Directors and Officers in Canada

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This guide considers many of the most significant duties and liabilities of directors and officers in Canada. It is specifically intended for directors and officers of business corporations formed under the *Canada Business Corporations Act* or under the corresponding provincial statutes of Alberta, British Columbia, Ontario or Quebec. It is general in nature and, as outlined in our disclaimer, does not address all potential duties and liabilities of directors and officers, particularly those that are specific to certain industries.

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This guide is intended for informational purposes only. It is not legal advice and is made available to you on the understanding that it will not be relied on as such. Not all issues relevant to D&O liability are addressed and certain nuances of the statutes discussed, and of the relevant common and civil law doctrines, may have been omitted in the interest of brevity. Many business corporations operate in regulated environments that can create further sector-specific duties and liabilities for their directors and officers that it is not possible to address in a brief introductory guide. **If a specific legal issue is of concern to you or your business, you should not take or refrain from taking any action without first obtaining the advice of a lawyer who is qualified in the appropriate jurisdiction(s) and thoroughly familiar with all relevant circumstances.** The distribution of this guide to you does not contribute to the creation, extension or revival of a lawyer-client relationship between us and you or any other person or entity. This guide is not intended for directors or officers of not-for-profit organizations, which fall under a distinct legal regime.

Corporate Law Duties and Liabilities

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Preliminaries

The statutes

In Canada, business corporations may be incorporated either under federal legislation known as the *Canada Business Corporations Act* (CBCA) or under the corresponding legislation of any province or territory. Although most Canadian companies choose either the CBCA or the legislation of their home province or territory, there is nothing to prevent them from incorporating under the legislation of any province or territory. Subject to relatively simple registration requirements, all Canadian business corporations are entitled to carry on business in any part of Canada without regard to their jurisdiction of incorporation. They are also generally able to switch from one governing statute to another through a process known as "continuance".

This guide focuses on the CBCA and the provincial business corporations statutes of the country's four largest provinces:

- **CBCA** – Canada Business Corporations Act (Federal)
- **ABCA** – Business Corporations Act (Alberta)
- **BCBCA** – Business Corporations Act (British Columbia)
- **OBCA** – Business Corporations Act (Ontario)
- **QBCA** – Business Corporations Act (Quebec)

We refer to these five statutes collectively as **the BCAs**. While this guide **does not** consider the corresponding legislation of the other six provinces and three territories (except as expressly stated otherwise), many of the principles and provisions discussed below are mirrored in those other statutes. One reason for this similarity is that, historically, most provincial and territorial business corporations laws were developed on the CBCA model. The three exceptions are the BCBCA – a modern statute that is organized somewhat differently than the CBCA – and the Nova Scotia and Prince Edward Island statutes, which, while modernized in some respects, continue to be based on 19th-century English company law.

Composition of the board

Number of directors

While public company boards must generally have at least **three** members, other corporations may have as few as **one**. A fixed number of directors, or a minimum and maximum number, will generally be specified in the articles.

Qualifications

Directors must be individuals, not corporate entities, who are at least **18 years old, of sound mind and not bankrupt**. The BCBCA adds an additional restriction barring persons who have been convicted of fraud or other offences relating to the promotion, formation or management of a business from serving as directors for a period of five years. The *Civil Code of Québec* contains a similar prohibition, but in that case any such disqualification requires a court order and is not automatic. It should also be noted – although it appears to make little practical difference – that the *Code* disqualifies "minors" from directorships rather than referring specifically to the attainment of the age of 18 (the QBCA follows the *Code* on this point).

Unless otherwise provided in the corporation's constating documents, a director need not be a shareholder.

Independence

In the case of public companies, many of the business corporations statutes require a certain number of directors who are not officers or employees of the corporation or of an affiliate. Under the CBCA, ABCA and QBCA, the minimum number of "independent" directors of a public company is two, while under the OBCA it is one-third of the total. These requirements have effectively been supplanted by securities commission rules that recommend a majority of independent directors on all public company boards (see page 48, below). There is no parallel provision in the BCBCA, although the securities commission rules apply to public companies incorporated under that statute.

Residency

Some of the statutes require a certain number or proportion of "resident Canadian" directors, as follows:

- **ABCA, OBCA:** 25% of the board (or 1 director, if the board has fewer than four members);
- **CBCA:** same as above, but increases to a majority for a small subset of corporations, primarily those that are in industries that are subject to Canadian ownership or control requirements.

The BCBCA and QBCA do not require resident Canadian directors, a position that the OBCA may also adopt in the near future, according to a 2016 proposal by the Government of Ontario.

Diversity

Board diversity has become a significant concern in recent years. While there are no mandatory requirements or quotas, public companies in all Canadian jurisdictions are now required under **National Instrument 58-101** to provide shareholders with details of their gender diversity policy, or, if such a policy has not been adopted, the reason for that decision. A proposed amendment to the CBCA reinforces that requirement and would introduce a similar requirement with respect to other forms of diversity. In addition to regulatory requirements of this type, shareholder advocacy groups (such as ISS) are increasingly factoring management's commitment to diversity into their voting recommendations.

Duties under Corporate Law

Many of the duties of directors and officers in Canada are defined in the business corporations statutes. The most significant of these are the duty to manage, the fiduciary duty, the duty of care, the duty not to support resolutions authorizing improper acts and the general duty of compliance.

Duty to manage

The fundamental legal duty of boards of directors in Canada is worded as follows in the CBCA, ABCA and OBCA, and in nearly identical language in the BCBCA and QBCA:

> Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation.

Boards, other than those of very small corporations, will usually focus on strategic matters affecting the organization's overall direction, leaving day-to-day decision-making to professional managers. They may establish guidelines for management decision-making and will usually require regular reporting from management on critical aspects of the business. The board's role can be described as that of "stewards of the corporation".

There are statutory limits on the powers that the board may delegate to management. Thus a board is not permitted to delegate the capacity to adopt, amend or repeal corporate by-laws, to issue securities, to declare dividends or to approve financial statements, among others. However, as discussed at page 18 below, these limits may not apply if a "unanimous shareholder agreement" (**USA**) is in place that transfers those board powers to another person or persons in accordance with the USA (or equivalent) provisions of the governing BCA.

Fiduciary duty

Directors and officers of business corporations have a **fiduciary duty** to act honestly, in good faith and in the best interests of the corporation. In other words, in acting as a director or officer, you must always focus on **promoting the corporation's interests**, even if doing so might cause a conflict with another interest that is significant to you, including other business or personal interests that you may have.

While the term "fiduciary duty" does not actually appear in the BCAs, it is widely recognized by the courts of the common law provinces. The term is not usually used in Quebec proceedings, even though the applicable principle is virtually the same.

The nature of the duty

According to the Supreme Court of Canada, the fiduciary duty requires directors and officers to:

- Act honestly and in good faith vis-à-vis the corporation;
- Manage the assets of the corporation so as to realize the corporation's objectives;
- Avoid conflicts of interest with the corporation;
- Not abuse their positions for personal benefit;
- Maintain the confidentiality of information they acquire by virtue of their position; and
- Serve the corporation selflessly, honestly and loyally.

To whom the duty is owed

While "promoting the corporation's interests" may sound like a relatively straightforward idea, in practice it can be difficult to distinguish the interests of the corporation from those of its constituent groups, particularly its shareholders. The Supreme Court of Canada has stated that the fiduciary duty of directors and officers is owed to the **corporation as such**, rather than to any particular constituency (e.g. shareholders, creditors, employees or community members). While shareholders are not the focus of the fiduciary duty, as a practical matter attention to the corporation's interest will generally promote shareholder interests as well, given that shareholders have an interest in a healthy and prosperous corporation. In addition, the Supreme Court has also stated that, in discharging its duties, the board of directors should **take account** of the **reasonable expectations of stakeholder groups**. In certain situations – e.g. where a change of control or a possible insolvency is on the horizon – it will be important to be able to show that **stakeholder expectations were considered** within a decision-making framework that recognized the paramountcy of the corporation's interests (particularly its interests over the longer term). Your counsel will be able to advise on how this balance can be struck in the specific circumstances that you are dealing with.

Personal gain

The fiduciary duty does not forbid all forms of "personal gain" on the part of directors and officers. Reasonable compensation for a director's or officer's work is obviously acceptable, as is any profit or income derived from shares in the corporation that such persons own. The line is sometimes crossed, however, when **a director or officer takes personal advantage of a business opportunity that**

belongs to the corporation, including by diverting the opportunity to another business or person**.** Even though transgressions of this type are often unintentional and of limited consequence to the corporation, Canadian courts tend to take a very dim view of them under what has come to be called the **"corporate opportunity doctrine"**. It is important to bear in mind that personal liability can result even if the director or officer does not act on the opportunity until after his or her relationship with the corporation has ended. See "Taking Advantage of Corporate Opportunities" (page 25, below).

Allegations and actions

Allegations against directors or officers with respect to fiduciary breaches often include:

- That their actions were improperly influenced by considerations of their own personal interest or of the interests of another corporation in which they hold an interest, on whose board they sit, or by which they are employed;
- That they gave more consideration than is appropriate to the interests of particular shareholders (or other stakeholders) of the corporation; or
- That they diverted a corporate opportunity to themselves, a family member or friend, or another entity outside the corporation.

Because this duty is owed to the corporation, any breach will be potentially actionable by the corporation itself, if necessary by means of a **derivative action** brought at the request of shareholders (see page 19, below). In many cases, however, facts that might support a fiduciary duty claim will instead (or in addition) be used to support an action under the **oppression remedy** (see page 20, below). Because oppression claims can be easier for shareholders, creditors and others to assert, and because they are very open-ended in terms of remedy (including personal remedies against directors and officers), they are often preferred by potential plaintiffs.

Note that the *Civil Code of Québec* may also allow direct actions by certain stakeholders in a limited set of circumstances with respect to breaches of a director's or officer's duty to act honestly, loyally and in the best interest of the corporation (comparable to the common law "fiduciary duty").

Consequences for indemnification

A director or officer's breach of his or her fiduciary duty may also have consequences for indemnification (see page 66, below).

Duty of care

The nature of the duty

Canada's business corporations statutes also require directors and officers to perform their duties with the **care, skill and diligence of a reasonably prudent person**. To understand how this requirement differs from the fiduciary duty, it can be useful to think in terms of "ends" and "means":

- The **fiduciary duty** is about "ends": it says that the things that a director or officer does must be done with the ultimate purpose of **promoting the corporation's interests**.
- The **duty of care** is about "means": it says that the things that a director or officer does must be **done well**, by meeting the applicable standard of care, skill and diligence.

The duty of care is measured **objectively**. In other words, even if a director or officer acts in good faith, he or she could still be liable for breach of the duty of care if he or she acted less carefully, skillfully and diligently than a reasonably prudent person would have acted in the circumstances. One "action item" arising from the duty of care is to ensure that you have an adequate working knowledge of the financial side of the business. This does **not** mean that you must know everything that a professional accountant or auditor would know (you are entitled to rely in good faith on the reports of the professionals that the company hires), but it **does** mean that you should know enough to understand the significance of the professional reports that you receive and to be able to ask probing questions about them.

Attending board meetings

While, as a director, you need not focus your attention on details of the corporation's day-to-day operations, you should **review board materials** and understand the matters that are or should be before the board. It is important to ask questions and not be reluctant to disagree with other board members or management. You must be diligent in **attending board meetings**. Whenever you miss a meeting, you should be sure to learn what occurred at the meeting (e.g. by reviewing the minutes). One reason that this is important is that, unless you dissent (as you may do after the fact), you are generally deemed to have consented to resolutions passed at meetings that you missed. Because liability can sometimes depend on whether you supported a certain board decision or not, it is important to ensure that the record reflects your votes accurately (or, if you were absent, your dissent from any decision, if you would have dissented).

To whom the duty is owed

Unlike the fiduciary duty, the duty of care is owed not only to the corporation but also to shareholders and creditors (although there has been some doubt about this with respect to the QBCA, and to a lesser extent the OBCA, due to differences in the way the relevant provisions of those statutes are worded). This does not mean, however, that a breach of this duty gives shareholders and creditors a right of action against directors and officers. In all Canadian jurisdictions other than Quebec, the position of the courts has been that shareholders and creditors cannot *directly* sue directors or officers for breaching the duty of care. Instead, the fact of such a breach could conceivably ground a lawsuit based on tort law (see page 30, below) or an oppression claim (see page 20, below).

In Quebec, the situation is slightly different. A breach of the duty of care by directors and officers of a CBCA corporation is potentially directly actionable under the *Civil Code of Québec* (CCQ), which creates a general cause of action for breaches of legal duties that would potentially apply whenever the CCQ applies. Indeed, it was on this basis that the Supreme Court of Canada specifically recognized, in one of Canada's leading cases on directors' and officers' duties, the right of creditors (in that case) to sue a Quebec-based CBCA corporation's directors.

When deciding whether the duty of care has been met, courts will generally defer to the business judgment of the board, provided that it acted in a reasonable and informed manner. In doing so, the courts are giving effect to what has come to be called the **Business Judgment Rule**, under which the courts generally avoid second-guessing decisions of corporate boards. Provided that such a decision was well-informed and reasonable in the circumstances, it will generally pass the "duty of care" test even if it was arguably, in light of hindsight, not the best possible decision.

Duty not to support improper resolutions

Nature of the duty

Each of the BCAs expressly requires the repayment of amounts improperly paid by the company as a consequence of board resolutions requiring actions that violate certain provisions of the BCA. Directors who vote for or consent to such resolutions may be jointly and severally liable to the corporation for the amount of any improper payment.

