OVERVIEW OF DIRECTORS’
AND OFFICERS’ DUTIES AND LIABILITIES

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Prepared by Sarah Ciarrocchi
Mandell Pinder LLP
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OVERVIEW OF DIRECTORS’ AND OFFICERS’ DUTIES AND LIABILITIES¹

Sarah Ciarrocchi
Mandell Pinder LLP
December, 2015

INTRODUCTION

The information and analysis in this paper are meant for interest and informational purposes for our clients and should not be construed, or relied upon, as legal advice.

Mandell Pinder LLP is pleased to offer clients a broad range of business law services that address the needs of Aboriginal owned businesses, including establishing and structuring corporate entities, corporate governance and policy development, advice on business arrangements with industry partners, and advice on commercial and real estate transactions. We would be honoured to assist you or your Nation with implementing your economic development goals. If you have any questions relating to directors’ and officers’ liability, please contact Sarah Ciarrocchi or any of our corporate solicitors.

This paper provides an overview of directors’ and officers’ duties and liabilities. For individuals that are acting as directors, or contemplating acting as directors of corporations, understanding these duties and liabilities is good governance and helps to protect against liability, both for the corporation and personally. For First Nations that own corporations, understanding the scope of directors’ and officers’ obligations can help to ensure that businesses are set up for success.

This paper refers to the duties and liabilities of directors and officers of corporations. Readers should note that directors and officers of societies and not-for-profit corporations have similar duties and liabilities. In addition, if businesses are operated through a partnership that includes a corporate partner, the directors of that company have directors’ duties and liabilities with respect to the partnership business.

A. DIRECTOR AND OFFICER DUTIES AND LIABILITIES - CORPORATE GOVERNANCE LAW

The directors and officers of a corporation have legal duties that have arisen from the common law and been codified in corporate legislation. In British Columbia, the Business Corporations Act, SBC 2002, c 57 (“BCBCA”) and the Canada Business Corporations Act, RSC 1985, c C-44 (“CBCA”) (BCBCA and CBCA, collectively, the “Corporate Statutes”) set out numerous legal duties and liabilities that apply to directors and officers.

¹ I am grateful for the assistance of Stephen Mussell, articled student at Mandell Pinder LLP in preparing this paper.
1. The Duty to Manage

Directors have a duty to manage, or supervise the management of, the business and affairs of their corporation. Section 136(1) of the BCBCA reads as follows:

136(1) The directors of a company must, subject to this Act, the regulations and the memorandum and articles of the company, manage or supervise the management of the business and affairs of the company.

As the directors are entitled to supervise the management of the corporation, they may delegate certain management responsibilities to officers, employees or agents of the corporation. The delegation of authority does not equal a delegation of duty and directors must be diligent in both appointing and overseeing delegates. There are exceptions to this general rule. Section 137(1) of the BCBCA allows a company to transfer, in whole or in part, the powers of the directors to manage or supervise the management of the business and affairs of the company to one or more other persons, provided the transfer is set out in the articles of the company. If the powers to manage are transferred in compliance with the Corporate Statutes then the directors are relieved of their director duties and liabilities.

In a limited partnership structure it is particularly important that the directors of the general partner company are engaged in managing or overseeing the management of the partnership business and not the limited partners. This is because a limited partner that takes part in the management of the limited partnership risks losing its liability protection. Therefore, the general partner must manage the limited partnership business. For example, for First Nations that are limited partners in a limited partnership, the board of directors of the general partner company must be active in managing or overseeing the management of the limited partnership rather than Chief and Council of the First Nation.

2. The Fiduciary Duty

Directors and officers have a legal duty to “act honestly and in good faith with a view to the best interests of the corporation.” This duty, known as the fiduciary duty, is codified in section 122(1)(a) of the CBCA and section 142(1)(a) of the BCBCA. Directors and officers have a fiduciary relationship with the corporation in a similar way that trustees have a fiduciary relationship with beneficiaries, and Chief and Council have a fiduciary relationship with the Band and its members. The fiduciary duty under the Corporate Statutes requires that directors and officers:

- Act honestly and in good faith vis-à-vis the corporation;
- Respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation;
- Avoid conflicts of interest with the corporation;

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2 Section 146(5) of the CBCA allows directors powers to be transferred to shareholders in a unanimous shareholders agreement.
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- Not abuse their position for personal benefit;
- Maintain the confidentiality of information they acquire by virtue of their position; and
- Serve the corporation selflessly, honestly and loyally.³

*Canadian Aero Service Ltd v O’Malley*, [1974] SCR 592 [*Canadian Aero Service*] is one of the leading cases on the fiduciary duty of directors and officers. In this case, two senior officers (the president and vice-president) of Canadian Aero Service Limited (“Can-Aero”) were involved in developing a business opportunity for Can-Aero. The senior officers eventually resigned and started a business of their own which offered the same services as Can-Aero. The newly formed company won a contract that was substantially the same as that pursued by Can-Aero when the defendants were employed there. Can-Aero sued the former officers, arguing that they had improperly capitalized on a business opportunity which arose from the work they had completed while officers of Can-Aero. The Supreme Court found the former officers personally liable for the amount of the contract after concluding:

