

DIRECTORS' DUTY OF CARE AFTER *PEOPLES*: WOULD IT BE WISE TO START WORRYING ABOUT LIABILITY?

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I. INTRODUCTION

Prior to the Supreme Court of Canada's decision in *Peoples Department Stores Inc. (Trustee of) v. Wise*¹ directors' statutory duty of care was considered to be a paper tiger by many commentators.² The standard of care was relatively lax. The scope of derivative actions was narrow in order to discourage opportunistic litigation. Courts were highly deferential when called upon to review directors' decisions. This view was supported by the fact that there had been "only a tiny handful of cases" in which directors were sued solely for a failure to satisfy the duty of care.³

Recent corporate governance reforms prompt a revision of this conventional wisdom as directors increasingly fear liability.⁴ The *Peoples* decision renders the need for revision even more pressing. When examining the liability of *Peoples*' directors toward creditors, the court proposed a more robust role for the duty of care in corporate

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1. (2004), 244 D.L.R. (4th) 564, [2004] S.C.J. No. 64 (QL).
2. See, e.g., Joseph Bishop, "Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers" (1968), 77 Yale L.J. 1078; Robert Flannigan, "The Personal Tort Liability of Directors" (2002), 81 Can. Bar. Rev. 247; Edward M. Iacobucci, "A *Wise* Decision? An Analysis of the Relationship between Corporate Ownership Structure and Directors' and Officers' Duties" (2002), 36 C.B.L.J. 337 at pp. 345-50; Kevin P. McGuinness, *The Law and Practice of Canadian Business Corporations* (Toronto, Butterworths, 1999), pp. 770-78.
3. Bernard Black and Brian Cheffins, *Outside Director Liability Across Countries*, John M. Olin Program in Law and Economics, Working Paper No. 266, Stanford Law School, 2003, at p. 69.
4. See Patrick J. O'Callaghan & Associates, *Is There a Shortage of Qualified Canadian Directors?* (2003), online at <<http://www.kornferry.com/Library/ViewGallery.asp?CID=551&LanguageID=1&RegionID=23>> (survey citing that liability risk is one of the top three reasons it is getting harder to find new board members).

governance. At the same time, the court reaffirmed the importance of deference toward directors' decisions through a new version of the business judgment rule. In the end, Peoples' directors were absolved from liability.

This comment canvasses the liability issues raised by the Supreme Court's conception of the duty of care. It argues that the Supreme Court's opinion underscores the inherent tension that exists between the authority and responsibility models of corporate governance. Although the Supreme Court appears to favour the authority model to curtail the scope of directors' liability, the decision's wording nonetheless provides justifications for greater judicial activism in corporate governance. Ultimately, the impact of the decision on the liability of directors will rest on the interpretation that courts give to the business judgment rule proposed in *Peoples*.

II. THE SCOPE OF THE DIRECTORS' DUTY OF CARE UNDER THE CANADA BUSINESS CORPORATIONS ACT

Corporate governance involves two concurrent and somewhat conflicting models: authority and responsibility.⁵ Corporation statutes vest authority with the board of directors over the deployment and management of the corporation's resources. Directors' authority must however be counterbalanced by responsibility-ensuring mechanisms to curtail the risk of opportunism. These mechanisms potentially reduce the authority of directors. Thus, there is an inevitable tension between the authority and responsibility models.

The *Peoples* decision reflects this tension. In *Peoples*, the Supreme Court had to decide whether directors of financially distressed corporations are accountable to creditors. The Supreme Court dealt with this issue by analysing directors' fiduciary duties and the duty of care. With respect to fiduciary duties, the Supreme Court set aside the traditional interpretation of the "best interests of the corporation", which gave primacy to shareholders' interests.⁶

5. Michael P. Dooley, "Two Models of Corporate Governance" (1992), 47 *Bus. Law.* 461.

6. The interpretation of the best interests of the corporation proposed by the Supreme Court endorses the stakeholder theory that had been put forward in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288, [1973] 2 W.W.R. 385 (B.C.S.C.). *Teck* had remained marginal in the Canadian jurisprudence. See 820099 *Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 (Div. Ct.); *Palmer v. Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161, 56 D.L.R. (4th) 128 (Div. Ct.);