While there are certain (mostly minor) differences among the BCAs, these improper resolutions generally include those that: (i) authorize improper dividends, commissions, share purchases or redemptions, (ii) authorize improper issuances of shares for non-monetary consideration, or (iii) authorize director indemnification contrary to the provisions of the relevant statute. These prohibitions – discussed in greater detail at page 22, below – collectively give rise to a duty on the part of directors that, for present purposes, can collectively be called the **duty not to support improper resolutions**.

As just noted, the list of improper resolutions varies somewhat among the BCAs. For example, although statutory restrictions on the granting of financial assistance have been repealed in most jurisdictions, certain disclosure requirements continue to exist under the ABCA and BCBCA (see page 23, below). The "improper resolutions" that are mentioned above are those that are most typically found in the BCAs.

General duty of compliance

Nature of the duty

Finally, there is also a **general duty of compliance** with the governing business corporations statute and associated regulations, as well as with the articles and bylaws (or "memorandum", under the BCBCA) of the corporation and any unanimous shareholder agreements that may be in force. Under Quebec law, this duty is derived from a provision in the *Civil Code of Québec* and was accordingly not duplicated in the QBCA when that statute was drafted, although the QBCA does contain a remedy for non-compliance with the same constating documents as in the CBCA. The BCAs vary with respect to potential penalties for non-compliance, but significant monetary penalties are possible and, in some cases, terms of imprisonment are provided for (even if rarely pursued in practice).

Defences

Under the BCAs, directors can assert specific defences with respect to many of the duties above. Note that the following are statutory defences that **do not** expressly apply to corporate officers.

Kinds of defence

The BCAs set out a variety of defences, including "reasonable diligence", "good faith reliance" and a third "combined" defence that incorporates both of those concepts. As discussed below, not all of the BCAs provide these defences in all circumstances. The defences may be briefly described as follows, with differences among the BCAs as noted.

Reasonable diligence

Available where a director exercised "the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances".

Good faith reliance

Available where a director relied in good faith on statements, documents and reports of the following types:

- Financial statements represented by an officer or in a written auditor's report as fairly reflecting the financial condition of the corporation (**all BCAs**; OBCA specifically includes interim reports and other financial reports);
- Any report by a professional person whose profession lends credibility to what is said in the report (**all BCAs**);
- Any report by an officer of the corporation on which it is reasonable in the circumstances to rely (**BCBCA, OBCA** and **QBCA**);

- Any report by an employee of the corporation on which it is reasonable in the circumstances to rely (**OBCA**); or
- Any record, information or representation that, in the court's opinion, provides reasonable grounds for the actions taken by the director. (**BCBCA**)

Combined defence

In three statutes – the CBCA, ABCA and OBCA – these defences are **combined**, for some or all purposes, into one defence. In other words, "good faith reliance" is considered by those statutes as one aspect of "reasonable diligence". In contrast, the BCBCA and QBCA recognize good faith reliance and reasonable diligence as distinct defences. The reason for this difference may be that the BCBCA and QBCA are newer statutes whose drafters considered the combination of the two defences in the older statutes to be conceptually awkward. In most situations, the difference between the two approaches is unlikely to be of much significance from a practical point of view.

Situations in which the defences are available

In all cases, two commonsense principles should be kept in mind. First, it will always be to your advantage as a director to perform your duties with care, diligence and skill (which the duty of care requires you to do in any event) and second, you will often have a defence with respect to actions that you or the board take while relying in good faith on the statements, documents and reports of professionals and certain other qualified persons. Your counsel will be able to tell you more about the nuances of the available defences under your corporation's statute of incorporation.

Technically speaking, there are differences among the BCAs with respect to which (if any) defences apply to each of (i) the fiduciary duty, (ii) the duty of care, (iii) the general duty of compliance and (iv) the duty not to support improper resolutions.

Table 1 / **Which Defences Apply Under the BCAs**[1]

Duties → Defences ↓	Fiduciary Duty	Duty of Care	General Compliance	Improper Resolutions
Good Faith Reliance	B, C	B, C, Q [2]	B	B
Reasonable Diligence	—	—	—	B, Q [3]
"Combined" Defence [4]	A	A	A, C, O	A, C, O
None of the Above	O, Q	O	Q	—

[1] In the table, A = ABCA, B = BCBCA, C = CBCA, O = OBCA and Q = QBCA.

[2] The **QBCA** creates a **presumption** that the duty of care has been met where there has been good faith reliance.

[3] The **QBCA** provides a specific diligence defence with respect to the authorization by the board of any of an enumerated list of resolutions.

[4] The "combined" defence is a combination of the good faith reliance and reasonable diligence defences, as described above.

While these differences may affect the manner in which a defence is asserted in the event of a lawsuit, it is unlikely that they would significantly affect a director's ability to defend himself or herself in most situations. Note that other defences may be available to directors or officers in certain specific cases. For example, each of the BCAs provides directors with a defence against liability for supporting certain types of resolution where he or she "could not reasonably have known" that the act authorized by the resolution contravened the BCA (this most typically applies to the issuance of shares for inadequate non-monetary consideration – see page 22, below).

Duties of Special Kinds of Directors

Because not all directors come to hold their positions under the same circumstances, it is worth reviewing how the fiduciary duty and duty of care apply to various classes of directors, including first directors, nominee directors (and non-director "board observers") as well as inside, outside and independent directors. While as a general rule there is no difference, there are some nuances to be aware of if you fall into any of the following classes of director.

First directors

A "first director" serves from the date the certificate of incorporation is issued until the shareholders have an opportunity to elect a board of directors (i.e. at their first meeting). A first director has the same fiduciary duty, duty of care and other duties as any other director. Under the OBCA, a first director cannot resign unless and until a replacement has been elected or appointed. The BCBCA generally requires that a first director of a corporation incorporated under that Act consent to such an appointment, either in writing or tacitly (by conduct, as defined), although it is also sufficient under that statute to be an incorporator who signed the articles.

Nominee directors

If you were nominated for election to the board by a particular shareholder or creditor, you may feel that you owe your allegiance to it or that your role is to pursue its interests on the board. This, however, is **not the case** under Canadian law. With one limited exception, a nominee director has the same duty as other directors to act in the best interests of the corporation. Therefore, if you are a nominee director, you cannot favour the interests of the party that nominated you.

The one exception is a provision unique to the ABCA, under which a nominee director may pay "special, but not exclusive" regard to the interests of his or her nominators, if and only if they are the holders of a class or series of shares, employees of the company, or creditors.

Having said that, most of the statutes do provide that a nominee director can be removed only through an ordinary resolution of the holders of the class or series of shares that had the exclusive right to elect him or her. The BCBCA's default requirement is a special resolution (which generally requires a "supermajority" to pass) but that statute specifically permits any alternative method of removal to be specified in a BCBCA company's memorandum or articles.

As a nominee, you may find yourself having to choose between conflicting duties. For example, as an employee of a nominating shareholder, you may become privy to confidential information of the shareholder that clearly affects the corporation's interests. Unless special provision has been made to help you deal with such a situation, it is possible that your only option will be to resign.

Inside and outside (independent) directors

While the Supreme Court of Canada has stated that all directors should be judged by the same "objective" standard, it has also affirmed the relevance of the circumstances surrounding directors' actions. Thus it appears that "inside" directors – who can be officers or employees of the corporation – may sometimes be held to a higher standard than "outside" or "independent" directors. For example, independent directors might not always be expected to be as familiar with the corporation's operations as directors who are also officers or employees. Conversely, because one of the reasons that it is important to have independent directors in the first place is their objective perspective, it is possible that independent directors will be held to a particularly high standard when it comes to asking probing questions about the corporation's finances and other matters, although all directors must approach their duties with a critical eye.

Independent directors may be required on **public company boards and committees** under securities law, the company's incorporating statute or applicable stock exchange rules. The role of the independent director in the public company context is discussed in detail on page 48, below.

Board observers and deemed directors

If your role is to be the eyes and ears of your nominator, then "observer" status is an alternative to being a full board member. It is important to remember, however, that many of the BCAs define "director" as a person "occupying the position of director by whatever name called". Therefore, if your role as observer is expanded too far – for example, if it is expanded to include participation in the deliberations or actions of the board – there is a risk that you could be found to be a *de facto* director and thereby subject to the same duties, obligations and liabilities as a duly elected board member. The definition of "director" in the BCBCA requires election or appointment to the board and does not include the "by whatever name called" language, so unintended characterizations of observers as full members may be less likely under that statute (although specific British Columbia statutes may include a "deemed director" provision, as is the case with the B.C. *Provincial Sales Tax Act*). The QBCA and *Civil Code of Québec* do not define the term "director", but Quebec courts have recognized the concept of de facto director in the same manner as have the courts of other provinces.

As just noted with respect to British Columbia's *Provincial Sales Tax Act*, certain statutes may contain "deeming" provisions under which persons who are not otherwise directors are treated as such for the purposes of a particular piece of legislation. Another example is Quebec's *Environment Quality Act*, which deems partners other than special (limited) partners in a partnership to be "directors" of the partnership for the purposes of determining personal liability for violations of the Act by the partnership. Your counsel will be able to identify situations in which such deeming provisions could apply in your industry.

Transferring Duties and Liabilities: Unanimous Shareholder Agreements

As a rule, the BCAs do not permit arrangements, contractual or otherwise, that purport to relieve directors of fundamental duties and liabilities, beyond the conventional delegation of managerial decision-making authority to the corporate officers. However, there is one important exception in Canadian law. The CBCA, ABCA, OBCA and QBCA allow a **Unanimous Shareholder Agreement** ("USA") that conforms to certain specific requirements set out in those statutes to relieve corporate directors of any or all of their statutory rights, responsibilities and liabilities. Depending on which BCA governs the corporation, a USA – which can include both shareholders and non-shareholders as parties – transfers the rights, responsibilities and liabilities in question **either** to all shareholders (ABCA, OBCA) **or** to at least some of the parties to the USA (CBCA, QBCA).

With respect to USAs generally, the following should be noted:

- A USA is the equivalent of a constitutional (or "constating") document of a corporation, comparable to its articles and bylaws.
- The rights, duties, obligations and liabilities that may be transferred by a USA are **not** limited to those originating in the relevant BCA itself.
- The ABCA expressly allows USAs to deal with certain matters in addition to directors' duties, e.g. the regulation of the election of directors.
- Under the QBCA, and Quebec's *Act respecting the legal publicity of enterprises*, if a USA transfers **all** board powers to shareholders and/or other persons:
  - a declaration must be provided to Quebec's Enterprise Registrar listing the names and domiciles of those to whom those powers have been transferred; and
  - the shareholders may, in such a case, choose not to establish a board of directors at all.

- Under the QBCA, and Quebec's *Act respecting the legal publicity of enterprises*, the existence or termination of a USA must be reported to the Enterprise Registrar, for entry in the enterprise register, if the USA restricts the powers of directors in any respect.
- The BCAs allow those who become shareholders without notice of an existing USA to pursue certain forms of redress on learning of the USA's existence.

While the **BCBCA** does not recognize the USA concept under that name, it does allow for a similar transfer of powers to be effected by a provision in the articles. Under the British Columbia legislation, the powers and liabilities of directors may be transferred to any other person or persons (the relevant provision does not refer to shareholders in particular). As in the cases of the other BCAs, transferrable powers and liabilities under the BCBCA are not limited to those that originate in the statute itself. Because a BCBCA company must effect any transfer of this nature through a provision in the articles, those transfers may be altered or amended by means of a special resolution (special resolutions do not require unanimous shareholder support). It is possible, of course, for the shareholders of a BCBCA company to enter into a "unanimous shareholder agreement" in the ordinary sense of that term, but such an agreement cannot have the effect of transferring the duties or liabilities of board members to other persons.

Enforcement of Directors' and Officers' Duties

While duties owed **directly** to shareholders, creditors or employees can be enforced by means of legal actions commenced by such persons, the enforcement mechanism for duties owed to the corporation itself (e.g. the fiduciary duty) is less straightforward. The following are the most common ways in which directors' and officers' duties under corporate law are enforced.

By the corporation, acting through the board of directors

With respect to duties that are owed to the corporation itself, it is generally the corporation, as a "legal person", that has the right to pursue a remedy. However, a corporation is obviously incapable of pursuing an action without help from "natural persons" – generally the directors. One way in which directors' and officers' duties are enforced, therefore, is through the commencement of an ordinary legal action by the corporation itself, at the instigation of the board, in which a breach of duty by one or more directors or officers is alleged.

However, while one could certainly imagine a **new** board doing this with respect to its predecessors, it does not take any deep insight into human nature to see that a member of an existing board might not be inclined to cause the corporation to take action to enforce his or her own duties or those of his or her fellow board members and/or corporate officers. This classic dilemma of organizational dynamics is resolved in Canadian business corporations law through the procedure known as a **derivative action**, as discussed immediately below.

Through a derivative action

Should the board of directors fail to pursue the corporation's legal rights diligently in the courts, shareholders or other proper parties ("complainants" or, in the QBCA, "applicants") can attempt to initiate an action on behalf of the corporation. Derivative actions require **court approval**, which is generally contingent on the court's having been satisfied (i) that the complainant is acting in good faith and (ii) that the proposed action is in the corporation's best interest. There is a **notice requirement** that, under the ABCA, OBCA and QBCA (but not the CBCA or BCBCA) does not apply if all directors are named as defendants to the proposed derivative action. The BCBCA specifically provides that the complainant must have made reasonable efforts to cause the directors of the company to prosecute or defend the proceeding.