[The senior officers] stood in a fiduciary relationship to Canaero, which in its generality betokens loyalty, good faith and avoidance of a conflict of duty and self-interest. Descending from the generality, the fiduciary relationship goes at least this far: a director or a senior officer ... is precluded from obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested upon full disclosure of the facts), any property or business advantage either belonging to the company or for which it has been negotiating; and especially is this so where the director or officer is a participant in the negotiations on behalf of the company.⁴

(a) Duty is Owed to the Corporation

Directors and officers owe their fiduciary duty to the corporation and not to any other stakeholders, such as shareholders, creditors or employees. This principle was confirmed by the Supreme Court in *Peoples*. In *Peoples* the Supreme Court noted that when considering what is in the best interest of the corporation, directors and officers may look to the interests of shareholders, employees, creditors, consumers, governments and the environment to inform their decisions but despite this, the duty remains owed to the corporation.⁵ In a subsequent case, the Supreme Court further stated that the “best interests” of the corporation are “not confined to short-term profit or share value” but instead address the longer term interests of the corporation.⁶

As a result of the duty being owed to the corporation, the directors and officers may not prefer the interests of any one stakeholder over the other. A director needs to be careful to comply with this obligation when he or she has been appointed to represent the interests of a shareholder. For

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³ *Peoples Department Stores v Wise*, 2004 SCC 68 at para 35 [*Peoples*].
⁴ *Canadian Aero Service* at 606 and 607.
⁵ Supra note 3 at para 42.
⁶ *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560 at para 38 [*BCE*].
example, if a director has been appointed to represent a First Nation in a company or partnership that is owned by multiple First Nations or by a First Nation and a third party company, the director must act in the best interests of the corporation and not in the best interests of the particular First Nation/shareholder that appointed him or her.

For a corporation where a First Nation is the sole beneficial shareholder, the best interests of the corporation will, in many cases, be the same as the best interests of the First Nation, although there may be circumstances where the interests do not align. For this reason, when First Nations are establishing corporations, the goals of the corporation, as they relate to the interests of the First Nation, should be clearly understood and stated. This can be done by restricting business activities in the Articles, policies or other means, such as governance and management agreements.7

(b) Conflicts of Interest

The fiduciary duty requires that directors avoid conflicts of interest. Conflicts of interest include situations where a director: (1) makes decisions motivated by personal interest or interests other than the best interest of the corporation; (2) personally contracts or competes with the corporation; or (3) appropriates corporate opportunities.

Generally, directors should avoid situations where a reasonable person would think there is a risk that a director’s duty to the corporation could be adversely affected by the director’s self-interest or duty to another person, corporation or organization.

The Corporate Statutes regulate conflict of interests that arise in transactions between a company and a director or parties related to the director.8

The Corporate Statutes require that:

1. a director disclose the nature and extent of any interest in a material contract or transaction to which he or she is a party (or has a material interest in a party);
2. the interested director refrain from voting on any resolution relating to such arrangements; and
3. the transaction is approved by non-interested directors and is reasonable and fair to the corporation.

If the director fails to properly disclose the conflict, then the contract or transaction can be set aside by the court and the director required to pay back to the corporation any profit or gain realized. Section 153 of the BCBCA also specifically requires a director or senior officer to promptly disclose if he or she “holds any office or possesses any property, right or interest that could result, directly or indirectly, in the creation of a duty or interest that materially conflicts with that individual's duty or interest as a director or senior officer of the company.”

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7 For example, the Articles could contain a prohibition on any business or activities that negatively impact or have the reasonable potential to negatively impact the Aboriginal title and rights of the First Nation, or Chief and Council can set the business goals of the corporation through policy.

8 Section 120 of the CBCA and section 148 of the BCBCA.
It is not uncommon for directors to be wearing multiple hats, especially in the case of First Nation owned corporations, where directors may also be members of Council, sit on multiple boards of directors, be employees, business owners, and/or operate in small communities or communities with extensive family relations. Potential conflicts of interest are bound to arise. The key is for directors to follow the proper procedure when a conflict does arise. Directors can protect themselves from liability or from accusations of acting in a conflict of interest by promptly disclosing actual and perceived conflicts of interest and removing themselves from Board discussions and voting on the matter. Developing and implementing a clear conflict of interest policy is a key step that all Boards should take to help ensure good governance. Ongoing education of directors and officers is also key to effective management of conflicts.

3. The Duty of Care, Diligence and Skill

Directors owe a duty of care to the corporation. Re City Equitable Fire Insurance Co Ltd, [1925] 1 Ch 407 [City Equitable] is the founding case on the duty of care owed by directors and officers to the corporation. In City Equitable it was first established that directors were expected to perform their duties with a “degree of skill [that] may reasonably be expected from a person of [their] knowledge and experience.” Further, it was held that a director is not required to give continuous attention to the affairs of the corporation, and that a director is entitled to rely on the corporation’s officers in the absence of grounds for suspicion.

The duty of care now codified in section 142(1)(b) of the BCBCA and section 122(1)(b) of the CBCA increases the standard of care set out in City Equitable. The Corporate Statutes state that when exercising the powers and performing the functions of a director or officer, a director or officer “must exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances.” In Peoples, the Supreme Court of Canada held that the standard of care under the Corporate Statutes is an objective one. This standard requires an inexperienced director to rise to the level of a reasonably prudent person, and holds a director with some special skill or knowledge (such as a lawyer) to the standard of a reasonably prudent person with that special skill. The duty requires directors and officers to be prepared for and attend meetings, make informed and reasoned decisions in light of all the circumstances about which they knew or ought to have known, obtain outside expertise when needed, and generally maintain adequate oversight over the corporation.

