

Directors' and Officer's Liability

The purpose of this information is to help directors and officers of non-profit corporations obtain a better understanding of what a non-profit corporation is and their obligations and liabilities under the law. This information is intended as a guide to users only and does not replace or take precedence over common law or *The Non-profit Corporations Act, 1995*.

Overview of the Corporate Structure

Individuals who accept a position on a corporate board of directors or as a corporate officer should fully understand the characteristics of the corporate structure and organization and their role in the corporation. They should also appreciate the nature and extent of the duties and obligations that are imposed both by common law and statutory legislation.

Nature of a Corporation – Including a Non-profit Corporation

When a non-profit organization is incorporated, it becomes a separate and distinct legal entity, possessing virtually the same powers as an individual. In Saskatchewan, *The Non-profit Corporations Act, 1995* s. 15(1) provides: “**a corporation has the capacity and, subject to this Act the rights, powers and privileges of a natural person**”. Thus, it acquires rights and obligations and may own and control assets, enter into contracts, incur debts, sue and be sued. A corporation, unlike individuals, can only act through agents, namely its directors and officers. Although the members are the owners of the corporation, they do not act for the corporation nor are they its agents. A corporation may also be legally disabled or dissolved if, for example, it fails to file the requisite reports with the Director of Corporations.

The governing statutes and the corporation's articles and bylaws stipulate the rights of the members, including their right to vote and to elect directors to the board.

The Principle of Limited Liability

The basic principle for corporations incorporated under *The Non-profit Corporations Act, 1995* is that members and directors are not liable for the defaults of the corporation. The corporation itself is a separate legal person, and is responsible for its own debts and obligations. Third parties become responsible for those debts and obligations only if another legal principle applies – for example, they give personal guarantees, participate in a fraudulent transaction or something of that sort.

In order to tap into this limited liability concept, it is necessary that the organization disclose its limited liability status on contracts, invoices and other similar documents. This involves making sure that the proper legal name of the organization appears on all those documents, including the “Inc.” or “Incorporated” portion of the name.

Nature of the Board of Directors

The board of directors, the governing body of the corporation, manages the corporate activities and affairs with all its attendant risks and uncertainties, for the collective benefit of all the members of the corporation, or in the case of a charitable non-profit corporation, for the benefit of the public.

Nature of a Directorship

The precise nature of the position that an individual holds as a corporate director is difficult to define. Legislation does not specifically define the term *director*. The definitions in the corporate statutes generally state: “A ‘*director*’ means a person occupying the position of director and ‘*directors*’ and ‘*Board of Directors*’ includes a single director”. Members of boards are usually described as directors, but they may also be referred to as agents, trustees, managers, or some other similar designation.

The position of a director is often described as an agent or trustee of the corporation, but neither term accurately describes a directorship. For example, an agent derives authority from a principal, whereas the authority of a director stems from the applicable corporate legislation, and the articles (charter) and bylaws of the corporation. In the case of a trusteeship, the trustee administering the property becomes the legal owner of the property with a duty to the beneficiary of the trust. Directors, however, do not hold title to the corporate property they administer, nor are they the owners of the corporation.

No specific authority is conferred on individual directors by virtue of their position as directors other than their being entitled to sit as members of the board. For example, a director acting individually cannot bind the corporation unless such authority has been specifically conferred by the board of directors. Directors can only exercise authority collectively as members of the board of the corporation.

A directorship is perhaps described as a managerial position entrusted with and responsible for the administration of the assets, activities and affairs of the corporation in an honest, fair, diligent, and ethical manner. A director must act within the bounds of authority conferred and with a duty to make and enact informed corporate decisions and policies in the best interests of the corporation and all of its members. A person holding a director’s position is personally accountable only for failing to meet these standards.

The courts have recognized that corporations, particularly business corporations in the pursuit of business ventures, must of necessity engage in certain speculations and risk taking that the actions of the directors on behalf of their corporations should not be unduly restricted so as to impede the activities of their corporations.

Nature of an Officership

Corporate officers are judged against the same standards of conduct as the directors of the corporation. However, since the delegation of certain powers to the officers of the corporation is prohibited, the range of their potential liabilities may not be as wide as that of directors of the corporation.

Duties and Obligations of a Director or Officer

Directors and officers can, however, become personally liable to third parties if they breach the duties and obligations imposed on them by law.

As a director or officer of a non-profit corporation, you have certain duties and obligations, which may result in personal liability if you fail to discharge them.

