood were writing prior to the Supreme Court of Canada's decision in *Peoples Department Stores* and five years before *BCE*. Their point was more one of identifying a specific issue raised by the conference of a wide degree of discretion on directors, rather than a criticism of any particular approach.

use their discretion to determine the particular set of interests that align with the corporation's in a given situation.

Imposing a fiduciary duty on directors *vis-a-vis* creditors is that such a duty would create conflict with directors' other obligations. It would necessarily imply that, at the point of the vicinity of insolvency, directors should exclude from their consideration the interests of shareholders and other stakeholders, unless those interests coincide with those of the firm's creditors. However, shareholders only cease to have an interest in a company if there are no practical circumstances in which the company can continue as a going concern. As Morgan and Underwood have noted, it is precisely at the moment of insolvency or looming insolvency where "shareholders' interests, the same as creditors', are at their most pressing: they risk losing it all." Furthermore, shareholders lack the contractual protections that many creditors will have bargained for, which offer additional safeguards to creditors in such a situation.[24]

As noted previously, the Court in *Peoples Department Stores* held that directors "must avoid conflicts of interest with the corporation" and must serve the corporation "selflessly, honestly, and loyally."[25] Assuming that a fiduciary duty towards creditors would take on a similar legal character once it was triggered, it is hard to square such a duty with how directors' roles have been historically understood. As noted by the Supreme Court of Delaware in *North American Catholic,* recognizing that directors of an insolvent or near-insolvent corporation owe direct fiduciary duties to creditors would create

> a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors. Directors...must retain

[24] *Ibid*, at pg 355.
[25] *Peoples Department Stores, supra* note 1, at para 36.

> the freedom to engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation.[26]

The last point is particularly important; it shows the practical necessity of conceptualizing of directors and creditors as arms-length parties. As Pelletier J.A. of the Quebec Court of Appeal pointed out in his reasons in the *Peoples Department Store* case, recognizing a fiduciary duty would establish "a general regime of director liability of benefit to third parties aggrieved by the management acts of directors."[27] It would imply that the corporation is "likely to become the property of the creditors solely because bankruptcy is imminent."[28] Another problem, as one commentator has noted, is that the interests of all a corporation's creditors may not coincide. Unsecured and secured creditors may, for example, have adverse interests if a company is considering a risky strategy that may enhance the value of unsecured claims.[29] While, as Pelletier J.A. recognized, creditors' interests in the management of a company may increase as it nears insolvency, directors are never really acting on behalf of the creditors but rather on behalf of the whole corporation.[30]

Not only would recognizing a fiduciary duty to creditors impede the ability of directors to take into account the financial interests of other stakeholders, it could also affect their ability to take into account other non-monetary interests. *Peoples Department Stores* and *BCE* are laudable for providing directors with some legal authority for managing the corporation in a

---

[26] *North American Catholic*, *supra* note 17, at pg 23.
[27] *Peoples Department Stores Inc. (Trustee of) v. Wise*, (2003), 41 C.B.R. (4th) 225, 224 D.L.R. (4th) 509 at para 68 (Que CA); para 92. Quoted in Morgan and Underwood, *supra* note 23, at 358.
[28] *Ibid*, at para 92.
[29] Stephane Rousseau, "La reconfiguration du devoir de loyaute des adminstrateurs de societe par action: de Charybde en Scylla?' (2000) 102 La revue de notariat 7 at 31. Quoted in Janis Sarra, "Taking the Corporation Past the Plimsoll Line: Director and Officer Liability when the Corporation Founders" (2001) 10 Int'l Insolv. Rev, 229 at 239.
[30] *Peoples Department Stores*, *supra* note 27.

socially responsible manner.[31] Creditors, by contrast, are primarily concerned with being repaid when a company is in the vicinity of insolvency. Recognizing a fiduciary duty to creditors would inhibit the ability of corporate directors to bargain strongly with creditors for the benefit of other stakeholders and to increase the odds of a company's survival. While, in many situations, creditors will have an interest in seeing a company survive, this is not always the case. Directors should not be put in a position where they are essentially acting as trustees for creditors, given that there are many other constituencies that are in a weaker bargaining position.