Unlike the fiduciary duty (duty of loyalty) as discussed above, in Peoples, the Supreme Court noted that directors and officers owe a duty of care not only to the corporation, but to all stakeholders including employees, suppliers, creditors, governments and the environment. A breach of the statutory duty of care does not provide a third party with an independent foundation for a claim against a director. However, it is relevant to the assessment of the standard of behaviour that should reasonably be expected of a director and is therefore relevant where a director (or Board) is sued in tort (i.e. with respect to negligence) or under the oppression remedy (see subsection 4 below).  

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9 Supra note 6.
(a) **The Business Judgment Rule**

Under the “business judgment rule,” Courts give deference to a business decision made by a director or officer provided it lies within a range of reasonable alternatives. This is based on the premise that directors and officers are better situated to make decisions relating to their corporation than courts and therefore a court should be hesitant to substitute its opinion for that of a director or officer. The Supreme Court, in *Peoples* and *BCE*, confirmed that a court will look to see that the director or officer has made a decision that falls within a range of reasonable alternatives but that perfection is not required. The Supreme Court also confirmed that the fact that a decision led to a poor result does not mean that the director breached his or her duty of care as long as the decision was within the range of reasonable alternatives at the time it was made.

(b) **Delegation and Reliance on Officers and Professionals**

While directors and officers are entitled to delegate duties to managers and others, they retain the obligation of ensuring that their duties are fulfilled either directly through their own actions, or indirectly through proper oversight. Directors must retain ultimate control over the corporation and ensure that it is being managed appropriately. This requires that directors keep themselves sufficiently apprised of the affairs of the corporation. In addition, they must exercise care in ensuring those delegates are competent. If they have, the generally accepted proposition is that a director is, in the absence of grounds for suspicion, justified in trusting an official with delegated authority to perform such duties honestly.

The Corporate Statutes specifically provide that directors are not liable for breaches if they have reasonably relied on information from an officer or other professionals in making directors decisions. This provision recognizes that the directors cannot be expected to have all the skills and expertise necessary to manage or oversee the management of a business and must rely on officers and professionals. Section 157 of the *BCBCA* provides that a director is not liable if the director relied, in good faith, on:

(a) financial statements of the company represented to the director by an officer of the company or in a written report of the auditor of the company to fairly reflect the financial position of the company,

(b) a written report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by that person, or

(c) a statement of fact represented to the director by an officer of the company to be correct

4. **Liability for Oppression**

Section 227 of the *BCBCA* allows a shareholder or “any other person whom the court considers to be an appropriate person” to apply to court for a remedy if there has been “oppressive” or “unfairly prejudicial” conduct. The *CBCA* contains the same remedy but also provides relief for conduct which “unfairly disregards” a complainants interest. Shareholders have the right to apply for this remedy but creditors or others may be found to be “appropriate” persons by the court.
The courts have established that oppressive or unfairly prejudicial conduct, or conduct which unfairly disregards a complainant’s interest, is conduct which violates reasonable expectations or discriminates without a legitimate business purpose. Oppression has been found in a wide range of situations including, the refusal to hold an annual general meeting,\(^{10}\) the company making contracts with entities related to a shareholder or directors,\(^{11}\) and excluding a shareholder from corporate management where the shareholder has a reasonable expectation of involvement.\(^{12}\) The oppression remedy is an equitable remedy that gives the court “broad, equitable jurisdiction to enforce not just what is legal but what is fair”.\(^{13}\) The Corporate Statutes allow the court wide discretion to grant any order it thinks appropriate, including prohibiting certain actions, appointing new directors to replace existing directors, setting aside a transaction, ordering compensation, requiring the trial of any issue, or any other order it considers appropriate.

Directors’ duties are relevant to the oppression remedy because the reasonable expectations of the stakeholders (shareholder, creditors) are that the directors will fulfill their fiduciary duty and duty of care.\(^{14}\) In certain circumstances directors may be personally liable for oppressive and unfairly prejudicial conduct. In *Budd v Gentra Inc*, [1998] OJ No 3109 (ONCA) the Ontario Court of Appeal set out the following factors to consider in determining whether a director should be personally liable for oppression:

- whether the director or officer gained a personal benefit from causing the corporation to act oppressively or unfairly prejudicially;
- whether the director or officer furthered his or her control of the corporation through the oppression; and
- whether the corporation is closely held, as that director or officer is more likely to have “total control” of the company.

5. **Other Liability Under the Corporate Statutes**

The Corporate Statutes require directors and officers to manage the corporation in compliance with the applicable Corporate Statute and in compliance with the articles or memorandum of the corporation. In addition, section 154 of the *BCBCA* and section 118 of the *CBCA* make directors personally liable for approving certain corporate actions. These include the following actions by the company:

- paying a dividend, or purchasing or redeeming shares in the company if the company is insolvent, or the payment would render the company insolvent;
- providing an indemnity if the director was not acting in good faith or the indemnity is otherwise not permitted under the applicable Corporate Statute;

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12 *Saarnok-Vuus v Teng*, 2003 BCSC 235 (CanLII).
13 *Supra* note 6 at para 58.
14 See *Peoples* and *BCE*. 
• carrying on any business or exercising any power that it is restricted by its memorandum or articles from carrying on or exercising, as a result of which the company has paid compensation to any person; and

• issuing a share that has not been fully paid for.

