1987 CarswellAlta 107, 52 Alta. L.R. (2d) 195, 78 A.R. 131, 38 D.L.R. (4th) 368

Keho Holdings Ltd. v. Noble

KEHO HOLDINGS LTD. and OLIVER v. NOBLE et al.

Alberta Court of Appeal

Laycraft C.J.A., Haddad and Irving JJ.A.

Judgment: April 27, 1987
Docket: Calgary No. 18698

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Counsel: *R.A.* ***Low***, for appellants.

J.C. Crawford, for respondents.

Subject: Corporate and Commercial

Corporations --- Shareholders — Shareholders' remedies — Relief from oppression — Orders for relief — General

Corporations --- Winding-up — Under provincial acts — By order of court — Under relief from oppression remedy

Corporations — Winding up and dissolution under provincial legislation — Winding-up orders — Grounds — Order available where powers of directors exercised or affairs of corporation conducted in oppressive or unfairly prejudicial manner or where just and equitable for corporation to be dissolved — Court discussing principles involved — Stock option to major shareholder and loan arranged for his personal company unfair — Order made under s. 234 of Business Corporations Act — Shareholder to cancel option and pay out loan or provide security — Dissolution order set aside.

Corporations — Winding up and dissolution under provincial legislation — Winding-up orders — Jurisdiction and discretion of court — Shareholder appealing winding-up order granted to minority shareholders — Winding-up order to be used only as last resort — Order under s. 234 of Business Corporations Act to be granted where equity can be achieved without dissolution.

The appellant corporation had been formed to act as an investment company in acquiring shares in two public companies for the original 20 subscribers. The appellant, O., had managed the corporation successfully but the

respondent shareholders were concerned that O. was managing the corporation for his own personal advantage, since he controlled a majority of the shares. The respondents cited three events allegedly indicating that O. had acted in an unfair and prejudicial manner towards them. They contended that O. had used his majority shareholding position to have himself and his nominees elected to the board of directors to the exclusion of the nominee of the respondents; that O. had been granted a stock option allowing him to acquire shares at a nominal price; and that O. had arranged for the corporation to obtain a loan from its bank which was then advanced to O.'s personal company without security. The application for the loan had not been brought to the directors for approval. The respondents obtained an order for liquidation and dissolution of the corporation under s. 207(1) of the Business Corporations Act and the appellants appealed.

Held:

Appeal allowed.

In order to apply successfully for an order under s. 207, an applicant must establish that an act or omission by a company or its directors is oppressive, is unfairly prejudicial or unfairly disregards the interests of any security holder, or that it is "just and equitable" that the company be dissolved. The respondents had not established an underlying obligation entitling them to a share in management based on a previous business relationship, much less one tantamount to a partnership. They also could not show mala fides. Consequently, the exclusion of the respondents from management was not oppressive in these circumstances. With respect to the bank loan advanced to O.'s company, O.'s actions showed that he treated the appellant corporation as his personal domain and prejudicially used it to his own personal advantage. As the stock option granted to O. amounted to a gratuitous payment, it had to be shown to be bona fide for the company's benefit. Dilution of the issued shares by exercise of the option would divert company profits to O. and away from other shareholders. In addition, exercise of the option would alter the shareholdings such that the respondent minority shareholders would not be able to block a special resolution. The option was therefore both oppressive and unfairly prejudicial to the remaining shareholders. The application for liquidation under the just and equitable rule could not be sustained on the basis that there had been a deadlock in management. A stalemate in passing a special resolution is not a deadlock in management. The granting of the stock option and the loan to O.'s company were sufficient to generate a loss of confidence in management. However, there had not been a loss of substratum in the corporation, as the primary object for which it had been incorporated had been met. Despite the actions of O., an order for winding up is a last resort and an order under s. 234 should be made in all cases where equity can be achieved without invoking the drastic remedy of dissolution. The sections of the Business Corporations Act regarding oppression should be broadly interpreted to settle intracorporate disputes equitably. Therefore, O. should repay the loan within 30 days or give satisfactory security for it and the stock option should be cancelled.