In a derivative action, the harm complained of must be a harm **to the corporation**, and the corporation is the plaintiff in the action. The role of the shareholders is to be the driving force behind the action. This is different than an oppression action, discussed immediately below, in which the harm alleged must be **to the shareholders** (or other permissible claimants), who then become the plaintiffs in the action.

Through a compliance order

Each of the BCAs allows shareholders to apply to the court for a compliance order requiring directors or officers to comply with one or more of the statutory duties that apply to them. An application of this nature may also be initiated under the various BCAs by a "complainant or creditor" (CBCA, ABCA, OBCA), "any other person whom the court considers to be an appropriate person" (BCBCA) or "any interested person" (QBCA). Additionally, under the OBCA, the Ontario Securities Commission may bring such a complaint in certain situations involving public companies.

Through an oppression remedy

Where directors or officers are alleged to have harmed the interests of shareholders (or of certain other stakeholders), the latter may ask the court to grant what is known as an **"oppression remedy"** against the corporation, its board and/or its officers. Under the CBCA, ABCA and OBCA, the term "oppression" refers to a situation in which the corporation has exercised its powers, or is threatening to exercise its powers, in a manner that is **oppressive** or **unfairly prejudicial** to, or which **unfairly disregards**, the interests of any security holder, director, officer or creditor. The BCBCA and QBCA define "oppression" in broadly similar terms, although there are certain differences in wording (notably, as discussed below, the QBCA definition does not refer to the interests of creditors).

The CBCA, ABCA, OBCA and QBCA oppression provisions state specifically that a **"complainant"** can include a current or former shareholder, director or officer.

These statutes also give the court discretion to extend the status of complainant to any other person who is a "proper person to make an application" (the QBCA uses slightly different language to the same effect). The BCBCA defines "complainant" more narrowly, as a "shareholder", but goes on to give the court discretion to include any "appropriate person" as a "shareholder" for this purpose. It is generally understood that, under the CBCA, ABCA and OBCA, the court's discretion may be exercised so as to recognize a non-shareholder **creditor** as a complainant. It is less clearly established that this is also possible under the BCBCA and (especially) the QBCA. In fact, given the different wording of the QBCA, some would argue that the recognition of a non-shareholder creditor as a complainant under that statute's oppression provision is quite unlikely. In the absence of definitive authority, the possibility that a creditor would be recognized as a claimant in a QBCA oppression action would need to be considered carefully by counsel in light of the specific facts of the given situation.

Canadian courts have generally analyzed oppression in terms of fair treatment. What is "fair" depends largely on the complainant's **"reasonable expectations"**. Deciding which expectations count as "reasonable" requires the judge to consider a variety of factors that are specific to the given situation, but courts are usually attentive to normal market practices and commercial common sense. It is generally the case that oppression requires some form of wrongful conduct. Less serious forms of oppression – for instance, those falling within the "unfair disregard" category – would be more likely to include actions that, while not performed in bad faith, nevertheless had unfair consequences.

When it comes to crafting a remedy for oppression, the courts have a great deal of discretion. To mention just a few examples that are particularly relevant to the current discussion, a court may order any or all of the following:

- Compensation in damages;
- The removal of directors;
- The addition of new directors; and
- That the corporation or its directors or officers refrain from doing something.

Those are just a few possibilities. In reality, there is almost no limit to the types of order that a court could potentially issue.

If a court determines that a **personal order against a director or officer** would be an appropriate remedy in an oppression case, it may issue such an order. Examples of oppression that might occasion a remedy against a director include personal "nest-feathering" or situations in which a director has taken inappropriate steps to increase his or her personal control over the company. A 2017 ruling of the Supreme Court of Canada stressed that director liability under the oppression remedy is not subject to the same limitations that have historically been held to apply to such liability under common law. In its reasons, the Court mentioned the following as a possible example: a director may be personally liable for oppression where he or she “strongly advocates for an oppressive decision motivated by a personal gain unique to that director”, even though the director does not control the corporation. Nor is it the case, according to the same Supreme Court decision, that a director must have benefitted personally from his or her participation in an oppressive act in order to be held personally liable, although any such benefit will be a significant consideration if it exists.

There is no statutory limit to the amount of any such order, although it must always be remembered that the oppression remedy is rectificatory rather than punitive – a fact that the Ontario Court of Appeal has described as tending to constrain the size of awards of this type.

As will be clear from the above discussion, the oppression remedy is flexible. That flexibility is one of the reasons that it is favoured by potential plaintiffs.

Problematic Board Resolutions

The following are a few commonplace situations that can be problematic under Canada’s business corporations statutes. For the most part, the applicable rules are a matter of common sense, but when these types of decision are being discussed by the board you should satisfy yourself that there are no compliance issues.

Dividends, redemptions and repurchases

If the board of directors declares dividends, or redeems or repurchases the corporation’s shares without complying with the solvency tests that are mandated by Canadian business corporations statutes, then, as a member of the board, you will potentially be jointly and severally liable to the corporation for the amount of the improper payment. You cannot authorize these types of payments if there are **reasonable grounds to believe that the corporation is insolvent or would become so after the payments were made**. Generally speaking, **insolvency** in this context is determined by applying both a cash-flow and a balance sheet test, although there are variations among the statutes, e.g. the QBCA does not apply the balance sheet test to declarations of dividends and the BCBCA does not apply it at all.

Provided that you are acting in good faith, you can rely on professional advice or on what an officer or an auditor of the corporation has represented as a financial statement fairly reflecting the corporation’s financial condition. As discussed above (see page 14), each of the statutes also provides a reasonable diligence defence in certain situations (those situations may vary from one statute to another).

Issuing shares for non-money consideration

When shares are issued in return for non-money consideration (e.g. in return for other shares, other forms of property or past services), the directors must be satisfied that the fair value of that consideration is no less than the value in money that would have been received on the date of the relevant resolution. If this requirement is not met, then the directors who voted for (or consented to) the resolution will generally be jointly and severally liable to the corporation for any deficiency. If you are in this situation, you may be able to avoid liability if you did not know and could not reasonably have known that the consideration was worth less than the value in money that could have been obtained – but only if you can prove that this was the case (note that the burden of proof may not be as clear under the BCBCA).

An example of a situation in which this issue might arise would be if the board decides to issue shares in the corporation at $10 per share (this does not necessarily have to be the market price of a share) and then agrees to take shares in another corporation in payment. If that happens, the board must be satisfied that the total value of the shares received is at least equal to $10 x the number of shares issued.

Approving director indemnification

If, as a director, you vote for or consent to the payment of an indemnity to another director or to an officer, and indemnification is **not** permitted in those circumstances under the applicable BCA, you may be jointly and severally liable with other board members to repay the corporation (to the extent that the corporation has not recovered the amounts by other means).

An example of an indemnity that would raise this issue is one paid to a director or officer who did not act honestly and in good faith with a view to the corporation's best interests. In a criminal action or administrative proceeding enforced by a monetary penalty, indemnities are generally permissible only where the director or officer had reasonable grounds for believing that his or her conduct was lawful. Indemnification is discussed in more detail on page 66, below.

Financial assistance

As noted above, the prohibition on financial assistance to shareholders or other persons, which was once found in most BCAs and which created certain potential liabilities for directors, has been eliminated from the CBCA and OBCA. It was also eliminated from Quebec law on the adoption of the QBCA in 2011. The ABCA and BCBCA specifically permit financial assistance "to any person" provided that, in a limited range of circumstances, disclosure is made. Note, however, that this does not mean that an act of financial assistance could not in some cases result in liability outside of the BCAs.

Conflicts of Interest

Transactions involving the corporation and the director's or officer's competing interests

if a director or officer enters into a material contract or a transaction with the corporation, he or she will have, or at least be potentially perceived to have, a **conflict of interest**. The same is true if an entity of which he or she is a director or officer, or in which he or she holds a material interest, enters into a contract or a transaction with the corporation.

While they do not prohibit a director or officer from dealing with the corporation, the BCAs do impose **minimum requirements** for any "material contracts or transactions" of this type (although the QBCA replaces materiality with a slightly different criterion). With respect to existing or proposed contracts or transactions with the corporation that meet the materiality test (or the similar QBCA test):

- The director or officer must **disclose** the conflict in the manner set out in the applicable statute;
- The board must **approve** the contract or transaction in a vote in which the interested director **does not take part**; and
- The contract or transaction must be **fair and reasonable** to the corporation; otherwise the court can set it aside (note that this does not apply under the BCBCA).

There may also be a requirement to report changes in a director or officer's previously reported interest in a material contract or transaction. As noted, the BCBCA test omits the "fair and reasonable" criterion, although a court may order an accounting of profits where the first two criteria are not met if it finds that the material contract or transaction was not fair and reasonable.

It is sometimes difficult to decide whether a contract is a material one or to feel confident that it is fair and reasonable to the corporation. Fortunately, this is a situation in which honest mistakes can usually be corrected. If, in good faith, you (as a director or officer) failed to disclose or to refrain from voting when you should have done one or both of those things, the shareholders can act retroactively to **ratify** the transaction, with the caveat (not applicable under the BCBCA) that the contract must have been fair and reasonable to the corporation. If the board takes this step, everything can then move forward as though you had fully complied in the first place.

Where the statutory provisions are not complied with, the corporation or its shareholders could apply to the court to have the transaction set aside or to require the director or officer to account for any personal profit. Under the BCBCA only, the court can order an accounting of profits in such a situation only if it finds that the contract or transaction was not fair and reasonable to the company.

Exceptions

Generally, a director may vote on a material contract or transaction with the corporation to which a disclosure obligation applies if it is a contract relating to his or her own compensation, indemnity or insurance. There is also an exception for contracts or transactions with an affiliate. The OBCA does not permit a director to vote on a contract or transaction relating primarily to his or her remuneration for non-director roles. The BCBCA exempts the director or officer from the reporting requirement (in addition to the voting restriction) in certain circumstances.

New directors and officers

A new director or officer is generally required to disclose interests in material contracts and transactions that predate his or her appointment.

No conflict as shareholder

If a director is also a shareholder, he or she is generally free to exercise his or her rights as a shareholder, including voting rights, in his or her own interest.

Taking advantage of corporate opportunities

As noted above, directors and officers are generally not permitted to take advantage of property or business opportunities that come to their attention by reason of their positions as directors or officers. Because directors and officers owe fiduciary duties to the corporation, they are expected to subordinate their personal interests and pursue these opportunities solely on behalf of the corporation. This obligation, known as the **corporate opportunity doctrine**, applies broadly and is strictly enforced.

Well-intentioned directors and officers can sometimes run into problems in situations where an opportunity has been rejected by the corporation (or appears unlikely to be of interest to it) or where they have resigned their positions and decide to pursue an opportunity that first came to their attention during their tenure with the corporation. It is important to remember that, even in situations like these, the corporate opportunity doctrine has been held to apply.

Because it is often difficult to determine whether an opportunity is subject to the corporate opportunity doctrine, it is always a good idea to speak with counsel about any opportunity that comes to your attention as the result of your involvement with a corporation of which you are, or were, a director or officer.

Recourse by Shareholders, Creditors and Employees

This section concludes with a brief consideration of selected issues relating to three key stakeholder groups: shareholders, creditors and employees – notably the avenues that each has for redressing alleged lapses of duty by directors and officers. Much of the information below has been discussed above. This section simply places it into the context of various stakeholder groups.

Shareholders

The statutory fiduciary duty of directors requires them to protect and advance the interests of the corporation. Nevertheless, the Supreme Court of Canada has stated that, as it pursues and protects the corporation's interests, the board can (and perhaps even must) consider the reasonable expectations of shareholders and other stakeholder groups. Those reasonable expectations will generally be shaped by accepted commercial practice. It will therefore generally be important for a board to turn its attention to the potential impact of its decisions on shareholders (and other stakeholders), which considerations may shape the actions that it ultimately takes in furtherance of the corporation's interests.

It is clear that the board should not favour any one shareholder group over any other and, in particular, that it should not put the interests of a majority shareholder ahead of those of other shareholders. Having said that, if a shareholder holds a controlling interest and is intent on opposing a bid, even for non-economic reasons, the board is not required to ignore the realities of the situation.

As noted above, shareholders can pursue directors or officers of whose conduct they do not approve by a variety of means, including a **derivative action** or an application for an **oppression remedy**.

Creditors

It is not usually necessary for the directors or officers of a financially healthy corporation to pay special attention to the interests of creditors. That is because the reasonable expectation of creditors is generally that the directors and officers will govern the corporation in such a way that their right to be paid will not be put unduly at risk. In other words, keeping the corporation in a good state of financial health will generally take care of the interests of creditors as well.

Creditors' interests take on much more importance in the decision-making process in two situations:

- Where the corporation is facing a financial crisis; and
- Where the board is considering a course of action that may put the solvency of the corporation at risk.

Directors of a corporation that is part of a larger **corporate group** should be especially attentive to the solvency issue. Group-wide initiatives – such as joint strategic initiatives, joint funding arrangements, providing guarantees, etc. – may benefit the parent corporation or other members of the group. However, if such group-wide initiatives were to result in the build-up of large inter-corporate receivables (for example), they could also have the potential to be disadvantageous to creditors of certain members of the group. Directors of a member of a corporate group must keep in mind that their fundamental duty is to the corporation on whose board they serve and not to the parent corporation or to the group as a whole. Insofar as a director can influence an inter-group initiative or arrangement, he or she should be confident that the initiative or arrangement is demonstrably in the best interests of his or her corporation. If the same person sits on the board of more than one member of a corporate group, consideration will have to be given to potential conflicts between the entities.