D) Creditors do not Require a Fiduciary Duty to Adequately Protect their Interests

In discussing the "striking similarity" between the approaches taken by Canadian and American courts in *Peoples Department Stores* and the *Production Resources*, Huff and Silberglied note how the two courts both concluded "that fiduciary duty law should not be used to fill in nonexistent gaps where other, existing laws already protect creditors."[32]

The most obvious means that creditors have of protecting themselves is via contract. Why should the law protect creditors where they have entered into freely negotiated arrangements in which they have failed to protect themselves by, for example, securing secured creditor status? A riskier loan comes with a higher rate of return. Creditors can (and do) take contractual measures to protect themselves from shareholder or director opportunism.[33] However, aside from senior secured lenders, who may be able to negotiate protective covenants, most creditors will not have any real oversight of the companies to which they extend credit.

---

[31] See para 42 of *Peoples Department Stores*, *supra* note 1 and para 81 of *BCE*, *supra* note 21.
[32] Huff and Silberglied, *supra* note 9, at pg. 457.
[33] Iacobucci, *supra* note 11, at pg. 408. Professor Iacobucci notes that many of these protections may not be effective in the vicinity of insolvency. For example, given limited liability, shareholders and their agents may not be concerned about liabilty for damages for breaching a debt contract in insolvency. However, he also point that this problem can be avoided in many cases by imposing personal guarantees in the case of closely held corporations where the risk of self-dealing by director shareholders is strongest.

Shareholders, by contrast, elect directors (many of whom will often also be shareholders). It is impossible to account for all possible future contingencies when negotiating a contract, and attempting to do so would lead to prohibitive transaction costs, particularly for smaller trade creditors. In some cases, smaller creditors may be at an inequality of bargaining power and negotiated contracts for the extension of credit may not leave some creditors adequately protected.[34] However, although contract alone may not offer sufficient protection for many creditors, other remedies do.

In *Peoples Department Stores*, Major and Deschamps JJ quoted a commentator who described the oppression remedy, which is available under the *CBCA* and provincial corporations statutes, as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world."[35] The Court held in *BCE* that the oppression remedy analysis should be approached in two steps. First, a court should look to the principles underlying the remedy, in particular at a stakeholder's reasonable expectations.[36] If a breach of reasonable expectations is established, a court should look to whether the conduct complained of amounts to "oppression", "unfair prejudice" or "unfair disregard" as set out in s. 241(2) of the *CBCA.*[37]

What constitutes a reasonable expectation is fact specific and contextual, and is complicated by the fact that different stakeholders in a corporation may have conflicting

[34] Morgan and Underwood, *supra* note 25, at pg. 339. It is also worth noting that involuntary creditors, such as tort claimants, have no power to negotiate covenants, and most trade creditors cannot practically do so. It should be pointed out, though, that while prior to the credit crisis borrowers may have been in a stronger bargaining position *vis*-a-*vis* lenders, it would be very difficult to argue that they are in such a position given the current economic situation.

[35] Stanley M. Beck, "Minority Shareholders' Rights in the 1980s" in *Corporate Law in the 1980s,* (Don Mills, ON: Richard de Boo, 1982), 311 at 312. *Supra* note 1, at para 48.

[36] The concept of reasonable expectations is fact specific and contextual. But from a survey of the case law the Court in *BCE* found that factors that a court should consider in determining what constitutes a party's reasonable expectations include general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and agreements; and the fair resolution of conflicting interests between corporate stakeholders. *Supra* note 21, at para 72.

[37] *Ibid,* at para 56.

interests. While all stakeholders are entitled to expect fair and just treatment, the Court in *BCE* was clear that "the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation."[38] This makes practical and intuitive sense. Creditors may, for example, demand that a struggling debtor post additional collateral or refuse to compromise on a repayment plan. Why should creditors expect debtors to behave with less self-interest than they themselves do? As Janis Sarra has noted, the specific content of what constitutes a particular stakeholder's "reasonable expectations" will shift with a company's fortunes. When a company is healthy and solvent, creditors will expect that the debtor comply with the terms and conditions under which credit is extended. As a company approaches insolvency,

> creditors may reasonably expect that the actions of the corporation and its directors and officers will continue to be in the corporation's best interest, having regard for the parties that hold the residual economic interest in the company; and a reasonable expectation that directors will not act to unnecessarily deplete corporate assets or inappropriately direct resources to themselves.[39]

The oppression remedy offers protection to creditors beyond that which they are likely to obtain in any contract because it is focused on the concept of what is fair and equitable rather than on legal rights.[40] Creditors may also, subject to a court's discretion, bring oppression claims in the context of a proceeding under the *Bankruptcy and Insolvency Act*[41] or the *Companies Creditors Arrangement Act*.[42] As the Court held in *Peoples Department Stores*, the availability of the oppression remedy as a possible mechanism for creditors to protect themselves from the

