



BEING A DIRECTOR: How to Minimize the Risks

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Most of us are so flattered to be asked to serve as a director of a business corporation, even a small privately held company, or a not-for-profit organization such as the local hospital, or a religious/charitable corporation, that we readily agree. Others willingly participate as volunteers in unincorporated community-based organizations, such as the local minor hockey or soccer league.

When we agree to take on these roles we do not often think of the legal liabilities we may be assuming in doing so. We may be lured by the prestige factor, or see an opportunity to make new contacts, oblige a client or customer, or make a contribution to our community. In this article, the terms "corporation" and "organization" are used interchangeably.

The media coverage of recent court cases warns us of the potential liability for directors of large business corporations, and the need for due diligence before and during one's tenure as director. It needs to be clearly understood that even though an organization may be perceived as smaller, the same sort of potential liabilities lurk for the unwary director.

Hundreds of federal and provincial statutory provisions impose liability on directors and officers. The common

law also imposes standards of care. Statutory offences impose liability without considering the size of a charity or that its directors are unpaid volunteers. Liabilities imposed on directors of not-for-profit organizations are the same as those imposed on officers of business corporations. The combined effect of the common law with the statutory provisions creates complexity that baffles even members of the legal profession, let alone laypersons to whom they may apply.

Directors of business and not-for-profit corporations, and also volunteers of unincorporated community-based organizations may be exposed to liability they never contemplated. So, how can you protect yourself if, despite the landmine of potential liabilities, you really do want to be a director?

Due Diligence Before Becoming a Director

The following are some of the steps and matters that a potential director should take or consider when being offered the opportunity to become a director of a corporation:

1. First and foremost, consider why you want to be a director.
2. Determine whether the organization is financially strong and stable.
3. If the organization is a charitable organization, clarify if it will be looking to you for a significant monetary contribution or to participate in fundraising activities.
4. Request and receive a written job description detailing specific responsibilities expected of a director and what committees you may be requested to sit on.
5. Find out the organization's selection criteria for directors.
6. Speak to other directors to get their perspective on the organization.
7. Ascertain what materials are usually circulated to directors before meetings and if they are sent on a timely basis.
8. Find out how much time will have to be devoted to the position.
9. Ascertain the organization's policy for appointing the chair of the board and the role of the chair.
10. Find out if the organization pays for the services of independent outside advisers, such as lawyers and accountants, where it is deemed necessary.
11. Request and review board and committee minutes for the past two or three years.
12. Find out if there is an orientation program for new directors.
13. Ask whether the organization has guidelines and procedures to deal with conflicts on the board.
14. Request and receive a report on current areas of concern for directors.
15. Request and receive from the organization's solicitors details of any outstanding and pending litigation or regulatory proceedings against the organization and/or its officers and directors.
16. Question whether the organization has formal policies for compliance with regulatory requirements.
17. Make sure the *Act* which governs the organization allows the indemnification of directors.
18. Obtain a contractual indemnity from the organization and from the person (be it a friend or client) who appointed you.
19. Ascertain whether directors' and officers' liability insurance coverage is available to the directors. Ascertain its limits and any exclusions.
20. If the corporation is a charitable corporation, ensure that investments being made by the organization are in compliance with relevant legislation and/or donor wishes.

Corporate Governance

The Corporate Governance Group assists clients in developing procedures to increase board and corporate effectiveness, comply with exchange and commission requirements, minimize directors' and officers' liabilities and meet shareholders' obligations. Key service areas include: assistance in structuring insurance indemnification programs; review board practices and procedures; conducting compliance audits; advice on legislative regulatory policy initiatives; and assistance in developing information packages and orientation programs for new directors.

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Photos Courtesy Getty Images

Due Diligence While Serving as a Director

The following are some pointers to assist the director in fulfilling his or her due diligence obligations:

1. Attend as many meetings of the board or any committee as you can.
2. Read the material sent to directors before a meeting.
3. Take accurate notes at board meetings and review minutes to ensure accuracy.
4. Make sure your concerns, if any, are set out in the minutes of the meeting.
5. Consult independent experts where necessary.
6. Try and become as thoroughly familiar with operations of the organization as possible.
7. Maintain familiarity with the financial status of the organization.
8. Ensure there are systems in place specifically designed to monitor variations that should be drawn to the attention of management and the board.

What Can the Corporation Do to Protect Directors?

1. The organization should appoint a staff person as the “point person” in the organization to answer questions of board members so there is consistency in answers.
2. There should be a policy that board candidates have some financial literacy.
3. Require near-perfect attendance at committee and board meetings.
4. Ensure that directors are adequately prepared for meetings.
5. Ensure via the Chair that there is ample time for discussion of each issue at a board or committee meeting.
6. Restrict directors to membership on no more than a set number of other boards.
7. Ensure that the Chief Financial Officer or person fulfilling that function distributes at each meeting a form similar to Schedule “A”.