Creditors may be able to pursue a complaint against the directors by means of the **oppression remedy**. They are specifically named as permissible oppression claimants in the ABCA and case law has established the same principle with respect to the CBCA and OBCA. As discussed above (see page 20), creditor oppression actions may also be possible under the BCBCA and QBCA, although to our knowledge this proposition has not yet been tested in litigation (and, as discussed, the QBCA situation is particularly unclear). It should be remembered that there is no automatic "right" to bring an oppression action: creditors, like any other potential litigants, must convince the court that allowing such a claim to proceed would be appropriate. Having said that, recourse to this remedy by creditors is increasingly common and often successful. As a result, the oppression remedy now effectively supplements the traditional but less flexible creditor remedies found in creditor preference and fraudulent conveyance legislation.

On the "eve of insolvency", the fiduciary duty is owed under Canadian law, as it is always owed, to the corporation itself. However, as just noted, the oppression remedy may be available to protect a creditor's interests where the conduct of the directors is unfairly prejudicial to that creditor, and a statutory duty of care may potentially be owed to the creditors (although this may depend on the wording of the duty of care in the applicable statute – see page 12, above).

Employees

Employees often have a very important stake, practically speaking, in their employer. Good corporate governance practices will usually consider the effect of decision-making on employees. Employees may in some cases be able to seek an oppression remedy if the directors or officers act so as to defeat their reasonable expectations, although to date such actions have been uncommon and largely unsuccessful. The interests of employees are protected by various other forms of legislation – see page 35ff., below.

Tort Liability and Extra-Contractual Liability

Tort Liability and Extra-Contractual Liability

As a director or an officer, it is possible to be sued personally with respect to alleged breaches of duties imposed by the law of **tort** or **extra-contractual liability**:

- **Tort** encompasses a range of legal wrongs, including nuisance, negligence, misrepresentation (negligent or fraudulent), inducing breach of contract, interference with economic relations and conspiracy to commit harm. In Canadian jurisdictions other than Quebec, these legal principles are based mainly on common law doctrines that have developed through centuries of court decisions.
- **Extra-contractual liability** is the civil law concept that corresponds to the common law concept of tort. The principles of the law of extra-contractual liability are set out in the *Civil Code of Québec* as interpreted by court cases. In Canada, it applies within Quebec only.

Tort Liability (Common Law)

The trend in common law Canada has been to expand what was formerly a very limited range of potential personal liability for directors, officers and employees with respect to acts carried out by them in their various corporate capacities. As a director or officer of a corporation, or even in some circumstances as a corporate employee, you might not be protected against personal liability:

- Where your actions were entirely or partly **in your own interest** or the personal interest of fellow directors, officers or employees, rather than in the interest of the corporation; or
- Where your actions constituted an **"independent tort"**, even if they were in the corporation's interest. See the discussion of independent torts, below.

The application of tort law in such situations is complex, but a basic principle to keep in mind is that directors, officers and employees **can** sometimes be held personally liable in tort even when their actions were performed in the context of their respective roles in the corporation. On the other hand, courts generally do not allow claims against directors or officers if the factual basis for the claim is the same as the factual basis of parallel claims against the corporation itself. For example, courts have rejected attempts by plaintiffs to tack on a "conspiracy to injure" tort claim against the board on top of a breach of contract claim against the corporation. In such a case, no personal interest is likely to have motivated the impugned act, which would also not have been "independent" of the corporation's own tort.

What is an independent tort?

While the meaning of "independent tort" has not been definitively established, director or officer conduct that can be characterized in any of the following ways is particularly likely to be found to constitute an independent tort:

- Fraud;
- Dishonesty;
- Nuisance;
- Causing physical injury; or
- Causing property damage.

Although any analysis would necessarily be fact-dependent, situations in which a director's or officer's conduct can be characterized in one of the above ways could potentially result in personal liability. There may be other situations of this kind as well.

Economic breach

One traditional exception to the possibility of personal liability is the so-called **"Rule in *Said v. Butt*"**, which, in certain circumstances, precludes a finding of personal liability against directors and officers on the basis that they have caused their corporation to breach a contract. This rule recognizes the legitimacy of an intentional breach for economic reasons, given that a breach is followed by appropriate compensation in damages from the corporate entity that breached to the innocent counterparty. Consistent with that rationale, this exception generally does not extend to situations in which the director's or officer's reason for inducing the breach is personal gain, ill-will or spite. Exactly when this rule applies is a complicated issue that needs to be considered on a case-by-case basis.

Extra-Contractual Liability (Civil Law)

Like their counterparts in the common law provinces, Quebec courts generally take the view that recourse with respect to wrongful corporate acts lies in an action against the corporation itself rather than its directors or officers personally. Nevertheless, in certain circumstances directors and officers can be held personally liable for "civil" (non-criminal) wrongs such as negligence, misrepresentation (negligent or fraudulent), inducing breach of contract (particularly if done in bad faith or maliciously), interference with economic relations and conspiracy to commit harm. In Quebec, all of these wrongs fall under the rules of "extra-contractual liability", which are (collectively) the civil law counterpart of the law of tort.

Generally speaking, in order to hold an director or officer liable under the rules of extra-contractual liability, the plaintiff will have to prove that he or she acted outside the limits of his or her mandate (e.g. was not just acting in the course of his or her duties) and committed a "personal fault", e.g. personally made a misrepresentation, acted negligently or fraudulently, abused someone's rights, or participated in an extra-contractual fault of the corporation.

While Quebec courts have not expressly adopted the *Said v. Butt* rule, many cases decided in that province have held that directors and officers will not be liable to a third party for encouraging the company to breach a contract if they acted within the limits of their mandate and there was no proof they had committed fraud, abuse of right, or have contravened a rule of public order. However, other Quebec cases have held directors liable on extra-contractual principles for engaging in conduct in clear breach of a contract into which the corporation had entered. In one situation, Quebec's Court of Appeal found a director liable for damages with respect to the corporation's breach of a non-competition clause into which it had entered. In the view of the court, there was no question that the director had been the prime mover behind the transaction through which the corporation had acquired the shares of another corporation in violation of the non-compete. Regardless of divergent outcomes of specific cases in Quebec, the conclusions reached by the Quebec courts are essentially applications of the general principle of extra-contractual liability as set out in article 1457 of the CCQ, under which a person who breaches his duty to respect rules of conduct imposed on him by law, usage or circumstances is liable for the resulting harm to others.

Other Statutory Duties and Liabilities

Other Statutory Duties and Liabilities

Many provincial and federal statutes, other than business corporations laws, impose specific liabilities on directors and officers. In any given province, there will be dozens of statutes that create director and officer liabilities. Many of those liabilities rarely arise or affect only a narrow range of industries, but some – such as those relating to **employment law, taxation** and **environmental law** – are of nearly universal application. We discuss those more general areas of liability further below. Before doing so, however, we will review two concepts that are broadly applicable across most forms of statutory liability.

Broadly Applicable Concepts

Jurisdiction

As a director or officer, your conduct will typically be subject to certain laws of the Canadian jurisdictions in which the corporation's business is carried on, in addition to the corporate law of the jurisdiction of incorporation. These jurisdictions include the provinces, territories and in some cases the federal government's jurisdiction. You should therefore ensure that you are well informed about laws and regulations in those jurisdictions that could potentially apply to your corporation and/or to you in your capacity as director or officer.

Because the law in these areas is generally not standardized from jurisdiction to jurisdiction, the following discussion should be considered a high-level overview only, applicable only to the jurisdictions specifically named. Non-Canadian readers in particular should be aware that Canada's regulatory laws are frequently **not** national in scope – for example, employment and environmental matters fall primarily under provincial jurisdiction in Canada.

Due diligence

Many statutes that create liabilities for a director or officer provide a **due diligence defence**. This defence, if available, generally allows defendants to avoid liability if they can demonstrate that they were duly diligent in establishing a process or system to prevent the commission of the event giving rise to the claim, and that reasonable care or reasonable steps were taken to ensure the effective operation of that process or system. Therefore, it will be important to review the corporation's processes for dealing with these types of obligations and liabilities and it is recommended that you receive regular reports on these items, confirming *inter alia* that any required remittances are being made as the obligations come due. The latter is particularly important because any failure to make such remittances can be difficult to remedy in the event that the corporation enters an insolvency or bankruptcy process – a situation that can sometimes have personal liability consequences for directors and officers.

Employment Law Liabilities

The following discussion generally assumes a **non-unionized** workplace. If a workplace is unionized (i.e., is subject to one or more **collective agreements**), potential liabilities of the board and senior management are likely to be somewhat more extensive than what we describe below.

Applicable legislation

Employment-related liabilities for directors and officers are created in the various federal or provincial business corporations acts ("BCAs") as well as in federal or provincial employment standards legislation. On a point of terminology, while only some of the provincial employment standards statutes are named "the Employment Standards Act", to keep things simple we will refer to them collectively in this section as "the ESAs".

Distinctions between BCA and ESA employment provisions

There are several key differences between the BCAs and the ESAs. One difference is that a provincial ESA **applies territorially** to all companies that are present in the jurisdiction, except insofar as any such company carries on a federally-regulated business (as described below). In contrast, a BCA applies **only to corporations that were incorporated (or continued) under that BCA**. Thus, if a corporation whose employees are all based in Ontario happens to be incorporated under the New Brunswick BCA (NBBCA), the employment-related corporate law provisions that apply will be those of the NBBCA, while the Ontario ESA will apply to its Ontario-based employees (assuming that the business is not federally regulated).

A second difference is that provincial ESAs deal with a **broader range** of employment issues than do the BCAs. The purpose of the ESAs is to set out the minimum standards for employees working in the provinces to which they apply. The range of issues covered by the ESAs includes hours of work, payment of wages, leaves of absence, vacation and termination of employment among many others. The purpose of the BCAs, in contrast, is to set out the requirements by which business corporations must abide in order to continue to avail themselves of the benefits of incorporation. While these requirements incidentally include some significant employment-related obligations, the BCAs are not primarily focused on corporations as employers.

A third – and very important – distinction relates to **how their respective employment-related enforcement mechanisms are triggered**. The BCA provisions require the employee to bring a lawsuit against the corporation (with the directors generally being potentially liable only if they are named in the suit), while the ESAs create a complaint-driven regulatory process that may result in an order against the corporation and its directors. Generally speaking, an employee cannot bring a civil claim based on statutory rights under employment standards legislation.

Liability for unpaid wages and debts: Alberta, Ontario and Quebec

Under the CBCA and the BCAs of Alberta, Ontario and Quebec, directors of a corporation may be held jointly and severally liable for debts owing for services performed in an amount not to exceed **the equivalent of six months' wages**. It is important to note that these "debts owing" can include amounts other than wages. Depending on the jurisdiction and the circumstances, they can encompass commissions, bonuses, holiday pay (as opposed to vacation pay) and expenses. Under the OBCA, there is a further liability for vacation pay. Severance and termination pay are generally thought to be excluded under the provincial regimes because they do not constitute debts owing for services performed. The QBCA expressly makes a due diligence defence available in these circumstances.

At the same time, the ESAs of each of these provinces (and B.C., as discussed separately below) create a somewhat similar set of liabilities. Under the Alberta, Ontario and Quebec ESAs, directors and (in certain cases) former directors are liable for up to six months' unpaid wages. There can also be additional penalties for failure to comply.

Liability related to unpaid wages: British Columbia

British Columbia's provisions are found exclusively in its *Employment Standards Act* and create a liability for **two months' wages**, including vacation pay in some circumstances (the B.C. provision applies to officers as well as to directors).

Liability related to unpaid wages: federally-regulated corporations

Directors of corporations with a federally-regulated workforce are liable under the *Canada Labour Code* for the equivalent of six months' wages, and in that case severance and termination pay may form part of what is owing. Federally-regulated employees include federal workers, employees of Canadian crown corporations and those employed in the following industries: banks, airlines and airports, shipping, canals and ports, railways, telecommunications, broadcasting, pipelines, grain elevators, feed mills and seed mills.

Liability related to unpaid wages: general issues

While affected employees must first attempt to collect any outstanding amounts from the corporation, under some legislation proceedings can be commenced against directors before all proceedings against the corporation are exhausted. Under the ABCA, a director is not liable if he or she reasonably believed the corporation could pay the debts as they fell due.

Company pension plan contributions

Depending on the terms and structure of its pension plan, a company may have an obligation under pension benefits legislation to hold contributions in trust. Directors and officers who acquiesce or participate in a breach of this obligation can be ordered by the court to make the contributions to the plan personally and may face potential fines and penalties.

Directors and officers should have processes in place to ensure that contributions to pension plans are made as required and not used for corporate purposes.

The above refers to company pension plans rather than to the Canada Pension Plan and Quebec Pension Plan, which are discussed under "Source Deductions", page 40, below.

Employee health insurance payments

Currently, three Canadian provinces – British Columbia, Ontario and Quebec – finance their health care programs in part through a special surtax or health care premium.

Ontario employers are subject to Employer Health Tax (EHT). EHT is a graduated payroll tax applied at a rate that ranges from 0.98% on the first $200,000 of payroll to 1.95% on payroll above $400,000. An exemption provision in the *Employer Health Tax Act* (EHTA) permits most corporate employers whose payrolls do not exceed $5,000,000 to exclude the first $450,000 of payroll from the calculation (the $450,000 figure will be adjusted for inflation in 2019 and every fifth year thereafter). Special rules apply in a range of specific situations, e.g. to corporate groups, to employers that are charities and with respect to certain employees who work outside Canada for extended periods. The EHTA makes the directors, officers and agents of a corporation liable for any offence of the corporation whether or not the corporation has been prosecuted or convicted – provided that those directors, officers or agents directed, authorized, assented to, acquiesced in, or participated in the commission of the offence in question.

