Director's and officer's duties in Canada

Corporate Update

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Directors and officers of a corporation are generally protected from personal liability by the “corporate veil.” This means that the corporation is the legal “person” that is held liable, not the individuals tasked with managing and running the corporation. In exchange for the protection provided by the corporate veil, Canadian law imposes a wide range of duties on a corporation’s directors and officers. Should they fail to carry out these duties, they risk losing the protection of the corporate form, and may face personal liability.

This article provides high level information on two overarching duties applicable to directors and officers of Canadian companies: a fiduciary duty and a duty of care. Breach of either of these duties may lead to personal liability.

Fiduciary duty

When acting as a director or officer, the law considers you to be a ‘fiduciary’ to the company. A fiduciary duty constitutes a legal standard of behaviour expected from you with regards to your dealing with the company. Generally speaking, it requires that in your role as a director or officer, you must ensure that the company’s interests are paramount, putting its interests ahead of your own or others (including, for example, a shareholder who might have nominated you as a director to the board). Put another way, your fiduciary duty requires you to act “honestly and in good faith with a view to the best interests of the corporation.”
As a company is often subject to competing concerns, it is difficult to generalize what is in the best interests of the company, and the specific obligations associated with your fiduciary duty will depend on the circumstance. At the very least, you must ensure that the company complies with all laws applicable to the carrying out of company business. You must also look out for the corporation’s long-term success beyond immediate profit and increased share value. While you are not required to consider the interests of all stakeholders in doing so - i.e. shareholders, employees, creditors and customers - you must treat individual stakeholders affected by corporate actions fairly and equitably. When competing interests coincide, your overriding duty is to do what is best for the company. This holds true even if the company is approaching insolvency. Disobeying the majority shareholders is not a breach of your fiduciary duties – you have been chosen to run the company and, as long as your actions are in its best interests, you are entitled to use your discretion to do so.

More specific obligations associated with your fiduciary duty will depend on the circumstances. Several are discussed below.

Duty to avoid conflicts of interest and to disclose relevant information

You must avoid situations where your obligations to the company and your personal interests are, or appear to be, at odds. Taking advantage of your authority for personal gain is a breach of your fiduciary duty. This means that you cannot make a profit at the company’s expense, or compete with the corporation in either a personal capacity or by being involved with a competitor. The courts traditionally apply a ‘strict ethic,’ stripping a director or officer of any profit made as the result of a breach of this duty, whether or not those profits were made at the company’s expense.

To avoid conflicts of interest, a general principle under Canadian law is that you must disclose all information about agreements you intend to enter or transactions in which you are involved that are potentially relevant to the company. Specifically, in Ontario, a director who is either a party to or has an interest in a material contract or transaction, or a material interest in a proposed material contract, must disclose that interest. If you make full disclosure of a conflict of interest to the board so they can independently consider it, you may be permitted to proceed with the disclosed transaction or activity without breaching your fiduciary duty. However, disclosure does not relieve you of your continuing duty to put the company’s interests ahead of your own.

Other circumstances to consider are where you, as director, are also a shareholder or employee of the company, or if you sit on the board of multiple companies. There is no conflict of interest in owning the company’s stock or in receiving your salary, dividends or other valid compensation, but if you own shares in the company you must put your obligations as a director or officer ahead of your interests as a shareholder. There is also no legal prohibition against a director accepting multiple appointments, but if you serve on multiple boards, you must be vigilant to ensure that you carry out your fiduciary obligations to each corporation that you serve. Failure to do so may constitute a breach of your fiduciary duty.

Duty of confidentiality, confidential information, and continuing confidentiality

As a director or officer, you must not reveal a company’s confidential information, including, for example, its trade secrets and client lists. This aspect of your fiduciary duty continues after you leave the organization. As long as the information remains the property of the company, you must keep it confidential and cannot use it to serve your own interests.

Unless you are bound by a non-competition agreement which applies following your departure from a company, you may go into a competitive business with the company following the end of your term as an officer or director. You may not, however, use the former company’s confidential information or take advantage of your previous position to actively solicit their customers. If the company decides not to pursue a business opportunity, you will not breach your fiduciary duty by taking the opportunity personally, but again you cannot use confidential information or other company resources.

Duty of care

In performing your duties as a director or officer, you must “exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.” This requirement sets a minimum standard of
business ability that all directors and officers must meet. Hence, when the courts evaluate directors’ and officers’ conduct, they do not make allowances for personal factors such as lack of experience or poor judgment. The courts will, however, consider the factual situation surrounding a director or officer’s actions.

Canadian corporate statutes also create a number of specific liabilities in this regard. For example, a director who consents to selling shares from treasury for non-monetary payment worth less than the shares’ fair market price can be personally liable for the unrecovered value. In addition, directors who consent to a share redemption or payment of a dividend without reasonably believing that the company will remain solvent can be liable to restore the amount paid. Depending on the applicable corporate statute, directors may also be liable for authorizing unreasonable or improper commissions, shareholder payments, financial assistance, and indemnities.

If you act prudently and on a reasonably well-informed basis, it is unlikely that you will breach your duty of care. The law does not require that you make perfect decisions, only that you make reasonable decisions based on the circumstances at the time. You may avoid liability by relying in good faith on properly prepared financial reports and on professional advice, such as advice from legal counsel. Unless you have grounds to suspect wrongdoing, you are entitled to rely on those to whom you have properly delegated tasks.

If the company does not meet certain statutory requirements, you may need to demonstrate that you took reasonable efforts, or, in other words, did your ‘due diligence’, to prevent the statutory breach in order to avoid liability. Examples include when the company fails to remit taxes on employee wages, fails to pay GST/HST or employment insurance premiums, fails to comply with workplace safety or environmental legislation, and in some provinces, fails to pay debts owing to employees.

Demonstrating due diligence may be a defence to directors’ and officers’ liabilities. To best demonstrate due diligence, it is recommended that directors and officers do the following:

- be proactive in ensuring that the company meets all statutory requirements;
- implement compliance programs that keep detailed records for your review;
- obtain regular updates on the compliance program’s effectiveness;
- report any substantial non-compliance immediately; and
- respond personally and immediately to the situation.

This article provides general information, is not exhaustive, and does not constitute legal advice. Directors and officers, or anyone considering becoming a director or officers, should consult a lawyer for further information on their duties and the standards they must meet in discharging those duties. Should you require further information on this topic please contact the author.

This article provides only general information about legal issues and developments, and is not intended to provide specific legal advice. Please see our disclaimer for more details.

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