Directors and officers liability in Canada: Guidance for global business leaders

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This article is part of a practical series written for international companies looking to establish, launch, operate or invest in a business Canada. Each article covers a major area of law in Canada – everything from employment laws to taxes. Access all the articles on the "Doing business in Canada: A practical guide from 'Eh' to 'Zed'" page.

Directors and officers of a corporation are subject to certain duties that arise under the statute governing the corporation, under various federal and provincial statutes that apply generally to carrying on business, and under common law. In a number of instances, a director or an officer can be held personally liable for failing to fulfill these duties.

The following is a general description of some of the duties of directors and officers and the liabilities that can arise from failing to fulfill these duties.

Duties and liabilities of directors

A corporation incorporated under the *Canada Business Corporations Act* (CBCA), and generally the other provincial/territorial corporate statutes, is a legal entity, separate and apart from its shareholders and directors. The shareholders elect directors to manage, or to supervise the management of, the business and affairs of the corporation. Practically speaking, directors will not be able to oversee all aspects of the business operations of the corporation. As a result, the role of directors is typically one of overseer as opposed to one of implementer.

(a) Fiduciary duty

Directors owe a "fiduciary duty" to the corporation. This means that they must act honestly and in good faith with a view to the best interests of the corporation. This also means acting loyally to the corporation and avoiding situations where a director's duty to the corporation conflicts with his or her self-interest. Importantly, Canadian courts have held that the fiduciary duty is owed exclusively to the corporation itself and not to any particular shareholder(s), creditors or other stakeholders. Unlike in the United States, the beneficiary of the fiduciary duty does not shift in the context of a sale transaction or in the vicinity of insolvency. Notwithstanding that the duty is owed to the corporation, directors may look to the interests of stakeholders to inform their decision-making process. The ability to consider a wide-range of stakeholders, including shareholders, creditors, consumers, employees, governments and the environment, was recently codified in the CBCA. However, it is important to remember that no single stakeholder's interests should prevail over any other.

The fiduciary duty includes a number of sub-duties. As part of fulfilling the fiduciary duty, a director must disclose his or her personal interest in a material contract with the corporation, refrain from voting on any resolution that presents a conflict of interest for the director and refrain from using corporate information or corporate property for personal benefit. Additionally, a director must not take personal advantage of a business opportunity that the corporation either had or was pursuing if the director became aware of that business opportunity while serving as a director. If a director fails to comply with any of these requirements, the director may be found to have breached his or her fiduciary duty. In such circumstances, the director may be required to account to the corporation for any gain earned as a result of the breach. A court may also award damages to the corporation to restore it to the position that it would have been in if the breach had not occurred.

(b) Duty of care

Directors also owe a duty of care to the corporation. For corporations incorporated under the federal CBCA and most provincially/territorially incorporated corporations, this duty of care is set out in the relevant corporate statute as a duty to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This means that a director must apply his or her knowledge, experience, skills and best judgment when exercising powers, performing functions and making decisions as a director. As such, the duty of care is an objective standard and the courts will apply that standard in determining whether a breach of the duty has occurred.

The competence expected of a particular director may vary based on the professional experience of that director. Those who possess greater knowledge or skill may be expected to meet a higher standard of care. A director will not be relieved from liability simply because he or she was absent from the directors' meeting at which the decision was made unless the director properly registered his or her dissent to the decision.

(c) Business judgment rule

When assessing a board of directors' compliance with its duties, Canadian courts will generally apply the "business judgment rule" which presumes that the directors acted on an informed basis, in good faith and in the best interests of the corporation. Deference is given to business decisions made by the board of directors provided that it falls within a range of reasonable alternatives. The business judgment rule acknowledges that directors are generally best suited to make business decisions for the corporation and courts will not impose hindsight on such decisions.

