LEGAL MEMORANDUM — CORPORATE GOVERNANCE

Role and responsibilities of directors

in Québec

Subject Duties, powers and liability of directors and officers **Scope** General application

This memorandum sets out the duties and obligations of directors in general and overall terms, in accordance with the provisions of the various applicable statutes and in particular the *Canada Business Corporations Act*.

> **Scope of this memorandum**
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> This memorandum is of general application, **subject to a unanimous shareholder agreement** conferring on the shareholders all of the powers vested in the directors.

I Role, rights and liability of directors

1. The role of directors and officers

Subject to a unanimous shareholder agreement, the directors manage the business activities and internal affairs of the corporation.

In practice, in almost all cases, the board of directors delegates its day-to-day management powers over the corporation’s affairs to officers whom it appoints, in particular the president, the chief executive officer, the chief operating officer, the chief financial officer and the secretary of the corporation. The board of directors may at any time withdraw any power it has delegated to an officer.

Officers are the mandataries of the legal person. Generally speaking, in carrying out the functions delegated to them, they have essentially the same duties and obligations as the directors.

On the other hand, account may be taken of the fact that they are better placed to have a thorough knowledge of the corporation and its day-to-day activities and, consequently, they may bear a heavier burden of proof in order to be relieved of liability.

2. The powers of directors and officers

Directors are required to act personally and must attend meetings of the board of directors (in person or through the adoption of resolutions).

In carrying out their functions, directors and officers must comply with the obligations imposed on them under the law, the articles and the by-law(s) of the corporation and, where applicable, the unanimous shareholder agreement.

3. The liability of directors and officers

The *Canada Business Corporations Act* provides that directors owe the corporation a duty to act, within the scope of their functions, with:

- Integrity
- Care
- Diligence

The *Civil Code* (articles 321 and 322) likewise provides, similarly to the *Canada Business Corporations Act*, that in carrying out his functions a director must comply with the obligations imposed on him by law, the constituting act or the by-laws and act with care, diligence, honesty and loyalty in the interest of the corporation.

▸3.1. General obligations

The duties of loyalty and honesty

These duties require directors not to derive any **personal benefit** from the office they hold (e.g. the risk of a conflict of interest). Furthermore, a director may not derive any profit whatsoever from a business opportunity belonging to the corporation. These duties also mean that directors and officers are under an obligation to disclose any conflict of interest.

Directors and officers owe their loyalty and honesty to the corporation and not to the shareholders.

The duties of care and diligence

These duties require directors to take the decisions that are most appropriate for the corporation; this does not necessarily mean taking the best decision, but rather taking the decision on an informed and considered basis.

A director will therefore not be held liable if the decision taken is not the best one for the corporation, provided that the decision-making process was a sound one. A director is not an expert and is not required to possess any particular skills or abilities.

The *Canada Business Corporations Act* contains provisions establishing a due diligence requirement in respect of both the duty of loyalty and the duty of care and diligence. Under section 123 (5), a director who has acted with care, relying in good faith on reliable financial statements or on reports from qualified persons, should not incur liability.

▸3.2. Particular obligations

In addition to the duties set out above, directors are also subject to obligations imposed by specific statutes, in particular the following:

1. **Declaration and payment of dividends.** Under the *Canada Business Corporations Act*, directors must satisfy themselves that, at the time of the declaration, there are no reasonable grounds to believe that the corporation is or would be unable to pay its liabilities as they become due.

2 **Employee wages.** The personal liability of directors for the payment of employee wages ranks among the most significant. It is, first of all, a solidary liability, meaning that the whole of the amounts claimed may be demanded from a single director, subject to that director's recourse against his co-directors.

> **KEY POINT**
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> The liability of directors for unpaid wages is **limited in two ways**: it extends only to **six months' wages** and it covers only **the period during which the director held office**, so that a director will sometimes be well advised to resign in order to reduce his potential liability.

3 **Taxes.** Directors may be held personally liable for amounts outstanding that are owed by the corporation. **Only the directors in office at the time the corporation is in default are solidarily liable for payment of the amounts owed.**

> **TIME FRAME**
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> Directors will therefore be liable only for the amounts owed at the time they were directors, and will not be held liable for amounts owed after the end of their term.
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> Directors may escape liability for tax debts by establishing that they could not have known of the default, or that they exercised a reasonable degree of care, diligence and skill in the circumstances, or that they ceased to be directors of the corporation **more than two years previously**.

II Risk management

1. The unanimous shareholder agreement

Corporate statutes allow shareholders to assume for themselves part of the powers vested in the directors by means of a unanimous shareholder agreement, which is frequently found in private corporations.

A director from whom certain powers have been withdrawn may not subsequently be held liable for the consequences of the exercise of that power. That liability is in fact transferred to the shareholders. The existence of a unanimous shareholder agreement may therefore constitute an effective defence for a director.

2. Directors' insurance

Directors may also protect themselves by taking out liability insurance. Directors' and officers' liability insurance protects the insureds against personal financial losses that may arise from wrongful acts liable to give rise to proceedings, or from acts of mismanagement or breach of the obligations incumbent on directors or officers (see Part I).

This protection is optional: it is not an obligation of directors; it is, however, **strongly recommended**, so that a director is not required to indemnify the corporation personally for errors committed during his term of office.

III Conclusion

The essence of a director's duty is to act honestly, diligently and in good faith, in the best interests of the corporation. Numerous specific duties attach to this general duty of good conduct. **A director who has a sound understanding of the extent of his potential liability is in a better position to reduce his exposure to risk.**

Legislation cited in this memorandum

- `Canada Business Corporations Act — s. 123 (5)`
- `Civil Code — arts. 321 and 322`

This memorandum sets out the duties and obligations of directors in general and overall terms. It does not constitute a legal opinion on any particular situation: each matter must be assessed in the light of its own facts and of the agreements applicable to the corporation.

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