Cases considered:

Brooks (William) & Co., Re. See — *William Brooks & Co.*

Dom. Steel Corp., Re, [1927] 4 D.L.R. 337, 59 N.S.R. 398 (C.A.) — *applied*

Ebrahimi v. Westbourne Galleries, [1973] A.C. 360, [1972] 2 W.L.R. 1289, [1972] 2 All E.R. 492 (H.L.) — *applied*

Elder v. Elder & Watson Ltd., [1952] S.C. 49 — *applied*

Ferguson and Imax Systems Corp., Re (1983), 43 O.R. (2d) 128, 150 D.L.R. (3d) 718, leave to appeal to

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S.C.C. refused 2 O.A.C. 158, 52 N.R. 317 — *applied*

Jackman v. Jackets Ent. Ltd. (1977), 4 B.C.L.R. 358, 2 B.L.R. 335 (S.C.) — *applied*

Johnson and W.S. Johnson & Sons Ltd., Re (1979), 95 D.L.R. (3d) 495, (sub nom. *Re W.S. Johnson & Sons Ltd.)* 17 A.R. 386 (T.D.) — *referred to*

Kurilpa Protestant Hall Pty. Ltd., Re, [1946] St. R. Qd. 170 (S.C.) — *referred to*

Loch v. John Blackwood Ltd., [1924] A.C. 783 (P.C.) — *applied*

Nat. Bldg. Maintenance Ltd., Re, [1971] 1 W.W.R. 8, affirmed [1972] 5 W.W.R. 410 (sub nom. *Nat. Bldg. Maintenance Ltd. v. Dove*) (B.C.C.A.) — *applied*

Scottish Co-op. Wholesale Soc. Ltd. v. Meyer, [1959] A.C. 324, [1958] 3 W.L.R. 404, [1958] 3 All E.R. 66 (H.L.) — *considered*

Timbers Ltd., Re, 11 Alta. L.R. 432, [1917] 2 W.W.R. 965, 35 D.L.R. 431 (C.A.) — *referred to*

William Brooks & Co., Re, [1962] N.S.W.R. 142 (S.C.) — *referred to*

Yenidje Tobacco Co., Re, [1916] 2 Ch. 426 (C.A.) — *distinguished*

Statutes considered:

Business Corporations Act, S.A. 1981, c. B-15

s. 207

s. 234

Canada Business Corporations Act, S.C. 1974-75-76, c. 33

Companies Act, 1948 (11 & 12 Geo. 6, c. 38)

Companies Act, R.S.B.C. 1960, c. 67

s. 185

Joint Stock Companies Act, 1848 (11 & 12 Vict., c. 45)

s. 5(8)

Authorities considered:

Institute of Law Research and Reform Report No. 36 (1980), vol. 1, "Proposals For A New Alberta Business Corporations Act".Huberman, "Compulsory Winding-Up — The 'Just and Equitable' Rule" (1966-67), 5 Alta. L. Rev. 135.**Words and phrases considered:**

deadlock in management

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exclusion from management

just and equitable

loss of confidence in management

loss of substratum

oppression

unfairly prejudicial

Appeal from order for liquidation and dissolution of company.

The judgment of the court was delivered by *Haddad J.A.*:

1 An order granted in chambers pursuant to the Business Corporations Act, S.A. 1981, c. B-15, s. 207(1), directed that the appellant corporation, Keho Holdings Ltd., be liquidated and dissolved. This appeal is taken from that order.

2 To facilitate an appreciation of the factual base upon which the respondent relied to satisfy the requirements of the statute to obtain this order I will quote the whole of s. 207 before I outline the facts.

