

THE RESPONSIBLE DIRECTOR by James A. Millard (Toronto: Carswell 1989)

Questions involving the rights and obligations of directors are as old as company law itself. For the most part in Canada, these questions have been dealt with as part of larger texts dealing with company law generally or in articles dealing with directors' duties. Until Millard's book was published in 1989, Wainbergs' work¹ was one of the only books devoting itself entirely to that topic. Wainbergs' work, however, is not so much a textbook but a lengthy paper of approximately 70 pages discussing various aspects of the topic.²

A person wanting to consult a book devoted to directors' duties in Canada would therefore generally need to consult either U.S. texts³ or, more recently, English books. Understandably, most of the writing in the area has been directed at the legal professional.

Two developments have taken place in the last decades in the field of corporate law that have made the need for a Canadian book on directors' responsibilities more pressing. Firstly, corporate law in Canada, which for a century basically followed English legislation, took its own course with the new *Business Corporations Acts* which were implemented federally and by most provinces.⁴ These Acts introduced a number of U.S. corporate concepts for which there was no English precedent. Included among the changes were statutory tests for directors' duties. The subjective standard of care for directors, which for over half a century had been set out in *Re City Equitable Fire Insurance Co.*⁵ was changed to an objective test.

These changes have substantially expanded minority shareholder actions by making it much easier for a complainant⁶ to bring an action for oppression where "the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests

¹ J.M. Wainberg and M.I. Wainberg, *Duties and Responsibilities of Directors in Canada*, 6th ed. (Don Mills: CCH Canadian Ltd., 1987) [hereinafter Wainberg].

² The authors acknowledge that their "text is largely based upon a feature article by the author, J. M. Wainberg, Q.C. in the *Financial Post* of February 11, 1967." *Ibid.* at iii.

³ U.S. texts devoting themselves exclusively to the obligations of directors have a long history extending back into the last century e.g., S.D. Thompson, *The Liability of Directors and Other Officers and Agents of Corporations* (St. Louis: William H. Stevenson 1880).

⁴ The *Canada Business Corporations Act*, S.C. 1974-75-76, c.33 was proclaimed in force effective December 15, 1975 [hereinafter CBCA]. The Alberta Legislature followed suit and passed the *Alberta Business Corporations Act*, S.A. 1981, c.B-15 [hereinafter ABCA] in 1981. Most other provinces have also followed the federal precedent with minor amendments.

⁵ [1925] Ch. 407, (C.A.).

⁶ For the purposes of the *Business Corporations Acts* a "complainant" is not limited to a shareholder but encompasses a much broader category. For example, the ABCA, s. 231(b) defines complainant as

- "(i) a registered holder or beneficial owner, or a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
- (ii) a director or an officer or a former director or officer of a corporation or of any of its affiliates, or
- (iii) any other person who, in the discretion of the Court, is a proper person to make an application under this Part."

of any security holder, creditor, director or officer...."⁷ This statutory right of action was accompanied by extensive remedial powers which included, among other things, the ability of a court to appoint new directors in the place of, or in addition to, all or any of the directors then in office.⁸ The result of these two changes in corporate law was predictable. If one raises the legal duty of care of a director and makes it easier for people to bring an action if there is a breach, it is very likely that more directors will be successfully sued. The predictable has happened.

If this were not enough, a second development has taken place concurrent with the changes in corporate law: the trend to impose personal liability on directors for corporate actions. The full impact of this avalanche of personal liability provisions in various statutes cannot be appreciated by consulting U.S. or English texts since they do not address the Canadian legislation.⁹ This type of legislation continues to expand and a person who is a director or is considering becoming a director must be concerned with this additional potential personal liability.

Since Millard's book was published in 1989, a new book dealing with directors liabilities has been published by Lazar Sarna and Hillel Neuer of the Quebec bar.¹⁰ This loose leaf manual of approximately 225 pages appears to be a Quebec version of Wainbergs' book.¹¹ The growing significance of a director's personal liability under numerous statutes is evident from a comparison of Wainbergs' work, wherein the authors essentially deal with such statutory liabilities in 5 pages¹², and the work of Sarna and Neuer who devote their longest chapter (of some 73 pages) to this topic.¹³ Neither book gives a complete list of federal and provincial statutes which impose personal liability on directors.

