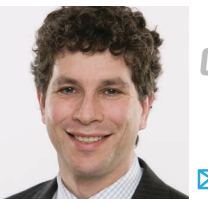

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Mulling about millinery

By Neill May

If you were to walk into a board meeting these days you would almost certainly see few, if any, directors wearing hats. This is likely due to current fashion trends, and to the sensible custom (particularly in Canada) of generally conducting board meetings indoors. But corporate directors are increasingly wearing multiple hats. They're just not ones you can see or touch. This is not a brilliant business opportunity for hat makers disappointed *Mad Men* ended without sparking a revival for hats. It is instead a function of the growing complexity of governance rules and principles. Directors in many hats is not just the catchy name for the Broadway musical that is part of my retirement plan, but a growing factor in boardroom dynamics.

It is common for corporations to have members of their boards be nominees or representative of shareholders. This has long been the case for private companies and for controlled public companies, and is increasingly the case even in more widely held public companies as shareholder activism continues to grow. The presence of nominee directors on boards raises questions about the confidentiality of corporate information and the potentially conflicting obligations of nominee directors.

The easy answer is that directors owe a fiduciary duty (including an inherent duty to maintain confidentiality) to the corporation, not to individual shareholders, and that duty trumps other obligations. But practical considerations often intrude. Nominee directors (and their nominators) might believe they should share material board information with nominating shareholders, that such information sharing has been sanctioned by express or implied consent, and/or no harm will result to the corporation whether because the interests of the corporation and the shareholder are aligned or for other reasons. The differing capacities some directors may have — some are nominees or are themselves shareholders, some are employees of the corporation, some are contractual counterparties — are often described as the directors wearing different hats.

In many respects the principles that guide directors in these circumstances are straightforward. Predictably, in the event of conflicting interests, nominee directors are expected to actively disavow the interests of their nominator. Similarly, when advocating a particular course of action, nominee directors are expected to demonstrate they conducted a reasonable analysis of the situation from the corporation's perspective. The objectives and plans of a shareholder, even a controlling shareholder, should not be determinative. An example of this can be found in *Deluce Holdings Inc. v. Air Canada*. An executive of a regional carrier had been terminated as part of the changed management strategy of the controlling shareholder, but the board had failed to conduct the analysis from the perspective of the regional carrier corporation's interests.

Disclosure issues, however, can be trickier. For example, nominee directors may be surprised to learn if they have a positive obligation to disclose information they learn from other sources (including the nominating shareholder) that affects the vital interests of the corporation. This was illustrated in the 1993 Ontario Court of Appeal decision *PWA Corp. v. Gemini Group Automated Distribution Systems Inc.* The nominee directors of Gemini were found to have breached their fiduciary duties to the corporation for failing to disclose the plans of their nominating shareholder to enter into a commercial arrangement with a competitor that would profoundly adversely affect the business of the corporation.

In sum, nominee directors have an obligation of confidentiality to the corporation, and an obligation to make disclosures to the corporation which might seem to compromise the interests of other parties (most obviously, the nominating shareholders). These are not only different hats, they are — to continue the tortured fashion metaphor — clashing hats.

As a practical matter, disclosure issues often arise in circumstances challenging to manage. By way of a hypothetical example, assume a nominee director learns the corporation's phenomenally talented senior executive is seriously considering leaving the corporation, but is instructed to not yet disclose that possibility to shareholders, including the director's nominator. In a meeting with the nominating shareholder, the director hears the shareholder is making decisions without knowing of the possible management change, which decisions may adversely affect the corporation itself (for example, not pursuing a unique opportunity to engage another senior executive candidate). Does the nominating shareholder say something, say nothing, or start coughing loudly in a pre-arranged signal?

The reference to different hats is a flawed metaphor. While it properly reflects that individuals serve in different roles, it disregards the fact the conflicts often occur inside the individual's head. He or she must consider issues from different perspectives, putting out of their mind the perspectives founded in his or her other roles. Nevertheless, the hat metaphor is probably more palatable than referring to directors with more than one role wearing multiple brains.

The reality is that many sensitive disclosure and conflict issues need to be addressed on their own facts. I have spent a significant amount of time debating specific fact patterns with colleagues, including one who — ironically, given the fashion references in this column — is as profoundly sartorially challenged as I. Because of that insult, and to demonstrate the importance and delicacy of disclosure issues, I will not give his name, but will simply refer to him as "Jon F." or "Feldman" so as to maintain confidentiality and discretion. **CL**

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