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**Directors, Officers and Managers Personal
Liability: The Legal Position in Canada**

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DIRECTORS, OFFICERS AND MANAGERS PERSONAL LIABILITY IN CANADA

In Canada, both statute and common law create personal liability for directors, officers and managers based on wrongful acts or, in certain defined circumstances, based merely on status as a director. The following is a general summary of the nature and extent of the duties and responsibilities imposed by law on directors, officers and managers, as well as a brief review of indemnification agreements and/or liability insurance which is available to protect their personal assets. It is not legal advice.

1. Structure of Canadian Corporate Entities

Politically, Canada is a federation and corporations in Canada may be incorporated under either federal or provincial legislation. The statutes governing both types of incorporation create similar duties for directors, officers and managers. Securities law in Canada is a provincial responsibility and both federally and provincially incorporated corporations are governed by provincial securities legislation. The interplay between provincial securities legislation and the corporate statutes creates “public” and “private” corporations. Except as otherwise described, the general concepts discussed apply to directors, officers and manager of both private and public corporations, as well as, where applicable, to Not for Profit corporations.

2. Who are Directors, Officers and Managers?

- (a) **Directors** — The term “director” is defined in Canadian corporate law, but not in an exhaustive fashion. An individual exercising functions equivalent to those expected of a director can be imposed with obligations of a director, even if they do not have the formal title. For example, a person who has resigned a directorship, but continues to act in the capacity of a director, will be deemed to be a director.
- (b) **Officers** — The day-to-day management of the business of the corporation is generally delegated by the directors to the officers of the corporation. The officers of a corporation so designated generally include the chairman of the board, the president, the vice-president, the secretary and the treasurer. Federal corporate law also defines officers to include each of the five highest paid employees of the corporation.

Corporate officers are judged against the same standard of conduct as the directors. However, since the delegation of certain powers to the officers of the corporation is prohibited (issuance of securities, declaration of dividends, approval of financial statements), the range of potential liabilities for officers and managers may not be as wide as that of the directors of the corporation.

- (c) **Managers** — There is no specific office of “manager” under Canadian corporate law. However, a manager may be deemed to be a director if acting in the capacity of a director. A manager who is a senior executive with the corporation will owe the same duties to the corporation as an officer.

3. Legal Basis of Directors, Officers and Managers Liability in Canada

a) Statutory, Civil and Contractual Legal Framework

The 120 plus statutes in Canada dealing with duties and liabilities of directors, officers and managers create civil liabilities, administrative penalties and criminal offences. Liability may depend simply on status as a director (liability for unpaid wages after bankruptcy), or there may be a defence of due diligence (failure to make tax remittances). In other circumstances, a director has the benefit of the usual standard putting the onus on the accuser to prove the case (tax fraud).

Directors, officers and managers can be personally liable for tortious behaviour or “wrongful acts” while working for a company independent of statute liability. For instance, in *Agda Systems International Ltd. v. Valcom* (1999), 43 O.R. (3d) 101 (C.A.), the court concluded that there was no principled basis to protect directors, officers and managers from liability on a personal basis on the basis that such conduct “was in pursuance of the interests of the corporation”. The tortious conduct in that case was inducing breach of contract by raiding another corporation’s employees to usurp a corporate opportunity.

Breaches of corporate contracts do not by themselves ordinarily create civil liability on directors, officers and managers. However, Canadian courts will entertain tortious claims in relation to contractual claims if an independent tort can be shown.

The securities area is a potential liability minefield for directors, officers and managers. Directors and officers of all corporations which offer securities in the primary or secondary market have numerous duties imposed on them. Although not an exhaustive list, these duties arise in connection with:

- (i) the issuance of securities by way of prospectus or prospectus exemption;
- (ii) regular disclosure of audited and interim financial information;
- (iii) timely disclosure of all material changes and facts concerning the corporation by way of press releases and material change reports;
- (iv) the provision of management proxy circulars;
- (v) reporting of trades by insiders;
- (vi) takeover bids.

Failure to comply with the requirements set out in the securities legislation could result in personal liability for a director, officer or manager.