In a paper dealing with "Criminal & Quasi-Criminal Aspects" of directors' and officers' liability, presented at a recent continuing legal education seminar dealing with directors' and officers' liability, the author lists 34 federal statutes containing provisions making directors liable for acquiescing in an offence of the company.¹⁴ In addition, the author

7. *Ibid.* s. 234(2)(c).

8. *Ibid.* s. 234(3)(f).

9. Although at common law it is possible to pierce the corporate veil and thereby find directors personally liable for certain corporate acts, this is not a major threat to directors in most instances since courts have been reluctant to do this. H.J. Kellough & P.E. McQuillan, *Taxation of Private Corporations and Their Shareholders*, 2nd ed. (Toronto: Canadian Tax Foundation, 1992) at 1:35-36.

10. L. Sarna and H. Neuer, *Directors and Officers*, (Montreal: Jewell Publications, 1992).

11. Wainberg, *supra* note 1.

12. Wainberg *supra* note 1 at 35-39.

13. *Supra* note 10 at Ch. 2.

14. A.G. Henderson, "Directors and Officers' Liability" (Address to Continuing Legal Education Society of British Columbia, 24 April 1990) at Ch. 1 appendix.

Advance Payments for Crops Act, R.S.C. 1985, c. C-49, s. 13(4).

Agricultural Products Board Act, R.S.C. 1985, c. A-4, s. 5(2).

Agricultural Stabilization Act, R.S.C. 1985, c. A-8, s. 17.

Atomic Energy Control Act, R.S.C. 1985, c. A-16, s. 20(2).

Bank Act, R.S.C. 1985, c. B-1, s. 169.

Bankruptcy Act, R.S.C. 1985, c. B-3, s. 204.

of the paper lists 48 British Columbia statutes,¹⁵ which contain similar provisions. Alberta and other provinces are no different than British Columbia in this respect.¹⁶

One area that has been of particular concern to directors is new environmental protection legislation, both federal and provincial,¹⁷ which has drawn much public attention. For example the *Canadian Environmental Protection Act* makes any officer, director or agent of a corporation who directed, authorized, assented to, acquiesced or

Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 250(2); 205(2); 32(4); 235(5); 153(9); 150(4); 149(4); 127(10).

Canada Cooperative Associations Act, R.S.C. 1985, c. C-40, ss. 120; 114(2).

Canada Corporations Act, R.S.C. 1980, c. C-32, ss. 136.93(2)(3); 133(3); 111.1(3); 129.1(1); 108.4(5); 108.3(2); 100.3(1)(2).

Canada Pension Plan Act, R.S.C. 1985, c. C-8, s. 103(2).

Canadian Wheat Board Act, R.S.C. 1985, c. C-24, s. 68(2).

Citizenship Act, R.S.C. 1985, c. C-29, s. 36(2).

Competition Act, R.S.C. 1985, c. C-34, s. 65(4).

Consumer Packaging & Labelling Act, R.S.C. 1985, c. C-38, s. 20(3).

Corporations & Labour Unions Returns Act, R.S.C. 1985, c. C-43, s. 9(2).

Cultural Property Export & Import Act, R.S.C. 1985, c. C-51, s. 46.

Defence Production Act, R.S.C. 1985, c. D-1, s. 28.

Electricity & Gas Inspection Act, R.S.C. 1985, c. E-4, s. 35(2).

Energy Administration Act, R.S.C. 1985, c. E-6, ss. 48(2); 31(2).

Energy Monitoring Act, R.S.C. 1985, c. E-8, s. 40.

Excise Tax Act, R.S.C. 1985, c. E-15, s. 96(3).

Export & Import Permits Act, R.S.C. 1985, c. E-19, s. 20.

Fishing & Recreational Harbours Act, R.S.C. 1985, c. F-24, s. 21.

Immigration Act, R.S.C. 1985, c. I-2, s. 99(1)(2).

Income Tax Act, R.S.C. 1985, c. 148, s. 242 as amended by S.C. 1970-71-72, c. 63.

Livestock Feed Assistance Act, R.S.C. 1985, c.L-10, s. 20(2).

Motor Vehicle Fuel Consumption Standards Act, R.S.C. 1985, c. M-9, s. 32.