Section 119 of the CBCA also provides that directors are liable to employees of the corporation for all debts not exceeding six months wages for services performed for the corporation. The directors can be held liable under this section if the debt owing by the corporation cannot be recovered or the company is in the process of dissolving. For companies incorporated under the BCBCA, the Employment Standards Act, RSBC 1996, c 113 provides for similar liability.

6. Liabilities Survive Dissolution

If a corporation is dissolved the liabilities of its directors and officers remain. Section 347 of the BCBCA provides that the “liability of each director [and] officer ...of a company that is dissolved continues and may be enforced as if the company had not been dissolved.” As is discussed in Part B below, directors and officers are at a higher risk of personal liability for a corporation’s failure to remit taxes and other amounts when the corporation is dissolved.

7. Indemnification and Insurance

The Corporate Statutes allow a corporation to indemnify a person for reasonable expenses incurred for civil, criminal, administrative, investigative or other proceeding that arise as a result of the person being or having been a director or officer of the corporation. A director or officer has a right to indemnification if he or she is successful in the outcome of the legal proceeding. However, a corporation is prohibited from indemnifying a director or officer if:

• the director or officer did not act honestly and in good faith with a view to the best interests of the company;

• in the case of a legal proceeding other than a civil proceeding, the director or officer did not have reasonable grounds for believing that the his or her conduct was lawful; or

• the proceeding is brought against the director or officer by or on behalf of the company.

The Corporate Statutes also permit a corporation to purchase and maintain insurance for directors and officers against any liability that may be incurred by reason of being or having been a director or officer. Insurance is subject to the limitations on indemnification. Individuals that are directors or contemplating being directors should ask whether there is directors’ insurance in place and whether there is an indemnity agreement.

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15 Subject to the Limitation Act, SBC 2012, c 13.
16 See CBCA section 124 and BCBCA Division 5.
17 The CBCA allows indemnification if there is a court order approving the indemnity.
18 See CBCA section 124(6) and BCBCA section 165.
8. Recent BC Case Law Examples

Examples of some recent British Columbia cases are summarized below to help illustrate directors’ and officers’ duties and liabilities under the corporate governance statutes.

(a) Kamloops-Cariboo Regional Immigrants Society v Herman, 2015 BCSC 886

In *Kamloops-Cariboo Regional Immigrants Society v Herman*, the court looked at the fiduciary duty of an executive director in the context of disputes between the board of directors and the employees. The plaintiff society (the “Society”) was a not-for-profit society and registered charity incorporated pursuant to the *Society Act*, RSBC 1996, c 433. The day-to-day operations were managed by an executive director. The executive director was directly accountable to the Board and was also a member of the Board.

The respondent, Mrs. Herman, was employed as executive director of the Society. During her tenure as executive director, several employees of the Society had a tumultuous relationship with the Board, resulting in employees taking medical leave for stress, accusations of mistreatment and harassment from the Board members, and the filing of complaints with the BC Human Rights Tribunal. Mrs. Herman herself also had an uneasy relationship with the Board and had filed a complaint with the Human Rights Tribunal. The stress eventually led Mrs. Herman to take sick leave as well.

While on sick leave, Mrs. Herman was approached by a number of employees of the Society who asked her to return to her position as the situation with the Board was worsening. In response, Mrs. Herman formed a committee with a number of her employees. It was not disputed that the intent of the committee was to remove and replace or “overthrow” the Board. The Board accused Mrs. Herman of breaching her fiduciary duties through her biased hiring practices, her complaints to the Human Rights Tribunal, and through the formation of the committee with the intent of “overthrowing” the Board.

The court held that under s. 25 of the *Society Act*, Mrs. Herman (as an officer and director) did indeed owe a fiduciary duty to the Society and was under a duty to act honestly and in good faith in the Society’s best interests. Regarding Mrs. Herman’s hiring practices, the court found that Mrs. Herman had little or no discretion in setting employee salaries and that there was little evidence Mrs. Herman’s hiring of family members (her daughter-in-law) was not legitimate. Further, regarding Mrs. Herman’s complaints to the Human Rights Tribunal, Mrs. Herman was merely exercising her right to file a complaint. Accordingly, the court concluded that Mrs. Herman was not in breach of her fiduciary duty with respect to those issues.

Regarding the allegation that Mrs. Herman had breached her fiduciary duty by forming a committee with the intent of “overthrowing” the Board, the Board argued that Mrs. Herman owed a fiduciary duty to the Society and not its employees. Therefore, the Board asserted, it was not her role to represent the employees to the detriment of the Society as whole.

The court found that Mrs. Herman had not acted in malice or self-interest to fulfill a personal vendetta against the Board by establishing the committee. Mrs. Herman established the committee as she perceived the Society was at risk from the Board’s actions, and her actions were taken in an...
attempt to protect the Society from that risk. Finally, Mrs. Herman’s attempts to protect employees of the Society and to listen to their complaints were found to be in the Society’s interest. The court noted that a not-for-profit cannot run efficiently and for its charitable purpose without employees. The court concluded that Mrs. Herman had acted in compliance with her duty to the Society and was not in breach of her fiduciary duties.

