

# The Intersection Between Form and Substance in Corporate Law

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In its recent decision in *Mennillo v. Intramodal inc.*, 2016 SCC 51 (“**Mennillo**”), the Supreme Court of Canada addressed, for the first time since 2008, the oppression remedy. At issue was whether a corporation’s failure to comply with the strict requirements of the *Canada Business Corporations Act* (the “**CBCA**”) in completing a share transfer was oppressive, even though the share transfer was agreed to and directed by the company’s shareholders and directors.

The majority of the Court, in reasons for judgment penned by Cromwell J., found that the intention to transfer the shares effectively trumped any deficiencies in carrying out that intention. There was a strong dissent, however, written by Côté J., who made an impassioned plea that courts not ignore statutory requirements or reward parties who do so.

## The Facts

The Respondent corporation, Intramodal inc., was incorporated on July 13, 2004. Two friends, Johnny Mennillo and Mario Rosati, were its only directors and officers. Mr. Rosati was issued 51 shares and Mr. Mennillo was issued 49.

On May 25, 2005, Mr. Mennillo sent a letter to Intramodal resigning as director and officer of the company. Intramodal argued at trial that this resignation also included Mr. Mennillo’s status as a shareholder of the company. It argued that he decided to transfer his shares to Mr. Rosati because he refused to be liable for Intramodal’s liabilities. Mr. Mennillo argued that he meant only to resign as a director and officer (which is indeed what his letter said), and not to relinquish his shares in the company.

On July 18, 2005, Intramodal’s lawyer filed an amending declaration to indicate that Mr. Mennillo had been removed as a director and shareholder of the company. This was not done in accordance with the requirements of the CBCA.

Mr. Mennillo advanced \$440,000 to Intramodal over the next two years. Messrs. Mennillo and Rosati met twice in July, 2007, although their stories differed over what happened at those meetings. By this time, Intramodal was a successful and profitable company. Mr. Mennillo gave evidence that he was unhappy that he was not sharing in the company’s profits. He also said that he rejected an offer at that time to transfer his shares to Mr. Rosati.

For his part, Mr. Rosati claimed that Mr. Mennillo was unhappy at the lack of return on his \$440,000 loan to Intramodal.

Between July 2006 and December 2009, Mr. Mennillo was paid \$690,000 by Intramodal. On December 7, 2009, Mr. Rosati gave Mr. Mennillo a cheque for \$40,000 marked “Full and Final payment”. According to Mr. Mennillo, that was the first time that he understood that he was no longer a shareholder of Intramodal. His lawyer sent a letter to Intramodal claiming that he had been unduly and

wrongfully stripped of his status as a shareholder of the corporation. He applied for an oppression remedy against Intramodal on September 7, 2010.

### **Can One Reasonably Expect a Corporation to Comply with Corporate Statutes?**

In the Court's first opportunity to squarely address the oppression remedy since its decision in *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, all nine justices affirmed the legal test contained in that decision. There are two elements that must be satisfied by an Applicant. First, he or she must "identify the expectations that he or she claims have been violated ... and establish that the expectations were reasonably held" and then must show that those reasonable expectations were violated by conduct that was oppressive, unfairly prejudicial to or unfairly disregarded the interests of any security holder.

The difference between the majority and minority judgments was not in the formulation of this legal test, but rather in its application.

Justice Cromwell reasoned that because it was Mr. Mennillo's intention that he transfer his shares in 2005, he could not reasonably have expected that he would continue to be treated as a shareholder. He found that the failure to properly remove Mr. Mennillo as a shareholder in accordance with his express wishes did not make it just and equitable for Mr. Mennillo to regain his status as a shareholder.

In her dissent, Justice Côté found that the acts of non-compliance with the CBCA were themselves evidence that satisfactorily established oppression against Mr. Mennillo. She found that Mr. Mennillo could have reasonably expected Intramodal to conduct itself in accordance with the provisions of the CBCA. By registering a transfer of Mr. Mennillo's shares without meeting the statutory prerequisites for doing so, it acted in a manner that unfairly prejudiced Mr. Mennillo.

### **Concurring Judgment Simplifies the Court's Message**

Justices Cromwell and Côté were not the only judges to pen an opinion in this case. The Chief Justice, joined by Moldaver J., wrote a separate, concurring judgment. Of the 263-paragraph decision, the Chief Justice required only eight. She succinctly wrote:

Having asked to be removed as a shareholder, Mr. Mennillo had no reasonable expectation that he would remain on the books as a shareholder. ... Mr. Mennillo has failed to establish a reasonable expectation that he would remain a shareholder in Intramodal inc. It follows that his action for oppression must fail.

Cutting through all of the evidentiary and legal land mines that arose in this case, the Chief Justice articulated the heart of the majority's reasoning, and reaffirmed the applicable test in an oppression remedy case: reasonable expectations rule.

A party will not be allowed to take advantage of mistakes, corporate sloppiness, or non-compliance with corporate statutes pursuant to the oppression remedy if to do so would bestow on it an advantage or benefit that it could not have reasonably expected. A breach of a corporate statute will not necessarily establish oppression.

### **Implications for Future Cases**

Justice Côté was concerned that if Intramodal inc. was permitted to avoid consequences for its failure to comply with the CBCA when making the share transfer, that it would encourage other corporations to ignore their corporate obligations as well. But corporations would be foolhardy to take such a lesson from this case. If anything, it highlights the confusion, chaos and exposure that are bestowed on a corporation when it fails to comply with its statutory obligations. If Intramodal had simply complied with the CBCA when establishing the share transfer, there would be no argument and a six-year legal odyssey to the Supreme Court of Canada would have

been avoided.

Corporations are best-served by having qualified corporate counsel acting on their behalf to ensure that statutory obligations are fully complied with, in the hopes that litigation can be avoided.

If your corporation develops a dispute with a stakeholder, or if you believe that you may have a claim for oppression against a corporation, you would be best served to contact litigation counsel as soon as possible. If you have any questions about your rights or best practices, please contact the authors and we would be happy to assist you.

*The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular applications of the law to specific situations, the reader should seek professional advice.*

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