

**DIRECTORS' AND OFFICERS'  
LIABILITY BEST PRACTICES  
GUIDELINES**

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## INTRODUCTION

A continuing challenge to all business is the efficient functioning of boards of directors. The major discipline provided by the legal system to accomplish this is directors' liability. With statutory liability from more than 100 separate pieces of legislation in Canada as well as civil liability, today's directors and corporate officers live with the constant threat of personal liability. While there is no substitute for the proper exercise of good business judgment, there are structural and procedural steps that can be taken by boards of directors and corporations to minimize and appropriately manage actual and potential liabilities of directors and officers. Miller Thomson LLP has developed best practices guidelines to assist corporations and their directors and officers in this process. The best practices guidelines are intended as a general guide to handling a number of issues that arise in relation to minimising potentially costly and distracting directors' and officers' liabilities. They are not intended as and cannot substitute for specific legal advice relating to particular liability matters.

## CORPORATE ARTICLES

- **Choice of Jurisdiction** – While broadly similar in most areas, there are differences in corporate statutes that can directly affect directors' and officers' liability. For example, while both the Ontario and the federal business corporations statutes now provide that directors and officers may be indemnified against any liability incurred in the individual's capacity as a director or officer, the formulation of the defences available to a director or officer including the due diligence defence is different in the different statutes. For example, the federal, Alberta and British Columbia legislation does not qualify financial statements that may be relied on by directors and officers as prepared according to generally accepted accounting principles but the Ontario legislation does. Of particular note

in regard to directors' and officers' liability are the provisions of Québec legislation governing companies which provides, in contrast to the corporate statutes referred to above, that a company must (not "may") assume the defence of liability claims against its directors and officers and pay damages, if any, unless the officer or director has committed a grievous offence or a personal offence separable from the exercise of his duties.

- **Special Provisions** - One of the risks of being a director or officer is that liability protection can be removed by the unilateral action of the corporation. Including directors' and officers' indemnification provisions in the articles of a corporation makes this more difficult as no change can be made until shareholders have voted on the matter. In contrast, by-law indemnification provisions can be amended with immediate effect subject to shareholder ratification at a later date.

## CORPORATE BY-LAWS

- **Indemnity Provision** – Both corporate by-laws as well as the articles may contain detailed indemnity provisions for the benefit of directors and officers and former directors and officers. Such indemnification provisions should operate in conjunction with the relevant statutory provisions and should, in proper cases, provide for indemnification in circumstances not explicitly authorized by statute.
- **Mandatory Indemnification** – If the statutory requirements for indemnification are met, corporate by-laws should provide for indemnification beyond the statutory minimum to directors and officers and former directors and officers as of right.
- **Expansion and Clarification of Defined Terms** – The indemnification provisions of corporate by-laws should specifically expand and define the statutory terms "costs, charges and expenses" to ensure that they are effective and functional. In particular, they must address coverage concerns that arise from decided legal cases.
- **Independent Advice** – Corporate by-laws should provide specifically for directors and officers to have access to independent legal advice in respect of their liabilities or potential liabilities

and to be indemnified for the cost of such advice.

- **Mandatory Directors' and Officers' Insurance** – Corporate by-laws should stipulate that the corporation obtain and keep in place appropriate directors' and officers' insurance.
- **Independent Chair** – In circumstances such as directors' and officers' indemnification where the interests of corporations and their directors and officers may diverge, it is often useful to have an independent chair for the board of directors. Accordingly, the by-laws should make provision for the appointment of an independent chairman at the request of the independent directors on the board.

### CONTRACTUAL INDEMNITIES

- **Individual Indemnification** – Each director and officer should receive a contractual indemnity from the corporation. The contractual indemnity should be fully integrated with the indemnification provisions of the corporation's by-laws.
- **Affiliated Corporations** – Where a corporation is not the controlling corporation or most credit worthy member of the corporate group, directors and officers of the controlled corporation should be indemnified by these corporations as well as by the corporation for which they are directors or officers. Either an additional contractual indemnity or a guarantee of the original contractual indemnity can be used.
- **Amplification of "Costs, Charges and Expenses"** – The individual indemnification in favour of each director and officer should contain amplification of the statutory terms "costs, charges and expenses" as provided in a corporation's by-laws.
- **Amplification of Proceedings Covered** – The individual indemnity in favour of each director and officer should provide protection to the director or officer in respect of all investigations, enquiries and hearings, whether or not charges are laid.
- **Individual Defence** – Each director and officer should have the right to defend himself or herself individually from any proceedings in which liability may arise and to be compensated for costs incurred in such defence.

- **Individual Counsel** – The contractual indemnity should provide each director and officer with the right to retain individual counsel at the expense of the corporation.
- **Advances of Costs** – The officers' and directors' contractual indemnification should provide for advances of defence costs to indemnified directors and officers on an "as-incurred" basis.
- **Integration of Indemnity** – The officers' and directors' contractual indemnity should be fully integrated with the directors' and officers' insurance coverage that is actually obtained and in place. This may necessitate periodic amendments to the indemnities if the directors' and officers' insurance coverage changes.
- **Dispute Resolution** – The officers' and directors' contractual indemnification should include a dispute resolution clause providing for binding arbitration.
- **Survival after Resignation** – The contractual indemnification as well as the corresponding by-law provisions affording protection to any director or officer should continue to operate after the director has left the board or the officer has resigned.