(b) *Geocomp Data Management Inc. v International PBX Ventures Ltd, 2015 BCSC 302*

In *Geocomp Data Management Inc. v International PBX Ventures Ltd* the Court looked at breach of fiduciary duty in the context of a director contracting with the company. Mr. Sookochoff owned and controlled Geocomp Data Management Inc. (“Geocomp”) and also acted as a director and the Chief Executive Officer of International PBX Ventures Ltd. (“PBX”). Geocomp entered into a services contract with PBX to provide management services to PBX. Mr. Sookochoff disclosed his interest in both Geocomp and PBX and also abstained from voting on the resolutions of the PBX board that approved PBX’s services contract with Geocomp.

Geocomp’s contract with PBX expired and Mr. Sookochoff, despite having knowledge, failed to inform anyone from PBX of the contract’s expiration. Geocomp continued to perform its services and to bill PBX for those services. In time, PBX fell into significant financial difficulty. As a result, employees of PBX voluntarily took a number of pay cuts and emergency funding was requested in order to keep PBX afloat. In addition, PBX passed a unanimous resolution (which Mr. Sookochoff participated in) to not enter into any management or employment contracts without specific approval of the directors. PBX’s financial situation eventually deteriorated to the point where it was effectively insolvent. Throughout PBX’s difficulties, Mr. Sookochoff never disclosed the fact that PBX’s contract with Geocomp had expired, and continued to accept full remuneration from PBX through Geocomp.

The court noted that as director and Chief Executive Officer of PBX Mr. Sookochoff owed PBX a duty to act honestly and in good faith with a view to the best interests of the company under s. 142(1)(a) of the *BCBCA*. In addition, under s. 147 of the *BCBCA* Mr. Sookochoff held a disclosable interest as he had a “material interest in the contract or transaction” that took place between Geocomp and PBX. The court further noted that Mr. Sookochoff also owed PBX a duty of loyalty to put the interests of PBX above his own.

The court held that when Mr. Sookochoff became aware that Geocomp’s contract had expired with PBX, he was required to disclose this fact to PBX’s board and to seek the board’s approval for any continuation of remuneration. In failing to do so Mr. Sookochoff was in breach of his fiduciary duties of loyalty and avoidance of conflict of interest. In addition, in the court’s view, as PBX’s financial position deteriorated Mr. Sookochoff had a heightened duty of disclosure. Further, Mr. Sookochoff must have known that PBX would not have renewed their contract with Geocomp given his position and his involvement in PBX’s unanimous resolution discussed above. The court concluded that Mr. Sookochoff’s failure to disclose the expiration of Geocomp’s contract with PBX when he knew PBX was in significant financial distress constituted a breach of his fiduciary duties of good faith, honesty and loyalty to PBX. As a result, Mr. Sookochoff was ordered to pay PBX restitution in the amount of $81,600.
(c) Bougainville Investment Corp v Semple, 2013 BCSC 1919

In Bougainville Investment Corp v Semple, the court sought to determine whether a director and officer of a corporation was in breach of his duties to the corporation by making a payment without formal board approval. Mr. Semple was the former director, president and chief executive officer of Bougainville Investment Corp. (“BIC”). BIC was incorporated with the intention of securing mining rights on the island of Bougainville, an autonomous region in Papua New Guinea.

BIC’s business model was described as being “high-risk” and relied heavily upon gaining social license with the people and the government of Bougainville. In an attempt to gain this social license, BIC invested heavily in a number of projects including building a communications centre, a biodiesel program, facilitating the growth of the fishing industry, and a number of other undertakings.

BIC was run in a highly informal manner despite dealing with millions of dollars. Meetings in which all board members were available were rare, communication between officers and board members mostly took place by email, and board approval was often tacit with no votes being taken or set process in place. For the most part, Mr. Semple was given significant latitude given his vast experience and familiarity with Bougainville.

Mr. Semple eventually came upon the idea of beginning a cattle project on Bougainville. Cattle and the infrastructure needed for raising cattle would be purchased, and the project would eventually be turned over to Bougainville as a self-sustaining industry. In order to get the cattle project off the ground, Mr. Semple requested some $175,000 from the board. He made the proposal through a number of emails to the board including one heavily detailed email in which Mr. Semple explained how preliminary preparations were progressing and contained full details of the cattle project. He also took pains to emphasize that he had not lost sight of BIC’s ultimate goals on Bougainville and that he believed the cattle project to be in furtherance of BIC’s main objective. In addition to this critical email, a number of other emails were exchanged that discussed the progression of the cattle project and outlined the costs required for it. These emails were sent to all board members excepting those who proved notoriously hard to contact. None of the board members expressed concern with the project and Mr. Semple eventually transferred the payment of $175,000 to his contacts on Bougainville who took steps to implement the cattle project. The board eventually confronted Mr. Semple on this payment, claiming that he had wrongfully caused the transfer of the funds without board approval.

The court noted that Mr. Semple owed a common law duty and statutory fiduciary duty to BIC under section 142 of the BCBCA. This duty required that Mr. Semple act honestly and in good faith vis-à-vis the corporation and to respect the trust and confidence that had been reposed in him to manage the assets of the corporation in pursuit of the realization of the objects of the corporation.