SCHEDULE "A" - Compliance Certificate for Directors

TO: The Directors of ABC LIMITED (the "Corporation")

As Senior Vice President, Finance, of ABC LIMITED, I hereby certify to the members of its Board of Directors that, for the financial quarter ending December 31, 200•, payments have been made as they fall due by the Corporation for amounts owed or accrued during the financial quarter related to obligations owed to or for the benefit of employees, the Governments of Canada and Ontario and for which directors of a corporation would or could otherwise be liable to make payment or to be in compliance with. These include, but are not limited to:

1. Employee payments and deductions related to salary, wages and remuneration to employees such as income taxes, Unemployment Insurance Contributions (UIC) and Canada Pension Plan (CPP) payments;
2. Wages to employees including vacation pay;
3. General Sales Tax remittances;
4. Premiums due on insurance including Directors and Officers liability insurance;
5. Amounts due under *Employer's Health Tax Act* (Ontario);
6. In addition, with reference to the legislation referred to below, the Corporation is in full compliance:
 - i. *Ontario Health and Safety Act* (Ontario) – the programmes, practices and procedures have been complied with,
 - ii. *Canadian Occupational Safety and Health Regulations* (Canada Labour Code, Part II) – the safety standards and procedures for the workplace have been adhered to,
 - iii. *Employment Equity Act* (Ontario) – there has been compliance with the legislative requirements, the filing of statistical analysis is required, and
 - iv. *Environmental Protection Act* (Ontario) – there has been compliance with legislative requirements and the Corporation's internal procedures.

Dated this • day of •, 200•.

Senior Vice President, Finance

Note: *This certificate could be expanded for business corporations to include payment of Corporations Tax, Retail Sales Tax, Competition Act concerns and other statutes as relevant.*

Court Notes

Stephen C. Nadler represented an established retailer of musical instruments who agreed to sell a 150th Anniversary Limited Edition Steinway grand piano (the "Piano") to a customer (the "Buyer"). The Buyer paid a modest deposit, leaving a substantial balance owing.

Normally, our client would not release a purchased item until the purchase price was paid in full. However, when the Buyer later advised our client that he was concerned the colour of the Piano's finish would not blend with the décor of his house, our client offered the Buyer a 2-week trial period and the Piano was delivered to the Buyer's home.

For several months, the Buyer refused to pay the balance owing for the Piano and, despite our client's

repeated requests, the Buyer would not allow our client to retrieve the Piano.

When our client retained our firm to deal with this situation, we immediately brought a motion for the interim recovery of possession of the Piano. At the motion hearing, the Judge granted our motion. The Buyer still refused to cooperate with our client and return the Piano. As a result, we sought the assistance of the Sheriff's Office. Shortly thereafter, enforcement officers with the Sheriff's Office, along with the assistance of a locksmith, were able to enter the Buyer's house and deliver possession of the Piano to our client. Needless to say, our client was very pleased to recover possession of the Piano.

Resignation of Directors: Some Potential Pitfalls

Good advice to a director is if he or she sees improper or unwise activity and the board is not responsive to criticism, or is adverse to change, the director should resign. What is the normal process? In Ontario, with one notable exception, the process appears simple:

- (1) Section 121 (1) of the *Ontario Business Corporations Act* ("OBCA") provides that a director ceases to hold office when he or she resigns.
- (2) Section 119 (1) provides that a director's resignation is effective the later of the date of the resignation or the receipt of the resignation by the corporation.

It is therefore of the utmost importance that the director who is resigning give written notice to the corporation and keep a copy of his or her cover letter and resignation. The director should ensure that his or her solicitor files a Form 1 with the Ministry under the *Corporations Information Act* (Ontario) giving notice of the change.

As noted above, there are a multitude of statutes, both federal and provincial, that could visit liability on directors. Of major concern is the liability of directors for up to six months of unpaid wages under the OBCA (Section 131 (1)), for accrued vacation pay for up to 12 months under the *Employment Standards Act* (Ontario) and for failure to deduct and remit employee deductions under the *Income Tax Act*. In the case of the latter, no proceedings may be taken after two years from the date of the director's resignation. While the courts have held failure to file the notice of the director's resignation under the *Corporations Information Act* (or other provincial equivalent) did not render the resignation ineffective, filing of the notice will remove an area of contention.

There have of late been several cases where the taxpayer has been put to the test of demonstrating he or she followed the appropriate steps to resign and thus avoid potential liability.

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The portion of the above dealing with the Resignation of Directors has been reprinted with permission from Directors Briefings for January 2005, a CCH Canadian Ltd. publication.

First Directors in Ontario

In Ontario under the OBCA a majority of directors must be resident Canadians or if there are two directors one may be a non-resident. Often a resident Canadian is asked to be a resident Canadian director to qualify the corporation.

