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Duties and Liabilities of Directors of
Non-Share Capital Corporations

I. INTRODUCTION

This memorandum summarizes your legal duties and potential liabilities as a director of a non-share capital corporation (the "Company") incorporated under the Ontario Corporations Act (the "OCA") or the Canada Corporations Act (the "CCA"). It is not intended as an exhaustive review of the law, nor to provide legal advice in any specific situation. You are urged to consult your own legal adviser in case of specific questions or concerns.

II. FIDUCIARY DUTY AND STANDARD OF CARE

The OCA and CCA do not set out your duty as a director in plain language, nor do they prescribe the standard of care to be met in carrying out that duty. Accordingly, the common law governs these matters with respect to the Company. Some of the applicable common law principles are summarized in the following paragraphs.

1. Fiduciary Duty

As a director, you stand in a fiduciary relationship to the Company and are required to act loyally, honestly and in good faith in the best interests of the Company. You must avoid any situation in which self-interest and duty come into conflict. A potential conflict of interest arises, for example, if the Company plans to buy computer equipment from a corporation owned and operated by your spouse.

If you have a direct or indirect interest in a contract or proposed contract with the Company that requires board approval, you have a duty to disclose your interest to the board when the matter is first discussed or, if the interest arises later, at the first board meeting after it has arisen. You must refrain from voting on the contract. If these requirements are satisfied, the statutory provisions state that you will not be held liable to the Company for any profit made in connection with the contract. Even if these requirements are not satisfied, however, you will not be liable to the Company for any profit you may make on the contract provided that the members of the Company confirm the contract and your interest and profit at a special meeting of the members called for that purpose. Extreme caution however, should be exercised. Recent initiatives of the Office of the Public Guardian and Trustee (OPGT) in Ontario have resulted in court decisions requiring some charitable institutions, regardless of their constating documents or curative procedures, to obtain a court order before the remuneration of directors will be permitted.

2. Standard of Care

In carrying out your duty as a director of the Company, you must exercise the care, diligence and skill that may reasonably be expected of a person with your knowledge and experience. This is a subjective standard of care: it depends on your personal knowledge and experience. For example, if you are a physician, you may be required to satisfy a higher standard of care with respect to medical and health-related matters than another board member without such professional expertise. Arguably, the degree of diligence which you must exercise should depend to some extent on the size and sophistication of the Company: A director of an organization with professional management staff should not be expected to devote as much time and attention to everyday operations as a director of a smaller organization without the same human and financial resources.

If the Company is designated as a charity under the Charities Accounting Act (Ontario), you may in some circumstances be considered a trustee of the Company's property. Some writers have argued and some Ontario courts have held that you are therefore subject to the objective (and more rigorous) standard of care

imposed upon trustees (namely, the degree of care, diligence and skill to be expected of a reasonable and prudent person in the management of his or her own affairs).

III. SOURCES OF POTENTIAL LIABILITY YOU FACE AS A DIRECTOR

You may be held personally liable as a director in respect of a variety of errors, omissions and wrongful acts that may be committed by the Company. Together with other directors of the Company, you are responsible for ensuring that the Company complies with applicable laws, its letters patent and its by-laws. If you disagree with a proposed action or decision of the board, you should protect yourself against potential liability by voting against the action or motion, and making sure that the dissenting vote is recorded in the minutes of the Company.

You may be held personally liable for unpaid employees' wages and salaries for a period not exceeding six months. Under the OCA (but not the CCA), you may also be liable for up to twelve months of employees' vacation pay. Your liability as a director continues for six months (OCA) or one year (CCA) after you cease to be a director. There is no statutory defence to claims by employees under these provisions.

Some other sources of liability, many of which continue for up to six years after you have ceased to be a director, include: failure to deduct, withhold, collect or remit amounts for federal and provincial income tax, unemployment insurance, the Canada Pension Plan, retail sales tax and the goods and service tax (GST); non-payment or evasion of the Ontario employer health tax; failure to take "reasonable care" to ensure compliance with the Ontario Occupational Health and Safety Act; violations of provincial employment standards legislation or the Canada Labour Code; and violations of federal or provincial environmental standards.

