

What Can Go Wrong when a Director is also the largest Shareholder

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One of the things I have enjoyed most about practising law is the wonderful and unusual fact situations that can arise. Having now practised for 20 years, I can recollect a number of situations that would involve some version of “I can’t believe that actually happened”. Earlier this year I had another. We acted as counsel for a public company and its board in a proxy contest where over 98% of shares were voted. That in itself is remarkable in the junior public markets where shareholder turnout is usually a fraction of that but the turnout wasn’t the best part. This was a hotly contested battle between the largest shareholder (who held over 42% of the shares himself and had the support of another shareholder with over 5% of the shares) and the independent directors who were acting to protect the interests of the minority public shareholders and held a minimal ownership position. I would normally advise management to settle if they knew going in that nearly 48% of the vote is already aligned against them but here there was a path to victory that the client chose to pursue. The vote went down to the wire and I don’t think anyone slept the night before wondering if any last minute twists would occur. Despite what you would expect on the facts, the independent directors prevailed. I’ve included a link to the [National Post’s](#) take if you are interested in more detail.

As entertaining as all of the machinations were, one of the issues that was highlighted for me as this situation developed is the tension that exists for public companies when there is one large shareholder with board representation. In our case, the 42% shareholder was also a director and the conflict had arisen at the board level when the independent directors were not as deferential to him as he had expected. The situation deteriorated, ended up in court and finally at the shareholder meeting.

In small public companies, it isn’t unusual to find a shareholder with a significant control block who usually also serves on the board. It can also be an issue where institutional investors in larger public companies demand representation on boards where they have a significant share position. While most of the time things run smoothly, problems can arise that public company directors should be aware of. The shareholder/director can have a very hard time separating her obligations to other shareholders (and other stakeholders) from her understandable self-interest as a large shareholder with a significant financial stake. While this problem can also exist in private corporations it is more pronounced in the public context where there are many small shareholders who have limited ability to participate in the governance of the company.

If you find yourself in this situation your fiduciary duty is paramount. At board meetings and for all board decisions, you are obligated to act in the best interests of the company and it is wrong to assume that because you are the largest shareholder (or are appointed at the largest shareholder’s request) those interests are the same. You should always keep in mind which hat you are wearing when taking a position on an issue. If you serve on the board of a company that has this issue, you also need to be vigilant and ensure best corporate governance practices are undertaken. If the shareholder/director can’t separate her interests and fulfil her fiduciary duties you may no longer be able to fulfil your own obligations and may need to resign. Investors should also be cognizant of the issue when making investment decisions as it can result in increased risk. If there is high director turnover there is likely an issue.

There is no simple solution when this issue arises and all parties should ensure they are fully aware of their obligations.

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

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