

DIRECTORS' DUTIES AND RESPONSIBILITIES

Directors of a corporation owe duties (and therefore may incur personal liability) to a broad group of persons including the corporation itself, shareholders of the corporation, employees of the corporation, creditors of the corporation, governments and agencies of government, certain other third parties and in some instances the public generally. Certain duties and liabilities of directors are established by statute, while others arise under the common law.

This memorandum has been prepared by MacPherson Leslie & Tyerman, legal counsel to the Saskatchewan Pharmaceutical Association. It discusses certain duties and responsibilities that are owed by the directors of a corporation, incorporated under the *Canada Business Corporations Act* (the "CBCA"). Similar duties and responsibilities are owed by directors of companies incorporated under *The Business Corporations Act (Saskatchewan)*.

This memorandum is intended solely for general informational purposes and should not be construed as, or used as a substitute for, legal advice with respect to specific issues or transactions, since such advice requires an evaluation of precise factual circumstances. Legal counsel should be consulted as to all questions that arise with respect to the laws, rules, regulations and other legal requirements discussed herein.

General Duties and Responsibilities

Directors have the duty to manage the business and affairs of the corporation. In doing so, directors may either exercise such power directly or indirectly through officers, employees or agents of the corporation.

The mandate of the directors of a corporation is to direct management of the business and affairs of the corporation. This includes the responsibility to undertake the investigation and analysis necessary to permit them to have an adequate knowledge of the business and operations of the corporation, to oversee management, provide guidance and develop policy.

Directors must conform to the general standards of loyalty, good faith and avoidance of conflict of duty and self interest. The relationship of a director to a corporation is a fiduciary one. A fiduciary is a person who, by his or her position, is able to affect the legal rights of others and has some power or control over the property of others. The fiduciary relationship between a director and a corporation requires the director to subordinate his personal business interests to the best interests of the corporation and its shareholders.

A director should act at all times in what he or she believes to be the best interests of the corporation as a whole. This includes the duty to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, careful and ordinarily skilful director would act in the circumstances.

Some Specific Duties and Liabilities of Corporate Directors

Every director of a corporation in exercising his or her powers and discharging his or her duties must act honestly and in good faith with a view to the best interest of the corporation and must also exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

The duty to act honestly and in good faith requires directors to be open and candid about their dealings which affect the corporation and to ensure that their personal interests and their duties to the corporation are not brought into conflict. Acting prudently has been described in a number of judicial decisions as proceeding carefully and deliberately, while trying to foresee the consequences.

Pursuant to statute, a director must also comply with the provisions of the legislation under which the company is incorporated, the regulations thereunder, the articles and by-laws of the corporation and any unanimous shareholder agreement.

In addition, to the specific liabilities under the incorporating statute, corporate directors can be held responsible for liabilities under a number of other statutes. Several of the most significant of these are the following:

1. *Employee Wage Claims* – Section 63 of *The Labour Standards Act* (Saskatchewan) provides that "the directors of a corporation are jointly and severally liable to an employee of the corporation for all debts due for services performed for the corporation, not exceeding six months' wages, while they are directors". The phrase "debts due for services performed for the corporation" is defined as meaning "all remuneration payable by an employer to an employee pursuant to this Act and, without limiting the generality of the foregoing, includes wages, annual holiday pay, public holiday pay and pay in lieu of notice".

The Labour Standards Act also provides, in section 86, that where a corporation has committed an offence against the Act, every director, officer or agent of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is guilty of an offence and is liable on summary conviction to the fine provided for the offence whether or not the corporation has been prosecuted or convicted.

2. *Unremitted Source Deductions* – Subsection 227.1(1) of the *Income Tax Act* (Canada) provides that a director may be jointly and severally liable together with the corporation to pay any unremitted source deductions, including taxes and any related interest penalties. The action may not be commenced against the director more than two years after the director last ceased to be a director of the corporation. A director is not liable under subsection 227.1(1) until the formal procedures for establishing the insolvency of the corporation have been complied with.

