NEW SCC DECISION ON OPPRESSION REMEDY IS INSTRUCTIVE FOR CLOSELY-HELD PRIVATE COMPANIES

Posted on November 25, 2016

Categories: Insights, Publications

Overview

In *Johnny Mennillo v. Intramodal Inc.* (2016 SCC 51), the Supreme Court of Canada ("**SCC**") has ruled that the failure of a company to follow formalities of the *Canada Business Corporations Act* ("**CBCA**") in regard to one of its shareholders will not automatically trigger the oppression remedy.

The SCC confirmed the criteria for the oppression remedy, and indicated that a claimant must first establish their reasonably held expectations, and then show how those expectations were violated by conduct that was oppressive, unfairly prejudicial or unfairly disregarding of their interests. The SCC's finding of no oppression in this case was grounded in these two well-established principles.

Facts of the case - Mennillo and Rosati's business dealings

This case involved two friends, Mario Rosati and Johnny Mennillo, who formed a road transportation company called Intramodal Inc. The parties agreed verbally that Rosati would manage the company while Mennillo would provide the financing. The shares were split 51 percent to 49 percent in favour of Rosati. The shareholders seldom complied with *CBCA* requirements, and put almost nothing in writing. There was no written shareholders' agreement, no partnership agreement, and no formal documentation for the monetary advances that were made by Mennillo. As the SCC decision notes, "this was a two-person, private company in which the dealings between the parties were marked by extreme informality."[1]

In May 2005, Mennillo resigned as a director and an officer of the company. He continued to finance the company but – importantly – no longer guaranteed the company's debts. The $440,000 Mennillo had advanced to the company was repaid to him over the course of the next few years. Upon being fully repaid, Mennillo was removed as a shareholder (although this share transfer was also not properly documented or registered). The critical fact as found by the Court was that Mennillo did not wish to remain a shareholder and told Rosati to have him removed as such; Mennillo however continued to express expectations of being treated as a shareholder beyond that point. In 2010, Mennillo filed an oppression suit alleging that Intramodal and Rosati acted oppressively and wrongfully stripped him of his shareholdings.

Findings in the lower Courts - oppression not established

Mennillo's oppression claim was dismissed at the trial level by the Quebec Superior Court. The trial judge looked at various facts, including: (a) the share certificate issuing Mennillo's common shares to him was not signed; (b) Intramodal insurance documents named Rosati as sole shareholder and Mennillo as a creditor; (c) a tax memo which indicated that the shares were owned by a single shareholder; (d) a letter from Mennillo's lawyer that made no mention of a share purchase but acknowledged a debt; and (e) a demand letter from Mennillo, stating that he resigned from the company. Based on these facts, the trial judge concluded that Mennillo held his shares on the condition that he guaranteed all of Intramodal's debts. Once Mennillo refused to provide the guarantee and sought to withdraw from the company, he agreed not to be a shareholder and became a mere lender and his shares were transferred to Rosati.

Mennillo appealed the dismissal, but that appeal was dismissed by a majority of the Court of Appeal of Quebec who agreed with the trial court's analysis on the oppression issue. The Court of Appeal further concluded that, at the time of Mennillo's resignation, the two parties had retroactively cancelled their agreement as well as the share issuance.

The SCC's Decision

The SCC found no palpable error in the trial judge's factual findings and upheld the determination that Mennillo had not been oppressed. In its decision, the Court addressed the following three questions of corporate law: (1) whether the share transfer could have been retroactively cancelled (as found by the Court of Appeal); (2) what were the consequences of Intramodal's failure to observe the formalities prescribed by the *CBCA*, and did such conduct constitute oppression; and (3) whether the shares could have been issued conditionally (as the trial judge found).

With respect to the first question, the Court found that share transfers could not have been retroactively cancelled. The Court held it is not possible to retroactively cancel shares by way of simple oral consent given that the solvency and liquidity tests must be met before shares can be cancelled.

On the third ground, the majority noted that the condition was a result of an agreement between the two individuals, and the company itself was not a party to it. Since the company was not a party to the agreement, the corporate law formalities applicable to a conditional issuance of shares were not in play.

The Court's Analysis on Oppression

The second issue considered by the Court concerned the oppression question, and whether Intramodal's failure to comply with the formalities of the *CBCA* could amount to oppression. The majority of the Court found that deficiencies in a company's compliance with *CBCA* requirements did not, on their own, constitute

oppressive conduct.

The Court noted that the oppression remedy is triggered by **conduct that frustrates reasonable expectations, not simply by conduct that is contrary to the *CBCA***. Here, the failure to observe the formalities associated with removing Mennillo as a shareholder was done in accordance with his express wishes, and could not be said to be an unfair or oppressive act. The SCC went as far as saying that, to find oppression on these facts would "permit Mr. Mennillo to use oppression proceedings as an instrument of oppression, rather than as a remedy for it".[2]

Chief Justice McLachlin, in her concurring reasons, noted that the case could also be disposed of on the basis that Mennillo failed to show a reasonable expectation that he should not be removed as a shareholder from Intramodal books. The Chief Justice stated that, "evidence of shareholder expectations is essential to whether conduct has been oppressive in a particular case."

Justice Côté dissented, stating that Mennillo was a shareholder of the company and because the parties expressly chose incorporation over a partnership, technical formalities could not be ignored.

Take Aways

It is not uncommon for closely-held, private companies to overlook legal formalities when conducting their day-to-day business dealings. This decision is therefore instructive for the businesses out there who may not have papered every transaction, or religiously followed strict technical formalities of their applicable corporate statute. The SCC's ruling provides these businesses with the confirmation (and indeed, perhaps also the comfort) that "sloppy paperwork on its own does not constitute oppression."[3]

Moreover, even though Intramodal was a *CBCA* corporation, many provincial business law statues are similar enough to the *CBCA* and have comparable oppression provisions, making this decision informative for many private companies across Canada.

by Katherine A. Reilly and Ravipal Bains

[1] 2016 SCC 51 at para. 68
[2] 2016 SCC 51 at para 198
[3] 2016 SCC 51 at para 17

A Cautionary Note