

## Memo re: Director's Liability

### **What is the difference between a shareholder and a director?**

One person is able to be a shareholder, director, or officer at the same time. However, each role has different duties and liabilities. Directors can hold shares in a company, but it is not a requirement unless the articles for incorporation state otherwise.

### **What are the rights of a shareholder?**

- Right to timely notice of meetings;
- Right to informative notice of meetings;
- Right to vote;
- Right to have a proper proxy accepted;
- Right to inspect corporate records; and
- Right to dividends.

### **What are the duties/liabilities of a shareholder?**

A shareholder's liability is pretty straightforward and limited. A shareholder liability to the corporation is limited to their investment in the payment of shares.

However, if shareholders sign an agreement to assume the rights, powers, and duties of directors then they would also be assuming the liabilities of those directors.

### **What are the duties/liabilities of a director?**

The main duty of a director is to manage the corporation. [s.102\(1\) of the Canada Business Corporations Act](#) states simply:

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

During the course of management however, directors of corporations also have a fiduciary duty and a duty of care and skill to maintain. The corporation itself as a separate entity takes on the majority of all liabilities after incorporation, but a director's failure to comply with their fiduciary duty and a duty of care and skill could result in the personal liability of a director itself. The statutory requirements for these two principle duties can be found in the [Canada Business Corporations Act at s.122](#). It reads:

“Every director and officer of a corporation in exercising their powers and discharging their duties shall **act honestly and in good faith with a view to the best interests of the corporation [fiduciary duty]**; and **exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances [duty of care and skill]**.”

While working as a director, it is important to keep these two duties in mind, so you do not find yourself **personally liable** for any issues as you conduct business for the corporation.

## **What is a fiduciary duty?**

There are three main categories for a finding of a lack of fiduciary duty to the corporation as a director.

1. Rendering or making decisions that are not in the best interests of the company;
2. Engaging in self-interested contracts; and,
3. Seizing the corporate opportunity.

Broadly speaking, these three categories touch upon the idea that you have been given a certain type of power as a director of a corporation, and you should ONLY be using that power for the purposes of which it was given to you in the first place.

### Rendering or making decisions that are not in the best interests of the company

You should not be using your power and position as a director to make any decisions that would not be in the best interest of the company. For example, issuing a bunch of shares at a discounted rate for a new party who is a friend of the board. One group of the corporation cannot be favoured over the other, and it is up to the directors to keep this balance in mind for the good of the overall corporation.

### Engaging in self-interested contracts

You should not be using your power and position as a director to enter into contracts on behalf of the corporation in which you have a personal interest. For example, if you own shares in a gravel company and then attempt to get your road-building corporation to choose that company as a business partner in order to increase your share values without disclosing your prior interest to the corporation, this is a huge breach of your fiduciary duty.

[S.120 of the \*Canada Business Corporations Act\*](#) references self-interested contracts. It simply states that a director or an officer of a corporation must disclose to the corporation the nature and extent of any interest that they have in a material contract or material transaction whether it is proposed or made. You can do this in writing or in the minutes of meetings of directors.

A self-interested contract could still be permitted if the interest was disclosed, the contract was approved by the directors, and the contract was fair and reasonable. When in doubt to whether you have a prior interest in a business agreement, disclosing is optimal to ensure transparency.

### Seizing the corporate opportunity

Seizing the corporate opportunity occurs when you are a director of a corporation and because of this position you become aware of a potential opportunity that the company may be trying to pursue, and instead you take it for yourself. For example, while working as a director you hear of a great contractual opportunity, and instead of allowing the corporation to enter into that contract, you take it instead for your own personal benefit.

Seizing the corporate opportunity also relates to insider trading, wherein as a director you gain access to information about a company that is not available to the general public and use that private information to trade/sell/etc. shares in that company. To use your position as a director to

gain private information about other companies to profit off the stock market is a huge breach of your fiduciary duty, and is a criminal offence offering up to 10 years imprisonment.

### **What is a duty of care and skill?**

Maintaining a duty of care and skill is a much more general threshold to meet. It requires that a director act honestly and use the skill and care reasonable for their knowledge or experience in relation to their work for the corporation. This could mean taking the time to read over all paperwork related to the business of the corporation, making informed decisions based on that information, and being reasonable in your decisions for the company to aid in its growth.

A director does not need to exhibit greater skill than expected of someone with their knowledge or experience, and they are not bound to give continuous attention to the affairs of his company. In the absence of any suspicion, one assumes a director or officer is performing honestly, this is called the business judgement rule.