> 207(1) The Court may order the liquidation and dissolution of a corporation or any of its affiliated corporations on the application of a shareholder,
>
> (*a*) if the Court is satisfied that in respect of a corporation or any of its affiliates
>
> (i) any act or omission of the corporation or any of its affiliates effects a result,
>
> (ii) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
>
> (iii) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, or
>
> (*b*) if the Court is satisfied that
>
> (i) a unanimous shareholder agreement entitles a complaining shareholder to demand dissolution of the corporation after the occurrence of a specified event and that event has occurred, or
>
> (ii) it is just and equitable that the corporation should be liquidated and dissolved.
>
> (2) On an application under this section, the Court may make any order under this section or section 234 it thinks fit.
>
> (3) Section 235 applies to an application under this section.

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Facts

3 Keho was incorporated 8th August 1961. The original subscribers were 20 in number, each of whom subscribed for 100 shares at a par value of $1 each.

4 Keho was formed as an investment company primarily to acquire shares in two public companies, Barons Oil Limited and North Continental Oil & Gas Corporation Ltd. The appellant Oliver has directed Keho's affairs since its inception with success and without remuneration. Its assets have grown and the company has prospered. The shares acquired in Barons, a profitable enterprise, and in North Continental comprise a total market value of $7,431,396 — against liabilities of $794,278. Keho's success is further manifested by its ability to pay dividends for a total of $3.50 per share over the past five years.

5 The real source of the respondents' discontent is their perception that the appellant Oliver, exercising control over a majority of voting shares, is in a position to exploit the company to his personal advantage. The respondents claim to represent in excess of 33 per cent of the common stock of Keho as opposed to Oliver's control of an excess of 66 per cent.

6 Material filed by the respondents lists Keho's shareholders as 15 in number and the issued shares at a total of 54,915. The respondents own between them a total of 19,090 shares. On the other side, Gyron Petroleum Ltd., an entity wholly controlled by Oliver, is the holder of 22,980, while Oliver and his two sons between them own 30 shares — for a total of 23,010 shares. This leaves 12,815 shares in the hands of others. Although the allegation of control is not directly challenged, the manner in which Oliver contrived to control these shares is not disclosed. I note, too, that the appellants' material places the total number of outstanding shares at 55,440. The discrepancy in the figures submitted by each side as to the issued shares is of no real consequence to the resolution of the issues at hand.

7 The specific complaints which triggered the application for liquidation focussed in the main on three separate events. The first occurred at the annual meeting of Keho on 27th February 1985; the second at the annual meeting 28th June 1986; and the third was a decision in connection with an advance of money undertaken by Oliver alone. The respondents argue that on each occasion Oliver violated the oppression and fairness criteria enacted pursuant to s. 207(1)(*a*).

8 The first event involves the election of directors. Upon incorporation the articles of association provided for a minimum of three and a maximum of seven directors. The minimum and maximum numbers were altered in 1965 to seven and eleven and again in 1974 to five and seven and, finally, at the annual meeting in June 1985 the numbers reverted to the original figures of three and seven. The respondents contend that the appellant Oliver exercised his control of voting power to ensure the election of only four directors, namely, his two sons, A.S. Cameron and himself. A nominee put forward by the respondents was not elected and the respondents challenge this exclusion as wrongfully depriving them of representation on the board.

9 The second matter under attack deals with the granting of a stock option to the appellant Oliver at the annual meeting of 27th February 1985. The option granted to Oliver the right to purchase 12,500 shares of common stock at a price of $1 per share. Oliver deposes this was devised to provide a means of reward for his 25 years' service to the company without financial recognition. The price per share, the respondents complain, is far below value to the prejudice of other shareholders.

10 The third decision creating discontent was taken by Oliver without reference to the board of directors. To

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assist his personal company, Gyron Petroleum Ltd., Oliver arranged for Keho to borrow $258,000 from its bank with interest at the prime rate. That money was then advanced by Keho to Gyron without security repayable with interest at 12 per cent — a rate, on Oliver's evidence, higher than prime.

11 Section 207 specifies four criteria — any one of which will entitle an applicant to an order for liquidation. The first three fall under s. 207(1)(*a*). The applicant must satisfy a court that an act or omission of a company or its directors is (a) oppressive to, or (b) unfairly prejudicial to, or (c) unfairly disregards the interests of any security holder. The latter is not relevant to this appeal. The fourth criterion, the "just and equitable rule", is found in subs. (1)(*b*).