Securities law is designed to curtail market abuses by ensuring that the investing public is fully informed of all material information concerning a corporation’s securities at the time such securities are offered to the public by way of prospectus or otherwise and, on an ongoing basis, thereafter. The overriding objective is to promote public confidence in the capital market.

The various provincial securities acts impose civil liability on directors and any other parties who sign a prospectus. A prospectus requires “full, true and plain disclosure of all material facts”. Where a prospectus contains a misrepresentation, a purchaser who purchases a security offered thereunder will be deemed to have relied on such misrepresentation and has a damages claim against the corporation and every other person who signed the prospectus in addition to any other remedy available in law.

Accurate disclosure is also required in private placement offering documents, take-over bid circulars, annual information forms, management proxy circulars, financial statements, press releases, material change reports and other documents required to be filed or presented under securities law. Failure to provide accurate disclosure in such documents is an offense which can result in criminal liability, and in some cases (the take-over bid) will result in civil liability. Furthermore, apart from the specific sanctions under the securities legislation, there is a movement to hold directors and officers liable in tort for their actions for harm done to secondary market investors relating to inaccurate or untimely disclosure of material information. Securities class actions are now appearing in Canada.

No person will be guilty of making a misrepresentation in any document if that person did not know, in the exercise of reasonable diligence, that the statement was misleading or untrue or that it omitted to state a fact that was required to be stated to make the statement not misleading in light of the circumstances in which it was made. This forms the basis for the *due diligence* defense.

Directors, officers and managers of Canadian corporations which issue securities in the American market are, of course, subject to the same types of claims in the United States as American directors.

As public concern for the environment gradually increased, a vast array of environmental legislation has been enacted to govern the contamination of land, air, water, the transportation of dangerous goods and the storage and disposal of hazardous waste. In order to ensure corporation compliance, environmental legislation has increasingly imposed personal liability on officers and directors for the actions or omissions of their corporations where those corporations deliberately violate such provisions.

There are numerous other duties and obligations imposed on directors, officers and managers by law in Canada. This outline merely highlights some of those potential liabilities.

b) Requirements of Directors, Officers and Managers

The corporate statutes disqualify certain persons from being directors such as persons under the age of 18, persons found to be of unsound mind by the courts and bankrupts. The corporate statutes also have varying requirements as to the number of Canadian directors on the board of a Canadian corporation.

c) The Business Judgment Rule

Courts generally respect the business decisions of Canadian directors, officers and managers so long as the decisions do not involve fraud or self-dealing and are made on an informed basis in what the director, officer or manager honestly believes to be the best interests of the corporation. In *Re City Equitable Fire Insurance Co. Ltd.*, [1925] Ch. 407, it was held that directors who have acted honestly and with care for the benefit of the corporation are not liable for mere errors in judgment.

d) Duties of Directors, Officers and Managers Toward the Corporation

Corporate statutes in Canada impose two general obligations on directors, officers and managers in connection with their management of the corporation's business and affairs:

- (i) to act honestly, in good faith and in the best interest of the corporation (the "Fiduciary Duty"); and
- (ii) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (the "Minimum Standard of Care").

The Fiduciary Duty requires the subordination of personal interests to those of the corporation. For example, if directors or officers use their position to obtain corporate opportunities or otherwise profit for themselves, they are required to give up the benefit to the corporation. Where a director has a material interest in another entity that is a party to a material contract being considered by the corporation, the relevant statutes require disclosure of the interest in writing to the corporation by the director.