There are three general areas of obligation of a director or officer *under The Non-profit Corporations Act, 1995* of Saskatchewan and the other applicable laws:

- a. **The fiduciary duty.** Fiduciary duty means having the character or nature of that of a trustee, having the characteristics of a trust, related to or founded upon trust or confidence. This is expressed in the Act as a requirement that each director, when exercising their powers as director, “*act honestly and in good faith with a view to the best interests of the corporation.*”

A part of the fiduciary duty is the proposition that a director must not be in a conflict of interest position in relation to the corporation. Assume the corporation wished to build a new building to house its office and one of its directors owned a construction company that was interested in building the building. That director would be in a conflict of interest in relation to the construction contract. If the director did not act properly in connection with the conflict of interest (by disclosing the conflict of interest and not becoming involved in any discussions on the contract), the director might become liable to account to the corporation in connection with the construction contract if it was awarded to the director’s corporation.

- b. **The duty of care.** This is phrased in the Act as a requirement that the directors and officers “*exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances*”. Expanding on this topic:
- i. directors are not obligated to take all possible care but they must use reasonable care;
 - ii. in the absence of grounds for suspicion, directors may delegate appropriate responsibilities to committees, officers and managers. Directors also have the right to rely on auditors, lawyers and other experts;
 - iii. directors do not have to have any particular qualification or any special skills, although they must exercise special skills they have. By way of example, a director who is an engineer would be obligated to look at a building which the corporation wishes to purchase with the eye of an engineer, and not simply as a non-engineer would;
 - iv. inaction is no excuse. A director will not have complied with the duty of care to the corporation if the director fails to give attention to the activities and affairs of the corporation.
- c. **Statutory liabilities.** A number of laws impose liability directly and personally upon the directors of the corporations for failure by the corporation to perform a particular obligation. The most commonly encountered of these are:
- i. liability for unpaid employees’ wages under *The Labour Standards Act*, and liability for unpaid withholdings on those wages under the *Income Tax Act (Canada)*. If the corporation does not pay the employees’ wages or does not pay withholdings on those wages to the Receiver General, the directors of the corporation are obligated personally to make up that amount. In the case of unpaid withholdings, the directors have a due diligence defence. This defence is not available to unpaid wages under *The Labour Standards Act*; liability is absolute insofar as it relates to unpaid wages.

- ii. liability for unpaid goods and services tax. Again, directors have a due diligence defence which is almost identical to the due diligence defence under the Income Tax Act (Canada).
- iii. Liability for environmental damage or breach of the occupational health and safety legislation. These Acts impose liability on directors if the corporation fails to meet its obligations under the Acts in some circumstances.
- iv. *The Non-profit Corporations Act, 1995* can also impose liabilities on directors in some circumstances. For example, under section 105 of the Act, directors can be liable if they authorize payment of profits to members of the corporation (unless it is to a member to whom services have been contracted for in order to carry out the activities of the corporation), if the corporation indemnifies a director in circumstances in which the indemnity is not available in accordance with *The Non-profit Corporations Act, 1995*, and a few other situations of a similar nature.

d. Corporate Criminal Liability

Criminal Liability of Directors and Officers

Directors and officers could be held criminally liable for any criminal offence that they commit in the course of their duties

Criminal Liability of Corporations

Corporations can also be held accountable for *Criminal Code* offences. Newly passed legislation permits the combined acts of corporation's representatives and senior officers to constitute criminally negligent offences. This legislation also holds corporations accountable for criminal offences when senior officers commit an offence to benefit the company, direct the work of other employees to commit an offence, or fail to take all reasonable measures to stop an employee from committing an offence.

The court can now impose a number of conditions on corporations when they are found guilty of committing a criminal offence. Those conditions could include such things as mandating that corporations change their policies and procedures, making the corporation publicly announce their conviction, ordering them to pay restitution, and/or giving them up to a \$100,000 fine for summary conviction offences.

- e. **Other points to note:** Traditionally, courts have been reluctant to set out precise rules of conduct that directors must follow when carrying out their activities.

The courts are also very reluctant to substitute or second guess a decision of corporate management provided that the decision was made honestly and within the scope of the authority of management.

The courts continue to consider the actions of directors and officers on a case-by-case basis, but board members and corporate officers are expected to adhere to certain general standards of conduct that have been judicially prescribed.

Insurance and Indemnities

Insurance is permitted to be obtained (though not necessarily obtainable!) against any liability to which a director or officer may be subject, except where the liability relates to a failure by the director or officer to act honestly and in good faith with a view to the best interests of the corporation. As a result, it is lawful to obtain insurance in any case where the corporation was able to give an indemnity, i.e. save a director harmless from loss or damage incurred.

Insurance is useful where, when the directors examine the risk to them, they conclude that there is a risk of a claim in circumstances where they cannot reasonably protect against it and the corporation does not have reserves that could be available to pay the liability. The situation will vary for each organization and will change from time to time as the organization's circumstances change.

If further clarification or information is required, you may call the Corporations Branch or consult with your solicitor.