12 Oppression and unfair prejudice each involve unfair conduct. I will consider them together. In doing so I do not intend to convey the notion that they do not have separate functions and applications.

13 The court is given authority under s. 234, to which I will allude later in these reasons, to temper the severity of liquidation with some other appropriate remedy.

Oppression and Unfair Prejudice

14 Oppressive conduct as a ground for relief originated in the English Companies Act, 1948 (11 & 12 Geo. 6). It first appeared in Canada in 1960 in the Companies Act of British Columbia, R.S.B.C. 1960, c. 67, s. 185. The oppression test was not generally available in the rest of Canada until the passage of the Canada Business Corporations Act, S.C. 1974-75-76 (proclaimed in force 15th December 1975). The unfair prejudice and unfair disregard rules were introduced for the first time in the Canada Business Corporations Act and all four criteria have been incorporated into the Business Corporations Act of Alberta. The words of s. 207(1)(*a*) are the same as those used in s. 234 of the federal statute.

15 The liquidation order does not identify the ground upon which it was issued. I will in this circumstance endeavour to review the principles which govern the three criteria of the statute relevant to the issues of this appeal.

16 In preparing proposals for the present legislation both the federal and provincial law reform agencies refer to and were guided by the standards reflected by Lord Cooper's words in *Elder v. Elder & Watson Ltd.*, [1952] S.C. 49 at 55. I quote:

> ... the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

(See Institute of Law Research and Reform Report No. 36 (1980), vol. 1, "Proposals For A New Alberta Business Corporations Act".)

17 Lord Keith described oppression with this statement in *Scottish Co-op. Wholesale Soc. Ltd. v. Meyer*, [1959] A.C. 324, [1958] 3 W.L.R. 404, [1958] 3 All E.R. 66 (H.L.) [p. 86]:

> Oppression under s. 210 may take various forms. It suggests, to my mind, as I said in *Elder v. Elder & Watson* (1952 S.C. 49), a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members.

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18 In my view the following extract taken from the reasons for judgment of Brooke J.A. in *Re Ferguson and Imax Systems Corp.* (1983), 43 O.R. (2d) 128, 150 D.L.R. (3d) 718, leave to appeal to S.C.C. refused 2 O.A.C. 158, 52 N.R. 317, presents a model of the principles to be employed in evaluating fairness [p. 137]:

> The policy of the law to ensure just and equitable treatment of minorities can be traced back to early cases. In *Allen v. Gold Reefs of West Africa, Ltd.*, [1900] 1 Ch. 656 at p. 671, Lindley M.R., speaking of the powers of a corporation to amend its articles, said:
>
> > ... it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded.
>
> In *Goldex Mines Ltd. v. Revill et al.* (1974), 7 O.R. (2d) 216 at p. 224, 54 D.L.R. (3d) 672 at p. 680, Arnup J.A. for this court, after considering the earlier cases, said:
>
> > The principle that the majority governs in corporate affairs is fundamental to corporation law, but its corollary is also important — that the majority must act fairly and honestly. Fairness is the touchstone of equitable justice and when the test of fairness is not met, the equitable jurisdiction of the court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused.
>
> But s. 234 must not be regarded as being simply a codification of the common law. Today one looks to the section when considering the interests of the minority shareholders and the section should be interpreted broadly to carry out its purpose: see the *Interpretation Act*, R.S.C. 1970, c. I-23, s. 11. Accordingly, when dealing with a close corporation, the court may consider the relationship between the shareholders and not simply legal rights as such. In addition, the court must consider the *bona fides* of the corporate transaction in question to determine whether the act of the corporation or directors effects a result which is oppressive or unfairly prejudicial to the minority shareholder. Counsel has referred us to a number of decisions. They establish primarily that each case turns on its own facts. What is oppressive or unfairly prejudicial in one case may not necessarily be so in the slightly different setting of another.