Under Quebec's *Act Respecting the Régie de l'Assurance Maladie du Québec*, a corporation must remit to the government an amount determined by a formula based on wages paid in Quebec and the overall size of the corporation's payroll. Under Quebec's *Tax Administration Act*, directors (but not specifically officers) are solidarily liable with the corporation for amounts that the corporation has failed to remit, although only where other forms of recourse against the corporation have failed or in cases of bankruptcy, winding-up, liquidation or dissolution. Under the legislation, directors enjoy the protection of due diligence and (objective) knowledge requirements.

While British Columbia's Medical Services Plan is also partly financed through health insurance premiums, employers in that province are not obligated to pay those premiums on behalf of their employees. However, in cases where employers voluntarily pay the premiums, a failure to remit such premiums creates a lien in favour of the B.C. Medical Services Commission. Directors and officers of the employer who concurred in that failure are liable on a "joint and several" basis for the shortfall and any penalty assessed (which could be as much as ten times the unpaid amount. In February 2018, the Government of British Columbia announced that Medical Services Plan premiums will be abolished as of January 1, 2020.

Directors and officers should therefore be satisfied that their corporation has processes in place that are designed to ensure that any applicable health insurance premiums and/or special health care taxes are being remitted and that all related requirements (e.g. record-keeping and retention requirements) are being followed.

Occupational health and safety

Under Alberta's *Occupational Health and Safety Act*, employers are generally obligated to ensure the health and safety of workers engaged in the work of the employer, as well as other workers who may be present at the employer's worksite. The definition of "employer" includes a director or officer of the corporation who "oversees the occupational health and safety of the workers employed by the corporation". For those with workplaces in Alberta, it will be important to be clear about the roles of directors and officers, as those who fall into the category just described may be exposed to liability under the Act that could, in principle, include fines of $1 million or more as well as a term of imprisonment of up to one year.

British Columbia's principal occupational health and safety legislation is the *Workers Compensation Act*, together with its associated occupational health and safety regulations. In B.C., employers are generally obligated to ensure the health and safety of all workers engaged in the work of the employer, as well as other workers who may be present at the employer's worksite. Under the Act, every director and officer must ensure that the corporation complies with the legislation and any director or officer who authorizes, permits or acquiesces in any breach of the statute by the corporation will be liable to fines of $1 million or more as well as a term of imprisonment of up to one year and potential additional or alternative penalties such as community service. Fines may be increased to the extent that the court is satisfied that the director or officer benefitted monetarily from the breach. However, there is a due diligence defence.

Ontario's *Occupational Health and Safety Act* imposes an obligation on directors and officers to take all reasonable care to ensure that the corporation complies with the Act, regulations and any orders made under the Act. Under the Act and its associated regulations, the corporation must ensure the safety of its workplaces, which entails providing prescribed and functioning safety equipment to workers, appointing competent supervisors, carrying out the safety procedures in the regulations and providing information, instruction and supervision to workers to protect their health and safety. Failure to perform these statutory duties may result in fines of up to $25,000 and imprisonment for up to one year. A defence is available in certain specific circumstances where the accused director or officer can prove that every precaution reasonable in the circumstances was taken.

Quebec's *Act Respecting Occupational Health and Safety* deems any director, officer, employee or agent of a corporation who prescribed or authorized an action or omission that constitutes an offence by the corporation under the Act, or consented to the commission of that offence, to have participated in that offence. Such individuals are liable to the penalties that apply in respect of the offence, whether or not the corporation itself has been prosecuted or convicted. Examples of offences under the Act include doing anything that might directly and seriously compromise the health, safety or physical well-being of a worker, failing to offer a worker appropriate training in occupational health and safety, or failing to ensure that the workplace and working procedures are safe. Directors and officers who are deemed to have participated in an offence under the Quebec statute (by prescribing, authorizing or consenting to the relevant act or omission) are generally subject to fines of up to $6,000, or up to $12,000 in the case of acts or omissions that directly and seriously compromise an employee's health, safety or physical well-being (because the maximum amounts are indexed to the Consumer Price Index, they are now slightly higher than the figures just mentioned).

Canada's federal *Criminal Code* imposes criminal liability for unsafe workplaces on all organizations, including corporations, public bodies, firms, partnerships, trade unions, municipalities and other associations. The *Code* creates a legal duty for all persons directing work to take reasonable steps to ensure the safety of workers and the public and sets out rules attributing criminal liability to organizations for the acts of their representatives. In addition to the penalties already in place under health and safety legislation, the *Code* imposes significant penalties, including fines ranging between $25,000 and $100,000 in the case of a summary conviction offence. There is no limit, however, on the fines that can be imposed with respect to the more serious ("indictable") offences. Terms of imprisonment can also be imposed.

Directors and officers should therefore take a relatively hands-on approach to health and safety issues, while being attentive to the slightly different rules that may govern their operations across Canada's jurisdictions.

Tax Liabilities

A corporation has a number of obligations to remit tax withheld on another person's behalf. Directors at the time of the required withholding or remittance may be jointly and severally liable (in Quebec, solidarily liable) with the corporation for the amount that should have been withheld or remitted together with interest and penalties. For example, amounts on account of income taxes payable by employees must be withheld by a corporate employer and remitted to the government. Also, amounts withheld for tax on transactions with foreign parties must be remitted. Unsuccessful enforcement against the corporation is a prerequisite and the director or officer can defend by proving due diligence. The same type of personal liability can exist for failure to make required source deductions under the tax legislation of Canada's provinces, again typically with a due diligence defence.

Directors or officers have typically been found liable where there has been:

- An absence of any positive action at the time the financial troubles arose;
- Deliberate payment of only some creditors; or
- A history of late remittances.

In addition, under the federal *Income Tax Act,* directors and officers who supervise the winding up of a corporation or the liquidation of its assets could be personally liable for taxes owing by the corporation unless they ensure that the corporation obtains a clearance certificate before the corporation's property is distributed. Even though in practice this is often not done, it is important to be aware of the possible consequences.

Finally, there is also a general liability, under the federal *Income Tax Act* as well as its counterparts in Alberta, British Columbia, Ontario and Quebec, applying to directors and officers who "directed, authorized, assented to, acquiesced in, or participated in the commission of" an offence by the corporation under the Act in question. Such directors and officers are considered party to and guilty of the offence and subject to the punishment that applies to the offence, whether or not the corporation itself has been prosecuted or convicted.

Source deductions (government pensions and employment insurance)

Besides deducting and remitting taxes from employees' wages (as discussed in the previous section), employers must also deduct employee contributions to the Canada Pension Plan (CPP), Quebec Pension Plan (QPP) and the federal Employment Insurance (EI) fund and remit them to the appropriate governmental authority, along with their employer CPP, QPP and EI contributions. If a corporation fails to satisfy a withholding or remittance obligation, or other obligations under any of these regimes, its directors and officers may be found liable (jointly and severally or solidarily) for the amount owing, plus interest and penalties. A due diligence defence applies.

Sales tax

Directors and officers may be personally liable for any GST or HST (depending on the province) that the corporation fails to remit to the federal government under the federal *Excise Tax Act*. A due diligence defence applies. Similar liabilities exist under Quebec's QST (a value-added tax similar to the GST and HST) and under British Columbia's Provincial Sales Tax (PST). Alberta has no provincial sales or value-added tax.

Other taxes

Taxing statutes often provide that directors or officers who play any part in the failure to pay the tax are also subject to a penalty. Liabilities are provided for under a number of provincial statutes, e.g. fuel tax statutes, as well as the federal *Customs Act*. The board and corporate management should be familiar with the various taxes that the corporation is liable to pay in the provinces in which it operates, including any potential director and officer liabilities that they entail.

Environmental Law

Environmental legislation imposes personal liability on directors and officers of corporations that violate environmental laws, subject to the due diligence defence discussed below. Created under a multiplicity of federal and provincial laws, these liabilities can arise from the personal conduct of a director or officer or as the result of the director or officer's being considered a party to an offence committed by the corporation. This latter form of liability can arise by virtue of being the directing mind of the corporation, by virtue of having aided the corporation in a violation of the law or by a presumption of liability created by law.

In widely-held corporations, where a director's control usually falls well short of what would be required to be a "directing mind", the issue of control remains a significant factor in allocating liability for environmental harm. This is evident from the fact that very few litigated cases in Canada have, to date, dealt with independent directors directly. Even so, independent directors should not take too much comfort in this, as courts are increasingly requiring that they make the most of the influence that they do have (by asking questions and following up on responses, for example). **Consequently, it is important that all directors understand the environmental risks of the corporation's business, satisfy themselves that policies and procedures are in place to address foreseeable environmental accidents or other issues, and exercise proactive management of environmental matters, including ensuring that the board receives periodic and punctual reports.**

Federal legislation

Canada's federal regulatory regime comprises environmental assessment and review procedures, prohibitions on discharges into the environment, license and permit requirements, spill reporting and clean-up requirements, ministerial powers to issue orders, and statutory offences. The five key federal environmental statutes are:

- The *Canadian Environmental Protection Act, 1999* (**CEPA**), which deals primarily with the manufacture, import, export, use, handling, release and disposal of toxic substances;
- The *Canadian Environmental Assessment Act, 2012* (**CEAA**), which applies to federal government and private projects that involve federal government funds or lands, or which require certain federal government approvals;

- The *Fisheries Act*, which notably prohibits the deposit of deleterious substances in water frequented by fish;
- The *Transportation of Dangerous Goods Act, 1992* (**TDGA**), which regulates the import, transport and handling of dangerous goods; and
- The *Hazardous Products Act* (**HPA**), which regulates the sale and import of hazardous products used in a workplace.

CEPA and the *Fisheries Act*, the most frequent sources of environmental liability at the federal level, as well as the TDGA and the HPA, each provide that any officer, director or agent of a corporation who directed, authorized, assented to, acquiesced in or participated in the commission of an offence under the Act by the corporation is party to and guilty of the offence, whether or not the corporation itself has been charged or convicted. The CEAA does not expressly refer to director and officer liability.

Pursuant to CEPA, every director and officer of a corporation also has a positive duty to take all reasonable care to ensure that the corporation complies with the provisions of CEPA and its regulations, except for the provisions regarding disposal at sea, where the only the directors and officers who are "in a position to direct or influence the corporation's policies or activities" have such positive duty.

Under both CEPA and the *Fisheries Act*, penalties for individuals range up to $600,000 upon conviction for less serious (summary conviction) charges and up to $2,000,000 for more serious (indictable) charges as well as up to six months or three years imprisonment, respectively.

Because CEPA imposes a positive duty of care to the directors and officers of a corporation, and can therefore apply even where a director or officer was not proactively involved in an offence, a director or officer cannot protect himself or herself by turning a blind eye to the corporation's environmental practices.

Alberta

The provisions governing directors' and officers' liability under Alberta's *Environmental Protection and Enhancement Act* (**AEPEA**) are virtually identical to those set out in CEPA. Potential fines vary depending on the offence, with a $100,000 maximum, in addition to up to two years imprisonment, for certain more serious offences. Similar liabilities and penalties are established by the *Dangerous Goods Transportation and Handling Act*.

Environmental protection orders may be issued under the AEPEA against the "person responsible for the contaminated site", which could include a director or an officer in circumstances where it could be shown that a director or officer personally caused or contributed to the release of the substance which resulted in the contamination. The legislation gives the provincial authority discretion with respect to the issuance of such orders, allowing consideration of the conduct of the responsible person (e.g. whether industry standards were followed and what steps were taken when the person became aware of the contamination).

British Columbia

British Columbia's *Environmental Management Act* (**EMA**) provides that where a corporation has committed an offence under the Act, any director or officer who authorized, permitted or acquiesced in the offence has also committed the offence. Offenders face up to six months imprisonment and fines that vary depending on the offence, with a $1,000,000 maximum applying to certain serious hazardous substances offences. Similar liabilities, with penalties of up to $100,000 and two years' imprisonment, are established by the *Transport of Dangerous Goods Act*.

Remediation orders may be issued under the EMA against the "person responsible" for the contaminated site. While directors and officers are not specifically mentioned under the definition of "person responsible", in some circumstances it is possible that they could be subject to an order (e.g. where they previously had an ownership interest in the site). There is a due diligence defence in cases where the contamination pre-existed the owner's ownership of the site or was not caused in any way by the owner.

Ontario

The provisions governing directors' and officers' liability under Ontario's *Environmental Protection Act* (**EPA**) are generally stronger than those at the federal level and in most other provinces. In Ontario, directors and officers have a positive duty to "take all reasonable care to prevent the corporation from causing or permitting [an] unlawful discharge", and are guilty of an offence where they fail to perform that duty. Moreover, where the corporation has been charged with an offence under the Act, the director or officer bears the burden of proving that he or she discharged this duty.

The regulators can obtain orders against persons who have or had the management or control of a property or undertaking to take various clean-up measures. If the orders are not complied with, the Government of Ontario can undertake the clean-up itself and seek reimbursement from those who failed to comply (which could include directors or officers in some cases). The EPA states that any person who has control of a contaminant is responsible for cleaning up, or (subject to a due diligence defence) for reimbursing others (including the Government) for the clean-up costs associated with the spill of a contaminant. Again, directors and officers could in some circumstances be such persons. There are also provisions for fines and imprisonment, which fall into two main categories depending on the precise offence, as follows:

- Up to $50,000 per day (up to $100,000 per day for a second or subsequent conviction) for individuals, in addition to the possibility of up to one year's imprisonment; or
- Up to $4,000,000 per day (increasing to a maximum of $6,000,000 per day for a second or subsequent conviction), in addition to the possibility of imprisonment for up to 5 years, less a day.