The court concluded that Mr. Semple was not in breach of his statutory and common law duties. Rather, he had acted at all times honestly and in good faith with a view to furthering the interests of BIC. He was explicit in stating that he had not lost sight of BIC’s ultimate goals, and the court found that the cattle project was consistent with BIC’s strategy on Bougainville. In addition, he did not divert any of the funds for his own purposes nor did he arrange for a third party to improperly profit from the expenditures. Further, given BIC’s informal procedures and processes Mr. Semple clearly
had a reasonably held belief that he had the approval of the board. At no time did any of the
members of the board express that they were against the cattle project despite being made well
aware of it through Mr. Semple’s communications with them.

(d) Mikulic v Peter, 2013 BCSC 941

In Mikulic v Peter, the court addressed, among other things, the reliance of one director on another
director to make business decisions for a company. Ms. Mikulic and Mr. Peter were both 50%
shareholders and the only directors in Island Gateway Corp. (“Island Gateway”). Both Ms. Mikulic
and Mr. Peter agreed, at the time of incorporation, that they would each have to consent to
corporate investments. Ms. Mikulic accused Mr. Peter of entering into a number of bad investments
that cost Island Gateway a significant sum of money. While Ms. Mikulic was aware of the
transactions, she argued that she had relied upon representations made by Mr. Peter. Ms. Mikulic
attempted to bring a derivative action against Mr. Peter for the loss in value of her shares. A
derivative action is an action brought by a person on behalf of the company.

As part of the court’s assessment of whether or not Ms. Mikulic’s derivative action would have a
reasonable chance of success, the court touched on duties owed by directors and officers. First, the
court noted that a derivative action is based on losses caused by the director through investment or
other decisions and that there must be some allegation, with reasonable particulars, of how the
director fell below the duty of care, diligence and skill set out in s. 142(1)(b) of the BCBCA. It was
not enough for Ms. Mikulic to allege that Island Gateway had lost money on certain investments.
Ms. Mikulic needed to show that the investments were imprudent or recognizably bad ones at the
time they were made.

Second, the court noted that Ms. Mikulic, as director, had the same duty of care as Mr. Peter. The
court found that Ms. Mikulic could not be relieved of this duty by simply stating she had relied upon
Mr. Peter’s representations. Given the factual matrix, Ms. Mikulic could very well have been in
breach of her duties as well. As a result, the court concluded that Ms. Mikulic could not commence
a derivative action against Mr. Peter.

B. OTHER STATUTORY SOURCES OF DIRECTORS’ AND OFFICERS’ LIABILITY

1. Overview

There are numerous (over 100) federal and provincial statutes that hold directors and officers
personally liable for a corporation’s failure to meet statutory obligations in certain circumstances.
Directors should make themselves aware of the specific laws that apply to their business operations
and have systems and procedures in place to ensure compliance.

Some common areas of director and officer liability risk include compliance with federal and
provincial income tax and goods and services tax laws, employment insurance and Canada pension
plan requirements for employees, employee wages, and compliance with occupational health and
safety and environmental laws. Examples of statutes that provide for the personal liability of
directors include the following:


• *Canada Pension Plan*, RSC 1985, c C-8.


• *Tobacco Tax Act*, RSBC 1996, c 452.


• *Workers Compensation Act*, RSBC 1996, c 462.

• *Canadian Environmental Protection Act, 1999*, SC 1999, c 33.

• *Environmental Management Act*, SBC 2003, c 53.

• *Securities Act*, RSBC 1996, c 418.

• *Criminal Code*, RSC 1985, c C-46.

Statutory provisions holding directors personally liable tend to be what are commonly referred to as “strict liability” offences. Strict liability offences only require that the accused caused the offence through his or her actions or omissions. However, directors and officers can prevent liability for a strict liability offence if they are able to prove that they exercised due diligence to prevent the offence. Directors and officers should be aware that no director or officer is exempt from the obligation to take steps to ensure that the corporation meets its statutory duties.19 The subsections below discuss directors’ and officer liability related to federal tax and employee deductions and environmental laws.

2. **Federal Tax Liability**

If the Canada Revenue Agency (CRA) is unable to collect amounts owing from a business under the *Income Tax Act*, the *Excise Tax Act*, the *Canada Pension Plan*, or the *Employment Insurance Act* then it can look to the directors to recover these amounts, including penalties and interest. An individual may be held personally liable if he or she was a director at the time the corporation was required to deduct, remit or pay under the applicable act, and is a current director or has acted as a director within the previous two (2) years. Directors can avoid liability by proving that they “exercised the

19 See *R v A-1 Mushroom Substratum Ltd*, 2011 BCPC 458 where the British Columbia Provincial Court noted that even silent or non-participating directors and officers (those not involved in the daily operations of the corporation) can be held liable under the *Workers Compensation Act*. 
degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."\textsuperscript{20}

In *Buckingham v R*, 2011 FCA 142 the Federal Court of Appeal considered the “due diligence” defence raised by a former director of several related corporations for the failure to make employee source deductions under the *Income Tax Act, Canada Pension Plan, and Employment Insurance Act* and for failure to make GST/HST remittances under the *Excise Tax Act*. The business had run into financial difficulties and had eventually ceased operations. The corporations had taken a number of unsuccessful steps to keep the business operating, including attempting to secure additional funding and reducing expenditures. When these steps didn’t work the corporations attempted to sell the business assets and part of the business in order to pay creditors (including the remittances owed to CRA) but this was also not successful.

