Directors' And Officers' Liability

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The following is intended for general information only, regarding some of the issues relating to purchasing a business in Saskatchewan. We advise you to seek specific legal advice prior to making any of the arrangements outlined in this article, as the particular facts of each person's situation will vary, as will the advisability and effectiveness of any particular strategy.

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1. Introduction

A corporation's officers and directors have the responsibility to manage the corporation. They must oversee management and decide business policy. They must act with a view to the best interests of the corporation as a whole, taking into account the interests of shareholders, creditors and employees. Many of the duties of directors and officers are found in the general formulations of policy in the Canada Business Corporations Act (the "CBCA") or The Business Corporations Act of Saskatchewan (the "SBCA"). However, with increasing regularity directors must look to other statutes to determine their duties and their obligations. There are more than 100 statutes which impose duties upon directors and officers and prescribe punishment in the way of fines or imprisonment where those obligations are not met. These statutory obligations do not embody empty threats. More and more, government is ensuring legislative
policy is followed by prosecuting the directing minds of corporate bodies. It is not low-level management and front-line employees who must worry about prosecution as much as the most powerful officers within a corporation and, of course, the directors.

The summary seeks to identify the most significant sources of director and officer liability. As mentioned above, there are many. Fortunately, the risk can be minimized. Through indemnification by the corporation, directors’ and officers' liability insurance, and by exercising due diligence in running the affairs of the corporation, directors and officers can significantly reduce their risk.

2. General Duties of Directors and Officers

• Fiduciary Duty and Duty of Care

The role of the Board of Directors under the CBCA and the SBCA is to manage the business and affairs of the corporation. The role of the officers is to undertake the day-to-day operations of the business and affairs of the corporation subject to the general supervision of the directors. Under both Acts, a director or an officer is subject to two duties to the corporation: a fiduciary duty and a duty of care. The fiduciary obligation requires every director and officer to act honestly, in good faith and in the corporation’s best interests. A director or officer is bound to act with the utmost loyalty and good faith for the benefit of the corporation and is accountable to the corporation for any personal profit or gain realized from any dealings with the corporation's assets or for any advantage he or she may secure by reason of his or her office.

The duty of care requires that every director and officer must exercise the care, diligence and skill which a reasonably prudent person would exercise in comparable circumstances.

• Liability for Certain Resolutions of the Board

Both the CBCA and the SBCA stipulate that certain activities of the Board are prohibited. If the Board authorizes any of these activities, the directors can be held liable. These activities are as follows:

- Issuance of shares for consideration other than money at less than fair market value;
- Purchase, redemption or acquisition of shares where the corporation is unable to meet the stipulated solvency test;
- Payment of an improper commission for the purchase of shares;
- Improper payment of a dividend where the corporation cannot meet the stipulated solvency test;
- Improper payment of indemnification under circumstances other than those permitted by the Acts; and
- Excess payments to a shareholder upon the exercise of dissenting shareholder rights.

• Liability for Wages of Employees
Under both the CBCA and the SBCA, directors of a corporation are jointly and severally liable to employees of the corporation for all debts not exceeding six months’ wages payable to each such employee for services performed for the corporation while they are directors. This liability includes any severance pay which may be found due and owing.

Likewise in Saskatchewan, under The Labour Standards Act directors are jointly and severally liable for all debts owed to employees, not exceeding six months’ wages.

- **Occupational Health and Safety**

Occupational health and safety legislation permits the prosecution of any director or officer who fails to ensure compliance by the corporation with such legislation. The general purpose of the legislation is to ensure a safe environment for employees. Once the Crown has proved a contravention by the corporation, it must then prove that the officer or director failed to take all reasonable care to prevent the contravention.

In order to avoid conviction, directors and officers will be required to ensure the corporation implements a system designed to ensure compliance, and will be required to ensure the corporation takes steps to enforce the effective operation of the system.

- **Liability for Taxes**

Under the Income Tax Act, a corporation is required to deduct tax at source on employees’ salaries and wages and to remit these amounts to Canada Revenue Agency. Under 227.1 of the Act, if a corporation does not comply with these requirements, its directors may be personally jointly and severally liable for the amount due, together with interest and penalties. A director can avoid liability if he or she exercised due diligence to prevent the failure to comply. Similar provisions exist in companion legislation for CPP and EIC contributions, and also with respect to GST under the Excise Tax Act.

Canada Revenue Agency’s practice with respect to assessments is that every effort will be made to collect the amount owing from any realizable assets of the corporation. Only once it is determined that there are insufficient assets to satisfy the amount owing will the directors be advised of possible actions against them.

- **Conflict of Interest**

Both the CBCA and SBCA require that any director or officer of the corporation that is a party to a material contract or proposed material contract of the corporation or is a director or officer of, or has a material interest in, any entity which is a party to a material contract or proposed material contract with the corporation, must disclose this interest in writing to the corporation or request to have entered in the minutes of the meeting of directors the nature and extent of the interest. The disclosure must be made at the first meeting at which the proposed contract is first considered or
at the first meeting after he or she becomes interested in the contract. The director must refrain from voting on any resolution to approve the contract, with a few exceptions such as when voting upon resolutions for indemnity or for insurance.

The disclosure requirements are part of the fiduciary relationship between directors and the corporation. Directors and officers must not put themselves in a position in which personal interest and corporate duties conflict. A director of a corporation is consequently precluded under the general law from dealing, on behalf of the corporation, with himself or herself in a manner which will cause the corporation to enter into engagements in which he or she has a personal interest which conflict with the interest of the corporation. If this rule is infringed, the contract is voidable at the option of the corporation and the director is liable to account to the corporation for any profits gained. An officer has similar duties towards his or her corporation and the consequences of contracting with the corporation are the same at common law as in the case of a director who is so contracting.