Several other Ontario statutes establish environmental compliance standards in certain specific areas. These include the *Ontario Water Resources Act*, the *Nutrient Management Act, 2002*, the *Pesticides Act* and the *Safe Drinking Water Act, 2002*. These statutes contain significant punitive provisions. For example, Ontario's *Safe Drinking Water Act, 2002* envisages maximum fines for offences that result in a drinking water health hazard of $4,000,000 per day (or $7,000,000 per day if a repeat offender), in addition to the possibility of imprisonment for up to 5 years, less a day.

Quebec

Quebec's *Environment Quality Act* creates a presumption that the director or officer of a corporation committed any offence committed by that corporation (or its agents, mandataries or employees), unless it is established that the director or officer "exercised due diligence and took all necessary precautions to prevent the offence". In addition, directors and officers of a corporation who has defaulted on the payment of an amount due to the Quebec Minister of Sustainable Development, Environment and the Fight Against Climate Change under the *Environment Quality Act* are solidarily liable, with the corporation, for the payment of the amount, unless they establish that they exercised due care and diligence to prevent the failure which led to claim.

Fines of up to $2,000,000 (fines of up to $1,000,000 applicable to natural persons are doubled for directors) and 3 years' imprisonment are possible in the case of the most serious offences (generally those involving the release of contaminants into the environment).

Due diligence measures

Directors and officers will generally not be found liable for environmental offences committed by their corporations where they are able to demonstrate that they have taken reasonable steps to ensure that those offences do not occur. What constitutes adequate due diligence can depend very much on the type of business and the environmental risks it faces. Some steps that a board might take to ensure the adequacy of due diligence include:

- Being satisfied that those charged with direct responsibility for environmental compliance are adequately supervised;
- Being satisfied that those making decisions on matters that might affect the environment adequately understand environmental issues;
- Introducing environmental policies, pollution prevention systems and monitoring and control mechanisms that meet industry standards;
- Requiring periodic and punctual reports to the board from those in charge of environmental matters, notably seeking to ensure that you are advised in a timely manner of any substantial non-compliance;

- Seeking to ensure that environmental concerns are promptly attended to by corporate officers and specifically attributing responsibility for such matters;
- Being aware of industry standards and their evolution; and
- Responding personally and immediately when you receive notice that a pollution prevention system has failed.

These steps are obviously not going to prevent all environmental problems from arising. What they are intended to do, however, is to establish a mechanism to seek to reduce the risk of environmental problems and ensure that those that do arise are promptly brought to the attention of the directors and officers and diligently and adequately dealt with. Ensuring that a structure is in place to properly deal with environmental issues will generally help a director or officer to meet his or her due diligence obligation. **Given the complexity and rapid development of environmental regulation, obtaining situation-specific advice from specialized counsel as soon as an issue arises is highly advisable.**

Public Companies

Public Companies

Officers and directors of **reporting issuers** may be exposed to liability and subject to additional obligations under corporate and securities laws as well as applicable stock exchange rules (the definition of "reporting issuer" is complex, but it corresponds broadly to the common term "public company"). For example, there is a potential for personal liability in connection with primary and secondary market disclosure, as well as for failure to comply with insider reporting requirements and/or insider trading and tipping restrictions. Public company boards are also subject to more rules than non-public boards, particularly with respect to the board's composition and the constitution and functions of committees. Directors and officers may also be exposed to liability for direct contraventions of securities law generally if they permit or acquiesce in the commission of an offence by the company.

Independent Directors

Independent directors play an important role for public companies in Canada. Canada's provincial and territorial securities regulators have adopted a "best practices" policy known as National Policy 58-201 *Corporate Governance Guidelines* which recommends that reporting issuers have **a majority of independent directors** on their boards. National Instrument 58-101 *Disclosure of Corporate Governance Practices* also requires that reporting issuers prepare certain prescribed disclosure regarding their governance practices which includes, among other things, the identity of directors who are independent, the basis for determining that directors are non-independent (as applicable), whether or not a majority of the directors are independent and, where a majority are not independent, how the board facilitates its exercise of independent judgement in carrying out its responsibilities. A director is considered to be "independent" if he or she has no direct or indirect material relationship with the company. A "material relationship" is a relationship that could, in the view of the company's board, be reasonably expected to interfere with the exercise of a board member's independent judgment. In attempting to comply with this recommended best practice, a board of directors should assess all relationships between the company and an individual, including significant shareholdings, in order to determine whether any material relationship exists.

Notwithstanding the board's discretion in determining whether a director is independent, certain relationships with the issuer or any affiliate are deemed to result in non-independence. Among these are employees and executives and persons who receive direct compensation of over $75,000 in a year (excluding director's fees and pensions). Certain immediate family members of these persons are also deemed to be "non-independent".

Where there is a real or perceived concern about conflicts of interest involving inside directors, the credibility of the decision-making process (and the likelihood that the court will defer to its outcome) will generally be improved by the establishment of a committee of independent directors to take control of the process.

Audit Committees

National Instrument 52-110 *Audit Committees* establishes the responsibilities of the audit committee of a reporting issuer. Both venture and non-venture issuers are required to have audit committees of at least three members, all directors. In the case of a **non-venture issuer**, *all* members of the audit committee must be independent (with certain limited exceptions as described below). In the case of a **venture issuer**, a *majority* of the audit committee must be directors who are *not* executive officers, employees or control persons of the venture issuer, or of an affiliate.

Independence requirement

Under NI 52-110, members of an audit committee must meet an enhanced independence test. In addition to the standard that applies to all directors (described above), audit committee members are "non-independent" if they have accepted, directly or indirectly, any consulting, advisory or other "compensatory fee" from the issuer or its subsidiaries, other than fees directly related to service on the board. Fees paid to spouses and children living at home are included, as are fees paid to accountancy firms, law firms, investment banks, financial advisors and consultants of which the director is a partner, member, or senior officer. In certain circumstances, members who are shareholders or who occupy specified positions with a shareholder may also be "non-independent" for audit committee purposes.

There are a number of situations in which a director of an issuer may serve on an audit committee even though he or she does not meet this test of independence. Where an issuer is making an initial public offering ("IPO"), for example, its audit committee need include only one independent member for up to 90 days after the date of its prospectus receipt. Exceptions are also often available where a potential audit committee member "fails" the independence test solely as a result of his or her status with a parent, subsidiary or affiliated entity, and where a member is added to the audit committee on a temporary basis or under exceptional circumstances. These exceptions can only be used if the board has determined that they will not compromise the audit committee's ability to act independently. A similar but separate set of exceptions applies to venture issuers: for example, in crisis situations that would best be addressed by having a member of the audit committee become an executive officer or employee of the issuer.

Financial literacy requirement

Audit committee members of non-venture issuers must demonstrate financial literacy. For the purposes of NI 52-110, "financial literacy" means that the director must be able "to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements." Having said that, financial literacy does **not** require a "comprehensive knowledge of GAAP and GAAS." Exceptions to the financial literacy requirement are limited, although NI 52-110 does provide that an audit committee member may be appointed without satisfying the requirement if he or she satisfies it within a reasonable period thereafter.

Insider Reporting

If you are what is known as a "reporting insider", you will have to report your holdings in the corporation and any trades you make in the corporation's securities or those of its subsidiaries. Under National Instrument 55-104 *Insider Reporting Requirements and Exemptions*, a reporting insider includes, among others:

- A director of a reporting issuer;
- The CEO, CFO or COO (including of a subsidiary) of a reporting issuer;
- A "significant shareholder" (as defined) of a reporting issuer;
- A director or other senior manager of a management company providing significant services to the reporting issuer or its subsidiaries;
- Anyone performing functions similar to any of the above;
- Anyone who routinely has access to information about the corporation's non-public material facts or material changes; and
- Anyone who exercises (or could exercise) "significant power or influence" over the corporation.

Insider reports are filed via the System for Electronic Disclosure by Insiders ("SEDI"). In addition to holdings and trades, a reporting insider is required to report hedging arrangements, such as equity monetization transactions, with respect to the securities you hold in the corporation. A reporting insider must also report with respect to interests he or she holds in the form of derivative instruments.

Prohibitions

Canadian securities laws and most of the BCAs regulate **insider trading** (exceptions include the QBCA). However, with the exception of the CBCA, the insider trading provisions in the BCAs are focused on private companies only. In addition, **tipping** is regulated under the securities laws and by the CBCA (but not by any of the CBCA's provincial counterparts) and **recommending** is regulated under Canadian securities laws.

Insider trading

According to the CBCA definition, "insider trading" occurs when a director, officer or other "insider" (as defined) of a corporation buys or sells securities "with knowledge of confidential information that, if generally known, might reasonably be expected to affect materially the value of any of the securities of the corporation."

Note that there are certain exceptions to this rule, for example, where the insider can show that he or she reasonably believed that the information was generally known. Under Canadian securities laws, "insider trading" occurs where any person in a "special relationship" with a reporting issuer or an issuer whose securities are publicly traded purchases or sells securities of such issuer with knowledge of a "material fact" or a "material change" with respect to the issuer that has not been generally disclosed.

Tipping

"Tipping", under the Ontario *Securities Act,* occurs when a director, officer or other person in a "special relationship" (see below) with a reporting issuer or any other issuer whose securities are publicly traded "inform[s], other than in the necessary course of business, another person or company of a material fact or material change with respect to the issuer before the material fact or material change has been generally disclosed." Other Canadian securities statutes, including those of Alberta, British Columbia and Quebec, contain similar provisions.

Recommending

In addition to the offences of insider trading and tipping described above, most provincial securities statutes prohibit the offence of "recommending" which occurs where a person or company in a special relationship with a public company recommends or encourages another person or company to purchase or sell securities of an issuer with knowledge of a material fact or material change that has not been disclosed. Like the offence of "tipping", a carve-out is provided where the prohibited behaviour is in the necessary course of business.

Other common prohibitions

Many Canadian securities statutes contain general **market manipulation** prohibitions or, in some cases, specific prohibitions against other types of impropriety, such as **front-running** (trading, tipping or touting a security on the basis of knowledge that a trade in that security is about to occur that will significantly affect its market price). In some cases, this type of activity may also be regulated under the Universal Market Integrity Rules (UMIR) of the Investment Industry Regulatory Organization of Canada (IIROC).

The CBCA also regulates some of this type of activity. It provides that an insider of a "distributing corporation" cannot generally short-sell securities of the corporation or its affiliates or sell a call or buy a part of a security of the corporation or its affiliates (there is a limited exception for options and convertible securities).

What constitutes a material fact or material change?

As the discussion above shows, the concepts of "material fact" and "material change" are important aspects of insider trading, tipping and recommending. Under Canadian securities laws, a **material fact** is a fact that "would reasonably be expected to have a significant effect on the market price or value" of securities that have been issued or are proposed to be issued, while a **material change** is a "change in the business, operations or capital of the issuer", or a decision by the board to implement such a change, where the change "would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer." A decision by senior management to **implement** a change can itself constitute a material change, supposing that it meets the "significant effect" standard just mentioned and provided also that senior management believes that board confirmation of the decision is probable.

Who Is bound by these prohibitions? (the "special relationship")

Generally speaking, any person or company in a "special relationship" with a public company is bound by these prohibitions, including:

- A director or officer of the public company or of any company that is an insider of the public company;
- A director or officer of another company that is engaging in or proposing to engage in certain kinds of business relationship with the company; and
- A former director or officer, with respect to any material information that they learned while in office.

Sanctions

Under the securities acts and BCAs

Civil remedies and penal sanctions exist for breach of the prohibitions discussed above. While Canadian securities statutes differ with respect to the precise amounts of maximum fines and other details, Ontario's sanctions are generally fairly representative. Under Ontario's *Securities Act*, a person found to have breached these provisions can be fined up to the greater of $5,000,000 or three times the illegal profit he or she earned (or the loss he or she avoided) and potentially face imprisonment for up to 5 years. On the civil side, he or she may be accountable to the corporation for any direct benefit received. He or she may also have to compensate the person with whom he or she transacted for any loss that that person suffered. The Ontario Securities Commission (and/or the securities commission of another province, if applicable) can also initiate a regulatory proceeding.

Under the CBCA, in the case of both private and public companies, a director may be accountable to the corporation for any profit he or she makes as a result of insider trading. On top of that, substantial fines and even imprisonment are possible. There is a statutory defence of reasonable belief that the confidential information had been generally disclosed. In a tipping situation, a director or officer could also be liable in damages to any person who buys or sells securities from any person whom he or she has tipped.

Defences

Certain statutory defences are available with respect to the prohibitions discussed above. These include the defence that you believed that the material fact or material change had been generally disclosed. Securities laws also recognize certain exceptions to these prohibitions. There are some differences among the various securities statutes with respect to the scope and availability of defences.

Under the Criminal Code

Under the *Criminal Code,* it is an offence to buy or sell securities, whether directly or indirectly, while knowingly using inside information. "Inside information" is defined as information relating to or affecting the issuer of a security that has not been generally disclosed and could be reasonably expected to significantly affect the market price or value of a security of the issuer. An offending party can be liable to imprisonment for up to 10 years. The first conviction under this section resulted in a 39-month prison term for the insider.

It is also a criminal offence to knowingly supply insider information to anyone if you are aware of a risk that the person will buy or sell the securities or pass the inside information on to someone who will. The maximum penalty with respect to this offence is 5 years in prison.

Related Party Transactions

Related party transactions in Canada are governed by Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions*. Although MI 61-101 has been adopted only in Ontario and Quebec, it has nationwide effect for practical purposes since it applies to all companies listed on the TSX or TSXV.