The Court held that the due diligence defence under the statutes at issue was an objective standard as the SCC explained in *Peoples*. As a result, a director or officer will not be judged according to his/her own personal skills, knowledge, abilities and capacities. Rather, the directors’/officers’ personal circumstances will be measured against what a reasonably prudent person would have done in the same circumstances.

The former director argued that if a director can demonstrate her or she has made serious and reasonable efforts to resolve the financial difficulties of the corporation then the standard of the due diligence defence is met. The Court held that the due diligence defence under the Acts required the director’s diligence to prevent the failure to remit rather than to correct a failure to remit after the fact. In this case, the corporations had diverted tax remittances in order to pay other creditors and ensure the continued operation of the business. The Court accepted that the director had a reasonable expectation that the sale of the business assets could result in a large payment which could be used to satisfy creditors, including the Crown. However, this plan did not meet the due diligence standard because he continued operations knowing that employee source deductions and GST would not be remitted. As a result, he consciously transferred part of the risks associated with the sale transaction to the Crown instead of taking steps to prevent the failure to make remittances before it occurred. The Court found the former director personally liable for amounts owing to CRA.

(a) **Section 87 of the Indian Act**

Directors of a business with employees that claim income tax exemptions under section 87 of the *Indian Act*, RSC 1985 c I-5 have personal liability for failing to withhold income tax if the exemption does not apply in the circumstances (and CRA is unable to recover against the corporation). Section 87 of the *Indian Act* states:

87. (1) Notwithstanding any other act of Parliament or any act of the legislature of a province, but subject to section 83 and section 5 of the *First Nations Fiscal Management Act*, the following property is exempt from taxation:...

b) the personal property of an Indian or a band situated on a reserve.

\textsuperscript{20} Section 227.1(3) of the *Income Tax Act* (Canada)
Under this section, employees who are status Indians may be exempt from income tax if the income is situated on reserve. As a result, their employer would be under no obligation to withhold and/or remit that employee’s income tax. If, however, the employer is mistaken and the employee should be having income tax withheld and/or remitted, the directors and officers of that corporation may expose themselves to personal liability for those outstanding tax amounts.

The analysis under section 87 of whether income is “situated on reserve” is fact specific and needs to be undertaken for each employee and when circumstances change. It is of the utmost importance that employers be familiar with the law as it relates to section 87 so as to not unduly expose themselves to liability under the Income Tax Act by failing to withhold and/or remit income tax in a situation that warrants it by law. Directors should take all reasonable steps to ensure that they can demonstrate due diligence on this matter.

3. Environmental Liability

Directors and officers may be held liable for environmental offences committed by a corporation which is under their management and supervision. Liability is imposed through various federal and provincial statutes such as the Canadian Environmental Protection Act, 1999 SC 1999, c 33 s 280(1) and the Environmental Management Act, SBC 2003, c 53 s 121. Convictions for environmental offences can result in significant penalties and fines, as well as prison sentences. For environmental offences that are strict liability offences, the defence of due diligence is available to directors.

One of the leading cases in Canada addressing the due diligence defence for directors’ environmental liability remains the Ontario Court of Justice’s decision in R v Bata Industries Ltd, [1992] OJ No 236, [Bata]. In Bata, an officer and a director of Bata Industries Ltd. were convicted of an offence under the Ontario Water Resources Act, RSO 1990, c O40 for causing or permitting the discharge of liquid industrial waste and ordered to pay a fine. The evidence showed that waste storage containers on the site of the company’s shoe factory had leaked industrial waste.

The Court found that the defendants could not establish a due diligence defence because they could not show that they exercised all reasonable care to establish a proper system to prevent the commission of the offence and to take reasonable steps to ensure the effective operation of the system. In assessing the defence of due diligence, the Court listed the following questions to consider with respect to the due diligence of directors:

(1) Did the board of directors establish a pollution prevention system? Was there supervision or inspection? Was there improvement in business methods?

(2) Did each director ensure that the corporate officers were instructed to set up a system sufficient within the terms and practices of its industry of ensuring compliance with environmental laws, to ensure that the officers report back periodically to the Board on the operation of the system, and to ensure that the officers had been instructed to report any substantial non-compliance to the Board in a timely manner?

The Court further noted that:
(1) The directors are responsible for reviewing the environmental compliance reports provided by the officers of the corporation, but are justified in placing reasonable reliance on reports provided to them by the corporate officers, consultants, counsel or other informed parties.

(2) The directors should substantiate that the officers are promptly addressing environmental concerns brought to their attention by government agencies or other concerned parties including the shareholders.

(3) The directors should be aware of the standards of their industry and other industries which deal with similar environmental pollutants or risks.

(4) The directors should immediately and personally react when they have been given notice that the system has failed.