The court held that the best interests of the corporation refer to the maximisation of the corporation's value.⁷ Although directors are allowed to consider the interests of shareholders and stakeholders in pursuing this objective, the Supreme Court ruled that it is not appropriate to permit directors to favour one group of stakeholders. Even if creditors' interests increase in relevancy as a corporation's finances deteriorate, directors continue to owe their fiduciary duties to the corporation whose interests "are not to be confused with the interests of the creditors or those of any other stakeholders".⁸ The Supreme Court recognized nonetheless that directors could be held accountable to creditors. The proper accountability mechanisms are however the oppression remedy and the statutory duty of care. Given that the observations of the court on the duty of care are particularly groundbreaking, this comment concentrates on this part of the decision.

1. The Extension of Directors' Duty of Care to Creditors and Other Stakeholders

In the opinion of the Supreme Court, the fiduciary duty and the duty of care have differing scopes of application. In contrast with the fiduciary duty, the duty of care does not refer to an identifiable party as the beneficiary of the duty. According to the court, since "the identity of the beneficiary of the duty of care is much more open-ended . . . it appears obvious that it must include creditors".⁹ This opinion reverses a fundamental principle of corporate law. At common law, it had long been established that directors, in the performance of their functions, stand in a fiduciary relationship to the corporation to which they owe fiduciary duties and a duty of care.¹⁰ In civil law, directors

Westfair Foods Ltd. v. Watt, [1990] 4 W.W.R. 685, 73 Alta. L.R. (2d) 326 (Q.B.), affd 79 D.L.R. (4th) 48, [1991] 4 W.W.R. 695 (C.A.), leave to appeal to S.C.C. refused 85 D.L.R. (4th) viii; Bruce Welling, *Corporate Law in Canada — The Governing Principles* (Toronto, Butterworths, 1991), p. 456. It is interesting to note that in *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254, 37 D.L.R. (4th) 193 (Gen. Div.), which the Supreme Court cites as approving *Teck*, it was held that "It is the directors' duty to take all reasonable steps to maximize value for all shareholders."

7. *Peoples*, *supra*, footnote 1, at para. 42.

8. *Ibid.*, at para. 43.

9. *Ibid.*, at para. 57.

10. *Percival v. Wright*, [1902] 2 Ch. 421; *Brant Investments Ltd. v. KeepRite* (1991), 1 B.L.R. (2d) 225, 80 D.L.R. (4th) 161 (Ont. C.A.); *Stern v. Imasco Ltd.*, [1999] O.J. No. 4235 (QL), 38 C.P.C. (4th) 347 (S.C.).

are the mandataries (or agents) of the corporation and owe their duties to the latter, their mandator (or principal).¹¹ These duties are meant to ensure the protection of the mandator who trusts the mandatory to manage her affairs.¹²

From an economic perspective, the proposed scope of the duty of care is puzzling. The duty of care serves to control one form of agency cost, shirking.¹³ The concept of shirking refers to underinvestment in managerial competence and care on the part of directors in the maximization of the value of the corporation.¹⁴ Although its effectiveness may be debatable, the duty of care addresses shirking by imposing *ex post* costs on those who engage in such opportunistic behaviour.¹⁵ It acts as a countervailing force on directors' incentive to shirk.

Shirking opposes, on the one hand, the interests of directors and, on the other hand, the interests of the corporation's stakeholders and shareholders. The latter shares the goal of restraining directors from acting in their self-interest to the detriment of the corporation. This convergence of interests renders the extension of the duty of care to particular constituencies unnecessary. It suffices that directors owe their duty of care to the corporation since the enforcement of the duty will serve the interests of stakeholders and shareholders.

