Duties and Liability of Directors and Officers

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Prepared By:
Colin C.J. Feasby
Osler, Hoskin and Harcourt LLP
Calgary, Alberta

Tamara R. Prince
Osler, Hoskin and Harcourt LLP
Calgary, Alberta

Assisted By:
Daniel Yaverbaum and Robbie Armfield

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INTRODUCTION

The duties and liabilities of directors and officers should be simple and obvious, yet almost 150 years after the institutionalization in some jurisdictions of limited liability corporations, the law remains uncertain. This rocky legal foundation can lead to personal litigation against directors and officers who will rely on corporate counsel to understand these duties and provide critical advice. The Supreme Court of Canada’s recent meditation on the nature of directors’ duties in *BCE Inc. v. 1976 Debentureholders* shows that the law continues to evolve and is ripe for re-examination.¹

This paper provides a general overview of the law concerning the duties and liabilities of directors and officers in Canada.² What follows is a brief discussion of:

(a) Directors’ and officers’ liability at common law;
(b) Directors’ and officers’ statutory duties and liability;
(c) The role of the “Business Judgment Rule”; and
(d) Indemnity and insurance issues.

LIABILITY AT COMMON LAW

General Rule

At its most basic level, the common law liability of directors and officers rests on the principle that the corporation is an independent legal entity, which is separate from the shareholders and the management of the corporation. This principle is enshrined in all Canadian corporate statutes, which grant corporations the rights, capacities, and powers of a natural person,³ and dates back to the foundational case of *Salomon v. A. Salomon and Co.*⁴ In that case Lord Halsbury held that, “once the company is legally incorporated it must be treated like any other independent person

¹ *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560 [*BCE*].
² This is not intended to be a comprehensive review and practitioners are encouraged to undertake further research.
with its rights and liabilities appropriate to itself."5 Due to this independent legal status, the liability of the corporation to third parties, including corporate stakeholders, will not ordinarily flow to directors and officers.

However, directors and officers, as distinct legal persons, are not immune from liability just by virtue of the office they hold. The general rule of director and officer liability at common law, subject to the Said v. Butt6 exception explained below, is that directors and officers can be personally liable for their independent actions7 or, alternatively, that the act by the director or officer must exhibit a “separate identity or interest from that of the corporation."8 The concept of “independence” requires a personal act by the director or officer that can attract liability. An officer or director signing a contract on behalf of the corporation does not thereby become personally liable. However, if a director or officer acts outside the scope of his or her authority, the act becomes independent and the director or officer may become personally liable. Similarly, directors and officers who authorize intentional torts such as assault, trespass to property, and nuisance will be found liable even if such torts were committed by a director or officer acting bona fide, within his or her authority and in the best interests of the corporation.9 Directors and officers can be found independently negligent, if the factual relationship between the director or officer and the third party supports a duty of care.10

The common law treated corporate stakeholders, such as shareholders, similarly to other third parties when it came to director and officer liability. Shareholders did not have the right to personally bring an action against the directors and officers for corporate acts, although shareholders did have the right to bring an action on behalf of the corporation against the directors and officers in limited circumstances.11 In response to the inability of shareholders to seek a remedy directly from directors and officers, the oppression remedy and derivative action were created.12

The general rule of director and officer liability at common law is grounded in fundamental principles of corporate law and is not controversial. The challenge in this area of law has been to create a principled method to restrict director and officer liability that is respectful of the notion of

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5 Ibid., at 30.
9 Said v. Butt, supra note 6 at 506.
11 Foss v. Harbottle (1843), 67 E.R. 189 (Eng.).
12 See oppression remedy ABCA, supra note 3 s. 242, CBCA supra note 3 s. 241.