- **Liability for Environmental Matters**

Regulatory authorities and governments increasingly are holding directors and officers responsible for environmental compliance. In Ontario, the Ministry of the Environment has taken a more aggressive approach in prosecuting individuals when it perceives them to have been responsible for corporate pollution. For example, the Ministry of the Environment (MOE) conducted a prosecution of both Bata Shoes and a director of Bata in relation to the discharge of chemicals from the site of the company's manufacturing operations. The MOE was also successful in having a conviction upheld on appeal in respect of a charge laid under section 16 of The Ontario Water Resources Act against George Crowe, managing director of a company which participated in the burial of 185 drums of toxic waste on a farm in eastern Ontario. It should be noted that the director was also the sole shareholder and the sole directing mind of the corporation. He was sentenced to six months in jail, which was reduced to 15 days by the Court of Appeal.

The key legislative provisions in Saskatchewan applicable to officers and directors in the environmental context are as follows:

- The Environmental Management and Protection Act, 2002, subsection 75(3);
- The Clean Air Act, subsection 22(2);
- The Dangerous Goods Transportation Act, section 21; and
- The Occupational Health and Safety Act, 1993 section 60.

The key federal legislative provisions applicable to officers and directors in the environmental context are as follows:

- Canadian Environmental Protection Act, 1999, section 280; and
- Fisheries Act, section 78.
3. Avoiding Liability

• Dissenting from the Offending Resolution

The liability discussed above is imposed upon directors who voted for or consented to resolutions authorizing the corporate actions which give rise to the prohibited act.

Consent is indicated by the signing of a resolution or by failing to dissent at a meeting. A director who is present at a meeting of directors, or a committee of directors, is deemed by either the SBCA or the CBCA, as the case may be, to have consented to any resolution passed or actions taken at that meeting unless he or she requests that his or her dissent be entered in the minutes or his or her dissent is so entered, or unless he or she delivers a dissent or sends one by registered mail to the registered office of the corporation immediately after the meeting is adjourned. A director who has actually voted in favour of, or consented to, a resolution cannot later dissent.

A director who is not present at a meeting at which a resolution was passed or action taken has seven days after he or she becomes aware of the resolution to dissent either by causing his or her dissent to be placed in the minutes of the meeting or by delivering a dissent or sending one by registered mail to the registered office of the corporation. Otherwise, he or she is deemed to have consented to the resolution or action taken.

• Reliance upon Statements and Reports

A director will also be protected from liability if he or she has relied in good faith upon financial statements of the corporation or a written report of the auditor if they are presented to him or her by an officer or the auditor, respectively, as fairly reflecting the financial conditions of the corporation. Such director will also be protected where he or she relies upon the reports of other professionals, whose profession lends credibility to the statements in those reports. It should be noted, however, that the directors must not simply accept all reports at face value. They must prudently and diligently make such inquiries of the officers or auditors or professionals, as the case may be, to ensure that the report is reasonable and that the recommendations are not in contravention of the relevant Act.

On environmental matters, a defendant director may in the same manner avoid liability by proving that he or she took all reasonable care or exercised due diligence. This may include having a written environmental policy, ensuring compliance with the policies, having adequate employee training and information, having adequate staffing levels to guard against environmental mishaps, having properly designed equipment, ensuring adequate maintenance, and having an emergency plan.

4. Protection of Officers and Directors Through Indemnification and Insurance
Under the CBCA and SBCA, the corporation must indemnify a director or officer in certain circumstances and may indemnify an officer and director in additional circumstances in order to relieve him or her from personal liability for breach of duty. A court may order indemnification in certain circumstances.

- **Mandatory Indemnification.**

  Generally, the corporation must indemnify an officer or director (including a former officer and director) against all costs or expenses reasonably incurred by him or her in connection with the defense of any civil, criminal or administrative proceeding to which he or she was made a party because of his or her association with the corporation provided that the officer or director:

  1. Was substantially successful on the merits in the defence of the action against him or her;
  2. Satisfied his or her fiduciary duty to the corporation; and
  3. In the case of criminal or administrative proceeding, had reasonable grounds for believing his or her conduct was lawful.

- **Permitted Indemnification**

  If an officer or director is not legally successful on the merits of his or her defence (ie. the first criterion mentioned immediately above has not been met), the corporation still has the discretion to indemnify the officer or director provided the other two criteria are met. In this case, the director or officer may be indemnified for costs and expenses, including an amount paid to settle the proceeding or to satisfy a judgement, that are reasonably incurred in respect of the proceeding against the officer or director. It is recommended that those acting as officers or directors enter into a specific contract of indemnity with the corporation.

- **Indemnification in Actions brought by the Corporation or Derivative Actions Against an Officer or Director**

  Where an action is brought by a corporation or on behalf of a corporation (ie. a derivative action) against an officer or director, a corporation may, with court approval, indemnify him or her against all costs and expenses reasonably incurred by him or her in connection with the action provided that:

  1. the officer or director was not in breach of his fiduciary duty to the corporation; and
  2. in the case of a criminal or administrative proceeding where a monetary penalty was imposed, the officer or director had reasonable grounds for believing that his or her conduct was lawful.

- **Insurance**
Under both the CBCA and the SBCA, the corporation may purchase for the officers and directors, insurance with respect to liability arising from the breach of the duty of care, diligence and skill. Such insurance should be reviewed carefully to ensure it contains adequate protection for the directors and officers against the risks discussed above; it will not, however, protect a director or officer from liability with respect to claims arising from a breach of fiduciary duty to the corporation, or dishonest or fraudulent conduct.

5. **Contacting a Lawyer on this Subject**

For more information on this subject or specific legal advice, contact Robertson Stromberg Pedersen LLP at (306) 652-7575.