Where the corporation is a reporting issuer, transactions between a director or an officer and the corporation fall within the definition of "related party transactions" and can therefore give rise to certain reporting and procedural requirements. As defined in MI 61-101, "related party transactions" include transactions as a result of which the issuer (whether directly or indirectly):

- Purchases or acquires an asset from the related party for valuable consideration;
- Purchases or acquires, as a joint actor with the related party, an asset from a third party if the proportion of the asset acquired by the issuer is less than the proportion of the consideration paid by the issuer;
- Sells, transfers or disposes of an asset to the related party;

- Sells, transfers or disposes of, as a joint actor with the related party, an asset to a third party if the proportion of the consideration received by the issuer is less than the proportion of the asset sold, transferred or disposed of by the issuer;
- Leases property to or from the related party;
- Acquires the related party, or combines with the related party, through an amalgamation, arrangement or otherwise, whether alone or with joint actors;
- Issues a security to the related party or subscribes for a security of the related party;
- Amends the terms of a security of the issuer if the security is beneficially owned, or is one over which control or direction is exercised, by the related party, or agrees to the amendment of the terms of a security of the related party if the security is beneficially owned by the issuer or is one over which the issuer exercises control or direction;
- Assumes or otherwise becomes subject to a liability of the related party;
- Borrows money from or lends money to the related party, or enters into a credit facility with the related party;
- Releases, cancels or forgives a debt or liability owed by the related party;
- Materially amends the terms of an outstanding debt or liability owed by or to the related party, or the terms of an outstanding credit facility with the related party; or
- Provides a guarantee or collateral security for a debt or liability of the related party, or materially amends the terms of the guarantee or security.

Who are "related parties"?

Under MI 61-101, "related parties" include not only directors and senior officers of the corporation, but directors and senior officers of its affiliates and major shareholders. "Senior officer" is explicitly defined to include "the chair or a vice-chair of the board of directors, a president, a vice-president, the secretary, the treasurer or the general manager of an issuer or any other individual who performs functions for an issuer similar to those normally performed by an individual occupying any such office" in addition to the senior officers (so defined) of the general partner of a limited partnership.

What must the corporation do in the event of a related party transaction?

Among the procedural safeguards relating to related party transactions are:

- Where the transaction could constitute a material change, disclosure of all relevant information to shareholders through a news release and a material change report containing prescribed information (MI 61-101 requires additional information beyond what would be found in a regular material change report).
- Provision of an information circular and holding of a meeting where "majority of minority" approval is required for a related party transaction (exceptions

include where the fair market value of the subject matter of the transaction is 25% or less of the issuer's market cap).

- The preparation and disclosure of a formal and independent valuation, supervised by independent directors (some exceptions).

The Companion Policy to MI 61-101 states that "it is good practice for negotiations respecting a transaction involving an interested party to be carried out by or reviewed and reported upon by a special committee of disinterested directors." One should also consider whether the relevant business corporations act requires the establishment of a special committee of independent directors in the circumstances.

Prospectus Disclosure

Directors and officers have specific duties relating to the preparation and certification of the disclosure in a prospectus (including any amendments). Specifically, directors may be liable for any misrepresentations in the prospectus to investors who purchase the securities in the offering, even if they did not actually sign the prospectus certificate. However, if a director withdraws his or her consent at a later time, he or she may be shielded from liability. Officers who sign can also be liable.

Directors should know what is in the prospectus, including any amendments, and must be satisfied that the company has measures in place to verify the information. If a director took all reasonable steps to ensure accuracy and believed that the statements made were accurate, he or she will most likely have a defence against liability. There is also a specific defence for forward-looking information that had a "reasonable basis" and was accompanied by appropriate cautionary language. Directors and officers should nevertheless be particularly diligent with respect to the use of forecasts in a prospectus in light of court decisions limiting the impact of cautionary language. Directors and officers may also be liable for misrepresentations contained in offering memoranda and circulars. Note that investor plaintiffs are **not** required to prove that they actually relied upon the inaccurate disclosure.

Continuous Disclosure

Directors and officers must also be confident about the company's processes and systems relating to its continuous disclosure obligations. Among other things, companies must disclose material changes in their affairs (and other "material information") in a timely fashion. Officers or directors who take part in any breach of these disclosure obligations can be fined or imprisoned.

Responding to Take-over Bids: Defensive Tactics

Responding to a take-over bid can often put certain directors in a conflict of interest situation, particularly inside directors (who may lose their posts in a take-over) or directors that are not independent of a particular shareholder. In determining the response to a take-over bid, including defensive measures, directors must pay particular regard not only to their general statutory duty to act in the best interests of the corporation as a whole (which among other things may involve consideration of the reasonable expectations of various stakeholder groups and the maximization of value to shareholders), but also to specific securities legislation and policies dealing with defensive tactics and disclosure obligations.

National Policy 62-202 – *Take-Over Bids – Defensive Tactics* sets out the general views of Canadian securities regulators with respect to defensive tactics adopted by target directors in response to take-over bids. It is important to note, as mentioned below, that the applicable securities law principles are sometimes difficult to reconcile with corresponding corporate law principles, particularly to the extent that Canada's securities regulators focus on the effect of board actions on shareholder interests. A careful response based on experienced legal advice is a must in such a situation.

The philosophy of NP 62-202 is that:

- The appropriate regulatory approach to take-over bids is to encourage unrestricted auctions;
- Target corporation shareholders have the right to make the take-over bid decision, and target directors have no valid reason to (unilaterally) deny the shareholders that right; and
- Specific rules for regulating target directors, other than those imposed by corporate law, are inappropriate.

NP 62-202 does not specify a fixed code of conduct for directors nor does it attempt to specify proper or improper defensive tactics. It does, however, set out some presumptions as to what may be proper or improper responses to a take-over bid:

- Prior shareholder approval might allay concerns that a tactic is abusive;
- The timing of the tactic may be relevant: regulatory scrutiny may be attracted when conduct occurs during the course of a bid (or immediately prior to a bid if the target board has reason to believe that a bid is imminent); and
- Certain listed defensive tactics may activate regulatory scrutiny, including share and asset lock-ups, asset purchases, and actions taken outside the ordinary course of business.

NP 62-202 suggests that securities regulators are less likely to intervene where target directors act to maximize shareholder value. The policy takes a somewhat different approach than corporate law in constraining possible target director conduct, in that the emphasis is undeniably on shareholder interests (potentially creating tension with the fiduciary duty under corporate law – see page 9, above). The policy focuses on the results of the target directors' actions, rather than on their intentions, with the result that any activity that denies or severely limits the target shareholders' access to a take-over bid can lead securities regulators to intervene. Taking this result-oriented approach means that regulators could potentially intervene even where the board has complied with its fiduciary duties under corporate law.

In relation to **shareholder rights plans** (also called **poison pills**), Canadian securities regulators under NP 62-202 have historically taken the approach that, when there is an outstanding take-over bid for the target company's securities, the question is not **whether** a shareholder rights plan will be cease-traded by the securities regulators, but rather **when** such a plan will be cease-traded. Generally, securities regulators in Canada have allowed a shareholder rights plan to remain operative for 45-75 days in the face of an outstanding take-over bid in order to allow the target board of directors to seek value-maximizing alternatives to the take-over bid. If there seems to be little likelihood that a superior alternative will arise for the target, shareholder rights plans have generally been cease traded to allow for the target's shareholders to decide whether or not to tender to the bid.

In 2016, Canada's securities regulators made amendments to the take-over bid regime under **National Instrument 62-104 – *Take-Over Bids and Issuer Bids*** that included, among other things, a requirement that take-over bids remain open for 105 days (up from the previous 35-day minimum), subject to certain exceptions. As a result, it is likely that shareholder rights plans will become less relevant in the context of hostile take-over bids, but they do remain relevant to prevent certain pre- or post-hostile bid actions which may inhibit a value-maximizing process. For instance, they may still be effective to restrict a creeping take-over bid, to limit the use of the private agreement exemption by the bidder and also restrict the ability of bidder to enter into lock-up agreements. A target company could adopt a rights plan in advance of the 105-day expiry date of a hostile bid in an effort to buy more time, but the target will have a heavy burden to prove that a value maximizing alternative is imminent to justify a rights plan staying in place past 105 days. A target board could also adopt a tactical rights plan in the face of a hostile bid and seek shareholder approval, although it is not clear how the regulators would respond.

For further information on take-over bid issues, including the establishment of independent committees as required under **Multilateral Instrument 61-101 – *Protection of Minority Shareholders in Special Transactions***, please see the Stikeman Elliott publication *Mergers and Acquisitions in Canada*, which is available on our website or from your usual contact at the firm.

Statutory Secondary Market Liability

Canadian securities law creates potential liabilities for public companies vis-à-vis buyers and sellers of corporate securities in the secondary markets (typically through a stock exchange like the TSX or TSXV). Specifically, these provisions provide those who purchase or sell securities from third parties in the secondary market with a right of action with respect to misrepresentations in disclosure documents or public oral statements or as a consequence of a failure to make timely disclosure of material changes. In certain situations, this liability can extend to a corporation's directors, officers, experts and spokespersons, as well as to "influential persons" (as defined) and directors and officers of influential persons.

Key features of the secondary market liability regime

The statutory secondary market liability regime originated in Ontario in the early 2000s and was quickly adopted across Canada. The legal recourse that it gives secondary market investors is more practical and effective than the traditional approach, which involved the common law tort of negligent misrepresentation (or civil law equivalent). One way in which the statutory regime differs from the traditional approach is that, while the latter requires each plaintiff to prove that it relied to its detriment on the alleged misrepresentation, the former creates a right of action without regard to whether the purchaser or seller of securities relied on the alleged misrepresentation. In other words, under the statutory regime, **reliance is neither required nor relevant**. This is important for two main reasons: (i) it makes the plaintiff's case easier to prove, and (ii) it removes a roadblock to pursuing such cases as class actions.

Another key feature of Canada's secondary market liability regime is the fact that it was designed to avoid costly **"strike suits"** (the U.S. name for opportunistic lawsuits filed in the hope of extracting settlements from companies eager to avoid costly litigation). Specifically, the Canadian legislation requires plaintiffs to obtain **leave of the court**, by demonstrating a reasonable possibility of success, before they will be allowed to commence an action. While the leave requirement has generally functioned as intended, secondary market liability actions have nevertheless become relatively common in Canada.

For a more complete account of Canada's secondary market liability regime, please refer to the Stikeman Elliott publication *Secondary Market Liability in Canada*, which is available on our website or from your usual contact at the firm.

Directors' and officers' liability

Under the secondary market liability regime, the primary defendant is generally the corporation itself (known in this context as the "responsible issuer"). However, **directors and officers of the responsible issuer may also be personally liable** for deficiencies in the corporation's disclosure, which could include inaccuracies in written or oral statements or outright failures to disclose. The following discussion highlights the key secondary market liability issues from a D&O perspective.

Authorization and knowledge

Authorization and knowledge are key concepts in this area of law. A plaintiff will (in most scenarios) be able to name a director or officer as an individual defendant to a secondary market liability action if the director or officer **"authorized"** the breach. In order for liability to be established in the ensuing trial, the plaintiff will need to prove (again, in most scenarios) that the director or officer had **"knowledge"** of the breach. It is important to note that the meanings of "authorization" and "knowledge" in this context are broader than the ordinary meanings of those terms. Specifically:

- "Authorization" can encompass more than just a deliberate form of authorizing, as indicated by the statutes' use of the phrase **"authorized, permitted** or **acquiesced in"**; and
- "Knowledge" includes not only **actual knowledge** but **wilful blindness** and **gross misconduct** (**gross fault** in Quebec).

The knowledge and authorization requirements are set out in Table 2 below, with respect to the four main kinds of breach under Canadian securities legislation – (i) the release of a written misrepresentation in a "core document", (ii) the release of a written misrepresentation in a "non-core document", (iii) the making of an oral misrepresentation, and (iv) the failure to make timely disclosure. In this connection, **"core document"** is defined to include a prospectus, a take-over bid circular, the annual information form (AIF), management discussion and analysis (MD&A), and certain other similar documents.

Table 2 / **Authorization and Knowledge Requirements: Eight Scenarios**[1]

Type of Breach → Person ↓	Written Misrep. (Core)	Written Misrep. (Non-Core)	Oral Misrepresentation	Timely Disclosure Failure
Director	—	K	A, K	A, K
Officer	A	A, K	A, K	A

[1] In the table, A = Authorization Must Have Occurred; K = Knowledge Must Be Proved.

As the table shows, directors need to pay particularly close attention to the documents that the corporation is planning to release (especially its core documents), as it is relatively easy for plaintiffs to establish liability against them in those cases. For their part, officers should take particular care to understand the contents of core documents and should also be especially vigilant when it comes to the corporation's disclosure obligations.

Defences

The legislation provides for a number of defences, including a due diligence defence. A director or officer's first line of defence against such actions will likely be to ensure that their corporation has an effective disclosure policy that is regularly being evaluated and tailored to changing circumstances. Internal policies and procedures for the control and dissemination of information should be consistent and in compliance with the legislation and stock exchange rules and policies.

Amount of liability

If there was no knowing breach of the law, director and officer liability is limited to the greater of $25,000 and 50% of the director or officer's annual compensation received from the issuer and its affiliates. Where there **was** knowledge of the breach, individual defendants may be found liable in damages without the protection of a cap. Under the legislation, damages are calculated in a way that is intended to provide investors with compensation for amounts lost on investments made during the period of an uncorrected disclosure deficiency (although they need not actually have disposed of the securities at all in order to be compensated). Because the liability in such situations is joint and several (or solidary, in Quebec's terminology), individual defendants are potentially be responsible for very significant damages awards. ("Joint and several" or "solidary" liability means that the plaintiff can seek the full amount of its damages award from any defendant it chooses, with that defendant then being responsible for recovering the other defendants' "shares" of the payment on its own.)