A more recent example of director environmental liability that has caused concern for directors is the Ontario Environmental Review Tribunal case of Baker v Ministry of the Environment, 2013 ONSC 4142 [Baker]. In Baker the Ontario Divisional Court upheld the decision of the Ontario Environmental Review Tribunal that refused to stay an order issued by the Ontario Ministry of Environment against former directors and officers of Northstar Aerospace, Inc. (the “Company”) and its parent, Northstar Aerospace (Canada) Inc. The former directors and officers were ordered to pay for remediation of contamination at the Company’s former aircraft parts manufacturing and processing site. The contamination resulted from manufacturing activities at the site from 1981 to 2009 and the migration of industrial chemicals from the site to nearby residential properties.

The Company had voluntarily commenced remediation activities in 2004 when it discovered contamination. When the Company ran into financial difficulties and filed for bankruptcy, it abandoned the remediation work. The accused directors were not directors at the time the operations caused the contamination. However, the Ministry of Environment asserted that the directors and officers had management and control of the site and remediation systems making them liable for the costs of the remediation. The directors and officers refuted liability on a number of fronts, but the issue was settled before liability could be established in court. The directors and officers agreed to pay a total of $4.75 million in exchange for the Ministry of Environment dropping their order.21 This case warns that regulators may seek to find directors and officers liable for remediation costs where a company is no longer able to finance remediation work, even where the directors and officers were not involved in the decision-making that led to the contamination.

C. LIABILITY UNDER TORT LAW

Directors and officers may be personally liable to third parties under tort law. While a director is clearly liable for his or her own tortious conduct (i.e. negligence and fraud), a director may be protected from liability for tortious conduct he or she undertakes while acting on behalf of the

21 On Oct. 28, 2013, The Globe and Mail reported that a group of former directors and officers of Northstar Aerospace Inc. had reached a settlement with the Ontario Ministry of the Environment regarding the Ministry’s order holding them personally responsible for a $15-million cleanup of a polluted parcel land that will result in the former directors and officers providing $4.75-million to cover environmental remediation at the former Northstar Aerospace site in Ontario.
corporation. *Said v Butt* [1920] 3 KB 497 established an exception to personal liability for directors for inducing breach of contract by the company provided a director is acting within the scope of his or her authority and acting in good faith. This means that if the company breaches a contract, a third party can sue the company for breach of contract but the directors cannot be sued personally for the tort of inducing breach of contract.

Other than the exception in *Said v Butt*, the personal liability of directors for tortious conduct they caused the corporation to undertake (for example, defamation, and negligent misrepresentation) is an unsettled area of law in Canada. In Ontario there is case law that says that directors and officers may be personally liable even if they are promoting the corporation’s interest and not their self-interest.\(^\text{22}\) In BC the case law suggests that directors and officers are protected from personal liability if they are acting on behalf of the corporation and within the scope of their authority.\(^\text{23}\) Directors and officers should consider potential tort liability when they are reviewing their directors’ and officers’ liability insurance.

**D. PROTECTION AGAINST DIRECTOR AND OFFICER LIABILITY RISKS**

There are a number of steps that companies can take to help directors and officers fulfill their duties, ensure good governance, and avoid liability risks.

1. **Director Due Diligence - Individual and Collectively**

Directors and Boards can take a number of practical steps to assist with compliance of director duties. These include the following:

- Hold regular board meetings;
- Be prepared for and attend meetings;
- Keep meeting minutes and clearly document decision-making;
- Be familiar with governance documents, including the *BCBCA* or *CBCA*, Articles of the company, and shareholders and partnership agreements (where applicable);
- Ask questions and seek appropriate professional advice when needed;
- Carefully choose and maintain oversight of delegates such as officers and others with key positions;
- Be aware of the laws that apply to the corporation and ensure that appropriate compliance and monitoring systems and adequate insurance is in place; and
- Provide board orientation for new directors.

\(^\text{22}\) see *ADGA Systems International Ltd v Valcom* (1999), 43 OR (3d) 101.

\(^\text{23}\) see *Merit Consultants International Ltd v Chandler*, 2014 BCCA 121.
2. Corporate Governance and Operational Policies

Establishing and implementing appropriate governance and operational policies can help directors and officers meet their duties. Some key governance policies include:

- Conflicts of interest policy;
- Directors code of conduct (this would include meeting attendance and confidentiality);
- Roles and responsibilities of officers and senior staff (this would include reporting to directors and financial management); and
- Human resources policies (if there are employees).

Depending on the business undertaken by the corporation, there will be key operational policies that should be in place. For example, if the corporation is operating a gas station then a policy or policies to ensure and monitor compliance with environmental laws should be required.

3. Directors’ and Officers’ Insurance

Purchasing and maintaining directors’ and officers’ liability insurance is an important step that corporations can take to help protect directors and officers. As noted in Part A(7) above the Corporate Statutes specifically allow corporations to purchase insurance for its directors and officers. Directors and officers should ask to be insured and should be aware of the exclusions that apply to their policy coverage.

4. Indemnity Agreement from the Company

Another step corporations can take to protect directors and officers is to enter into an agreement to provide an indemnity for liabilities incurred in the performance of their duties. In the alternative the Articles of a company could include a deemed indemnity agreement between the company and the directors. As set out in Part A(7) above the Corporate Statutes provide for mandatory indemnification in certain circumstances, and permit and prohibit indemnification in other circumstances. The obvious weakness of an indemnity is that it does not provide any protection during times that a company does not have adequate assets.