National Energy Board Act, R.S.C. 1985, c. N-7, s. 121(2).

Petroleum Incentive Program Act, R.S.C. 1985, c. P-13, s. 28 [s. 57 now part of the *Canadian Ownership and Control Determination Act*, R.S.C. 1985, c. C-20, s. 25].

Transportation of Dangerous Goods Act, R.S.C. 1985, c. T-19, s. 11.

Unemployment Insurance Act, R.S.C. 1985, c. U-1, ss. 93(17); 74.

Veterans Land Act, R.S.C. 1970, c. V-4, s. 47.

Weather Modification Information Act, R.S.C. 1985, c. W-5, s. 7(2).

Weights & Measures Act, R.S.C. 1985, c. W-6, s. 35(3).

¹⁵ *Ibid.*

¹⁶ In her paper "Overview of Environmental Law" presented at the Twenty-Fifth Annual Banff Refresher Course Corporate Commercial May 9 - 13, 1992 (Edmonton: Legal Education Society of Alberta, 1992) Donna Tingley sets out a current list of some 28 Alberta statutes dealing with the environment many of which contain director's liability provisions. The paper presented by William J. Hartnett at the same conference and entitled "Environmental, Occupational, Health and Safety Liability of Corporate Directors and Officers" lists 32 Alberta statutes containing director's liability provisions.

¹⁷ This legislation has mushroomed to such an extent that R. Cotton & A.R. Lucas, *Canadian Environmental Law*, 2nd ed., (Toronto: Butterworths, 1991) has now expanded to six loose leaf volumes which are crammed with various federal and provincial Acts and regulations dealing with the environment.

participated in the commission of the offence guilty of the offence.¹⁸ The federal act provides that a person is not to be found guilty if the person establishes "that he exercised all due diligence to prevent its commission".¹⁹ But what is "due diligence"? In Alberta the recently passed *Environmental Protection and Enhancement Act*²⁰ provides for similar personal liability and it contains a due diligence defence albeit with a somewhat different wording.²¹ The growing importance of environmental liability in the corporate context is evident from the prominent treatment being accorded this subject in current legal education seminars.²²

The increased exposure to personal liability has not gone unnoticed in the corporate boardrooms. During the last six months of 1992 the well publicized resignations of directors from the boards of Westar Mining Ltd., Canadian Airlines International Ltd., and Peoples Jewellers Ltd.²³ brought into prominence the seriousness with which directors viewed their potential liabilities particularly where the corporation was not in a position to indemnify them if they were found liable.

With this background it is now possible to review Millard's book. At the outset it should be pointed out that the author states

This book has been written primarily for the benefit of directors of Canadian 'public' corporations to highlight some of the legal problems which now attend that position.²⁴

It is not a legal text, nor does it purport to be such. However, it does refer to some forty, mostly Canadian, cases. It is divided into five chapters dealing with: general position of a director, normal business activities, corporate reorganizations, takeover bids, and insolvencies. Although the chapters identify the different situations in which a director may be required to exercise judgment subject to statutory or other rules, the treatment of any particular topic is not by any means exhaustive. Since the book is directed primarily at a non legal audience it generally does not delve into minute details.

One of the risks that an author takes in trying to capsulize in simple language a decision without appearing overly nitpicky is the possibility of leaving an incorrect impression with the reader. This occasionally occurs in the book.

¹⁸ "Where a corporation commits an offence under this Act, any officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence, and is liable to the punishment provided for the offence, whether or not the corporation has been prosecuted or convicted." *Canadian Environmental Protection Act*, S.C. 1988, c. 22, s. 122.

¹⁹ *Ibid.* s. 125.

²⁰ S.A. 1992, c. E-13.3 s. 218.

²¹ "No person shall be convicted of an offence if that person establishes on a balance of probabilities that he took all reasonable steps to prevent its commission." *Ibid.* s. 215.

²² For example, the Twenty-Fifth Annual Banff Refresher Course on Corporate Commercial law (*supra* note 16) contains six papers dealing with various facets of environmental issues.

²³ *Financial Post*, (26 December 1992) at 16.

²⁴ J.A. Millard, *The Responsible Director* (Toronto: Carswell, 1989) at iii [hereinafter Millard].

