THE LAW SOCIETY OF UPPER CANADA
Emerging Issues in Directors' and Officers' Liability 2012

Toronto – March 1, 2012

Directors' and Officers' Duties and Liabilities under the CNCA and the ONCA

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A. INTRODUCTION

- Volunteering as a director or officer of a NFP corporation can attract civil liability
- This presentation will explain the standard of care for directors and officers of NFP corporations, an overview of the duties and liabilities of directors and officers together with the statutory protections, all under the recently proclaimed CNCA and soon to be proclaimed ONCA (collectively referred to as "NFP legislation")
- Since the CNCA and ONCA are modeled on for-profit corporate statutes, comparisons will be made to the CBCA and OBCA in order to provide some clarity for how the NFP legislation may be applied

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B. STANDARD OF CARE

- Directors of for-profit corporations are held to an objective standard of care under the *Canada Business Corporations Act* ("CBCA") and the Ontario *Business Corporations Act* ("OBCA")
- Like the CBCA and OBCA, the CNCA and ONCA establish an objective standard of care, i.e. "the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances"
  - Known as the "Business Judgment Rule", the rule protects directors and officers against hindsight and second guessing by creditors and other stakeholders, holding directors to a standard of reasonableness, not perfection
  - i.e. The court will defer to the expertise of the directors and will not interfere with reasonable business decisions

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C. STATUTORY DUTIES

1. Duty to Manage or Supervise Management

- Directors are responsible for all aspects of the corporation's operations on a joint and several basis
- To fulfill duties, directors must ensure:
  - All aspects of the corporation's operations are familiar, including attending directors' and members' meetings, ensuring proper delegation of directors' powers, and reviewing minutes and resolutions or actions taken at missed meetings
  - Provisions in both the CNCA and ONCA deem directors to have consented to any resolutions or actions taken at meetings, unless a dissent is recorded
  - Certain directors' powers cannot be delegated to officers, for example, approval of financial statements

2. Duty to Comply with the Incorporating Statute

- Directors must comply with all applicable acts and regulations and the corporation's governing documents (articles, by-laws, and unanimous member agreement ("UMA"), if applicable)
- Under the CNCA, directors must additionally verify the lawfulness of the articles and the purpose of the corporation (no equivalent provision in the ONCA)

3. Duties to Members

- Directors also have certain duties to the members of the corporation, although it is not specifically a fiduciary relationship
- Case law affirms that relationship between a corporation and members is an implicit contractual obligation to comply with the constating documents and by-laws

4. Use of Unanimous Member Agreement (UMA)

- A feature exclusive to the CNCA, an agreement which restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the activities and affairs of the corporation
- Members may only enter into a UMA if they are members of a non-soliciting corporation (meaning the corporation receives less than the prescribed amount of $10,000 in gross annual revenues)
- Parties to the UMA who are given those powers have all the rights, powers, duties and liabilities of a director of the corporation, thereby presumably relieving the director from responsibility
- However, since the director's duties arise under the common law, it may be that such an agreement is deemed unenforceable from the standpoint of relieving the director from all liability

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D. COMMON LAW FIDUCIARY DUTIES

1. Duty to Act in Good Faith, Honestly, Loyally
- The common law has also reinforced the duty to the corporation and not directly to the members, creditors, or other stakeholders
- In dealing honestly with the corporation, a director must disclose the entire truth in his or her dealings as a director

2. Duty to avoid conflict of interest
- Directors must declare and avoid any conflicts of interest or anything that gives a director the appearance of a personal benefit

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- Where a conflict of interest arises, it must be declared, and the director must not participate in any discussion or vote and, depending on the circumstances, the director may have to resign
- If this procedure is not followed, directors may be made to account for any profits or gain realized from the contract or transaction
- Both the CNCA and ONCA require both directors and officers to properly disclose their interest at specific times and in specific manners and this obligation is ongoing

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- Despite statutory protection provided where the director of a charity declares a conflict of interest, no reliance can be placed on these provisions since the director will generally still be in breach of their fiduciary duty at common law

3. Duty to Continue
- Directors have continuing obligations to the corporation which cannot be relieved by resignation
- Both the CNCA and ONCA provide for a limitation period of 2 years
- As such, it is possible for a former director to continue to be held accountable for their duties while they were still a director even up to 2 years since ceasing to be a director