There is a serious and underrated risk for directors named in the Articles of Incorporation. Section 119(2) of the OBCA reads as follows:

Until the first meeting of shareholders, the resignation of a director named in the articles shall not be effective unless at the time the resignation is to become effective a successor has been elected or appointed. (our underlining).

The underlined portion above seems to mean that if a first meeting has been held or organizational resolutions signed, a first director can then resign even if he or she has not been replaced.

In *Netupsky v The Queen* (2003), 30 B.L.R. (3d) 46 the Tax Court of Canada held that even a sole director could resign on the theory one cannot be forced to remain as a director.

Suggestions:

1. If you are uncertain of the corporation's financial future or are accommodating someone to comply with a provincial statute you should consider incorporating under the *Canada Business Corporations Act* or other provincial statute which does not have a provision like Section 119(2) or under the *Nova Scotia Companies Act* which has no requirement that a director be a resident Canadian.
2. If you do act as a first director, make sure you are replaced by a permanent director as soon as possible.
3. Arrange for the first meeting of shareholders as soon as possible so you could put yourself in a position to resign if necessary.

Professional Notes

Howard S. Black appeared on ROBTv's *MoneyTalk* to speak on "Wealth Transfers and Dispute Resolution" on January 13, 2005 and again on April 14, 2005 to speak on "Estate Planning - Wills and Dispute Resolution."

Timothy R. Dunn presented "Landlord As Creditor: What Remedies Are Available?" at the Six-Minute Debtor Creditor Lawyer held by the Ontario Bar Association on March 31, 2005.

Catherine Francis' article "*Peoples Department Stores Inc. v. Wise: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care*" was published in the *Canadian Business Law Journal* as part of a Symposium on the Supreme Court's Judgment in the Peoples Department Stores Case.

Arnie Herschorn delivered a paper entitled "The Solicitor's Role in Due Diligence" at the Real Estate Summit on April 6, 2005. His review of *The Hateful and the Obscene: Studies in the Limits of Free Expression* appeared in the March 2005 *Canadian Bar Review*.

The Board of Directors of **Meritas** has approved the appointment of **Ken Kallish** as a Vice-Chair of the organization. In that capacity, Ken will serve as Chair of the Member Relations Committee, which maintains member firm quality.

Hartley R. Nathan, Q.C., will deliver a lecture at the Canadian Institute on September 29, 2005 on "Letters of Intent". He is also engaged by CCH Canadian Ltd. to edit a sixth edition of *Wainberg and Nathan on Company Meetings and Rules of Practice*, now to be called *Nathan on Company Meetings and Rules of Practice*, expected in Fall 2005.

Stephen Posen and **Michael S. Horowitz** were part of the faculty at the Law Society of Upper Canada Six-Minute Commercial Leasing Lawyer 2005 held on February 16, 2005 in Toronto. Stephen presented his paper on "Ethics in Negotiating Leases" and Michael presented his paper (co-authored with **Christina C. Kobi**) on "Restaurant Leases: Special Clauses and Issues". Stephen also presented "Landlord Remedies for Tenant Defaults" at the PM Springfest held in Toronto on April 6, 2005.

Minden Gross sponsored the **ICSC Canadian Shopping Centre Law Conference** in Toronto on March 3-4, 2005.

Michael S. Horowitz was a member of the Program Planning Committee and acted as Co-chair of the Breakfast Roundtables. **Ian J. Cantor** led a Breakfast Roundtable on "Lease Remedies", **Robyn Kestenberg** and **Adam L. Perzow** led another on "Landlord's Waivers", and **Timothy R. Dunn** and **David T. Ullmann** led another on "Insolvency Issues in Leasing - 2005 Update." Michael was also a moderator and **Christina C. Kobi** was a panelist of the Practical Workshop entitled "What is Special About a Condominium Lease", **Stephen Posen** was a panelist of the Plenary Session "The Experts Revisited", and **Stephen J. Messinger** was a panelist of the Concurrent Session "From Here to Eternity."

David T. Ullmann appeared on ROBTv's *The Trading Desk with Pat Bolland*. His first appearance was on February 14, 2005 as part of a discussion on bidding options for the insolvent Stelco, as February 14 was the bidding deadline. David was interviewed again on March 2, 2005 about Stelco's rejection of the takeover bids offered and the possible repercussions. He appeared again on April 14, 2005 to discuss Stelco's rejection of a surprise \$1.4 billion deal that Stelco's union negotiated with Brascan, an asset management company.

Firm News

Martin Maierovits was recently elected Vice Chairman of Kashruth Council of Canada. Kashruth Council of Canada is a not-for-profit organization that is the premier agency for certification of kosher food products in Canada.

Minden Gross welcomes Carl Schwebel as a member of our Real Estate group.

Minden Gross is pleased to announce the admission to partnership of Michael A. Goldberg, Michael S. Horowitz, Christina C. Kobi, Stephen C. Nadler, Daniel A. Rothberg and Jack B. Tannerya.