The extension of the scope of the duty of care creates a personal right of action for every shareholder and stakeholder of the corporation. This will likely marginalize the derivative action that had been developed to enable shareholders and stakeholders to bring an action in the name or on behalf of the corporation. The

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11. Article 322 of the Civil Code of Quebec, S.Q. 1991, c. 64 (CCQ). See *Bank of Montreal v. Ng*, [1989] 2 S.C.R. 429, 62 D.L.R. (4th) 1. The general duty of care of mandataries established by article 2138 CCQ is enacted in the subsection entitled "Obligations of the mandatory towards the mandator".
 12. *Laflamme v. Prudential-Bache Commodities Canada Ltd.*, [2000] 1 S.C.R. 638, 185 D.L.R. (4th) 417.
 13. Victor Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract" (1985), 85 Col. L. Rev. 1403 at p. 1432; Iacobucci, *supra*, footnote 2, at p. 345.
 14. Frank H. Buckley, Mark R. Gillen and Robert Yalden, *Corporations — Principles and Policies*, 2nd ed. (Toronto: Emond Montgomery, 1995), p. 579; Eric O. Orts, "Shirking and Sharking: A Legal Theory of the Firm" (1998), 16 Yale J. & Pol'y Rev. 265 at pp. 277-78.
 15. Robert Cooter and Brian J. Freeman, "The Fiduciary Relationship: Its Economics Character and Legal Consequences" (1991), 66 N.Y.U. L. Rev. 1045 at p. 1056; Doug Harris *et al.*, *Cases, Materials and Notes on Partnerships and Canadian Business Corporations*, 4th ed. (Toronto, Carswell, 2004), p. 211. For a critical view, see Buckley, Gillen and Yalden, *ibid.*, at pp. 588-89; Iacobucci, *supra*, footnote 2.

demise of the derivative action in duty of care cases will remove the procedural hurdles the plaintiff faced.¹⁶ It will no longer be necessary for the plaintiff to establish her complainant status. Moreover, the plaintiff will not have to prove that she made reasonable efforts to cause the directors to commence the action directly, that she is acting in good faith, and that it is *prima facie* in the interest of the company that the action be brought. These conditions sought to prevent opportunistic strike suits, to curtail unmeritorious or groundless claims, and to avoid the multiplicity of lawsuits.¹⁷ The creation of a personal right of action for directors' breach of the duty of care may open the door to these problems.

To assess this risk, it appears apposite to draw a distinction between shareholders and other securities holders, and stakeholders. For the former, the creation of a personal right of action could have little impact given that they already have access to the oppression remedy. Given its breadth, the oppression remedy covers directors' decisions. Furthermore, the substantive ground of unfairness is almost always broader than the substantive trigger for the invocation of fiduciary duties.¹⁸ This has led courts to routinely characterize directorial conduct that is a breach of fiduciary duty as oppressive.¹⁹ In other words, the oppression remedy already enables shareholders and other security holders to "transform" a fiduciary duty-type claim into an oppression action and thereby to launch derivative-type actions.²⁰

Some qualifications are warranted in Québec where the Companies Act²¹ does not provide comprehensive remedies to protect minority shareholders.²² The Act does not contain an

16. Sections 238 and 239 of the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (CBCA).

17. Robert W.V. Dickerson et al., *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971), vol. I, at para. 482.

18. Harris et al., *supra*, footnote 15, at p. 913.

19. *Ibid.* See *Brant Investments Inc. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, 80 D.L.R. (4th) 161 (C.A.); *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, 160 D.L.R. (4th) 131 (Ont. Ct. (Gen. Div.)); *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 44 B.L.R. (2d) 115, 42 O.R. (3d) 177 *sub nom. Maple Leaf Foods Inc. v. Schneider Corp.* (C.A.).

20. Jeffrey G. MacIntosh, "The Oppression Remedy: Personal or Derivative?" (1991), 70 Can. Bar Rev. 29. See, e.g., *Sparling v. Javelin International Ltd.* [1986] R.J.Q. 1073 (QL) (S.C.).