Whether a director, officer or manager meets the Minimum Standard of Care is a question of fact. It is expected that they will employ their skills (a director with accounting experience will be expected to apply those skills in recognizing financial accounting issues of the corporation). Someone who reasonably relies on the financial statements, written reports and advice of their professional advisors does not breach this duty. Indicia of a reasonably prudent director include attendance at meetings, active involvement, questioning and reviewing of management activities.

e) Duties of Directors, Officers and Managers Towards Majority and Minority Shareholders

Directors, officers and managers owe a duty of loyalty to the corporation and not to the majority or minority shareholders; however, as they are the instrument through which the corporation and its shareholders interact, those interactions may create liability, for instance, over the issuance of misleading financial statements. Disputes between competing groups of shareholders often lead to directors, officers and managers being named in law suits.

f) Duties of Directors, Officers and Managers in Case of Bankruptcy

On insolvency of a corporation, a director faces a number of obligations, including:

- (a) under the corporate and employment statutes, payment of up to 6 months unpaid employee wages — strict liability (an ongoing duty of a director is to ensure the regular payment of employee wages);
- (b) under the *Income Tax Act* (“ITA”), payment of all unremitted employee income tax deductions, Canada Pension Plan (“CPP”) deductions and Employment Income (“EI”) deductions — subject to a due diligence defence (inside directors have a higher onus to meet with this defence than do outside directors); and
- (c) under the *Excise Tax Act* (“ETA”), payment of all unremitted Goods and Services Tax (“GST”).

The issue of whether directors, officers and managers owe a fiduciary duty to a company’s creditors has surfaced in a number of cases. The likely answer is generally not, except perhaps in circumstances where the corporation was insolvent when entering into the transaction or the transaction rendered the corporation insolvent. See also 5(c) below with respect to liability for representations regarding corporate solvency.

g) Status of the Enforcement of Directors, Officers and Managers Liability With Respect to Tax, Labour and Environmental Regulations

It is an offence under the ITA for an individual to direct, authorize, assent to, acquiesce in or participate in an offence under the ITA. Such offences can lead to civil or criminal liability. The greatest risk for directors in respect of tax matters is where the corporation becomes insolvent after having failed to make tax remittances. The directors are liable for these amounts, subject to a due diligence defence.

Similarly, federal and provincial labour and employment statutes create offences for individuals who direct or allow breaches of these statutes including, for example, keeping false records and failing to ensure a safe workplace.

Environmental legislation throughout the country contain provisions for individual liability where violations occur.

In practice, prosecution of individual directors, officers and managers is relatively rare for tax, labour and environmental matters.

However, in cases of employment discrimination or sexual harassment, for which human rights commissions have jurisdiction, prosecution of individuals is more frequent because of individual culpability.

In cases of gross negligence in environmental matters, individuals will be prosecuted.

h) Directors, Officers and Managers Criminal Liability

In theory, status as a director, officer and manager creates increased risk of criminal liability under various Canadian statutes, including tax and securities legislation. In reality, directors,

officers and managers are rarely prosecuted in Canadian criminal courts in respect of things done in those capacities. Egregious conduct may lead to criminal charges in Canada but such charges are very rare.

4. Statute of Limitations

a) Shareholders' Actions

Six years.

b) Contractual Disputes

Six years.

c) Discrimination Actions

In Ontario, six months unless delay incurred in good faith. Human rights commissions have jurisdiction over discrimination cases across Canada. Limitation periods vary by jurisdiction and administrative practice.

d) Sexual Harassment Actions

Same as discrimination actions.

e) Wrongful Termination Actions

Six years.

f) Fraud

No limitation period.

g) Tax

Two years from the date the director ceased to be a director.

5. Who Can Sue?

a) Corporation (Derivative Actions)

Derivative actions are relatively rare in Canada. Such actions can be brought by shareholders on obtaining court approval or by the board of directors. Directors, officers and managers may well be named in such proceedings.

b) Shareholders

To date, shareholder class actions in Canada have been held back by the lack of an equivalent to the American “fraud on the market” doctrine. If the trend towards change continues, however, as shareholder actions for negligent misrepresentation have now been certified as class proceedings in Canada, and if those cases succeed, then it is to be expected that the number of shareholder class actions will increase significantly in Canada. For now, Canadian directors, officers and managers of Canadian companies whose shares trade in the United States face a greater risk of shareholder class actions in the United States than in Canada.