19 I concur, without hesitation, that these sections ought to be broadly and liberally interpreted. A broad interpretation will reflect the intention of the legislation to ensure settlement of intracorporate disputes on equitable principles as opposed to adherence to legal rights. The equity approach employed by Brooke J.A. was earlier expressed by Lord Wilberforce in *Ebrahimi v. Westbourne Galleries*, [1973] A.C. 360, [1972] 2 W.L.R. 1289, [1972] 2 All E.R. 492 (H.L.), in his review of the application of the just and equitable rule. This statement will be supported later by quotations taken from *Ebrahimi*.

20 The acts alleged by the respondents to constitute oppressive and unfair conduct are:

21 (a) exclusion from management,

22 (b) unsecured loan to Gyron Petroleum Ltd.,

23 (c) the granting of a share option to Oliver.

Exclusion from Management

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24 I return to the *Ebrahimi* case. Proceedings there were brought under the just and equitable rule. The principles enunciated by Lord Wilberforce in his speech to the House of Lords are most relevant in the determination of this issue. He said at p. 380:

> In all these ways a particular director-member may find himself no longer a director, through removal, or non-re-election: this situation he must normally accept, unless he undertakes the burden of proving fraud or mala fides. The just and equitable provision nevertheless comes to his assistance if he can point to, and prove, some special underlying obligation of his fellow member(s) in good faith, or confidence, that so long as the business continues he shall be entitled to management participation, an obligation so basic that, if broken, the conclusion must be that the association must be dissolved. And the principles on which he may do so are those worked out by the courts in partnership cases where there has been exclusion from management ...

25 I extract from the headnote (p. 361) some elements of an underlying obligation:

> Elements which give rise to the superimposition of equitable considerations may include one, or probably more, of the following: (i) an association formed or continued on the basis of a personal relationship involving mutual confidence; (ii) an agreement, or understanding, that all, or some, of the shareholders, shall participate in the conduct of the business; (iii) restriction on the transfer of the members' interest in the company. The fact that the company is a small one, or a private company, is not enough.

26 Additional extracts from Lord Wilberforce in the same context will appear later in these reasons under the heading "Just and Equitable". The ratio I take from the foregoing announcements is that equity will intervene on behalf of the shareholder excluded from management if he can prove some underlying obligation entitling him to management participation. This obligation must surely lie at the heart of the relationship between shareholders.

27 In *Ebrahimi* partners in a business incorporated a company to take over the business. The partners were the company's first directors. A son of partner N. entered the company acquiring shares and becoming a director. Partner N. and the son having a voting majority of shares removed the other partner from the board of directors. It was held, invoking equitable considerations, that there was an obligation entitling the removed shareholder to management participation and the company was ordered to be wound up.

28 The respondents contend that the original subscribers had a relationship "tantamount to a partnership" which entitles them to participate in management. There is no evidence to substantiate that submission. Keho was formed by 20 persons who did not have a previous business association with one another. In that setting they did not create an enterprise tantamount to a partnership when they joined together for the incorporation of Keho. This is not analogous to the situation which prevailed in *Ebrahimi* or *Re Yenidje Tobacco Co.*, [1916] 2 Ch. 426 (C.A.).

29 In *Re Yenidje Tobacco Co.* an entity formed by two businessmen acquired their respective businesses. They held equal shares and one shareholder contrived to exclude the other from participating in the operation of the company. In substance the business they formed was a partnership in the guise of a company. On that account it was wound up by the court applying the "just and equitable" rule.

30 Some of the original subscribers in Keho are no longer members of the company. Although some of the respondents, with the exception of Green, have served as directors on earlier boards, none of them served on the

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first five boards following incorporation. The lack of a management agreement or arrangement or obligation is apparent from the record.

31 The respondents have not established an underlying obligation nor have they made out a case for mala fides. The exclusion from management does not, in these circumstances, constitute conduct which violates the test for oppression and fairness.

Loan to Gyron Petroleum Ltd.