### DIRECTORS' AND OFFICERS' INSURANCE COVERAGE

- **Policy Review** – While directors' and officers' insurance is offered by a limited number of insurers, there is no uniformity of terms and each policy must be carefully reviewed in its particular context. Reviews can be conducted by an insurance broker and/or legal counsel.
- **Multiple Policies** – The need for proper policy review is compounded where coverages are obtained from more than one insurer and combined in "towers" to achieve desired coverage limits.
- **Individual Copies** – Directors and officers should each be provided with complete and updated copies of the applicable directors' and officers' insurance policies.
- **Extended Discovery** – Directors' and officers' insurance coverage should include an extended discovery period provision.
- **Breach of Fiduciary Duty Cover** – Where statutory provisions permit, breach of fiduciary

duty coverage should be included in the directors' and officers' insurance.

- **Severability** – The directors' and officers' insurance coverage should be fully severable in order to ring fence coverage that is void or voidable by reason of breach of warranty by the insured corporation or any director or officer.
- **Cover for Directors** – Directors' and officers' coverage should include direct indemnities to directors for losses or consequences of wrongful acts for which the directors or officers are not indemnified by the corporation.
- **Cover for the Corporation** – The directors' and officers' insurance policy should indemnify the corporation for amounts for which it is in turn required to indemnify its directors and officers under their contractual indemnities.
- **Cover for Appointed Directors** – The directors' and officers' cover should apply to all directors regardless of whether they have been elected or appointed as, for example, occurs when a vacancy is filled between shareholder meetings.
- **De facto Directors and Officers** – The directors' and officers' insurance coverage should cover persons who are *de facto* directors or officers, i.e., exercise similar authority to directors and officers with respect to the corporation or another specified entity.
- **Directors and Officers of Subsidiaries** – The directors' and officers' insurance coverage should provide automatic cover for directors and officers of all subsidiaries of the corporation effective from the time of acquisition of such subsidiaries without other formality.
- **Appropriate Deductible** – The appropriate deductible in any circumstance will depend on the availability of coverage in the market as well as the corporation's own liquidity. It should be reviewed at least annually.
- **Separate Loss Provision** – The directors' and officers' insurance coverage should include a separate loss provision.
- **Allocation Provision** – The directors' and officers' insurance coverage should include an allocation clause so as to permit the allocation of coverage between directors, officers, the corporation and matters for which the corporation (and not the

insurer) is solely responsible.

- **Claims Definitions** – The definitions of claims and related terms in the directors' and officers' insurance policy should be as broad as possible.
- **Representations and Warranties for Corporate Transactions** – The directors' and officers' insurance coverage should protect directors from third party claims arising from breaches of representations and warranties in commercial transactions with the corporation.
- **Claims Arising Cover** – Coverage in the directors' and officers' insurance policy should be available on a "claims-arising" basis versus a "claims-made" basis. Claims-made policies do not protect directors or officers after the policy period has ended unless specific extension coverage is obtained and this coverage does not always fully cover the same liability as the original policy coverage during the term.
- **Priority of Payment Clause** – A priority-of-payment clause should be included in the directors' and officers' insurance coverage in order that coverage available for directors and officers is not diluted by claims made by the corporation in its own right.
- **Ownership of Coverage** – The directors and officers should be specifically identified as personal owners of the insurance in their favour. This provision can be particularly helpful in insolvency scenarios. Additional information on the operation of insurance cover in these scenarios may be found under the heading **INSOLVENCY PROCEEDINGS** below.
- **No Rescission Clause** – The directors' and officers' insurance coverage should stipulate that it is non-rescindable.

## **CORPORATE PROCEDURES AND POLICIES**

- **Governance Principles** – Each board of directors should establish governance principles and guidelines for the ongoing operation of the board.
- **Committee Charters** – Each board committee should have its own charter and such charters should be reviewed at least annually by the members of the committee.
- **Statement of Business Principles** – Each corporation should adopt a statement of business

principles and such statement should be annually reviewed by the full board of directors.

- **Compliance Function** – Each corporation should have in place an effective compliance function. The board of directors should be familiar with the operation of this function and receive regular reports on same.
- **Governance Committee** – In addition to the compliance function, each corporation should have in place a governance committee with an appropriate charter that oversees all aspects of corporate governance. This committee should meet at least twice each year or more often as required.
- **Regular Meetings** – The corporation’s board of directors should meet at least four times per year and more often as required. Committee meetings should be held at least twice per year.
- **Appropriate Minuting** – Minuting of all corporate meetings should be conducted on a basis that will allow the directors to assert all available defences including the due diligence defence. For example, minuting should include due diligence procedures undertaken by the board of directors with respect to corporate disclosure documents and minutes should clearly indicate where boards of directors are relying on external advice and the scope and nature of such advice. It should be possible to infer from the minutes the relative weight given to a matter in terms of the board’s allocation of time to that matter. Reports from any accountant or other professional should be specifically identified and attached. Matters such as any intra-board disagreement are extrinsic to a decision reached and should not be minuted. Directors should be encouraged not to keep or retain notes of meetings, which might later be subpoenaed in litigation proceedings to supplement or contradict board minutes and decisions.
- **Documentation** – Documentation for all meetings of boards and their committees should be comprehensive and should include periodic compliance reporting. All compliance violations should be reported to the board and to its subcommittees. Board “books” should be distributed sufficiently in advance of meetings so as to provide a reasonable opportunity for

full review by the directors.