The courts often do not find a breach of duty of care and skill unless a director was grossly negligent or some other high standard for misconduct. An example of this could be some director's deciding to buy out shareholders without maintaining the proper due diligence in ensuring they are purchasing them at fair price with proper the legal guidance. If the director bought the shares for significantly less than they were worth because none of them took the time to read the agreement, this could be seen as grossly negligent and therefore a failure to maintain a duty of care and skill to the corporation.

### **What is the oppression remedy?**

A 'complainant' or stakeholder in the corporation (a director, officer, shareholder, creditor, etc.) may also use [s.241\(1\) of the Canada Business Corporations Act](#), referred to as the 'oppression remedy', to pursue legal action against a person who undergoes a corporate action that infringes on the stakeholder's legitimate expectations. The definition of 'oppression' is quite broad, with the CBCA stating it includes any action that is "...oppressive or unfairly prejudicial or that unfairly disregards the interests of any security holder, creditor, director or officer".

Oppression claims can be asserted against the corporation itself or any of its affiliates. So a shareholder could pursue a claim against a director, a director could pursue a claim against another director, etc. The determination of whether an action was oppressive is very fact-driven, meaning all the circumstances will be taken into account to decide if the actions of an affiliate did fall below a stakeholder's 'legitimate expectations'.

Some factors that can be taken into account when considering whether a corporate action fell below a reasonable/legitimate expectation includes, but is not limited to:

- General commercial practice;
- The nature of the corporation;
- The relationship between the parties;
- Past practices;
- Representations and agreements;

- Steps the claimant could have taken to protect itself; and,
- The fair resolution of conflicting interests between corporate stakeholders.

If there are conflicting interests within the corporation, a director must resolve those conflicts while maintaining their fiduciary duty to act in the best interest of the corporation.

### **Additional statutory liabilities for directors**

Director's also have liabilities under certain statutes that can make them personally liable for actions and omissions.

- ***Income Tax Act***

Under corporate taxing statutes, a director may have to take reasonable measures to ensure the corporation they are managing does not fail to withhold, collect, or remit tax. [S.227.1\(1\) of the Income Tax Act](#) states:

“Where a corporation has failed to deduct or withhold an amount... has failed to remit such an amount or has failed to pay an amount of tax for a taxation year... **the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable**, together with the corporation, to pay that amount and any interest or penalties relating to it.”

227.1(3) of the *Income Tax Act* provides a statutory due diligence defence. This simply means that if a director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances then they will not be personally liable for a failure to pay tax.

In the past, the courts have also relieved a director from personal liability if they were deceived by a business partner, they were not aware that the business was in financial difficulty, and in instances where they were denied access to business records and books and therefore had no way to take remedial action.

- ***Excise Tax Act***

Also related to taxes, directors could be found to be personally liable under certain statues of the [Excise Tax Act](#), specifically [s.323](#), and [s.96\(3\)](#).

S.323(1) states that if a corporation fails to pay its net tax amount or pay an amount as required under section 230.1, the directors at the time the corporation was required to remit or pay that amount, “...are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount.”

Like s.227.1(3) of the *Income Tax Act*, to avoid liability under this section of the *Excise Tax Act* (besides quite obviously paying your net tax amount on time), s.323(3) then further states a director is not liable as per s.323(1) if they "...exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

s.96(3) of the *Excise Tax Act* also makes reference to director's liabilities, stating, "[w]here a corporation commits an offence under this Act, any 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 summary conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.

- ***Business Corporation Statutes/Employment Standards Act***

The federal and provincial business corporation statutes contain provisions respecting directors' liability for unpaid wages. [S.119\(1\)](#) of the *Canada Business Corporations Act* references this stating:

"Directors of a corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively."

The Ontario *Employment Standards Act* imposes liability on directors for unpaid wage claims in certain circumstances as well under [s.81\(1\)](#). It states a director of an employer will be jointly and severally liable for wages if:

- (a) the employer is insolvent, the employee has caused a claim for unpaid wages to be filed with the receiver appointed by a court with respect to the employer or with the employer's trustee in bankruptcy and the claim has not been paid;
- (b) an employment standards officer has made an order that the employer is liable for wages, unless the amount set out in the order has been paid or the employer has applied to have it reviewed;
- (c) an employment standards officer has made an order that a director is liable for wages, unless the amount set out in the order has been paid or the employer or the director has applied to have it reviewed; or
- (d) the [Labour Relations] Board has issued, amended or affirmed an order under section 119, the order, as issued, amended or affirmed, requires the employer or the directors to pay wages and the amount set out in the order has not been paid.