32 In respect of this loan three salient features stand out:

33 (1) Keho borrowed money from its bank to lend to Gyron;

34 (2) Gyron was not required to post security; and

35 (3) Oliver arranged this transaction without the approval of Keho's board of directors — having acted alone.

36 A disturbing aspect of Oliver's conduct is that he seems to have considered his position beyond challenge by using Keho's line of credit to his personal advantage. He treated Keho as his personal domain. He acted improperly and his conduct can only be characterized as prejudicial to Keho and its shareholders. I agree with the decision handed down by Fulton J. in *Jackman v. Jackets Ent. Ltd.* (1977), 4 B.C.L.R. 358 at 361, 2 B.L.R. 335 (S.C.). In that case there were only two shareholders. The majority shareholder, acting alone, arranged to borrow a large sum of money on the security of company property and then advanced in excess of $200,000, without security, to a company wholly owned by that shareholder. Fulton J. held that to constitute prejudicial conduct.

37 I conclude then that Oliver's performance does not meet the standard of fairness underlined by Lord Cooper in *Elder* and in the other authorities to which I have referred.

Share Option

38 The share option to Oliver was approved at a shareholders' meeting on 28th June 1986. The respondents' factum suggests obliquely that the control of shares fell within the jurisdiction of the board of directors but the vires of the transaction was not pursued or put in issue. I am left therefor to consider the fairness of the option on its merits.

39 The option stipulates a price for the shares according to the respondents' submission which is considerably less than book or market value and exercise of the option would have the effect of diluting the value of all other outstanding shares. Oliver acknowledged that a block of shares belonging to an estate had negotiated a year earlier at a price, which he termed generous, of $72 per share. Using that figure the respondents calculate the share option conferred upon Oliver a benefit equivalent to $662,500. The benefit to Oliver upon exercise of the option under any form of scrutiny would be substantial.

40 The appellant Oliver cannot and makes no attempt to advance a legal entitlement to the option. His justification is on moral grounds. The option in these circumstances amounts to a gratuitous payment. Justification for a gratuity falls upon those by whom it is authorized. It must be shown that the payment was bona fide for the company's benefit. The benefit conferred by the option is analogous to that in *Re Nat. Bldg. Maintenance Ltd.*, [1971] 1 W.W.R. 8, affirmed [1972] 5 W.W.R. 410 (sub nom. *Nat. Bldg. Maintenance Ltd. v. Dove*) (B.C.C.A.).

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In that case McFarlane J.A., at p. 412, held that the payment of management fees for past services to a director was "oppressive as being a device to divert the profits of the company ex clusively to himself". Dilution of the issued shares by exercise of the option would divert company profits to Oliver away from the other shareholders through the declaration of dividends. A similar factual situation arose in *Re Kurilpa Protestant Hall Pty. Ltd.*, [1946] St. R. Qd. 170 (S.C.), where an application for liquidation was successful.

41 Further cause for grievance is that the shareholdings of Gyron in Keho (41.8 per cent) combined with that of Oliver, should the option be exercised, would give him control of 52.6 per cent of the outstanding shares. Moreover, the respondents between them control approximately 34 per cent of the issued shares — sufficient to block a special resolution. Exercise of the option would alter that position. It would reduce the respondents' total percentage to slightly in excess of 28 per cent.

42 Indeed, Oliver's apprehension over this transaction is demonstrated by a statement in his affidavit filed in response to the originating notice launching these proceedings, wherein he says that "if the Court feels that this stock option is unfair to the applicants I am fully prepared to agree to cancel said stock option in full, or in part".

43 I view the stock option as unfair. It is both oppressive and unfairly prejudicial to the remaining shareholders. It cannot stand.

Just and Equitable

44 The "just and equitable" rule is of long standing. It has been part of corporate legislation since it first appeared in the Joint Stock Companies Act, 1848 (11 & 12 Vict., c. 45), s. 5(8). It was in due course enacted as part of the Companies Act of this province and then carried forward into the Business Corporations Act.