IV. WHAT SHOULD YOU DO TO PROTECT YOURSELF?

1. Due Diligence

As a practical matter, you should diligently carry out the duties associated with being a director. This includes asking questions at each board meeting about areas of concern such as employee remittances, documenting matters discussed and decisions taken at board meetings, ensuring that proper professional expertise is made available to the Company and the board and, if necessary, being prepared to resign if you are uncomfortable with the Company or its practices or if you are unable to attend board meetings regularly.

At common law, you are not bound to attend all board meetings and are not liable for anything done at a meeting unless you are put on notice that a duty which ought to have been discharged at the meeting was not discharged. If you attend a board meeting, you are bound to exercise the appropriate standard of care in dealing with matters raised at the meeting. You may not delegate your powers by, for example, appointing a substitute to attend board meetings.

2. Indemnification

The OCA and CCA permit you to be indemnified by the Company, with the consent of its members, for all expenses and liabilities incurred by you in carrying out your duties as a director, and other expenses or charges incurred by you in connection with the affairs of the Company unless the expenses or charges were occasioned through your wilful neglect or default. The consent may be obtained at any meeting of the members. Corporate by-laws often give this type of protection to directors. By indemnifying you against certain expenses and liabilities, the Company agrees to assume responsibility for them and to reimburse you for any payments covered by the indemnity. This will not assist you if the Company has no assets. Indeed, in many cases third party claims are made against directors only when the Company itself has no assets available to satisfy the claims.

3. Liability Insurance

If the Company has few assets and financial resources, the protection afforded to you by the Company's indemnity may be very limited. The Company should therefore consider purchasing directors' liability insurance, which is available through most insurance brokers. The decision to purchase directors' liability insurance will depend in part on the degree of potential liability faced by directors, the cost of the insurance and the law relating to the appropriateness of the Company's funds being used to buy insurance to protect the Company's directors. If affordable, coverage should include negligent and wilful breaches of the directors' standard of care. In addition, each director should be insured throughout the period during which liability may be incurred (which may last for a number of years after the director has left the board). It is advisable to have a directors' resolution approving the purchase of such liability insurance confirmed by the members of the Company at their next meeting.

If the Company fits the definition of a charity under the Charities Accounting Act, and the Company decides to pay the directors' liability insurance premiums, the OPGT has taken the position that this is a benefit afforded the directors and may subject the Company to an audit by the OPGT. To avoid such audit, a court order permitting the payments must be obtained, or the Company may request a consent order directly from the OPGT. Senior staff at the OPGT have advised us that the OPGT will usually consent to such payments if the Company demonstrates to the satisfaction of the OPGT that such insurance is beneficial to the Company, the level of insurance coverage and the premiums are reasonable and there is a sufficient level of risk to warrant the insurance policy for the directors.

V. SUMMARY

An invitation to sit on the board of directors of the Company may be an honour, but it also involves significant responsibilities. Failure to fulfil responsibilities as a director may breach statutory obligations or cause harm to the Company or a third party, thereby rendering you liable for fines or damages. In certain cases, failure to comply with statutory obligations may result in imprisonment. You can minimize the risk of exposure to liability by obtaining an indemnity from the Company and coverage under directors' liability insurance. The most important protection, however, consists of your own due diligence: familiarizing yourself with the Company's letters patent, by-laws, operations and management; attending and participating in board meetings; and seeking outside professional help when necessary.

This newsletter is prepared as a service to Not-For-Profit organizations known to the lawyers of Borden & Elliot. It is not intended to be a complete statement of the law nor an opinion of our firm on any subject. Although we endeavour to ensure its accuracy, no one should act upon it without a thorough examination of the law after the facts of the specific situation are considered.

Directors of charities and other not-for-profit organizations face special challenges at a time when governments are reducing spending and all corporations face increasing public scrutiny. Borden & Elliot's Not-for-Profit Organizations Practice Group brings together specialists in corporate governance and restructuring, taxation, pensions, employment, health, litigation and other areas of the law to provide our clients with cost-effective legal advice, to help them achieve their policy objectives as well as their financial targets.

For more information about our group and its members, see our Not-for-Profit Organizations Group Profile.

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