(d) Oppression

Under the CBCA and other provincial/territorial corporate statutes, shareholders whose interests have been harmed (or allegedly harmed) by a corporation's directors or officers may ask the Court to grant the "oppression remedy" against the corporation, the directors and/or the officers. The oppression remedy may also be available to certain other stakeholders in limited circumstances. Under the CBCA, "oppression" is broadly defined as acts that are "oppressive or unfairly prejudicial or that unfairly disregard the interests of any security holder, creditor, director or officer". Where conduct has been determined to be oppressive, the Court may make an order to rectify the complaint. Importantly, in order to seek the oppression remedy, the director or officer must be implicated in the oppressive conduct and the remedy sought must be appropriate for the circumstances. The oppression remedy is not intended to be punitive.

(e) Other duties and liabilities

Other directors' duties arising from federal and provincial legislation include:

- **Duties relating to wages and pensions:** Under the various federal and provincial statutes governing employment standards, directors can be held liable to the corporation's employees for unpaid wages and vacation pay earned by the employees during the individual's directorship. Moreover, where a corporation commits an offence under provincial pension benefits legislation, a director may be held personally liable if the director participated in the offence.
- **Tax-related duties:** A director may be liable for employee source deductions, non-resident withholding taxes, excise taxes, and certain other provincial taxes that the corporation has failed to withhold, deduct or remit, as required. In addition, directors can be personally liable where a corporation commits an offence under federal or provincial tax legislation.
- **Duties arising from environmental legislation:** Directors can be held liable where the corporation commits certain environmental offences. This liability can arise even where the director was not actively involved in committing the offence since directors are deemed to have control of the corporation and its employees. Directors may be fined, imprisoned or found liable for damages for the corporation's offences.
- **Duties relating to publicly traded corporations:** Directors of publicly traded corporations are subject to additional duties and potential liabilities. A director of a publicly traded corporation must ensure that the corporation has complied with the various filing, disclosure and reporting requirements, and restrictions arising from relevant provincial securities statutes. Failing to do so can give rise to serious penalties, including fines or imprisonment, or both.
- **Other duties:** Depending on the nature of the activities of the corporation, directors may be subject to a number of other duties and liabilities, including those arising from bankruptcy and insolvency legislation, pension benefits legislation and legislation governing financial institutions. The penalties for breaching these duties may consist of fines, imprisonment or liability for payment of damages.

Duties and liabilities of officers

Under the CBCA, the directors of the corporation may designate and appoint officers to manage the business and affairs of the corporation, with certain limitations. Like directors, a corporation's officers owe a fiduciary duty to the corporation and are generally subject to the same duty of care imposed on directors. Therefore, officers face many of the same potential liabilities as directors. Whether an employee is an officer will depend not on the employee's stated position or title, but on the degree of actual power and control that the employee has over the corporation.

Protections and defences for directors and officers

Directors and officers can limit their personal liability in the following ways:

- **Corporate Indemnity:** In certain circumstances, corporations may indemnify their directors and officers for actions taken on the corporation's behalf. However, this indemnity is unavailable if the director has breached his or her fiduciary duty, if the corporation is insolvent or if a court finds an indemnity otherwise inappropriate.
- **Shareholders Agreement:** In some cases, a director's liability can be limited by a unanimous shareholders agreement that transfers liability from the directors to the shareholders of the corporation.
- **Insurance:** As a further protection, directors and officers can obtain director and officer liability insurance to protect against certain types of losses and claims. However, insurance typically does not cover cases such as fraud, conspiracy, criminal behaviour and human rights violations.
- **Resignation:** As a last resort, a director or an officer can resign to avoid liability arising from future events. However, this does not exonerate the director or officer from liability arising from events that occurred during his or her term as director or officer.
- **Due Diligence:** Generally, directors and officers are entitled to a due diligence defence. Such defence may protect a director from liability if it can be proven that the director took all reasonable steps to avoid the event giving rise to liability, or that the director had a reasonable belief in a mistaken set of facts that, if true, would have made the director's conduct reasonable in the circumstances. The due diligence defence is available to officers in a more limited set of circumstances.

Depending on the nature of the offence, and the corporate statute under which the corporation was formed, there may be other statutory and common law defences and protections available to a director or an officer.

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