21. R.S.Q., c. C-38 (QCA).

22. See Raymonde Crête and Stéphane Rousseau, *Droit des sociétés par actions — principes fondamentaux* (Montréal: Éditions Thémis, 2002), pp. 808-71.

oppression remedy or even a statutory derivative action. Minority shareholders are still confronted by majority rule when they seek to attack directors' decisions.²³ By extending the scope of directors' duty of care, *Peoples* creates a new remedy for shareholders that will enable them to challenge directors' conduct without having to circumvent majority rule.²⁴

For other stakeholders, the impact could be significant. To launch an oppression remedy, they must convince the court that they are a proper person to make an application. Courts have been reluctant to grant complainant status to creditors and employees.²⁵ They have developed guidelines to prevent creditors "from routinely accessing the broad discretionary remedies available to parties who have been oppressed".²⁶ The ability of creditors and other stakeholders to rely on the duty of care to launch a personal action against directors may enhance the range of remedies at their disposition. To fully appreciate this claim, it is necessary to examine the role of s. 1457 of the Civil Code of Québec in the enforcement of the duty of care.

2. Article 1457 of the Québec Civil Code and the Enforcement of the Duty of Care

The court states that article 1457 CCQ provides the mechanism through which the directors' duty of care is enforced. It is uncontroversial that article 1457 applies to dealings between directors and stakeholders. This provision enacts a general liability regime that applies to every person, irrespective of status.²⁷ The fact that directors are mandataries of the corporation does not exonerate them from this liability regime *per se*.²⁸

23. *Foss v. Harbottle* (1843), 2 Hare. 41, 67 E.R. 189; *Lagacé v. Lagacé*, [1966] C.S. No. 489 (QL) (S.C.).

24. Recently, Québec tribunals have attempted to develop mechanisms to protect minority shareholders by relying on the common law concept of equity in *Laurent v. Buanderie Villeray ltée*, [2001] Q.J. No. 5796 (QL) (S.C.), and on the civil law concept of abuse of right in *Équipements Ovila Poulin inc. v. Carrier*, [2002] Q.J. No. 5358 (QL) (S.C.).

25. Anthony Van Duzer, "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" (1993), 25 Ottawa L. Rev. 463. See, e.g., *First Edmonton Place Ltd. v. 315888 Alberta Ltd.*, [1988] A.J. No. 511 (QL), 60 Alta. L.R. (2d) 122 (Q.B.), appeal adjourned [1990] 2 W.W.R. 670, 71 Alta. L.R. (2d) 61 (C.A.).

26. David Thomson, "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty not to Oppress?" (2000), 58 U.T. Fac. L. Rev. 31 at p. 36.

27. *Proulx v. Entreprises de Radiodiffusion de la Capitale inc.*, [1996] R.R.A. No. 714 at p. 717 (QL) (Que. S.C.).

28. Claude Fabien, *Les règles du mandat*, dans Chambre des notaires du Québec, *Répertoire de droit*, «Mandat», Doctrine – Document no. 1 (Montréal, 1986).

Hitherto, courts had refrained from drawing on s. 122 of the Canada Business Corporations Act to construct the standard of conduct imposed by article 1457.²⁹ They had followed the more traditional approach of seeking what would have been the conduct of a reasonably prudent and diligent person in the circumstances.³⁰ In doing so, the courts proved reluctant to impose liability on directors in actions brought by creditors.³¹ The creditor seeking to hold directors liable had to demonstrate that the directors had committed a personal fault. Such fault had to be autonomous and could not result solely from the breach of contract by the corporation.³²

The proof of an autonomous fault was not easy since courts considered mere negligence insufficient to find directors liable. The threshold of the fault stood between questionable conduct and fraudulent or abusive conduct.³³ This threshold was unusual since under article 1457 a non-intentional fault that arises from an imprudent or negligent action leads to the same civil liability as one that arises from a deliberate action to cause injury. Still, courts were more inclined to find directors liable toward creditors where their conduct was fraudulent or manifested bad faith than where it constituted mere negligence.

