

Director by Default

A director's lot is not always a happy one but a lot of care plus some insurance can protect against the worst.

If you are an owner/manager of an incorporated business, you are almost certainly also a director. As a director you should be aware of your legal responsibilities and liabilities, which may not always be as obvious as you might think.

Incorporation Process

No matter what the jurisdiction of incorporation in Canada, all corporations are required to have at least one director. The board of directors occupies the middle ground between the shareholders and the corporation and has a responsibility to both. To be a director, one must have reached the age of majority, be of sound mind, have never been bankrupt or (in some jurisdictions) have ever been convicted of a crime involving fraud. Except for British Columbia, which has removed the requirement, foreign subsidiaries are required to have a portion of their directors resident in Canada.

Director's Duties

A director's common-law duty to be careful used to be minimal and only became an issue where gross carelessness was involved. Today a director is expected to exercise the care, diligence, and skill of a "reasonably prudent person." In law, a reasonably prudent person is not an average person but one who has the knowledge and capacity to foresee the risk inherent in his or her actions, calculate its magnitude and likelihood of occurrence, and recognize any alternative less risky actions, if any. Such a duty of care can expose directors to significant liability for negligence.

Directors also have a fiduciary duty. In other words, although the directors are elected by the shareholders to look after shareholder interests in the direction of the company, the primary fiduciary duty of the directors is to the corporation itself.

Fiduciary duty requires directors to avoid conflicts of interest and act honestly and in good faith toward the corporation. Thus, if a director were to lend corporate funds to a relative for reasons that were not in the best interest of the company, the director could be liable for any losses to the Company resulting from the failure to act in the best interest of the company.

If you are a director of a corporation, care must be taken to ensure that:

- you do not take advantage of your position as director and receive benefits not normally available to other employees, officers or customers of the corporation;
- your personal interest does not conflict with the best interest and goals of the company. (For example, if your relative is one of the bidders in a contract to provide goods or services to the company.);
- you indicate the conflict of interest and refrain from participating in discussions concerning the project and definitely refrain from voting;
- you maintain corporate confidentiality on all aspects of business; and

e) all decisions are made in the best interest of the company and its shareholders.

Informed Decisions

To ensure the standards of care, diligence and skill are met, the director has a duty to be informed before making decisions. This may mean refusing to make a decision until sufficient information concerning proposals and their (potential) impact on the company are received and analyzed to the director's satisfaction. In the end, directors' decisions can be supported by professional advice, but the decision itself cannot be delegated to these same professionals.

Supervisory Role

The director's role is one of overall supervision ensuring that the executives perform their duties in the best interest of the company.

All companies have officers, a president, vice presidents, a treasurer and a secretary hired by the board of directors. That being said, the directors cannot shirk their overall responsibilities to manage a company by irresponsibly delegating management to the officers. Ultimately, the directors are responsible for the actions of the appointed officers.

Directors' Liability

When directors act in good faith and within the boundaries of their authority it is difficult to be held liable for decisions or actions that may have precipitated from those decisions.

If, for example, directors have complied with prevailing safety legislation by reviewing all health and safety requirements of their business, it is unlikely they would be held liable if a worker were injured on the job. On the other hand, if a worker was injured on the job and it was established that the directors had ignored legislation, failed to consider available accident reports or advice from officers or employees, there is a high probability the directors could be held personally and jointly liable.

Avoiding Liability

There are three ways directors can reduce the risk of liability — due diligence, disclosure of personal interests and self defense.

Due Diligence

Directors could ward off negligence lawsuits by keeping records that show they obtained the required information, examined and understood it (and/or sought professional expertise), and made an informed decision. Cautious directors may wish to maintain personal records of all decisions in which they participated as well as copies of all minutes.

Disclosure of Personal Interests

Failure to disclose conflict of interest can result in voided contracts if the conflicted director is present during the vote or if it was determined that the director was part of the quorum that authorized the agreement. Further, the director may be required to make restitution for any profits made from the non-arms length project.

Self Defense

By mere attendance at the directors' meeting, a director may be deemed to have consented to the resolutions passed even without actually voting. This could be disastrous to a conflicted director long after the directors' meeting if legal action is taken against the company and its directors.

To ensure the conflicted director is exonerated from any participation, the director, if present at the meeting should request that an abstention or dissent be entered in the minutes.

Directors who vote for or consent to a resolution are not entitled to dissent. Thus, if a director disagrees with the other Board members, abstention does not clear potential responsibility. If you disagree, vote "no" and make sure the vote is recorded.

Insure Your Directors

Because directors can be sued, companies should ensure indemnification of all legal expenses, including amounts paid to settle actions or satisfy judgements. The company should purchase and maintain liability insurance for the directors.

Obviously, the coverage would hold only if the director acted honestly and in good faith in the best interest of the company. If the case against the director is criminal, for example, the coverage would only hold if the director(s) had reasonable grounds for believing that conduct was not unlawful.

Review Your Position

Owner/managers should review corporate documents with their company lawyer to determine who are the directors of record, and with their lawyers and accountants, those areas where they may be held personally liable if they fail in their compliance with legal and regulatory requirements. If the potential risk to personal assets is greater than the owner/manager wishes to assume, it may be possible to restructure the organization to lessen or eliminate the personal impact. It may also be possible to shelter personal assets from future contingent liability by reviewing ownership of personal holdings.

If restructuring is not possible, then a full understanding of corporate areas that may transfer personal risk will permit the owner/manager the ability to institute appropriate protocols and procedures to limit personal exposure.

This'n That at Logan Katz

Logan Katz was a proud sponsor and participant of the Laurentian Bank's annual golf tournament. This year's event was in support of the Soupière de l'Amitié de Gatineau and La maison Mathieu Froment.

We were also honoured to be the major sponsor of the annual golf tournament hosted by *Association pour l'intégration sociale d'Ottawa* (Ottawa Social Integration Association), an organization that provides services to people with intellectual disabilities and to their families. The sold-out event raised in excess of \$30,000 for the cause.

Once again Logan Katz's will be sponsoring the University of Ottawa, Telfer School of Management Accounting Club for their 7th annual Accounting Case Competition on October 16, 2010. This event brings 3rd and 4th-year accounting and finance students together from universities across Ontario and Quebec.