Sarbanes-Oxley and its Canadian Equivalents

If your company issues or has registered securities in the U.S. public markets, you must also be aware of your obligations under the *Sarbanes-Oxley Act.* CEOs and CFOs have specific obligations to certify to investors the accuracy of certain reports and statements, including financial statements. There are significant criminal penalties for wilfully false certification. You should determine the extent to which the requirements of the statute apply to your company. In the U.S., if the corporation has to restate financial results, directors and officers may have to reimburse the corporation for any incentive-based or equity-based compensation or disgorge any profit realized on the sale of the corporation's securities.

Similar requirements have been implemented in Canada as well, including requirements that the CEO and CFO certify that the issuer's filings (whether interim or annual) fairly present the financial condition, financial performance and cash flows of the issuer and do not contain any misrepresentations. They must also make certifications relating to the establishment and effectiveness of its disclosure controls and procedures (DC&P) and internal controls over financial reporting (ICFR). Related disclosure must also be provided in the company's corresponding interim or annual MD&A.

Class Actions

Class Actions

While class actions are generally a more recent phenomenon in Canada than they are in the U.S., they are now well-established in the Canadian legal landscape. Class actions are simply another way of procedurally advancing a lawsuit. They do not, in themselves, create any legal obligations for a company, its directors or its officers that would not exist otherwise. They simply provide a more efficient route for potential plaintiffs to pursue certain claims, for example by allowing a large number of parties with relatively small individual claims to assert their legal claims more cost-effectively by proceeding as a class. No lawsuit **has** to proceed as a class action; plaintiffs can always sue individually if they prefer.

The following discussion is based on Ontario law, which, while similar to that of most other Canadian jurisdictions in this respect, may differ in a number of points of detail from other Canadian class actions regimes.

Common Types of Class Action

Class action lawsuits against corporations and their directors and officers may include, for example, claims on behalf of shareholders (or other security holders) with respect to alleged breaches of corporate law, competition law or securities law (e.g. under the secondary market liability regime discussed in the previous section). Other common types of class actions faced by corporations include those respecting product liability, as well as employment class actions and class actions related to breaches of privacy or data security, although it is not typical in these cases to name directors and offers as defendants.

Criteria for Certifying or Authorizing Class Actions

Before a proposed class action can proceed to trial, it must be "certified" (or, in Quebec, "authorized") by the court. In all Canadian jurisdictions, **this has emerged as a pivotal stage of the process.** Defendants often resist certification or authorization vigorously, in hopes of avoiding a costly trial.

Under Ontario law, which in this respect is typical, the court must be satisfied that there are at least two persons comprising an identifiable class and that the claims disclose a cause of action and raise common issues. The court will also need to determine whether the class proceeding is the **preferable procedure** as compared with other dispute resolution mechanisms, such as individual court proceedings or consumer complaints procedures. Criteria that the court may consider include the following:

- Whether the proposed class action is the preferable means of resolving the whole dispute, or just the "common issues";

- Whether the proposed class action is preferable to all other possible means of resolving the dispute, or preferable only to a series of individual actions (e.g., the court might find that a small-claims process is preferable when amounts at issue are small);
- The relative magnitude of the common issues, as compared to the individual issues, that would have to be considered in the proposed class action; and
- Whether the proposed class action would advance the goals of "access to justice" and "behaviour modification" (e.g., of manufacturers or similar defendants) that class actions were intended by the legislature to promote.

The **merits** of a claim are not generally considered at the certification or authorization stage.

Multi-jurisdictional Class Actions

Because each of Canada's jurisdictions has its own class proceedings legislation, it is not uncommon for a defendant to face more than one class action with respect to the same facts. Note, however, that while this may be possible, it is by no means a necessary consequence of a plaintiff class that includes residents of more than one province. The reason is that courts of Canadian provinces have the authority to certify or authorize "national" class actions whose plaintiff classes include individuals from other provinces. There is as yet no mechanism by which actions in multiple provinces may be consolidated in order that the defendant can focus on defending a single action. In some instances, defendants may seek to stay one or more overlapping actions in favour of proceeding in a single jurisdiction; whether such an application will or will not be granted will, however, depend on the facts and circumstances of the case. It is therefore possible that a certain type of claim against directors and officers might need to be defended in multiple parallel proceedings.

Being Proactive: Indemnification and D&O Insurance

Being Proactive:
Indemnification and D&O Insurance

Directors and officers typically counter the possibility of personal liability through indemnities and D&O insurance. The following discussion touches on some indemnity and insurance basics. Determining the type and amount of protection that is appropriate in any particular case will generally require input of counsel and an insurer with specialized knowledge of D&O coverage issues and the inherent risks of each industry sector.

Indemnification

Each of the BCAs allows corporations to provide an indemnity to a director or officer of the corporation, a former director or officer of the corporation or a person who acts or acted at the corporation's request as director or officer of another company of which the corporation was a shareholder or creditor. In this section, we refer to these persons generally as "directors and officers".

With the exception of the QBCA, the BCAs create specific rules for three different situations:

- Situations in which the corporation **may** indemnify,
- Situations in which the corporation **must** indemnify, and
- Situations in which indemnification is **not permitted**.

In addition, it is permissible (or, in certain circumstances under the QBCA, mandatory) in some of these situations for the corporation to **advance funds** to a director or officer in order to defray costs, charges and expenses related to a proceeding. While the fact that indemnities must be provided in some situations precludes the need for a specific agreement with respect to those situations, the fact that most of the BCAs allow indemnities to be extended to certain additional situations means that indemnities will often be part of the discussion when directors and officers negotiate their compensation arrangements.

The **BCBCA** restricts the term "indemnity" to judgments, penalties, fines and settlements. Costs, charges and legal fees are "expenses" that are "paid" (rather than "indemnified") by a BCBCA company. The other BCAs use the term "indemnity" in a broader sense. Those who fall under the BCBCA should note that the indemnification provisions discussed below are subject to the court's authority under the BCBCA, on application of either the company or a director or officer, to make orders that it considers appropriate, regardless of what the other provisions say.

When the corporation may indemnify

Under the CBCA, ABCA, BCBCA and OBCA, a corporation **may** indemnify (or, as appropriate under the BCBCA, "pay") costs, charges and expenses reasonably incurred by a director or officer in respect of a proceeding – including amounts paid to settle an action or to satisfy a judgment – provided that the director or officer fulfilled his or her fiduciary duty to the corporation or associated entity, **and** (in the case of a criminal proceeding or administrative action involving a fine) had reasonable grounds for believing that his or her conduct was lawful.

Under the **QBCA**, the corporation generally has no discretion with respect to indemnification: indemnities are either mandatory or they are forbidden (one exception may be a derivative action or other situation in which the corporation is the plaintiff, as discussed below).

When the corporation must indemnify

Under the CBCA and OBCA, a corporation **must** (if requested) indemnify costs, charges and expenses reasonably incurred by a director or officer with respect to the defence of any proceeding (civil, criminal, administrative or otherwise) to which the director or officer was subject in virtue of his or her association with the corporation or with certain other associated entities under the following circumstances (the first of which is the same as the condition under which a court "may" indemnify, as noted above):

- The director or officer fulfilled his or her fiduciary duty to the corporation or associated entity, **and** (in the case of a criminal or administrative action involving a fine) he or she had reasonable grounds for believing that his or her conduct was lawful; **and**
- The director or officer was not found by the court or other authority in charge of the proceeding to have acted improperly.

The ABCA replaces the second bullet point above with a requirement for **substantial success on the merits** in the person's defence of the action or proceeding and, in addition to the fiduciary duty requirement, requires a further finding that the person "is **fairly and reasonably entitled** to the indemnity".

The BCBCA requires a company to pay the expenses (as defined above) of a director or officer who has either been wholly successful **on the merits or otherwise** or substantially successful **on the merits**, provided that the expenses have not been reimbursed by any other means.

The QBCA replaces the second bullet point above with the requirement that the director or officer have not been found by a **court** to have committed an **intentional or gross fault** (concepts belonging to the civil law). Findings of authorities **other** than courts, and findings of improper actions that did not constitute an intentional or gross fault, do not appear to be encompassed by this wording. The precise implications of this in a particular situation should be addressed by Quebec counsel familiar with the situation.

When indemnification is not permitted

As described under the previous heading, the BCAs each **prohibit** indemnification where the director or officer failed to fulfill his or her fiduciary duty or when (in the case of a criminal or administrative action involving a fine) he or she did not have reasonable grounds for believing that his or her conduct was lawful. The British Columbia and Quebec statutes each add some further nuances:

- **BCBCA:** There are additional restrictions that are mainly of a technical nature, in addition to the BCBCA's prohibition on indemnification and payment of expenses in the case of an action by the corporation or a derivative action (see below).
- **QBCA:** As mentioned above, indemnification is also not permitted under the QBCA if a court determines that the director or officer has committed "an intentional or gross fault". (Note that, under the QBCA, the determinations with respect to breach of fiduciary duty and lack of reasonable grounds for believing one's conduct to be lawful may be made "by a court **or** by any other competent authority".)

Where the corporation is the plaintiff

Note that, under the CBCA, ABCA, OBCA and QBCA, **court approval** is required before a corporation can indemnify a director or officer (or advance funds to him or her) in the case of an action by the corporation (including a derivative action – see page 19, above) that is taken to procure a judgment in the corporation's favour. Under the BCBCA, neither indemnification nor the payment of expenses are permitted in such a situation, subject to the broad authority that the BCBCA gives to the court to make an order that it considers appropriate.

Advancing funds

Under the CBCA, ABCA and OBCA, a corporation may advance funds to the director or officer with respect to the costs, charges and expenses of a proceeding.

The BCBCA is similar, except that it expressly requires that: (i) the director or officer provide a **written undertaking** that repayment will be made; (ii) expenses be paid only as they are "actually and reasonably incurred"; and (iii) no expenses be advanced if the lawsuit is by or on behalf of the corporation itself (see previous subsection).

Under the QBCA, a corporation generally **must** advance funds in all situations in which it must indemnify. In the situations discussed in the previous subsection, it is possible that there would be an indemnity without a corresponding advance of funds.

Repayment of advanced funds

Each of the BCAs has a slightly different rule about repayment:

- **CBCA:** The director or officer must repay advanced funds if he or she did not fulfill his or her fiduciary duty or (in the case of a criminal or administrative action involving a fine) if he or she did not have reasonable grounds for believing that his or her conduct was lawful.

- **ABCA:** Same as CBCA but also requires repayment if the indemnity was not fair and reasonable or if the director or officer was not successful on the merits in his or her defence of the proceeding.
- **BCBCA:** Same as CBCA, while also expressly requiring repayment if the payment was contrary to the company's memorandum or articles.
- **OBCA:** The director or officer must repay the money if he or she did not fulfill his or her fiduciary duty.
- **QBCA:** Same as CBCA, except that the QBCA specifies that a failure to meet the relevant condition is to be determined by the court (or other competent authority) and adds that any advance must be repaid if the court determines that the director or officer committed an intentional or gross fault.

Taxation of indemnities

It should be noted that because indemnities may be characterized as a taxable benefit and taxed as income, directors and officers often attempt to negotiate a tax gross-up. This is an issue that you, in consultation with your advisors, may wish to consider as part of any compensation package.

Indemnification and insolvency

In the event of insolvency, corporations seeking protection before the courts from their creditors pursuant to the *Companies' Creditors Arrangement Act* (CCAA) retain their board of directors. By contrast, in proceedings under the *Bankruptcy and Insolvency Act*, a trustee is appointed who supplants the board of directors. Consequently, in CCAA proceedings it is common for the initial order to provide for a charge in favour of the continuing directors to provide security for any potential statutory liabilities in recognition of their ongoing participation in the court-supervised reorganization.

D&O Insurance

The CBCA, BCBCA, OBCA and QBCA permit corporations to purchase and maintain insurance ("D&O insurance") for the benefit of directors and officers for any liability incurred by them in their capacities as directors or officers. The ABCA makes an exception in the case of liability that relates to a failure to act honestly and in good faith with a view to the best interests of the corporation. Realistically, however, it is unlikely that an insurer would offer coverage for dishonest acts, except in very limited circumstances.

Another corporation, such as the corporate parent, may be able to purchase the insurance for a director who has joined a board at the request of this other corporation and has acted in the best interests of the corporation of which he or she is a director.

The appropriate form of D&O insurance for a particular situation should be determined in consultation with counsel and a specialized provider of this type of coverage.

About the Firm

When Heward Stikeman and Fraser Elliott first opened the firm's doors in 1952, they were united in their pledge to do things differently to help clients meet their business objectives.

In fact, they made it their mission to deliver only the highest quality counsel as well as the most efficient and innovative services in order to steadily advance client goals.

Stikeman Elliott's leadership, prominence and recognition have continued to grow both in Canada and around the globe. However, we have remained true to our core values.

These values are what guide us every day and they include:

- Partnering with clients – mutual goals ensure mutual success.
- Finding original solutions where others can't – but they must also be grounded in business realities.
- Providing clients with a deep bench of legal expertise – for clear, proactive counsel.
- Remaining passionate about what we do – we relish the process and the performance that results from teamwork.

A commitment to the pursuit of excellence – today, tomorrow and in the decades to come – is what distinguishes Stikeman Elliott when it comes to forging a workable path through complex issues. Our duty and dedication never waver.

This is what makes Stikeman Elliott the firm the world comes to when it counts the most.

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