The *Income Tax Act* (Canada) sets forth a due diligence defence providing that a director is not liable where he has exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. In reported cases involving this provision, it has been held that mere delegation of financial matters to a controller or its reliance upon other directors to look after financial matters are not sufficient to avoid liability.

Revenue Canada has in the past suggested that directors should take the following positive actions to limit their liability exposure:

- (a) ensure internal procedures and controls are established to provide for prompt remittance of source deductions;
- (b) call upon financial officers of the corporation to report regularly on the continued implementation of these procedures and controls; and
- (c) obtain regular confirmation that withholdings and remittances have in fact been made during all relevant periods.

The *Income Tax Act* (Saskatchewan) contains provisions which parallel section 227.1 of the *Income Tax Act* (Canada). Personal liability for directors can also result where a corporate employer fails to make the required remittances under the *Canada Pension Plan Act* (Canada) and the *Unemployment Insurance Act* (Canada). Each of these Acts provides a due diligence defence for directors which is similar to that found in the *Income Tax Act* (Canada).

3. *Income Tax Act Filings* – Section 239 of the *Income Tax Act* (Canada) provides that it is an offence to file a false or deceptive return, or in any manner evade or attempt to evade compliance with the Act or payment of the taxes imposed by the Act. Section 242 provides that where a corporation is guilty of an offence under the *Income Tax Act* (Canada), an officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in, or participated in the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.
4. *Remittance of GST* – Under Section 323 of the *Excise Tax Act* (Canada), the directors of a corporation are jointly and severally liable together with the corporation to pay the GST owing together with any interest and penalties relating thereto. The *Excise Tax Act* (Canada) provides for a due diligence defence similar to that contained in the *Income Tax Act* (Canada).
5. *Other Revenue Legislation* – *The Revenue and Financial Services Act* (Saskatchewan) provides for the collection of provincial tax pursuant to certain revenue and taxation statutes including *The Education and Health Tax Act* (Saskatchewan) and *The Corporation Capital Tax Act* (Saskatchewan). Subsection 73(1)(g) of this Act provides that it is an offence to fail to remit tax collected or deemed collected pursuant to any of the foregoing statutes. Subsection 77(1) provides that where a corporation has committed an offence, any officer, director, employee or agent of the corporation who directed, authorized, assented to or participated in the commission of the offence is guilty of an offence and is liable on summary conviction to the fine provided for whether or not the corporation has been prosecuted or convicted.

Occupational Health and Safety Legislation – Section 60 of *The Occupational Health and Safety Act, 1993* (Saskatchewan) provides that where a corporation has committed an offence under the Act, any officer, director, manager or agent of the corporation who directed, authorized or participated in the commission of the offence is liable on summary conviction to the penalties for individuals provided for in the offence, whether or not the corporation has been prosecuted.

6. *Pension Legislation – The Pension Benefits Act, 1992 (Saskatchewan)* imposes obligations upon a corporation with respect to the administration and investment of funds in connection with the corporation's pension plans. Where a corporation is guilty of an offence under such Act, any director who directed, authorized, assented to, acquiesced or participated in the commission of the offence is liable on summary conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.
7. *Other Statutes* – There are numerous other federal and provincial statutes which impose duties, responsibilities and liabilities upon directors, including statutes that impose liability on directors for breaches or failures of the corporation in circumstances where a director directed, authorized, assented to or acquiesced in or participated in a breach or commission of an offence by the corporation.

Reducing a Director's Exposure to Liability

Some liabilities of corporate directors are strict, that is to say arise from the fact of being a corporate director. Other liabilities may, however, be limited or reduced by a director.

Due Diligence: Meeting the Duty of Care

A director is not liable for certain liabilities, such as that under section 118 [issuing shares for consideration other than money at less than the fair monetary equivalent], 119 [liability for wages] or 122 [duty of care] of the CBCA, if he relies in good faith on:

- (a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or
- (b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to the statement made by him.