- **In camera Sessions** – Each meeting of the board of directors and of each committee of the board of directors should terminate with an *in camera* session without management in which minutes are taken in order to provide the independent directors with the opportunity to discuss openly and frankly any concerns they have with management.
- **Legal Advice** – Boards of directors will from time to time require independent legal advice to be given to the directors as a group. As noted, contractual indemnities should provide for independent legal advice to individual directors.
- **Other Advisors** – Depending on circumstances, directors may need other independent advice including on financial, valuation, forensic audit and actuarial matters.
- **Risk Management Plan** – The board of directors should establish a formal risk management plan. A risk management plan will address a number of topics including loss of key employees, adequacy of resources for needs of the business, appropriate transfers of risk to others via contract terms or insurance, maintenance of insurance worthy status, proper understanding and analysis of past insurance claims (“Lessons Learned”) and regular updates by brokers and legal counsel for officers and directors of all relevant industry developments.
- **Directors’ and Officers’ Representations and Warranties** – As the breach of any representations and warranties given to the directors’ and officers’ insurer can give rise to the voiding of the insurance coverage, all directors and officers should review the representations and warranties to the insurer and conduct due diligence of management on same.

#### **INSOLVENCY PROCEEDINGS**

- **Alternatives to Bankruptcy** – If a corporation is in financial difficulty, directors should carefully explore whether it is possible to restructure or compromise debts through alternative proceedings such as a bankruptcy proposal, proceedings under the *Companies’ Creditors Arrangement Act (CCAA)* or under the *Winding Up Act*. Bankruptcy should be a last resort.

- **Bankruptcy** – Directors have certain statutory obligations imposed upon them when the corporation declares bankruptcy. These obligations include: preparing a list of the corporation's creditors, assets and liabilities for the trustee in bankruptcy; delivering all of the corporation's books and records to the trustee; attending at an examination under oath regarding the causes of the bankruptcy; aiding in the realization of property; executing powers of attorney as required. Directors should familiarize themselves with these obligations prior to assigning the corporation into bankruptcy.
- **Claims against Directors** – Should a compromise of claims or a restructuring be contemplated under a CCAA proceeding or a proposal under the *Bankruptcy and Insolvency Act*, directors should attempt to include claims against the directors in the proposal if appropriate.
- **Tax and Wage Liabilities** – As directors can be held personally liable for unpaid employee wages, vacation pay and source deductions (such as income tax), directors should ensure proper systems are put in place for the payment of wages and statutory remittances. Appropriate systems may include a third party payroll processing service and separate bank accounts which hold wages and vacation pay as they accrue and government remittances as they arise. The directors should periodically monitor these remittances or speak to the Chief Financial Officer or other responsible person to verify that the corporation is able to meet its statutory remittance obligations. In addition, a certificate signed by the Chief Financial Officer or other responsible corporate accountant and delivered at board meetings, certifying that the corporation is current with its statutory remittance obligations can be implemented as part of corporate procedures.
- **Trust Accounts** – As directors are often targeted when the corporation's trust obligations are not properly maintained, directors should ensure that they are aware of all such obligations and that proper trust accounts are maintained. The directors should verify that trust funds are properly segregated and not intermingled with the corporation's general accounts or other funds.
- **Directors' and Officers' Insurance** – Directors and officers should know what directors' and officers' insurance is in place and ensure that coverage extends to liabilities incurred should the corporation become insolvent. Directors and officers should be aware of what is and what is not covered under the policy as well as the notice requirements and its expiry date. As insurance coverage can be disputed, it is also wise for directors to consider, where appropriate, setting up a directors' and officers' trust to be maintained by the corporation. Where the corporation is contemplating entering protection under the CCAA and the directors are asked to continue to serve during the proceedings, directors should ensure that the initial court order contains an indemnity in favour of the directors along with a priority charge on the corporation's property as security for the indemnity.
- **Resignation** – Should it become evident that the corporation is headed towards insolvency, it may be in the best interests of a director to consider resigning. This will not completely insulate the director from liability, but it may protect the director from further exposure for the corporation's obligations (such as unpaid wages being incurred on a daily basis). The resignation will also activate the commencement of a limitation period for claims that may be brought against the director. However, this decision should be made carefully as it may impact the corporation's ability to restructure and may affect the directors' and officers' insurance coverage unless there is coverage for claims or imposed liability incurred for post-resignation events.
- **Environmental** – Directors should regularly review the corporation's activities and all environmental audits to ensure all that the corporation is complying with all environmental legislation.

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