45 In *Ebrahimi*, acknowledged as a leading authority on the use of the "just and equitable" rule, Lord Wilberforce rejected attempts to categorize the type of cases which fall within the ambit of the criteria governing that rule. Laycraft J. (now C.J.A.) took the same approach in *Re Johnson and W.S. Johnson & Sons Ltd.* (1979), 95 D.L.R. (3d) 495 at 513, (sub nom. *Re W.S. Johnson & Sons Ltd.)* 17 A.R. 386 (T.D.).

46 Lord Wilberforce discussed the application and impact of the "just and equitable" doctrine in these words [p. 379]:

> It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.
>
> It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence — this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company — so that if confidence is lost, or one member is removed

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> from management, he cannot take out his stake and go elsewhere.
>
> It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly through the force of the words themselves.

47 The respondents rely on four grounds as justification for liquidation under the just and equitable rule. They are:

48 (a) deadlock in management;

49 (b) loss of confidence in management;

50 (c) loss of substratum; and

51 (d) a partnership analogy.

Deadlock in management

52 The respondents contend deadlock on the ground that as shareholders comprising approximately 34 per cent of the issued shares they have been excluded from representation on the board of directors. That reasoning eludes me. They also assert deadlock because they are in a position to prevent the passing of a special resolution — a resolution requiring 66 2/3 per cent of the outstanding shares to succeed. I do not perceive this to be deadlock in management. In my view the principles to be extracted from the authorities dealing with deadlock have no application to that setting. In his article "Compulsory Winding-Up — The 'Just and Equitable' Rule" (1966-67), 5 Alta. L. Rev. 135 at 149-50, David Huberman expressed with clarity the principle of deadlock:

> While the classic case of "deadlock" is the situation where there are only two equal shareholders at odds, or two equal factions at odds, the authorities now establish (despite cases to the contrary) that "for a situation in a company to be recognized as a deadlock, equal holdings of stock by the contesting factions is not required." The trend is, hence, to treat "*complete* deadlock" and "deadlock in *substance*" alike ...
>
> The proposition that an "absolute deadlock" is not required and that a "deadlock in substance" will suffice finds its clearest expression in the cases dealing with casting votes. Theoretically and technically, the presence of a casting vote in one of two equal factions at serious odds with one another precludes the possibility of an absolute deadlock and ensuing corporate paralysis. Fortunately, the courts have held, subject to dictum in one case, that the presence of a casting vote is *not* a bar to obtaining a winding-up order under the "deadlock" category.

Also see *Re Timbers Ltd.*, 11 Alta. L.R. 432, [1917] 2 W.W.R. 965, 35 D.L.R. 431 (C.A.). I do not regard a stalemate for the passing of a special resolution to be a deadlock in management if indeed a stalemate is likely to occur. Moreover the evidence is unclear that such likelihood exists.

Loss of confidence in management

53 The granting of the stock option and the loan to Gyron both lend validity to this submission.

54 The test was eloquently put by Lord Shaw in *Loch v. John Blackwood Ltd.*, [1924] A.C. 783 at 788 (P.C.):

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> It is undoubtedly true that at the foundation of applications for winding up, on the "just and equitable" rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the company's business. Furthermore the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter, and it is under the statute just and equitable that the company be wound up.

55 *Re William Brooks & Co.*, [1962] N.S.W.R. 142 (S.C.), and *Re Kurilpa Protestant Hall Pty. Ltd.* [supra] both stand for the proposition that where those in control issue new shares to themselves or their nominees so as to keep control and suppress a dissident minority they have laid the foundation for a justifiable lack of confidence. I find that proposition persuasive and applicable. In addition to a share option, in the latter case, large profits were earned and concealed by management through the payment of undisclosed bonuses. Although the share option in this appeal may not have been given to suppress dissidents, exercise thereof would give Oliver voting control to permit him, if he so chose, to manage the affairs of Keho to the detriment of other shareholders.