(see subsection 123(4) of the CBCA).

In connection with the statutory standard of care, diligence and skill imposed on directors by section 122 of the CBCA, it can be expected that a court in determining whether a director has passed the test of acting as a reasonably prudent person will give consideration to, among other things:

- (a) the information available to the director;
- (b) the time available for the decision;
- (c) the alternatives open to the director; and
- (d) the significance of the decision to the corporation.

In a general sense, diligent conduct of a director consists of the following components:

1. careful investigation and observation of the evolving condition of the corporation;
2. detailed review and inquiry into the facts relating both to those matters brought before the board and to those matters of which the director learns independently and which are significant either because of their magnitude or because of some characteristic which has a special importance to the corporation; and
3. the exercise of prudent judgement directed to the best interests of the corporation.

In order to assist in meeting the statutory duty of care, diligence and skill corporate directors should:

1. attend directors' meetings and review the minutes of prior directors' meetings, such that the director is aware of all matters being considered and approved by the Board of Directors;
2. insist on receiving, before the meeting, documents and reports which are to be dealt with at a directors' meeting and review the same in detail;
3. make those inquiries which a person of ordinary care in the director's position or in managing the director's own affairs would make;
4. not abdicate the director's duties to manage to other corporate directors or officers; and
5. in appropriate circumstances, obtain and rely upon the advice of specialists and outside experts.

Dissent Rights of Directors

The CBCA deems a director to have consented to a resolution approved by the board of directors, unless the directors' dissent is expressed or recorded in writing in accordance with the provisions of the CBCA. Section 123 of the CBCA sets forth the dissent rights of directors.

Disclosure of Contractual Conflicts of Interest

Pursuant to section 120 of the CBCA, a director of the corporation who is a party to a material contract or proposed material contract with the corporation, or is a director or officer of or has material interest in any party to a material contract or proposed material contract with the corporation, must disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest. Disclosure of interest in a material contract is to be made at the meeting at which the proposed contract is first considered, or if the director was not then interested in the proposed contract after he becomes so interested or if the person who is interested in the contract later becomes a director, at the first meeting after the person becomes a director.

If the material contract or proposed material contract is one that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, the director should disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of its interest forthwith after the director becomes aware of the contract or proposed contract. Subject to certain limited exceptions a director is not permitted to vote on any resolution to approve a material contract or proposed material contract in which such director has an interest.

General notice to the directors declaring that a director has a material interest in a particular party and is to be regarded as interested in any contract made with that party, is a sufficient declaration of interest in relation to any contract so made.

Delegation to and Reliance on Officers, Experts and Other Advisers

The scheme of the CBCA makes it clear that the role of directors is to "direct" management of the business and the affairs of the corporation and not manage themselves. There are specific provisions in the CBCA establishing protections for directors against personal liability under the CBCA where they engage in proper delegation to and reliance on experts and officers. For example, a director is not liable for certain offences under that Act if he relies in good faith upon the financial statements represented to him by an officer or any written report of the auditor of the corporation fairly to reflect the financial condition of the corporation. Similarly, a director will not be liable under the CBCA for certain offences if he relies on the report of a lawyer, accountant, engineer or other person whose profession lends credibility to a statement made by him.

Indemnity

The CBCA permits the corporation to indemnify a director (other than in connection with an action to procure a judgement in favour of the Corporation) against all costs, charges and expenses, including any amount paid to settle an action or satisfy a judgment, reasonably incurred by the director in respect of any civil, criminal or administrative action or proceeding to which he is made a party by reason of being or having been a director or officer of such a corporation or body corporate. Statutory prerequisites must be met before a corporation can provide the indemnity. As well, the corporation must be in a financial position to honor the indemnity.

Directors and Officers Insurance

Subsection 124(4) of the CBCA permits, but does not require, a corporation to purchase and maintain insurance for the benefit of its directors against any liability, except where the liability relates to the director's failure to act honestly and in good faith with a view to the best interests of the corporation.

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