The test for certification as a class action in Canada is whether a definable class has a common cause of action with common issues for which the preferable procedure for resolution is a class action. On the surface, it is a more liberal test than that applied by American courts. Significant class action activity in Canada is less than 10 years old. The nature and scope of class actions in Canada is still coming into focus.

c) Creditors

Absent fraud, or the equivalent, it is difficult for a creditor to make out a case in a Canadian court to recover a corporate debt from a director, officer or manager. However, a creditor has succeeded in a claim for negligent misrepresentation against the chief financial officer of a company in respect of statements made about the company’s solvency. See *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 (C.A.). The court held that the C.F.O. had committed a personal wrongful act, independent of the company.

d) Third Parties

Directors, officers and managers of public corporations do face some nuisance suits as a result of their status. Outside of egregious conduct, such actions are unlikely to succeed so long as the individual has not committed an independent wrong from the wrong done by the corporation.

e) Insolvency Administrator/Trustee in Bankruptcy

If the insolvency administrator or monitor or trustee in bankruptcy believes that a director, officer or manager has committed a culpable wrong against the corporation, such as theft, fraud or a grossly improvident contract, then proceedings may be taken, depending on the circumstances.

f) Regulatory Authorities

Securities regulation is provincial. The provincial securities commissions undertake proceedings to enforce their Acts. In recent years, these prosecutions have become more frequent. For instance, the size of the enforcement arm of the Ontario Securities Commission has increased, as have prosecutions.

Employment and labour matters are regulated by both employment commissions and human rights commissions, both of which regularly involve individuals.

Generally, these regulatory authorities only name directors, officers and managers where it is believed that they have committed the wrongful behaviour.

g) Employees

Actions by employees through regulatory authorities to collect wages after insolvency name the individual directors. In civil actions, employees will name individual directors, officers or managers if the employee believes the individual personally wronged them.

6. What is the Enforceability of a Foreign Judgment on Canadian Directors, Officers and Managers under Canadian Law?

Foreign judgments are enforceable in Canadian courts after appropriate enforcement proceedings.

7. Can the Directors, Officers and Managers be Liable for Punitive Damages Under Canadian Law and are Punitive Damages Insurable Under Canadian Law?

Directors, officers and managers can be liable for punitive damages under Canadian law. Such damages are insurable.

Recently, the Supreme Court of Canada in *Whiten v. Pilot*, [2002] S.C.C. 18, restored a jury's punitive damages award of \$1 million. It was one of the highest punitive damages awards made in Canada to date. No director, officer or manager of the company was named in the action.

8. Can the Company Indemnify its Directors, Officers and Managers Under Canadian law and Under Which Conditions?

Directors, officers and managers may reduce their exposure to personal liability by obtaining an indemnity agreement from the corporation. In an indemnity agreement, the corporation and/or third party such as a major shareholder, agrees to indemnify and save harmless the individual against claims that may be made against them as a result of the performance of their duties.

Corporate legislation allows a corporation to indemnify its directors, officers and managers provided that they acted honestly and in good faith with a view to the best interests of the

corporation. With respect to the liability for criminal or administrative actions, the individual must also have had reasonable grounds for believing that the conduct was lawful in order to be indemnified. If the action is brought by the corporation, the court has the power to order the corporation not to indemnify the individual. Directors, officers and managers have a right to be indemnified if they are successful on the merits of the defense and have complied with the above conditions.

9. Is Directors, Officers and Managers Liability Insurance Legal?

The corporate statutes generally permit a corporation to purchase and maintain insurance for the benefit of its directors, officers and managers against any liability which may be incurred by them, provided that the liability does not result from a failure to act honestly and in good faith with a view to the best interests of the corporation. If the policy provides for such coverage, the corporation is prohibited from paying that insurance premium. A corporation, on the same basis, may also purchase and maintain insurance premiums for its directors and officers who acted as a director or officer of another corporation at the request of the corporation.

In British Columbia, there are no limitations on the actions of directors and officers that may be insured.

10. General Comments

As elsewhere, the greatest risk a director, officer or manager in Canada faces is when the company collapses. The risk is not only personal liability, but the great cost in defending either civil, criminal or administrative proceedings. Directors, officers and managers need viable indemnity agreements and/or appropriate liability insurance to protect their personal assets.

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