This causes directors to be jointly and individually liable for an employees' wages as well as other amounts owed such as severance and notice pay up to a limit equivalent to six months' wages.

- ***Workers' Compensation Acts***

s.136(1) and s.213 of the [Workers' Compensation Act](#) reference liabilities placed on corporate directors. S.136(1) stipulates a director is personally liable if the employer is a corporation and the corporation defaults on the payment of an assessment levied.

s.213 details a more generalized liability based on the acts or omissions of the directors themselves if an offence is committed by the corporation, stating:

“Where an offence is committed by a corporation, any officer, director, representative or agent of the corporation **who ordered, authorized or consented to the performance of the act or omission that constitutes the offence** is party to the offence and liable to the same penalty as that provided for the corporation, whether or not the corporation has been penalized, prosecuted or convicted.”

- ***Canadian Environmental Protection Act***

There are provisions under environmental acts that hold directors personally liable for pollution or other damaging environmental effects that are caused from their actions or occurred during their watch of the business of the company. There are references to such liabilities under numerous environmental acts, most notably the federal *Canadian Environmental Protection Act* under [s.280\(1\)](#). This states:

“...any director, officer, agent or mandatary 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 penalty provided for by this Act for an individual in respect of the offence committed by the corporation, whether or not the corporation has been prosecuted or convicted.”

If a director is found to have done their due diligence to take ‘all reasonable care’ to prevent the commission of the offence, then the due diligence defence can apply, and a director could not be found personally liable for the pollution or other environmentally harmful action.

- ***Bankruptcy and Insolvency Act***

[S.101](#) of the *Bankruptcy and Insolvency Act* was expanded in 2019, adding additional liabilities for directors. The act states that in the case of a business becoming bankrupt, a director will be liable if they authorize the payment of termination or severance pay, incentive benefits or other benefits to directors and officers in the 12 months preceding the bankruptcy or other insolvency.

Under this act there is also the historical liability imposed on directors against authorizing the payment of dividends or the redemption or repurchase of shares during the 12-month look back period of the initial bankruptcy event.

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- ***Companies' Creditors Arrangement Act***

[S.36.1](#) of the *Companies' Creditors Arrangement Act* incorporates s.101 of the *Bankruptcy and Insolvency Act*,

**Other liabilities as directors**

Directors must also take care to not divulge any confidential information about the corporation during the course of their work.

Directors must be aware that they could be found personally liable for tort claims (specifically personal injury and/or property damage caused by negligence) for an action done to a third-party of the corporation if the director has done that action on their own behalf. Simply because you injured or damaged someone's property while working as a director for the corporation may not mean you will not be found solely and personally liable. It will depend on the circumstances.

Helpful Resources for Further Information

For further information please see the following additional resources

→ Highlighted sources are the most important

Title	Source	Link	Type of Media	Notes
Directors and Officers	Government of Canada	<a href="#">Here</a>	Website	
Responsibilities of Directors in Canada	Torys LLP	<a href="#">Here</a>	PDF	Comprehensive business law guide on the role of directors in publicly traded companies in Canada.
Share Structure and Shareholders	Government of Canada	<a href="#">Here</a>	Website	
Directors' Duties in Canada: Six Key Concepts	Stikeman Elliott	<a href="#">Here</a>	Legal Article	
The Oppression Remedy: An Overview	Milosevic Fiske LLP	<a href="#">Here</a>	Legal Article	Solid outline of reasonable expectations of stakeholders.



Oppression Remedy Guidelines	Government of Canada	<a href="#">Here</a>	Website	
<i>Canada Business Corporations Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections referenced s.102(1) s.119(1) s.120 s.122 s.241(1)
<i>Income Tax Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections referenced: s.227.1(1) s.277.1(3)
<i>Excise Tax Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections referenced s.323.1(1) s.323.1(3) s.96(3)
<i>Employment Standards Act</i>	Government of Ontario website	<a href="#">Here</a>	Statute	Sections referenced s.81(1)
<i>Workers' Compensation Act</i>	Nova Scotia Legislature	<a href="#">Here</a>	Statute	Sections referenced s.136(1) s.213
<i>Canadian Environmental Protection Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections referenced s.280(1)
<i>Bankruptcy and Insolvency Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections referenced s.101
<i>Companies' Creditors Arrangement Act</i>	Justice Laws Website	<a href="#">Here</a>	Statute	Sections references s.36.1