In *Peoples*, the Supreme Court stated that the liability of directors under article 1457 shall be judged in light of the duty of care defined in s. 122 of the CBCA, which enacts a negligence standard. This suggests that the requirement of intentional fault established by the jurisprudence may no longer be valid. If this is so, every negligent act on the part of directors will open the door to potential liability toward third parties irrespective of whether or not the act was committed in the course of functions *qua* director. Indeed, in *Peoples*, although the decision to implement the procurement

29. For a presentation of the classic approach, see Louise-Hélène Richard, "Le devoir d'indemnisation de la compagnie québécois: réflexions sur la responsabilité personnelle du mandataire" (1988), 48 R. du B. 785 at pp. 811-21.

30. Jean-Louis Baudouin and Patrice Deslauriers, *La responsabilité civile*, 5th ed. (Cowansville, Éditions Yvon Blais, 1998), pp. 111-14. See *Germain v. Restaurants McDonald du Canada Ltée*, [1996] R.R.A. No. 184 (QL) (Que. S.C.).

31. See Stéphane Rousseau, "The Liability of Directors toward Creditors in Civil Law: A Note on *Peoples Department Stores Inc. v. Wise*", [2003] 1 Annual Review of Insolvency 121.

32. *Constructions Serafini inc. v. Gold Coin Development Corp.*, 2000 CarswellQue 2411 (Que. C.A.).

33. *Corp. d'hébergement du Québec v. Gestion V.S.P. (1982) inc.*, 2001 CarswellQue 1190 (Que. S.C.), affd [2003] A.Q. No. 4895 (QL) (C.A.).

policy was clearly made in the course of the directors' functions, the court was willing to consider that it would be actionable conduct if it qualified as negligent.

This interpretation may raise fears that the liability of directors toward creditors and other stakeholders will expand. However, it is important to emphasize that the liability of directors will not be triggered only by the proof of a fault. Recall that creditors will have to establish that they have suffered damage as a result of this fault. They will have to prove that their damage is direct, *i.e.* that their damage is not the consequence of the damage caused to the primary victim, the corporation.³⁴ The importance of this condition has been recognized in corporate law since *Burland v. Earle*.³⁵ Admittedly, this distinction is lost in the *Peoples* decision. The Supreme Court seems to suggest that the Wise brothers would have had to indemnify the creditors if they had been found to have breached their duty of care when adopting the procurement policy. This opinion is unfortunate. The direct damage requirement serves to prevent double recovery. Where the directors indemnify the corporation, the creditors and other stakeholders benefit in the same proportion as they were injured.³⁶ Furthermore, this requirement secures "the *pari passu* principle that all creditors should be treated equally upon the insolvency of the corporation".³⁷ In effect, "[i]f each creditor were able to sue for his own loss, then those rules aimed at achieving some measure of justice and certainty between creditors would be effectively by-passed".³⁸ To avoid these negative consequences, courts applying the *Peoples* decision will have to be vigilant to limit liability claims against directors to direct damages.

34. Baudouin and Deslauriers, *supra*, footnote 30, at p. 350, para. 529.

35. [1902] A.C. 83 at p. 93 (P.C.). See also *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577; *Silverman v. Heaps*, [1967] C.S. No. 536 at p. 539 (QL) (Que. S.C.).

36. *Hercules Management Ltd. v. Ernst & Young*, *ibid.*; *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216, 54 D.L.R. (3d) 672 (C.A.); MacIntosh, *supra*, footnote 20, at pp. 61-62. To try to determine the precise amount of damage suffered by the creditors for the harm done to the corporation in order to avoid double recovery would prove a daunting task.

37. Dan Prentice, "Creditor's Interests and Director's Duties" (1990), 10 Ox. J. Leg. St. 265 at pp. 275-76. Similar concerns were expressed in *Comeault v. Bird*, [2002] O.J. No. 483 (QL) at para. 20, 27 B.L.R. (3d) 154 (Ont. S.C.).