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E. FIDUCIARY DUTIES FOR CHARITABLE PROPERTY

- Common law in Ontario has held that, with regard to charitable property, directors of charitable corporations are subject to high order fiduciary obligations similar to those of trustees
- This is in part a function of the *Charities Accounting Act* ("CAA") in ss 2(1), which identifies what corporations are deemed to be a trustee within the meaning of the CAA and that property acquired by such corporations is deemed charitable property
- Both the CNCA and the ONCA are consistent in this regard

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- However, the CAA is silent on who has the capacity to carry out the role of trustee
- Under the CAA, directors and officers, as the guiding minds of the corporation, would likely have the high fiduciary duty of care for charitable property
- The CNCA, though, specifically states that directors are not trustees for any property of the corporation
- While the ONCA does not provide a similar provision to the CNCA, ss 5(2) provides that if there is a conflict between the Act and the law applicable to charitable corporations, then charity law will prevail
- Since there is a conflict, in Ontario at least, charity law would prevail and thus the assumption is that directors of NFP corporations have the high fiduciary duty in relation to charitable property

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F. STATUTORY LIABILITIES

1. Liability for Improper Payments to Members, Directors and Officers

- Directors who vote for or consent to a resolution authorizing a payment or distribution to a member, director or officer or a payment of an indemnity contrary to the act, are jointly and severally liable to restore any money or other property to the corporation
- If a director satisfied a judgment, that director is entitled to recover from the other directors who also voted for or consented to the unlawful act
- While both the CNCA and ONCA provide the authority for directors to fix the remuneration of directors, officers and employees, this is in contradiction to the common law which prohibits the payment of remuneration or other benefits to directors of charities for all services, unless court approval is first obtained

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2. Liability for Employee Wages
- The CNCA holds directors jointly and severally, or solidarily, liable to employees for all debts not exceeding 6 months wages for services performed for the corporation while they are directors
- The ONCA contains a similar provision, although directors are additionally liable for up to 12 months vacation pay
- The CNCA provides for a “reasonable diligence” defence to escape liability for wages
- However, under the ONCA, directors are strictly liable for these amounts
- In this regard, the “reasonable diligence defence” in the ONCA does not specifically provide that it is a defence available for liability for wages, like the provision in the CNCA
- Therefore, it appears that the defence is not available for directors of ONCA corporations for employee wages

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3. Liability for General Offences, False or Misleading Statements and Misuse of Membership Information
- General offence provisions exist under both the CNCA and ONCA for any contravention of the act or regulations, other than the requirement referred to previously regarding the duty to comply with the organization’s articles, by-laws and UMA
- It is an offence to use information obtained from a register or list of members or debt obligation holders for a purpose other than those specified in the acts as appropriate
- It is also an offence to make or assist in making a false or misleading statement in a document required under the applicable Act or the Regulations
- Directors and officers may also be held responsible for offences of the body corporate that they authorized, permitted or acquiesced to

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4. Liability During Liquidation and Dissolution
- The ONCA contains a provision that if, during the course of winding up, it appears that a present or former director or officer has misapplied, retained or become liable or accountable for property of the corporation, or has committed any misfeasance or breach of trust in relation to it, the court may compel that director or officer to restore the property
- The CNCA doesn’t contain such a provision, but does permit the liquidator to apply to the court in order to examine anyone who has concealed, withheld or misappropriated any property of the corporation

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G. **REMEDIES**

1. Oppression Remedy

- Exists only in the CNCA
- Is an order that a court may make if it is satisfied that any act or omission, or conduct of the activities or affairs of the corporation or the exercise of the powers of the directors or officers is oppressive or unfairly prejudicial to or unfairly disregards the interests of any shareholder, creditor, director, officer or member
- The powers of the court for orders in satisfying a finding of oppression are considerable, including that the corporation "or any other person" pay a member all or part of the membership fee amount
- The court is precluded from making an order for an oppression remedy in the case of a "religious corporation" (see below)

2. Court-ordered Liquidation, Dissolution and Winding-up

- Under the CNCA, if any act or omission, conduct of the activities or affairs of a corporation or any of its affiliates, or the exercise of the powers of the directors are oppressive, unfairly prejudicial to or unfairly disregard the interests of any shareholder, creditor, director, officer or member, or causes such a result, the court may order a winding-up of the corporation
- Under the ONCA, similar language is used, except it does not allow for oppressive behaviour as grounds for winding-up
- Under the CNCA, the court may not order a wind-up if the corporation is a "religious corporation" (see below)

3. Derivative Action

- The NFP legislation allows for a complainant to apply to the court for an order granting them leave to bring an action in the name of and on behalf of the corporation or any of its subsidiaries, or to intervene in an action for the purpose of prosecuting, defending or discontinuing the action on its behalf
- Under both Acts, complainants have to give at least 14 days notice to the directors of their intention to apply to the court and be acting in good faith, and it must be in the interests of the corporation that the action be brought, prosecuted, defended or discontinued
- Both Acts also provide that leave may not be granted if the corporation is a "religious corporation" (see below)