---

[38] *Ibid*, at para 66.
[39] Janis P. Sarra, "Creating Appropriate Incentives, A Place for the Oppression Remedy in Insolvency Proceedings" in J.P. Sarra, ed. in chief, *Annual Review of Insolvency Law 2009* (Toronto: Carswell, 2010) 99 at 101.
[40] *BCE*, *supra* note 21, at para 71.
[41] R.S., 1985, c. B-3. [*BIA*]
[42] R.S., 1985, c. C-36. [*CCAA*] See, for example, *Re Sammi Atlas Inc.* (1998), 36 B.L.R. (2d) 318, 49 C.B.R. (3d) 165 (On. Gen. Div. [Commercial List]). *Harbert Distressed Investment Master Fund Ltd.* v. *Calpine Canada Energy Finance II ULC* (2005), 2005 CarswellNS 342, [2005] N.S.J. No. 317 (N.S. Sup. Ct). However, instances of this actually occurring in these types of proceedings are relatively rare. Sarra, *supra* note 40.

prejudicial conduct of directors undermines any perceived need to extend the statutory fiduciary duty to protect creditors.[43]

The fact that a creditors' interests increase in relevancy as a corporation's finances deteriorate is apt to be relevant to a court's exercise of discretion to grant a creditor standing to bring an oppression remedy claim or a derivative claim in the name of the corporation.[44] The derivative action is another means by which creditors may seek a remedy against directors personally. While the derivative action is only available to creditors in limited circumstances – where the creditor has a direct financial interest in or a particular legitimate interest in how the affairs of the company are being managed – it provides further protection to creditors from harm arising from managerial self-dealing or asset-stripping prior to insolvency.[45] While derivative claims are brought on behalf of the corporation, creditors may also bring a personal action against directors for breach of the statutory duty of care in s. 122(1)(b) of the *CBCA*. This can assist creditors in challenging a business decision that was prejudicial to creditors if a court determines that directorial conduct was objectively unreasonable.

There are also a number of other specific statutory provisions that protect creditors against fraudulent or self-dealing transactions; naming all of them is beyond the scope of this paper. The *BIA* contains a number of protections for creditors. For example, s. 96 allows courts to void transactions made at undervalue. S. 101 allows a court to inquire into dividends paid within a year of insolvency and examine whether they were paid when a corporation was insolvent or rendered a corporation insolvent. If so, the trustee in bankruptcy may have a right of recovery against directors and shareholders. Creditors can seek leave to commence, defend,

---

[43] *Peoples Department Stores, supra* note 1, at para 51.
[44] *Ibid.*
[45] Janis P. Sarra and Ronald B. Davis, *Director and Officer Liability in Corporate Insolvency: a Comprehensive Guide to Rights and Obligations* (Markham: LexisNexis, 2010) at 82, citing *Re Daon Development Corp.* (1984), 54 B.C.L.R. 235 (Sup. Ct) at 243; *Jacobs Farms Ltd. v. Jacobs*, [1992] O.J. No. 813 (Ont. Crt. (Gen. Div.)).

continue or intervene in actions on behalf of the estate of a bankrupt corporation under s. 38 of the *BIA*, in specified circumstances. Creditors also ultimately have control rights when a company is put into bankruptcy protection in the sense that they can vote against a plan of arrangement or compromise under the *CCAA* or the *BIA*. In Delaware, despite the absence of a tool as powerful as the oppression remedy, courts have concluded that creditors are afforded sufficient protection by other areas of the law such that imposing a fiduciary duty would be unnecessary. To summarize, in addition to the far-reaching oppression remedy, creditors may negotiate contractual protection, initiate derivative or breach of duty of care actions under the *CBCA*, and avail themselves of other statutory and common law protections. The current legal landscape provides creditors with more than sufficient protection.

E) Conclusion

The intent of this paper has not been to argue that creditors are either unworthy or not in need of adequate legal protection, but rather to argue that creditors do not require a certain *type* of legal protection. To impose on directors of a corporation a fiduciary duty towards creditors when a company is in the vicinity of insolvency would, it has been submitted, represent an impractical, undesirable and unnecessary development in Canadian law. Given the recent unanimous decisions of the Supreme Court of Canada in *Peoples Department Stores* and *BCE*, it appears as if the state of the law in this area is here to stay in Canada. The result of these legal developments has not been to prejudice creditor interests or to make Canada a hostile lending environment. It has been, rather, a recognition of the position that the proper protection for creditors – given the nature of the fiduciary duty and the need for directors to account for many different stakeholder interests – lies elsewhere in the law.