38. C.A. Riley, "Directors' duties and the interests of creditors" (1990), 10 Co. Law. 87 at pp. 90-92.

III. THE CONTENT OF THE DUTY OF CARE: THE STANDARD OF CONDUCT AND THE STANDARD OF REVIEW

1. An Objective Standard of Conduct

Pursuant to the CBCA, directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This rather straightforward language has spurred considerable debate as to whether the statutory formulation of the duty of care raised the subjective standard of conduct set at common law.³⁹ In *Peoples*, the court stated unequivocally that the statutory duty of care establishes an objective standard of care.⁴⁰ It is not an entirely abstract standard since the expression “in comparable circumstances” requires the consideration of the context in which a given decision is made. The court however cautions that the contextual analysis does not amount to the introduction of a subjective element that would lead to the adaptation of the standard of conduct to reflect the knowledge and experience of the particular individual.⁴¹

The Supreme Court's comments are welcome given the long-standing ambiguity on this question. The court's conception of the duty of care is more in line with contemporary preoccupations regarding the quality of corporate decision-making. The objective standard of conduct may lead to the identification of core elements concerning the behaviour expected from a reasonable person acting as director. The contextual approach also supports the development of a more demanding standard of conduct that takes into account corporate governance preoccupations.⁴² It provides a mechanism for the integration into the standard of conduct of the informal “best practices” governance norms that have become more demanding for directors over the last few years.⁴³ To some extent, the duty of

39. See *Soper v. Canada*, [1998] 1 F.C. 124, 149 D.L.R. (4th) 297 (C.A.); McGuinness, *supra*, footnote 2, at pp. 772-73; Martha O'Brien, “The Director's Duty of Care in Tax and Corporate Law” (2003), 36 U.B.C. L. Rev. 673.

40. *Peoples*, *supra*, footnote 1, at para. 63.

41. *Ibid.*, at para. 62.

42. *Ibid.*, at para. 64.

43. See the Australian decision of *A.S.I.C. v. Rich*, [2003] N.S.W.S.C. 85 at pp. 146-47 (N.S.W.S.C.): “Much of the literature of corporate governance is in the form of exhortations and voluntary codes of conduct, not suitable to constitute legal duties . . . Nevertheless, in my opinion this literature is relevant to the ascertainment of the responsibilities to which [the Chairman] was subject.”

care could thus enhance the regulatory dimensions of corporate governance best practices.⁴⁴

More disappointing is the lack of guidance as to how the standard of conduct is to be adapted to ensure the protection of creditors' interests. The decision does not indicate whether the care expected of directors is to be measured in light of the corporation's contractual obligations. Put differently, will a decision by directors that leads to a breach of contract by the corporation be considered to be a breach of the duty of care? Or will it be necessary to prove that directors have breached a norm of conduct that is independent from the contract between the creditors and the corporation? The Supreme Court appears to support the latter interpretation as it focuses on the conduct of directors as they adopted the procurement policy. The court gives little consideration to the contractual relations that existed between Peoples and its creditors. This approach seems preferable to avoid making the directors the guarantor of the corporation's obligations. Considering the interpretation it gave to the duty of care, the Supreme Court could have articulated more clearly the relation between the standard of conduct and the dealings that exist between the corporation and its stakeholders.

2. The Business Judgment Rule: Whither the Enhanced Scrutiny Standard?

Although it favours a more stringent duty of care, the court emphasized the need to preserve directors' authority. Tribunals "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".⁴⁵ The hindsight bias can lead "some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*".⁴⁶ Therefore, the court observed that tribunals should be guided by a rule of deference when reviewing business decisions.

The need to preserve directors' authority led to the emergence of two concurrent business judgment rules in Canadian

44. See Melvin A. Eisenberg, "Corporate Law and Social Norms" (1999), 99 Col. L. Rev. 1253 at p. 1276; Richard A. Posner and Eric B. Rasmusen, "Creating and Enforcing Norms, with Special References to Sanctions" (1999), 19 Int'l Rev. Law & Econ. 369.

45. *Peoples*, *supra*, footnote 1, at para. 64.

