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Corporate Securities Law

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Peoples Department Stores Inc. v. *Wise* - Supreme Court of Canada Weighs in on Duties of Directors

On October 29, 2004, the Supreme Court of Canada released its much anticipated decision in *Peoples Department Stores Inc. (Trustee of)* v. *Wise*. The Court unanimously ruled that directors and officers owe their fiduciary duties to the corporation at all times, even when the corporation is in the nebulous "vicinity of insolvency," declining to adopt the approach favoured in some other jurisdictions where fiduciary duties are owed to creditors when a corporation is in financial difficulty.

The decision is welcome news for corporate directors, both because it clarifies an area of Canadian corporate law that was becoming less certain in recent years and because it rescues directors from the near-impossible position of trying to manage a shifting fiduciary duty as the fortunes of a corporation rise and fall.

Wise Stores Inc. purchased Peoples Department Stores Inc. in 1992. Lionel, Ralph and Harold Wise were majority shareholders, officers and directors of Wise and, after the purchase, the only directors of the Peoples subsidiary.

Almost immediately, problems arose with the joint operation of Wise and Peoples. In search of a solution, the Wise brothers consulted the vice-president of finance of Wise who suggested merging the inventory systems of the two companies. An inevitable result of the joint inventory procedure was that Peoples would be extending a significant trade credit to Wise. The new policy was implemented in February 1994 and, before the end of that year, both Peoples and Wise were bankrupt. Peoples' trustee in bankruptcy subsequently brought an action against the Wise brothers, in their capacity as directors of Peoples, claiming that they had breached both their fiduciary duty (i.e. their duty of loyalty) and their duty of care (i.e. their duty of due consideration and skill) to the creditors of Peoples.

The trial judge of the Quebec Superior Court determined that the Wise brothers had failed to fulfill both duties when they adopted the new inventory policy. In reaching that determination, the judge stated that Canadian law should evolve in the direction adopted by the courts in Great Britain, Australia and New Zealand, which have held that directors owe a fiduciary duty to the creditors of a corporation when the corporation is near insolvency.

The Quebec Court of Appeal set aside the trial judge's decision, finding that the conduct of the Wise brothers was reasonable in the circumstances. The Court of Appeal further held that the trial judge had erred in applying case law from other jurisdictions that established that a director owes a fiduciary duty to creditors when a corporation is near insolvency.

The Supreme Court of Canada affirmed the decision of the Quebec Court of Appeal and held that the Wise brothers did not breach their fiduciary duty or duty of care as directors of Peoples. On the question of fiduciary duties, the Court held that those duties are at all times owed *to the corporation*, even when the corporation is insolvent or in the "vicinity of insolvency". The Court held that the phrase the "best interests of the corporation" should not be read simply as the "best interests of the shareholder". From an economic perspective, the "best interests of the corporation" means the maximization of value of the corporation. This is not to say that it is not legitimate, in certain circumstances, for the directors to consider the interests of stakeholders, including employees, suppliers, and creditors when assessing the best interests of the corporation; however, the duty of the directors remains to act honestly and in good faith with a view to creating a "better" corporation, not furthering the interests of any particular group of stakeholders. The Court considered it unnecessary to read the interests of creditors into the fiduciary duty since creditors have the oppression remedy available to them (if directors act in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, any creditor) and also an action based on the duty of care.

The Court held that directors owe a duty of care to creditors and other stakeholders, which provides that directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The "business judgment rule", which was explicitly adopted by the Court, will help directors satisfy this duty. The Court held that directors will not be held to be in breach of their duty of care if they act prudently and on a reasonably informed basis. The Court emphasized that "perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision-making…".

In exploring the duty of care, the Court rejected the "objective subjective" test previously outlined by the Federal Court of Appeal in *Soper* v. *Canada*; that approach involves an objective assessment based on the specific skills and experience of each *individual* director. The Court indicated that the appropriate standard is an objective standard that takes into account the context in which a particular decision was made, but holds all directors to the same standard of care.

The decision of the Supreme Court of Canada should provide directors with comfort that where a board of directors has made a business decision honestly and in good faith, and has acted prudently and on a reasonably informed basis, a court should not (and will not) second-guess the judgment of the directors.

If you wish to discuss the decision or have any questions regarding the duties of directors, please contact a member of the Corporate Securities team.

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