BY NEILL MAY

Fiduciary duties and flaming furniture

The law prohibiting the removal of furniture tags raises a lot of questions. There is of course the obvious question of why a law that is presumably consumer protection oriented would apply to apparently perpetually prohibit the consumer from removing the tag from his or her own furniture. Beyond that, if a removed tag is replaced, does that right the wrong? Is there a market for forged replacement tags? Who enforces the law (and is that job really all that fulfilling . . .)? The answers to these questions are probably easy, but it's more fun to speculate. Whatever the answers, when one takes an extreme case, for example if a furniture tag were surrounded with explosives and detonated in the presence of the furniture cops, one would expect the mischief of the law to have been engaged. The cases with seemingly very clear facts, though, do not usually provide much useful guidance for those seeking to understand the nuances of the law.

In that respect, the law of fiduciary duties in Canada bears some similarities to the hypothetical of extreme furniture tag abuse described above. An example of this came with the recent decision of the Ontario Court of Appeal in *Re Unique Broadband Systems Inc.* In that case, the sole asset of UBS was its controlling interest in Look Communications Inc. Look sold its primary asset, a band of telecommunications spectrum, at a value considered by the UBS board to be a disappointing price, and its efforts to sell its other assets were not successful. After the completion of the spectrum sale, the UBS board determined to create a cancellation payment pool under the company's stock appreciation right (SAR) plan; each holder of SARs (including all of the directors) would receive a cancellation payment based on a value significantly in excess of the trading price of the UBS shares. The UBS board also created a bonus pool for certain personnel (at much higher levels than historical bonus entitlements), and the directors of Look (which included members of the UBS board) created additional SAR cancellation and bonus pools at the Look level.

The total compensation for UBS fiduciaries under these plans totalled approximately 97.6 per cent of the company's market capitalization. Moreover, an HR consultant testified the package did not meet any test of reasonableness, and the court noted the awards were made without any credible or objective evidence supporting the levels awarded.

The former CEO and director of UBS, Gerald McGoey, made a claim against the company for his extraordinary compensation awards. The Court of Appeal dismissed McGoey's appeal of the decision of the trial court, which had held McGoey breached his fiduciary duty, acted in his own self-interest, and failed to act honestly and in good faith in the best interests of the company. The court reaffirmed the importance of fiduciary duties, and confirmed the "business judgment rule," which provides some shelter to directors' and officers' decisions against judicial second-guessing, only applies where the fiduciaries have satisfied the "rule's preconditions of honesty, prudence, good faith, and a reasonable belief that his actions were in the best interests of the company."

The case harkens back to the 2002 Ontario Superior Court decision in *UPM-Kymmene Corporation v. UPM-Kymmene Miramichi Inc.* (mercifully referred to as the Repap case). In that case an employment contract was set aside by the court in circumstances where, the court determined, the directors had not made any of the inquiries or investigations that would have enabled them to engage in a proper analysis of the matter and form a reasonable judgment about whether to approve the agreement. The court also concluded that the board had failed to establish a proper process for independent review of the agreement.

With the guidance provided by this jurisprudence, Canadian directors and those advising them now know — speaking facetiously — that where a potential conflict arises, such as board and executive compensation, having an apparently nearly complete absence of proper process (as in the Repap case) is problematic, as is having conflicted directors make awards at disproportionate and unsupported values, in an amount constituting almost 100 per cent of the equity value of the company (as in UBS).

The UBS case also addresses the interesting issue — not speaking facetiously — of whether a breach of fiduciary duty can be excluded from a contractual definition of "cause," such that on a termination for breach of fiduciary duty there may be contractual entitlement to benefits that would be denied in the case of a "with cause" termination. The court essentially concluded that a breach of fiduciary duty must be treated as an element of "cause."

Unfortunately there is less guidance for boards facing decisions not involving metaphorical flaming mattresses and exploding ottomans (there is perhaps an inference to be drawn from the fact those are the cases that seem to be litigated, although that may speak as much to the mindset of insurance companies as anything else). What is clear is that, at a minimum, some degree of proper and defensible process is a necessity. No La-Z-Boys were injured in the writing of this column. CL

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