For example, when dealing with the obligations of a director when determining the liquidity of a company before declaring a dividend, Millard states that on the basis of the *R. v. Sands Motor Hotel Ltd.*²⁵ decision "the directors must determine not only whether there are no reasonable grounds for believing that the corporation will not be able to pay its liabilities after the payment of the dividend but also, in making that decision, they must determine whether it is reasonable to believe that a contingent liability will ultimately be a liability and, if so, what is the probable amount of that liability."²⁶ However, what is not stated is that in the *Sands* case, the Department of National Revenue had sent a letter to the taxpayer corporation advising the corporation that the sale of the hotel owned by the Corporation was considered to be an adventure in the nature of trade and not a capital transaction. The result was to bring all the gain into income as opposed to treating it as a capital gain, a part of which would not be taxable. Although it is correct that at the time of receipt of such letter from the Department of National Revenue, the directors have to make a decision as to whether they consider Revenue Canada's position to be correct, it puts an entirely different light on the matter when it is known that there was prior notice given to the directors of the potential income tax liability. The passage in the book leaves the mistaken impression that directors could be personally accountable for a corporation's income tax liability even though they could not reasonably be aware of it and furthermore that they could be held accountable for dividends paid when such income tax liability results in an inability to meet the solvency tests.²⁷

Another example of where the treatment of a particular decision is somewhat misleading, is in the treatment of *Smith v. Van Gorkum*.²⁸ In the relatively long examination of the case²⁹ the author looks at the ramifications of this decision which resulted in personal liability of directors who had approved a takeover bid without proper consideration of the merits of the bid. Although the decision was startling and gave rise to much debate, the author does not indicate that within a year the state of Delaware amended its General Corporation Law to specifically permit a limitation of liability provision in a corporate charter effectively eliminating the harshness of *Van Gorkum* if the charter option was exercised.³⁰ The wording of the Delaware amendment applies only to directors and not officers and does contain certain exceptions.³¹ This provision in

²⁵. [1985] 1 W.W.R. 59, 84 DTC 6464. (Sask. Q.B.).

²⁶. Millard, *supra* note 24 at 22.

²⁷. In the *Sands* case the taxpayer was ultimately vindicated when the Tax Court of Canada granted the taxpayers appeal and found the gain from the sale of the hotel to be a capital gain as contended by the taxpayer in the beginning. *Supra* note 25.

²⁸. 488 A. (2d) 858 (Del. 1985).

²⁹. Millard, *supra* note 24 at 79-80.

³⁰. J.F. Olson & J.O. Hatch III, *Director & Officer Liability: Indemnification and Insurance* (New York: Clark Boardman Company, 1990) at para. 1.07[1].

³¹. Del. Gen. Corp. Law § 102(b)(7) (Supp. 188)
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....

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters -

....

Delaware was followed in a number of other state legislatures.³² In fact the foregoing amendment to the Delaware General Corporation Law became effective July 1st, 1986 and by October 10th, 1986 more than 350 issuers of securities subject to Securities and Exchange Commission filings had filed proxy materials relating to liability relief, indemnification proposals or both.³³ In short, *Van Gorkum* broke new ground in directors' liability but its long term affect was substantially curtailed and contained through legislative action in Delaware, the most important incorporating jurisdiction in the U.S. None of this is referred to by Millard even though his book was published some three years after these developments took place in Delaware. The book therefore may be satisfactory for a layman, however, from a lawyer's point of view it does not appear to be as well researched as one would expect.

In certain other areas, subsequent events have overtaken some of the commentary. For example, when discussing the position of a nominee director,³⁴ the author did not have the benefit of the *Ballard* case,³⁵ a 110 page tour de force which explored among other things the position of a nominee director under the *Ontario Business Corporations Act*.³⁶ However, his observations with respect to the realities confronting a nominee director in trying to comply with his responsibilities still appear to be as relevant as ever.³⁷ It is obvious that the author has had many years of experience in working with and advising directors and is aware of the practical difficulties facing directors. These non-legal observations, although limited, form a valuable part of the book.

Since Chapter IV, dealing with takeover bids was written, new cases have been decided³⁸ which throw further light on matters left unresolved in that chapter.