4. Compliance or Restraining Order

- Under the NFP legislation, a compliance or restraining order directs a corporation or any director, officer, employee, agent, public accountant, auditor, trustee, receiver, receiver-manager, sequestrator or liquidator of a corporation to comply with the NFP legislation, the regulations and the articles, by-laws or UMA (if applicable) of the corporation, or restrains any such person from acting in breach of them
- The court also has the power to make any further order that it thinks fit

5. Specific Rights for Members

- Directors and officers need to be aware that the NFP legislation generally expands the rights and remedies available to members of NFP organizations
- Both the CNCA and ONCA enhance the accountability of directors to members by providing members with the power to remove directors by ordinary resolution at any time
- Under the CNCA, members who are entitled to vote at an annual meeting may submit proposals to make, amend or repeal a by-law or propose nominations for the election of directors

- Under the ONCA, members who are entitled to vote at an annual meeting may raise any matter, referred to as a “proposal” as long as 60 days notice is given
- Members under both the CNCA and ONCA may also apply to the court to have a contract or transaction annulled or set aside if a director or officer fails to comply with their duties regarding disclosure of interest
- As well, the court may order that the director or officer account for any profit or gain realized
- Plus right to access to membership register
- Right to inspect the corporation’s financial records

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H. STATUTORY PROTECTION

1. Reasonable Diligence Defence

- A director is not liable if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
- CNCA – directors may use this defence to exonerate themselves from liability for unpaid wages, improper payments to members, or the duty to comply
  - Same defence is available to officers
- ONCA – not available to officers and cannot be used against liability for employee wages

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2. "Religious Corporations" and the "Faith-Based Defence"

- With respect to an oppression remedy or derivative action under the CNCA, the court is precluded from making an order if the corporation is a "religious corporation"
- Also under the CNCA, the court may not order liquidation or dissolution if: (a) the corporation is a religious corporation; (b) the act or omission, the conduct or exercise of power is based on a tenet of faith held by the members; and (c) it was reasonable to base the decision on a tenet of faith, having regard to the activities of the corporation

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- Under the ONCA, the derivative action is not available as a remedy in the case of a "religious corporation"
- However, the ONCA does not require that the director's decision be based on a tenet of faith held by the members and that it was reasonable to base such a decision on a tenet of faith
- Therefore, it appears that the ability of directors to rely on the "religious corporation" exemption for derivative actions under the ONCA is not as onerous as under the CNCA
- Neither the CNCA nor the ONCA provide a definition for "religious corporation" so it remains to be seen how this section will be interpreted

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I. INDEMNITIES

1. Mandatory Indemnification

- The NFP legislation provides that a present or former director or officer is entitled to indemnification against all costs, charges and expenses reasonably incurred by them in connection with the defence of any civil, criminal, administrative, investigative or other action/proceedings in which they have been involved because of their association with the corporation

2. Permissive Indemnification

- Both Acts permit indemnification of a present or former director or officer against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by the individual in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the corporation
- As well, both Acts provide that the corporation may advance the money for costs, charges and expenses of a proceeding referred to above, provided that the director or officer is found to have acted honestly and in good faith with a view to the best interests of the corporation (otherwise the advance must be paid back)

3. Prohibited Indemnification

- A corporation under either the CNCA or ONCA cannot indemnify if the director or officer failed to act honestly and in good faith
- In the case of a criminal or administrative proceeding or action that is enforced by a monetary penalty, a corporation under either Act cannot indemnify if the director or officer had no reasonable grounds for believing that their conduct was lawful
- As well, both the CNCA and ONCA state that a corporation cannot indemnify if the corporation does not have court approval in respect of an action by or on behalf of the corporation to obtain judgment in its favour to which the director or officer may be made a party because of their association with the corporation

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J. INSURANCE

- Both the CNCA and ONCA permit a NFP corporation to purchase and maintain personal liability insurance for the benefit of a present or former director or officer of the corporation, or another individual who acts or acted at the corporation's request as a director or officer or in a similar capacity of another entity
- Under the ONCA, however, director and officer insurance may not be purchased unless the corporation complies with the Charities Accounting Act or a regulation made under that Act that permits the purchase of such insurance, or a court order is obtained authorizing the purchase
- Insurance policies are not all the same, so the quality of coverage can change between insurers

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