46. *Ibid.*

jurisprudence.⁴⁷ Pursuant to the first, directors were liable only for “gross negligence”, not for mere errors of judgment.⁴⁸ Pursuant to the second, the court’s deference was conditional on the existence of a prudent and diligent decision-making process.⁴⁹ Without referring to these prior versions, the court proposed a new business judgment rule following which tribunals should refrain from finding directors liable for “bad” business decisions where two conditions are met. The first concerns the decision-making process and requires that directors acted prudently and on a reasonably informed basis. The second involves an examination into the reasonableness of the decision made: “The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known.”⁵⁰ This business judgment rule which consists in a two-pronged test mimics the enhanced scrutiny test developed in Delaware.⁵¹

The choice made by the Supreme Court in favour of the enhanced scrutiny test is surprising. In Delaware, this test applies only where the board faces a conflict of interests.⁵² It shifts the onus of proof on directors who must satisfy the conditions of the test to benefit from the court’s deference. If they fail, directors must then prove the entire fairness of their decision. In *Peoples*, the Supreme Court presents the enhanced scrutiny test as applying to every instance where directors’ decisions are being challenged. Does this imply that courts will now engage in more detailed review of directors’ decisions?

47. Stéphane Rousseau, “Le rôle des tribunaux et du conseil d’administration dans la gouvernance des sociétés ouvertes: réflexions sur la règle du jugement d’affaires” (2004), 45 C. de D. 469.

48. *In Re City Equitable Fire Insurance Co.*, [1925] 1 Ch. 407 (C.A.); *Peoples Department Stores Inc. (trustee of) v. Wise* (2003), 224 D.L.R. (4th) 509, [2003] R.J.Q. 796 (Que. C.A.).

49. See, e.g., *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 27 B.L.R. (3d) 53, 214 D.L.R. (4th) 496 (Ont. S.C.), affd [2004] O.J. No. 636 (QL), 42 B.L.R. (3d) 34 (C.A.).

50. *Peoples*, *supra*, footnote 1, at para. 67.

51. *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34 at p. 45 (Del. 1994): “The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decision making process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors’ action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.”

52. *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

To canvass an answer to this question, it is worth emphasizing first that the Supreme Court's version of the test does not change the onus of proof for the plaintiff who still must prove that the directors do not deserve the tribunal's deference. Second, the reasoning indicates that the crucial part of the test is the reasonableness of the decision. The court criticized the directors for their decision-making process, noting that they "could have been more precise in pursuing a resolution to the intractable inventory management problems, having regard to all the troublesome circumstances involved at the time the new policy was implemented".⁵³ Nonetheless, the Supreme Court considered that the procurement policy was a reasonable business decision "that was made with a view to rectifying a serious and urgent business problem in circumstances in which no solution may have been possible".⁵⁴ Thus, the court held that the directors could not be held liable for a breach of their duty of care in respect of the creditors of *Peoples* for having adopted the procurement policy. The court's opinion suggests that the quality of the directors' decision-making process will rarely be sufficient in a finding of liability unless the plaintiff also proves that the decision itself was unreasonable.

Thus, the impact of the enhanced scrutiny test on directors' liability will depend on the tribunals' conception of the unreasonableness criteria. If tribunals follow *Schneider*, which states that this criterion requires proof that "a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction", the enhanced scrutiny test will have little impact on directors' liability.⁵⁵ The deference of courts toward directors' decisions will then be similar to the traditional "gross negligence" test. In this case, the proposed business judgment rule will limit the role of the duty of care in providing a regulatory dimension to corporate governance best practices. If they depart from *Schneider*, tribunals could use the wide discretion conferred by the unreasonableness criterion to review more closely directors' decisions. This could lead to a greater liability risk for directors.

53. *Peoples*, *supra*, footnote 1, at para. 71.

54. *Ibid.*, at para. 68.

55. *Ibid.*, at para. 65, quoting from *Pente Investment Management Ltd. v. Schneider Corp.*, *supra*, footnote 19, at p. 192.

IV. CONCLUSION

In *Peoples*, the Supreme Court has rendered a complex and somewhat puzzling decision on directors' duty of care. This comment argued that the court's reasons are best understood as an attempt to strike a balance between the authority and responsibility models of corporate governance. Although the court appears to have favoured the authority model through its proposed business judgment rule, the decision's wording leaves room for courts to tilt the balance in the direction of the responsibility model. Thus, the *Peoples* decision may lead to a greater role for the judiciary in corporate governance.