A substantial part of Chapter V dealing with insolvencies and liquidations deals with the liquidation of the Canadian Commercial Bank and the Northlands Bank. Reference is made to the then pending litigation against directors and various other parties with respect to the collapse of the Canadian Commercial Bank. Speculation with respect to this

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under section 174 of this Title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this subsection to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.

³² *Ibid.* para. 1.07 [1].

³³ *Ibid.* at 6-3-4 (SEC Staff Guidelines Regarding Delaware Directors' Duty of Care and Indemnification).

³⁴ Millard, *supra* note 24 at 6-7.

³⁵ 820099 *Ontario Inc. v. Harold E. Ballard Ltd.* (1992), 3 B.L.R. (2d) 113 (Ont. Court of Justice).

³⁶ *Business Corporations Act*, R.S.O. 1990, c. 38.

³⁷ Millard, *supra* note 24 at 7.

³⁸ 347883 *Alberta Ltd. v. Producers Pipelines Ltd.* (1992), 3 BLR (2d) 237 (Sask. CA) and *Re Canadian Jorex Ltd.* (1992), 4 BLR (2d) 1 (Ont. Securities Commission).

litigation has now been made academic by settlement of the action, the terms of which have remained confidential.

Of more significance are subsequent events indicating that a fundamental shift in power is occurring in the area of corporate control, something which might now warrant a separate chapter. Ever since the landmark work by Berle and Means,³⁹ conventional wisdom has been that shareholders as owners do not control large corporations even though they elect the board of directors. Berle and Means presented a cogent thesis that large corporations are essentially governed by self-perpetuating management that influences who is appointed to the board.⁴⁰ "Management" as contemplated by Berle and Means was a combination of the "board of directors and the senior officers of the corporation."⁴¹ In practice senior officers, like senior civil servants wielded immense power since they not only worked full time for the corporation but also sat as directors. Outside directors generally relied on their judgment. This is no longer the case. The higher legal obligations imposed upon directors, coupled with deteriorating financial conditions leading to shareholder unrest, have resulted in directors exercising power in a truly revolutionary manner. Senior officers whose jobs were generally considered guaranteed are now being relieved of their duties. This revolution is taking place in the boardrooms of some of the largest corporations in the world. On October 26, 1992, Robert Stempell, chairman of General Motors, submitted his resignation when it was apparent that he would be removed by the directors.⁴² This was not an insulated incident. There have been numerous other examples both in Canada⁴³ and the U.S.⁴⁴ Flexing of directors' muscles has not been limited to companies in financial difficulty but in isolated instances has also included financially successful companies. SunBeam - Oster had been led out of bankruptcy by its chief executive officer but this did not prevent the board from dismissing him because of his abrasive management style.⁴⁵ None of this could have been anticipated when Millard wrote his book.

³⁹. A.A. Berle Jr. & G.C. Means *The Modern Corporation and Private Property* (New York: The MacMillan Company 1932).

⁴⁰. "As his personal vote will count for little or nothing at the meeting unless he has a very large block of stock, the stockholder is practically reduced to the alternative of not voting at all or else of *handing over his vote to individuals over whom he has no control and in whose selection he did not participate*. In neither case will he be able to exercise any measure of control. Rather, control will tend to be in the hands of those who select the proxy committee by whom, in turn, the election of directors for the ensuing period may be made. Since the proxy committee is appointed by the existing management, the latter can virtually dictate their own successors. Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible. This form of control can properly be called "management control." *Ibid.* at 86-88.

⁴¹. *Ibid.* at 220.

⁴². J. Greenwald, "What Went Wrong" *Time*, (9 November 1992) at 44.

⁴³. J. McFarland, "Executives Under Fire" *The Financial Post* (30 January - 1 February 1993) at 1. Included among Canadian corporations that have made such changes are Northern Telecom and Petro-Canada.

⁴⁴. J. McNish, "Akers Out as IBM CEO" *The Globe and Mail Report on Business*, (27 January 1993) at B1. Other U.S. corporations making senior executive changes include IBM, COMPAQ, Paramount Pictures and Time Warner.

⁴⁵. "Corporate Coup" *Time* (25 January 1993) at 13.

Nevertheless the book still serves a useful purpose in providing a readable introductory summary of the many facets of directors' responsibilities for its stated audience.

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