56 The circumstances leading to the loan to Gyron is bound to generate a loss of confidence in management.

Loss of substratum

57 The premise of this argument is that the purpose of the company was to have 20 equal shareholders who would hold shares in two public companies. The respondents say that since the equality of shareholders has been altered the substratum of the company has been removed. This leads to the question — what is substratum? In *Re Dom. Steel Corp.*, [1927] 4 D.L.R. 337 at 349, 59 N.S.R. 398 (C.A.), Rogers J. offers his explanation of the substratum theory — which I readily adopt:

> Then what is the loss of *substratum* theory? There are many English decisions dealing with the subject and they were extensively commented upon at the bar by counsel on both sides. They are fully considered in 1 Palmer's Company Precedents, 12th ed., pp. 55-9. It would serve no useful purpose to review them here. In the result, it may I think be accurate to say that, however wide the words of a memorandum of association or of the statute be defining the objects and powers of a company, and however much in detail these objects and powers are set forth, the Court may, by reading the memorandum or statute and considering the circumstances under which the company came into being, ascertain what the primary paramount or main object of the company was to be, and if that object has failed, it may treat the *substratum* of the company as gone and regard it as impossible for the company to carry on the real business for which it was formed, and accordingly make a winding-up order.

58 The primary object of Keho upon incorporation was to invest in shares in Barons and North Continental Oil. This objective has been met. There is no loss of substratum. Moreover, the base upon which this argument rests is destroyed in two ways:

> (1) Provisions of the memorandum of association outlining a detailed scheme for the sale and disposition of shares by a shareholder. The scheme provides for the offer of shares to the other shareholders and, failing acceptance of all shares offered, sale of the remainder is authorized to any other person.

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(2) The number of shareholders has been reduced from the original 20 to 15.

This ground of appeal is without merit.

The partnership analogy

59 I have already dealt with this submission in an earlier context. Keho is not an incorporated partnership. Its existence does not bring it within the principles of a partnership in the guise of a corporation: *Re Yenidje Tobacco Co.*, supra, and *Ebrahimi v. Westbourne Galleries*, supra.

Conclusion

60 Under the Companies Act of this province, whenever a court detected conduct violating the just and equitable rule it had to decide whether to grant or refuse a winding-up order. The Act permitted no alternative relief: see *Re Johnson*, supra, at p. 500. The flexibility of ss. 207(2) and 234 now provide for several alternatives.

61 The correct approach in my view is to make an order under s. 234 in every case where equity could be achieved without invoking the drastic remedy of dissolution.

62 The appellants' plea is that if the court find impropriety on the party of Oliver the company be given relief from the severity of liquidation by recourse to the provisions of s. 234. To avoid quoting its lengthy clauses it suffices to say that the section offers the court a long list of alternatives to liquidation, various and general in nature. The directions which follow to let Keho survive fall within the purview of the section.

63 Having concluded that the share option and the loan to Gyron violate the oppression and fair play criteria, the next matter for consideration is to determine the appropriate remedy. In doing so I take into account the management skills Oliver has shown in guiding the destiny of Keho. In my view liquidation ought to be avoided if at all possible.

64 The share option issue can be dealt with expeditiously. Oliver has volunteered to cancel the option if it is unfair. It is unfair. I would direct that the appellant be enjoined from exercising the option and Keho from accepting in the event Oliver purports to do so.

65 This leaves the loan to Gyron for solution. I would direct the appellants, to avoid liquidation, to comply with either of these alternatives:

66 (a) that the loan be paid within 30 days from the release of these reasons for judgment; or

67 (b) that within 30 days from the release of these reasons the appellants secure the loan to the satisfaction of the respondents or to the satisfaction of this court on further application by either party.

68 Accordingly, the order from which this appeal is taken will be set aside and the appeal allowed by the substitution of an order embodying the directions I have given.

69 The appellants have had a measure of success in this appeal. The order I have made, however, does not absolve the appellants of blame for their conduct. The ultimate success in the proceedings goes to the respondents as they have established grounds to obtain a form of relief. In the circumstances I would not allow costs of

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this appeal to either party.

Appeal allowed.

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